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MONTHLY REPORT • ECONOMIC AND FINANCIAL MARKET OUTLOOK

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ECONOMIC & FINANCIAL ENVIRONMENT

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From LIBOR to SOFR

Oil, a tense market under strain»

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Outlook for the Spanish economy in 2024: a year full of challenges

CaixaBank Research

MONTHLY REPORT - ECONOMIC AND FINANCIAL MARKET OUTLOOK
November 2023

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Key themes and outlook for 2024

In a month in which, unfortunately, geopolitical risk is once again taking centre stage, in the Dossier on the 2024 Outlook we review the key themes and forecasts for next year. The first theme is precisely how difficult it will be to recover a balance in the macroeconomy, in a world in which geopolitical instability has reached levels not seen in many decades. It is true that our baseline scenario contemplates a smooth landing for the world economy which would allow inflation in developed countries to fall from 4.6% to 2.6%, with a manageable cost in terms of both GDP growth (2.9% in 2024) and employment, as we expect economic activity to recover in the second half of the year following the stagnation seen during the first half in much of the OECD. However, after the disruptions of recent years the business cycle is highly fragile, especially given the destabilising potential of simultaneous wars in the Middle East and Ukraine through their impact on expectations and energy markets.

In this context, with interest rates at 15-year highs, one of the main assumptions of our central forecast scenario is the continuity of the disinflationary process. On the one hand, this could provide a good support for the financial markets once expectations of a shift in monetary policy are consolidated, while on the other it would continue to contribute to an improvement in economic agents' purchasing power. The problem is that determining what inflation will do next is also shrouded in uncertainty, both due to the behaviour of factors that are beyond central banks' control (such as the oil price or the tone of fiscal policy) and because of doubts surrounding the inertia of the components of the consumer price index that have greater momentum, in a context in which the risks of second-round effects have not disappeared. In this regard, the second article in this month's Dossier on the 2024 Outlook concludes that the momentum – that is, the annualised and seasonally adjusted change in the 3-month average of the CPI compared to the previous three months – of the components not sensitive to energy prices in the euro area (40% of the basket of components at present) is close to 3%. While well below the 2022 peaks, this is still a notch above the pre-pandemic level and the ECB's target. Therefore, the direct and indirect impact of the energy shock is gradually fading in Europe, although we must remain cautious given the complexity of the geopolitical scenario and the risk that some prices may have acquired greater inertia than in the past. That caution could translate into interest rates being kept at their current levels through to the second half of next year, when we would see a change of trend in the monetary cycle (anticipating the return of inflation to the target rate in 2025), albeit with financial conditions still clearly in restrictive territory.

Next year will also be full of challenges for the Spanish economy, as we discuss in the final article of the Dossier of this same report. After economic activity was supported by the strength of tourism and the fall in energy prices during the first half of 2023, since the summer we have witnessed a slowdown caused by the impact of higher interest rates, the rise in the oil price since July and particularly weak growth in the euro area, which we believe will lead to this year ending with an average growth of 2.4%. For 2024, our baseline forecast scenario contemplates GDP growth of 1.4%, as it is foreseeable that the headwinds which have weakened the Spanish economy in recent months will initially persist, taking into account the delays with which monetary policy decisions are transmitted to economic activity, the poor outlook for the main euro area economies (at least until Q2) and the effects of a somewhat more neutral fiscal policy, given the withdrawal of the fiscal measures implemented to offset the impact of the war in Ukraine. The downside risks affecting the scenario are clearly significant, given the uncertainty surrounding the behaviour of energy prices and interest rates. However, on the upside there are also mitigating factors, such as the strength of the disposable income and the savings rate of households in recent quarters and the boost to economic activity that could be provided by the European funds. It is in this delicate balance that we will find ourselves next year.

José Ramón Díez
November 2023

Chronology

OCTOBER 2023

7 A new war breaks out between Hamas and Israel.
20 Greece regains an investment grade sovereign rating after S&P raises it to BBB–.

SEPTEMBER 2023

14 The ECB raises rates by 25 bps, placing the depo rate at 4.00% and the refi rate at 4.50%.

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.

Agenda

NOVEMBER 2023

3 Spain: industrial production (September).
Spain: registration with Social Security and registered unemployment (October).
8 Portugal: employment (Q3).
9 Portugal: international trade (September).
14 Portugal: labour costs (Q3).
15 Japan: GDP (Q3).
17 Spain: Fitch rating.
Portugal: Moody's rating.
24 Spain: loans, deposits and NPL ratio (September).
28 Portugal: loans and deposits (October).
29 Spain: CPI flash estimate (November).
Euro area: economic sentiment index (November).
30 Spain: state budget execution (October).
Portugal: GDP breakdown (Q3).
Euro area: CPI flash estimate (November).

DECEMBER 2023

1 Spain: DBRS rating.
4 Spain: registration with Social Security and registered unemployment (November).
Portugal: industrial production (October).
12-13 Federal Open Market Committee meeting.
14 Governing Council of the European Central Bank meeting.
14-15 European Council meeting.
18 Spain: quarterly labour cost survey (Q3).
20 Portugal: balance of payments (October).
22 Spain: quarterly national accounts (Q3).
Spain: balance of payments and NIIP (Q3).
Spain: state budget execution (November)
26 Spain: loans, deposits and NPL ratio (October and Q3).
Portugal: home prices (Q3).
28 Portugal: NPL ratio (Q3).
29 Spain: CPI flash estimate (December).
Spain: household savings rate (Q3).
Portugal: CPI flash estimate (December).

Consumption hoists up the Spanish economy

The pace of growth of the Spanish economy has slowed, as evidenced by the lower GDP growth rate recorded in Q3. The main reason for this is the weakness of the external environment: the euro area has registered a slight decline in economic activity and its three main economies are stagnant. In contrast, the statistics for household consumption in Spain, one of the pillars of the economy, remain strong.

In general, household consumption fluctuates less than the economy as a whole throughout the business cycle. Thus, when we are in an expansionary phase, consumption tends to grow at a slower rate than GDP. In contrast, when GDP growth moderates, consumption tends to do so more gently. This is the pattern that we will probably observe in the coming quarters.

But not all types of consumption behave alike. There are certain categories, such as leisure, catering, textiles and fashion and other durable goods which experience bigger fluctuations than the economy as a whole, and these are usually a good indicator of where in the cycle the economy lies. In contrast, spending on essential goods, such as food and purchases at pharmacies, is more stable over time.

For instance, during the last two recessions, the consumption of durable goods fell more than twice as much as aggregate consumption. However, between 2014 and 2019, the latter increased by 14%, while spending on durable goods grew by 42%. The recovery after COVID-19 has followed a similar pattern: whereas total household consumption only recovered the pre-pandemic level in Q3 2023, the consumption of durable goods reached this milestone over a year ago and it now stands 7% above that level.

The latest available data continue to offer a broadly positive message, albeit with some important nuances. According to CaixaBank Research's Real-Time Consumption Tracker, face-to-face and online spending using CaixaBank cards, plus cash withdrawals, grew by 3.8% year-on-year in October. This is a significant rate of increase, albeit somewhat less than the 5.5% recorded in Q3. On the other hand, when we analyse the various items of expenditure, we observe differences that corroborate the aforementioned peculiarities in how consumption behaves.

Spending on essential goods continues to show strong growth in excess of 10%, partly due to the sharp year-on-year increase in food prices. In contrast, the items that are more sensitive to the business cycle show different trajectories. On the one hand, spending on leisure and catering continues to go from strength to strength, while at the opposite end of the spectrum retail spending was weaker and even registered negative growth rates. This is most likely not a sign of weakness, but rather a consequence of the high autumn temperatures, which have led people to postpone certain purchases which they usually make at this time of year. Now that the cold finally seems to have come, we may see a normalisation of this pattern. We will be able to verify this hypothesis in real time using the CaixaBank Consumption Tracker, which you can view on our website.

Over the next year, consumption is likely to consolidate its role as the primary force sustaining the Spanish economy. On the one hand, some of the factors that have limited its recovery to date will likely fade. Inflation, for instance, ought to settle into a downward trajectory, especially the core indicator which is still relatively high. On the other hand, the ECB's reference interest rates are not expected to increase any further and, in fact, they are likely to begin to come back down from mid-next year. In this context, the 12-month Euribor may have already peaked, and during the next year market expectations suggest that it could moderate to end up at around 3%.

Finally, despite the current challenges, the financial position of households is less stressed than had been anticipated a few quarters ago. Gross household income recorded a historic growth rate in Q2 and the savings rate was above 10% of household income. As discussed in the Dossier of this Monthly Report on the 2024 Outlook, this statistic provides an important buffer for households in order for them to maintain their consumption over the coming quarters. All this suggests that household consumption could continue to hoist up the Spanish economy for some time to come.

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	0.79	0.25	0.25	4.50	5.75	4.25
3-month SOFR	3.62	1.01	0.23	0.21	4.74	5.65	3.85
12-month SOFR	3.86	1.48	0.34	0.52	5.48	5.50	3.15
2-year government bonds	3.70	1.04	0.13	0.66	4.30	4.20	2.80
10-year government bonds	4.69	2.57	0.92	1.46	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	3.45
1-month Euribor	3.18	0.50	–0.56	–0.60	1.72	3.87	3.19
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	3.15	2.50
10-year government bonds	4.30	1.54	–0.57	–0.31	2.13	2.70	2.60
Spain							
3-year government bonds	3.62	1.69	–0.57	–0.45	2.66	3.05	2.82
5-year government bonds	3.91	2.19	–0.41	–0.25	2.73	3.13	2.99
10-year government bonds	4.42	3.17	0.05	0.42	3.18	3.80	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	3.22	3.04
5-year government bonds	3.96	3.94	–0.45	–0.35	2.53	3.24	3.14
10-year government bonds	4.49	4.67	0.02	0.34	3.10	3.60	3.45
Risk premium	19	314	60	65	97	90	85
EXCHANGE RATES							
EUR/USD (dollars per euro)	1.13	1.26	1.22	1.13	1.06	1.07	1.12
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	85.0	79.0
Brent (euros/barrel)	36.4	62.5	41.3	66.2	76.8	79.4	70.5

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	3.5	2.8	2.9
Developed countries	*2.7*	*1.4*	*–4.2*	*5.6*	*2.6*	*1.4*	*1.1*
United States	2.7	1.8	–2.2	5.8	1.9	2.0	0.8
Euro area	2.2	0.8	–6.3	5.6	3.4	0.5	0.7
Germany	1.6	1.2	–4.2	3.1	1.9	–0.4	0.3
France	2.2	1.0	–7.7	6.4	2.5	0.8	0.7
Italy	1.5	–0.3	–9.0	7.0	3.8	0.7	0.6
Portugal	1.5	0.5	–8.3	5.5	6.7	2.4	1.8
Spain	3.7	0.6	–11.2	6.4	5.8	2.4	1.4
Japan	1.4	0.4	–4.3	2.3	1.1	1.3	1.1
United Kingdom	2.7	1.2	–10.4	8.7	2.5	0.6	0.5
Emerging and developing countries	*6.5*	*4.9*	*–1.8*	*6.9*	*4.1*	*3.9*	*4.2*
China	10.6	8.0	2.2	8.5	3.0	5.2	4.6
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	2.2	1.8
Mexico	2.3	1.5	–8.7	5.8	3.9	2.7	1.9
Russia	–	1.4	–2.7	5.6	–2.1	1.0	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	4.2	3.7	3.2	4.7	8.7	6.9	5.2
Developed countries	*2.1*	*1.6*	*0.7*	*3.1*	*7.3*	*4.6*	*2.6*
United States	2.8	1.8	1.3	4.7	8.0	4.2	2.4
Euro area	2.2	1.4	0.3	2.6	8.4	5.6	3.1
Germany	1.7	1.4	0.4	3.2	8.7	6.2	3.3
France	1.9	1.3	0.5	2.1	5.9	5.3	2.9
Italy	2.4	1.4	–0.2	1.9	8.7	6.6	2.9
Portugal	3.1	1.1	0.0	1.3	7.8	4.6	2.4
Spain	3.2	1.3	–0.3	3.1	8.4	3.7	3.6
Japan	–0.3	0.4	0.0	–0.2	2.5	2.5	1.5
United Kingdom	1.6	2.3	0.9	2.6	9.1	7.5	3.6
Emerging countries	*6.7*	*5.6*	*5.2*	*5.9*	*9.8*	*8.5*	*7.1*
China	1.7	2.6	2.5	0.9	2.0	0.7	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	5.6	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	7.2	4.8	1.6	1.4
Government consumption	5.0	1.1	3.6	3.4	–0.2	2.4	1.3
Gross fixed capital formation	5.6	–1.4	–9.0	2.8	2.4	2.6	3.0
Capital goods	4.9	0.1	–12.6	4.4	1.9	0.2	3.9
Construction	5.7	–2.9	–9.2	0.4	2.6	4.3	2.4
Domestic demand (vs. GDP Δ)	4.4	–0.2	–9.0	6.6	2.9	1.7	1.6
Exports of goods and services	4.7	2.9	–20.1	13.5	15.2	2.9	0.4
Imports of goods and services	7.0	0.2	–15.0	14.9	7.0	1.1	1.0
Gross domestic product	**3.7**	**0.6**	**–11.2**	**6.4**	**5.8**	**2.4**	**1.4**
Other variables							
Employment	3.2	–0.4	–6.8	6.6	3.8	2.2	1.4
Unemployment rate (% of labour force)	10.5	19.5	15.5	14.8	12.9	12.1	11.8
Consumer price index	3.2	1.3	–0.3	3.1	8.4	3.7	3.6
Unit labour costs	3.0	0.6	7.7	0.3	0.4	3.9	3.1
Current account balance (% GDP)	–5.9	–0.3	0.6	0.8	0.6	1.8	1.7
External funding capacity/needs (% GDP)	–5.2	0.1	1.1	1.9	1.5	1.5	2.0
Fiscal balance (% GDP)[1]	0.3	–6.6	–10.1	–6.8	–4.7	–4.2	–3.6

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	1.1	0.8
Government consumption	2.3	–0.3	0.4	4.6	2.4	1.1	1.2
Gross fixed capital formation	–0.4	–0.7	–2.2	8.7	2.7	1.3	5.0
Capital goods	3.2	2.6	–5.4	15.3	5.5	–	–
Construction	–1.5	–2.6	1.0	7.4	1.3	–	–
Domestic demand (vs. GDP Δ)	1.3	0.1	–5.3	5.7	4.8	0.7	1.7
Exports of goods and services	5.3	4.0	–18.8	13.4	16.7	5.5	2.4
Imports of goods and services	3.6	2.7	–11.8	13.2	11.0	1.5	2.4
Gross domestic product	**1.5**	**0.5**	**–8.3**	**5.5**	**6.7**	**2.4**	**1.8**
Other variables							
Employment	0.4	–0.5	–1.9	2.7	2.0	1.1	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	4.6	2.4
Current account balance (% GDP)	–9.2	–2.9	–1.2	–0.8	–1.4	1.2	1.2
External funding capacity/needs (% GDP)	–7.7	–1.6	0.1	1.0	–0.4	2.3	2.6
Fiscal balance (% GDP)	–4.6	–5.1	–5.8	–2.9	–0.4	–0.1	–0.1

Forecasts

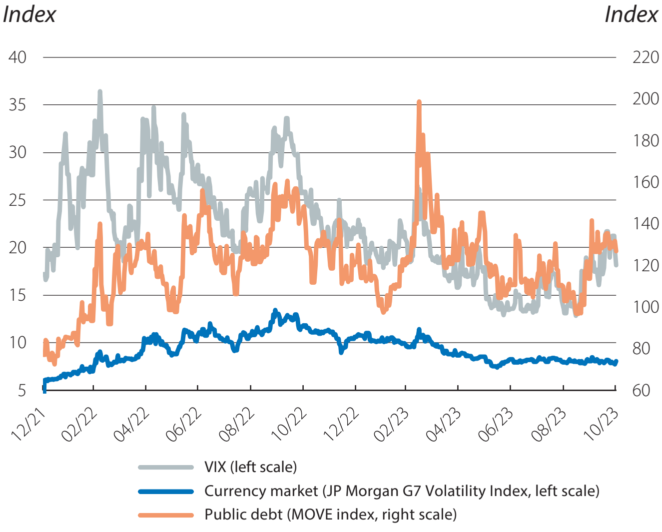
Monetary policy on «pause»

Central banks take the spotlight despite the conflict between Israel and Hamas. The final stretch of the year began with two major catalysts. The first was the outbreak of a new source of geopolitical instability, namely the conflict between Israel and Hamas, which initially generated a spike in volatility in most assets and increased investor caution. As the weeks drew on, and despite the region's potential for destabilisation in the event of further escalation, investors' nerves were calmed by the apparent local nature of the conflict and attention shifted to the major central banks (the second catalyst). First the ECB and then the Fed agreed to leave their official rates unchanged in October. This reinforced the view that the monetary tightening cycle has reached its peak and served as an incentive for a recovery in risk appetite among investors, albeit a rather tepid one.

Commodities withstand the pressure of the crisis. Unlike Russia's invasion of Ukraine, commodity prices, and especially energy prices, did not buckle in the face of the initial shock of the crisis in the Middle East. This is partly due to the fact that none of the countries involved in the conflict are major producers of primary resources and that the current international monetary context (with interest rates remaining higher for longer) helps to cushion a price rally through lower demand. However, prices remained volatile in the face of the heightened uncertainty and due to the fact that, if the conflict were to spread to more countries, it would have a greater impact on the production and commercial transit of some energy products. While the price of a barrel of Brent initially rose but then dropped back down again to around the level at which it had begun the month, the price of natural gas (Dutch TTF) increased to the levels of eight months ago, also driven by external factors of temporary nature (such as the sabotage of a gas pipeline in Finland and strikes at a gas company in Australia).

Central banks take a pause and warn that they will maintain the restrictive policy for as long as it takes. After over a year of interest rate hikes and tighter financial conditions, the major advanced economies have begun to show clear signs of cooling, mainly through their inflation rates. Although these rates are still higher than desired by their respective monetary authorities, the fact that the disinflationary pattern has been both pronounced and sustained was a key factor in the major central banks' decisions to pause the cycle of rate hikes at their latest meetings. However, they are still far from declaring victory in the fight against inflation, and in this regard they reiterated a restrictive bias and their intention to keep rates high for some time. Thus, at its October meeting the ECB left interest rates at the levels already set in September (the depo rate at 4.00% and the refi rate at 4.50%). The Fed, meanwhile, kept rates at 5.25%-5.50%, and although it acknowledged that

Volatility in the financial markets



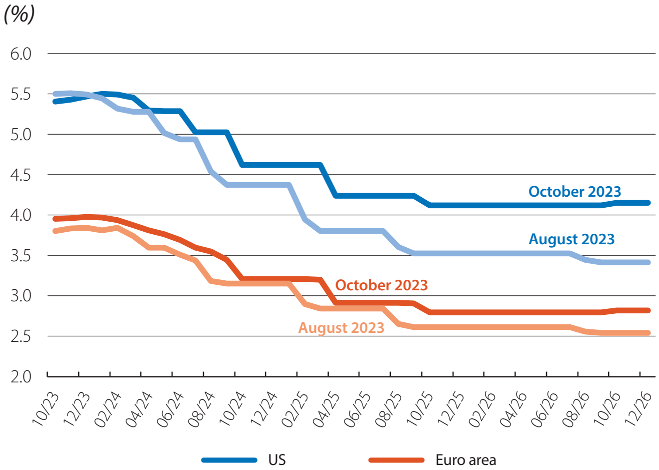
Source: *CaixaBank Research, on data from Bloomberg.*

Commodities

	Measure	Price	Change (%)			
			Israel/ Hamas*	October	Year to date	2022
Commodities	Index	104.7	2.0	0.9	–7.2	13.8
Energy	Index	36.8	1.2	–1.2	–10.8	–4.4
Brent oil	$/barrel	85.7	1.3	–5.5	–0.3	33.5
Natural gas (Europe)	€/MWh	47.6	24.4	20.9	–37.7	–0.3
Precious metals	Index	217.7	7.7	7.9	1.3	25.3
Gold	$/ounce	1,986.3	8.4	8.7	8.9	44.8
Industrial metals	Index	138.8	–0.1	–2.1	–16.0	6.1
Aluminium	$/MT	2,236.5	–0.1	–4.7	–6.0	16.7
Copper	$/MT	8,109.5	0.8	–1.9	–3.1	12.4
Agricultural	Index	64.6	1.1	0.6	–6.1	–1.9
Wheat	$/bushel	562.3	–1.1	–0.4	–29.0	7.5

Note: ** Taking the closing prices of 6 October as a baseline benchmark.*
Source: *CaixaBank Research, based on data from Bloomberg.*

Fed and ECB: expectations for reference interest rates



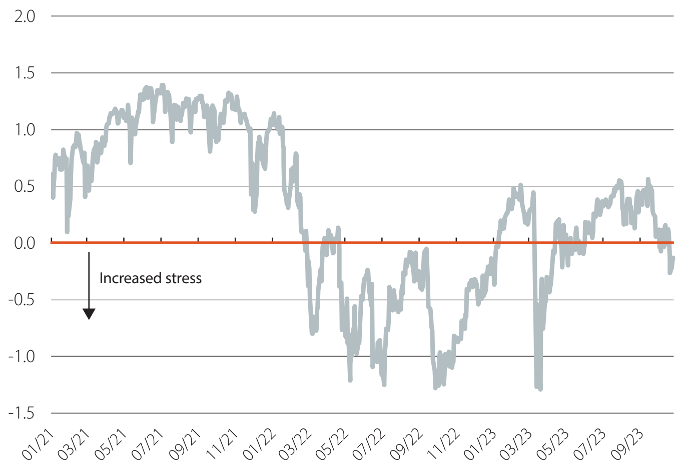
Note: *Forwards on the EFFR and the OIS of the euro area based on market yield curves.*
Source: *CaixaBank Research, based on data from Bloomberg.*

financial conditions have continued to tighten, it left the door open to further rate rises given the strength of the US economy. In both cases, financial markets interpreted the pauses as an end to the cycle of rate hikes on both sides of the Atlantic. In other advanced economies, the central banks of Canada and England also chose to keep their rates unchanged at 5.00% and 5.25%, respectively. The counterpoint was provided by the Bank of Japan, which despite its highly expansionary policy took a small step towards withdrawing its yield curve control policy (the Bank of Japan sets a «ceiling» of 1.0% for the 10-year sovereign rate, but from now on it is likely to treat this threshold with greater flexibility, formally considering it only a «benchmark»).

Improvement in the slopes of the sovereign yield curves. In the sessions leading up to the Fed and ECB meetings, and despite the geopolitical uncertainty, the expectation of a monetary environment marked by rates remaining higher for longer was the main catalyst for the sovereign markets. In the US, this sentiment was reinforced with the publication of data that showed the economy remained resilient, triggering a surge in long-term bond yields: in the case of the 10-year treasury, the yield reached as high as 5% (momentarily) for the first time in 16 years. However, following the Fed meeting, the data published on the labour market showed a certain loss of traction and sovereign debt yields once again declined, alongside investors' reduced expectations of further rate hikes by the Fed. In the euro area, on the other hand, the weak economic data led to a downward adjustment in short-term yields, while long-term yields were affected by contagion from the eventual decline in US sovereign rates. The risk premiums of Europe's periphery countries narrowed, especially in the case of Italy after S&P kept its credit rating unchanged. In the currency markets, meanwhile, the dollar capitalised on the improvement in yields on its curve relative to that of the euro area and remained at around 1.05 against the euro.

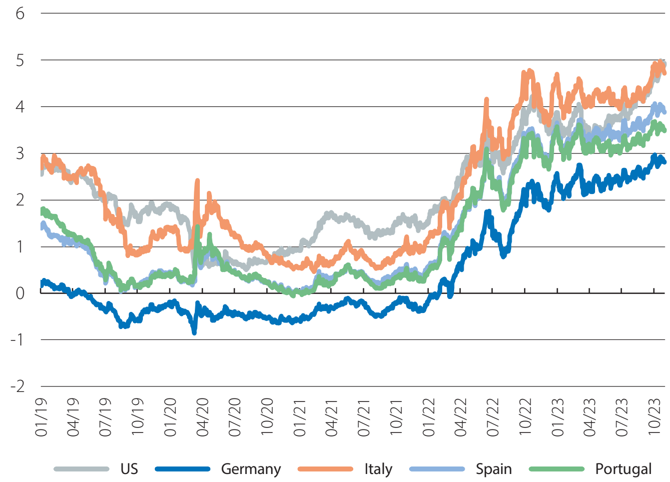
The stock markets have recorded three consecutive months of losses. Despite posting annual gains of 7%, the MSCI World Index fell by around 2% in October. This was a result of the confirmation of interest rates remaining higher for longer, both in advanced economies and the major emerging ones, as well as investor caution in the face of the instability triggered by some geopolitical risks. In addition, both factors coincided with the beginning of the Q3 corporate earnings season in the US and the euro area. Up until the end of October the picture has been mixed, as earnings have exceeded expectations by more than 70% in the case of the US, but the pace of their growth is the lowest of recent quarters and the outlook for 2024 looks less optimistic. On balance, these factors penalised the market capitalisation of the major Western stock markets, which lost 3% in the month on average, while those of emerging markets also fell despite the new monetary and fiscal stimuli in China.

US: financial conditions
Index



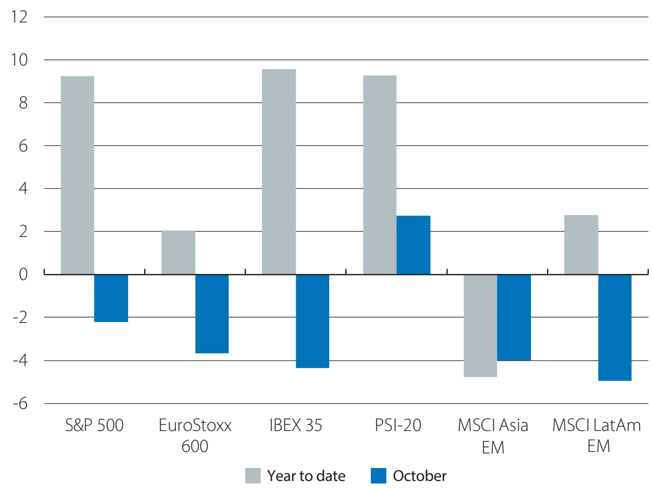
Source: *CaixaBank Research, based on data from Bloomberg.*

Evolution of 10-year sovereign rates
(%)



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

Main stock market indices
Change (%)

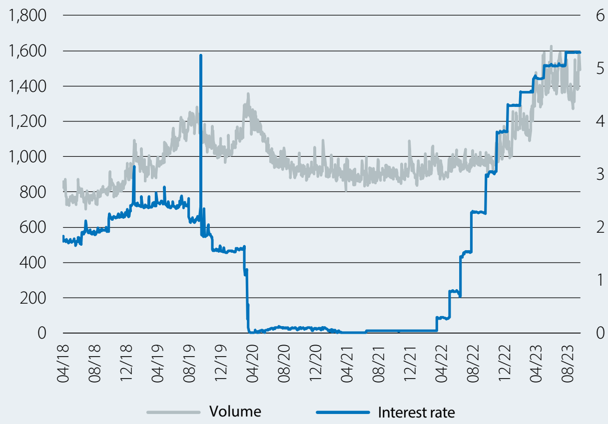


Source: *CaixaBank Research, based on data from Bloomberg.*

From LIBOR to SOFR

On 30 June 2023, the publication of data on the USD LIBOR, the interest rate at which banks lent US dollars to each other, was ceased. This was not a sudden end, as the relevant authorities had been warning since 2017 of the need to abandon the LIBOR in favour of another benchmark, the SOFR. In this article we explain what these acronyms refer to and which are the differences between them.

Secured Overnight Financing Rate (SOFR)
(USD billions) *(%)*



Source: *CaixaBank Research, based on data from the Federal Reserve Bank of New York.*

What was the LIBOR and why did it stop being published?

LIBOR stands for London InterBank Offered Rate. It was the average interest rate on transactions that a selection of banks carried out with one another on a daily basis, for each currency and maturity term, and it was regulated by the FCA.[1] That is, on a specific day, of all the loans denominated in, say, US dollars which banks granted to each other for a one-month term, the average interest rate at which these transactions had been carried out was calculated in order to obtain the 1-month USD LIBOR. This interest rate was of the utmost importance, since the rate on many loans granted to households and non-financial firms was linked to it.

However, following the financial crisis and partly due to the reduced willingness of banks to lend each other liquidity, the number of such transactions sharply declined. From then on, the average was no longer calculated according to the transactions actually carried out; instead it began to be based on the results of a survey in which the banks were asked what interest rate would be applied to such loans.[2] This detracted from its representativeness and even led to episodes of bad practices.

Given the importance of the LIBOR, the FCA began working on alternatives to the base interbank interest rate before discontinuing the publication of the LIBOR in January 2022, in the case of the LIBOR denominated in British pounds, Japanese yen and Swiss francs, and in June 2023 for the version denominated in US dollars.[3]

What is the SOFR and how does it solve the problems of the LIBOR?

Focusing on the case of the US dollar, the SOFR (Secured Overnight Financing Rate) is an interest rate developed by the US Federal Reserve which has been published since 2018. This interest rate is the result of calculating the weighted average of all one-day loans granted by various financial institutions to each other within the Federal Reserve System. Conceptually, this makes it similar to the LIBOR. However, as we will see later, there are important differences. In fact, since it began to be calculated, the volume of the daily transactions used to calculate the SOFR has exceeded 1 trillion dollars on average, with a minimum value of 0.7 trillion dollars, thus limiting the main problem with the LIBOR: its limited representativeness.[4] In addition, the SOFR is published by the New York Federal Reserve based on the transactions actually observed, rather than reported transactions.

Are the LIBOR and the SOFR equivalent?

Conceptually, both are interest rates resulting from observing transactions between financial institutions. However, in the case of the SOFR, the loans that are used to calculate the benchmark are secured by US sovereign debt, while the loans used to calculate the LIBOR have no collateral and are thus unsecured. This means that the level of risk involved in the transactions used to calculate the SOFR is generally lower than in those used for the LIBOR, and the interest rate is therefore slightly lower.

Another major difference is that in the case of the SOFR only the one-day interest rate is published, by definition, whereas the LIBOR was also reported for the interest rates on interbank transactions with terms of 1 week,

1. The United Kingdom's Financial Conduct Authority.
2. Andrew Bailey, the current governor of the Bank of England and then CEO of the FCA, explained that for one particular currency and maturity term there were just 15 transactions in all of 2016. See Andrew Bailey's speech entitled *The future of LIBOR*, given on 27 July 2017 in Bloomberg, London.
3. In this article we focus on the case of the US and its new benchmark interest rate, the SOFR, but for the aforementioned countries there are also new alternative rates that have replaced the LIBOR. In the United Kingdom the main benchmark is now the SONIA (Sterling Overnight Index Average); in Switzerland, the SARON (Swiss Average Rate Overnight), and in Japan, the TONA (Tokyo Overnight Average Rate) and the TIBOR (Tokyo InterBank Offered Rate).
4. This greater representativeness is the result, in part, of including other financial institutions (insurers or fund managers, among others) in addition to the major banks. For further details on these transactions and how the SOFR is calculated, see: https://www.newyorkfed.org/markets/reference-rates/sofr.

1 month and 3, 6 and 12 months. In order to obtain the interest rate at these maturities under the new system, the Chicago Mercantile Exchange (CME) calculates the implicit interest rate using SOFR futures at these maturity terms and publishes them on its website.

However, considering the differences between the LIBOR and the SOFR, the latter offers us reasonable continuity as a metric of interbank interest rates in the US.

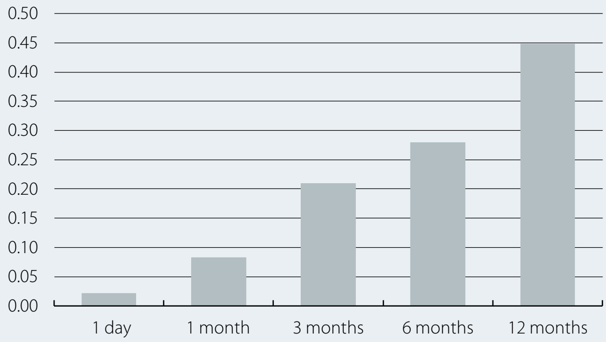
What about the Euribor?

These types of interbank benchmarks were revised for all major advanced-economy currencies in order to improve their representativeness, and the Euribor, with its various maturity terms, was no exception. However, unlike the LIBOR, for the Euribor the calculation methods were improved and since 2019 the same indicator has been published but with an improved methodology.[5]

Ricard Murillo Gili

Spread between the LIBOR and the SOFR at different maturities

(bps)



Note: *Sample from January 2020 to June 2023, except for the 12-month rates, which we show from September 2021.*
Source: *CaixaBank Research, based on data from S&P Global, via Refinitiv.*

5. For further details, see the Focus «Questions and answers about the Euribor» in the MR07/2022.

Oil, a tense market under strain

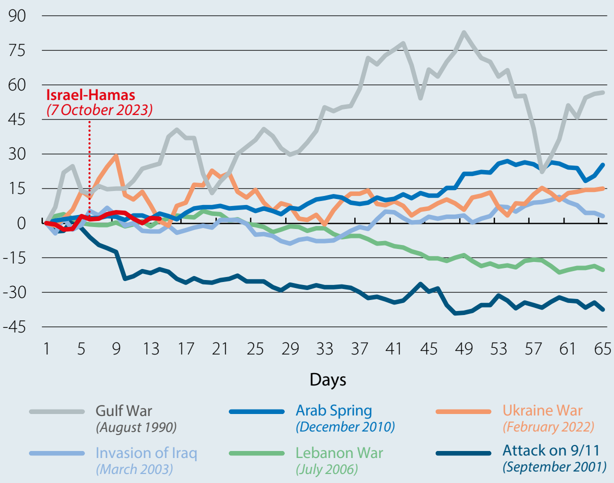
The conflict between Israel and Hamas that broke out in early October is first and foremost a humanitarian tragedy. Although it is still very difficult to quantify the impact of the escalation on the world economy, what is clear is that one of the main focuses of attention falls on the oil market, given the location of the conflict and the risk of it spreading to involve more countries in the Middle East. So far, the financial markets have reacted relatively cautiously, although volatility has increased. In the crude oil market, there has been some upward pressure on prices. However, in order to better understand the outlook for this market, we must first take a step back, given that some of the stress in oil prices has been apparent since the summer.

Mismatches between supply and demand

Global crude oil markets began to tighten notably in mid-July, as the balance between supply and demand began to show signs of instability. The nervousness increased after Saudi Arabia[1] made the surprise announcement in early September that it would extend its voluntary production cuts – in addition to the OPEC agreements – of 1 million barrels a day (b/d) until the end of the year. With this measure, its production would remain around 9 million b/d through to the end of 2023, the lowest level in several years. In parallel, Russia,[2] an OPEC ally, also extended the reduction of its exports by 300,000 b/d. Both of these measures were in addition to the production cuts that OPEC and its allies had already established and which in June were extended until the end of 2024. Moreover, they came at a time when crude and distillate inventories in the US (the world's leading producer) were at exceptionally low levels,[3] as well as when global oil demand was on track to reach record levels,[4] despite the doubts surrounding China's economic growth.[5]

Impact of geopolitical events on the price of oil

Change (%)



Note: *Data as of 25 October 2023.*
Source: *CaixaBank Research, based on data from Bloomberg.*

The sum of these circumstances applied upward pressure on the Brent barrel price between July and September, pushing it up to 96 dollars. This was more than a 20% increase and placed the price at its highest level since November 2022. Furthermore, this rally was accompanied by an upward shift across the entire oil futures price curve. However, at the beginning of Q4 2023, the «higher for longer» rhetoric of the major central banks cooled some of the buying euphoria and prices eased by around 10 dollars a barrel.

A risk barely anticipated

In the first 20 days of the conflict between Israel and Hamas, the oil price has risen by around 7%, driven up by risk premiums linked to the uncertainty triggered by the war, placing it at around 90 dollars a barrel. However, in comparison to previous episodes of geopolitical tensions directly involving Middle Eastern countries, the initial reaction of the oil price was rather «contained». In part, this «containment» reflects the fact that, since the 1973 crisis, the share of production by countries such as the US and Russia has increased to the detriment of OPEC countries, as well as reflecting the improvements in recent years in the trade and diplomatic relations that many Gulf countries maintain with Israel.[6]

1. Saudi Arabia is the leading producer country in OPEC, accounting for an estimated 32.2% of the organisation's total current production. Globally, it is the second largest producer behind the US, and in 2022 its production amounted to 12.1 million b/d.
2. Russia is the third largest oil producer in the world (11.2 million b/d in 2022). It is estimated that the joint market share of Saudi Arabia and Russia exceeds 40% of the total production of OPEC and its allies.
3. Although its production amounted to 17.7 million b/d in 2022, the US is a net importer of crude oil because its refineries are not set up to process the new forms of oil that the country produces, which are lighter and contain lower levels of sulphur (shale).
4. OPEC and the IEA estimate that in 2023 global oil demand will be around 102 million b/d, driven largely by demand from non-OECD countries (mainly China and India) and the consumption of aviation fuel (kerosene).
5. Despite the slowing pace of growth in its economy, China's imports of oil, including refined products, have risen by 19% year-on-year between January and September, driven by increased passenger traffic, industry and household consumption.

6. In 2020, the United Arab Emirates, Bahrain, Sudan and Morocco, together with Israel, signed the Abraham Agreements, normalising their diplomatic and trade relations. In the weeks leading up to the war, Saudi Arabia was also close to formalising its trade relations with Israel.

However, the current situation has highlighted a geopolitical risk that has barely been taken into account in recent years. Neither Israel nor Palestine are major oil producers, but Iran's links to Hamas[7] highlights the significant risks posed to the energy scenario in the event of an escalation of the conflict involving more countries. One of the scenarios that arouses the greatest concern among investors and analysts is Iran becoming involved in the conflict, as its geographical location means that it dominates the Strait of Hormuz, through which between 30% and 40% of the all the world's oil that is exported by sea passes (between 15% and 20% of global production), as does around 20%-25% of the global maritime trade in liquefied natural gas.

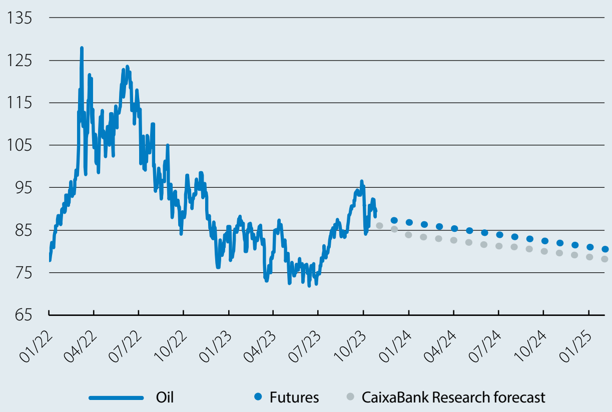
Oil prices will remain «higher for longer»

In addition to the ongoing diplomatic efforts by countries and international organisations to resolve the conflict, the main players in the oil market are trying to implement measures to cushion the potential effects that an escalation of the war could have on oil prices. The US has temporarily lifted its oil sanctions on Venezuela,[8] for at least six months. The US Department of Energy has also announced that, in order to increase the country's strategic reserves, it plans to purchase 6 million barrels at 79 dollars a barrel. On the other hand, Saudi Arabia has said that it has no plans to extend its production cuts and that it has enough idle capacity to relaunch supply. However, at the time of writing, investors did not seem to consider the measures announced to be sufficient and the risk premiums applied to prices remained high.

In short, looking ahead to next year, all the indicators suggest that crude oil barrel prices will remain high. The pressure on global oil inventories, which was already palpable before the war, is likely to persist until at least early 2024, when producing countries could recover their extraction quotas. However, it should also be borne in mind that demand from China will continue to support the growth of global demand.[9] Thus, the futures markets indicate prices just over 80 dollars for 2024 as a whole. Nevertheless, these figures are highly sensitive to developments in the war in the Middle East, and if the conflict were prolonged or were to spread to more countries, it would intensify the pressures on supply and the risk premiums on the price of oil futures.

Beatriz Villafranca

Brent oil price
(Dollars/barrel)



Note: *Data as of 25 October 2023.*
Source: *CaixaBank Research, based on data from Bloomberg.*

7. Iran is the eighth largest oil producer in the world and accounts for 11% of all OPEC production. In 2023 its production has increased significantly (+20% up to September) as a result of a slight easing of the sanctions which the US imposed on Iran in 2016.
8. Some of the sanctions imposed in 2017 will be lifted in exchange for compliance with certain constitutional guarantees ahead of Venezuela's 2024 elections. The consensus of analysts estimates that, in the short term, Venezuela's production would only reach 200,000 b/d, given the lack of investment and the obsolescence of its industry.
9. The IEA estimates that the growth in global oil demand in 2024 will be almost 102 million b/d, of which 77% is expected to correspond to China.

Interest rates (%)

	31-October	30-September	Monthly change (bp)	Year-to-date (bp)	Year-on-year change (bp)
Euro area					
ECB Refi	4.50	4.50	0	200.0	250.0
3-month Euribor	3.97	3.95	2	184.0	224.6
1-year Euribor	4.05	4.23	–18	76.1	137.9
1-year government bonds (Germany)	3.64	3.69	–5	103.8	151.6
2-year government bonds (Germany)	3.02	3.20	–19	25.2	103.4
10-year government bonds (Germany)	2.81	2.84	–3	23.5	66.5
10-year government bonds (Spain)	3.88	3.93	–5	22.0	65.3
10-year government bonds (Portugal)	3.53	3.60	–8	–6.1	38.2
US					
Fed funds (upper limit)	5.50	5.50	0	100.0	150.0
1-year government bonds	5.45	5.45	0	76.3	75.6
2-year government bonds	5.09	5.04	4	66.2	46.8
10-year government bonds	4.93	4.57	36	105.6	83.0

Spreads corporate bonds (bps)

	31-October	30-September	Monthly change (bp)	Year-to-date (bp)	Year-on-year change (bp)
Itraxx Corporate	86	80	5	–4.9	–25.9
Itraxx Financials Senior	98	91	8	–0.8	–22.9
Itraxx Subordinated Financials	179	166	14	7.3	–37.6

Exchange rates

	31-October	30-September	Monthly change (%)	Year-to-date (%)	Year-on-year change (%)
EUR/USD (dollars per euro)	1.058	1.057	0.0	–1.2	7.7
EUR/JPY (yen per euro)	160.410	157.950	1.6	14.2	10.4
EUR/GBP (pounds per euro)	0.870	0.867	0.4	–1.7	1.0
USD/JPY (yen per dollar)	151.680	149.370	1.5	15.7	2.6

Commodities

	31-October	30-September	Monthly change (%)	Year-to-date (%)	Year-on-year change (%)
CRB Commodity Index	539.5	548.6	–1.6	–2.8	–2.0
Brent ($/barrel)	87.4	95.3	–8.3	1.7	–9.1
Gold ($/ounce)	1,983.9	1,848.6	7.3	8.8	21.3

Equity

	31-October	30-September	Monthly change (%)	Year-to-date (%)	Year-on-year change (%)
S&P 500 (USA)	4,193.8	4,288.1	–2.2	9.2	11.5
Eurostoxx 50 (euro area)	4,061.1	4,174.7	–2.7	7.1	12.1
Ibex 35 (Spain)	9,017.3	9,428.0	–4.4	9.6	13.2
PSI 20 (Portugal)	6,257.1	6,090.3	2.7	9.3	9.1
Nikkei 225 (Japan)	30,858.9	31,857.6	–3.1	18.3	11.6
MSCI Emerging	915.2	952.8	–3.9	–4.3	4.8

The world economy, with an uneven cooling

Regional disparities in the global economy are accentuated. Economic activity continues to digest the inflation rally which irrupted almost two years ago amid mismatches between supply and demand (derived from the pandemic) and the increase in energy and food prices (with the war in Ukraine). At first, the world economy showed greater resilience than expected. However, in recent quarters tight financial conditions have started to bite, driven by the central banks' pursue of a restrictive policy, which is weighing particularly heavily on real estate markets, investment and economic activity. However, the cooling is more pronounced in advanced economies than in emerging economies, and within both groups there are notable exceptions, such as the resistance of the US in the former group and the difficulties which China is experiencing in the latter.

The US withstands the headwinds. US GDP grew by an impressive 1.2% quarter-on-quarter in Q3 2023, more than double the average for the first half of the year (+0.5%) and with a solid composition (private consumption grew by 1.0%, public consumption by 1.1% and residential investment increased by 1.0% after nine consecutive quarters of setbacks). This resistance shown by economic activity has not stopped the reduction in inflation, which continues to converge towards the Fed's 2% target. However, in September the CPI offered mixed signals. Specifically, headline inflation remained unchanged at 3.7% year-on-year, mainly due to the rise in energy prices. Core inflation, on the other hand, fell 0.2 percentage points to 4.1%. However, its month-on-month dynamics were less encouraging than in previous months, with a stable rate of 0.3%, while the breakdown by component showed an acceleration in the inflation of shelter (0.6% vs. 0.3% in August), which accounts for over 40% of the core index.

Europe feels the cold. In the euro area, GDP fell by 0.1% in Q3 after growing by 0.2% in Q2 (revised upwards by 0.1 pp). In part, this figure reflects the volatility of GDP in Ireland (–1.8% quarter-on-quarter vs. +0.5% in Q2), although excluding the Irish data the euro area would have virtually stagnated in Q3. This slowdown in economic activity occurred across almost all the major economies, with a 0.1% quarter-on-quarter decline recorded in Germany (following stagnation in the first half of the year), moderate growth of 0.1% in France (not so modest if we consider that the 0.6% growth rate in Q2 was heavily supported by temporary effects, after which a reversal could have been expected) and stagnation in Italy (0.0% in Q3 vs. –0.4% in Q2), while Spain showed greater buoyancy (0.3%).

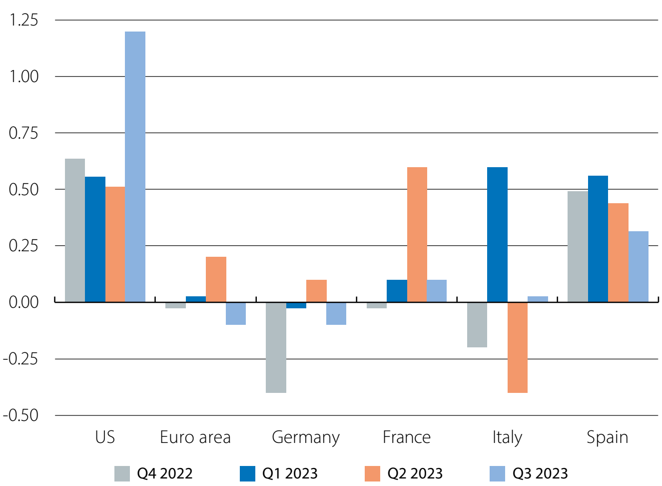
European inflation falls below 3%. The positive side of the cooling of euro area activity can be found in inflation, with

IMF: GDP growth forecasts
Annual change (%)

		Projections		Change vs. July WEO	
	2022	2023	2024	2023	2024
World economy	3.5	3.0	2.9	0.0	–0.1
Advanced economies	2.6	1.5	1.4	0.0	0.0
US	2.1	2.1	1.5	0.3	0.5
Euro area	3.3	0.7	1.2	–0.2	–0.3
Japan	1.0	2.0	1.0	0.6	0.0
United Kingdom	4.1	0.5	0.6	0.1	–0.4
Emerging and developing economies	4.1	4.0	4.0	0.0	–0.1
China	3.0	5.0	4.2	–0.2	–0.3
India	7.2	6.3	6.3	0.2	0.0

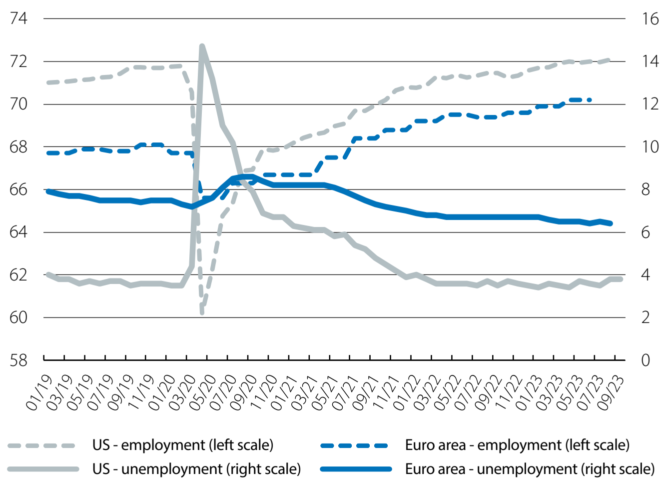
Source: *CaixaBank Research, based on data from the IMF (WEO, October 2023).*

Advanced economies: GDP
Quarter-on-quarter change (%)



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

Advanced economies: employment and unemployment
(% of the total population aged 15 to 64) *(% of the labour force)*



Source: *CaixaBank Research, based on data from Eurostat and the European Commission.*

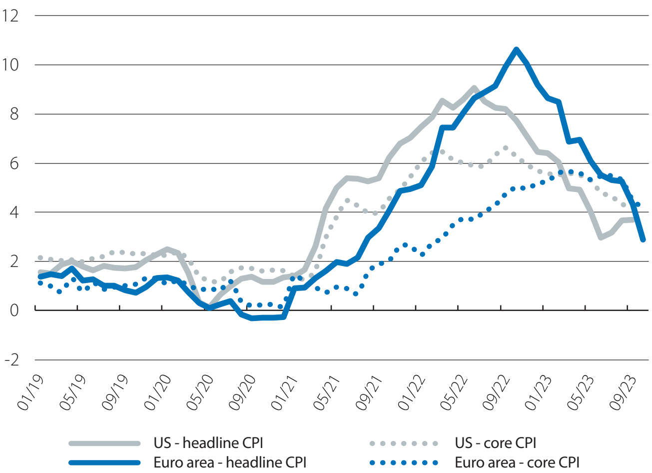
the latest data reinforcing the prospect of it being bent to 3% in the coming months. In particular, headline inflation in the euro area fell sharply in October to 2.9% year-on-year (–1.4 pps), while core inflation fell to 4.2% (–0.3 pps). The region as a whole had not seen such low levels since the summer of 2021 (headline inflation) and the summer of 2022 (in the case of core inflation). The fall in October reflected a strong base effect in energy prices (which registered a year-on-year contraction of 11.1%, undoing the stress in the energy component experienced in the autumn of 2022). Nevertheless, and significantly, a sustained slowdown was also observed in all other components, most notably in the case of industrial goods (–0.6 pps) and services (–0.1 pps). In addition, according to the seasonally adjusted estimates of the HICP published by the ECB, annualised month-on-month inflation stood at –0.1% (headline) and 1.2% (core) in October, while inflation momentum stood at 4.5% (headline) and 3.2% (core).

Growth rates remain disparate heading into the 2023 year end. In the euro area, the first indicators available for Q4 indicate a continuity of the recent sluggish economic activity: in October, the PMI remained in contractionary territory, both in industry (43.1 points) and in services (47.8, the lowest level since early 2021). Moreover, this weakness was widespread across the bloc (the composite PMI remained in contractionary territory in Germany, France and Italy). In the US, in contrast, the composite PMI for October remained in slightly expansive territory (50.7) and improved moderately in both manufacturing (50.0 vs. 49.8 in September) and services (50.6 vs. 50.1). Also, in October the US labour market created 150,000 jobs, a positive figure but below the pre-pandemic average rate, while the unemployment rate rose slightly to 3.9%.

The Chinese economy takes a breather in a demanding environment. Although China's economic activity continues to be hampered by an ongoing crisis in the real estate sector, GDP grew by a significant 1.3% quarter-on-quarter in Q3 2023, following 0.5% growth recorded in Q2 (revised 0.3 pps downwards). In year-on-year terms, growth slowed to 4.9% (vs. 6.3% in Q2), reflecting the fading of the base effects which were present in the previous quarter as a result of the lockdowns in force in Q2 2022. On the positive side, the economic activity indicators showed an improvement during the course of the quarter, with retail sales (5.5% year-on-year in September vs. 4.6% in August) pointing to a recovery in private consumption. In contrast, the slowdown in investment intensified (+3.1% year-on-year vs. 3.8% up to Q2), affected by the persistent weakness of the real estate sector. As for the initial data available for Q4, the Caixin PMIs continue to paint a picture of an economy that is struggling to sustain its post-pandemic recovery, with a composite index lying at the stagnation threshold in October (50 points), a slight decline in manufacturing (49.5) and a slight improvement in services (50.4).

Advanced economies: CPI

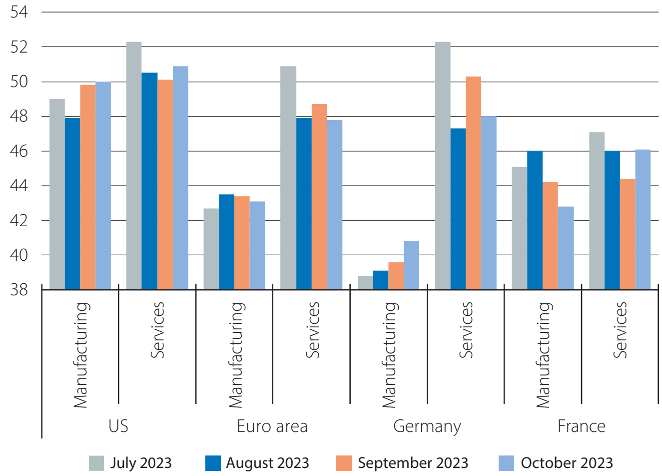
Year-on-year change (%)



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

Advanced economies: PMI

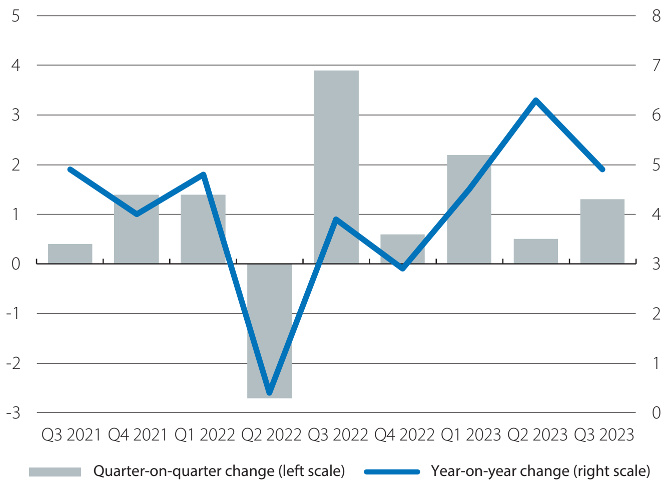
Index



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

China: GDP

Change (%) *Change (%)*



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

What will de-risking mean for the EU?

After decades of rapid expansion in global trade, partly driven by China's integration into the world economy, the latest wave of globalisation has been losing steam. There are many factors behind this slowdown, including the fading of certain comparative advantages, such as the wage cost gap, as new global production centres developed, particularly in Asia.[1] In addition to these macro-trends, in the last decade there has been an increase in geopolitical tensions and in the level of uncertainty relating to trade policies. All this has revived discussions around concepts such as economic security and has led to profound changes in the economic policies of the world's major trading powers.

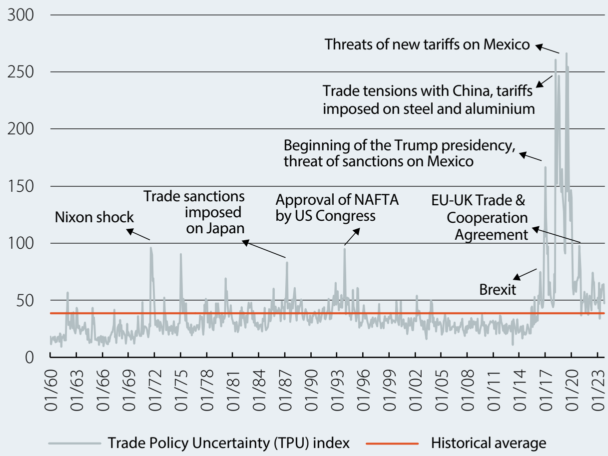
In 2015, the Chinese authorities presented the «Made in China 2025» plan with the aim of boosting the country's production in strategic sectors. In 2022, two economic stimulus packages were approved in the US, namely the Inflation Reduction Act and the Chips and Science Act, aimed at boosting the country's industry in the green and digital spheres. In the EU, the new «strategic autonomy» has materialised since the pandemic in the launching of large-scale investment programmes, such as Next Generation EU and RePowerEU.[2] This return to industrial policy comes at the same time as barriers to trade and capital flows are increasing, while national security laws, intellectual property laws and mechanisms for controlling investment flows are also under review.

De-risking, decoupling, fracturing, reshoring, nearshoring, friendshoring... understanding the new era of globalisation

The multiple shocks which we have suffered in recent years have placed the interdependencies between economies under the spotlight. In previous editions of this same report, we have seen just how significant the interdependencies between the European, Asian and American economies are, especially in manufacturing and particularly in sectors such as electronics, machinery, transportation, chemicals and pharmaceuticals.[3] On the one hand, the emergence of China as the «world's factory» in the field of electronics profoundly transformed value chains in the sector, as the country went from being almost irrelevant in the sector's production to utterly dominating its value chains (see second chart). On the other hand, the US was able to strengthen its technological leadership (see the high value added which its industry generates in the third chart), despite a significant portion of production being relocated to Asia, particularly China.

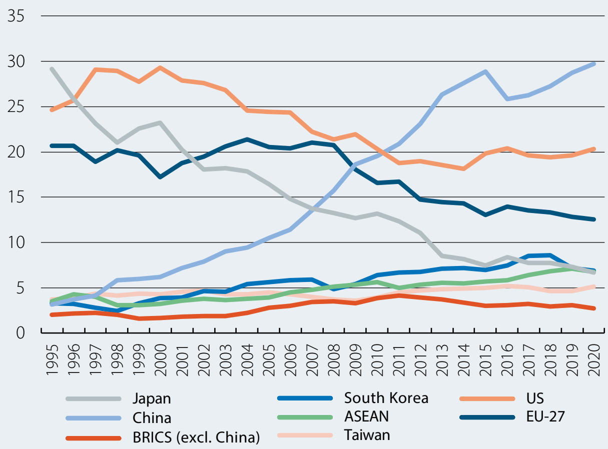
This sector offers a prime example of the crossroads at which the EU currently finds itself in a context of growing trade tensions, as it is dependent on the production capacity of a trading partner such as China, on the one hand, and on the innovation dynamism of the US, on the other.

Trade policy uncertainty
Index



Notes: The Trade Policy Uncertainty (TPU) index is built using searches of electronic newspaper archives, and is calculated by counting the monthly frequency of articles discussing trade policy uncertainty (as a percentage of the total number of articles). Latest figure: 1 October 2023.
Source: CaixaBank Research, based on data from D. Caldara et al. (2020). «The Economic Effects of Trade Policy Uncertainty», JME, 109,38-59 (downloaded from: https://www.matteoiacoviello.com/tpu.htm, on 17/10/2023).

Origin of the value added of global demand in the electronics sector
(% of global demand)



Source: CaixaBank Research, based on data from the OECD Trade in Value Added (TiVA) database.

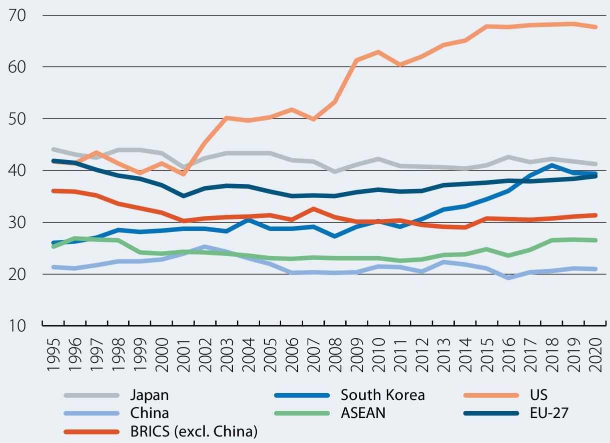
1. See the Focus «¿Quo vadis, globalisation? (part I and II)» in the MR10/2023.
2. In each of these regions, it is estimated that the programmes will amount to hundreds of millions of dollars. See M.J. Zenglein and A. Holzmann (2019), «Evolving Made in China 2025 – China's industrial policy in the quest for global tech leadership», MERICS, Papers on China nº 8, and the Franco-German Council of Economic Experts (2023), «Joint Statement – The Inflation Reduction Act: How should the EU react?».
3. We concluded, for example, that China's «electronic footprint» in the largest advanced and emerging economies was equally as significant as Russia's «energy footprint» is in the EU.

These «dependencies», however, work in different directions and have multiple dimensions. A partial analysis of global value chains (e.g. without considering the relationships between different sectors) can lead to a distorted view of a region's dependencies. The same is true if factors such as the geographical concentration of production, the scarcity of certain products or the level of substitutability between production factors are not taken into consideration.[4]

In this context, in recent months the EU has proposed a European Economic Security Strategy focused on minimising the risks arising from trade dependencies in a context of accelerating technological change, while also seeking to keep the bloc's economy both open and buoyant. This new approach has resulted in the emergence of new jargon: de-risking has come in part to substitute an earlier discussion, more focused on decoupling or so-called «friendshoring» (the relocation of production to allied countries). In this regard, the European Commission has recently published a recommendation[5] in which, out of 10 critical technologies, it identifies four priority areas where it considers there are more likely to be immediate and sensitive risks: advanced semiconductors, artificial intelligence, quantum technologies and biotechnologies.[6] In addition, the recommendation calls for risk assessments to be based, among other factors, on a thorough analysis of these technologies' value chains, as well as on the identification of «threats and threat actors» and geopolitical factors.

Technological intensity of the value chain of each country in the electronics sector

Value added/gross production (%)



Source: *CaixaBank Research, based on data from the OECD Trade in Value Added (TiVA) database.*

EU de-risking in the double transition: the search for chips, rare earths, investment and trade agreements

Just as today's interdependencies are the result of decades of global economic integration and have produced numerous benefits for all parties, minimising risks and vulnerabilities in value chains will not be a short-term task and will entail costs. In this new phase of globalisation, perhaps more than ever, the devil will be in the details. If the battle for technological leadership (and the ensuing geopolitical benefits) remains active, we may see a gradual rethinking of global value chains. The case of electronics offers a good illustration of the EU's challenges and priorities in this sphere: in order to minimise the risks associated with external dependencies, the bloc wishes to continue to encourage investment in new technologies through strategies and programmes defined at the EU level, while at the same time avoiding, insofar as possible, a protectionist escalation. On the other hand, the challenges of the energy and digital transition highlight the importance of ensuring continued access to markets and products where bottlenecks could form across various technologies or sectors, such as chips or rare earths. In those cases where the bloc is lagging too far behind the technological frontier or is geographically too far away from the extraction sources, the idea is that economic diplomacy will be the best weapon for de-risking in an environment of growing geopolitical tensions. This can be achieved through the search for multilateral dialogue forums and new trade agreements in order to facilitate the gradual and effective diversification of Europe's value chains.

Luís Pinheiro de Matos

4. See, in this regard, ECB (2023), «The EU's Open Strategic Autonomy from a central banking perspective – Challenges to the monetary policy landscape from a changing geopolitical environment», International Relations Committee Work stream on Open Strategic Autonomy, nº 311.
5. See Recommendation on Critical Technology Areas, published by the European Commission on 3 October 2023.
6. The other six technology areas considered critical include: advanced connectivity, navigation and digital technologies; advanced sensing technologies; space and propulsion technologies; energy technologies; robotics and autonomous systems; and advanced materials, manufacturing and recycling technologies. The selection of the technologies where the risk assessment is considered a priority was based on criteria such as the technology's «enabling and transformative» nature or the risk of civil and military fusion.

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

UNITED STATES

	2021	2022	Q4 2022	Q1 2023	Q2 2023	Q3 2023	08/23	09/23	10/23
Activity									
Real GDP	5.8	1.9	0.7	1.7	2.4	2.9	–	–	–
Retail sales (excluding cars and petrol)	15.8	9.3	7.5	5.9	3.3	2.2	3.9	4.0	...
Consumer confidence *(value)*	112.7	104.5	104.2	105.5	106.1	104.5	108.7	104.3	102.6
Industrial production	4.4	3.4	1.8	1.3	1.0	0.9	0.1	0.1	...
Manufacturing activity index (ISM) *(value)*	60.7	53.5	49.1	48.3	47.8	47.1	47.6	49.0	46.7
Housing starts *(thousands)*	1,606	1,551	1,405	1,375	1,378	1,385	1,269	1,358	...
Case-Shiller home price index *(value)*	267	307	304	303	302	302	316.5	...	...
Unemployment rate *(% lab. force)*	5.4	3.6	3.6	3.5	3.5	3.5	3.8	3.8	3.9
Employment-population ratio *(% pop. > 16 years)*	58.4	60.0	60.0	60.1	60.2	60.3	60.4	60.4	60.2
Trade balance [1] *(% GDP)*	–3.6	–3.7	–3.7	–3.6	–3.5	–3.3	–3.0	...	...
Prices									
Headline inflation	4.7	8.0	7.1	6.7	6.3	5.8	3.7	3.7	...
Core inflation	3.6	6.2	6.0	5.7	5.6	5.6	4.3	4.1	...

JAPAN

	2021	2022	Q4 2022	Q1 2023	Q2 2023	Q3 2023	08/23	09/23	10/23
Activity									
Real GDP	2.2	1.0	0.4	2.0	1.6	...	–	–	–
Consumer confidence *(value)*	36.3	32.2	30.4	30.7	31.2	32.2	36.2	35.2	35.7
Industrial production	5.8	0.0	0.7	–1.8	–1.8	–2.0	–4.4	–3.7	...
Business activity index (Tankan) *(value)*	13.8	9.5	7.0	1.0	5.0	9.0	–	–	–
Unemployment rate *(% lab. force)*	2.8	2.6	2.5	2.5	2.5	2.6	2.7	2.6	...
Trade balance [1] *(% GDP)*	–0.3	–3.7	–3.8	–4.0	–4.0	–5.3	–2.7	...	...
Prices									
Headline inflation	–0.2	2.5	3.9	4.1	3.9	3.6	3.1	3.0	...
Core inflation	–0.5	1.1	2.8	3.0	3.2	3.5	4.3	4.3	...

CHINA

	2021	2022	Q4 2022	Q1 2023	Q2 2023	Q3 2023	08/23	09/23	10/23
Activity									
Real GDP	8.4	3.0	2.9	4.5	6.3	4.9	–	–	–
Retail sales	12.4	–0.8	–2.7	5.8	...	...	4.6	5.5	...
Industrial production	9.3	3.4	2.8	3.2	4.5	4.2	4.5	4.5	...
PMI manufacturing *(value)*	50.5	49.1	48.1	51.5	49.0	49.7	49.7	50.2	49.5
Foreign sector									
Trade balance [1,2]	681	898	898	946	943	898	906.4	901.0	871.1
Exports	30.0	7.1	–6.8	0.1	–5.4	–10.8	–9.5	–6.2	–7.9
Imports	30.0	0.8	–6.9	–7.0	–6.7	–8.6	–7.3	–6.2	3.0
Prices									
Headline inflation	0.9	2.0	1.8	1.3	0.1	–0.1	0.1	0.0	...
Official interest rate [3]	3.8	3.7	3.7	3.7	3.6	3.5	3.5	3.5	3.5
Renminbi per dollar	6.5	6.7	7.1	6.8	7.0	7.2	7.3	7.3	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	Q4 2022	Q1 2023	Q2 2023	Q3 2023	08/23	09/23	10/23
Retail sales *(year-on-year change)*	5.4	1.0	–2.8	–2.7	–1.9	...	–2.2	...	...
Industrial production *(year-on-year change)*	9.9	2.2	2.0	0.4	–1.1	...	–5.0	...	...
Consumer confidence	–7.5	–21.9	–26.9	–26.9	–26.9	–26.9	–16.0	–17.8	–17.9
Economic sentiment	110.7	101.9	96.5	96.5	96.5	96.5	93.7	93.4	93.3
Manufacturing PMI	60.2	52.1	47.1	48.2	44.7	43.2	43.5	43.4	43.1
Services PMI	53.6	52.1	49.0	52.8	54.4	49.2	47.9	48.7	47.8
Labour market									
Employment (people) *(year-on-year change)*	1.5	...	1.6	1.6	1.3	...	–	–	–
Unemployment rate *(% labour force)*	7.7	6.7	6.7	6.6	6.5	6.5	6.4	6.5	...
Germany *(% labour force)*	3.6	3.1	3.0	3.0	3.0	3.0	3.0	3.0	...
France *(% labour force)*	7.9	7.3	7.2	7.1	7.3	7.3	7.3	7.3	...
Italy *(% labour force)*	9.5	8.1	7.9	7.9	7.6	7.4	7.3	7.4	...
Real GDP *(year-on-year change)*	6.1	3.5	1.8	1.2	0.5	0.1	–	–	–
Germany *(year-on-year change)*	3.3	1.9	0.8	–0.2	0.1	–0.4	–	–	–
France *(year-on-year change)*	6.8	2.6	0.8	1.0	1.1	0.7	–	–	–
Italy *(year-on-year change)*	8.6	3.9	1.6	2.1	0.3	0.0	–	–	–

Prices

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

	2021	2022	Q4 2022	Q1 2023	Q2 2023	Q3 2023	08/23	09/23	10/23
General	2.6	8.4	10.0	8.0	6.2	5.0	5.2	4.3	2.9
Core	1.5	3.9	5.1	5.5	5.5	5.1	5.3	4.5	4.2

Foreign sector

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

	2021	2022	Q4 2022	Q1 2023	Q2 2023	Q3 2023	08/23	09/23	10/23
Current balance	3.1	–0.7	–0.7	–0.5	0.3	...	1.5	...	...
Germany	7.7	4.2	4.2	4.4	5.1	...	7.7	...	...
France	0.4	–2.0	–2.0	–1.9	–1.8	...	–2.1	...	...
Italy	2.4	–1.5	–1.5	–1.4	–1.1	...	–0.5	...	...
Nominal effective exchange rate [1] *(value)*	**94.3**	**90.9**	**91.9**	**93.3**	**94.6**	**95.9**	**96.2**	**95.5**	**95.1**

Credit and deposits of non-financial sectors

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

	2021	2022	Q4 2022	Q1 2023	Q2 2023	Q3 2023	08/23	09/23	10/23
Private sector financing									
Credit to non-financial firms [2]	3.5	6.7	7.9	5.7	3.9	1.0	0.7	0.2	...
Credit to households [2,3]	3.8	4.4	4.0	3.2	2.1	1.1	1.0	0.8	...
Interest rate on loans to non-financial firms [4] *(%)*	1.2	1.8	2.9	3.8	4.5	5.0	5.0	5.0	...
Interest rate on loans to households for house purchases [5] *(%)*	1.3	2.0	2.9	3.7	4.3	4.7	4.7	4.7	...
Deposits									
On demand deposits	12.8	6.3	1.4	–3.9	–8.0	–11.3	–12.0	–11.4	...
Other short-term deposits	–0.8	4.5	12.0	17.6	22.5	23.2	23.7	22.0	...
Marketable instruments	11.6	3.7	7.5	19.3	21.9	20.2	20.5	19.1	...
Interest rate on deposits up to 1 year from households *(%)*	0.2	0.5	1.1	1.9	2.5	3.0	3.1	3.1	...

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 feels the effects of the weak external environment

After a better-than-expected first half of the year, the flash estimate for Q3 GDP confirms the weakening of the economy that was already anticipated by the various economic indicators. The slowdown in the second half of the year is mainly due to the cooling of economic activity in the euro area and the impact of the interest rate hikes. On the upside, the economy's capacity to generate employment in a less favourable environment continues to stand out.

GDP growth slows in Q3, weighed down by foreign demand. GDP grew 0.3% quarter-on-quarter in Q3 2023 (1.8% year-on-year), which is 10 percentage points less than the previous quarter and the lowest growth rate since Q1 2022, although the Spanish economy has performed better than the large European economies. Domestic demand has been taking over from foreign demand as the economy's driver of growth. This is especially the case for private consumption which, supported by the containment of inflation and the strength of the labour market, has finally recovered pre-pandemic levels. In contrast, foreign demand deducted 0.4 pps from quarter-on-quarter GDP growth, as exports fell more sharply than imports.

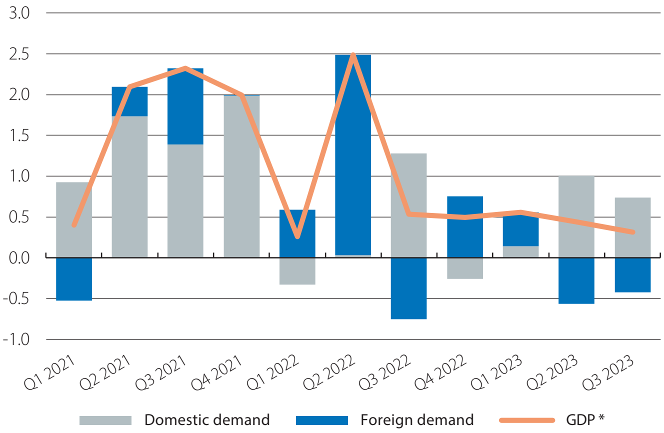
The GDP figure for Q3 2023 is in line with our forecast scenario, meaning that the risks surrounding our growth forecast for 2023 as a whole, of 2.4%, remain balanced. For 2024, we estimate that the pace of growth of the Spanish economy will slow to 1.4%, affected by the impact of the lower buoyancy of our main trading partners and the recent rebound in the oil price, albeit with a gradual improvement over the course of the year as the external environment and confidence among economic agents improve and as the NGEU funds are executed.

The initial data available for Q4 suggest the slowdown continues. In October, the Purchasing Managers' Index (PMI) for the manufacturing sector fell 2.6 points to 45.1 points, meaning that it has been in contractionary territory (below 50 points) for seven consecutive month now. The PMI for the services sector, meanwhile, remains in expansionary territory, specifically at 51.1 points. As for the Harmonised Business Confidence Index (HBCI) developed by the National Statistics Institute, it recorded its first decline in the past year, specifically of –2.0% quarter-on-quarter, reflecting the deterioration in the expectations of business leaders regarding their firms' progress. In particular, the percentage of optimists fell (19.2% of the total, 3 points less than in the previous quarter), while the proportion of pessimists increased (by 1.9 points to 18.9%), placing the balance (the difference between these two percentages) at 0.3 (previously 5.2).

The tourism sector ended the summer season with excellent records. In the period July-September, 29 million foreign tourists arrived in our country, and they spent 38.6 billion euros, representing growths of 12.9% and 19.4% year-on-year, respectively. Compared to pre-pandemic levels, the number of tourist arrivals exceeds the 2019 figure by 0.7%, while the expenditure figure is 16.0% higher. The number of overnight stays in tourist accommodation establishment was 0.5% higher

Spain: contribution to GDP growth by component

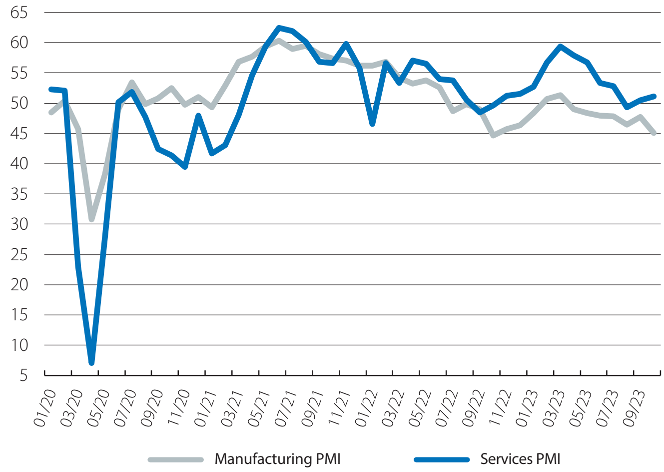
Contribution to the quarter-on-quarter change in GDP (pps)



Note: ** Quarter-on-quarter change (%).*
Source: *CaixaBank Research, based on data from the National Statistics Institute (CNTR).*

Spain: PMI

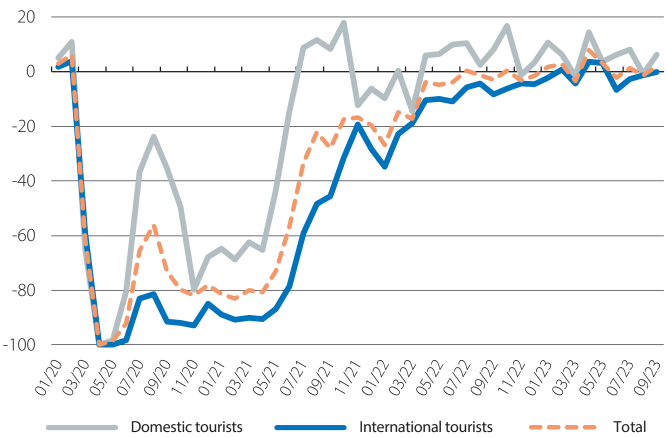
Level



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

Spain: tourist overnight stays

Change vs. the same month of 2019



Note: *Overnight stays by tourists in hotels, rural tourism establishments, tourist apartments and campsites.*
Source: *CaixaBank Research, based on data from the National Statistics Institute.*

than in the summer of 2019: international tourism continued to improve and reached just 1.5% below the pre-pandemic number of overnight stays, while in the case of domestic tourism the figure was 3.7% higher.

The labour market performed better than expected in Q3. The data from the LFS for Q3 2023 were better than expected due to a significant increase in the number of people in employment, as well as in the total labour force. Employment increased by 209,100 people, beating both last year's figure (+77,700) and the Q3 average for the period 2014-2019 (+174,800). With this statistics, the employment rate (the number of people in employment as a percentage of the population aged 20 to 64) has reached an all-time high, standing at 71.4%. The improvement in this rate is largely due to the greater incorporation of women into the labour market and the higher retirement age, and it is essential for improving the economy's growth potential, as it represents an increase in the degree of utilisation of the available labour resources.

As for unemployment, it increased by 92,700 people in the quarter, nudging the unemployment rate up by 20 percentage points to 11.8%. This increase contrasts with the decline that usually occurs in Q3 (–185,000 on average in the period 2014-2019) and is attributable to the exceptional increase in the overall labour force (301,900, the second largest increase in the series in a third quarter, only surpassed by the anomalous figure recorded in 2020). This increase in the labour force, which has brought the total to a record high (24.12 million people), was mainly due to the increase in the foreign population, which grew by 144,200 people. The Spanish population in the labour force, meanwhile, grew by 93,800 people, and those with dual nationality by 63,800. Since Q1 2018, which is when the total labour force began to grow, only abruptly interrupted by the pandemic, the labour force has recorded cumulative growth of 1.45 million people, mostly foreign nationals (825,800 people vs. 189,600 Spaniards and 435,400 people with dual nationality).

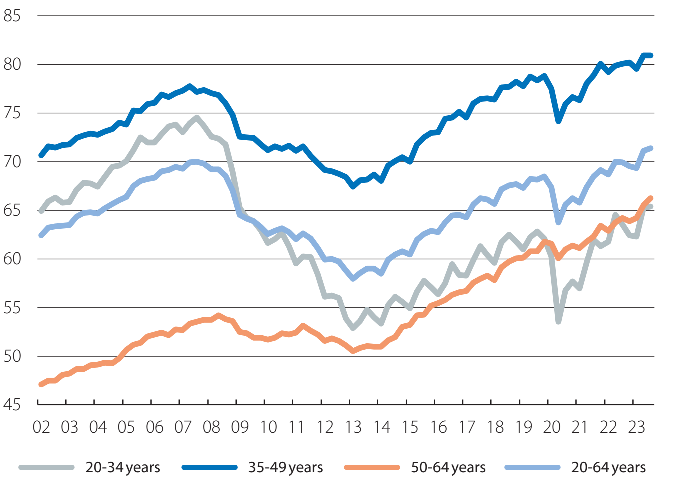
Recent developments in the labour market point to weaker job creation. The Social Security affiliation data for October show an increase in employment of 92,861 people, the weakest October figure since 2015. In seasonally adjusted terms, employment recorded an increase of 5,077 registered workers, below the monthly average for Q3 (15,651). Looking ahead to 2024, we expect the rate of job creation to remain positive but relatively contained, with an increase of +1.4% compared to 2023, which should allow the unemployment rate to be reduced to 11.8% on average for the year.

Inflation is slowing and stabilised in October at 3.5%, largely thanks to the fall in fuel prices. The core inflation rate (which excludes energy and unprocessed food) fell sharply to 5.2% (5.8% in September), the lowest level since May 2022. This statistic, together with the downward trend of recent months, suggests that the underlying inflationary pressures are gradually moderating.

For 2024, the headline inflation rate is likely to remain at similar figures to this year (3.6% annual average) if the anti-inflation measures are withdrawn. However, we do expect a moderation in core inflation (which excludes food and energy) from 4.6% in 2023 to 3.0% in 2024.

Spain: employment rate by age group

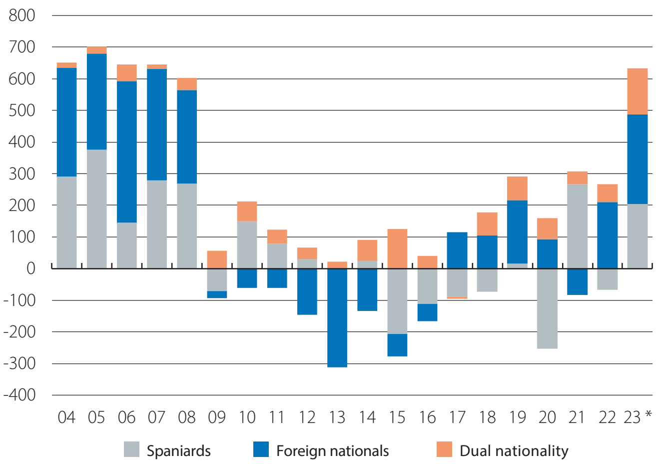
Employed population as a proportion of the working age population (%)



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

Spain: annual change in the labour force

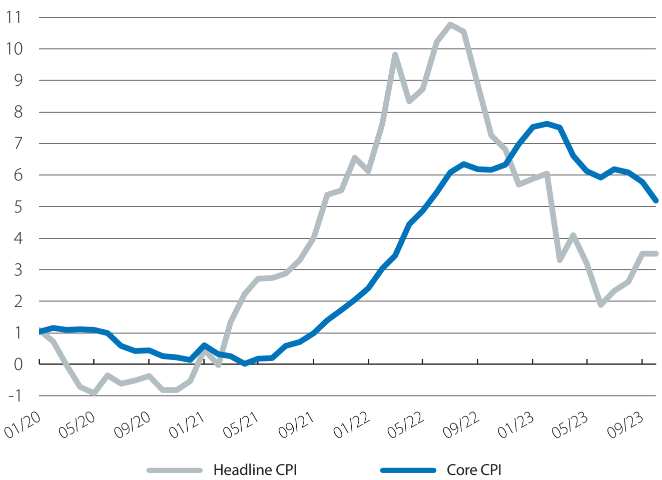
(Thousands)



Note: ** Q3 2023 versus Q4 2022.*
Source: *CaixaBank Research, based on data from the National Statistics Institute (LFS).*

Spain: CPI

Year-on-year change (%)



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

Sectoral specialisation penalises the productivity of the Spanish economy

Why is productivity so low in Spain and why has it grown so little in recent years? Although the answer is complex and a whole range of factors are involved, two of the key causes of the Spanish economy's low labour productivity, as well as the low growth thereof, are the country's production specialisation and the small size of its companies.

Labour productivity in Spain increased by 9.3% between 2010 and 2019 (an average of 1.0% per year).[1] Productivity growth was widespread across the vast majority of economic sectors, as demonstrated by the fact that 82% of Spanish workers are employed in sectors that have experienced labour productivity growth in the period analysed. However, both the level of productivity and its growth rate remain modest compared to other euro area countries, such as Germany.

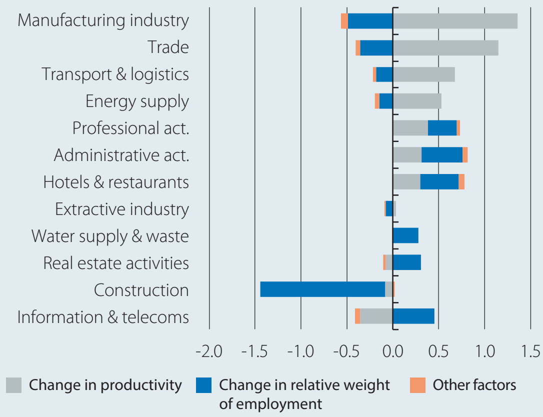
In which sectors has productivity grown the most?

Productivity in the economy as a whole can be improved either by boosting productivity in each individual sector or by shifting employment from sectors with relatively low productivity to those with higher productivity. If we break down the increase in productivity over the period 2010 to 2019 between these two factors, we see that the entirety of the improvement was due to productivity growth occurring in practically all sectors (see grey bars in the first chart).

The manufacturing industry contributed the most to productivity growth between 2010 and 2019, managing to increase its Gross Value Added (GVA) by 18.2% with only a 2.5% increase in the number of workers. The trade, transport and logistics, and energy supply sectors also made a significant contribution.[2] The hotels and restaurants sector, as well as professional and administrative activities, also made positive contributions to productivity growth, albeit to a lesser extent.

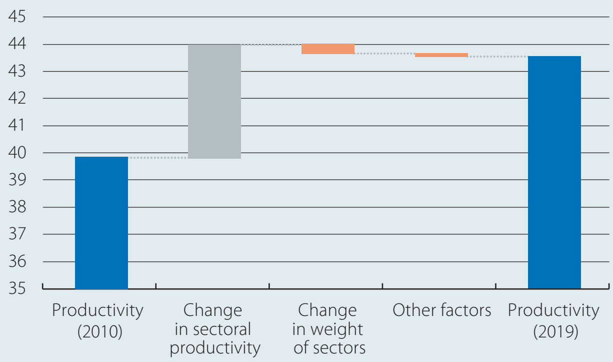
Another highly productive sector (second only to the energy supply sector) is that of information and telecommunications. However, its contribution to total productivity growth between 2010 and 2019 was negative because the increase in employment in the sector (24.8%) was much higher than the increase in its GVA (10.1%). The construction and real estate sectors also registered a decline in productivity during this period.[3]

Contribution of each factor and sector to total productivity growth between 2010 and 2019
(pps)



***Note:** The increase in productivity between 2010 and 2019 was 9.3%. This chart shows the contribution of each factor and economic sector to this change.*
***Source:** CaixaBank Research, based on data from Eurostat.*

Spain: breakdown of productivity growth between 2010 and 2019
(Euros per worker)



***Note:** Breakdown of the increase in productivity over the period 2010 to 2019 between (1) the change in productivity within each sector (intensive margin) and (2) the change in the relative weight of the different economic sectors (extensive margin).*
***Source:** CaixaBank Research, based on data from Eurostat.*

Has the change in the sectoral composition of employment contributed to productivity growth?

The answer is that it has not done so across the board. In fact, the change in the sectoral composition of

1. In this Focus, we analyse the sectors that make up the market economy, with the exception of agriculture and financial and insurance activities. Specifically, we include sections B-J and L-N of the National Classification of Economic Activities (known as the CNAE), the GVA of which represents 45% of total nominal GDP in Spain (55% in Germany). The data are drawn from Eurostat's structural business statistics and are available up until 2020, but we take 2019 as a final benchmark in order to avoid the distortions in production and employment that occurred due to the pandemic.
2. The energy supply sector experienced the highest increase in productivity between 2010 and 2019 (38.4%). It also significantly increased its GVA (34.5%), despite a reduction in the number of people it employed (–2.8%).

3. In the case of construction, the decline in productivity is explained by the fact that GVA fell by more than employment (–20.8 and –19.4%, respectively). In the case of real estate activities, the sharp rise in employment (40.4%) far exceeded the increase in GVA (29.7%).

employment has subtracted 1.2 pps from productivity growth during this period. In other words, we estimate that the productivity of the Spanish economy would have been 1.2% higher in 2019 if the production specialisation of 2010 had been maintained.

This result is mainly explained by a reduction in the proportion of total employment found in the manufacturing industry,[4] a sector in which productivity per worker is 39% higher than for the economy as a whole. Among the sectors with relatively high productivity (above average), employment in the extractive and energy supply industries has also declined as a proportion of the total. In contrast, sectors with a relatively lower level of productivity, such as hotels and restaurants or administrative activities, have registered an increase as a proportion of total employment.[5] Thus, despite the impressive productivity gains in these two sectors during this period (14.6% and 12.7% respectively, above the average of 9.3%), the fact that these low-productivity sectors have gained so much relative weight in the mix of total employment limits the economy's aggregate productivity gains.

The comparison with Germany is not favourable

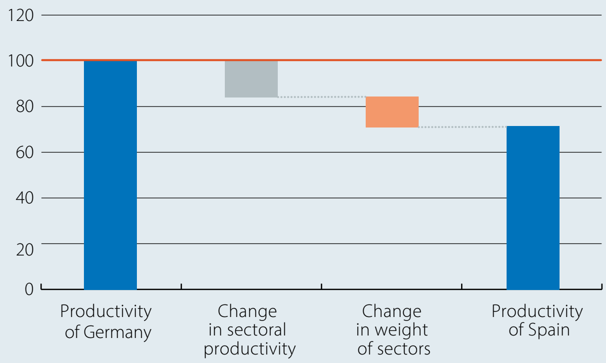
As we have seen, between 2010 and 2019, apparent labour productivity in Spain increased by 9.3%. This increase, however, is much lower than the 16.7% recorded in Germany in the same period. As a result, the productivity gap between Spain and Germany widened during this period: whereas in 2010 productivity in Spain was 23.4% lower than in Germany, in 2019 this gap had grown to 28.2%.

Again, if we break down the productivity gap between Spain and Germany in 2019 between (i) the productivity gap within each sector (intensive margin) and (ii) the difference in the relative weight of the various economic sectors (extensive margin), we observe that much of the difference is explained by the lower productivity of most Spanish sectors (the only exceptions are hotels and restaurants, transport and logistics, and energy supply, where the labour productivity in Spain is higher than that of Germany). However, the relative weight of the various economic sectors also plays a significant role (this factor explains 40% of the productivity gap between the two countries).

To a large extent, the gap is due to the significant role of Germany's manufacturing industry in the economy in

4. Employment in manufacturing has gone from representing 16.9% of the total in 2010 to 15.9% in 2019 (–1 pp).
5. The relative weight of employment in the hotel and restaurants industry has increased from 10.3% in 2010 to 12.4% in 2019 (+2.1 pps), while in the case of administrative activities it has gone from 10.2% to 12.0% (+1.8 pps).

Spain and Germany: breakdown of the productivity gap in 2019
(Euros per worker)



***Note:** Breakdown of the productivity gap between Spain and Germany between (1) the productivity gap within each sector (intensive margin) and (2) the difference in the relative weight of the various economic sectors (extensive margin).*
***Source:** CaixaBank Research, based on data from Eurostat.*

2019 (accounting for 26.1% of employment and 34.5% of GVA) compared to that of Spain (15.9% of employment and 22.2% of GVA). On the other hand, in Spain, both the hotels and restaurants sector and trade have a much higher relative weight than they do in Germany. In particular, we estimate that the productivity of the Spanish economy would be 15.9% higher if it had Germany's production specialisation. In other words, the productivity gap would be reduced from 28.2% to 16.8% (Spain's productivity would be 83.2% of Germany's).

Company size also matters

Another important aspect of Spain's sectoral composition which contributes to lower productivity is the distribution of the size of companies in the economy. It is the case in all countries that larger companies tend to be more productive than those with fewer workers. This distinction is particularly relevant when comparing Spain with Germany: Spanish micro-enterprises (from 0 to 9 workers) are the main employers in market sectors (accounting for 35.5% of employment in 2019 compared to 18.6% in Germany). In contrast, the relative weight of employment in large German companies (with over 250 workers) stands at 42%, compared with 32% in Spain.

If, in addition to the sectoral composition, we also take into account the different size of the companies in each economy, we estimate that the productivity of the Spanish economy would be 28.6% higher if it had both Germany's sectoral specialisation and its company size. In this case, the productivity gap would be reduced to 7.7%, compared to an observed gap of 28.2%.

Judit Montoriol Garriga and Erik Solé Vives

Spanish households' finances improve thanks to job creation and a reduction of debt

Increase in the savings rate

In Q2 2023 there was a sharp rise in the Spanish household savings rate, accentuating the change of trend initiated in the previous quarter. Specifically, having peaked at 19.4% in Q1 2021[1] due to the collapse in consumption during the pandemic, we witnessed how the savings rate steadily declined, reaching as low as 7.9% by the end of 2022. This downward trend in savings was truncated in Q1 2023 (savings rate of 8.5%) and the rebound intensified in Q2, when the savings rate in the cumulative last twelve months rose to 10.2%, placing it well above the pre-pandemic average (7.2% on average in 2015-2019).

The savings rate is also high in seasonally adjusted terms (11.7% in Q2 2023 in static terms, after bottoming out at 4.0% in Q3 2022).

Disposable income is growing well above household spending

The rebound in the savings rate was driven by the fact that the total gross disposable income of all households grew by a spectacular 12.2% year-on-year in Q2 2023 (static figure), the highest rate in the entire historical series. The main factors behind this growth were: the increase in total wages (+8.7% year-on-year), reflecting the rise in employment (growth of +3.1% year-on-year in the number of employees) and greater buoyancy in wages (growth of +5.2% in remuneration per worker), the increase in social benefits (+9.7% year-on-year, driven by the pension revision), self-employed workers' income and income from assets thanks to the increase in the payment of dividends and other investment income. All this has more than offset the increase in net interest payments, which have risen to 3.3 billion euros (an increase of 1 billion versus the static figure for Q2 2022).

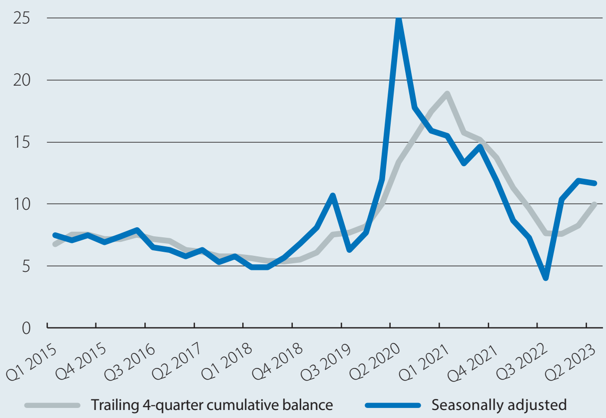
This growth in gross disposable income offers greater scope for an increase in consumption over the coming quarters, and this in turn would translate into higher GDP growth. This can be illustrated with a simple calculation: if the savings rate were to fall by 1 more point than expected next year, then the impact on GDP growth would be around +0.4 pps.[2] As for the level of disposable income per household, growth remains at 5.8%; although high, this is a more moderate growth rate as there has been a sharp rise in the number of households. Specifically, in the last year some 275,000 households were created in net terms (+1.4% year-on-year), largely due to migratory flows.

Following the upward revision of the historical series of gross disposable income and the strong figures for 2023,

1. Savings as a percentage of disposable income, trailing four-quarter cumulative balance.

Spain: savings rate

(% of gross disposable income)



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

Spain: non-financial accounts of households

	Q2 2022 (€ millions)	Q2 2023 (€ millions)	Change (%)
Total employee wages (+)	161.966	176.054	8,7
Self-employed workers' incomes (+)	55.256	60.142	8,8
Net asset incomes (+)	8.435	12.101	43,5
*Net interest payments * (–)*	–2.313	–3.312	43,2
Other (dividends, other investment income, etc.) (+)	10.748	15.413	43,4
Incomes taxes (–)	–25.752	–28.042	8,9
Net soc. sec. contributions (–)	–48.461	–53.060	9,5
Social benefits (+)	68.184	74.792	9,7
Other (+)	4.225	9.203	117,8
Final GDI (National Accounting)	223.853	251.190	12,2

Note: ** Before the allocation of financial brokerage services measured by the indirect method (referred to as SIFMI).*
Source: *CaixaBank Research, based on data from the National Statistics Institute.*

real disposable income per household already recovered its pre-pandemic level back in Q1. Total disposable income in real terms, meanwhile, was already 3.5% above the pre-pandemic level by the end of Q2.

In contrast, household spending relating to consumption has been losing steam as inflation has moderated and interest rates have risen. Indeed, in Q2 there was a significant gap between the growth of total wages and

2. To understand this calculation, it must be taken into account that the savings rate captures the level of savings relative to gross disposable income, and gross disposable income stands at 60% of nominal GDP. Therefore, a 1-point reduction in the savings rate would, in theory, lead to an increase in GDP growth of around 0.6 points through increased consumption. Considering that the portion of consumption which corresponds to imports is 30%, we calculate that the impact on GDP growth would be 0.4 pps.

that of household spending. Whereas these two variables were growing at relatively similarly rates in Q1 (8.6% and 7.3% year-on-year, respectively), in Q2 total employee wages grew well above household expenditure (8.7% year-on-year vs. 5.2%).

For 2023 as a whole, following such strong data we anticipate that the growth of gross disposable income will far exceed 6.0%, and this should allow aggregate household consumption in real terms to end the year well above its 2022 level, despite the increase in interest rates and inflation remaining high.

Where savings are being allocated and the improvement in households' net financial position

Households' net acquisition of financial assets in Q2 2023 amounted to 41 billion euros, very similar to Q2 2022 and above the Q2 average of 32.6 billion between 2015 and 2019. Households increased their bank and cash deposits (+7 billion euros vs. 21 billion in Q2 2022) and invested in debt securities, equities and investment funds (6.7 billion and 4 billion, respectively, well above Q2 2022). The acquisition of assets was accompanied by a sharp rally in their valuations (29 billion euros), mainly due to the gains registered in equities and investment funds (increase of 27 billion). As such, the stock of households' gross financial assets grew by 70 billion euros, reaching a total of 2.81 trillion.

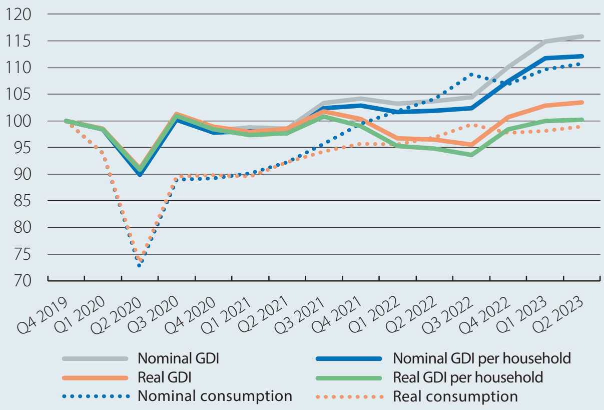
Household debt, meanwhile, rose by just under 7.4 billion euros (essentially due to seasonal factors), although it stood at 49.9% of GDP, –0.5 pps compared to Q1 2023, placing it in line with the level of mid-2002. The debt ratio of Spanish households thus lies 5.5 pps below the Euro area average.

Given that the growth of financial assets has outstripped that of financial liabilities, there has been an increase in net household financial wealth of 61 billion euros compared to the previous quarter, placing it slightly above 2.05 trillion euros (145.4% of GDP).

In short, the strengthening of households' finances has exceeded expectations and is good news for the Spanish economy, as the challenging context looks set to continue over the coming quarters.

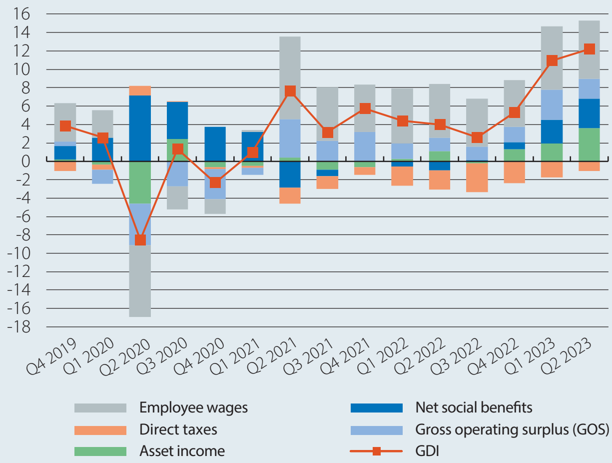
Javier Garcia-Arenas

Spain: gross disposable income and household consumption
Index (100 = Q4 2019)



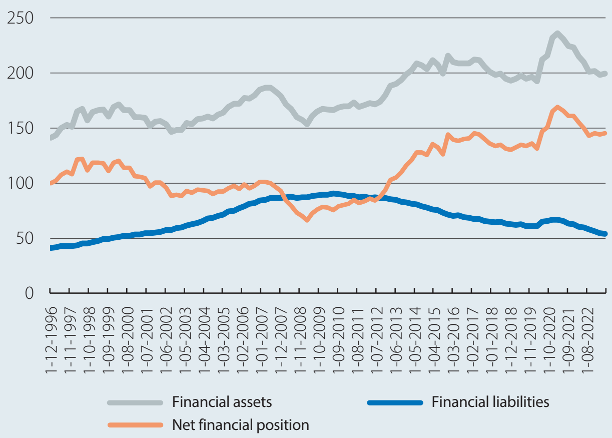
Note: *Seasonally-adjusted data.*
Source: *CaixaBank Research, based on data from the National Statistics Institute.*

Spain: household disposable income
Annual change (%) and contributions



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

Spain: financial balance sheet of households
(% of GDP)



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

Activity and employment indicators

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

	2021	2022	Q4 2022	Q1 2023	Q2 2023	Q3 2023	08/23	09/23	10/23
Industry									
Industrial production index	8.8	2.9	0.8	1.3	–1.9	–	–3.4	...	...
Indicator of confidence in industry *(value)*	0.6	–0.9	–5.3	–4.4	–5.3	–8.3	–6.5	–8.8	–8.6
Manufacturing PMI *(value)*	57.0	51.0	45.6	50.1	48.5	47.3	46.5	47.7	45.1
Construction									
Building permits *(cumulative over 12 months)*	4.7	15.4	2.6	–1.8	1.7	–	5.5	...	...
House sales *(cumulative over 12 months)*	9.6	29.0	17.4	10.2	3.5	–	–2.9	...	...
House prices	3.7	7.4	5.5	3.5	3.6	...	–	–	–
Services									
Foreign tourists *(cumulative over 12 months)*	64.7	129.8	129.8	90.7	40.6	21.8	25.9	21.8	...
Services PMI *(value)*	55.0	52.5	50.8	56.3	56.0	50.9	49.3	50.5	...
Consumption									
Retail sales	5.1	0.9	1.9	6.7	6.1	7.0	7.1	6.5	...
Car registrations	158.0	–3.0	2.6	45.5	9.9	6.9	7.8	2.3	18.1
Consumer confidence index *(value)*	–12.9	–26.5	–27.9	–22.7	–19.2	–15.8	–15.2	–20.3	–19.7
Labour market									
Employment [1]	3.0	3.1	1.4	1.8	2.9	3.5	–	–	–
Unemployment rate (% labour force)	14.8	12.9	12.9	13.3	11.6	11.8	–	–	–
Registered as employed with Social Security [2]	2.5	3.9	2.7	2.5	2.8	2.7	2.8	2.7	2.6
GDP	**6.4**	**5.8**	**3.8**	**4.1**	**2.0**	**1.8**	–	–	–

Prices

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

	2021	2022	Q4 2022	Q1 2023	Q2 2023	Q3 2023	08/23	09/23	10/23
General	3.1	8.4	6.6	5.1	3.1	2.8	2.6	3.5	3.5
Core	0.8	5.1	6.5	7.6	6.2	6.0	6.1	5.8	5.2

Foreign sector

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

	2021	2022	Q4 2022	Q1 2023	Q2 2023	Q3 2023	08/23	09/23	10/23
Trade of goods									
Exports *(year-on-year change, cumulative over 12 months)*	21.2	22.9	22.9	20.5	12.3	–	7.3	...	...
Imports *(year-on-year change, cumulative over 12 months)*	24.8	33.4	33.4	24.0	10.7	–	2.9	...	...
Current balance	**9.3**	**8.2**	**8.2**	**22.1**	**28.8**	**–**	**34.4**	**...**	**...**
Goods and services	11.8	16.3	16.3	31.6	43.3	–	50.7	...	...
Primary and secondary income	–2.5	–8.1	–8.1	–9.5	–14.5	–	–16.3	...	...
Net lending (+) / borrowing (–) capacity	**20.1**	**20.7**	**20.7**	**36.3**	**42.7**	**–**	**48.0**	**...**	**...**

Credit and deposits in non-financial sectors [3]

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

	2021	2022	Q4 2022	Q1 2023	Q2 2023	Q3 2023	08/23	09/23	10/23
Deposits									
Household and company deposits	6.1	4.9	3.8	1.7	0.4	...	–0.6	...	...
Sight and savings	10.3	7.9	5.0	0.3	–4.0	–6.9	–7.2	–6.8	...
Term and notice	–24.4	–19.7	–7.3	7.7	40.1	68.8	69.9	73.2	...
General government deposits	15.5	9.6	–3.2	7.4	6.8	11.3	6.9	14.6	...
TOTAL	**6.7**	**5.2**	**3.2**	**2.1**	**0.8**	**...**	**–0.1**	**...**	**...**
Outstanding balance of credit									
Private sector	0.3	0.7	0.5	–0.9	–2.2	–3.3	–3.5	–3.4	...
Non-financial firms	1.1	0.9	0.9	–1.0	–2.7	–4.5	–5.0	–4.7	...
Households - housing	0.2	1.0	0.2	–1.2	–2.4	–3.4	–3.4	–3.4	...
Households - other purposes	–1.2	–0.6	–0.1	–0.1	–0.4	0.1	0.2	0.0	...
General government	15.3	0.2	–1.1	–0.2	–3.3	–4.6	–4.5	–4.1	...
TOTAL	**1.1**	**0.7**	**0.4**	**–0.9**	**–2.3**	**–3.4**	**–3.6**	**–3.4**	**...**
NPL ratio (%) [4]	**4.3**	**3.5**	**3.7**	**3.5**	**3.5**	**...**	**3.6**	**...**	**...**

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.*

The Portuguese economy shrinks in Q3

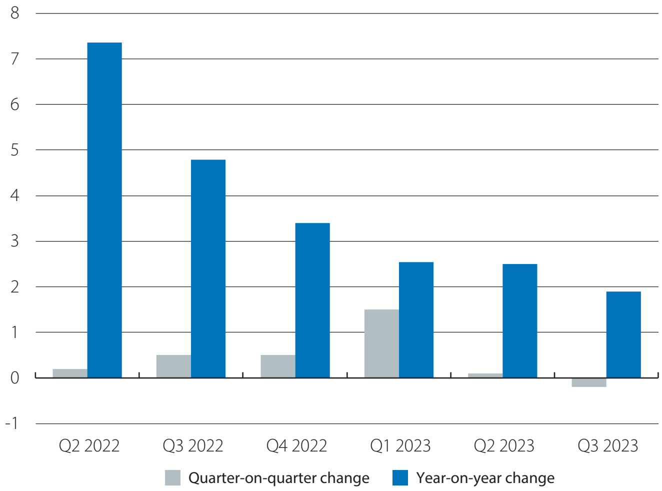
GDP falls short of expectations in Q3 with a 0.2% quarter-on-quarter slowdown. As this is a flash indicator, the breakdown by component is not yet known, but the National Statistics Institute points to the weakening of economic activity among Portugal's trading partners as the main factor, as this would have weighed down exports of both goods and services, including tourism. However, the production shutdown and resulting suspension of exports from the Auto-Europe factory during two weeks of the quarter will also have had an impact. For Q4, the available information is still very limited: on the upside, the Bank of Portugal's daily economic activity indicator recorded an average year-on-year growth of 3.9% in October, compared to 2.7% in Q3. On the downside, the sentiment indicators for October show a deterioration in confidence among economic agents. The data published to date suggest a moderation in the pace of economic growth and pose significant risks to our forecast scenario (GDP growth of 2.4% in 2023 and of 1.8% in 2024).

Disinflation underway. According to the National Statistics Institute's estimate, the headline CPI surprised analysts by falling sharply in October to 2.1%. This is 1.5 pps below the September figure and marks the first time the index has fallen below 3% since December 2021. The core index, meanwhile, also continued to moderate, reaching 3.5% (4.1% in September). In any case, these encouraging figures were driven by base effects, particularly in the energy index, so we cannot rule out a rebound in inflation at the end of the year. On the other hand, the effect of monetary policy is beginning to weigh more heavily on demand and a slowdown in the price of services is likely after the summer season.

Upward revision of the home price forecast. Given the strength of the home price index in Q2 2023, we have revised upwards our forecast for 2023 as a whole and now expect an average increase of 7.1% in 2023, compared to the 4.0% previously forecast. Despite the fall in the number of home sales (–22.9% compared to the same quarter of 2022), the market remains supported by low unemployment, strong demand from non-residents and budgetary measures aimed at accommodating the increases in credit. In any event, the effect of a prolonged monetary adjustment and of government measures aimed at boosting the housing supply ought to help stabilise prices in the medium term.

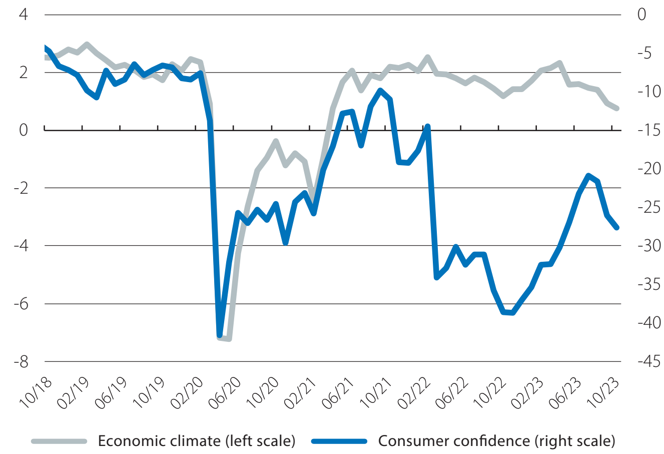
The consolidated general government current account balance to September shows a surplus of 3.7% of GDP, marking an 80-pp improvement compared to the same period last year. This trend has been supported by a significant increase in current revenues (8.5% vs. 6.8% in the case of expenditure), reflecting the strength of the labour market and the positive tone in consumption. This improvement in the national accounts leads us to revise our forecast for the budget balance in 2023 to a surplus of 0.7% of GDP, bringing the public debt ratio down to 103% of GDP.

Portugal: GDP
Change (%)



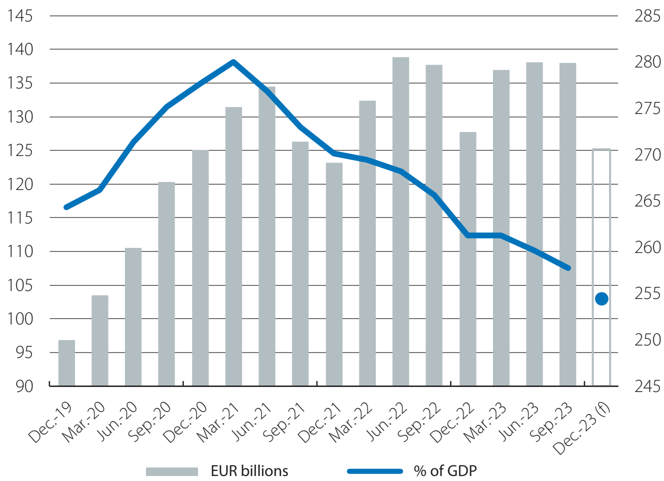
Source: *CaixaBank Research, based on data from the National Statistics Institute of Portugal.*

Portugal: economic climate and consumer confidence
Year-on-year change (%) *(pps)*



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

Portugal: public debt
(% of GDP) *(EUR billions)*



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

Activity and employment indicators

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

	2021	2022	Q4 2022	Q1 2023	Q2 2023	Q3 2023	08/23	09/23	10/23
Coincident economic activity index	3.5	5.7	4.2	4.0	4.2	4.2	4.2	4.0	...
Industry									
Industrial production index	4.5	0.4	–0.3	1.0	–5.0	–4.3	–4.7	–5.6	...
Confidence indicator in industry *(value)*	–5.3	–3.4	–6.3	–5.0	–5.6	–9.4	–9.6	–9.7	–10.2
Construction									
Building permits - new housing (number of homes)	13.5	6.2	13.6	8.8	–3.0	...	...	...	...
House sales	20.5	1.3	–16.0	–20.8	–22.9	...	–	–	–
House prices *(euro / m² - valuation)*	8.6	13.8	13.6	12.9	9.1	8.1	8.8	7.8	...
Services									
Foreign tourists *(cumulative over 12 months)*	51.5	158.9	158.9	117.2	52.6	24.8	30.5	24.8	...
Confidence indicator in services *(value)*	0.1	15.1	9.9	11.1	13.4	5.8	6.3	2.8	–0.8
Consumption									
Retail sales	4.9	4.8	0.0	1.7	3.0	1.6	–0.4	1.2	...
Coincident indicator for private consumption	4.9	3.9	1.8	2.2	2.9	3.1	3.1	3.1	...
Consumer confidence index *(value)*	–17.2	–29.7	–37.0	–35.1	–29.4	–22.8	–21.9	–22.9	–25.1
Labour market									
Employment	2.8	2.0	0.5	0.5	1.6	...	1.4	1.2	...
Unemployment rate (% *labour force*)	6.6	6.0	6.5	7.2	6.1	...	6.2	6.5	...
GDP	**5.7**	**6.8**	**3.4**	**2.5**	**2.6**	**1.9**	–	–	–

Prices

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

	2021	2022	Q4 2022	Q1 2023	Q2 2023	Q3 2023	08/23	09/23	10/23
General	1.3	7.8	9.9	8.0	4.4	3.5	3.7	3.6	2.1
Core	0.8	5.6	7.2	7.1	5.7	4.4	4.5	4.1	3.5

Foreign sector

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

	2021	2022	Q4 2022	Q1 2023	Q2 2023	Q3 2023	08/23	09/23	10/23
Trade of goods									
Exports *(year-on-year change, cumulative over 12 months)*	18.3	23.2	23.2	21.6	11.8	...	...	...	...
Imports *(year-on-year change, cumulative over 12 months)*	22.0	31.7	31.7	24.5	12.6	...	...	...	...
Current balance	**–1.6**	**–2.8**	**–2.8**	**–1.2**	**1.5**	**...**	**...**	**...**	**...**
Goods and services	–5.5	–4.7	–4.7	–2.8	–0.3	...	...	...	...
Primary and secondary income	3.9	1.9	1.9	1.6	1.9	...	...	...	...
Net lending (+) / borrowing (–) capacity	**2.1**	**–0.5**	**–0.5**	**1.5**	**4.5**	**...**	**...**	**...**	**...**

Credit and deposits in non-financial sectors

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

	2021	2022	Q4 2022	Q1 2023	Q2 2023	Q3 2023	08/23	09/23	10/23
Deposits [1]									
Household and company deposits	9.3	6.4	6.4	0.5	–2.1	–2.6	–2.2	–2.6	...
Sight and savings	16.3	7.3	7.3	–3.1	–9.0	–9.4	–10.5	–9.4	...
Term and notice	1.2	5.2	5.2	5.4	7.5	6.9	9.5	6.9	...
General government deposits	–4.1	12.4	12.4	11.1	1.4	5.5	2.4	5.5	...
TOTAL	**9.0**	**6.5**	**6.5**	**0.8**	**–2.0**	**–2.4**	**–2.0**	**–2.4**	**...**
Outstanding balance of credit [1]									
Private sector	2.9	1.8	1.8	0.0	–1.2	–2.0	–1.7	–2.0	...
Non-financial firms	2.2	–0.4	–0.4	–2.1	–3.5	–3.9	–3.6	–3.9	...
Households - housing	3.3	3.2	3.2	1.5	0.1	–0.9	–0.7	–0.9	...
Households - other purposes	3.0	2.9	2.9	0.0	0.4	–0.9	–0.1	–0.9	...
General government	3.8	–2.7	–2.7	–2.0	0.6	–1.4	–2.1	–1.4	...
TOTAL	**2.9**	**1.7**	**1.7**	**–0.1**	**–1.1**	**–2.0**	**–1.7**	**–2.0**	**...**
NPL ratio *(%)* [2]	**3.7**	**3.0**	**3.0**	**3.1**	**3.1**	**...**	–	–	–

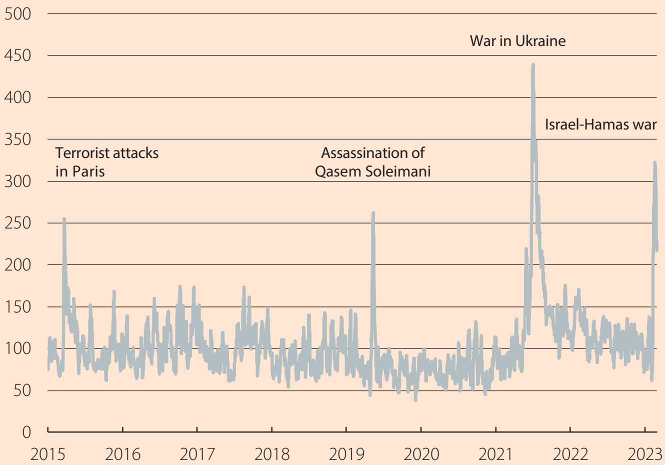
Notes: *1. Residents in Portugal. The credit variables exclude securitisations. 2. Period-end figure.*
Source: *CaixaBank Research, based on data from the National Statistics Institute of Portugal, Bank of Portugal and Refinitiv.*

The search for economic stability in an unstable world

Geopolitical risk, fragmentation and deglobalisation are some of the most searched words on social networks in recent months and reflect the complex and unstable environment that the international economy has been navigating in the last few years. This is an environment marked by a chain of shocks of a highly diverse nature that are distorting the functioning of supply and limiting the effectiveness of the demand policies that seek to recover the lost economic stability. These shocks, which feed back into each other and thus have a destabilising potential that is greater than the sum of the parts, make up what historian Adam Tooze has called a polycrisis. Although the beginning of this process can be traced back to the global financial crisis of 2008,[1] events have precipitated since the pandemic, as in the absence of an ongoing solution the business cycle has had to deal with bottlenecks in production chains and their effects on inflation, the war in Ukraine and, most recently, the return of instability in the Middle East. Therefore, as geopolitics gains prominence, there are signs that we are in the midst of a decoupling of the global economy, with the rise of concepts such as de-risking and strategic autonomy. All this entails trends such as the return of industrial policy, the search for less fragile value chains and greater cooperation with trading partners,[2] while greater limitations are imposed on technology transfers to countries considered rivals.

Geopolitical risk

Índex (100 = long-term average)



Source: *CaixaBank Research, based on data from https://www.matteoiacoviello.com/gpr.htm and Bloomberg.*

In this context of change, the business cycle has continued to show resilience as it faces the cumulative effects of both the disruptions of recent years and the uncertainty that comes with such a turbulent outlook. We thus anticipate that the world economy will end 2023 with growth of 2.8% (0.6 pps less than in 2022), but with the weakening concentrated in developed countries (1.4% versus 2.7% in 2022), especially those that are more dependent on the industrial sector such as Germany (–0.4%), while emerging countries will maintain last year's cruising speed (4%). The recession that had been feared following the energy price rally in the summer of 2022 has thus been avoided, but the pace of economic growth remains mediocre and uneven. Most worryingly, the medium-term outlook remains poor, as the IMF's forecast for the end of the decade (global economic growth of 3.1% in 2028) anticipates a stagnation of potential growth. To put it in context, this represents 0.5 points less than the medium-term growth that had been anticipated before the pandemic and it is almost 2 points below the growth of prior to the 2008 global financial crisis.

For 2024, an ailing economy will be highly vulnerable to any new shocks, as on the one hand the tailwinds that have allowed it to overcome the obstacles of the recent past will fade (accumulated savings, expansionary fiscal policy, etc.), while on the other hand the restrictive effects on demand of the monetary tightening process will be acutely felt in the coming months. The hope is that the economic slowdown will allow the decline in inflation to be consolidated, which would pave the way for a shift in monetary policy next year and provide good support to the bond and equity markets, in turn reducing the risks to financial stability (5.5 trillion dollars of corporate debt alone is due to mature in 2024). However, the continuation of the disinflationary process will also be subject to a high degree of uncertainty, as developments in the coming months will depend on factors that are beyond the central banks' control, such as energy prices and the tone of fiscal policy. Moreover, all this comes as the hardest task is yet to come, namely reducing inflation from 4% to 2%.

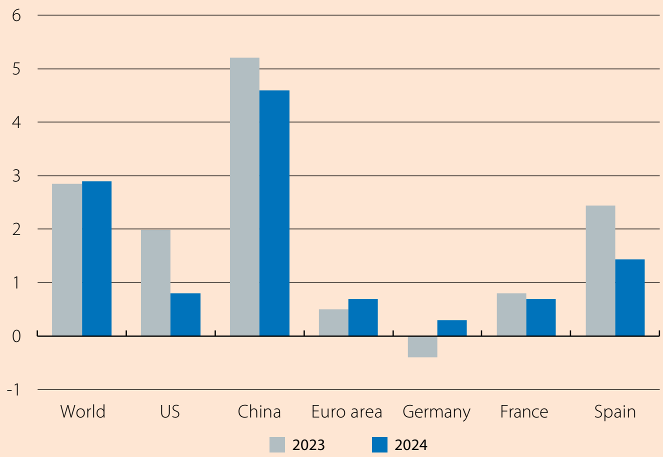
This central scenario with a soft landing would allow the recovery of macroeconomic stability to be consolidated by closing the gap between global supply and demand, with an affordable cost in terms of GDP growth and employment. Global economic growth is expected to be slightly under 3% in 2024, but most of the slowdown will be in developed countries (+1.1% in 2024 vs.

1. When global trade flows (exports plus imports) peaked in terms of GDP.
2. In the case of the US, the speech by Jake Sullivan (National Security Advisor) at the Brookings Institution on 27 April and the National Security Strategy reflect this transformation that is now underway.

+1.4% in 2023), as the weakness which the euro area will continue to show (+0.7% in 2024) will coincide with an anticipated cooling of the North American economy in the first half of the year. However, the strength which the labour market and consumption continue to show in the US could limit the slowdown in economic activity and deactivate recessive signals such as the inversion of the yield curve slope; in contrast, in Europe the evolution of business and consumer confidence, the weakness of the industrial sector and the tightening of credit conditions suggest that growth will remain close to stagnation, at least until the summer of 2024. Emerging countries, meanwhile could even grow slightly more than they did this year (4.2% vs. 3.9%), thanks to the good performance of India, Turkey and oil-producing countries, in an environment in which central banks such as those of Brazil, Peru, Vietnam and Chile are already lowering interest rates. That said, the big question is what will happen with the Chinese economy, considering that we are witnessing a «structural» slowdown linked to a rebalancing of the growth model that could bring the country's medium-term potential growth down to 3%. The Chinese authorities seem willing to tolerate this slower growth (we expect growth of 4.6% in 2024, compared to the official target of 5% set for 2023), but the uncertainty is regarding how the new geopolitical environment will affect China's growth model, given the persistent ratcheting up of restrictions on exports of high-tech goods to the Asian country and the incipient restructuring of value chains that is already apparent in the trade flows of countries such as Vietnam.

Global: GDP

Annual change (%)



Source: *CaixaBank Research.*

In short, the weakness and fragility of the business cycle increase the sensitivity of the economic forecast scenarios to new shocks that could emerge on the horizon. This is especially the case because the layers of risk that threaten the outlook remain challenging. With interest rates at their highest levels in the last decade, coupled with the effects that rising geopolitical tensions could have on weakened expectations and strained energy prices, any forecasting exercise is fraught with uncertainty and even more so in a year with US presidential elections. This sense of unstable balance will dominate the performance of the economy throughout 2024 – something which we will no doubt have to get used to and which will demand considerable flexibility among economic agents when it comes to making decisions. Such are the times in which we live.

José Ramón Díez

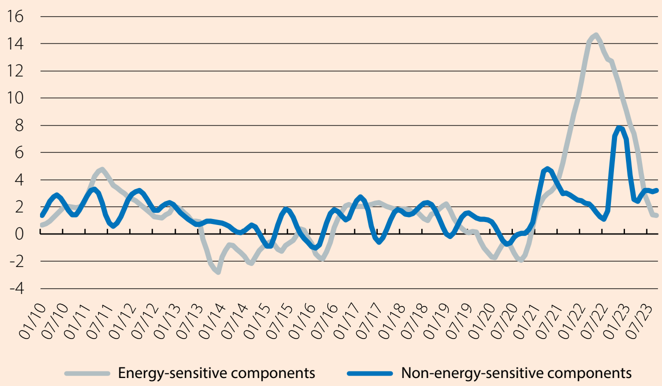
Inflation and monetary policy outlook for 2024

As we approach the end of 2023, interest rates are at their highest levels in 15 years. This follows the peaks in inflation reached in 2022, which forced the central banks to tighten monetary policy, cool down economic activity and ensure price stability in the medium term. Although it is still far from the 2% target rate, inflation in both the euro area and the US has fallen steadily throughout 2023, and one of the key assumptions in our 2024 outlook is that it will continue to do so next year, facilitating the first interest rate cuts by the Fed and the ECB. But how robust is this disinflationary assumption? How much of a hurry are the central banks in to lower rates?

To answer these questions, we begin with a diagnosis of inflation in three phases, starting with the initial impacts on prices (such as the bottlenecks associated with the pandemic or the energy crisis due to the war in Ukraine), continuing with the resulting indirect effects (the increase in the price of goods and services which, although not directly impacted by the initial shock, have been driven up by production costs and relative price adjustment) and ending with the second-round effects due to the feedback loop between prices, business margins and wages, which tends to give inflation greater inertia. Throughout this diagnosis, our indicator of reference will be momentum, a metric which captures the current state of inflation better than year-on-year rates.[1]

Euro area: momentum of HICP components according to their sensitivity to energy prices

(%)

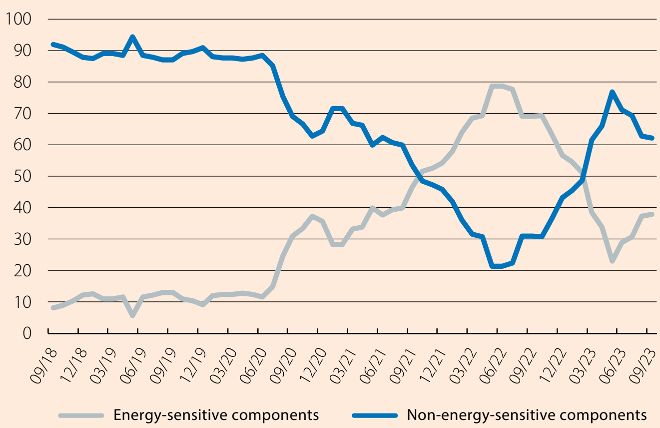


Notes: *Momentum is defined as the annualised change in the three-month average price index relative to the previous three months (with seasonally adjusted data). The chart shows a smoothed version. We identify the energy sensitivity of each sub-component of the headline HICP based on their statistical correlation with the energy HICP (details in footnote 2).*
Source: *CaixaBank Research, based on data from Eurostat.*

In the euro area, the main trigger for inflation was the tightening of energy prices due to the war in Ukraine. To assess the extent to which energy prices have filtered through to other prices and/or continue to determine inflation as a whole, we have analysed which components of the CPI are sensitive to energy prices and what price dynamics they follow.[2] As the first two charts show, the energy crisis spread to a large part of the price basket, to the point that the «energy-sensitive» components came to account for almost 80% of the CPI and were largely responsible for the inflation rally. However, by the autumn of 2023 the situation had normalised, albeit with a small but: whereas before the pandemic the momentum of non-energy-sensitive components fluctuated around the 2% mark, after the energy shock the momentum of these components has increased a notch and now lies closer to 3% than to the 2% rate to which the ECB aims.[3]

Euro area: relative weight of headline HICP components according to their sensitivity to energy prices

(%)



Note: *We identify the energy sensitivity of each sub-component of the headline HICP based on their statistical correlation with the energy HICP (details in footnote 2).*
Source: *CaixaBank Research, based on data from Eurostat.*

This first exercise indicates that the direct and indirect impact of the energy shock is close to fading, but it also suggests that we should remain cautious given the risk that some prices may have acquired greater inertia. In order to

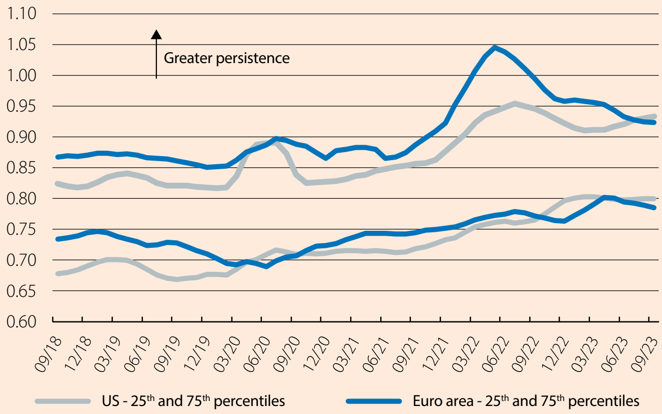
1. Momentum is the change in the three-month average CPI compared to the previous three months (annualised and seasonally adjusted). It strikes a good balance between being a low volatility metric (like year-on-year rates of change) while also providing real-time information (like month-on-month rates).
2. With the breakdown of the HICP basket into 94 sub-components, we estimated the relationship between the momentum of each sub-component ($\pi_t^{i,m}$) with the momentum of energy ($\pi_{t-k}^{ener,m}$):

$$\pi_t^{i,m} = \alpha + \beta\pi_{t-k}^{ener,m} + \varepsilon_t$$

We analysed four cases (ranging from $k = 0$ to $k = 3$) in 24-month rolling windows. We consider a component «energy sensitive» if it has a positive β that is statistically significant in at least one of the energy momentum lags.
3. The same exercise for the US shows that the importance of the components that are sensitive and non-sensitive to energy prices is much more stable over time and, in fact, their inflation rates follow similar dynamics. This reflects the differing nature of the inflation rally in the US, where it has been more influenced by imbalances in domestic supply and demand than by the energy crisis.

analyse this risk, we examined the degree of persistence of inflation in a second year.[4] As can be seen in the third chart, this analysis shows that the inertial component of inflation has broadly increased over the past two years. However, this increase is relatively moderate and there is a decrease in the momentum shared among the components, regardless of their degree of persistence. In fact, in the US, where this persistence could be of greater concern due to the nature of the country's inflation, the more inertial components have recently shown less momentum than the rest and, excluding rents (shelter, which accounts for a high proportion of the index but follows but idiosyncratic dynamics),[5] they explain only a small portion of aggregate inflation.

Inflation persistence
Index



Notes: *We estimate an AR(1) for the momentum of each sub-component of the headline CPI using 24-month rolling windows and we obtain the distribution of autoregressive coefficients of all sub-components. The chart shows the evolution over time of the coefficients corresponding to the 25th and 75th percentiles of these distributions (smoothed time series).*
Source: *CaixaBank Research, based on data from the Bureau of Labor Statistics and Eurostat.*

Thus, as we are now in this third and final phase of the inflationary crisis, the central banks consider it is no longer necessary to raise interest rates any further. As the members of the ECB and the Fed have stated in their recent appearances, keeping interest rates «high for longer» could be sufficient to finish this last mile and reach the 2% target. In this regard, one exercise that can illustrate how the financial markets are internalising this strategy is the greater sensitivity to economic surprises that the longer maturities of the various yield curves are showing compared to the shorter sections.[6]

Sensitivity of expectations on Fed interest rates to economic surprises *
Coefficient

Note: ** We show the evolution of the coefficient β of the regression set out in footnote 6 for each of the various maturities (3, 6, 12 and 18 months) for the 20-month rolling window.*
Source: *CaixaBank Research, based on data from Bloomberg.*

As the last chart shows, the sensitivity of futures on the Federal Reserve interest rate to surprises in the publication of economic data is greater for longer-term maturities (18 months) than it is for shorter-term maturities. This dynamic has existed from 2012 through to the present day; that is, the same economic surprise causes a greater rebound in long-term maturities than in short-term ones, given that with a longer time horizon there are more opportunities for the Fed to raise interest rates at its regular meetings. Nevertheless, what we can see in recent months is how the sensitivity of 18-month futures continues to increase moderately, while that of 3 and 6-month futures is decreasing. This suggests that the markets are no longer so focused on how much more the Fed will raise interest rates by, but rather on how long it will keep them high for.

However, we believe that in 2024 we are likely to see the first interest rate cuts, albeit moderate ones in the absence of a sharp slowdown in economic activity. Above all, we expect they will not be of sufficient magnitude for us to declare that the restrictive monetary policy environment has been abandoned.

4. Using CPI breakdowns (82 sub-components in the US and 94 components in the euro area), we estimated the auto-regressive behaviour of the momentum of each sub-component in 24-month rolling windows:

$$\pi_t^{i,m} = c + \rho \pi_{t-1}^{i,m} + \varepsilon_t$$

In each window, we sorted the estimated values of ρ from lowest to highest and we classified the subcomponents into three categories based on their persistence: low (ρ among the lowest 25% of values), moderate (between 25% and 75%) and high (ρ among the highest 25% of values).
5. See the Focus «The importance of rents in US inflation» in the MR09/2023.
6. We estimate the following regression using a rolling window with 20 observations,

$$\Delta i_t^n = \beta^n s_t + cpi_t + \varepsilon_t$$

Δi denotes the daily change in futures on the Fed's interest rate for maturities of *n* months (3, 6, 12 and 18); *s* denotes the difference between the figure published and that expected by the Bloomberg consensus for the CPI and job creation in the US; *cpi* is a variable which takes a value of 1 if the date corresponds to the publication of inflation data and 0 if it is employment; and ε_t is an error term. In the fourth chart we show the evolution of the four coefficients β^n.

A new European fiscal framework for 2024... will it be possible?

The upturn in debt yields on a global scale has put the fiscal situation back in the spotlight. The case of Europe is of particular interest, since in 2024 the fiscal rules will be reinstated after having been suspended since 2019 due to the pandemic and the outbreak of the war in Ukraine. The purpose of this «pause» was to develop a new fiscal framework and in April 2023 the European Commission presented a draft of its proposal, which serves as the basis for drawing up the final document which should be adopted before the end of the year, before being implemented in 2024. The ECB is also urging an agreement to be reached on time, aware of the challenge posed by the current situation (economic slowdown and high levels of debt).

What the new fiscal framework proposes

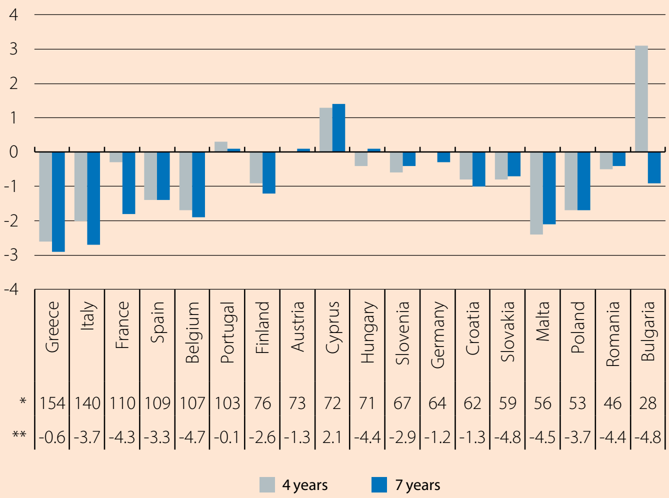
The European Commission's proposal reinforces the key role of national governments, which will have to draw up a four-year fiscal plan (extendible to seven years if they present reform and investment plans that promote growth) in order to reduce excessive structural deficits and ensure the sustainability of their debt in accordance with the European Commission's analyses. This reduction path will be tailored for each country, negotiated between the Commission and each Member State and approved by the Council.[1]

These multi-year plans are subject to two major restrictions or safeguards. On the one hand, the benchmarks of 3.0% of GDP for the government deficit and of 60% for public debt are maintained as medium-term targets. On the other hand, the reduction path incorporates a primary net expenditure rule[2] as a control variable and requires an annual reduction in the deficit of at least 0.5% of GDP. The European Commission has limited itself to setting «a minimum fiscal reduction of 0.5% of GDP per year», but various sources[3] interpret that in order for this measure to contribute to fiscal consolidation it must refer to the structural deficit. Therefore, the main developments appear to be that the fiscal adjustment path will be made more flexible by adapting to each country's particular situation; a primary expenditure rule is applied as a control variable (rather than the structural deficit); the 1/20th debt reduction rule (which states that debt should be reduced by the equivalent of 1/20th of the difference between its value as a percentage of GDP and the 60% target) is abolished, and a deficit-based reduction rule is introduced in its place.

Is the proposed plan more or less strict than the current one?

Bruegel[4] has evaluated the Commission's proposal by calculating the implications of the fiscal adjustment for all EU countries with debt exceeding 60% of GDP or a deficit exceeding 3%. In its conclusions, it acknowledges that the proposed framework remains ambitious, given that on average Member States will be required to reduce their structural deficit by around 2% of GDP between 2025 and 2028 in the four-year plans (slightly less if the plans last seven years). In addition, both frameworks agree on which countries will face the most aggressive adjustments and which ones the least aggressive, but they differ on the magnitude of the adjustment. In fact, for almost half of the cases where both the deficit and the debt level exceed the required thresholds, the structural deficit reduction proposed under the new framework would be lower, by almost 1.0% of GDP on average, than the current one establishes (in both four and

Difference in the structural deficit reduction required in the multi-year plans under the new framework vs. the current framework
(pps of GDP)



	Greece	Italy	France	Spain	Belgium	Portugal	Finland	Austria	Cyprus	Hungary	Slovenia	Germany	Croatia	Slovakia	Malta	Poland	Romania	Bulgaria
*	154	140	110	109	107	103	76	73	72	71	67	64	62	59	56	53	46	28
**	-0.6	-3.7	-4.3	-3.3	-4.7	-0.1	-2.6	-1.3	2.1	-4.4	-2.9	-1.2	-1.3	-4.8	-4.5	-3.7	-4.4	-4.8

Notes: ** Public debt (% of GDP). ** Fiscal balance (% of GDP). Both forecasts for 2024 by the European Commission.*
Source: *CaixaBank Research, based on data published by Bruegel.*

1. In addition, after the reduction period has ended, each country must generate fiscal margin in order to be able to cope with the costs associated with the ageing of the population.
2. Refers to public expenditure excluding interest charges, the cyclical component of unemployment spending and one-off measures, and net of revenues arising from any new tax measures.
3. e.g. Bruegel.
4. See Z. Darvas, L. Welslau and J. Zettelmeyer (2023). «A quantitative evaluation of the European Commission's fiscal governance proposal». Working Paper 16/2023. Bruegel.

seven-year plans), and this would benefit Greece, Italy, Belgium and Spain in particular. In the case of Austria, France, Germany and Portugal, the intensity of the reduction would be similar under both frameworks, especially for the four-year plans.

Still no agreement with less than two months to go before the year end

To «untangle» the negotiations, Germany and France have initiated a bilateral dialogue in order to facilitate an agreement before the end of the year. There seems to be widespread consensus on the adoption of tailored fiscal consolidation plans. Beyond that, the French bloc is calling for greater flexibility in order to avoid stifling economic growth, while the German bloc, which has already managed to convince the European Commission to include in the draft the requirement for all Member States to reduce their deficit by a minimum of 0.5% of annual GDP, also wants to include a mandatory annual debt reduction of 1.0% of GDP in all cases where debt exceeds 60% of GDP. Italy, for its part, continues to call for a «golden rule» in order to remove strategic spending from the deficit computation (which each country then deciding whether such spending should correspond to green, digital or defence investments). Meanwhile, Spain's proposal stresses that the plans must include adequate safeguards that do not jeopardise the investments needed to boost growth, while still guaranteeing the reduction of the debt and the deficit.

The political authorities point out that there is already agreement on 70% of the plan, but consensus on the most conflictive aspects is yet to be reached and it will be difficult for everything to be approved before the end of the year: it will need to be approved by all national parliaments and then be backed by a qualified majority in the European Council in order to finally be put before the European Parliament. In addition, with the upcoming European elections on 6 June 2024 and with all parties busy campaigning, we cannot rule out the possibility that the approval of the new fiscal framework could be delayed until the second half of next year. As a result, all the indicators suggest that 2024 may be a transitional year in terms of fiscal governance.

Budgets presented

In this context, the budgets presented by the major economies show their commitment to a return to fiscal orthodoxy, but also confirm the difficulties in meeting the demands, whether under the current framework or what is expected for the new one. Italy, for example, has presented a less ambitious budget plan than the one presented in April and now anticipates that the fiscal deficit, having stood at around 5.3% of GDP in 2023, will reach 4.3% in 2024 and will not fall to –3.0% until 2026. In addition, the reduction of the structural deficit would be rather sharp in 2024 (–1.1 pps of GDP), but it would be somewhat unambitious in 2025 and 2026, which explains the persistence of the levels of public debt (139.6% of GDP in 2026 vs. 140.2% in 2023).

There is a similar pattern in the case of France, which, after estimating a fiscal deficit of around 4.9% for 2023, is postponing when it expects to meet the –3.0% target until 2027 (making it one of the last to achieve it); with a structural deficit that would be cut by just 0.4 pps in 2024 (in subsequent years the reduction could be even smaller), this would mean that public debt would remain above 109% of GDP until 2026 and would barely fall from current levels (109.7% in 2023). At the opposite end of the spectrum we have Germany, the champion of fiscal austerity, which has already announced that it will reinstate the constitutional «debt brake» rule (which limits borrowing to no more than 0.35% of GDP per year), despite the slowdown of its economy. In short, the budgets have been drawn up with the intention of returning the fiscal metrics to more sustainable levels, but without forgetting that Europe is going through a delicate phase (a short and moderate recession cannot even be ruled out), which will condition the speed and intensity of the much-needed fiscal adjustment. In any case, in a context as complex as the current one, it will be the financial markets that will ultimately pass sentence on the suitability of the adjustment in each case.

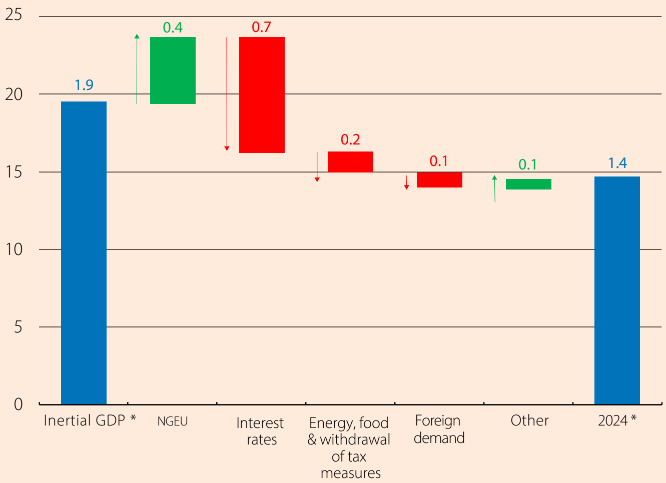
Rita Sánchez Soliva

Outlook for the Spanish economy in 2024: a year full of challenges

Starting point

The consequences of the war between Russia and Ukraine have continued to dominate the dynamics of the economy throughout 2023. The war sparked an energy crisis which triggered a sharp rebound in inflation and led the ECB to embark on an aggressive cycle of interest rate hikes. The energy crisis had its maximum impact in 2022, but it quickly faded in the closing weeks of 2022 and the beginning of 2023. Along with the recovery of tourism, the rapid moderation of energy prices allowed for an improvement in consumption and the Spanish economy grew at significant rates during the first half of 2023. However, with the energy channel exhausted, the second half of 2023 has seen a moderation in the economy's growth rate, as it also confronts a series of headwinds. These factors include inflation, driven by rising food prices and the rebound in the oil price since July 2023, the impact of the higher interest rates and the sharp slowdown in growth in the euro area. Thus, whereas GDP grew by an average of 0.5% quarter-on-quarter in the first half of 2023, in Q3 the economy grew by a more modest 0.3% quarter-on-quarter. All in all, within the context of this slowdown we expect the economy to grow by 2.4% in 2023 as a whole.

Spain: breakdown of 2024 GDP growth
(pps)



Note: ** Annual change (%).*
Source: *CaixaBank Research.*

2024 outlook

For 2024, we expect the economy's growth rate to moderate to 1.4%. In the first chart we show the breakdown of this forecast according to its main determining factors.[1] As can be seen, in the absence of external shocks we could have expected a growth rate of almost 2.5%, thanks in part to the support of European funds.

However, we expect the economy to be weighed down by a series of factors. The first one is the impact of the interest rate hikes. The ECB began raising rates in July 2022 and has since increased them by 450 bps. Our forecast is that this cycle of rate hikes has already reached its peak in September (with the depo rate at 4.0% and the refi rate at 4.5%) and that the ECB will keep rates at their current levels until the second half of 2024, at which point it would begin to gradually lower them.[2] According to these forecasts, the 12-month Euribor would be close to 3.6% on average during 2024, after averaging around 3.9% in 2023. Although rates may be lower in 2024 than in 2023, it should be recalled that the impact of a rate hike takes a long time to filter through to the economy. Typically, the maximum impact occurs between one and two years after the rate rise.[3] These delays explain why, although we expect lower rates in 2024 on average than in 2023, the impact of interest rates on GDP growth is substantially negative in 2024.[4]

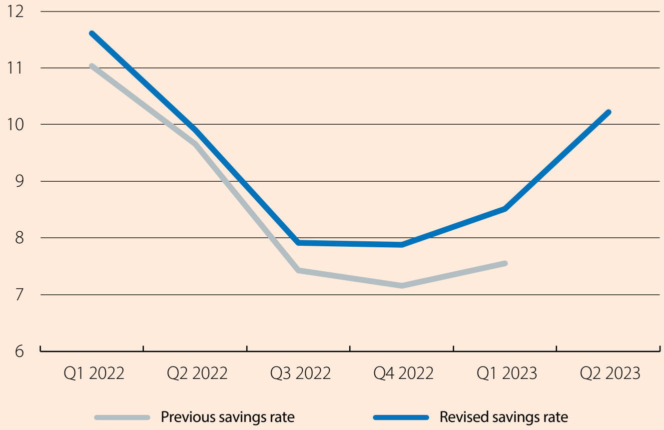
Secondly, we expect that inflation will continue to weigh down economic activity, albeit to a lesser extent than in the last two years. On the positive side, we expect that the underlying inflation dynamics are likely to moderate during the course of 2024. This moderation will come about thanks to the gradual depletion of the contagion effect (the impact that the sharp rise in energy and food prices has on the prices of other products in the CPI basket) and the absence of significant second-round effects. Thus, we expect core inflation (excluding energy and food) to go from 4.6% in 2023 to 3.0% in 2024. In contrast, the withdrawal in early 2024 of the main tax cuts that were introduced in response to the war in Ukraine are expected to add around 1 pp to inflation in

1. We begin with inertial GDP growth, which is calculated using a regression of the annual change in GDP on the first lag of this variable and the output gap of the previous year. The delay captures the ordinary inertia of GDP, while the output gap captures the momentum of the economy according to where it is in the business cycle.
2. For further information on the interest rate forecast, see the Focus «New scenario: international economy and market outlook» in the MR10/2023.
3. See ECB. «A model-based assessment of the macroeconomic impact of the ECB's monetary policy tightening since December 2021». Economic Bulletin 3/2023.
4. The impact of interest rates is calculated using CaixaBank Research's semi-structural model for Spain. We introduced into the model the difference between the rates that we were forecasting for the period Q1 2022 to Q4 2024 as of December 2021 (prior to the outbreak of the war between Russia and Ukraine) and those in our current forecast for the same period (together with the actual figures to date) in order to obtain the impact in each year of the rate hike cycle. The entire cycle between 2022 and 2024 is evaluated so that the model captures the typical delays of the impact of rate rises.

2024, mainly through the energy and food components.[5] On the whole, we expect average headline inflation to barely moderate in 2024 compared to 2023 (3.6% compared to 3.7%), so it will continue to make a negative contribution to growth.[6]

Finally, the low economic growth that is forecast for the euro area (0.7% in 2024 according to CaixaBank Research, compared to potential growth of 1.4% according to the IMF) will also have an adverse effect on our economy.[7]

Spain: savings rate
Gross disposable income (%)



Note: *4-quarter cumulative rate.*
Source: *CaixaBank Research, based on data from the National Statistics Institute.*

A scenario immersed in risks

This scenario, however, could change depending on whether some of the risks surrounding it materialise. In particular, there is a risk that the current geopolitical conflicts could further strain energy and commodity markets and/or global supply chains. Also, the impact of the cycle of interest rate hikes could be greater than anticipated, impacting our economy not only directly but also through slower growth in the euro area. As an illustration, the table offers the reader a set of sensitivities of GDP growth to changes in some of the key assumptions underlying our scenario.[8]

However, not all are downside risks, as there are also upside risks. The good pattern in disposable income is one of them.[9] In the first half of 2023, household gross disposable income grew by 11.5% year-on-year, a figure that is both significant and well above average inflation in the same period, which was around 4%. This growth was largely due to the 8.5% year-on-year increase in wage earners' remuneration (the most important component of disposable income), as a result of both the strong pace of employment growth in the period, at around 3% year-on-year, and higher wage growth. The strength shown by the labour market has more than offset the increase in net interest payments resulting from the higher rates. Specifically, in absolute terms, the increase in wage earners' remuneration between the first half of 2022 and 2023 amounted to around 47 billion euros, which far exceeds the increase in net interest payments of around 2.4 billion.[10]

Spain: average for the year (2024)

	Impact on GDP growth (in pps)
Inflation (+1 pp)	–0.1
Oil price (+20 dollars)	–0.3
12-month Euribor (+1 pp)	–0.1
Euro area GDP growth (–1 pp)	–0.2
Savings rate (–1 pp)	0.4

Source: *CaixaBank Research.*

Beyond the recent strength shown by disposable income, also of note is the upward revision of the historical series carried out by the National Statistics in its last publication. The greater buoyancy of disposable income has been reflected in the savings rate: according to the new data, the household savings rate in Q1 2023 was around 1 pp higher than previously reported (see second chart).

The upward revision of the savings rate in Q1 2023, together with the high level of savings in Q2 2023, could lead to more buoyant private consumption in 2024. As an illustration, if the savings rate in 2023 closes 1 pp above our current macroeconomic forecast scenario (1 point is precisely the magnitude of the aforementioned upward revision), this would mean households would have a larger savings buffer heading into 2024. Assuming they used that savings buffer in full in 2024, we estimate an impact on GDP of around 0.4 pps (see the sensitivities table).

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5. Primarily, the withdrawal of the VAT reduction on electricity, gas and food, as well as the reduction of excise duty on electricity.
6. To calculate the impact of the inflation of non-core elements (energy and unprocessed food) we introduced into the semi-structural model shocks in the non-core components in order to model the direct and indirect impact of these shocks (the latter captured by the inertia presented by the price equation in the model).
7. The foreign demand shock measures the difference between the GDP growth that is forecast for the euro area for 2024 and its potential GDP (obtained from the IMF), and it translates this difference in growth to export flows net of the import content of those exports.
8. These figures are not alternative scenarios that we consider more or less likely; rather, they offer an illustrative sensitivity analysis to changes in some of the assumptions used in our scenario.
9. For more information on the evolution of gross disposable income in Q2 2023, see the Focus «Spanish households' finances improve thanks to job creation and a reduction of debt» in this same *Monthly Report*.
10. Data on interest payments per the National Statistics Institute's non-financial accounts.

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