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MONTHLY REPORT • ECONOMIC AND FINANCIAL MARKET OUTLOOK
NUMBER 484 | DECEMBER 2023

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CaixaBank Research

MONTHLY REPORT - ECONOMIC AND FINANCIAL MARKET OUTLOOK
December 2023

The *Monthly Report* is a publication developed jointly by CaixaBank Research and BPI Research (UEEF)

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Date this issue was closed:
5 December 2023

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A better 2023 than expected

The year 2023 began with forecasts mired in pessimism and fears. The major developed economies were expected to experience only modest growth and there were even fears that some of them, such as Spain, would record negative growth rates at some point during the year. The global context certainly did not invite optimism. With the blow that the war in Ukraine had dealt to energy prices and commodities in general, the omens could not be good. Even the possibility of some European countries having to impose power cuts was not ruled out.

In the end, things have gone far better than that. In terms of growth, a year ago the GDP of the US and European economies was expected to grow by 0.2% and –0.1%, respectively. In contrast, today, just shy of the year end, they are expected to reach 2.4% and 0.5%. In the case of the Spanish economy, there has also been a significant improvement in the outlook throughout the year. The analyst consensus now places expected GDP growth for 2023 at 2.3%, whereas a year ago it was not even expected to reach 1%.

One of the keys to this improvement has been the moderation of energy prices in general, and of gas prices in particular, especially in the European market. A year ago, the futures market placed the TTF gas price, which is the benchmark in Europe, at 150 euros/MWh at the end of 2023. In contrast, during November it was trading at around 50 euros/MWh. European countries reacted quickly and managed to find alternative sources to Russian gas more easily than expected. In fact, they are going into this winter with their reserves full and with liquefied natural gas vessels queuing to unload. The moderation of energy prices has facilitated a faster tempering of inflation, which has allowed households to lose less of their purchasing power. Thus, household consumption has held up better than expected in the major developed countries, registering growth rates that are expected to reach 2.2% in the US and 1.4% in Spain for 2023 as a whole.

In the case of the Spanish economy, the foreign sector also stands out, having performed much better than anticipated. Clearly, the excellent tourist season has been key. That said, exports of non-tourism services have also been surprisingly buoyant. A year ago it was expected that the current balance in 2023 would deteriorate and would only barely be positive, with the consensus estimate placing it at around 3 billion euros. However, today the consensus estimate places it close to 32 billion euros.

Another factor that has helped cushion the energy shock is the fact that the major developed economies were able to tackle it without major macroeconomic imbalances. This prevented dynamics which would have amplified the impact by making it more severe and persistent, as was the case with the real estate and financial crisis just over a decade ago. Moreover, the economic policy response, in both the fiscal and the monetary spheres, has been generally rapid and effective.

All this has been of the utmost importance for allowing employment to remain buoyant during 2023, far exceeding the outlook at the beginning of the year. Faced with the prospect that the bump would be temporary, many companies opted to keep their jobs in place, thus avoiding the need to find replacement workers in the near future in a labour market that is already stressed and in which many companies are struggling to find workers. Thus, the unemployment rate in the US and the euro area is on track to end the year with an average of more than half a point below what was expected at the end of 2022, at 3.7% and 6.5%, respectively. In the case of the Spanish economy, the surprise been even greater still and the unemployment rate will likely end up 1 pp below expectations, at around 12%.

For 2024, the forecasts are less flattering, not least because it is feared that the impact of the rise in interest rates may still impact economic activity. For the US, the analyst consensus places the anticipated growth rate at just above 1%, while the estimate for the euro area is 0.6% and for the Spanish economy, 1.3%. The risks surrounding the scenario are numerous, but they are not all negative. If the inflationary pressures consolidate the rapid decline they have experienced in recent months and central banks lower interest rates somewhat faster than expected, we are likely to be penning another positive recap a year from now.

Oriol Aspachs
December 2023

Chronology

NOVEMBER 2023

10 The EU's Copernicus programme reports that 2023 saw the hottest January-October period on record globally, 1.43°C above the 1850-1900 average, and records in the months of June, July, August, September and October.

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%.

Agenda

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).

JANUARY 2024

3 Spain: registration with Social Security and registered unemployment (December).
5 Euro area: CPI flash estimate (December).
8 Portugal: employment and unemployment (November).
Euro area: economic sentiment indicator (December).
9 Portugal: international trade (November).
Portugal: turnover in industry (November).
10 Spain: financial accounts (Q3).
22 Spain: loans, deposits and NPL ratio (November).
25 Governing Council of the European Central Bank meeting.
US: GDP (Q4 and 2023).
26 Spain: labour force survey (Q4).
30 Spain: GDP flash estimate (Q4).
Spain: CPI flash estimate (January).
Portugal: GDP flash estimate (Q4).
Euro area: GDP (Q4).
Euro area: economic sentiment indicator (January).
30-31 Federal Open Market Committee meeting.
31 Portugal: CPI flash estimate (January).
Portugal: budget execution (December).

Winds of change for monetary policy

Having launched the most intense monetary tightening cycle of recent decades, it appears that the central banks are on track to solve the unexpected upturn in inflation which the international economy has had to cope with since the first half of 2021. At least, that is what the shift in monetary policy expectations since the first half of November is anticipating, as better than expected CPI records in the US, the euro area and Great Britain not only ruled out the prospect of further rate hikes, but also opened the door to potential rate cuts as soon as Q2 2024. Thus, investors are now anticipating rate cuts of 125 bps on both sides of the Atlantic in the next 12 months. This has translated into sharp declines in sovereign yields (of between 50 and 80 bps for 10-year maturities) and in the 12-month Euribor (which has dropped from 4.1% to 3.7%), as well as triggering rallies in the main stock market indices (which are up almost 10% in four weeks) and reducing financing costs among private issuers, with reductions ranging from 50 bps for investment-grade European companies to 110 bps in the case of high-yield issuers.

The result of this risk-on movement, besides the rally in the value of investment portfolios of all kinds, has been a significant easing of financial conditions, anticipating the monetary policy shift that is expected in 2024. The basis underpinning this shift in expectations is well-founded; indeed, the underlying trend in prices appears to be approaching 3%, a far cry from the highs of 2022 (6%), indicating that the hardest work for the central banks is now behind them. Several measures of inflation momentum appear to corroborate this hypothesis, including the seasonally adjusted (and annualised) version of the CPI published by the ECB (with 3.0% headline CPI and 2.0% in the case of the core index last month) and the pattern in key components of the US price index, such as shelter (+0.3% in October). From here on, the «idyllic» scenario which the markets are anticipating for 2024 has two weaknesses: the need for central banks to remain firm in their monetary policy tone until they see conclusive indications that there are no major hurdles in the last mile (inflation moving between 3% and 2%) and, related to this, the assumption that this faster correction in inflation can be achieved at a very moderate cost in terms of economic activity. In short, the behaviour of the financial markets since 13 November assumes that the economy will make a soft, even immaculate landing, without any collateral damage or risks of new shocks on the horizon. Therefore, in this game of cat and mouse between investors and central banks, over the coming weeks it will be the monetary authorities' turn to try, through well-calibrated communication, to reel in the recent euphoria of the financial markets which could otherwise act as a hindrance for achieving their objectives on time and without any hiccups.

The reality is that, with the economy's current level of indebtedness, this monetary shift would act as a significant catalyst for the growth outlook, as well as for reducing financial stability risks in 2024, even if it ends up being less intense than currently anticipated. After all, according to data from the IIF (Institute of International Finance), at the end of Q3 this year the public and private debt accumulated by the world economy amounted to 307 trillion dollars (335% of GDP), having increased by around 75% since 2008 (+133 trillion dollars). Considering that average growth since the global financial crisis has been 3.1%, that means that in order to generate each additional percentage point of economic activity, the global economy has needed to borrow over 2.8 trillion dollars (almost twice the size of the Spanish economy). This reliance on leverage has increased since 2018, as for every point of growth, global debt has increased by 4.8 trillion dollars, in a challenging environment in which the world has had to deal with the costs of the pandemic, wars and the rise in energy prices.

A breakdown of this pattern reveals that the increase in public debt since the pandemic has been greater than in private debt, with the situation deteriorating more in developed countries than in emerging ones, reflecting a greater fiscal effort in the OECD to cushion the impact of the various supply shocks. It should also be noted that the repayments which emerging countries will have to make next year will be similar to those of this year (around 7 trillion dollars), while in the case of developed countries the increase is much more significant (18 trillion in 2024 vs. 10 trillion in 2023), especially in the case of the US' funding needs. All of the above, together with a challenging political environment with elections in the US, Mexico and India and, therefore, with significant uncertainties in the fiscal sphere, suggest that the path ahead is likely to be somewhat bumpier than currently anticipated by the markets.

José Ramón Díez

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

Financial markets

	Average 2000-2007	Average 2008-2020	2021	2022	2023	2024	2025
INTEREST RATES							
Dollar							
Fed funds (upper limit)	3.43	0.77	0.25	4.50	5.75	4.25	2.50
3-month SOFR	3.62	0.99	0.21	4.74	5.65	3.85	2.40
12-month SOFR	3.86	1.42	0.52	5.48	5.50	3.15	2.80
2-year government bonds	3.70	0.99	0.66	4.30	4.20	2.80	2.50
10-year government bonds	4.69	2.44	1.46	3.62	3.60	3.10	3.00
Euro							
ECB depo	2.05	0.15	–0.50	1.77	4.00	3.50	2.50
ECB refi	3.05	0.69	0.00	2.27	4.50	4.00	3.00
€STR	–	–0.55	–0.58	1.57	3.91	3.45	2.55
1-month Euribor	3.18	0.42	–0.60	1.72	3.87	3.19	2.48
3-month Euribor	3.24	0.57	–0.58	2.06	3.82	2.94	2.40
6-month Euribor	3.29	0.70	–0.55	2.56	3.95	3.00	2.43
12-month Euribor	3.40	0.86	–0.50	3.02	4.08	3.06	2.45
Germany							
2-year government bonds	3.41	0.27	–0.69	2.37	3.15	2.50	2.25
10-year government bonds	4.30	1.38	–0.31	2.13	2.70	2.60	2.50
Spain							
3-year government bonds	3.62	1.53	–0.45	2.66	3.05	2.82	2.67
5-year government bonds	3.91	2.01	–0.25	2.73	3.13	2.99	2.83
10-year government bonds	4.42	2.96	0.42	3.18	3.80	3.60	3.30
Risk premium	11	158	73	105	110	100	80
Portugal							
3-year government bonds	3.68	3.05	–0.64	2.45	3.22	3.04	2.93
5-year government bonds	3.96	3.63	–0.35	2.53	3.24	3.14	3.03
10-year government bonds	4.49	4.35	0.34	3.10	3.60	3.45	3.30
Risk premium	19	297	65	97	90	85	80
EXCHANGE RATES							
EUR/USD (dollars per euro)	1.13	1.26	1.13	1.06	1.07	1.12	1.15
EUR/GBP (pounds per euro)	0.66	0.84	0.85	0.87	0.87	0.89	0.90
OIL PRICE							
Brent ($/barrel)	42.3	77.3	74.8	81.3	85.0	79.0	73.0
Brent (euros/barrel)	36.4	60.6	66.2	76.8	79.4	70.5	63.5

Forecasts

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

International economy

	Average 2000-2007	Average 2008-2020	2021	2022	2023	2024	2025
GDP GROWTH							
Global	4.5	2.9	6.3	3.5	2.8	2.9	3.1
Developed countries	*2.7*	*1.0*	*5.6*	*2.6*	*1.4*	*1.1*	*1.7*
United States	2.7	1.5	5.8	1.9	2.0	0.8	1.7
Euro area	2.2	0.3	5.6	3.4	0.5	0.7	1.6
Germany	1.6	0.8	3.1	1.9	–0.4	0.3	1.4
France	2.2	0.3	6.4	2.5	0.8	0.7	1.4
Italy	1.5	–1.0	7.0	3.8	0.7	0.6	1.7
Portugal	1.5	–0.2	5.7	6.8	2.4	1.8	2.4
Spain	3.7	–0.3	6.4	5.8	2.4	1.4	2.0
Japan	1.4	0.1	2.3	1.1	1.3	1.1	1.1
United Kingdom	2.7	0.3	8.7	2.5	0.6	0.5	0.3
Emerging and developing countries	*6.5*	*4.4*	*6.9*	*4.1*	*3.9*	*4.2*	*4.1*
China	10.6	7.5	8.5	3.0	5.2	4.6	4.4
India	7.2	5.7	9.0	7.3	6.0	6.7	5.5
Brazil	3.6	1.2	5.0	2.9	3.0	1.8	1.8
Mexico	2.3	0.7	5.7	4.0	3.2	2.1	2.1
Russia	–	1.0	5.6	–2.1	2.7	1.5	1.3
Türkiye	5.5	4.3	11.4	5.5	4.3	2.6	3.5
Poland	4.2	3.2	6.9	5.5	0.3	2.6	3.2
INFLATION							
Global	4.2	3.7	4.7	8.7	6.9	5.2	4.0
Developed countries	*2.1*	*1.5*	*3.1*	*7.3*	*4.6*	*2.6*	*1.9*
United States	2.8	1.7	4.7	8.0	4.2	2.4	1.7
Euro area	2.2	1.3	2.6	8.4	5.6	3.1	2.1
Germany	1.7	1.4	3.2	8.7	6.2	3.3	2.2
France	1.9	1.3	2.1	5.9	5.3	2.9	2.0
Italy	2.4	1.3	1.9	8.7	6.6	2.9	2.0
Portugal	3.1	1.0	1.3	7.8	4.6	2.4	2.1
Spain	3.2	1.2	3.1	8.4	3.7	3.6	2.2
Japan	–0.3	0.4	–0.2	2.5	2.5	1.5	1.5
United Kingdom	1.6	2.2	2.6	9.1	7.5	3.6	2.3
Emerging countries	*6.7*	*5.5*	*5.9*	*9.8*	*8.5*	*7.1*	*5.4*
China	1.7	2.6	0.9	2.0	0.7	2.0	1.6
India	4.5	7.3	5.1	6.7	5.3	5.0	4.5
Brazil	7.3	5.5	8.3	9.3	4.8	4.3	3.7
Mexico	5.2	4.1	5.7	7.9	5.6	4.5	3.9
Russia	14.2	7.5	6.7	13.8	5.8	5.4	4.5
Türkiye	22.6	9.8	19.6	72.3	53.9	52.6	29.0
Poland	3.2	2.0	7.3	15.9	7.3	4.2	3.1

Forecasts

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

Spanish economy

	Average 2000-2007	Average 2008-2020	2021	2022	2023	2024	2025
Macroeconomic aggregates							
Household consumption	3.6	–0.9	7.2	4.8	2.2	1.9	2.2
Government consumption	5.0	1.3	3.4	–0.2	2.6	1.4	1.2
Gross fixed capital formation	5.6	–2.0	2.8	2.4	1.9	2.5	3.0
Capital goods	4.9	–0.8	4.4	1.9	–0.1	3.7	3.1
Construction	5.7	–3.4	0.4	2.6	3.1	1.5	3.0
Domestic demand (vs. GDP Δ)	0.2	0.1	0.3	0.1	0.0	0.1	0.1
Exports of goods and services	4.7	1.1	13.5	15.2	0.6	–1.6	1.8
Imports of goods and services	7.0	–1.0	14.9	7.0	–0.7	–0.7	2.4
Gross domestic product	**3.7**	**–0.3**	**6.4**	**5.8**	**2.4**	**1.4**	**2.0**
Other variables							
Employment	3.2	–0.9	6.6	3.8	2.2	1.4	1.6
Unemployment rate (% of labour force)	10.5	19.2	14.8	12.9	12.1	11.8	11.4
Consumer price index	3.2	1.2	3.1	8.4	3.7	3.6	2.2
Unit labour costs	3.0	1.1	0.3	0.4	3.9	3.1	2.6
Current account balance (% GDP)	–5.9	–0.2	0.8	0.6	1.8	1.7	1.9
External funding capacity/needs (% GDP)	–5.2	0.2	1.9	1.5	1.5	2.0	2.4
Fiscal balance (% GDP)[1]	0.3	–6.8	–6.8	–4.7	–4.2	–3.6	–3.0

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

Forecasts

Portuguese economy

	Average 2000-2007	Average 2008-2020	2021	2022	2023	2024	2025
Macroeconomic aggregates							
Household consumption	1.7	–0.1	4.7	5.6	0.9	0.7	1.8
Government consumption	2.3	–0.2	4.5	1.4	1.2	1.3	1.0
Gross fixed capital formation	–0.4	–0.8	8.1	3.0	1.3	5.0	6.4
Capital goods	3.2	2.0	15.3	5.5	–	–	–
Construction	–1.5	–2.3	7.4	1.3	–	–	–
Domestic demand (vs. GDP Δ)	1.3	–0.4	6.0	4.7	0.7	1.6	2.5
Exports of goods and services	5.3	2.2	12.3	17.4	5.5	2.7	4.5
Imports of goods and services	3.6	1.5	12.3	11.1	1.6	2.5	4.8
Gross domestic product	**1.5**	**–0.2**	**5.7**	**6.8**	**2.4**	**1.8**	**2.4**
Other variables							
Employment	0.4	–0.6	2.7	2.0	1.1	0.4	0.3
Unemployment rate (% of labour force)	6.1	11.0	6.6	6.0	6.6	6.5	6.3
Consumer price index	3.1	1.0	1.3	7.8	4.6	2.4	2.1
Current account balance (% GDP)	–9.2	–2.7	–0.8	–1.4	1.2	1.2	1.6
External funding capacity/needs (% GDP)	–7.7	–1.5	1.0	–0.4	2.3	2.6	3.0
Fiscal balance (% GDP)	–4.6	–5.1	–2.9	–0.3	0.7	0.4	0.6

Forecasts

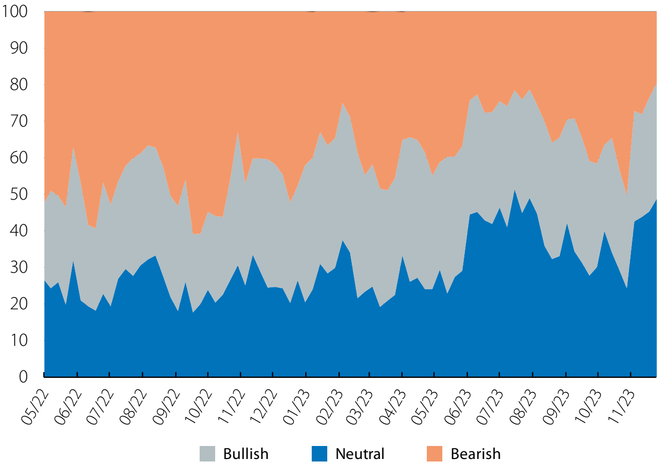
Expectations of a soft landing lead to a rally in the markets

Rapid shift in market sentiment in November. From August to October, the tone in financial markets was dominated by the restrictive monetary policy, persistently above-target inflation, and expectations of rates remaining «higher for longer», which collectively weighed down the stock markets and drove up sovereign yields. But in the face of new economic data pointing to a soft landing in the major economies, the narrative in the markets changed course in November. This was thus a month in which investors showed a risk-on tone, prompting gains in the stock markets, declines in sovereign debt yields and, finally, favouring a weakening of the dollar against its main counterparts.

The central banks stop raising rates and the markets speculate on the first rate cuts. At their October meetings, the major central banks opted to hit the pause button and kept interest rates unchanged, following two years of steady rate hikes in what has been one of the most aggressive cycles of monetary policy tightening in recent decades. The markets have interpreted this pause as the end of the hiking cycle and the current levels as the peak rates on both sides of the Atlantic, a view which we share here at CaixaBank Research. However, several members of the major central banks stressed numerous times during the month that there is still a long way to go to reach the inflation target, emphasising that their strategy now involves keeping monetary policy in restrictive territory for some time to come. Indeed, formally, the central banks' communications still keep the door open to further potential rate rises if required. Yet despite these messages, in November the markets ratcheted up their expectations of rate cuts in 2024, driven by the cooling of economic activity indicators and the decline in the latest inflation data. Specifically, in the case of the Fed, at the end of November investors brought forward their expectations regarding the first rate cut to March 2024 and projected cumulative cuts of –115 bps in the year as a whole (in October they pointed to June for the first rate cut and to cumulative cuts of 65 bps). As for the ECB, the implicit market rates reflected expectations that the first rate cut would be brought forward to March (previously, April), with anticipated cumulative declines of 120 bps in 2024 (previously, 85 bps).

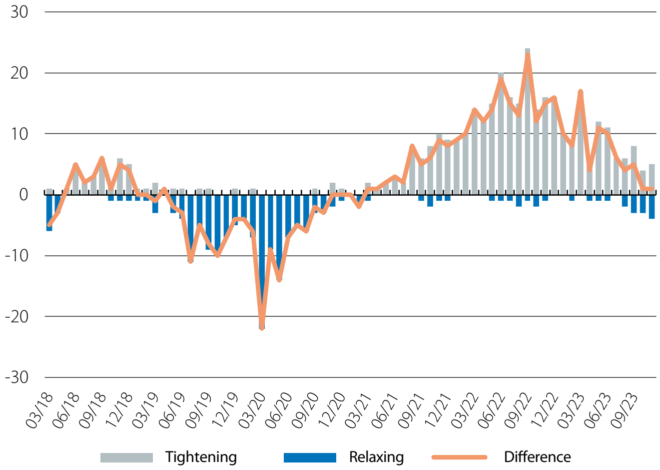
Sovereign bond yields record their worst month in years. These expectations of a pivot in monetary policy occurring sooner rather than later in 2024 translated into a significant rally in sovereign debt. 10-year sovereign rates amassed declines of over 60 bps in the US and of almost 40 bps in Germany, marking the biggest movements since 2011 in the case of the US and since 2021 for Germany, thereby undoing a large part of the increases registered during the second half of the year. Euro area periphery economies saw their risk premiums narrow, as they experienced even sharper declines than the core economies, boosted by Italy whose sovereign debt rating was confirmed by Moddy's and Fitch. Short-term yields also experienced declines, albeit more limited than those

US: market sentiment
(%)



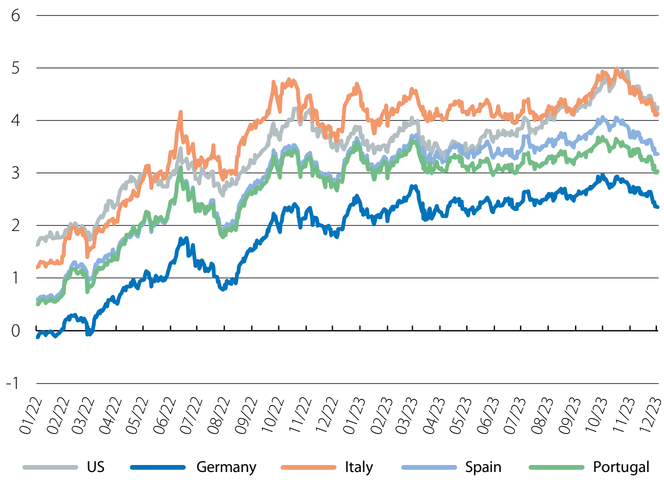
Note: *Percentage of respondents to the American Association of Individual Investors survey regarding their sentiment: optimistic (bullish), neutral or pessimistic (bearish).*
Source: *CaixaBank Research, based on data from Bloomberg.*

Central banks that change rates
(Number)



Note: *Sample of 35 central banks, comprising 11 from advanced economies and 24 from emerging economies.*
Source: *CaixaBank Research, based on data from Bloomberg.*

10-year sovereign debt yields
(%)



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

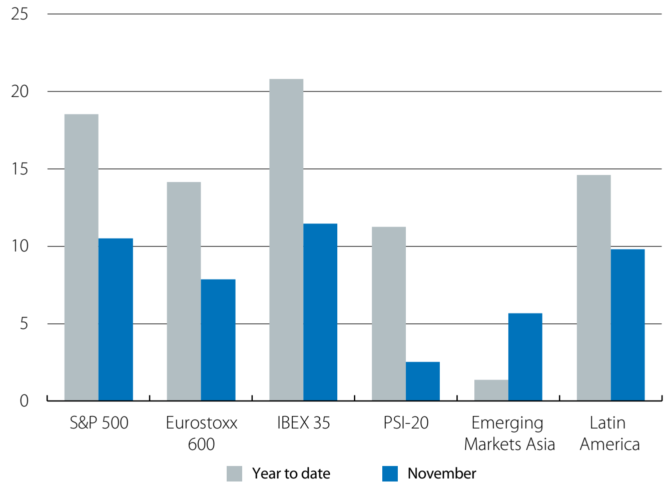
in the longer sections of the curve (e.g. of around 40 bps and 20 bps in the case of 2-year sovereign rates in the US and Germany, respectively), meaning that the sovereign yield curves maintain their inverted slopes.

Volatility falls to a low in the equity market. The higher risk appetite favoured a decline in volatility (in the case of the S&P 500, bringing it down to the lows of January 2020) and an improvement in the performance of the stock market in November. The main indices thus posted their best month so far this year, with gains of almost 8% in the Eurostoxx 50 and of around 10% in the S&P 500. In Europe, the IBEX 35 performed particularly well, reaching its highest level this year following five weeks of consecutive gains (its best streak since the end of March). Significant gains were also recorded in emerging markets, with the MSCI EM index up just over 7%, mainly due to rallies in the Latin American indices (with Argentina leading the charge after Javier Milei's presidential victory). In contrast, the Chinese stock markets closed almost flat, given the lack of momentum in its economy and the persistent difficulties of the real estate sector.

The dollar loses appeal. The protagonist of the month in the foreign exchange market was the US dollar, which, in a context favourable to risky assets, lost its appeal as a safe-haven asset. Specifically, the dollar recorded its worst month of 2023, depreciating against its main counterparts and the DXY index falling 3%. The euro/dollar touched 1.10 dollars momentarily, hovering most of the time at around 1.09 dollars. The dollar even offered a respite to the heavily depreciated Japanese yen, which in the same month went from registering its lowest values in the last 30 years to recovering to the levels of September 2023, in a context marked by speculation about the end of the Bank of Japan's yield curve control policy (see the Focus «Japan: a change of course for monetary policy» in this same report).

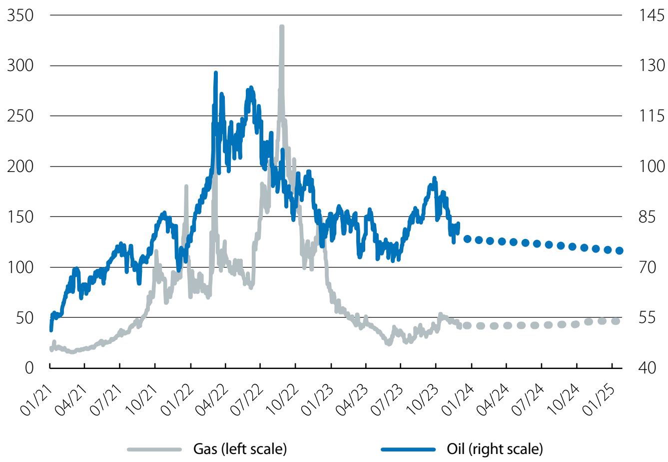
Oil looses steam with all eyes on OPEC and its allies. In the commodity markets, all attention focused on the OPEC and allies meeting held at the end of the month. Expectations around the meeting kept Brent prices within a contained range awaiting further announcements. As a result, the risk-on tone exhibited in other financial markets was not reflected in crude oil prices. As expected, member countries announced the extension of their production cuts to 1 million barrels a day (b/d), with additional voluntary cuts that could total 2 million b/d, effective between January and March 2024. The days before the meeting by numerous rumours about disagreements between African members and Saudi Arabia, which triggered some volatility in oil prices. The price of the barrel of Brent hovered well below the 90-dollar level at which it had ended October, to finally close at around 80 dollars/barrel in November. Prices were also affected by the growing nervousness about a slowdown in global demand, which is already apparent in the high levels of US inventories. On the other hand, the European benchmark for natural gas continued to decline, falling below 44 euros/MWh, in a context marked by high reserves for the time of year (around 95%) and a warmer-than-usual autumn.

International stock markets
Change (%)



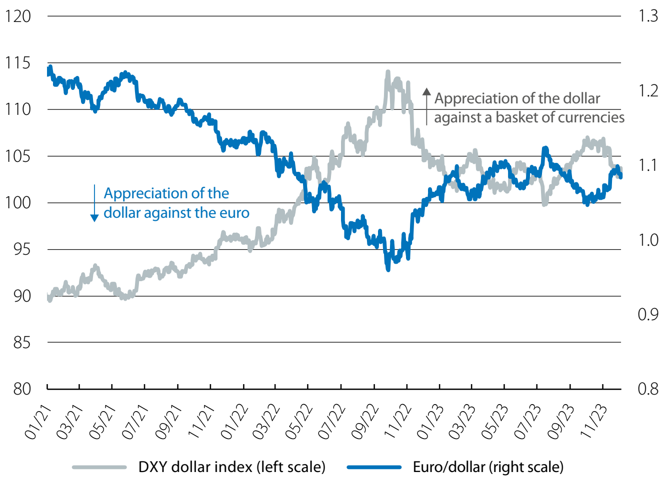
Source: *CaixaBank Research, based on data from Bloomberg.*

Oil and gas prices
(€/MWh) *$/barrel*



Notes: *TTF natural gas and Brent oil prices. The dots indicate the prices of oil and gas futures contracts for the months of January 2024 to April 2025.*
Source: *CaixaBank Research, based on data from Bloomberg.*

US: valuation of the dollar
Index *(Euro/dollar)*



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

The ECB, in the midst of a review

The ECB is reviewing the operational framework with which it implements interest rates. Below, we take a look at the main question marks in this process.

How are rates implemented?

The ECB directly controls three interest rates, the depo, refi and MLF. The depo rate – or deposit facility rate – is that at which banks can deposit their excess liquidity in the ECB, and it sets a floor for market interest rates (no institution with access to the depo rate would want to lend at lower rates.) At the other end of the scale, the MLF rate is the cost of borrowing ECB liquidity overnight through the marginal lending facility (MLF), and it sets a ceiling on market rates (no one with access to the MLF would want to borrow at higher rates).

In the middle is the refi rate – or main refinancing operations rate – which was the reference rate before the global financial crisis (GFC): given a particular refi rate, the ECB estimated the demand for liquidity in the banking system as a whole and supplied it with loans (with a one-week term) granted at the refi rate (through so-called refinancing operations, which were conducted via auction). After the ECB provided a total supply of liquidity, the interbank market was then responsible for redistributing it among the various institutions. As can be seen in the first chart, the floor and ceiling set by the depo and MLF rates ensured that market rates always remained within that corridor, and pre-GFC the ECB managed to anchor them in the middle (at the refi rate) by injecting a total supply that was very close to the demand.

However, with the GFC and the freezing of the interbank market, the ECB had to assume a more direct role. In 2008, refi-rate loans switched to being granted on a fixed-rate full allotment (FRFA) basis: instead of offering fixed amounts at auction, each institution could obtain as much liquidity as it wished from the ECB. This, and the significant growth in the liquidity of the system, ended up anchoring market rates to the depo rate: the option of depositing liquidity with the ECB became the anchor for the price of all other alternative uses of that abundant liquidity.

Why is there so much liquidity?

The door was opened by the FRFA system in 2008, but liquidity began to accumulate more notably in 2010-2012, following the launch of financial stabilisation tools (with the purchases under the Securities Markets Programme and the VLTRO injections, among others), and it was greatly intensified with the asset purchase programmes initiated in 2015 (APP) and 2020 (PEPP) and with the various rounds of TLTROs (targeted longer-term refinancing operations, granted by the ECB between 2014 and 2021).

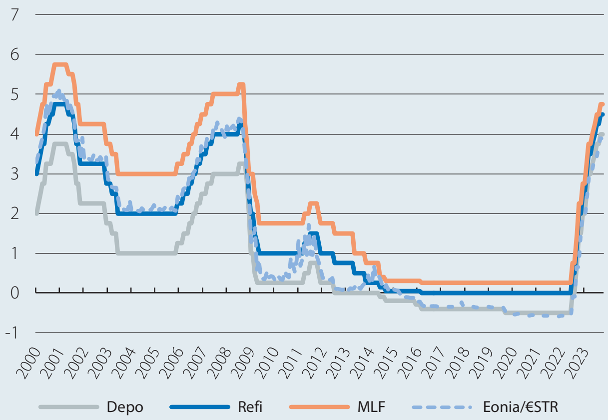
With the repayments of the TLTROs that began in 2022 and the reduction of the APP initiated in 2023, there has recently been a steady decline in the size of the central bank's balance sheet and in the liquidity in the system. It is for precisely this reason that the ECB is now reviewing an operational framework based on excess liquidity.

What are the benefits of implementing rates with excess liquidity?

Excess liquidity and the anchoring role of the depo rate have reduced the volatility of market interest rates. Moreover, compared to the pre-GFC system, the ECB no longer has to accurately estimate the system's minimum

ECB: official and market interest rates

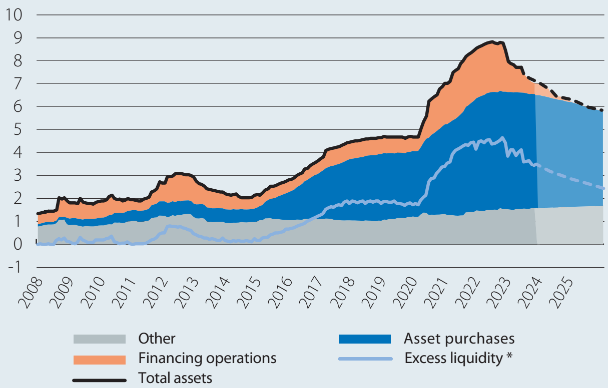
(%)



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

ECB balance sheet: total assets

(EUR trillions)



Note: ** Deposits in the deposit facility plus excess reserves less use of the marginal lending facility.*
Source: *CaixaBank Research, based on data from the ECB.*

liquidity needs,[1] although that does not mean it can relax either: even if liquidity is abundant across the system as a whole, there can be turbulence if it is unevenly distributed, as exemplified by the flash crash of the US federal funds market in September 2019. Finally, an abundance of liquidity has the advantage of maintaining a high volume of safe assets in the system and ensuring protective buffers as a preventative measure in the event of episodes of stress.

Are there any drawbacks?

The most direct disadvantage is the larger balance sheet size that the central bank must sustain, with the consequent larger footprint in the financial markets (influencing a wide range of interest rates and with collateral effects such as a shortage of bonds in secondary markets). In addition, it entails financial risks for the central bank's own profit and loss account. Furthermore, the excess liquidity injected by the central bank can discourage the interbank market and distort information on benchmark interest rates such as the €STR.[2]

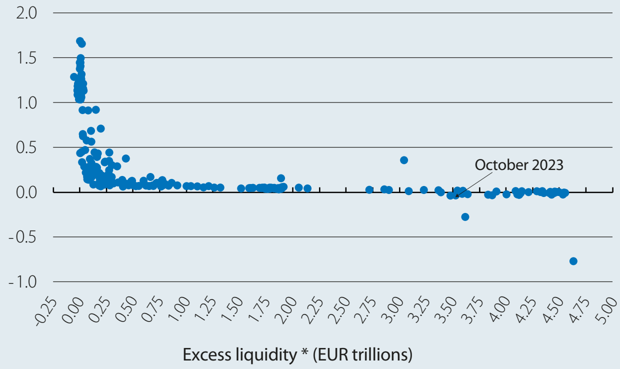
Is there an option that balances the costs and the benefits?

The statements seem to favour a system with abundant liquidity and giving continuity to the current framework,[3] but with a slightly different implementation.[4] Whereas to date the excess liquidity has been proactively injected by the ECB, an alternative approach would be to offer abundant and regular refinancing operations such that it would be demand itself that would determine its liquidity needs. The Bank of England, which has adopted such a system, offers these operations at the same interest rate at which it remunerates the reserves. On the other hand, if the ECB were to follow the example set by the Riksbank, which uses a similar system, it could establish a narrow corridor: for example, with refinancing operations at the refi rate, with this rate falling within a narrow corridor between the depo and the MLF rates (the Riksbank's corridor is ±10 bps).

In addition to being more self-regulated (demand is self-satisfied and an adequate distribution of liquidity is more easily ensured),[5] this system has the advantages of being robust against fluctuations in reserves and allowing the central bank to have a smaller bond portfolio, with a smaller footprint in the markets.

Euro area: interest rate spreads and excess liquidity

Spread between the OIS rate and the depo rate (pps)



Note: ** Deposits in the deposit facility plus excess reserves less use of the marginal lending facility.*
Source: *CaixaBank Research, based on data from Bloomberg and the ECB.*

What is the immediate outlook for the ECB?

The ECB's operational review will determine the size and composition of its balance sheet in the long term. In 2024 and 2025, we estimate that it will still maintain a relatively large balance sheet and will continue to operate with abundant liquidity. In particular, during 2023 the size of the ECB's balance sheet will have dropped by 1 trillion euros due to the repayments of the TLTROs (–0.85 trillion) and the end of reinvestments under the APP (–0.2 trillion). These dynamics will continue in 2024 and 2025, intensified by the end of reinvestments under the PEPP. However, even if they were to affect excess liquidity on a 1-to-1 basis, by the end of 2025 the central bank's excess liquidity would still exceed 2 trillion euros (see second chart).[6] With such ample liquidity, the depo rate would remain the benchmark anchor for market rates (see third chart).[7]

1. This is no mean feat, given that liquidity needs are now not only higher (both for regulatory reasons and due to an increased perception of risk) but also more uncertain.
2. The euro short-term rate (€STR), which reflects the interest rate on overnight loans between financial institutions, trades below the depo rate (its theoretical lower limit). The €STR «leaks» below the depo rate because it includes transactions between entities with access to the deposit facility and institutions without access: these latter transactions would gain relative weight in a less dynamic interbank market, accentuating the «leaks».
3. Philip Lane, *Central bank liquidity: a macroeconomic perspective*, 9 November 2023.
4. Isabel Schnabel, *Back to normal? Balance sheet size and interest rate control*, 27 March 2023.
5. To achieve this, it is essential that the refinancing operations do not create any stigma.
6. This projection assumes the repayment of all the remaining TLTROs (some 500 billion euros by December 2024), the passive reduction of the APP (zero reinvestments) and the passive reduction of the PEPP beginning in the summer of 2024 (three months with reinvestments at 50%, three months more at 30% and then 0%).
7. The historical relationship is subject to the usual caveats: structural changes in the demand for reserves could cause the market rate to slide with higher levels of excess liquidity than in the past.

Interest rates (%)

	30-November	31-October	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	3.96	3.97	–1	183.2	199.2
1-year Euribor	3.93	4.05	–13	63.5	108.4
1-year government bonds (Germany)	3.43	3.64	–21	82.8	129.0
2-year government bonds (Germany)	2.82	3.02	–20	5.2	78.7
10-year government bonds (Germany)	2.45	2.81	–36	–12.4	63.3
10-year government bonds (Spain)	3.47	3.88	–41	–19.1	65.9
10-year government bonds (Portugal)	3.14	3.53	–39	–44.9	40.7
US					
Fed funds (upper limit)	5.50	5.50	0	100.0	150.0
3-month SOFR	5.37	5.38	–1	78.2	91.9
1-year government bonds	5.12	5.45	–33	43.0	50.2
2-year government bonds	4.68	5.09	–41	25.4	45.3
10-year government bonds	4.33	4.93	–60	45.2	82.2

Spreads corporate bonds (bps)

	30-November	31-October	Monthly change (bp)	Year-to-date (bp)	Year-on-year change (bp)
Itraxx Corporate	68	86	–18	–23.1	–19.9
Itraxx Financials Senior	78	98	–20	–21.2	–18.7
Itraxx Subordinated Financials	142	179	–37	–29.8	–29.6

Exchange rates

	30-November	31-October	Monthly change (%)	Year-to-date (%)	Year-on-year change (%)
EUR/USD (dollars per euro)	1.089	1.058	3.0	1.7	3.5
EUR/JPY (yen per euro)	161.370	160.410	0.6	14.9	13.4
EUR/GBP (pounds per euro)	0.863	0.870	–0.9	–2.6	0.4
USD/JPY (yen per dollar)	148.200	151.680	–2.3	13.0	9.5

Commodities

	30-November	31-October	Monthly change (%)	Year-to-date (%)	Year-on-year change (%)
CRB Commodity Index	529.9	539.5	–1.8	–4.5	–6.4
Brent ($/barrel)	82.8	87.4	–5.2	–3.6	–4.7
Gold ($/ounce)	2,036.4	1,983.9	2.6	11.6	12.9

Equity

	30-November	31-October	Monthly change (%)	Year-to-date (%)	Year-on-year change (%)
S&P 500 (USA)	4,567.8	4,193.8	8.9	19.0	12.1
Eurostoxx 50 (euro area)	4,382.5	4,061.1	7.9	15.5	10.0
Ibex 35 (Spain)	10,058.2	9,017.3	11.5	22.2	19.6
PSI 20 (Portugal)	6,474.6	6,257.1	3.5	13.1	9.2
Nikkei 225 (Japan)	33,486.9	30,858.9	8.5	28.3	18.6
MSCI Emerging	987.1	915.2	7.9	3.2	0.9

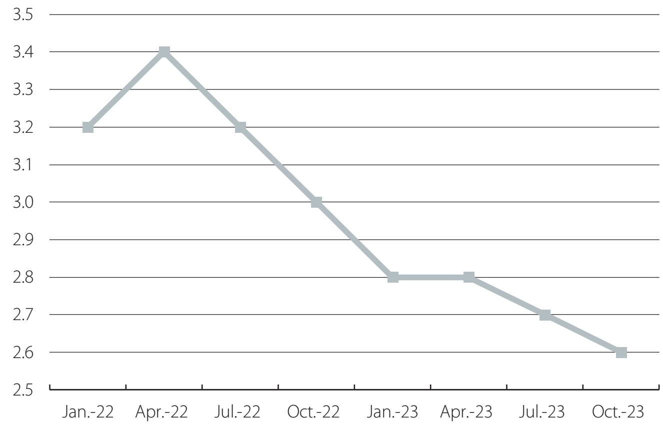
Declining expectations and caution in the international economy

Uncertainty offers no respite at the end of the year. The world economy is experiencing a slowdown at different speeds as it heads into the 2023 year end and the beginning of 2024. This slowdown is particularly sharp in Europe, rather more gentle in the US, while China, despite meeting the authorities' growth targets, finds itself entangled in the difficulties of its real estate sector. At this pivotal moment, the world economy is aiming for a smooth landing that would allow inflation to be reduced without excessively jeopardising growth, but it is doing so in an environment fraught with risks. In the geopolitical sphere, the already delicate situation due to the war in Ukraine has been compounded by the conflict between Israel and Hamas. In the more strictly economic sphere, meanwhile, inflation still has some way to go before reaching the central banks' target rates, and although the cycle of monetary policy tightening appears to have peaked, its effects are still filtering through to the economy.

The US... and the slowdown that refuses to materialise. The rate hikes implemented by the Fed (525 bps since February 2022) are not yet fully visible in the macroeconomic data. In fact, in Q3 GDP was still growing at a robust rate of 1.3% quarter-on-quarter (more than double that of the first half of the year), thanks to the buoyancy of private consumption (0.9% vs. 0.2%) and at the expense of savings (4.0% of disposable income vs. 5.1% in Q2). However, in Q4, various trackers are suggesting that GDP may slow to 0.5% quarter-on-quarter, and while the economy seems to be achieving a smooth landing, we cannot rule out an even sharper slowdown during the first half of 2024. Indeed, the available indicators are suggesting just that. In October, retail sales and industrial production fell (–0.1% and –0.6% month-on-month, respectively), while the industrial climate and confidence indicators make the likelihood of a rebound seem remote: the ISM index for October once again stood at levels compatible with a shrinking of the manufacturing sector (46.7 vs. 49.0) and confirmed the exhaustion of the service sector (51.8 vs. 53.6), while consumer confidence fell in November for the fourth consecutive month (61.3 vs. 63.8) and the composite PMI was at levels compatible with economic activity close to stagnation (50.7 in November). Inflation, for its part, accentuated its decline in October, especially the headline index (3.2% vs. 3.7%), while the correction in the core index remains less pronounced (4.0% vs. 4.1%). The disinflationary evidence also observed in other indicators (production prices at 2.4% year-on-year, compared to 5.0% at the beginning of the year; or freight costs already below their pre-COVID average) suggest that the Fed's 2.0% target could potentially be reached sometime during the second half of 2024.

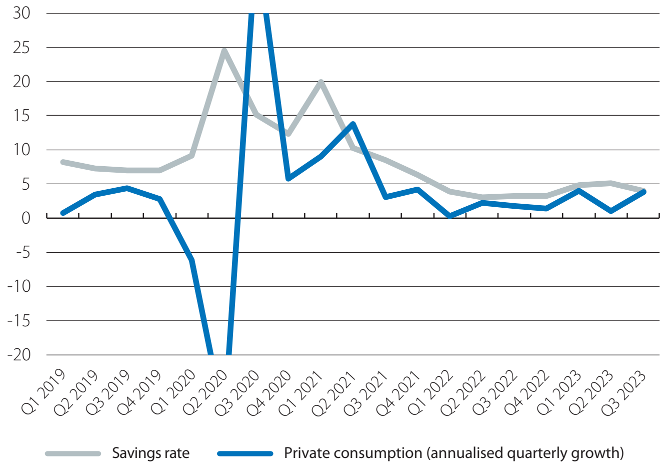
The euro area faces the weakest expectations. The economy shrank in Q3 (–0.1% quarter-on-quarter) and the outlook for the following months shows no signs of improvement. In fact, the consolidation of the PMI below the 50-point threshold in November for the sixth consecutive month increases the possibility of a further, moderate fall in GDP at the end of the year – a risk also hinted at by the European Commission's economic sentiment indicator. In its autumn report, the

Global GDP growth forecasts for 2024
(%)



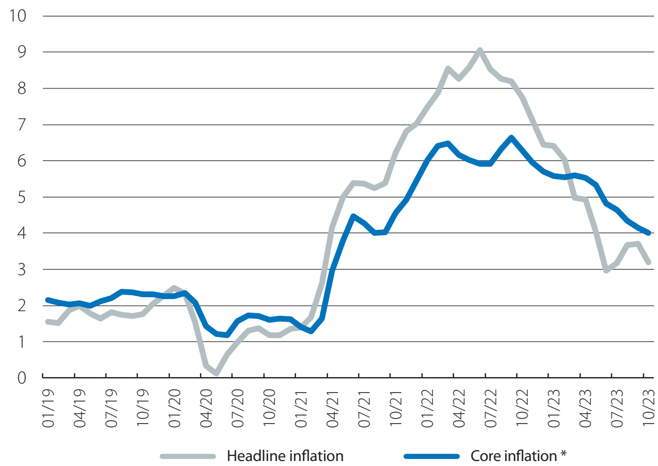
Source: *CaixaBank Research, based on analyst consensus forecasts published by Reuters.*

US: private consumption and household savings rate
(%)



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

US: headline and core inflation
Year-on-year change (%)



Note: ** The core inflation index excludes energy and all food.*
Source: *CaixaBank Research, based on data from the BLS.*

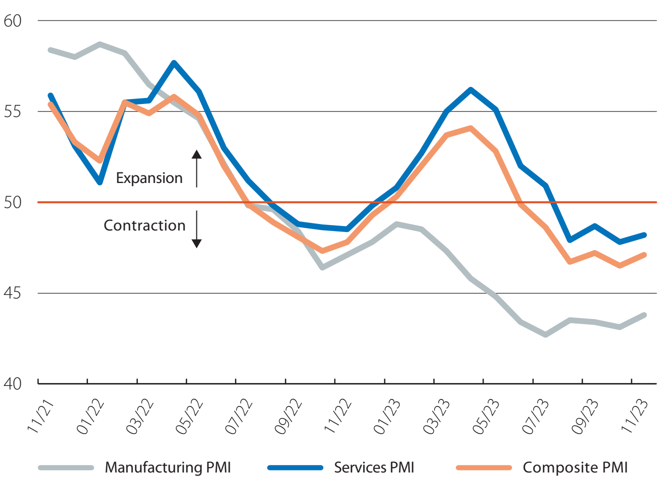
Commission also points out that the rise in the cost of living (inflation has risen by more than 12% since January 2022), weak foreign demand and the tightening of monetary conditions have taken a toll on economic activity, and this explains the further cuts to its growth forecasts for the region as a whole, now at 0.6% for 2023 and 1.2% for 2024. In this context of economic slowdown, the moderation in inflation intensified in November, both for the headline index (2.4% vs. 2.9%) and for core inflation (3.6% vs. 4.2%). In fact, headline inflation fell to the lows seen in the summer of 2021, while core inflation reached its lowest point since the spring of 2022. The breakdown by component revealed a particularly sharp moderation in services (–0.6 pps, to 4.0%) and in non-energy industrial goods (2.9%, finally reflecting the normalisation of the global bottlenecks in final prices). In addition, the moderation of inflation was widespread among the large economies and the seasonally adjusted data published by the ECB place the momentum at 3.0% for headline inflation and at 2.0% for the core index (momentum is defined as the annualised quarter-on-quarter change in the HICP and is a better reflection of recent inflation trends than year-on-year rates).

Germany engages in fiscal rigour. Aware that their economy has cooled the most, the German authorities were planning to reallocate some 60 billion euros that were initially earmarked for alleviating the consequences of the pandemic to projects related to climate change. However, the German Constitutional Court declared this «transfer» unconstitutional, while simultaneously reviving the «debt brake» rule (which limits borrowing to 0.35% of GDP per year). This decision forced the government to draw up a supplementary budget of around 43 billion euros for the remainder of 2023 and it will appeal to parliament to maintain the suspension of the debt brake for the fourth consecutive year, claiming that a «state of emergency» persists in 2023, thus delaying its reintroduction until 2024.

Tax cuts in the United Kingdom to stimulate the economy. GDP stagnated in Q3 (0.0% quarter-on-quarter vs. 0.2%), after a more buoyant than expected first half of the year, and the Bank of England itself anticipates that economic activity will remain virtually stagnant until the end of 2024. This weakness in the economy led Finance Minister Jeremy Hunt to present measures aimed at reviving growth (including tax cuts for individuals and businesses) at an estimated cost of 15.6 billion pounds a year through to 2029 (around 0.5% of GDP). It is estimated that these measures will have a modest impact on growth (less than 0.3 pps on average per year through to 2029), which explains why the country's Office for Budget Responsibility itself has cut its forecast for potential growth by 0.2 pps to 1.6%.

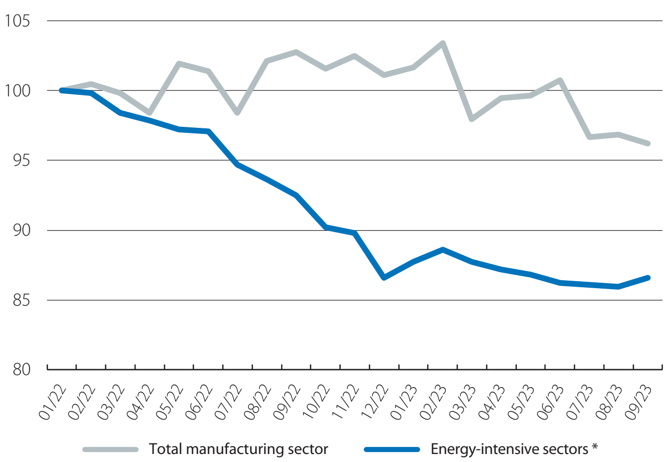
Growth increases in Q3 in Eurasia and Latin America, with some exceptions. Japan's GDP fell more than expected (–0.5% quarter-on-quarter vs. 1.1%), weighed down by the weakness of its domestic demand, while Russia's GDP managed to accelerate (1.3% quarter-on-quarter vs. 0.8% previously), driven by the arms industry and the more than 30% increase in oil prices in the period. On the other hand, Latin American economies experienced a good Q3: Mexico registered 1.1% quarter-on-quarter growth vs. 0.8%; Chile, 0.3% vs. –0.3%; and Colombia, 0.2% vs. –1.0%. In Asia, the acceleration of economic activity was also widespread in Q3: China registered 1.3% growth vs. 0.5%; Philippines, 3.3% vs. –0.7%; Malaysia 2.6% vs. 1.5%, and Singapore, 1.4% vs. 0.1%.

Euro area: PMI
Index



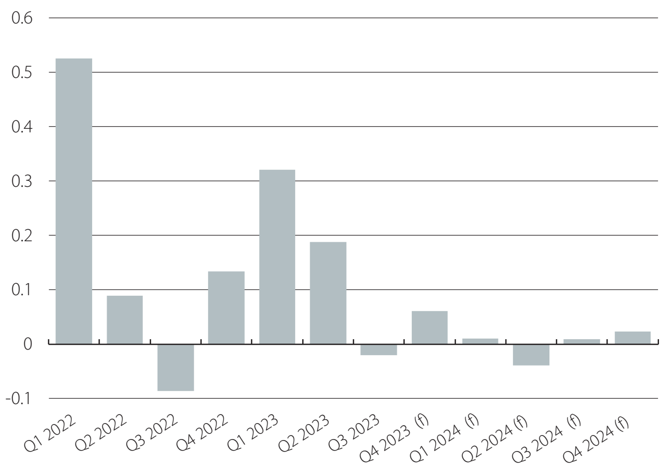
Source: *CaixaBank Research, based on data from S&P Global PMI.*

Euro area: industrial production
Index (100 = January 2022)



Note: ** Chemicals, non-metallic minerals, base metals, and paper pulp and paper.*
Source: *CaixaBank Research, based on data from Eurostat.*

UK: GDP
Quarter-on-quarter change (%)



Note: *(f) Bank of England forecasts (Monetary Policy Report, November 2023).*
Source: *CaixaBank Research, based on data published by the Bank of England.*

Japan: a change of course for monetary policy

Spurred by an economy that has lived through a long period of low growth and insufficient inflation, since the 2000s the Bank of Japan (BoJ) has been a pioneer in the implementation of unconventional monetary policies, such as asset purchase programmes (QE), negative interest rates and the yield curve control policy (YCC). The inflation rebound that Japan has experienced over the past two years – initially triggered by supply chain bottlenecks, the rise in global energy and food prices and the devaluation of the yen, but which more recently appears to be generating self-sustaining dynamics –[1] has led to a rethinking of monetary policy in the country.

How can the yield curve be kept under control without maintaining yield curve control?

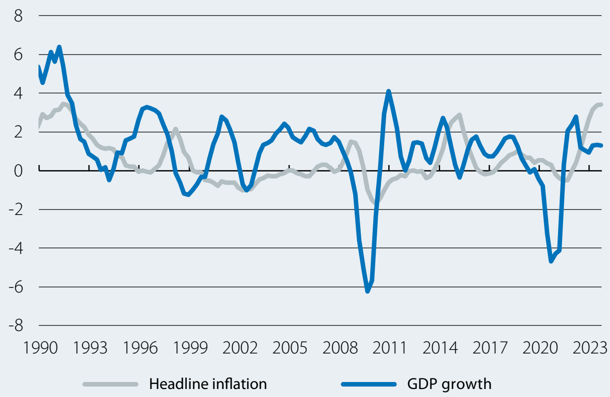
In recent years, a core element of the BoJ's monetary policy has been YCC. This tool consists of setting target interest rates for specific maturities of the sovereign yield curve, which implies an implicit commitment to acquire (or sell) those assets in the amount necessary to keep rates in line with the target. Specifically, in 2016, after lowering its official rate and bottoming out at –0.1%, the BoJ decided to bolster its monetary policy by controlling the yield curve and set a target for the 10-year sovereign interest rate at 0%.[2] Thus, while Japanese rates at shorter maturities were tied to the official BoJ interest rate, YCC served to influence longer maturities along the curve and to keep those rates close to target.

Since the BoJ announced YCC, it has managed to keep the 10-year sovereign rate close to 0% with more gradual balance sheet increases than in the past (see second chart). This does not alter the fact that, in times of stress such as the pandemic, the BoJ has still had to increase its degree of intervention. However, beginning in 2022 – at a time when inflation was beginning to leave its mark, the interest rate spread with the US was widening and the yen was losing value (see third chart) – expectations began to emerge that the BoJ could abandon YCC and the institution began to take small steps in that direction. Since then, 10-year interest rates have «de-anchored» from 0% and have recently been trading at around 1%.

1. Headline inflation stood at 3.3% in October, while core inflation stood at 4.0%. The Bank of Japan expects core inflation of 3.8% for the 2023 fiscal year and of 1.9% for 2024.
2. One of the benefits of this type of tool is that it allows for clear communication of monetary policy, thus helping to convey a greater sense of certainty to investors. YCC can therefore be understood as a more transparent alternative to QE programmes, which do little to clarify «how low» the central bank wants these rates to be. YCC may also be more efficient than QE programmes insofar as the same target rate can be achieved with a lower level of asset purchases, provided investors believe the central bank. See the Focus «Yield curve control: a new tool for the Fed?», in the MR09/2020.

Japan: headline inflation and GDP growth

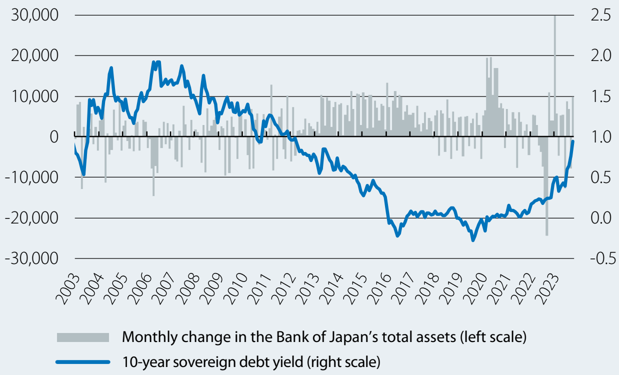
Year-on-year change (%)



Note: *The chart shows four-quarter moving averages.*
Source: *CaixaBank Research, based on data from Bloomberg.*

Japan: 10-year sovereign rate and central bank assets

(JPY millions) *(%)*



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

In part, this de-anchoring reflects the lower stringency of the BoJ: despite having a YCC policy with a target of 0%, in 2018 it introduced a fluctuation range of ±0.1 pp around this target rate, in 2021 it extended that range to ±0.25 pps, in December 2022 it raised it to ±0.5 pps, and in July 2023 it stated that beyond this range it considered 1% to be the maximum level the 10-year sovereign rate could reach. In late October we saw another sign indicating that the end of YCC was looming: without touching interest rates, the BoJ declared that the 1% limit is now considered a «benchmark». This suggests a greater tolerance for the sovereign rate to fluctuate around that threshold, while also reflecting concerns that defending that limit too strictly could impact the ordinary functioning of the market. This shift in communications is just part of a sequence of a number of small steps.[3]

Although YCC can be considered a success to date, from the point of view of anchoring expectations and managing the central bank's balance sheet,[4] at a time of monetary policy change in Japan there is uncertainty about what the «day after» will bring. For instance, while the process of abandoning YCC is expected to be prudent and gradual, there is a risk that when the central bank ceases to ensure a particular interest rate in the market, asset prices could become more volatile as investors «test» the new equilibrium. This, in turn, would have ramifications for large holders of sovereign debt (in particular, financial institutions such as pension funds and insurance companies), potentially forcing the authorities to act in order to support the financial system.

«Ueda strategy»: one eye on financial stability... two on deflation

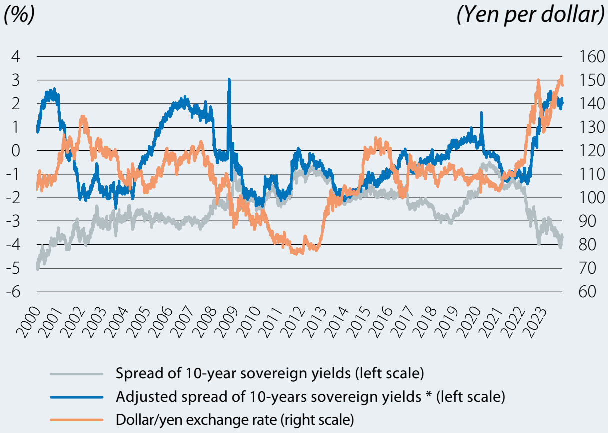
For now, the market response to these monetary policy adjustments has been limited, and market stability and control of the yield curve have been maintained. Nevertheless, the withdrawal of YCC comes with significant challenges. Domestically, the insurance sector is the most exposed to rate hikes, as the second-largest holder of sovereign bonds (after the BoJ), accounting for 40% of the sector's total assets. On the other hand, pension funds could be more affected by a rapid appreciation of the yen, as a significant portion of their assets are denominated in foreign currencies. Externally, the risk is that the narrowing of the interest rate spread between Japan and the other major global economies could trigger greater capital repatriation flows. Indeed, the ECB has itself pointed out that a more sudden withdrawal of Japanese investors from the euro area's bond market could have a significant impact on prices, amplifying the effects of the ECB's own quantitative tightening.[5]

Looking ahead to 2024, the end of YCC is expected to lead to a gradual rise in interest rates. In addition, according to market expectations, in the first half of the year the BoJ could announce the first official interest rate rise, putting an end to negative rates.

One risk that worries the BoJ in the medium term is that Japan could fall back into a prolonged period of deflation. Governor Kazuo Ueda has repeatedly pointed out that his primary focus is on preventing a return of the deflationary nightmare, stressing that in order to meet this goal, sustained wage increases above 2% are needed. In other words, the BoJ wants a «good» price-wage spiral, in the sense that this would help it to maintain its inflation target. Every March, Japan's biggest corporations meet with the unions to negotiate wage rises for the following fiscal year (which begins in April). This process, which also influences wages offered in smaller companies, is known as *shuntō*, or the spring wage offensive. Will the 2024 *shuntō* also lay the foundations for a monetary policy offensive in Japan?

Luís Pinheiro de Matos

Japan: dollar-yen exchange rate and sovereign spreads



Notes: ** The adjusted spread of sovereign yields takes into account the cost of hedging against exchange rate fluctuations when investing in assets denominated in foreign currencies (in this case, against fluctuations in the dollar-yen exchange rate). The chart shows daily data.*
Source: *CaixaBank Research, based on data from Bloomberg.*

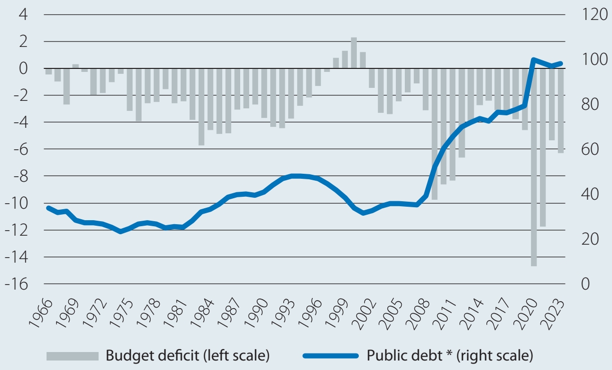
3. For further details, see P. Kowalewski and S. Shirai (2023). «History of Bank of Japan's more than two decades of unconventional monetary easing with special emphasis on the frameworks pursued in the last 10 years». ADBI Working Paper nº 1.380, Asian Development Bank Institute.
4. As of 2023, the BoJ holds over 50% of the total sovereign bonds in circulation on its balance sheet, compared to 30% in 2016.
5. Around 4% of euro area bonds in circulation are held by Japanese investors, and this figure rises to 6% in the case of France (3% in Spain and Germany), while in the case of US bonds they hold 3%.

The US national accounts: current situation and future outlook

The US federal government deficit for the fiscal year ended 30 September 2023 increased from 1.4 trillion dollars to 1.7 trillion, or from 5.3% to 6.3% of GDP.[1] These deficit levels are among the highest in advanced economies, and in the US since the 1960s they have only been exceeded during the Great Recession (2009-2012) and the pandemic (2020-2021). The figures are rather alarming, and in this article we will try to shed light on the reasons for this increase in 2023, the impact it could have on the US economy, and the medium-term outlook for the sustainability of US public (federal government) debt.

As can be seen in the table, the increase in the deficit compared to the years prior to the pandemic can be explained in part by lower tax revenues, but above all by a marked increase in public spending. This increase is especially visible under the categories of Health and Medicare (+0.6 pps) and Interest payments (+0.9 pps). The increase in this latter category is to be expected in the current context of high interest rates, which has led the 10-year treasury interest rate to average 3.9% in 2023, compared to an average of 2.25% between 2015 and 2019. On the other hand, the slight increase in the Other expenses category from 2.6% to 2.9% hides the accounting effect of the cancellation of student loans, which increases the portion allocated to the 2022 fiscal year (hence the rebound to 5.1%) and decreases that attributed to 2023. If we were to undo this accounting effect, we would see that the fiscal deficit relative to GDP would be 1.5 pps lower in 2022 (–4.5%) and 1.2 pps higher in 2023 (–7.5%). On the income side, the fall between 2022 and 2023 is primarily explained by a normalisation of revenues from the collection of taxes on capital, which in 2022 were unusually high due to the significant gains recorded in the stock market in the previous year.

US: budget deficit and public debt
(% of GDP) *(% of GDP)*



Note: ** Excludes intergovernmental debt.*
Source: *CaixaBank Research, based on data from the Federal Reserve Bank of St. Louis and the Congressional Budget Office.*

US: fiscal revenues and expenditure by source
(% of GDP)

	Average for 2015-2019	2022	2023
Personal income taxes	8.3	10.5	8.1
Business taxes	1.4	1.7	1.6
Social security	5.9	5.9	6.0
Other revenues	1.5	1.4	0.8
Total fiscal revenues	**17.1**	**19.6**	**16.5**
National defence	3.2	3.1	3.0
Health and Medicare	5.8	6.7	6.4
Social security	7.5	8.3	7.9
Interest payments (net)	1.5	1.9	2.4
Other expenses	2.6	5.1	2.9
Total fiscal expenditure	**20.6**	**25.1**	**22.7**
Fiscal deficit	**–3.5**	**–5.5**	**–6.3**

Source: *CaixaBank Research, based on data from the US Department of the Treasury, Final Monthly Treasury Statement.*

The impact on GDP has been positive in 2023 but this may not be the case going forward

This increase in the deficit has made a positive contribution to GDP growth so far in 2023. In fact, public consumption in the last four quarters has grown at an average rate of 1.1% quarter-on-quarter, contributing almost one third of total GDP growth despite only accounting for 17% of GDP. Going forward, however, public consumption is expected to cease acting as a tailwind for GDP growth, having a neutral impact at best. The latest projections by the Congressional Budget Office (CBO) estimate that the budget deficit as a percentage of GDP will remain above 5.5% throughout the entire projection horizon, decreasing by just 0.1 pp in 2024 before increasing again by 0.4 pps in 2025. However, the contribution of the deficit to GDP growth depends less on its level and more on its rate of change.[2] Therefore, the CBO's projections actually imply a somewhat neutral contribution to GDP growth in the coming years.

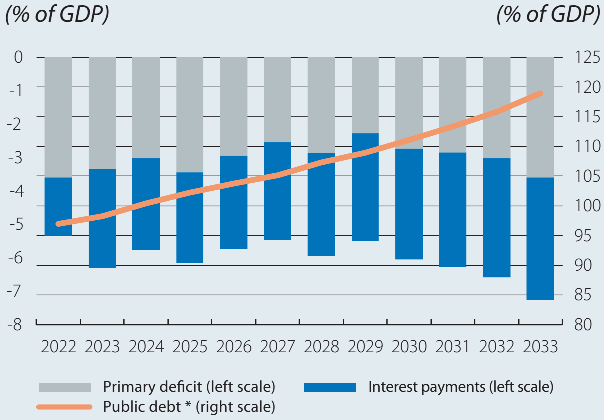
1. Fiscal years in the US run from October to September (for example, the 2023 fiscal year runs from October 2022 to September 2023). Throughout the article we will refer to the federal deficit and debt, excluding state and local government accounts.
2. For example, if an economy with a fiscal deficit of 1% of GDP increased its deficit by 2 pps to 3%, that year (t+1), assuming a fiscal multiplier of 1, GDP growth would be 2 pps higher. The following year (t+2), maintaining the deficit at 3%, GDP would remain at the same level, but growth would be 2 pps lower than the previous year.

As can be seen in the last chart, according to these projections by the CBO, which are based on a scenario with no changes in fiscal policy, US public debt as a percentage of GDP would follow an upward trend, climbing from today's 98% to almost 120% by 2033. This increase reflects relatively stable but high primary deficits (of around 3%), while the projections envisage nominal GDP growth (4.2% on average between 2023 and 2033) above the cost of debt (3.1%), which helps to ensure the sustainability of public debt. Specifically, of the 20-pp increase in debt projected by the CBO, the accumulation of deficits explains 33 pps, while the gap between rates and GDP growth (i – g) would tend to reduce it by around 13 pps. However, in a context marked by high interest rates and a gradual withdrawal of the Federal Reserve as a holder of treasuries (through quantitative tightening), the financial burden of this debt will become heavier: for instance, while the CBO projects that the gap (i – g) will tend to reduce debt levels by an annual average of 1.7 pps during the period 2023-2027, this support factor would drop to 0.6 pps by 2033.

Beyond the impact that high interest rates may have, the increase in public debt relative to GDP in the CBO's forecasts is also explained by a sustained increase in public spending that is not offset by an equivalent increase in tax revenues, which in fact are projected to remain stable throughout the forecast horizon. According to the CBO itself, this increase in expenditure is primarily due to the rise in items related to health and social security, and with the expected ageing of the population this trend is expected to continue beyond 2033.

In addition to these headwinds, we must also consider the current complex political situation in the US, with a political polarisation that increases the frequency of potential federal government shutdowns given the difficulties in reaching agreements to fund the government,[3] and with the debt limit being reached. In an extreme scenario, this could even lead to the Department of the Treasury being unable to pay its obligations. In this regard, and following the difficulties in the latest negotiations in June to reach a bipartisan agreement to suspend the debt ceiling, Moody's maintained its rating of US sovereign debt at the top of the scale (Aaa), but downgraded its outlook from «stable» to «negative». In addition to the political situation, the rating agency also mentioned the high-interest-rate environment and the absence of fiscal measures to reduce the budget deficit as factors behind its downgrading of the outlook.

US: CBO deficit and public debt projections



Note: ** Excludes intergovernmental debt.*
Source: *CaixaBank Research, based on data from the Congressional Budget Office.*

Therefore, we believe that the US national accounts will remain on analysts' lips for the next few years and will continue to generate noise in the financial markets whenever key dates for the funding of government budgets or for avoiding a breach of the debt ceiling approach. Moreover, there will be no shortage of voices rightly warning of the dangers of maintaining high primary deficits that cause public debt as a proportion of GDP to steadily rise.

Ricard Murillo Gili

3. The most recent agreement, reached at the last minute on 14 November, extended government funding until 19 January 2024 for some measures and until 2 February for others. New agreements must then be reached in order to avoid a government shutdown.

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

UNITED STATES

	2021	2022	Q4 2022	Q1 2023	Q2 2023	Q3 2023	09/23	10/23	11/23
Activity									
Real GDP	5.8	1.9	0.7	1.7	2.4	3.0	–	–	–
Retail sales (excluding cars and petrol)	15.8	9.3	7.5	5.9	3.3	2.2	4.3	3.5	...
Consumer confidence *(value)*	112.7	104.5	104.2	105.5	106.1	104.5	104.3	99.1	102.0
Industrial production	4.4	3.4	1.8	1.3	1.0	0.9	–0.2	–0.7	...
Manufacturing activity index (ISM) *(value)*	60.7	53.5	49.1	48.3	47.8	47.1	49.0	46.7	46.7
Housing starts *(thousands)*	1,606	1,551	1,405	1,375	1,378	1,385	1,346	1,372	...
Case-Shiller home price index *(value)*	267	307	304	303	302	302	318.3	...	...
Unemployment rate *(% lab. force)*	5.4	3.6	3.6	3.5	3.5	3.5	3.8	3.9	3.7
Employment-population ratio *(% pop. > 16 years)*	58.4	60.0	60.0	60.1	60.2	60.3	60.4	60.2	60.5
Trade balance [1] *(% GDP)*	–3.6	–3.7	–3.7	–3.6	–3.5	–3.3	–3.0	–2.9	...
Prices									
Headline inflation	4.7	8.0	7.1	6.7	6.3	5.8	3.7	3.2	...
Core inflation	3.6	6.2	6.0	5.7	5.6	5.6	4.1	4.0	...

JAPAN

	2021	2022	Q4 2022	Q1 2023	Q2 2023	Q3 2023	09/23	10/23	11/23
Activity									
Real GDP	2.6	1.0	0.5	2.5	2.2	1.5	–	–	–
Consumer confidence *(value)*	36.3	32.2	30.4	30.7	31.2	32.2	35.2	35.7	36.1
Industrial production	5.8	0.0	0.7	–1.8	–1.8	–2.0	–3.4	–0.9	...
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	2.6	2.5	...
Trade balance [1] *(% GDP)*	–0.3	–3.7	–3.8	–4.0	–4.0	–4.0	–2.4	–2.1	...
Prices									
Headline inflation	–0.2	2.5	3.9	4.1	3.9	3.6	3.0	3.3	...
Core inflation	–0.5	1.1	2.8	3.0	3.2	3.5	4.3	4.0	...

CHINA

	2021	2022	Q4 2022	Q1 2023	Q2 2023	Q3 2023	09/23	10/23	11/23
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	10.7	4.2	5.5	7.6	...
Industrial production	9.3	3.4	2.8	3.2	4.5	4.2	4.5	4.6	...
PMI manufacturing *(value)*	50.5	49.1	48.1	51.5	49.0	49.7	50.2	49.5	49.4
Foreign sector									
Trade balance [1,2]	681	899	899	947	944	898	901.6	871.7	868.8
Exports	30.0	7.1	–6.8	0.1	–5.4	–10.8	–6.2	–7.9	–1.4
Imports	30.0	0.7	–6.9	–7.1	–6.8	–8.5	–6.2	3.0	–0.6
Prices									
Headline inflation	0.9	2.0	1.8	1.3	0.1	–0.1	0.0	–0.2	–0.5
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	7.2

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	09/23	10/23	11/23
Retail sales *(year-on-year change)*	5.4	1.0	–2.7	–2.7	–1.9	–1.8	–2.9	–1.1	...
Industrial production *(year-on-year change)*	9.9	2.2	2.0	0.4	–1.2	–4.8	–6.9	...	...
Consumer confidence	–7.5	–21.9	–26.9	–26.9	–26.9	–26.9	–17.7	–17.8	–16.9
Economic sentiment	110.7	101.9	96.5	96.5	96.5	96.5	93.4	93.5	93.8
Manufacturing PMI	60.2	52.1	47.1	48.2	44.7	43.2	43.4	43.1	44.2
Services PMI	53.6	52.1	49.0	52.8	54.4	49.2	48.7	47.8	48.7
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	6.5	6.5	...
Germany *(% labour force)*	3.6	3.1	3.0	2.9	2.9	3.0	3.1	3.1	...
France *(% labour force)*	7.9	7.3	7.2	7.1	7.3	7.4	7.3	7.3	...
Italy *(% labour force)*	9.5	8.1	7.8	7.9	7.7	7.6	7.6	7.8	...
Real GDP *(year-on-year change)*	6.1	3.5	1.8	1.3	0.6	0.0	–	–	–
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	0.9	1.2	0.6	–	–	–
Italy *(year-on-year change)*	8.6	3.9	1.6	2.1	0.3	0.1	–	–	–

Prices

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

	2021	2022	Q4 2022	Q1 2023	Q2 2023	Q3 2023	09/23	10/23	11/23
General	2.6	8.4	10.0	8.0	6.2	5.0	4.3	2.9	2.4
Core	1.5	3.9	5.1	5.5	5.5	5.1	4.5	4.2	3.6

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	09/23	10/23	11/23
Current balance	3.1	–0.7	–0.7	–0.5	0.3	2.0	2.0	...	...
Germany	7.7	4.4	4.4	4.6	5.3	8.6	8.6	...	...
France	0.4	–2.0	–2.0	–1.9	–1.8	–2.0	–2.0	–3.2	...
Italy	2.4	–1.5	–1.5	–1.4	–1.1	–0.1	–0.1	...	...
Nominal effective exchange rate[1] *(value)*	**94.3**	**90.9**	**91.9**	**93.3**	**94.6**	**95.9**	**95.5**	**95.0**	**95.2**

Credit and deposits of non-financial sectors

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

	2021	2022	Q4 2022	Q1 2023	Q2 2023	Q3 2023	09/23	10/23	11/23
Private sector financing									
Credit to non-financial firms[2]	3.5	6.7	7.8	5.7	3.9	1.0	0.2	–0.3	...
Credit to households[2,3]	3.8	4.4	4.0	3.2	2.1	1.0	0.8	0.6	...
Interest rate on loans to non-financial firms[4] *(%)*	1.2	1.8	2.9	3.8	4.5	5.0	5.0	5.2	...
Interest rate on loans to households for house purchases[5] *(%)*	1.3	2.0	2.9	3.7	4.3	4.7	4.7	4.8	...
Deposits									
On demand deposits	12.8	6.3	1.4	–3.9	–8.1	–11.3	–11.4	–11.5	...
Other short-term deposits	–0.8	4.5	12.0	17.6	22.5	23.2	21.9	21.4	...
Marketable instruments	11.6	3.7	7.5	19.4	22.0	20.5	19.9	22.9	...
Interest rate on deposits up to 1 year from households *(%)*	0.2	0.5	1.1	1.9	2.5	3.0	3.1	3.3	...

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.*

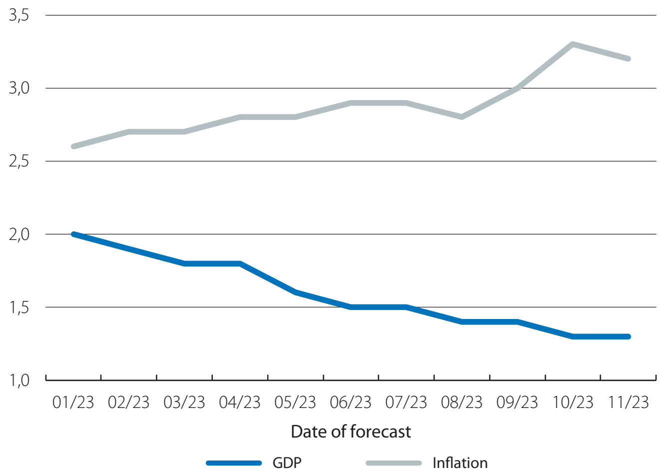
Source: *CaixaBank Research, based on data from the Eurostat, European Central Bank, European Commission, national statistics institutes and Markit.*

The Spanish economy maintains a similar growth rate to the previous quarter

We bid farewell to a better 2023 than expected, but 2024 will be fraught with challenges. This time last year, the forecasts for our economy were not exactly flattering. Still mired in a severe energy crisis, the analyst consensus in December 2022 foreshadowed GDP growth of around 0.8% for 2023 as a whole, with negative figures even expected in one of the earlier quarters of the year. Fortunately, these predictions did not materialise and all the indicators suggest that the year will end with a very respectable growth of 2.4%, largely thanks to the energy crisis dissipating quicker than expected and the boost provided by the foreign sector. However, with the sharp cumulative rise in interest rates since July 2022, totalling 450 bps, it is foreseeable that the economy will begin 2024 dragging its feet. The speed and intensity with which the ECB has had to raise rates has been reflected in the revisions of analysts' forecasts for 2024. Whereas at the beginning of 2023 the consensus estimate for GDP growth in 2024 was of around 2%, as of November 2023 it stood at 1.3%, a figure very close to CaixaBank Research's own forecast of 1.4%. However, while the impact of the interest rate rise will be significant, there will still be support factors that will allow the economy to continue to grow, albeit at a slower pace. These include the strength of the labour market, which helps to boost confidence and household incomes, and the support from European funds.

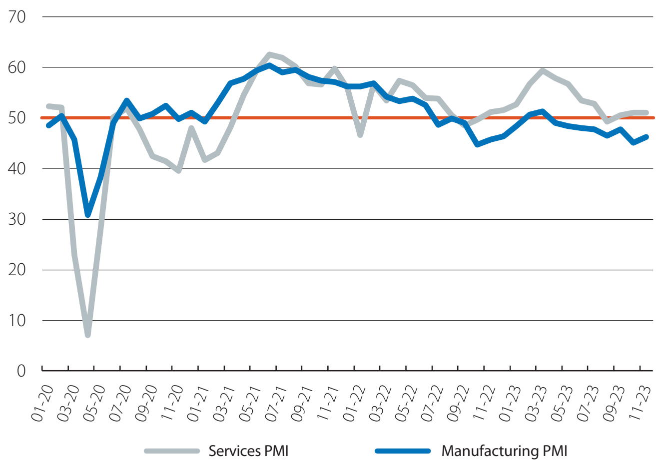
The main available economic indicators show a pattern of stability compared to the previous quarter. The PMI for the services sector recorded an average of 51.1 points between October and November, a figure very similar to that of Q3, at 50.9 points, and slightly above the threshold that denotes growth. In contrast, the counterpart indicator for the manufacturing sector weakened slightly, averaging 45.7 points so far this quarter, down from 47.3 points in the previous quarter. Industrial production, meanwhile, grew by 0.1% up until October compared to the previous quarter average (–0.6% quarter-on-quarter in Q3) and retail sales, also to October, remained flat in quarter-on-quarter terms. Within the set of consumption indicators, the durable goods segment seems to be faring somewhat better, with vehicle registrations increasing by 6.5% quarter-on-quarter based on data up to November, compared to a 4.8% increase in the previous quarter. Also, CaixaBank Research's consumption indicator, based on card data, shows a rebound in spending in November following the slump in October. Specifically, spending grew in November by 7.0% year-on-year, exceeding the average growth in Q3 of 5.5%. Finally, as we will see below, the labour market continues to generate employment, albeit at a slightly lower rate, at 0.1% quarter-on-quarter based on data up to November, compared to the 0.2% registered in Q3. Thus, with its nuances, the scoreboard of indicators shows a similar performance to the previous quarter, so it is reasonable to expect similar GDP growth as well (GDP grew by 0.3% quarter-on-quarter in Q3).

Spain: analyst consensus forecasts for 2024
Annual change (%)



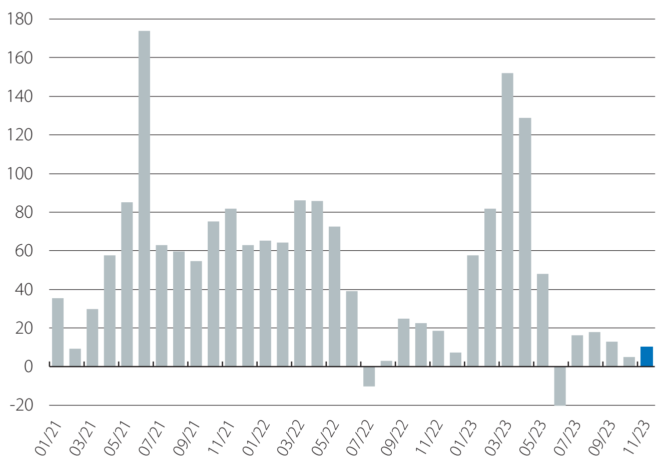
Source: *CaixaBank Research, based on data from the Consensus Forecast.*

Spain: PMI
Level



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

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



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

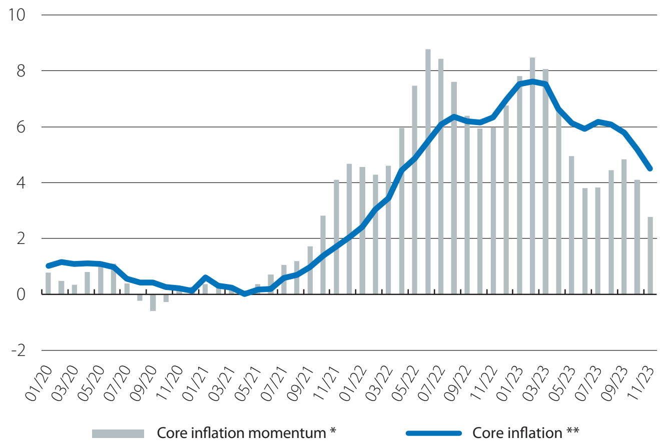
The labour market continues to perform well despite the economic slowdown. Although the number of registered workers fell in November (–11,583 people), as is commonplace before the start of the low season in the tourism sector, in seasonally adjusted terms employment continues to be created (+10,348), and the number of unemployed people continues to decline (–24,573 people). Thus, the total number of registered workers, with no seasonal adjustments, reached 20,806,074 workers, 522,443 more than a year ago, and the year-on-year rate stabilised at 2.6%.

Inflation continues to show signs of moderation. Following the upturn in inflation during Q3, partly driven by the sharp rise in oil prices between July and September, we have seen signs of moderation in both October and November. In October inflation slowed its upward trend and stabilised at 3.5% and in November it decreased by 0.3 pps to 3.2%. Although this shift is partly due to the moderation in oil prices (Brent oil is at around 82 dollars/barrel ($/b) compared to $95/b at the end of September), not everything can be attributed to this channel. Core inflation, which excludes the energy component and unprocessed food, has also shown a marked moderation, standing at 4.5% in November, after registering 5.2% in October and 5.8% in September. Also, looking at the momentum of core inflation, a measure which better reflects recent price pressures, we see that in November it stood at 2.8%, hinting at a downward trend in the year-on-year rate of the core index in the coming months.

The current account balance continued to improve in September. The current account, in 12-month cumulative terms, showed a surplus of 2.65% of GDP in September, the largest surplus since March 2018. The year-on-year comparison reveals an improvement in the balance, as a percentage of GDP, of 2.26 points. This was driven by the 3.18-pp improvement in the trade balance of goods and services, which more than offsets the 0.91-pp deterioration in the income balance, with the latter affected by the rise in interest rates. Within the trade balance, the improvements have been widespread, although the correction of the energy deficit stands out, having decreased by 1.08 pps due to the sharp fall in energy prices, which explains around 35% of the improvement in the total trade balance.

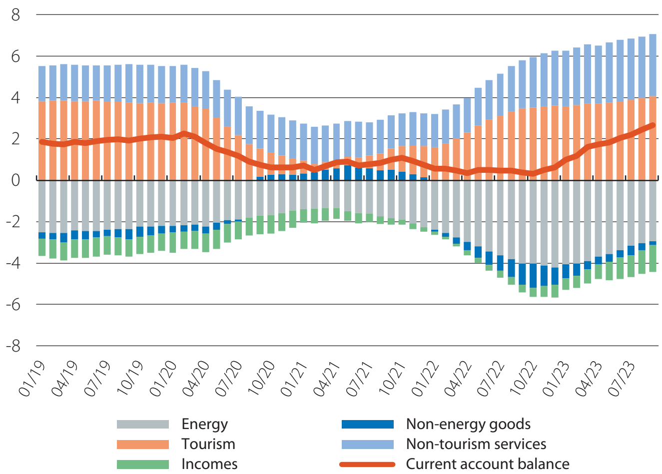
The slowdown in home prices is truncated in Q3 2023. Both the appraisal value and the transaction price of unsubsidised housing continued to show positive growth in Q3 2023 and accelerated the pace of that growth relative to the previous quarter (1.1% quarter-on-quarter vs. 0.3% in Q2 for the appraisal value, and 2.5% quarter-on-quarter vs. 2.1% in Q2 in the case of transaction prices). Thus, the year-on-year rates accelerated to 4.2% from 3.0% in Q2, in the case of the appraised value, and to 4.5% from 3.6% for transaction prices. This resilience in home prices despite the loss of momentum in demand, with an 8.5% drop in the number of sales in the year to date, appears to reflect a persistent shortage of supply, affected by the low level of planning permissions being granted for new homes.

Spain: core inflation and its momentum
(%)



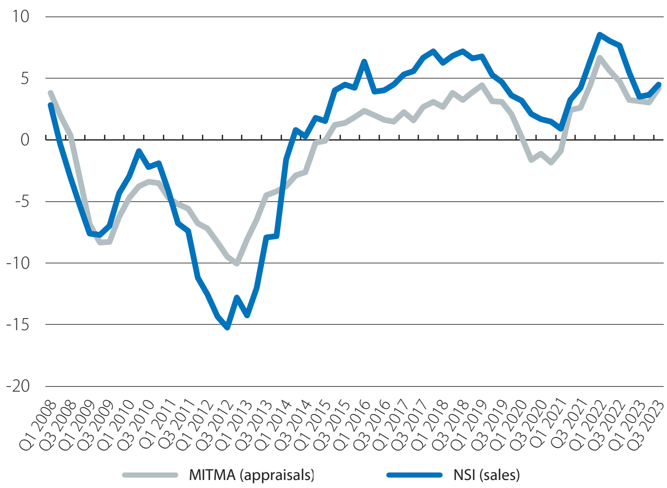
Notes: ** Core inflation momentum is the moving change in the last three months versus the previous three months. ** Core inflation excludes unprocessed food and energy.*
Source: *CaixaBank Research, based on data from the National Statistics Institute.*

Spain: current account balance
12-month cumulative balance (% of GDP)



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

Spain: home prices
Year-on-year change (%)



Source: *CaixaBank Research, based on data from the Ministry of Transport, Mobility and Urban Agenda (MITMA) and the National Statistics Institute (NSI).*

The export intensity of Spain's economic sectors

What is the current state of the foreign sector in Spain and how has it evolved in recent years? In this Focus, we analyse the changes in the export intensity of the various sectors of the Spanish economy dedicated to non-tourism goods and services.[1]

Between 2016 and 2021,[2] the period for which detailed information is available, Spanish companies' sales abroad increased by 20%, with notable increases in both exports of goods (21%) and non-tourism services (19%). The increase has been widespread, as 78% of the sectors analysed experienced an increase in sales abroad during the period. This increase corresponds to an expansion of the export base, both geographically, with sales to markets outside the EU increasing by 36% compared to 10% in the case of EU markets during the same period, and in terms of sectors, with greater internationalisation of some sectors which previously barely conducted transactions abroad.

Which sectors sell the most abroad?

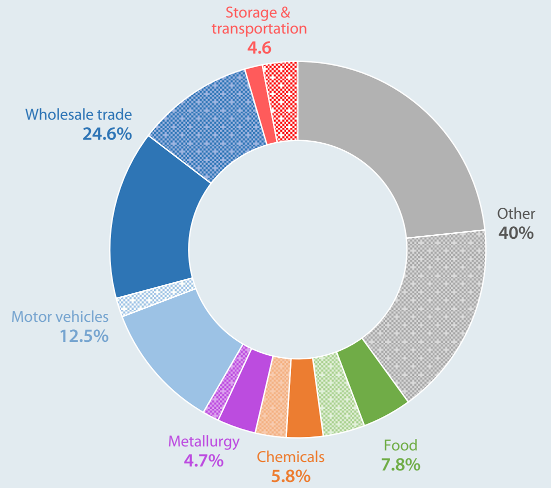
Despite the widespread improvement in foreign sales in most sectors, Spanish exports are highly concentrated in six sectors (food, metallurgy, chemicals, motor vehicle manufacturing, storage and transportation, and wholesale trade), which account for 60% of Spanish firms' total foreign turnover.

If we look at the evolution between 2016 and 2021, of particular note is the increase in the relative weight of Spanish exports in the storage and transportation sector (+1.6 pps), while the automotive industry has seen its role reduced (–3 pps).

Export intensity: a more granular analysis

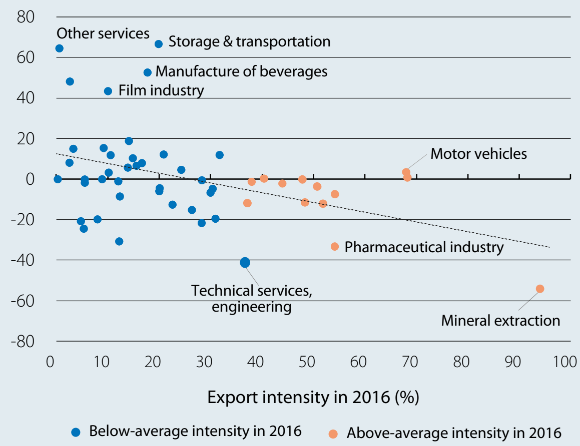
Although revealing, the data presented above fail to show the importance of foreign markets for many sectors. Given that a sector's foreign turnover will depend on its overall size, those sectors which export a significant portion of their production but have a low total turnover are not represented. In order to analyse the situation in greater detail, we use a measure known as export intensity, which is the ratio between the foreign turnover and the total turnover of each sector.[3] In this way, we can quantify the role of foreign trade in each sector, free of the distortions caused by their total turnover. Using this measure, the export intensity of all

Spain: structure of exports by sector and destination



Note: *The coloured areas without dots denote the percentage of foreign sales destined for the EU, while the areas with dots denote the percentage for non-EU destinations.*
Source: *CaixaBank Research, based on data from the National Statistics Institute.*

Spain: changes in export intensity
Change in 2016-2021 (%)



Source: *CaixaBank Research, based on the Structural Business Statistics for the Trade, Services and Industrial Sectors, compiled by the National Statistics Institute.*

sectors as a whole decreased by 3 pps during the period 2016-2021. However, this reduction has been mainly due to the fall in the export intensity of the manufacturing and extractive industries, which account for a large portion of total exports. In contrast, the export intensity of smaller sectors has increased considerably, such as in the case of beverage manufacturing (+9 pps), the film industry (+4 pps) and storage and transportation (+13 pps), where exports now account for a third of their total sales.

1. We exclude, for example, tourism services such as hotels and restaurants.
2. Data from the Structural Business Statistics for the Trade, Services and Industrial Sectors, compiled by the National Statistics Institute.
3. We define export intensity $Int = \frac{Turnover_{foreign}}{Turnover_{Total}}$

There has thus been a convergence among sectors, and the differences in export intensity between sectors are now at a minimum. Those sectors which had lower export intensity[4] at the beginning of the period show higher growth (+1 pp) during the period than those which began with greater intensity (–5 pps). The foreign sector is now a more essential market for more economic sectors and reflects the expansion of the Spanish economy's export base.

During the period analysed, export intensity grew more in non-tourism service activities (+1 pp) than it did in the case of manufacturing and the trade of goods, which on average experienced a reduction in export intensity (–3 pps), thus consolidating non-tourism services as a major driver of Spain's foreign trade.

Features of sectors with high export intensity

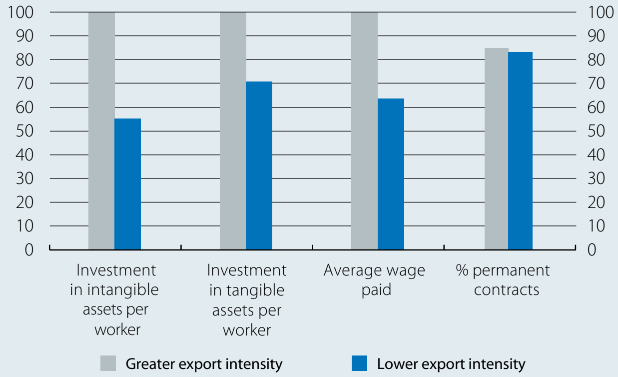
The business characteristics observed in sectors with above-average export intensity are markedly different to those observed in sectors with lower intensity.

In particular, companies in sectors with higher export intensity invest more, in both tangible and intangible assets, and in the latter case contribute to greater human capital formation. They create more high-quality employment, since a larger portion of their workforce are employed on permanent contracts (although the difference is small) and they incur higher expenditure on wages and social security contributions per employee. In addition, on average the sectors with higher export intensity have a much higher number of large companies (3%) than those with lower export intensity (0.3%).

Erik Solé

Spain: business characteristics according to export intensity

(100 = data for companies with greater export intensity) *(pps for permanent employment contracts)*



Note: *Sectors with a greater export intensity denote those sectors of the Spanish economy in which the export intensity is above the average of all the sectors considered in 2021.*
Source: *CaixaBank Research, based on data from the National Statistics Institute (INE) and the Ministry of Inclusion, Social Security and Migration (MISSM).*

4. The 25 sectors with the lowest export intensity out of the sample of 51 sectors.

Activity and employment indicators

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

	2021	2022	Q4 2022	Q1 2023	Q2 2023	Q3 2023	09/23	10/23	11/23
Industry									
Industrial production index	8.8	2.8	0.8	1.3	–1.8	–2.2	–1.4	...	...
Indicator of confidence in industry *(value)*	0.6	–0.8	–5.3	–4.4	–5.3	–8.3	–8.7	–8.6	–9.7
Manufacturing PMI *(value)*	57.0	51.0	45.6	50.1	48.5	47.3	47.7	45.1	46.3
Construction									
Building permits *(cumulative over 12 months)*	4.7	15.4	2.6	–1.8	1.7	4.2	3.6	...	...
House sales *(cumulative over 12 months)*	9.6	29.0	17.4	10.2	3.5	–3.0	–5.7	...	...
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	21.8	19.7	...
Services PMI *(value)*	55.0	52.5	50.8	56.3	56.0	50.9	50.5	51.1	...
Consumption									
Retail sales	5.1	0.9	2.0	6.7	6.1	6.9	6.3	5.0	...
Car registrations	158.0	–3.0	2.6	45.5	9.9	6.9	2.3	18.1	7.0
Consumer confidence index *(value)*	–12.9	–26.5	–27.9	–22.7	–19.2	–15.8	–20.3	–19.8	–19.6
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	2.7	2.6	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	09/23	10/23	11/23
General	3.1	8.4	6.6	5.1	3.1	2.8	3.5	3.5	3.2
Core	0.8	5.1	6.5	7.6	6.2	6.0	5.8	5.2	4.5

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	09/23	10/23	11/23
Trade of goods									
Exports *(year-on-year change, cumulative over 12 months)*	21.2	22.9	22.9	20.5	12.3	4.5	4.5	...	...
Imports *(year-on-year change, cumulative over 12 months)*	24.8	33.4	33.4	24.0	10.7	–1.2	–1.2	...	...
Current balance	**9.3**	**8.2**	**8.2**	**22.1**	**28.8**	**37.4**	**37.4**	**...**	**...**
Goods and services	11.8	16.3	16.3	31.6	43.3	55.5	55.5	...	...
Primary and secondary income	–2.5	–8.1	–8.1	–9.5	–14.5	–18.1	–18.1	...	...
Net lending (+) / borrowing (–) capacity	**20.1**	**20.7**	**20.7**	**36.3**	**42.7**	**50.8**	**50.8**	**...**	**...**

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	09/23	10/23	11/23
Deposits									
Household and company deposits	6.1	4.9	3.8	1.7	0.4	–0.3	0.1	...	...
Sight and savings	10.3	7.9	5.0	0.3	–4.0	–6.9	–6.8	–7.7	...
Term and notice	–24.4	–19.7	–7.3	7.7	40.1	69.5	74.2	79.5	...
General government deposits	15.5	9.6	–3.2	7.4	6.8	11.3	14.6	14.2	...
TOTAL	**6.7**	**5.2**	**3.2**	**2.1**	**0.8**	**0.5**	**1.1**	**...**	**...**
Outstanding balance of credit									
Private sector	0.3	0.7	0.5	–0.9	–2.2	–3.4	–3.5	–3.9	...
Non-financial firms	1.1	0.9	0.9	–1.0	–2.7	–4.6	–4.8	–5.6	...
Households - housing	0.2	1.0	0.2	–1.2	–2.4	–3.4	–3.3	–3.3	...
Households - other purposes	–1.2	–0.6	–0.1	–0.1	–0.4	0.0	–0.4	–1.0	...
General government	15.3	0.2	–1.1	–0.2	–3.3	–4.6	–4.1	–5.9	...
TOTAL	**1.1**	**0.7**	**0.4**	**–0.9**	**–2.3**	**–3.4**	**–3.5**	**–4.0**	**...**
NPL ratio (%) [4]	**4.3**	**3.5**	**3.7**	**3.5**	**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 fall in foreign demand weighs down growth in Portugal

The National Statistics Institute confirms a 0.2% contraction in GDP in Q3 and a slowdown in year-on-year growth to 1.9%. The fall in GDP was due to a negative contribution to quarter-on-quarter growth (–1.3 pps) from foreign demand, as a result of the decline in exports (–2.3%), both in the case of goods (–1.4%) and services (–3.9%). In the former case, this is a one-off decline due to the two-week production stoppage at Autoeuropa. Domestic demand, meanwhile, improved its contribution to GDP to 1.0 pp (0.4 pps of which comes from the increase in inventories), thanks to the growth of gross fixed capital formation (0.6%) and consumption, both private (0.5%) and public (0.9%).

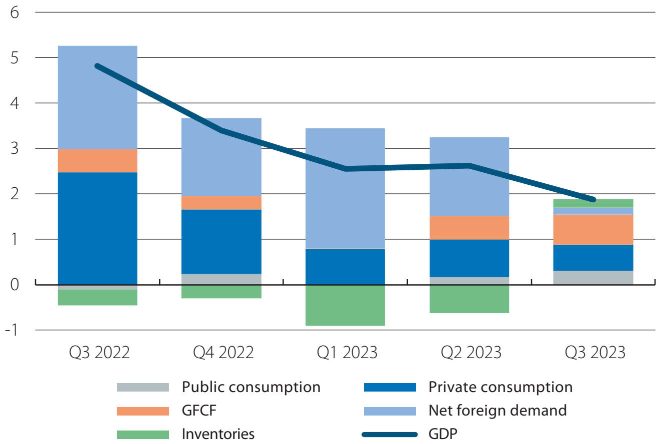
Inflation, in sharp decline. The latest data are very encouraging: the preliminary estimate for November indicates a headline inflation of 1.6%; we have to go back to October 2021 to find a rate below 2%. Although the November figure is partly explained by the base effect in food prices, the inflation decline extends across the entire basket of components (the core components fell by 0.2% monthly). While we expected negative inflation rates in energy, Brent prices have fallen more sharply than expected, even after the upheaval triggered by the conflict in the Middle East. Consequently, we expect average inflation in 2023 to be an improvement on our current forecast (4.6%).

The labour market loses momentum in the closing stages of the year. Job creation moderated in October to a year-on-year rate of 1.1%, with a quarter-on-quarter fall of 0.2%. The unemployment rate, meanwhile, increased by 0.1 pp to 6.7%, although it remains at historically low levels and in line with the 2019 average. The number of layoffs surpassed 10,400 in October, the highest number since May 2022 and above the October average for the last five pre-pandemic years (879 people).

The current account balance continues to recover. In the first nine months of the year it accumulated a surplus of 3,943 million euros, an improvement of 6,890 million compared to the previous year. This was thanks to the lower deficit in the energy balance (due to the drop in prices) and the greater surplus in services, including both tourism and other sectors. As a percentage of GDP, we estimate that the current account will register a surplus in this period of 2.0%.

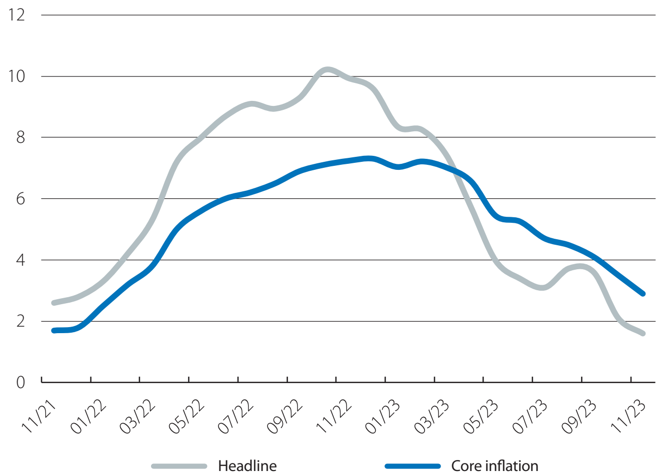
Mixed signals from the tourism sector in Q3. In the first nine months of 2023, total tourist accommodation revenues exceeded 4,800 million euros, the highest recorded in that period, and in August overnight stays broke a new record, at over 10 million. However, resident tourism is showing weaker behaviour, with a stagnation in the number of tourists in Q3 and a 4% year-on-year decrease in overnight stays by resident tourists. For 2023 as a whole, we expect the main tourism indicators to surpass the pre-pandemic levels, while for 2024 we anticipate more modest growth, in line with the economic slowdown in the main source markets.

Portugal: contribution to year-on-year GDP growth by component
Year-on-year change (%) and pps



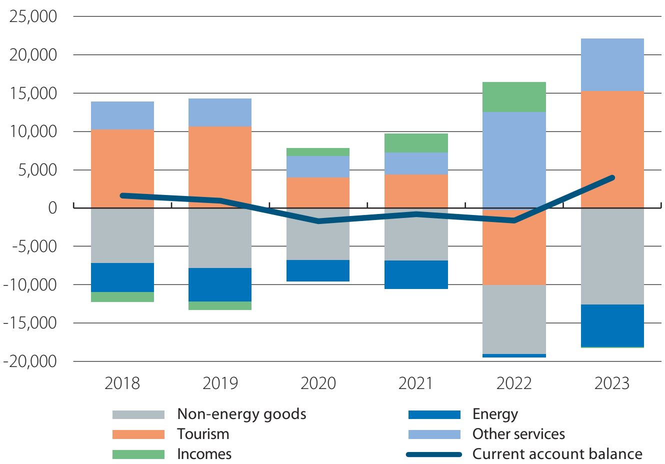
Source: *CaixaBank Research, based on data from the National Statistics Institute of Portugal.*

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



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

Portugal: current account balance
(EUR millions)



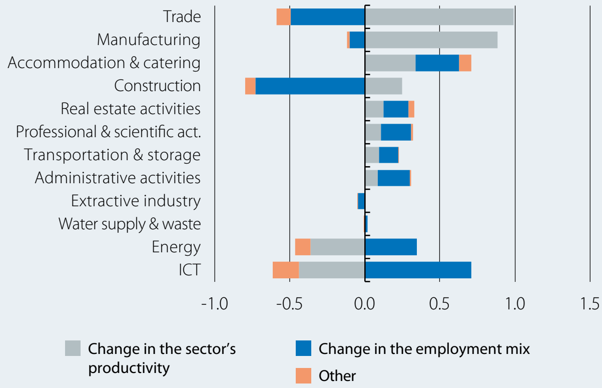
Note: *2023 data up to September.*
Source: *CaixaBank Research, based on data from the National Statistics Institute of Portugal.*

Unravelling the behaviour of Portugal's economic productivity

Portugal continues to stand out among its European counterparts for its low productivity. In 2019 it ranked ninth from the bottom among all EU countries, with an output generated per worker equivalent to 26,500 euros,[1] well below that of Spain (43,400 euros) or Estonia (which in 2010 was 18% below Portugal and in 2019 lies 23% above, with 32,700 euros per worker). Although Portugal's productivity has increased by 10% in the last 10 years, implying an average annual growth of around 1%, this is the fourth-worst performance in all of the EU.

An economy's total productivity can be improved in two ways: by increasing productivity in the various economic sectors or by shifting employment from less productive sectors to others with higher productivity. In this Focus, we analyse what has been the basis of the improvement in Portugal's productivity between 2010 and 2019.

Portugal: contribution of each factor and sector to the increase in total productivity between 2010 and 2019
(pps)



Notes: *The increase in productivity between 2010 and 2019 was 10.3%. This chart shows the contribution of each factor and economic sector to this change.*
Source: *CaixaBank Research, based on data from Eurostat.*

The improvement in the individual productivity of the different economic sectors has been the main factor...

In Portugal, the improvement in the economy's overall productivity between 2010 and 2019 occurred both because of the change in the structure of employment by sector and, above all, because of the improvement in productivity in virtually all economic sectors.

The first chart shows that trade was the sector that made the biggest contribution to the increase in total productivity during the period analysed, with an increase in gross value added (GVA) of more than 18% and a fall in employment of 0.5%. Trade was closely followed by manufacturing, with increases in GVA and employment of around 25% and 8%, respectively. In addition, accommodation and catering and the construction sector, in that order, provided a positive contribution to the improvement in productivity, albeit to a lesser extent than the two aforementioned sectors.

On the other hand, there were two sectors which made negative contributions to Portugal's productivity: ICT and energy supply. In the former case, both its GVA and employment increased significantly, but the growth in employment was far greater, at almost 54%; in the case of energy, employment increased significantly, but GVA decreased slightly. However, despite a more than 20% drop in productivity in both cases, these two sectors remain the most productive in the Portuguese economy.

It is also important to note that, in addition to these two sectors, the water supply and waste, transportation and storage, real estate and manufacturing sectors had a productivity level that exceeded that of the country as a whole. Furthermore, in 2019, over 95% of the employed population worked in sectors where productivity had increased.

... although the change in the sectoral composition of employment has also played a positive role

The contribution to the increase in productivity derived from the change in the sectoral composition of employment has been less significant than the effect mentioned above, but it has nonetheless been positive, unlike what has happened, for instance, in Spain.[2] If the structure of employment observed in 2010 had remained unchanged in 2019, then the country's total productivity would have been 1.5% lower than the level actually achieved.

1. The analysis carried out in this Focus only considers the sectors that make up the market economy considered by Eurostat, excluding financial and insurance activities, which means that general government administrations and the agriculture and fishing industries are also excluded. The choice of this period arises from the information available in Eurostat's structural business statistics, only up until 2020, a year which we excluded from our analysis due to the distortions caused by the pandemic.

2. The change in the sectoral composition of employment in Spain made a negative contribution, of –1.2 pps, to the evolution of total productivity in the country, i.e. productivity in 2019 would have been 1.2% higher if the employment structure of 2010 had been maintained. For further information, see the Focus «Sectoral specialisation penalises the productivity of the Spanish economy» in the MR11/2023.

This situation is primarily explained by the increase in employment in ICT,[3] the sector with the second highest productivity per worker (105% above the national productivity). Although to a lesser extent, increases in employment in the energy sector, as well as in accommodation and catering, also made a positive contribution to the productivity gains. On the other hand, the construction and trade sectors made a negative contribution, because there was a fall in employment in these two sectors.

This analysis of the composition of employment allows us to go further in our conclusions; in fact, the sectoral change in employment could have had a more positive impact if the employment growth had been channelled into more productive sectors. As an example, if the employment generated in the accommodation and catering sector had been channelled into a sector with higher productivity, such as ICT, then productivity growth could have reached 15%.

The comparison with Finland puts us in a bad position

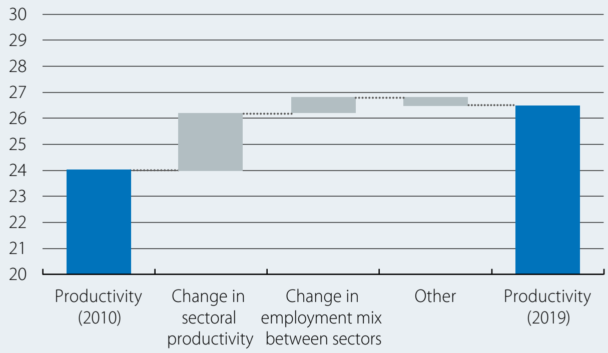
The increase in productivity in the Portuguese economy between 2010 and 2019 (10.3%) falls short of the increase observed in the Finnish economy over the same period (13.4%).[4] As a result, the productivity gap between the two economies has widened: the productivity of the Portuguese economy was around 60% lower than that of Finland in 2010 and has slipped to 61% lower in 2019.

Most of this difference is explained by the lower productivity of Portugal's economic sectors compared to those of Finland, particularly manufacturing, trade and construction, while the sectors with the closest productivity levels were the extractive and energy supply industries. If Portugal had Finland's labour specialisation, then the productivity of the Portuguese economy would be 13.5% higher; that is, the productivity gap relative to the Finnish economy would be reduced to 55.6% (still a very wide gap). However, if Portugal's economic sectors had a productivity level equivalent to that registered in the same sectors in Finland, and if we maintained Portugal's employment structure in 2019, then the gap with respect to Finland would be reduced to around 6%.

In short, Portugal faces significant productivity challenges, which reveal a limited capacity to generate value compared to other European countries. It is essential to implement specific strategies and investments in order to stimulate better economic performance in the country and improve the population's standard of living, and this should be done without delay. After all, if productivity in the countries of Europe evolves over the next 10 years at the same rate as it did between 2010 and 2019, Portugal will fall to penultimate position in the EU ranking, ahead of only Greece.

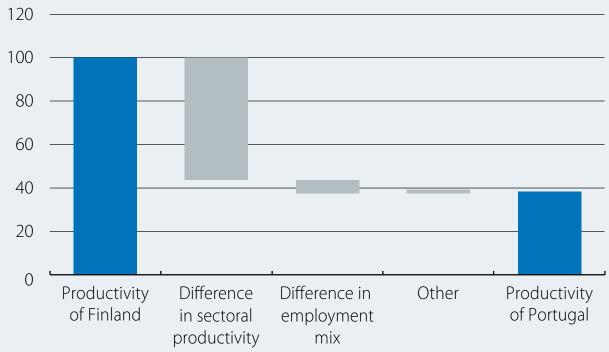
Vânia Duarte

Portugal: breakdown of productivity growth between 2010 and 2019
(EUR thousands per worker)



Note: *We have broken down the productivity growth between 2010 and 2019 into (1) the change in productivity within each sector and (2) the change in the employment mix – or the relative weight of employment – between the various sectors of the economy.*
Source: *CaixaBank Research, based on data from Eurostat.*

Portugal and Finland: breakdown of the productivity gap in 2019
(100 = Finland)



Note: *We have broken down the productivity gap between Portugal and Finland into (1) the difference in productivity in each sector and (2) the difference in the employment mix between the various sectors of the economy.*
Source: *CaixaBank Research, based on data from Eurostat.*

3. Employment in this sector increased from 2.5% of the total employment in the economy in 2010 to 3.5% in 2019.
4. We have chosen to use Finland for a comparison with Portugal as it accounts for a similar proportion of the euro area's total GDP.

Activity and employment indicators

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

	2021	2022	Q4 2022	Q1 2023	Q2 2023	Q3 2023	09/23	10/23	11/23
Coincident economic activity index	3.6	5.8	4.2	4.0	4.2	4.2	4.0	2.8	...
Industry									
Industrial production index	4.5	0.4	–0.3	1.0	–5.0	–4.7	–6.3	–1.0	...
Confidence indicator in industry *(value)*	–5.3	–3.4	–6.3	–5.0	–5.6	–9.4	–9.7	–10.2	–9.1
Construction									
Building permits - new housing (number of homes)	13.5	6.2	13.6	9.0	–1.2	–63.6	8.4	...	...
House sales	20.5	1.3	–16.0	–20.8	–22.9	...	–	–	–
House prices *(euro / m^2 - valuation)*	8.6	13.8	13.6	12.9	9.1	8.1	7.8	8.2	...
Services									
Foreign tourists *(cumulative over 12 months)*	51.5	158.9	158.9	117.2	52.6	24.9	24.9	22.1	...
Confidence indicator in services *(value)*	0.1	15.1	9.9	11.1	13.4	5.8	2.8	–0.8	–1.0
Consumption									
Retail sales	4.9	4.8	0.0	1.7	3.0	1.5	1.2	0.7	...
Coincident indicator for private consumption	4.9	3.9	1.8	2.2	2.9	3.1	3.1	2.1	...
Consumer confidence index *(value)*	–17.2	–29.7	–37.0	–35.1	–29.4	–22.8	–22.9	–25.1	–28.2
Labour market									
Employment	2.2	2.3	1.2	1.4	2.8	2.2	1.5	1.1	...
Unemployment rate (*% labour force*)	6.7	6.2	6.6	7.2	6.1	6.1	6.6	6.7	...
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	09/23	10/23	11/23
General	1.3	7.8	9.9	8.0	4.4	3.5	3.6	2.1	1.6
Core	0.8	5.6	7.2	7.1	5.7	4.4	4.1	3.5	2.9

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	09/23	10/23	11/23
Trade of goods									
Exports *(year-on-year change, cumulative over 12 months)*	18.3	23.2	23.2	21.6	11.8	3.1	3.1	...	...
Imports *(year-on-year change, cumulative over 12 months)*	22.0	31.7	31.7	24.5	12.5	1.0	1.0	...	...
Current balance	**–1.6**	**–2.8**	**–2.8**	**–1.2**	**1.5**	**4.1**	**4.1**	**...**	**...**
Goods and services	–5.5	–4.7	–4.7	–2.8	–0.3	2.1	2.1	...	...
Primary and secondary income	3.9	1.9	1.9	1.6	1.9	2.0	2.0	...	...
Net lending (+) / borrowing (–) capacity	**2.1**	**–0.5**	**–0.5**	**1.5**	**4.5**	**7.3**	**7.3**	**...**	**...**

Credit and deposits in non-financial sectors

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

	2021	2022	Q4 2022	Q1 2023	Q2 2023	Q3 2023	09/23	10/23	11/23
Deposits [1]									
Household and company deposits	9.3	6.4	6.4	0.5	–2.1	–2.6	–2.6	–2.7	...
Sight and savings	16.3	7.3	7.3	–3.1	–9.0	–9.4	–9.4	–11.4	...
Term and notice	1.2	5.2	5.2	5.4	7.5	6.9	6.9	9.3	...
General government deposits	–4.1	12.4	12.4	11.1	1.4	5.5	5.5	8.3	...
TOTAL	**9.0**	**6.5**	**6.5**	**0.8**	**–2.0**	**–2.4**	**–2.4**	**–2.4**	**...**
Outstanding balance of credit [1]									
Private sector	2.9	1.8	1.8	0.0	–1.2	–2.0	–2.0	–2.3	...
Non-financial firms	2.2	–0.4	–0.4	–2.1	–3.5	–3.8	–3.8	–4.3	...
Households - housing	3.3	3.2	3.2	1.5	0.1	–0.9	–0.9	–1.2	...
Households - other purposes	3.0	2.9	2.9	0.0	0.4	–0.8	–0.8	–0.6	...
General government	3.8	–2.7	–2.7	–2.0	0.6	–1.4	–1.4	–3.1	...
TOTAL	**2.9**	**1.7**	**1.7**	**–0.1**	**–1.1**	**–2.0**	**–2.0**	**–2.3**	**...**
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.*

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Design and production: www.cegeglobal.com
Legal Deposit: B. 21063-1988 ISSN: 1134-1920