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ECONOMIC & FINANCIAL ENVIRONMENT

DOSSIER: NGEU EUROPEAN FUNDS: AN HISTORIC OPPORTUNITY FOR QUALITY REFORM

CaixaBank Research

MONTHLY REPORT - ECONOMIC AND FINANCIAL MARKET OUTLOOK
July-August 2021

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

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This time can and must be different

We Europeans feel that economic policy failed to live up to the circumstances during the Great Recession. Some feel this way because not all the necessary reforms were carried out – and many are still pending to this day. Others feel let down because public sector support during the crisis and the subsequent recovery was insufficient. No doubt everyone is partly right, and that explains why the frustration was widespread. This time can be different. This time must be different.

The main pieces needed for this to be the case are already on the table. The first is the decisive and rapid reaction from monetary policy, which has acted without hesitation since the beginning of the current crisis. Above all, the most differential element compared to the Great Recession is an expansive fiscal policy in all European countries. In addition to this is the European NGEU programme, which has been praised so often – and deservedly so – for the volume of funds it intends to mobilise, for the impetus that an ambitious reform agenda can offer and for the transformative potential it represents for the European institutional architecture. What is the missing piece to make this time different? Effectiveness.

The economic impact of fiscal policy is very varied. It can be virtually non-existent if the money is spent on projects that generate neither an economic nor a social return. No doubt some recent action in this regard comes to mind. But it can also become a tool for economic transformation, with a high and persistent impact. The prime example of this is the so-called Marshall Plan, but there are also many other recent examples. There are many aspects that influence whether the balance tilts one way or the other. But there is one that is key to the effectiveness of fiscal policy and in which there is ample room for improvement: the evaluation of public policies.

We must aspire to make the evaluation of public policies another ingredient in the cycle of their design, approval and implementation; to ensure that these evaluations are carried out systematically and rigorously, and that their outcome is made public and is taken into account in political decisions. The conviction that drives this reasoning: if economic policy decisions are better informed, then the economic impact of fiscal policy will be greater.

The context is pressing. With vast public deficits and high levels of debt, resources, which are always scarce, must be used even more effectively. But in addition to this warning, which is unavoidable for an economist, the current context also offers major opportunities. The development of big data techniques, machine learning and artificial intelligence is enabling the emergence of new sources of economic information which can greatly improve the ability to evaluate public policies. We can now track the evolution of economic activity in real time and with a very high level of disaggregation. This should enable us to assess the impact of public policies and correct them, if necessary, much more quickly and effectively. The indicator developed by CaixaBank Research during the pandemic to take real time measurements of changes in inequality and the effect of public sector aid can serve as a useful tool in this regard.

Beyond the elements of necessity and opportunity, we have a moral duty to use public resources in the best way possible, especially now that a very substantial portion will be obtained thanks to the solidarity of the various European countries. Public policy evaluation is a very valuable tool in this regard, as it would enable us to show, both to citizens and to European partners, that the resources are used effectively. This would improve the diminished confidence in institutions, and in the democratic system in general, and would also strengthen the European project.

The government has already made its first moves. In mid-June, the prior public consultation on the «Proposed Draft Law on the Institutionalisation of Public Policy Evaluation» was completed. Not everything is in the hands of economic policy. But it must do everything in its power to live up to the circumstances. If this is achieved, this time will be different. If not, the frustration could be difficult to digest.

Oriol Aspachs
July-August 2021

Chronology

JUNE 2021

11 G7 summit at which an agreement was reached on a global minimum tax on multinationals.
15 First issue linked to Next Generation EU, raising 20 billion euros.
Five-year truce agreed by the EU and the US in the trade dispute between Airbus and Boeing.
16 The European Commission endorses Spain's Recovery and Resilience Plan.

APRIL 2021

1 OPEC and its partners approve a gradual increase in oil production for May, June and July 2021.
27 The European Parliament gives its final approval for the agreement governing the new relationship between the EU and the United Kingdom, already in force since January.
30 Spain submits its Recovery Plan to the European Commission to gain access to NGEU funds.

FEBRUARY 2021

13 The US Senate absolves Donald Trump from impeachment for the second time.
24 Ghana is the first country to receive a vaccine package as part of COVAX, the WHO-led programme aimed at ensuring equitable access to COVID-19 vaccines among developing countries.

MAY 2021

10 New crisis between Israel and Hamas with attacks in Israel and the Gaza Strip lasting two weeks. The ceasefire was established at the end of the month.
19 The EU opens its borders to fully-immunised tourists.
20 Global Health Summit organised by the G-20 and the EU in which support was pledged for greater production and distribution of vaccines to poor countries.

MARCH 2021

5 The EU and the US suspend tariffs which they had imposed on each other in retaliation for state aid to their respective aerospace industries.
11 The ECB indicates that it will increase the rate of weekly debt purchases under the pandemic emergency purchase programme (PEPP), although it did not alter the programme's design or total capacity (1.85 trillion euros).
19 Various EU countries resume use of the AstraZeneca COVID-19 vaccine (suspended mid-month) after the European Medicines Agency reiterated its safety and efficacy.

JANUARY 2021

15 The official global COVID-19 death toll surpasses 2 million people.
20 Joe Biden takes the oath of office to become the new US president. Earlier in the month, Donald Trump supporters had stormed Congress in protest at the election results.

Agenda

JULY 2021

2 Spain: registration with Social Security and registered unemployment (June).
8 Portugal: turnover in industry (May).
9 Portugal: international trade (May).
12 Spain: financial accounts (Q1).
15 Portugal: tourism activity (May).
22 Spain: loans, deposits and NPL ratio (May).
Governing Council of the European Central Bank meeting.
27 Portugal: loans to the non-financial private sector (June).
27-28 Federal Open Market Committee meeting.
29 Spain: labour force survey (Q2).
Spain: CPI flash estimate (July).
Euro area: economic sentiment index (July).
US: GDP (Q2).
30 Spain: GDP flash estimate (Q2).
Spain: state budget execution (June).
Portugal: GDP flash estimate (Q2).
Euro area: GDP (Q2).

AUGUST 2021

2 Portugal: industrial production (June).
3 Spain: registration with Social Security and registered unemployment (July).
6 Spain: industrial production (June).
10 Portugal: turnover in services (June).
11 Portugal: employment (Q2).
13 Portugal: tourism activity (June).
Japan: GDP (Q2).
19 Spain: foreign trade (June).
25 Spain: loans, deposits and NPL ratio (June).
30 Spain: CPI flash estimate (August).
Euro area: economic sentiment index (August).
31 Portugal: GDP breakdown (Q2).

Pandexit: a different recovery

The last few weeks have confirmed that the international economy has turned a corner, and from this point on we will see a recovery begin to take shape. This will be a recovery with special characteristics, given the exceptional nature of both the crisis and the economic policy responses. *Pandexit* will reflect the application of expansionary fiscal programmes the likes of which have not been seen in recent decades, as well as the maintenance of extremely dovish financial conditions by the central banks, the consequences for private spending of the accumulation of forced savings, and the acceleration of the digitalisation process of our economies. We must also not forget that the optimisation of the recovery's path, and therefore the amplification of the effect of fiscal multipliers, will only be achieved by applying the economic reforms that have been postponed so many times before (see the Dossier of this *Monthly Report*). This would make it easier for the revival to be inclusive and environmentally neutral.

Right now, in this initial phase of recovery, the visibility is still low and therefore the decision has rightly been taken to stay on the current course and not change the tone of the recipes applied since the beginning of the crisis. The is still a lot of noise and it is affecting the behaviour of economic variables, with higher than expected indicators both in prices and, for example, in confidence levels, where we are witnessing the highest levels of business optimism in almost a decade and a half. This is normal, taking into account the mismatch caused by the pandemic in the global supply and in the operation of supply chains, with effects on logistics, stock management, the supply of essential commodities (semiconductors), etc. The return to normal should go hand in hand with the opening up of the bottlenecks caused by the rapid recovery in demand. The reality is that, only a year after the recession began, trade in goods and services has recovered to pre-COVID levels, whereas this took almost 24 months in the financial crisis of the late 1990s. This is a sign that we are unlikely to see a regression in the globalisation process, beyond the logical adjustments to reduce the fragility of supply chains.

The economic authorities have rightly decided that it is preferable not to rush and rather to wait and see how the economic variables evolve from the summer onwards, following the buoyant rebound in economic activity we expect to see in the middle of the year. The only urgent matter remains getting the pandemic under control, as the proportion of the population that has been vaccinated in most of the emerging world, with the exception of part of Eastern Europe and the Middle East, is very low. This makes them vulnerable to the delta variant, which spreads rapidly and introduces significant downside risks to their growth outlook. Therefore, the short-term priority is to increase the percentage of the vaccinated population, an indispensable means of limiting mutations of the virus which push back the point at which full herd immunity will be achieved. In this regard, with only 28% of the world's population having received at least one dose, the IMF has estimated the cost of the global immunisation programme at 50 billion dollars, with a potential positive effect on global economic activity of around 9 trillion dollars in 2025.

In this context, the most relevant developments in recent weeks have been the rapid expansion of the delta variant of the virus, the new upward revision of nominal growth forecasts in the US and Europe, and, most notably, the beginning of a subtle shift in the tone of the Fed which marks the starting pistol for the most complex monetary normalisation process in history, with potential implications for global financial stability. What is important, beyond economists' assessments of whether the US central bank is behind the curve with inflation reaching the psychologically significant level of 5%, is that the markets, at least for now, continue to buy the message of inflationary transience. This is demonstrated by the 10-year US bond remaining around the 1.5% mark and medium-term inflation expectations remaining perfectly anchored (at around 2.5%). In other words, an ideal «Goldilocks» scenario is still expected, characterised by long-lasting and high growth, a temporary inflation shock, and monetary authorities that are extremely cautious with the exit strategy, lifting the foot off the accelerator gently. This outlook continues to support the good performance of the markets, but the slightest doubt among investors regarding the transitory nature of the rebound in inflation could lead to corrections in financial assets prices, especially in the summer, when the reduction in liquidity increases the sensitivity to negative surprises.

In short, in this first half of the year it has been certified that the world's major economies will recover in 2021 the GDP levels lost in the crisis. However, over the coming months we will continue to face a difficult scenario, subject to the effects of potential mutations of the virus and the imbalances that the disruptions in global production chains could be causing. This is a far cry from the uncertainty of a year ago, when we doubted the effectiveness of the vaccines, or even the pre-crisis concerns about the risk of a situation like that endured in Japan or one of secular stagnation.

José Ramón Díez Guijarro

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

Financial markets

	Average 2000-2007	Average 2008-2017	2018	2019	2020	2021	2022
INTEREST RATES							
Dollar							
Fed funds (upper limit)	3.43	0.55	2.50	1.75	0.25	0.25	0.25
3-month Libor	3.62	0.75	2.79	1.91	0.23	0.25	0.45
12-month Libor	3.86	1.26	3.08	1.97	0.34	0.50	0.80
2-year government bonds	3.70	0.80	2.68	1.63	0.13	0.25	0.50
10-year government bonds	4.70	2.58	2.83	1.86	0.93	2.00	2.10
Euro							
ECB depo	2.05	0.32	–0.40	–0.50	–0.50	–0.50	–0.50
ECB refi	3.05	0.90	0.00	0.00	0.00	0.00	0.00
Eonia	3.12	0.55	–0.36	–0.46	–0.47	–0.45	–0.45
1-month Euribor	3.18	0.67	–0.37	–0.45	–0.56	–0.48	–0.43
3-month Euribor	3.24	0.85	–0.31	–0.40	–0.54	–0.50	–0.40
6-month Euribor	3.29	1.00	–0.24	–0.34	–0.52	–0.48	–0.38
12-month Euribor	3.40	1.19	–0.13	–0.26	–0.50	–0.45	–0.35
Germany							
2-year government bonds	3.41	0.55	–0.60	–0.63	–0.73	–0.60	–0.45
10-year government bonds	4.30	1.82	0.25	–0.27	–0.57	–0.25	0.00
Spain							
3-year government bonds	3.62	2.06	–0.02	–0.36	–0.57	–0.26	–0.06
5-year government bonds	3.91	2.59	0.36	–0.09	–0.41	–0.10	0.12
10-year government bonds	4.42	3.60	1.42	0.44	0.05	0.35	0.50
Risk premium	11	178	117	71	62	60	50
Portugal							
3-year government bonds	3.68	4.02	–0.18	–0.34	–0.61	–0.16	0.05
5-year government bonds	3.96	4.67	0.47	–0.12	–0.45	–0.11	0.14
10-year government bonds	4.49	5.35	1.72	0.40	0.02	0.35	0.53
Risk premium	19	353	147	67	60	60	53
EXCHANGE RATES							
EUR/USD (dollars per euro)	1.13	1.29	1.14	1.11	1.22	1.17	1.17
EUR/GBP (pounds per euro)	0.66	0.83	0.90	0.85	0.90	0.87	0.85
USD/GBP (pounds per dollar)	0.59	0.64	0.79	0.76	0.74	0.75	0.72
OIL PRICE							
Brent ($/barrel)	42.3	82.5	57.7	65.2	50.2	64.0	63.0
Brent (euros/barrel)	36.4	63.2	50.7	58.6	41.3	54.7	53.8

Forecasts

Percentage change versus the same period of the previous year, unless otherwise indicated

International economy

	Average 2000-2007	Average 2008-2017	2018	2019	2020	2021	2022
GDP GROWTH							
Global	**4.5**	**3.4**	**3.6**	**2.8**	**–3.3**	**5.9**	**4.6**
Developed countries	***2.7***	***1.3***	***2.3***	***1.6***	***–4.7***	***5.3***	***4.0***
United States	2.7	1.5	3.0	2.2	–3.5	6.5	4.3
Euro area	2.2	0.7	1.9	1.3	–6.7	4.2	4.1
Germany	1.6	1.3	1.3	0.6	–5.1	3.2	3.7
France	2.2	0.8	1.8	1.5	–8.2	5.7	3.8
Italy	1.5	–0.5	0.8	0.3	–8.9	4.3	3.9
Portugal	1.5	0.0	2.9	2.5	–7.6	3.7	4.7
Spain	3.7	0.3	2.4	2.0	–10.8	6.0	4.8
Japan	1.4	0.5	0.6	0.0	–4.7	2.3	2.2
United Kingdom	2.9	1.1	1.3	1.4	–9.8	7.0	5.7
Emerging and developing countries	***6.5***	***5.1***	***4.5***	***3.6***	***–2.2***	***6.3***	***4.9***
China	10.6	8.3	6.7	6.0	2.3	8.3	5.6
India	9.7	6.8	7.3	4.8	–7.0	9.2	7.3
Brazil	3.6	1.6	1.8	1.4	–4.1	4.0	2.5
Mexico	2.4	2.1	2.2	–0.2	–8.3	4.8	2.7
Russia	7.2	0.9	2.5	1.3	–3.1	3.0	2.2
Turkey	5.4	5.1	2.8	0.9	1.6	4.3	3.4
Poland	4.2	3.4	5.4	4.8	–2.7	4.5	4.8
INFLATION							
Global	**4.1**	**3.7**	**3.6**	**3.5**	**3.2**	**3.9**	**3.3**
Developed countries	***2.1***	***1.5***	***2.0***	***1.4***	***0.7***	***2.3***	***1.7***
United States	2.8	1.7	2.4	1.8	1.2	3.7	2.3
Euro area	2.1	1.4	1.8	1.2	0.3	1.9	1.4
Germany	1.7	1.3	1.9	1.4	0.4	2.5	1.6
France	1.8	1.2	2.1	1.3	0.5	1.9	1.4
Italy	1.9	1.5	1.2	0.6	–0.1	1.5	1.3
Portugal	3.0	1.2	1.0	0.3	0.0	0.9	1.3
Spain	3.2	1.4	1.7	0.7	–0.3	1.7	1.3
Japan	–0.3	0.3	1.0	0.5	0.0	0.2	0.7
United Kingdom	1.9	2.4	2.5	1.8	0.9	1.7	1.6
Emerging countries	***6.7***	***5.6***	***4.9***	***5.1***	***5.1***	***5.1***	***4.5***
China	1.7	2.6	2.1	2.9	2.5	1.2	1.6
India	4.5	8.0	3.9	3.7	6.6	5.1	5.5
Brazil	7.3	6.1	3.7	3.7	3.2	5.5	3.8
Mexico	5.2	4.2	4.9	3.6	3.4	4.2	3.4
Russia	14.2	8.7	2.9	4.5	4.9	3.5	4.0
Turkey	27.2	8.4	16.2	15.5	14.6	14.2	8.0
Poland	3.5	2.0	1.2	2.1	3.7	4.1	3.0

Forecasts

Percentage change versus the same period of the previous year, unless otherwise indicated

Spanish economy

	Average 2000-2007	Average 2008-2017	2018	2019	2020	2021	2022
Macroeconomic aggregates							
Household consumption	3.6	–0.6	1.8	0.9	–12.4	6.6	5.0
Government consumption	5.0	0.9	2.6	2.3	3.8	3.0	0.6
Gross fixed capital formation	5.6	–2.8	6.1	2.7	–11.4	6.6	5.3
Capital goods	4.9	–0.5	5.4	4.4	–13.0	15.9	5.5
Construction	5.7	–5.2	9.3	1.6	–14.0	–0.1	5.1
Domestic demand (vs. GDP Δ)	4.5	–0.7	2.5	1.6	–8.3	5.8	4.1
Exports of goods and services	4.7	3.1	2.3	2.3	–20.2	11.4	7.7
Imports of goods and services	7.0	–0.3	4.2	0.7	–15.8	10.1	5.9
Gross domestic product	**3.7**	**0.3**	**2.4**	**2.0**	**–10.8**	**6.0**	**4.8**
Other variables							
Employment	3.2	–1.0	2.6	2.3	–7.5	5.5	3.0
Unemployment rate (% of labour force)	10.5	20.5	15.3	14.1	15.5	15.7	14.6
Consumer price index	3.2	1.4	1.7	0.7	–0.3	1.7	1.3
Unit labour costs	3.0	0.1	1.2	2.4	5.3	–1.3	0.3
Current account balance (% GDP)	–5.9	–0.8	1.9	2.1	0.7	1.5	1.6
External funding capacity/needs (% GDP)	–5.2	–0.3	2.4	2.6	2.6	1.7	1.8
Fiscal balance (% GDP)[1]	0.4	–6.7	–2.5	–2.9	–11.0	–8.6	–6.0

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

Forecasts

Portuguese economy

	Average 2000-2007	Average 2008-2017	2018	2019	2020	2021	2022
Macroeconomic aggregates							
Household consumption	1.7	0.1	2.6	2.6	–5.8	1.9	3.6
Government consumption	2.3	–0.6	0.6	0.7	0.4	2.7	0.5
Gross fixed capital formation	–0.3	–2.0	6.2	5.4	–1.8	8.8	8.1
Capital goods	6.2	2.0	9.2	4.3	–	–	–
Construction	–1.9	–4.4	4.7	7.2	–	–	–
Domestic demand (vs. GDP Δ)	1.3	–0.5	3.1	2.8	–4.6	3.4	4.1
Exports of goods and services	5.2	4.0	4.2	4.0	–18.7	8.4	8.4
Imports of goods and services	3.6	2.2	5.0	4.7	–12.0	7.5	6.3
Gross domestic product	**1.5**	**0.0**	**2.9**	**2.5**	**–7.6**	**3.7**	**4.7**
Other variables							
Employment	0.4	–0.6	2.8	1.2	–1.9	0.5	1.5
Unemployment rate (% of labour force)	6.1	11.8	7.2	6.6	7.0	7.8	7.5
Consumer price index	3.0	1.2	1.0	0.3	0.0	0.9	1.3
Current account balance (% GDP)	–9.2	–3.5	0.6	0.4	–1.2	–0.5	0.0
External funding capacity/needs (% GDP)	–7.7	–2.2	1.6	1.2	0.1	1.3	2.3
Fiscal balance (% GDP)	–4.6	–6.1	–0.3	0.1	–5.7	–4.9	–3.1

Forecasts

The markets wiegh up the Fed's message

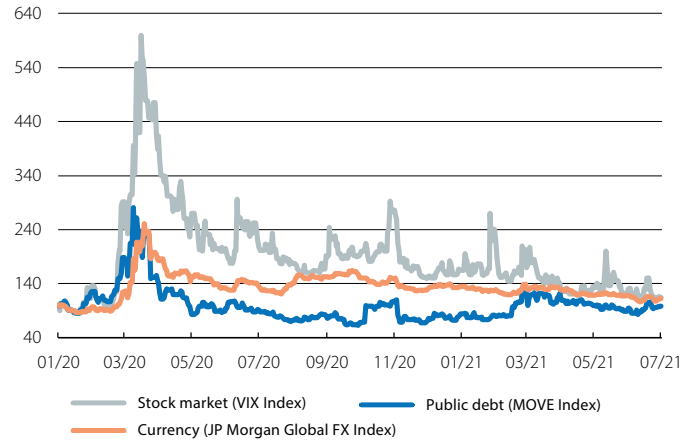
Investors maintain an optimistic inertia, although doubts persist. In June, investors remained engaged in an ongoing process of assessing the transitory nature of the inflationary pressures, the respective decisions of the Fed and the ECB, and the pace of the economy's recovery. All this took place in a context of a constant threat of the spread of new variants of COVID-19. Nevertheless, investor sentiment remained relatively optimistic thanks to the strength of the business cycle in the US, the acceleration in the euro area driven by services, and the increase in vaccinations worldwide. In this regard, financial markets showed a significant degree of complacency which fuelled risk appetite. Equities and some commodities, such as oil, registered yet another month of gains, with the permission of risk-free debt, mainly that of the US, which moderated its volatility while waiting for investors to determine whether they consider the inflationary stress to be temporary or permanent.

The Fed initiates the debate on tapering and brings forward the first rate hike. As expected, at the last FOMC meeting, the monetary institution kept interest rates unchanged (currently in the 0.00%-0.25% range) as well as the rate of monthly asset purchases (treasuries and MBSs). The Fed also acknowledged that the economic recovery has accelerated in recent months, and accordingly the Committee revised its growth forecasts for 2021 up to 7% year-on-year in Q4 (previously 6.5%), maintaining those for 2022 unchanged (3.3%). It also raised the expected inflation rate for this year (+1 pp to 3.4%), although it highlighted the transitory nature of the price increases. However, in his subsequent appearance, Jerome Powell conveyed two messages which investors interpreted as a slight shift in the Fed's monetary policy. The first was that most FOMC members voted to bring the first rate hike forward to 2023 (see chart for changes compared to the March meeting). The second was that the Committee opened the debate on a potential reduction of the asset purchase programme (tapering), in the face of the risk of a persistent increase in inflationary pressures. Over the following days there were differing statements from various members of the Fed, including from Powell himself in Congress. These finally tempered investors' spirits by underscoring the need for a further recovery in the labour market before withdrawing the monetary stimulus (see the Focus «US: (in)complete recovery of the labour market» in this same *Monthly Report*).

The ECB improves its forecasts and maintains the rate of the PEPP. At its June meeting, the ECB was also more optimistic about the euro area's macroeconomic outlook and revised its growth forecasts for 2021 and 2022 up to 4.6% and 4.7% (previously 4.0% and 4.1%, respectively). It also revised its inflation forecasts upwards (1.9% and 1.5%, previously 1.5% and 1.2%), although it considers the current rise in prices

Implicit volatility in the financial markets

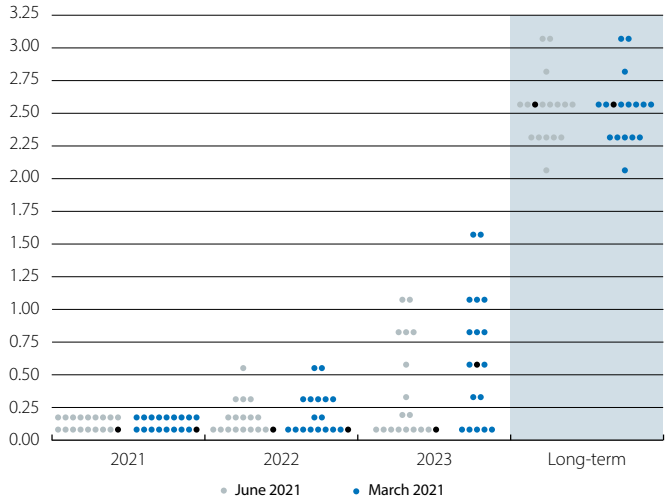
Index (100 = January 2020)



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

Federal Reserve: expected evolution of interest rates

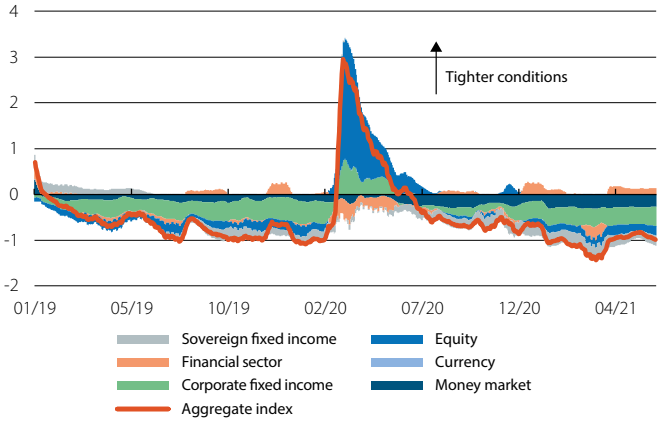
(%)



Notes: *Each point represents a voter from the Federal Reserve's Federal Open Market Committee. The median voter is marked in black.*
Source: *CaixaBank Research, based on data from the Federal Reserve.*

Financial conditions in the euro area: the CaixaBank Research index and its components

Index (0 = historical average)



Source: *CaixaBank Research.*

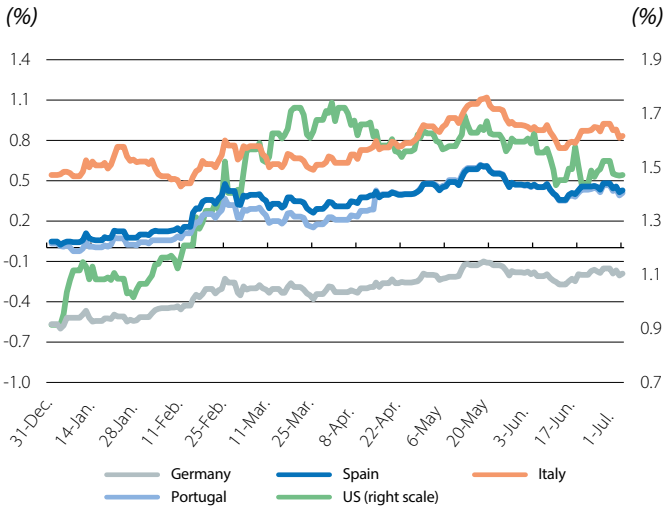
temporary. In addition, the bank chose to preserve the accommodative financial conditions in order to avoid a tightening in the event of any future sovereign interest rate hikes, thus keeping interest rates and the monetary stimuli unchanged. To this end, Christine Lagarde expressed the need to keep purchases under the PEPP in Q3 at a «significantly higher» rate than that observed at the beginning of the year (we expect it to remain at around 80 billion euros a month, as in April and May).

Fluctuations continue in the fixed-income markets. The FOMC's hawkish message initially generated a rebound in US sovereign long-term interest rates (the yield on the 10-year treasury rose by 8 bps), as well as a cooling of inflation expectations, especially in the medium term. However, the subsequent statements by several members of the Fed, including President Powell's in the US House of Representatives pointing to the transitory nature of the inflation rallies and their link to the reopening of the economy, served to calm investors' spirits and favoured a decline in treasury yields to 1.47%. In the euro area, meanwhile, the ECB's willingness to maintain the monetary stimulus, coupled with the improvement in the economic data, boosted sovereign debt yields, especially in the case of peripheral debt, resulting in a narrowing of spreads vis-à-vis Germany. In addition, the EU carried out the first debt placements to finance the NGEU programme, which were very well received among investors.

The stock markets close a good semester. Investor optimism linked to the progress in the economic recovery and the vaccination roll-out prevailed for much of June, despite doubts over inflation and high valuations in some sectors. Overall, equity markets on both sides of the Atlantic performed well, as they have done since the beginning of the year, with gains of over 2% in the S&P 500 and 5% in the Nasdaq, which reached new all-time highs. Gains in the euro area were more modest, partly due to the poorer performance of stock prices in banking and tourism sectors. Emerging-country indices, meanwhile, also registered gains driven by inflows of foreign capital and the recovery of commodities.

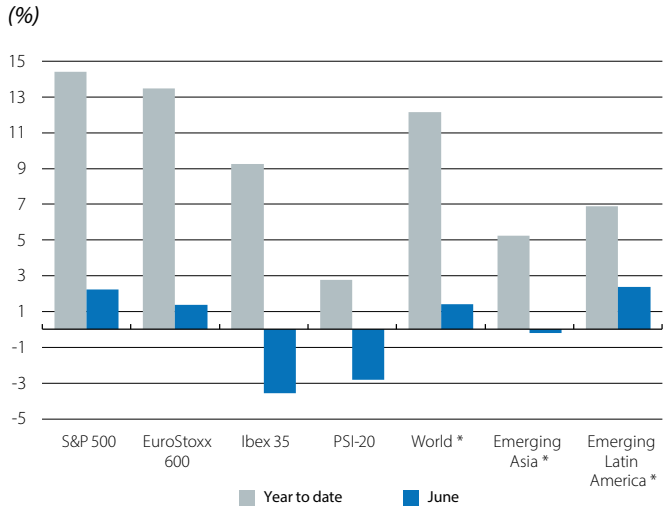
Oil and the dollar on the rise. The prospect of earlier rate hikes by the Fed and the strength of the US business cycle drove the appreciation of the dollar against other currencies for much of the month. The reassuring message from the members of the Fed did not stop the euro from reaching 1.19 dollars, its lowest in two months. Emerging currencies also bore the brunt of the dollar's strength, registering significant depreciations, with the exception of the Brazilian real which appreciated a 4%. On the other hand, the price of a barrel of Brent rose to 75 dollars, a peak in the last two and a half years. This rally was driven by the economic recovery and occurred in the run-up to the meeting between OPEC and its allies in July, when they could agree on a modest increase in production.

Yields on 10-year sovereign debt



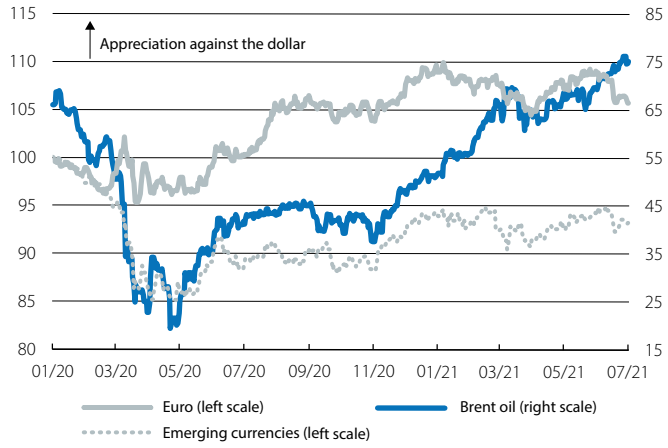
Note: *Germany, Spain, Italy and Portugal are represented on the left-hand scale.*
Source: *CaixaBank Research, based on data from Bloomberg.*

Evolution of the main stock market indices



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

International currencies against the dollar and Brent oil price



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

Does the potential rise in long-term yields pose a risk to equities?

The rise in inflation rates (especially in the US) is filling many of the financial newspapers' salmon-pink pages and triggering a whole host of reports by experts. In this situation, investors are wondering about the implications this rally could have for long-term bond yields and, ultimately, stock prices. In principle, the consensus of analysts aligns with the discourse of the major central banks, namely that this spike in inflation is expected to be transitory; there could still be one or two difficult months ahead, but it will moderate. This is the dominant message, and it appears to have the bond markets' vote of confidence, according to the trend in yields since March. However, if the rebound in inflation were stronger and/or more persistent than currently expected, how would the bond market react and how could equities be affected?

In response to the first question, experience tells us that a negative surprise in inflation is generally not well received by the fixed-income markets. Investors, in a bid to protect their expected real return, would demand higher nominal interest rates. Focusing on the US, with 10-year yields oscillating around 1.5%, it is not difficult to imagine that it could rebound to slightly above 2.0%, the level at which it was fluctuating shortly before the pandemic. Predicting higher levels, such as 3%, would be premature. The last time 10-year yields oscillated between 3.0% and 3.2% was in late 2018, when the economy's output gap was positive and the country was clearly growing above its potential (at around 3% versus a potential rate of just under 2%). At that time, the possibility of a sustained rise in inflation seemed high and the Fed had been tightening its monetary policy for some time already. Today, the economy, while recovered from the contraction experienced in 2020, still has room for improvement in several areas (see the Focus «US: (in) complete recovery of the labour market» in this same *Monthly Report*).

As for the potential impact on equities of rising long-term yields, a look to the past may be helpful. The first idea is that it is more common for the stock market to experience rallies when interest rates are rising than it is for it to suffer setbacks. Considering annual data, since 1961 there have been 10 years in which 10-year yields have risen and the S&P 500 has fallen, whereas there have been twice as many times when the S&P 500 has risen on par with IRRs.[1] The second idea is that there are other factors that could help to drive up the stock market, even if IRRs also rise, such as corporate earnings: in 86% of the years in which both the S&P 500 and yields have risen, the average earnings growth has been 10%. There have been three exceptions, in which earnings fell and the S&P 500 closed with gains, but those gains were driven by expectations of the growth that would occur in the following year (31% on average). However, it is true that a rise in yields can have a temporary negative impact on the stock market, especially in the case of a particularly sharp or unexpected rise. Reviewing the trend followed by the S&P 500 in the 12 months following the beginning of the seven cycles of rising yields we have identified since 1990 (see first table), there have been corrective episodes with a drawdown,[2] averaging 8%.

Finally, it is interesting to simulate the sensitivity of the S&P 500 to fluctuations in 10-year bond yields, on the

A look to the past: US bonds and S&P 500

Upward cycles in the US 10-year IRR (1990-2020)				Evolution of the S&P 500 *					Drawdown
Start	Duration (M)	Starting IRR	Change	–6 m.	–3 m.	During	+3 m.	+6 m.	
October 1993	13	5.32	2.62	5%	4%	–1%	5%	14%	–8.9%
January 1996	4	5.65	1.26	10%	5%	9%	1%	11%	–3.8%
October 1998	15	4.52	2.13	–7%	–11%	38%	3%	3%	–9.6%
June 2003	48	3.32	1.78	10%	17%	53%	–1%	–2%	–7.8%
December 2008	6	2.39	1.31	–35%	–28%	6%	13%	20%	**
April 2013	8	1.73	1.16	9%	6%	15%	3%	8%	–5.8%
July 2016	27	1.49	1.66	12%	4%	30%	–6%	4%	–9.7%
Averages =	**16.4**	**3.13**	**1.62**	**0%**	**2%**	**22%**	**2%**	**8%**	**–7.6%**

Notes: *The current upward cycle, which began in July 2020, may not have ended. Calculations performed up to the last monthly close. * S&P 500 returns during the upward cycle of the IRR, as well as in the 3 and 6 months before and after that cycle. ** The drawdown is not calculated because it was a year of sharp falls at the beginning of the 2008-2009 financial crisis.*
Source: *CaixaBank Research, based on data from Bloomberg.*

1. The years in which yields have experienced setbacks have not been considered in this analysis.
2. Our exercise considers the biggest drop between the high point and low point in the price series within the reference period in question.

Sensitivity analysis: 10-year bonds and S&P 500

Level of 10-year IRR

Earnings per share ($)	0.75%	0.90%	1.05%	1.20%	1.35%	1.50%	1.65%	1.80%	1.95%	2.10%	2.25%
200	5,426	5,197	4,986	4,792	4,613	4,446	4,291	4,146	4,011	3,884	3,765
198	5,372	5,145	4,937	4,744	4,566	4,401	4,248	4,105	3,971	3,845	3,728
196	5,318	5,093	4,887	4,696	4,520	4,357	4,205	4,063	3,931	3,807	3,690
194	5,264	5,041	4,837	4,648	4,474	4,312	4,162	4,022	3,891	3,768	3,652
192	5,209	4,989	4,787	4,601	4,428	4,268	4,119	3,980	3,850	3,729	3,615
190	5,155	4,937	4,737	4,553	4,382	4,223	4,076	3,939	3,810	3,690	3,577
188	5,101	4,885	4,687	4,505	4,336	4,179	4,033	3,897	3,770	3,651	3,539
186	5,047	4,833	4,637	4,457	4,290	4,135	3,990	3,856	3,730	3,612	3,502
184	4,992	4,781	4,588	4,409	4,244	4,090	3,947	3,814	3,690	3,573	3,464
182	4,938	4,729	4,538	4,361	4,197	4,046	3,905	3,773	3,650	3,535	3,426
180	4,884	4,677	4,488	4,313	4,151	4,001	3,862	3,731	3,610	3,496	3,389

Source: *CaixaBank Research.*

one hand, and anticipated earnings per share, on the other. The results are shown in the second table, which takes as a starting point the current consensus expectation for earnings per share of 190 dollars[3] and a 10-year yield of 1.5%. Given that the S&P 500 currently stands at around 4,250 points, the implicit risk premium would be 5.15%.

In the table we can see the results that would be obtained for different combinations of expected IRR and EPS, keeping the risk premium stable. It is important to understand that this is a theoretical simulation which, as such, implies a simplification of a somewhat more complex reality. In any case, of the set of possible «solutions», we focus on those highlighted in a box within the table, as they correspond to a theoretical increase in the 10-year yield within the range of 1.8%-2.1%. In these cases, and keeping the expected EPS unchanged, the S&P 500 would be correctly valued between 3,939 and 3,690 points, somewhat below current levels.

Obviously, higher earnings growth than is currently expected would tend to offset the negative effect of the rise in 10-year yields, just as a relaxation of the implicit risk premium would have a positive effect on the index's theoretical level. In this regard, the almost 1-pp rise which 10-year yields in the US have experienced since August 2020 has not stopped the S&P 500 from rallying 28% in the same period. This bullish episode has undoubtedly been influenced by the strong recovery in corporate earnings (+54% in Q1 2021 and +35% expected for 2021 as a whole) and a moderation of the implicit risk premium of 0.6 pps.[4]

As we said, this is a basic sensitivity analysis which leaves out many elements, but it nevertheless helps us to assess to what extent a rise in sovereign rates could affect the US stock market.

José Luis López

3. This is a model which discounts the cash flows that investors would receive in the S&P 500 if this were a listed stock. These flows include the dividends paid by the components of the index and share buyback transactions. It has been considered appropriate to use the average of the past five years, in which 90% of earnings per share have been used for such purposes.

4. Average figure estimated by Professor Aswath Damodaran from the Stern School of Business at New York University.

Interest rates (%)

	30-June	31-May	Monthly change (bp)	Year-to-date (bp)	Year-on-year change (bp)
Euro area					
ECB Refi	0.00	0.00	0	0.0	0.0
3-month Euribor	–0.54	–0.54	0	0.3	–12.5
1-year Euribor	–0.48	–0.48	0	1.6	–25.0
1-year government bonds (Germany)	–0.62	–0.63	0	9.0	–8.1
2-year government bonds (Germany)	–0.66	–0.66	0	3.8	–0.6
10-year government bonds (Germany)	–0.21	–0.19	–2	36.2	18.8
10-year government bonds (Spain)	0.41	0.46	–5	36.5	–9.0
10-year government bonds (Portugal)	0.39	0.46	–7	36.0	–8.3
US					
Fed funds (upper limit)	0.25	0.25	0	0.0	0.0
3-month Libor	0.15	0.13	1	–9.3	–15.3
12-month Libor	0.25	0.25	0	–9.6	–28.7
1-year government bonds	0.07	0.03	3	–3.8	–8.1
2-year government bonds	0.25	0.14	11	12.8	8.8
10-year government bonds	1.47	1.59	–13	55.5	79.2

Spreads corporate bonds (bps)

	30-June	31-May	Monthly change (bp)	Year-to-date (bp)	Year-on-year change (bp)
Itraxx Corporate	47	50	–3	–0.9	–18.4
Itraxx Financials Senior	55	59	–4	–4.5	–23.2
Itraxx Subordinated Financials	103	108	–5	–8.1	–58.8

Exchange rates

	30-June	31-May	Monthly change (%)	Year-to-date (%)	Year-on-year change (%)
EUR/USD (dollars per euro)	1.186	1.223	–3.0	–2.9	5.4
EUR/JPY (yen per euro)	131.750	133.970	–1.7	4.4	9.0
EUR/GBP (pounds per euro)	0.857	0.860	–0.4	–4.1	–5.0
USD/JPY (yen per dollar)	111.110	109.580	1.4	7.6	3.4

Commodities

	30-June	31-May	Monthly change (%)	Year-to-date (%)	Year-on-year change (%)
CRB Commodity Index	556.0	548.5	1.4	25.3	53.2
Brent ($/barrel)	75.1	69.3	8.4	45.0	78.8
Gold ($/ounce)	1,770.1	1,906.9	–7.2	–6.8	0.0

Equity

	30-June	31-May	Monthly change (%)	Year-to-date (%)	Year-on-year change (%)
S&P 500 (USA)	4,297.5	4,204.1	2.2	14.4	37.9
Eurostoxx 50 (euro area)	4,064.3	4,039.5	0.6	14.4	25.9
Ibex 35 (Spain)	8,821.2	9,148.9	–3.6	9.3	22.1
PSI 20 (Portugal)	5,035.0	5,180.2	–2.8	2.8	15.7
Nikkei 225 (Japan)	28,791.5	28,860.1	–0.2	4.9	30.2
MSCI Emerging	1,374.6	1,376.2	–0.1	6.5	37.3

Global economic activity at a turning point; inflation, we shall see

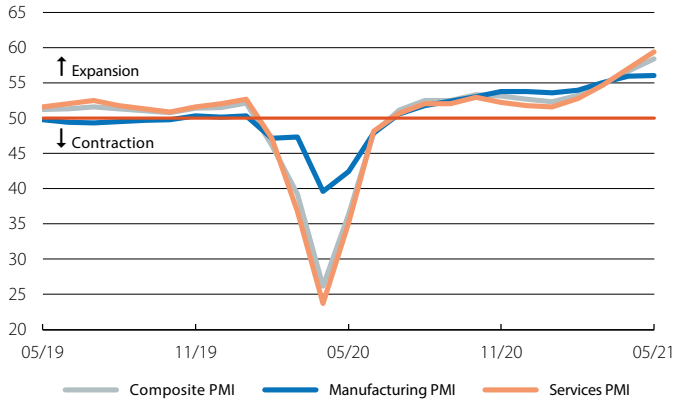
The global economy in the expansionary phase of the cycle. The set of economic indicators available at the end of Q2 2021 coincide in signalling that, with only a few exceptions, the recovery has turned a corner. The stabilisation of the pandemic, thanks to progress in the vaccination campaigns, is allowing restrictions on movement and social mixing to be lifted, giving a dose of confidence to consumption. As a result, the recovery is gathering momentum and is now spreading to the sectors that had been hardest hit by the crisis. Unless there is an unexpected rise in infections due to the new variants, this trend is expected to consolidate over the coming quarters. The strong rebound in demand, however, has encountered supply-side difficulties, mainly in the form of delays in the supply of industrial sector inputs, but also in the availability of labour in some countries. Our central scenario foresees that these bottlenecks will be gradually resolved without inflicting major harm on the recovery. Nevertheless, the risk that they could persist for longer than expected has increased.

Inflation is also higher than expected and is beginning to concern the central banks. Without undervaluing the good tone of the economic indicators, the focus in recent weeks has once again been on inflation. Indeed, consumer prices have rebounded in most countries, in some cases reaching levels not seen in decades. In addition to the positive base effects, which reflect the year-on-year comparison with the months of «hibernation» in 2020, there have been pressures generated between the rising demand and the supply-side constraints. As we have mentioned, these factors should gradually fade, giving way to a moderation in inflation in the second half of the year and, mostly, in 2022. Nevertheless, the balance of risks is skewed towards a prolongation of the inflationary pressures, and this too is beginning to concern the central banks. In this regard, since the beginning of June, six central banks in emerging markets have announced official rate hikes, while in developed countries there is already talk of the eventual withdrawal of some of the stimulus (see the Financial Markets section).

Rebalancing the public finances and corporate tax under the spotlight. Another event on the global scene worth highlighting is the agreement reached in early June at the G7 summit on the taxation of large multinationals. Among the main elements discussed is a deal, on the one hand, to set a minimum 15% corporate tax rate and, on the other, a proposal to restructure the way taxes are collected from large multinationals so as to distribute the taxable income base among the various countries in which they operate. The agreement was initially ratified by 130 countries in the OECD in early July. However, a number of obstacles still have to be overcome for it to be implemented (see the Focus «Rebalancing the public finances and corporate tax under the spotlight» in the MR06/2021).

Global PMI indicators

Level



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

Inflation tracker

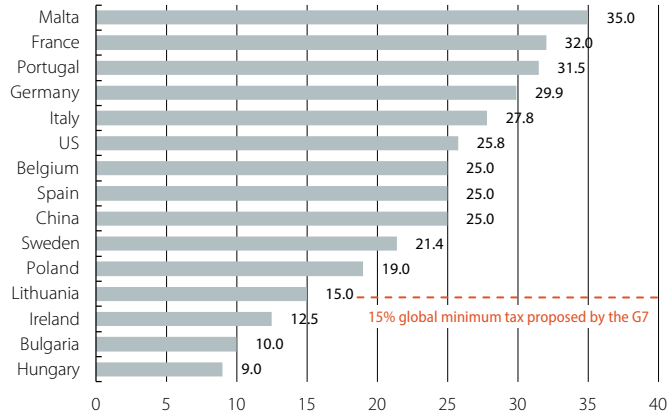
	Latest value	2021 average	2020 average	2019 average	2014-2018 average
Global indices					
Dry Baltic Index (level)	3,383.0	2,367.5	1,085.4	1,324.5	990.3
Industrial Metals Price Index (level)	156.0	149.0	111.0	116.0	117.0
Brent crude oil (dollars per barrel)	75.1	66.2	41.6	64.6	65.1
Semiconductors Index (level)	67.6	77.9	36.8	16.5	24.3
FAO Food Price Index (%)	39.7	27.3	3.1	–0.7	-3.9
Euro area indices					
Headline CPI inflation (%)	1.9	1.4	0.3	1.2	0.8
Core CPI inflation (%)	0.9	1.0	0.7	1.1	0.9
5Y5Y inflation expectation rate (%)	1.6	1.5	1.1	1.3	1.7
IPP inflation (%)	9.6	5.5	-2.6	0.6	0.0
US indices					
Headline CPI inflation (%)	5.0	3.0	1.2	1.8	1.5
Core CPI inflation (%)	3.8	2.2	1.7	2.2	2.0
5Y5Y inflation expectation rate (%)	2.3	2.4	2.0	2.1	2.3
IPP inflation (%)	6.5	4.3	0.2	1.7	1.3

Greater than +1 std. dev.
Between +0.5 std. dev. and 1 std. dev.
Average +/– 0.5 std. dev.
Between –0.5 std. dev. and –1 std. dev.
–1 std. dev. and more

Notes: *Values closer to the red (blue) indicate inflations that are higher (lower) than usual. Values in grey are in line with the historical average or with the various central banks' target rates.*
Source: *CaixaBank Research, based on data from Refinitiv and Bloomberg.*

Corporation tax

(%)



Source: *CaixaBank Research, based on data from the OECD and the Tax Foundation.*

US

Inflation in the eye of the storm. The US is the country enduring the most pronounced inflationary pressures. After digesting several rounds of fiscal stimuli, the economy has already reached its pre-pandemic levels in Q2. The pick-up in private spending has spread to the vast majority of economic activities and triggered alarms of overheating in some sectors, such as in the housing market. Business surveys report a shortage of productive factors, which in turn is raising production costs. In this context, inflation has once again been higher than expected: in May it stood at 5% (headline CPI), a level not seen since the run-up to the global financial crisis of 2008. We continue to expect a gradual fall in inflation rates starting from the summer, as the transitory effects fade (base effects, supply constraints affecting suppliers and a labour shortage). Having said that, it is true that the risks of overheating have increased significantly.

Progress in the recovery of jobs, but still with nuances. As for the labour market, the recovery has been somewhat less robust than that registered in the overall economy, although the rate of job creation did rebound in June (850,000 jobs). Wages, meanwhile, have accelerated, partly due to the difficulties employers are experiencing in filling vacancies. On balance, the number of people in employment is still 5% below the pre-pandemic level, while participation in the labour market remains depressed. We continue to believe that it will still take some time before the labour market shows the «substantial progress» towards full employment that the Fed refers to in its messages (see the Focus «US: (in)complete recovery of the labour market» in this same *Monthly Report*).

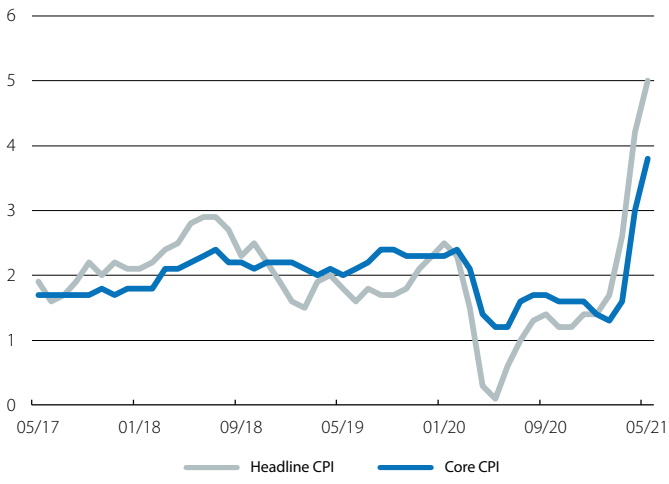
Monetary policy also at a turning point. It is precisely the incompleteness of the recovery in the labour market that explains why the Fed has not responded more aggressively to the rebound in inflation. However, at its June meeting the central bank took the first steps towards the eventual withdrawal of some of the monetary stimulus, appearing less complacent about the risk of further inflationary pressures (see the Financial Markets section for further details). On the other hand, in Washington, the Biden administration appears to have secured an agreement in the Senate for an infrastructure plan worth some 1.2 trillion dollars (559 billion in new spending). While still well below Biden's ambitious infrastructure plan (The American Jobs Plan, which amounted to just over 2 trillion dollars), it nevertheless represents a first step towards the new president implementing his agenda.

EURO AREA

Economic activity takes off while inflation is boarding. In Europe, after a weak start to the year, the widespread lifting of restrictions is leading to a strong revival in demand, mainly in those sectors that had so far lagged behind in the recovery. In June, business surveys (such as the PMI) reached their highest records in the past 15 years. On the other hand, supply constraints in global chains are already pushing up production costs: in Germany, for example, production prices rose by

US: CPI

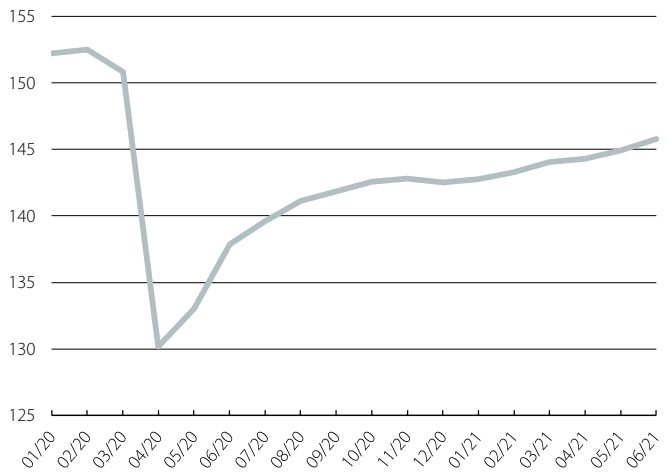
Year-on-year change (%)



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

US: total people in employment

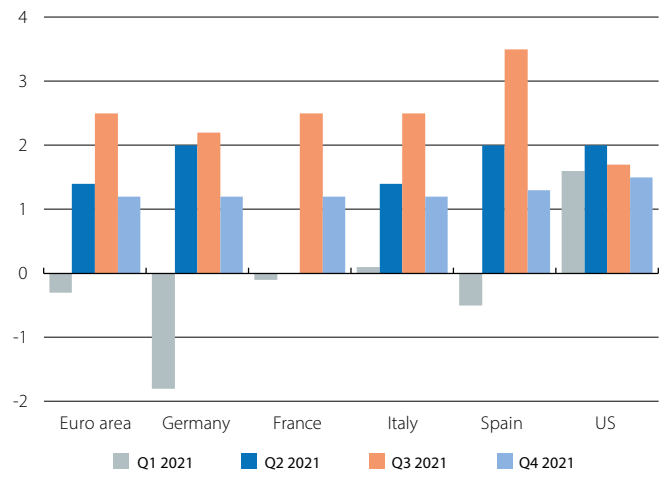
Millions



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

Euro area and the US: evolution of GDP

Quarter-on-quarter change (%)



Source: *CaixaBank Research, based on data from Eurostat and the BEA (for historical data) and our own forecasts.*

7.2% year-on-year in May, the biggest increase in over 20 years. However, unlike in the US, there are few signs that the inflationary pressures have spread to the labour market. Also, consumer price inflation has remained contained (core inflation stood at 0.9% year-on-year in June), at least for the time being. The pick-up in demand and the emergence of bottlenecks could lead to a sharper rise in inflation over the coming months, although we consider these factors to be transitory in nature.

Fiscal stimulus (from the EU) in sight. In addition to this cocktail of pent-up demand, the reopening of economies and greater optimism among private agents, yet another factor is arriving on the scene in the form of the approval of new fiscal stimuli, with the distribution of the European Recovery Instrument (Next Generation EU). We expect that the European Council will ratify the recovery plans sent by the various countries, most of which were endorsed in June by the European Commission, and that the first disbursements can be distributed in the summer. As we discuss later on, these will have a greater impact in countries in the south (with Italy and Spain leading the pack) and in the east. The EU transfers and the European Commission's decision in June to extend the suspension of fiscal rules in 2022 have reinforced the idea that fiscal policy will continue to have a clear easing bias over the coming years.

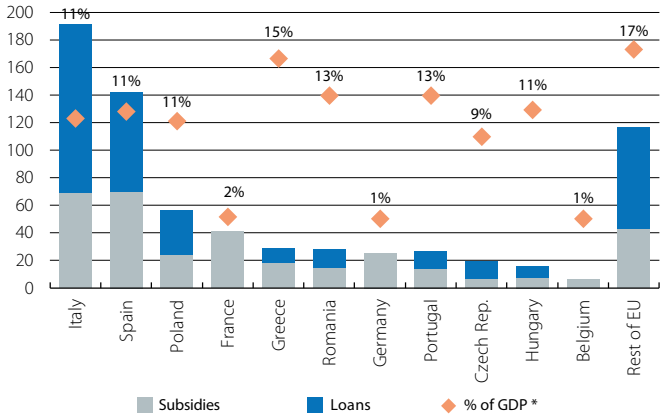
EMERGING ECONOMIES

Improvement in the health and economic spheres, but risks abound. Improvements in the pandemic are also evident among emerging economies. A clear example is India, recently at the epicentre of the COVID-19 pandemic, where the number of infections and daily deaths have fallen to their lowest in the last three months. The exception remains Latin America and some regions of Asia (such as Brazil, Colombia and Indonesia), where infections have increased, in some cases reaching all-time highs. However, even in many of these economies, the revival of demand, both internal and external, and the improvement in commodity prices and those of other export goods are causing economic activity to sprout. Our view is that, following a better-than-expected Q1 2021, the recovery will gather pace in the coming months. One risk factor is the shift in monetary policy expectations in advanced economies and the recent strength of the US dollar. The surge in inflation and signs of currency weakness are triggering more decisive responses from central banks.

China: more signs of slowdown. The latest monthly indicators, generally below expectations, confirm that the Chinese economy has slowed down this quarter as the authorities continue to place more emphasis on stability. That said, the growth outlook for 2021 (around 8.0%) remains well above the official target of 6.0% and leaves room for restrictive financial conditions which aim to continue to support the improvement in the quality of credit. On the other hand, rising commodity prices have driven up production prices (9.0% year-on-year in May), although their impact on consumer prices remains rather moderate (1.3% year-on-year in May).

Distribution of the European Recovery Instrument

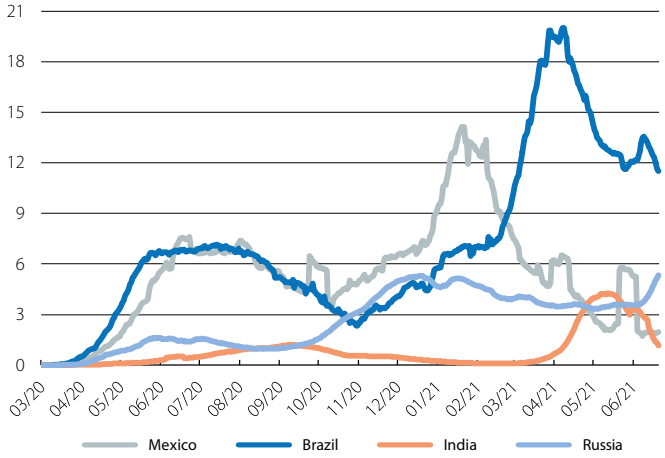
(EUR billions)



Note: ** Percentage of 2019 national GDP the total aid represents.*
Source: *CaixaBank Research, based on data from the European Commission, Bruegel and the national Recovery and Resilience Plans.*

Emerging economies: cumulative deaths due to COVID-19

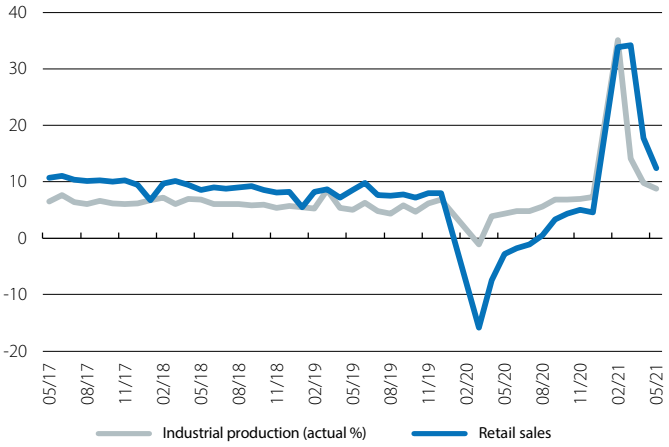
Deaths per 100,000 inhabitants accumulated in 14 days



Note: *Data available up to 1 July 2021.*
Source: *CaixaBank Research, based on data from Johns Hopkins CSSE, UN World Population Prospects.*

China: industrial production and retail sales

Year-on-year change (%)



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

US: (in)complete recovery of the labour market

The COVID-19 outbreak led to the most severe adjustment in the US labour market since the Great Depression. In just two months, the number of people in employment fell by 15%, equivalent to just over 22 million people. For reference, during the global financial crisis of 2008-2009, the cumulative decline amounted to 6% (around 9 million). Looking at the unemployment rate, one of the most commonly used indicators for tracking the labour market, it rose from an exceptionally low 3.5% in February 2020 to around 15% in April 2020.

Since then, the labour market has made a dramatic recovery: more than 11 million people have now found a job. But to what extent is there still room for further recovery in the labour market? In the context of high inflation and highly accommodative monetary policy, this question is particularly important.

Recovery of the labour market: it depends how you look at it

The unemployment rate stood at a contained 5.8% in May 2021, not far off the natural rate of unemployment estimated by the Congressional Budget Office (4.5%). In addition, various business surveys point to difficulties in filling job vacancies. These include the ISM survey (in both the manufacturing and the service sector), the NFIB survey conducted on small businesses, and the Fed's periodic field study known as the Beige Book. The number of available vacancies has risen to historic highs (9.3 million in April) and now exceeds the number of people who have not yet returned to employment. In fact, in April there were as many unemployed people as there were vacancies. As a result, average wages have increased significantly in recent months: a cumulative 1.2% between March and May, despite the fact that most of the jobs being created are concentrated in professions with below-average wages. All of this adds weight to the idea that the US labour market is experiencing a buoyant recovery.

However, if we look at a wider range of labour market indicators, the message is more nuanced. Despite the rapid increase in employment, there are still some 7.5 million fewer people in employment than there were prior to the outbreak of the pandemic. Moreover, not only has the recovery been uneven at the sector level (since the measures imposed have forced certain business activities to shut down for months on end), but also between different social groups: it is occurring slower among women, African Americans and Latinos, for instance.[1] The shock is also proving more severe among younger people and those with a lower level of education.

In the attached tracker table, we show various metrics that allow us to assess the margin that still exists for the labour market to continue to recover. Consistent with the patterns just mentioned, the assessment differs

Labour market tracker

	Latest value	2021 average	2020 average	2019 average
Unemployment rate (%)	5.8	6.1	8.1	3.7
U6 unemployment rate (%)	10.2	10.7	13.7	7.2
African American unemployment rate (%)	9.1	9.5	11.5	6.1
ISM manufacturing employment index (level)	50.9	54.5	44.3	50.9
ISM services employment index (level)	55.3	55.8	46.0	55.0
Businesses unable to fill vacancies (%)	48.0	41.4	32.3	36.4
Businesses planning to hire (%)	26.0	20.8	16.0	19.0
Long-term unemployed (27 weeks) (as % of total people unemployed)	40.3	41.5	18.3	21.1
Labour force participation (%)	61.6	61.5	61.7	63.1
Labour force participation >55 years (%)	38.4	38.3	39.2	40.2
Unemployed to employed (as % of people unemployed)	24.8	24.4	28.0	27.7
Weekly unemployment benefit applications (thousands)	385.0	661.8	1,531.9	219.3

Note: *The values in green lie around the average for the most recent expansionary cycle (2014-2018) and are indicative of a use of standard labour resources. The light blue values indicate that labour market utilisation remains incomplete or is below normal levels. The orange values, meanwhile, are indicative of high labour market utilisation, or that there is some mismatch between the supply and demand of labour resources.*
Source: *CaixaBank Research, based on data from Refinitiv.*

1. One might think that these social differences are largely due to these groups being overrepresented in the sectors that have been forced to close. However, even taking these differences into account the recovery is still uneven. For the case of women, see the study by M.S. Fabrizio, D.B. Gomes and M.M. Tavares (2021). «COVID-19 She-Cession: The Employment Penalty of Taking Care of Young Children», International Monetary Fund. And https://libertystreeteconomics.newyorkfed.org/2021/02/black-and-white-differences-in-the-labor-market-recovery-from-covid-19.html for the case of African Americans.

depending on which indicator we look at. However, as the Fed rightly concludes, most indicators suggest that there is still room for further recovery.[2]

Difficulties filling vacancies with a large number of jobs still to be recovered: how do these two realities coexist?

Among the main reasons behind the relative shortage of labour, there are two factors that reduce participation in the labour market, which in May 2021 stood at 61.6%, almost 2 pps below pre-pandemic levels.

Firstly, a large number of people are unable to return to the labour market because of family issues: caring for the sick or for children whilst education centres are closed, a phenomenon that has affected women more than men. According to the household survey, some 3 million people are not looking for work because of these direct effects of the pandemic. If we were to include these individuals again in the labour force and treat them as unemployed, the unemployment rate would be around 7.5%.[3]

Secondly, a high percentage of American baby boomers have taken early retirement. Since the beginning of the COVID-19 crisis, the number of employees over the age of 55 has fallen by around 2 million, by far the cohort with the highest incidence. Moreover, around 60% of these people have stopped seeking employment (presumably because many of them have decided to retire) and are no longer counted as part of the labour force.[4] As a result, the participation rate among people aged over 55 has fallen to almost the lowest level in the past 15 years.

One last factor that does not affect the participation rate, but which may also explain the difficulty in filling vacancies, is the extra unemployment aid that has been approved during the crisis.[5] These higher subsidies seem to have reduced the incentives for people to seek employment, even though these individuals remain classified as part of the labour force (unemployed).[6]

What can we expect in the short-term?

Early retirement is a structural factor that will continue to weigh on the labour market and which suggests that the benchmark level of employment is slightly lower than the pre-crisis level. Thus, while there are approximately 7.5 million jobs still to recover to reach pre-pandemic levels, it is likely that employment could only increase by 5 million.

However, the other factors are more temporary in nature and should moderate over the coming months as the vaccination campaign and the easing of restrictions (including the reopening of schools) continue. Also, an extension of the extra unemployment aid seems unlikely. In fact, in July, half of all states are no longer supplementing most unemployment aid, and by September all such subsidies will have come to an end.

Thus, from Q3 onwards we should see a recovery in many labour market indicators. Furthermore, we should not be surprised to see a spike in the unemployment rate at some point during this recovery, as some of the individuals who had left the labour force rejoin it. This more widespread improvement ought to continue and gain momentum during the course of Q4.

With inflation well above target, labour market indicators have taken centre stage in the Fed's monetary policy strategy. Indeed, the central bank has established that it will not make changes to its accommodative measures until «substantial progress» is made towards achieving full employment. Given the unusual nature of this crisis, both in the decline and in the recovery, we expect the Fed to remain very cautious, resulting in a very gradual withdrawal of the monetary stimulus.

Clàudia Canals and Antonio Montilla

2. For further information, see https://www.frbsf.org/economic-research/files/el2021-15.pdf.
3. Much closer to alternative unemployment rates, such as that produced by the Dallas Federal Reserve with various universities (Real-Time Population Survey).
4. Some studies point towards an even higher number or early retirements among baby boomers. See https://www.economicpolicyresearch.org/jobs-report/the-pandemic-retirement-surge-increased-retirement-inequality.
5. The number of people receiving some form of aid has remained stable at around 16 million since March, well above the pre-pandemic level.
6. It should be noted, however, that there are one or two studies which suggest this factor has a lesser effect than that indicated in numerous journalistic articles (https://www.frbsf.org/economic-research/files/el2021-15.pdf).

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

UNITED STATES

	2019	2020	Q2 2020	Q3 2020	Q4 2020	Q1 2021	03/21	04/21	05/21
Activity									
Real GDP	2.2	–3.5	–9.0	–2.8	–2.4	0.4	–	–	–
Retail sales (excluding cars and petrol)	4.0	2.2	–4.9	5.4	4.7	11.9	20.0	39.9	23.8
Consumer confidence *(value)*	128.3	101.0	90.0	93.1	93.8	99.1	114.9	117.5	117.2
Industrial production	–0.8	–7.2	–14.9	–6.7	–4.3	–1.7	1.5	17.6	16.3
Manufacturing activity index (ISM) *(value)*	51.2	52.5	45.7	55.0	59.0	61.4	64.7	60.7	61.2
Housing starts *(thousands)*	1.295	1.396	1.086	1.440	1.575	1.599	1.725	1.517	1.572
Case-Shiller home price index *(value)*	217	228	224	229	239	248	252	...	...
Unemployment rate *(% lab. force)*	3.7	8.1	13.1	8.8	6.8	6.2	6.0	6.1	5.8
Employment-population ratio *(% pop. > 16 years)*	60.8	56.8	52.9	56.1	57.4	57.6	57.8	57.9	58.0
Trade balance[1] *(% GDP)*	–2.7	–3.2	–2.7	–2.9	–3.2	–3.6	–3.6	–3.7	...
Prices									
Headline inflation	1.8	1.2	0.4	1.2	1.2	1.9	2.6	4.2	5.0
Core inflation	2.2	1.7	1.3	1.7	1.6	1.4	1.6	3.0	3.8

JAPAN

	2019	2020	Q2 2020	Q3 2020	Q4 2020	Q1 2021	03/21	04/21	05/21
Activity									
Real GDP	0.0	–4.7	–10.2	–5.5	–1.0	–1.5	–	–	–
Consumer confidence *(value)*	38.9	31.1	24.6	30.5	33.0	33.3	36.1	34.7	34.1
Industrial production	–2.7	–10.6	–20.7	–12.7	–4.2	–1.5	1.0	15.9	...
Business activity index (Tankan) *(value)*	6.0	–19.8	–34.0	–27.0	–10.0	5.0	–	–	–
Unemployment rate *(% lab. force)*	2.4	2.8	2.7	3.0	3.0	2.8	2.6	2.8	3.0
Trade balance[1] *(% GDP)*	–0.3	0.1	–0.5	–0.3	0.1	0.7	0.2	0.6	0.8
Prices									
Headline inflation	0.5	0.0	0.1	0.2	–0.8	–0.4	–0.1	–0.5	–0.1
Core inflation	0.6	0.2	0.3	0.1	–0.3	0.2	0.3	–0.1	–0.2

CHINA

	2019	2020	Q2 2020	Q3 2020	Q4 2020	Q1 2021	03/21	04/21	05/21
Activity									
Real GDP	6.0	2.3	3.2	4.9	6.5	18.3	–	–	–
Retail sales	8.1	–2.9	–4.0	0.9	4.6	34.0	34.2	17.7	12.4
Industrial production	5.8	3.4	4.4	5.8	7.1	24.6	14.1	9.8	8.8
PMI manufacturing *(value)*	49.7	49.9	50.8	51.2	51.8	51.3	51.9	51.1	51.0
Foreign sector									
Trade balance[1,2]	421	527	409	444	527	629	14	43	46
Exports	0.5	3.6	–0.2	8.4	16.6	48.9	30.6	32.3	27.8
Imports	–2.7	–0.7	–9.5	3.6	5.4	28.2	38.2	43.1	51.1
Prices									
Headline inflation	2.9	2.5	2.7	2.3	0.1	0.0	0.4	0.9	1.3
Official interest rate[3]	4.4	4.4	4.4	4.4	4.4	4.4	4.4	4.4	4.4
Renminbi per dollar	6.9	6.9	7.1	6.9	6.6	6.5	6.5	6.5	6.4

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

	2019	2020	Q2 2020	Q3 2020	Q4 2020	Q1 2021	03/21	04/21	05/21
Retail sales *(year-on-year change)*	2.4	–1.0	–6.6	2.4	1.4	2.3	13.1	23.9	...
Industrial production *(year-on-year change)*	–1.3	–8.6	–20.2	–6.9	–1.5	3.3	11.5	39.3	...
Consumer confidence	–7.0	–14.3	–18.5	–14.4	–15.7	–13.7	–10.8	–8.1	–5.1
Economic sentiment	103.7	88.2	72.0	88.5	91.4	95.3	100.9	110.5	114.5
Manufacturing PMI	47.4	48.6	40.1	52.4	54.6	58.4	62.5	62.9	63.1
Services PMI	52.7	42.5	30.3	51.1	45.0	46.9	49.6	50.5	55.2
Labour market									
Employment (people) *(year-on-year change)*	1.2	–1.6	–2.9	–2.1	–1.8	–1.9	–	–	...
Unemployment rate *(% labour force)*	7.6	8.0	7.6	8.6	8.3	8.2	8.1	8.0	...
Germany *(% labour force)*	3.1	4.2	4.2	4.5	4.6	4.5	4.5	4.4	...
France *(% labour force)*	8.5	8.1	7.2	9.1	8.1	7.9	7.9	7.3	...
Italy *(% labour force)*	10.0	9.3	8.4	9.9	9.9	10.5	10.4	10.7	...
Real GDP *(year-on-year change)*	1.3	–6.7	–14.6	–4.1	–4.7	–1.3	–	–	...
Germany *(year-on-year change)*	0.6	–5.1	–11.2	–3.8	–3.3	–3.1	–	–	...
France *(year-on-year change)*	1.8	–8.0	–18.4	–3.5	–4.6	1.2	–	–	...
Italy *(year-on-year change)*	0.3	–8.9	–18.1	–5.2	–6.5	–0.8	–	–	...

Prices

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

	2019	2020	Q2 2020	Q3 2020	Q4 2020	Q1 2021	03/21	04/21	05/21
General	1.2	0.3	0.2	0.0	–0.3	1.1	1.3	1.6	2.0
Core	1.0	0.7	0.9	0.6	0.2	1.2	0.9	0.7	1.0

Foreign sector

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

	2019	2020	Q2 2020	Q3 2020	Q4 2020	Q1 2021	03/21	04/21	05/21
Current balance	2.5	2.4	2.3	2.2	2.4	2.6	3.3	5.3	10.7
Germany	7.5	7.0	6.8	6.8	7.0	7.1	9.3	14.5	28.2
France	–0.7	–1.9	–1.4	–1.7	–1.9	–1.8	–2.3	–3.1	–4.7
Italy	3.2	3.5	3.0	3.4	3.5	3.6	4.6	7.9	15.1
Nominal effective exchange rate[1] *(value)*	92.4	93.9	93.3	95.6	95.7	95.5	94.9	95.2	95.3

Credit and deposits of non-financial sectors

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

	2019	2020	Q2 2020	Q3 2020	Q4 2020	Q1 2021	03/21	04/21	05/21
Private sector financing									
Credit to non-financial firms[2]	3.8	6.3	7.1	7.1	7.0	6.4	5.3	3.2	1.9
Credit to households[2,3]	3.4	3.2	3.0	3.1	3.2	3.1	3.3	3.8	3.9
Interest rate on loans to non-financial firms[4] *(%)*	1.2	1.2	1.2	1.3	1.3	1.1	1.0	1.3	...
Interest rate on loans to households for house purchases[5] *(%)*	1.5	1.4	1.4	1.4	1.4	1.3	1.3	1.3	...
Deposits									
On demand deposits	8.0	12.9	12.9	14.1	15.2	16.1	14.2	12.7	12.0
Other short-term deposits	0.3	0.6	0.3	1.0	1.4	1.0	0.9	0.3	–0.7
Marketable instruments	–1.9	10.0	7.1	10.9	18.3	13.1	7.0	10.5	11.3
Interest rate on deposits up to 1 year from households *(%)*	0.3	0.2	0.2	0.2	0.2	0.2	0.2	0.2	...

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.*

Spain's Scrabble-shaped recovery: W, K, V... or Delta?

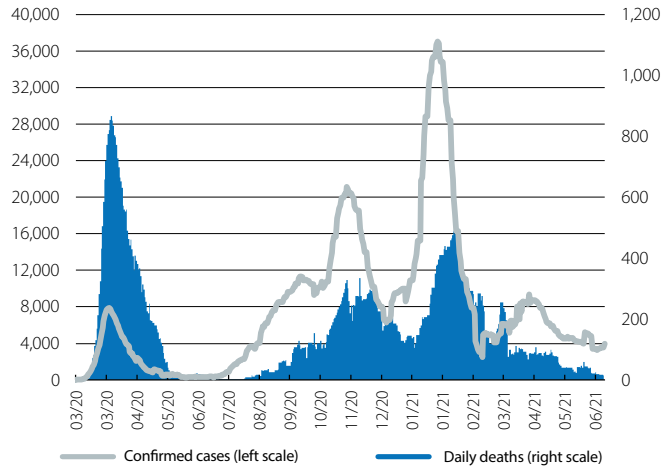
A first semester ending with good news, but also with some uncertainty on the horizon. Although the restrictions were gradually eased during the course of Q2 2021, the incidence of infections remained contained in June, ending the month with a 14-day cumulative infection rate of 100 cases per 100,000 inhabitants. New confirmed daily cases also stabilised in June at around 4,000, well below the average of almost 26,000 cases reached in January or those observed in April and May (with 7,700 and 5,500 daily cases on average, respectively). Despite a rebound in cases in some regions and among younger age groups in recent weeks, the rate of positive test results remains below 5% (having reached over 15% in January), and the vaccination rate rose in June to around 7,000 weekly immunisations per 100,000 inhabitants. Over the coming months, the pandemic will continue to be the major determining factor for the outlook. The immunisation of age groups over 50, which represent 90% of all hospitalisations, is expected to be completed within the next few weeks. With the emergence of new and potentially more contagious strains – such as the Delta variant – rapid progress in the vaccination roll-out will be vital in alleviating pressure on the health system while achieving a sustained revival in economic activity.

Economic activity took off in Q2, driven by the vaccinations. Amid the third wave of the pandemic in Europe, GDP contracted by 0.5% in Q1 2021. However, as the constraints on economic activity were gradually lifted, most of the available economic activity indicators began to accelerate rapidly in Q2. In particular, the PMI sentiment indices for the manufacturing and services sectors both stood above 60 points in June. The recent improvement was most significant on the services side, having climbed above 50 points (the threshold separating contraction from expansion) in April for the first time since July 2020. In this environment, following an 8% drop in Q1, the CaixaBank consumption indicator decreased by just 1% between April and June. This improvement was observed in the level of spending registered on both Spanish (+8 pps) and foreign cards (+7 pps), with changes of +4% and –52% compared to pre-COVID levels. The remaining indicators also recovered in Q2, including cement consumption, which in May stood 3.5% above the same month of 2019, following a 3.7% year-on-year decline in Q1. The recovery is thus taking a gear – or W-shaped look, hoping to have finally surpassed its last turning point.

The revival of the labour market intensifies. The number of workers registered with social security rose by 1.2% in June, corresponding to the incorporation of over 230,000 people in the month, surpassing the previous record registered in July 2020. The number of people on ERTE furlough schemes declined (–84,205, on a monthly average), causing the number of registered workers not on furlough to increase by 317,000 in the month. On the other hand, in June we witnessed a historic

Spain: new confirmed cases and daily deaths

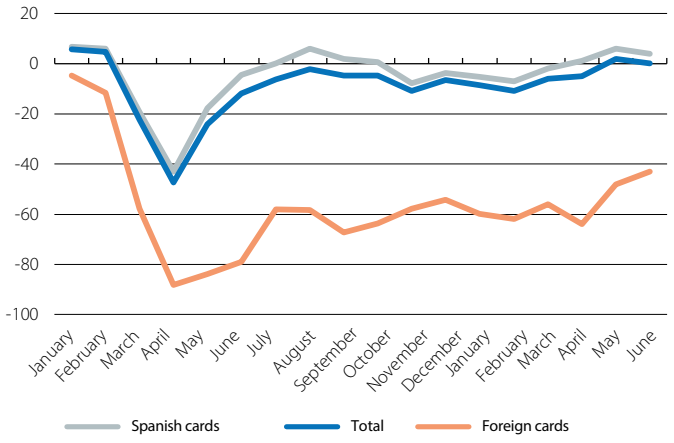
*Confirmed cases ** *Daily deaths ***



Notes: *7-day average number of infections and deaths. * Positive PCR and antigen tests by notification date. ** Deaths by notification date.*
Source: *CaixaBank Research, based on data from the Ministry of Health.*

*Spain: CaixaBank consumption indicator **

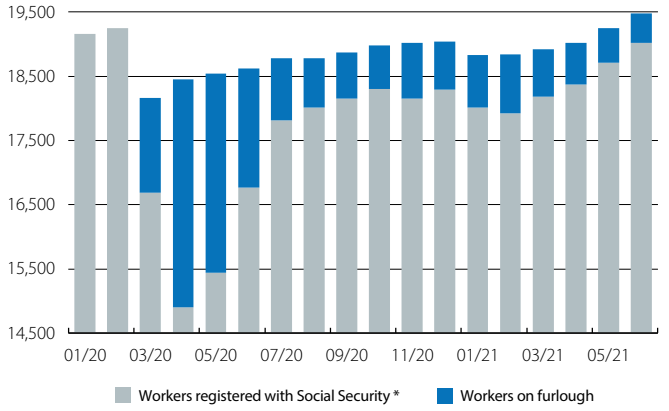
Year-on-year change (%)



Note: ** This indicator includes spending on cards issued by CaixaBank, non-client spending on CaixaBank POS terminals and withdrawals from CaixaBank ATMs.*
Source: *CaixaBank Research, based on internal data.*

Spain: evolution of the number of workers registered with Social Security and on furlough

(Thousands of people registered with S.S. and on furlough)



Note: ** Workers registered with Social Security who are not on furlough (either total or partial).*
Source: *CaixaBank Research, based on data from the Ministry of Work and Social Economy, and the Ministry of Inclusion, Social Security and Migration (MITRAMISS).*

fall in registered unemployment, of 166,911 people. With these data, the number of unemployed exceeds 600,000 and effective employment stands some 476,700 people below the levels observed in June 2019. However, the latest trends in the labour market place the Spanish economy on a very encouraging path to recovery, with a rapid revival in the sectors hardest hit by the restrictions on activity.

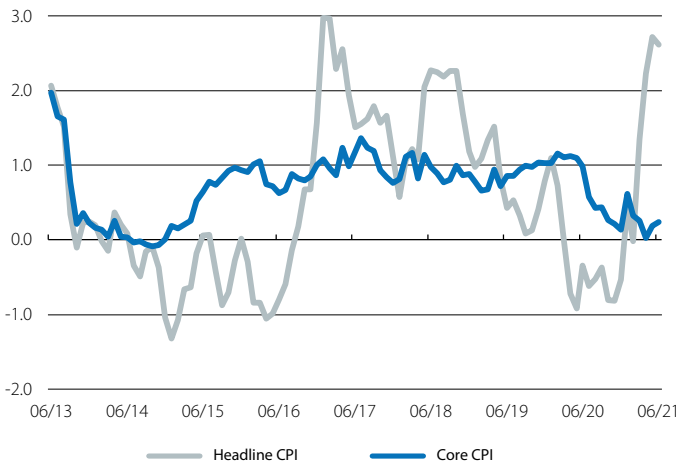
With economic recovery on the horizon, watch out for inflation. The CPI registered a year-on-year increase of 2.6% in June, according to the National Statistics Institute's flash estimate. This figure puts average inflation for the year to date at 1.6%, its highest since 2018. Core inflation, meanwhile, remains at very contained levels of around 0.2%, its lowest since 2014, giving rise to a K-shaped inflation trend. The recent rally in the price index is largely influenced by the rise in energy prices. This in turn is a consequence of higher commodity prices and higher carbon emissions in international markets, as well as being driven by more short-term factors, such as the base effects resulting from the sharp declines recorded last year. Looking ahead to the coming months, the contained level of core inflation could give way to greater buoyancy while the base effects gradually fade.

The current account is recovering, driven by a record high balance of goods. The current account stood at 0.7% of GDP in April, giving continuity to the encouraging trend already visible in previous months. In April, both exports and imports continued to recover and registered year-on-year changes of –1% and –8%, respectively, on a 12-month cumulative basis. The deficit in the balance of goods stood at –0.8% of GDP, an improvement of around 1.7 pps compared to April 2020. Most notably, the surplus of non-energy goods reached 0.6% of GDP in April, its highest level since 2015. A substantial portion of the improvement observed in the balance of goods is due to the lower energy deficit, which will be undone by the rise in energy prices and as the Spanish economy recovers. Nevertheless, the recovery in the balance of services, particularly tourism, could also facilitate an improvement in the current account balance during the course of the year.

The public accounts remain heavily affected by the pandemic; the real estate sector less so. The general government deficit (excluding local public corporations) stood at 1.8% of GDP in April. This places it some 0.7 pps below the level observed in April 2020 but 1.3 pps above the deficit of April 2019. The decline compared to 2020 is explained by the increase in government revenues between January and April, with a year-on-year change of 5.4%, largely driven by a significant 10.5% increase in tax revenues. On the other hand, the trend in the housing price index (HPI) supports the buoyancy of the real estate sector. House prices in Spain increased by 0.9% year-on-year in Q1 2021, a 0.6-pp slowdown compared to the previous quarter. The rise in prices of new homes slowed sharply (from 8.2% in Q4 2020 to 2.3% in Q1 2021), but continues to grow above the second-hand housing market, which registered an increase of 0.7%.

Spain: CPI

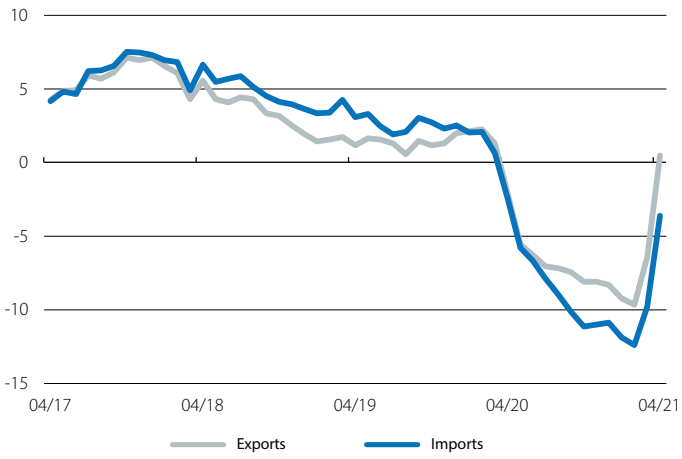
Year-on-year change (%)



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

*Spain: foreign trade of goods **

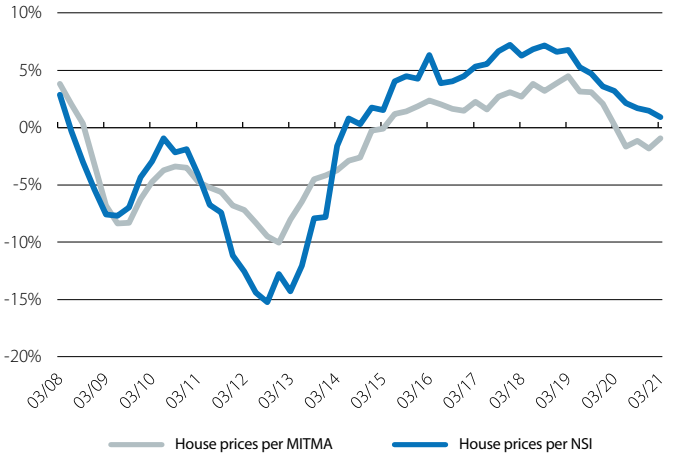
Year-on-year change in the 12-month cumulative balance (%)



Note: ** Nominal data, series not seasonally adjusted. Excludes energy.*
Source: *CaixaBank Research, based on data from the Department of Customs.*

Spain: housing prices

Year-on-year change (%)



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

The competitiveness of the Spanish foreign sector: current snapshot and 3D roadmap

The pandemic has been felt in all sectors of the economy, particularly in tourism services, a key sector for the Spanish economy. Nevertheless, the foreign sector held up very well in the face of an unprecedented shock, and despite not having this traditional contribution the current account managed to maintain a surplus. The starting point for rebuilding a path of sustainable growth is better than one might have expected.

Where the Spanish foreign sector is now: Spanish exports in the world

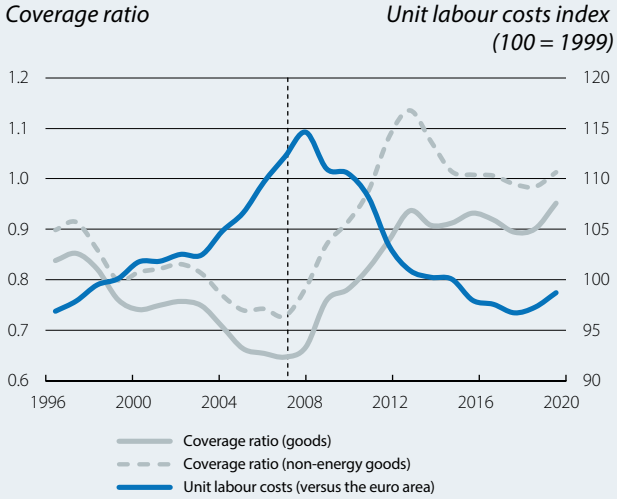
Focusing on the balance of goods in 2020, a year with a historic fall of 10.8% of GDP, Spanish exports of non-energy goods fell by 8.3%, but managed to remain above 250 billion euros (around 22% of GDP) for the fourth consecutive year.[1] This, combined with the fall in imports, led to a coverage ratio for imports of goods of 0.95 and a deficit in the balance of goods of 1.2% of GDP, an all-time low.

To understand these good dynamics in the foreign sector in an environment of significant economic weakness, as well as the sector's medium-term outlook, we must put the evolution of Spanish exports over the last decade in perspective. Between 2000 and 2008, the Spanish economy had an average current account deficit of 6.2% of GDP. This was a result of historical trade imbalances in both goods and income accounts (of –7.4% and –2.5% of GDP on average in this period, respectively) which were only partially offset by the surplus in the service account.[2] Between 2009 and 2020, on the other hand, the current account registered an average surplus of 0.5% of GDP. This was driven by a significant improvement in the balance of non-energy goods, which went from an average deficit of –4.7% of GDP between 2000 and 2008 to a surplus of 0.1% starting from 2009, with 7 surpluses in 12 years.[3]

The coverage ratio for imports of non-energy goods thus increased from 0.78 in 2008 to a high of 1.13 in 2013, stabilising from then on at around 1 (see first chart). The improvement in the trade balance reflects the gains in competitiveness achieved over the last decade, both relative to euro area countries (as illustrated by the unit labour cost index in the first chart), which represent the main destination market for Spanish exports, and in comparison to the main international competitors in different economic sectors. Since 2008, the share of Spanish goods in the euro area's total exports has increased significantly, from 6% to 6.8% (see second chart). The agrifood sector has performed particularly well. Between 2008 and 2020, the Spanish market's share

1. In historical terms, this decline compares to the 14.2% drop in exports in 2009, following the 2008 financial crisis, in the midst of a recession which caused Spain's GDP to shrink by 3.8%. Exports of non-energy goods from Spain accounted for 16% of GDP at the end of 2008.
2. The balance of services registered a surplus of 3.6% of GDP on average between 2000 and 2008, largely thanks to tourism services, with a surplus of 3.5% of GDP in the same period.
3. The services balance also helped, generating an average surplus of 4.9% between 2009 and 2020. Non-tourism services played a major role, with an average surplus of 1.5% of GDP over the period (well above the 0.1% average for the previous period). Similarly, the income balance registered an improvement, climbing to a deficit of 1.6%, on average. On the other hand, the energy balance deteriorated slightly, with its deficit worsening from 2.7% of GDP between 2000 and 2008 to 2.9% between 2009 and 2020.

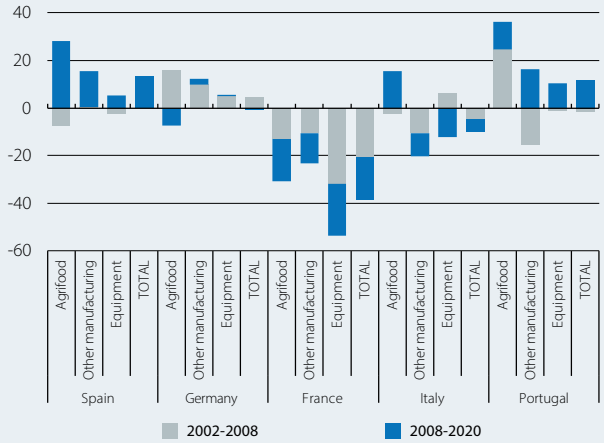
Spain: import coverage ratio and unit labour costs



Notes: *The coverage ratio (left-hand scale) measures the percentage of imports that is covered by exports. Lower coverage levels indicate a more deficient trade position. The unit labour cost index (right-hand scale) is an indicator of the Spanish economy's competitiveness vis-à-vis the euro area. An increase in this indicator indicates a deterioration in the price-competitiveness of Spanish goods and services.*
Source: *CaixaBank Research, based on data from the Bank of Spain.*

Market shares of euro area countries in the world

Year-on-year change in the share of each country's exports in the total volume of exports from euro area countries to the rest of the world (%)



Notes: *The vertical scale shows the year-on-year change in exports between 2002, 2008 and 2020. Exports (in euro) are grouped into SITC categories. Each country's total corresponds to their total share of exports to the rest of the world. Therefore, it also includes the SITC categories not highlighted in the chart.*
Source: *CaixaBank Research, based on data from Eurostat.*

in the euro area's agrifood exports rose by more than 2 pps from 9.8% to 12.6% – hoisting Spain up to seventh position in the global ranking.[4] But the success also extends to the manufacturing sector, both in equipment and transport goods and in other manufacturing segments. Since 2008, Spanish goods have gained considerable market share in these sectors, with gains of 5.4% and 15%, respectively (both sectors with market shares of between 6% and 7%). Moreover, in an environment of increasing international competition, these substantial improvements in the international position of Spanish exports compare with a stabilisation of Germany's market share and with significant losses in the competitiveness of the manufacturing sectors in France and Italy, as well as the French agrifood sector.[5]

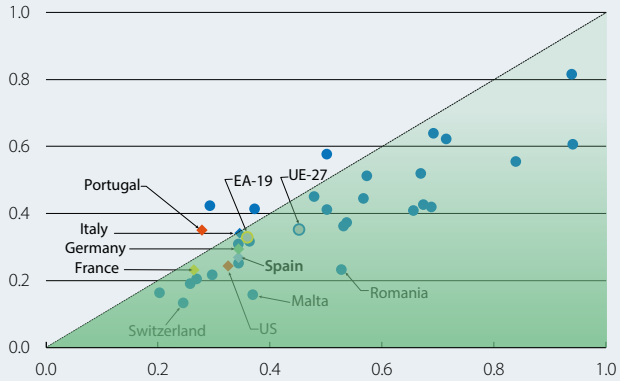
The 3 Ds of competitiveness: diversify, decarbonise and digitalise

In addition to these sectoral trends and the gains in competitiveness across the breadth of the Spanish economy, another promising trend is the growing diversification of the export base. This is reflected in the steady increase in the number of firms making regular exports, which has gone from some 35,000 in 2010 to around 47,000 in 2018, and whose trade volume amounts to 97% of the total declared volume of exports (compared to 93% in 2010). Among these regular exporting firms, medium-sized enterprises – defined as those with between 50 and 250 employees – registered a 62% increase in their trade volume, while the number of medium-sized exporting enterprises rose by 25%.[6] Taken together, this development reflects an improvement in both the extensive and the intensive margin. In other words, it represents an expansion of the export base and also of the average size of the exporting firms. This can also be considered an additional factor in the competitiveness of Spanish exports, insofar as larger firms are associated with greater efficiency and better access to financial markets.

In parallel, data suggests that Spain's foreign sector has already begun the decarbonisation process in recent years. The intensity of carbon dioxide (CO_2) in Spanish exports decreased by 22% between 2009 and 2019, compared to 8.5% across the euro area as a whole (see third chart).[7] Besides being a good sign for the decarbonisation of the economy, this factor could be

Spain: evolution of the CO_2 intensity of exports from 2009 to 2019

(Quantity of CO_2 per USD exported, 5-year cumulative balance)



Note: *The horizontal scale shows the intensity of CO_2 in exports in 2009, while the vertical scale shows the value in 2019. EU-27 and EA-19 excluding Belgium, Slovenia and Ireland.*
Source: *CaixaBank Research, based on data from the IMF.*

an indication that Spanish firms are in a good competitive position for the initial stages of the climate transition and the major structural reforms that lie ahead. Finally, together with the decarbonisation of exports, the digitalisation process will intensify over the coming years, with the emergence of new opportunities related to e-commerce, but also with the challenges that will test businesses' ability to reinvent their production and management processes in order to become more competitive. More than ever, these transformations will underscore the importance of investment in infrastructure and human capital, which is widely recognised as one of the major challenges facing the Spanish economy.[8]

Where the Spanish foreign sector is heading: the time to take the next step forward is now

Over the coming years, the Spanish economy will face significant challenges. Diversification, digitalisation, and decarbonisation could emerge as the most visible faces of the profound structural transformation that will take place. To this end, within the next few months the Spanish economy will receive a major impetus in the form of funds from the NGEU programme. Having defined the roadmap, all that remains is to execute the plan: to reach the podium in this arduous triathlon, all the available tools will need to be used to maximise the speed of execution and minimise the risk of hitting stumbling blocks along the way. The continued success of the Spanish export sector will depend on each D, for detail.

Luís Pinheiro de Matos

(See an extended version of this article at caixabankresearch.com)

4. For more details, see the article «The resilience of Spanish agrifood exports» in the agrifood *Sector Report*.
5. The case of Portugal is more similar to that of Spain, with an 11.9% increase in the market share of Portuguese goods, going from 1.2% to 1.4% between 2008 and 2020. In Portugal, agrifood and manufacturing goods also stood out, registering gains of over 10%, as did the chemicals sector, with an 8.1% increase in the country's share of exports.
6. In turn, the volume of trade of both large corporations and of micro and small enterprises that regularly export rose by around 56%, while the total number of these companies grew by approximately 33%, in both cases.
7. Looking at CO_2 intensity in exports from the major EU economies during the same period, it declined by 16% in Germany, by 11% in France and by 1% in Italy. Malta and Romania are among the economies that reduced the carbon content of their exports the most, both by more than 50%. At the other end of the spectrum, in Portugal this figure increased by 27%.
8. See, for example, P. Cuadrado, E. Moral-Benito and I. Solera (2020). «A sectoral anatomy of the Spanish Productivity Puzzle». Occasional Papers nº 2006, Bank of Spain. And Bank of Spain (2019). «Challenges for the Spanish economy in the postpandemic scenario» in the 2019 Annual Report. For a detailed analysis of the digitalisation of the Spanish economy, see the Dossier «Digitalisation and European funds: a winning pair» published in the MR03/21.

Activity and employment indicators

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

	2019	2020	Q2 2020	Q3 2020	Q4 2020	Q1 2021	04/21	05/21	06/21
Industry									
Industrial production index	0.7	–9.4	–23.4	–5.3	–2.4	2.9	48.2	...	...
Indicator of confidence in industry *(value)*	–3.9	–14.0	–27.8	–11.9	–11.0	–7.3	2.6	4.6	0.2
Manufacturing PMI *(value)*	49.1	47.5	39.4	51.4	51.1	53.0	57.7	59.4	...
Construction									
Building permits *(cumulative over 12 months)*	17.2	–12.8	–12.5	–19.1	–19.9	–19.1	–6.9	...	...
House sales *(cumulative over 12 months)*	3.6	–12.7	–11.8	–17.7	–17.6	–17.7	–9.4	...	...
House prices	5.1	2.1	2.1	1.7	1.5	...	–	–	–
Services									
Foreign tourists *(cumulative over 12 months)*	1.4	–36.8	–22.8	–50.7	–72.6	–85.4	...	...	...
Services PMI *(value)*	53.9	40.3	28.4	47.3	43.0	44.3	54.6	59.4	...
Consumption									
Retail sales	2.3	–7.1	–18.3	–3.5	–3.0	–0.4	40.5	19.6	...
Car registrations	–3.6	–29.2	–68.6	–7.5	–13.2	12.7	1.787.9	177.8	...
Consumer confidence index *(value)*	–6.3	–22.8	–27.9	–26.9	–26.3	–22.1	–11.6	–9.9	–11.7
Labour market									
Employment [1]	2.3	–2.9	–6.0	–3.5	–3.1	–2.4	–	–	–
Unemployment rate (% labour force)	14.1	15.5	15.3	16.3	16.1	16.0	–	–	–
Registered as employed with Social Security [2]	2.6	–2.0	–4.4	–3.0	–2.0	–1.4	3.2	3.8	...
GDP	**2.0**	**–10.8**	**–21.6**	**–8.6**	**–8.9**	**–4.2**	**–**	**–**	**–**

Prices

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

	2019	2020	Q2 2020	Q3 2020	Q4 2020	Q1 2021	04/21	05/21	06/21
General	0.7	–0.3	–0.7	–0.5	–0.7	0.6	2.2	2.7	2.6
Core	0.9	0.7	1.1	0.5	0.2	0.4	0.0	0.2	...

Foreign sector

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

	2019	2020	Q2 2020	Q3 2020	Q4 2020	Q1 2021	04/21	05/21	06/21
Trade of goods									
Exports *(year-on-year change, cumulative over 12 months)*	1.8	–10.0	–7.2	–8.9	–10.0	–8.1	–1.0	...	...
Imports *(year-on-year change, cumulative over 12 months)*	1.0	–14.7	–9.3	–13.3	–14.7	–14.0	–7.8	...	...
Current balance	**26.6**	**7.7**	**18.1**	**11.5**	**7.7**	**6.1**	**7.7**	**...**	**...**
Goods and services	37.5	16.8	27.7	20.3	16.8	15.2	16.1	...	...
Primary and secondary income	–10.9	–9.0	–9.6	–8.8	–9.0	–9.1	–8.4	...	...
Net lending (+) / borrowing (–) capacity	**30.8**	**12.7**	**22.6**	**16.3**	**12.7**	**11.0**	**12.9**	**...**	**...**

Credit and deposits in non-financial sectors [3]

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

	2019	2020	Q2 2020	Q3 2020	Q4 2020	Q1 2021	04/21	05/21	06/21
Deposits									
Household and company deposits	5.4	7.5	8.0	9.0	8.7	8.9	5.2	...	...
Sight and savings	10.7	12.3	13.0	13.8	13.7	14.1	9.6	...	...
Term and notice	–13.4	–16.5	–16.1	–16.5	–17.1	–20.4	–22.9	...	...
General government deposits	8.8	1.0	–6.6	5.2	11.8	11.2	12.8	...	...
TOTAL	**5.6**	**7.1**	**7.1**	**8.7**	**8.9**	**9.1**	**5.7**	**...**	**...**
Outstanding balance of credit									
Private sector	–1.5	1.2	1.5	2.0	2.4	2.3	0.4	–1.1	...
Non-financial firms	–3.4	4.9	6.1	7.1	7.9	7.8	1.6	–2.2	...
Households - housing	–1.3	–1.8	–2.1	–1.8	–1.5	–1.0	–0.4	–0.1	...
Households - other purposes	3.2	0.8	0.7	0.3	–0.1	–1.8	–0.5	–1.0	...
General government	–6.0	3.0	0.1	1.1	8.8	9.5	16.2	16.7	...
TOTAL	**–1.7**	**1.3**	**1.5**	**1.9**	**2.7**	**2.7**	**1.3**	**–0.1**	**...**
NPL ratio (%)[4]	**4.8**	**4.5**	**4.7**	**4.6**	**4.5**	**4.5**	**4.5**	**...**	**...**

Notes: *1. Estimate based on the Active Population Survey. 2. Average monthly figures. 3. Aggregate figures for the Spanish banking sector and residents in Spain. 4. Period-end figure.*

Source: *CaixaBank Research, based on data from the Ministry of Economy, the Ministry of Public Works, the Ministry of Employment and Social Security, the National Statistics Institute, the State Employment Service, Markit, the European Commission, the Department of Customs and Special Taxes and the Bank of Spain.*

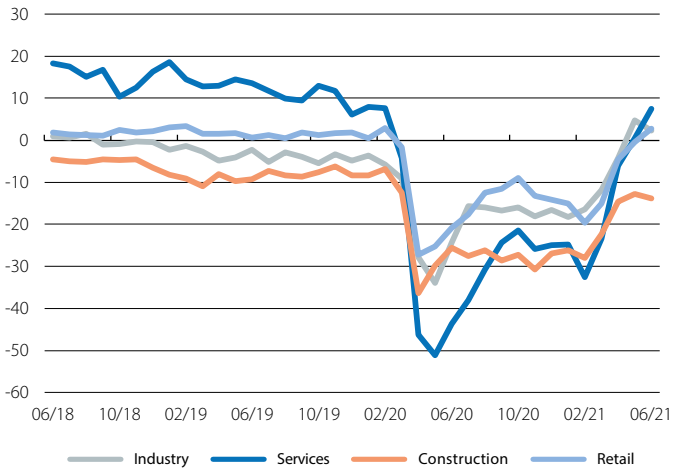
The summer brings economic recovery in Portugal, despite the pandemic

Q2 ends with improvements. In the penultimate week of June, the daily economic activity indicator, which compiles information relating to the various sectors (e.g. road traffic, payment card usage, electricity consumption, etc.) stood 4% above the level of the end of 2020 and indicated a recovery in economic activity on the order of 7% compared to Q1 2021. Similarly, turnover in services and in industry have registered significant recoveries in the first two months of Q2. Notably, in May, retail sales were already above the level of January 2020. Confidence has also recovered rapidly in all sectors, benefiting from the easing of lockdowns and progress in the vaccination roll-out. It is plausible that economic activity in Q2 has benefited from increased consumption associated with greater household savings during the lockdown. It should be recalled that in Q1, the savings rate increased to 14.3% of disposable income, the highest level in the series, which leads us to believe that in the rest of the year household spending will rise and will reflect the gradual reversal of the previously accumulated savings.

The rise in infections could slow the recovery, but not derail it. In contrast with the recovery in economic activity in the closing stages of Q2, Q3 began marked by the increase in infections, which in some parts of the country (specifically in Lisbon) is causing the lifting of restrictions to be postponed. This could lead to less decisive growth in Q3 and Q4, albeit without jeopardising the recovery in economic activity. It should not be forgotten that, despite the rise in new infections and the increased presence of more transmissible variants, the incidence of deaths remains low and the vaccination roll-out is progressing at a faster rate than in the rest of the EU (more than 50% of the population has already received at least one dose and 30% already have both doses), suggesting that new periods of strict lockdown could be avoided.

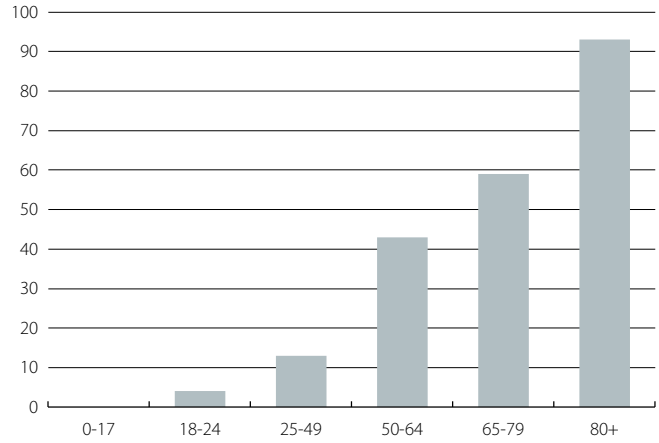
Employment continues to recover slowly following the end of lockdown. The employed population increased slightly in May (+13,800 people versus the previous month), the fourth consecutive month with a positive (albeit not very significant) quarter-on-quarter change. Compared to pre-pandemic levels, there are still some 21,800 fewer jobs. The unemployment rate, meanwhile, crept up in May to reach 7.2% (7.0% in April). The importance of the employment support measures is clear: if the 299,281 people on simplified lay-off in May were to become unemployed, and the rest of the variables were to remain constant, then the unemployment rate would reach around 13% in May. Despite the relatively benign behaviour of unemployment to date, we maintain the expectation that unemployment will deteriorate towards the end of the year.

Portugal: confidence in various economic sectors
(%)



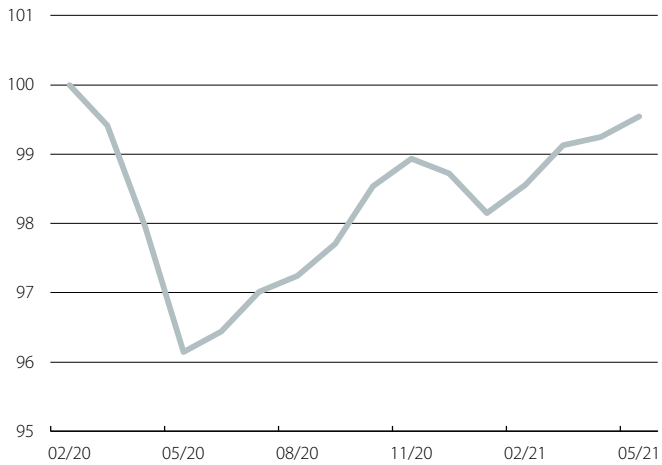
Source: *CaixaBank Research, based on data from the European Commission.*

Portugal: full vaccination by age group
(% of the population)



Source: *CaixaBank Research, based on data from the Portuguese Directorate General for Health.*

Portugal: employment
Index (100 = February 2020)



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

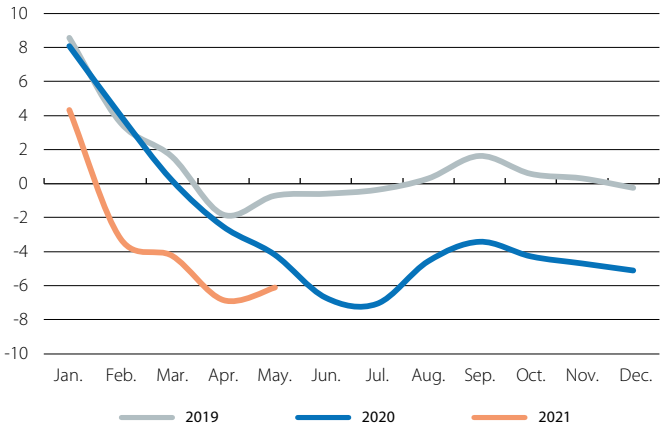
The public accounts continue to be affected by the COVID-19 crisis. In particular, the consolidated general government deficit stood at 6.1% of GDP up to May (–4.2% in the same period of 2020 and –0.7% in May 2019). The year-on-year deterioration in the deficit can be explained by the decline in incomes and the rise in expenditure. In particular, among the latter, pandemic-related expenditures have played a significant role: it is estimated that COVID-related measures with an impact on the budget balance are equivalent to 3.1% of GDP up to May. However, the weight of these measures as a percentage of GDP is expected to decline between now and the end of the year, in line with the gradual improvement in economic activity and the progressive withdrawal of restrictions as normality returns. That said, there is still uncertainty over precisely what impact the new restrictions, as well as the prolongation and/or creation of new measures to support the economy, will have on the public accounts. In this context, public debt reached 129.8% of GDP in May. Although high, this figure is nonetheless 3.8 pps below that of the end of 2020.

The real estate market remains resilient. In Q1, house prices grew more moderately than in the previous quarter, but valuations remain strong (+1.6% quarter-on-quarter and +5.2% year-on-year). In the same period, some 43,757 homes were sold (+0.5% year-on-year) and the value of properties sold increased by 2.5% year-on-year, placing the average price based on sales at 158,300 euros (+2.0% year-on-year, a more moderate increase than in the previous quarter, but nonetheless an indication that the market remains resilient). Meanwhile, the evolution of the Condifencial Imobiliário price index suggests that in Q2 the trend of market appreciation will continue.

COVID accentuates the risks to financial stability. The balance of financial risks is dominated by elements such as the high levels of indebtedness, the risk of a deterioration in the financial conditions, the banking sector's exposure to public debt, and the risk of a reduction in the value of real estate assets used as collateral in mortgages. In turn, the pandemic could create problems with respect to firms' creditworthiness and could lead to an increase in defaults. In short, the banking sector is facing pressure in terms of profitability, with low interest rates, competition from other players and the likely increase in defaults. The data for Q1, however, do not yet reflect this increase in defaults, with an NPL ratio of 4.6%, –0.3 pps compared to the end of 2020. However, this value could increase in the future once the moratoria are brought to an end, particularly among those businesses and sectors hardest hit by the pandemic. Indeed, moratoria continue to account for a considerable portion of the stock of credit, at 11.7%, and even more so in the case of loans to businesses (30.4%).

Portugal: general government balance *

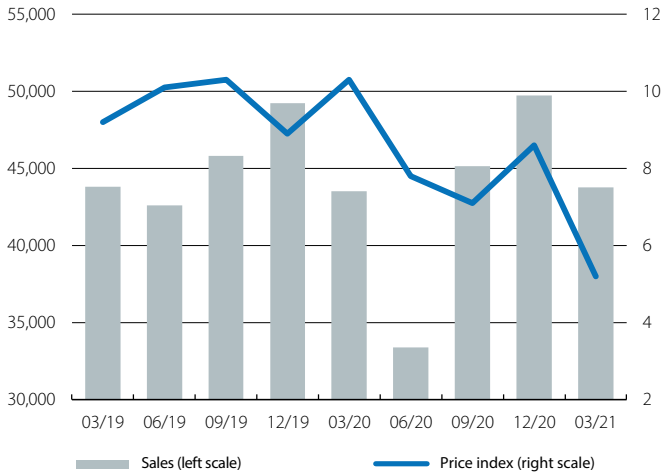
(% of GDP)



Note: ** Public accounting data.*
Source: *CaixaBank Research, based on data from the DGO.*

Portugal: house sales and prices

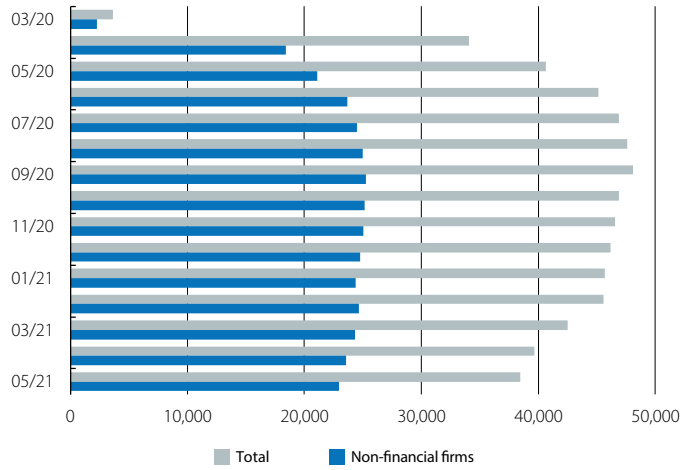
(Number of homes) *Year-on-year change (%)*



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

Portugal: loans under moratorium

(EUR millions)



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

Portugal: can it pick up the pace in the digital race?

The COVID-19 pandemic has reinforced the importance of digitalisation in our lives. Thanks to this technological innovation, more than 22% of the employed population in Portugal was able to switch to teleworking in Q2 2020, young people were able to attend classes remotely, we were able to order food from our favourite restaurants and watch films and series on streaming platforms, doctors and patients could stay in touch through remote appointments, and citizens could access public services digitally. In short, digitalisation allowed the economy and society to avoid coming to a complete stop during the lockdown. Not only did this help to soften the economic and social blow of the pandemic, but it has also underscored the importance of making further progress in this sphere. In this context, it is important to look at Portugal to assess where it is in this process and what challenges it faces in dealing with this «digital race».

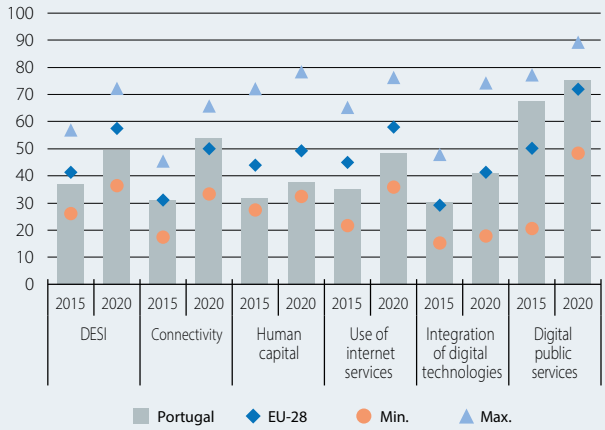
Digitalisation: where we are now...

To analyse Portugal's current situation, we will use the Digital Economy and Society Index (DESI) developed by the European Commission, which assesses the position of 28 EU countries (still including the UK) across five spheres: connectivity, human capital, the use of internet services, the integration of digital technology by enterprises and digital public services.

According to the 2020 DESI, which uses 2019 data, Portugal ranks 19th, placing it below the EU average. In fact, the gap has been widening over the past four years. Compared to 2015, Portugal is among the countries that made the least progress, a sign that it is falling behind in the digital transition race.

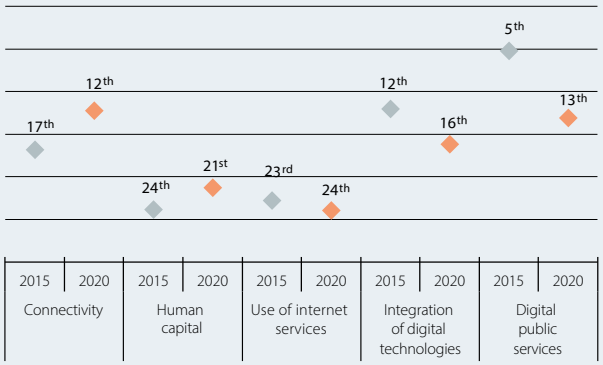
However, not all the signs are negative. Portugal stands out favourably in two spheres: connectivity and digital public services. That said, this is a relative position reached by very different means. With regard to connectivity, Portugal has climbed five positions compared to 2015. However, this result hides significant discrepancies. On the one hand, the country fares rather well in terms of fixed broadband access of at least 100 Mbps (2nd) and fixed high-speed internet coverage (7th). On the other hand, it is at the bottom of the table in terms of the number of mobile data subscriptions per 100 people, as well as in the broadband price index. It also scores poorly in the index that measures countries' readiness for 5G (8.3% of the available spectrum in 2020, compared to 21% across the EU as a whole). On the other hand, with regard to the second sphere, that of digital public services, Portugal fell considerably from the 5th position it held in 2015. However, as was the case with connectivity, the situation is somewhat varied. On the one hand, it scores poorly in digital public services available to businesses (19th), but ranks 2nd in administrative procedures that can be carried out online.

Portugal: DESI indicator and its components
(Level)



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

Portugal: rank in various spheres of the DESI
(Rank among 28 countries)



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

More alarming still is the position it holds in terms of human capital and the use of the internet, despite progress compared to 2015, especially in the latter category. Portugal is one of the lowest-ranked countries when it comes to human capital. In fact, the DESI reveals that 26% of the Portuguese population in 2019 possessed no digital skills (9% in the EU as a whole) and that 52% had only basic digital skills (58% on average in the EU). In turn, ICT specialists represented only 2.4% of total employment in 2019, which would place Portugal 25th in the ranking.

With regard to the use of internet services in the personal sphere, 22% of the Portuguese population had never used the internet in 2019, more than twice as much as in the EU as a whole. While Portuguese users rank highly

in use of the internet to access news and social media, the percentage who use it for remote banking or shopping is comparatively lower.

The picture regarding the integration of digital technology by companies is not terribly flattering either: Portugal fell to 16th position in 2020, down four from 2015. The country certainly performs well in terms of SME turnover from e-commerce, but it has one of the worst results with regard to the use of social networks, where only 16% of businesses have a presence, compared to 25% in the EU. It has also registered a decline in the percentage of SMEs selling their products online, from 18% in 2019 to 16% in 2020, placing it below the EU average (18%). In fact, SMEs are less active in the field of digitalisation than large corporations: they are typically concentrated in more traditional sectors, which have less ability to innovate and in which the obstacles are accentuated by the low digital literacy levels of the owners, managers and employees, as well as the difficulty in obtaining financing for more risky projects.[1]

... and where we are heading

In recent years, the country has made progress with several initiatives in the digital sphere. As an example, in the field of connectivity there has been a major focus on fibre optic internet, which has been extended across more remote areas. In terms of human capital, through the INCoDe.2030 programme, for instance, the country has prioritised digital inclusion for the most vulnerable, as well as education and qualification, specialisation and research. As for initiatives to promote digitalisation in enterprises, through the Indústria 4.0 strategy the country is improving employee qualifications and facilitating the digital transition in more than 20,000 businesses. Portugal also made progress in boosting the presence of SMEs in e-commerce and digital services, for instance through the ComércioDigital.t programme. In the field of digital public services, key initiatives include SIMPLEX, the creation of the ePortugal website (which groups together services for both citizens and businesses) and PEM Móvel (which allows medical prescriptions to be sent using smartphones). However, Portugal is lagging behind in the availability of the 5G network, which will serve as the foundation for a profound digital transition. In fact, the country has already failed to meet one European objective (to have at least one city with a commercial offer of 5G in 2020) and is one of three countries with no such 5G commercial offer.

What about the role of the National Recovery and Resilience Plan (known as RRP) in the digital transition in Portugal? Portugal will allocate 15% of RRP funds to the digital transition, i.e. 2,460 million euros. This amount will be divided into five components: 4.0 enterprises (650 million euros), quality of public finances (406 million), economic justice and business environment (267 million), more efficient general government administrations (578 million) and digital schooling (559 million). The investments are divided into promoting the digital transition in enterprises, improving the population's digital skills, making Public Administration more digital and simpler by reducing bureaucracy, promoting information sharing among various bodies and creating conditions for teleworking in the public service as well as mechanisms for monitoring the public accounts.

We saw in the DESI analysis that one of Portugal's greatest Achilles' heels was digital education. In contrast, the portion of RRP funds allocated to this category will be around 5% of the total, and much of this investment is destined for the Public Administration. Despite the undeniable benefits of more efficient, digital and less bureaucratic public services, a more decisive commitment to the population's digital skills would also be important; indeed, there is little point in making important digital services available to citizens and businesses if they do not have the ability to use them properly. In this digital race which the country is facing, it is important not to leave anyone behind. In short, the RRP will be a step forward in terms of digitalisation, but with a little more intent (i.e. addressing more emphatically those areas which the DESI detects as being weaker) it could represent a much more ambitious leap forward.

Vânia Duarte

1. European Commission (2019). «The digitalisation of small and medium-sized enterprises in Portugal: Models for financing digital projects».

Activity and employment indicators

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

	2019	2020	Q3 2020	Q4 2020	Q1 2021	Q2 2021	04/21	05/21	06/21
Coincident economic activity index	1.1	–5.3	–6.6	–5.5	–3.9	...	–1.7	–0.5	...
Industry									
Industrial production index	–2.2	–6.9	–0.5	–2.1	–0.8	...	37.3	27.1	...
Confidence indicator in industry *(value)*	–3.2	–15.8	–19.4	–14.7	–13.6	–5.0	–9.7	–4.7	–0.7
Construction									
Building permits - new housing (number of homes)	15.2	3.3	–10.8	12.7	42.4	...	72.7	...	...
House sales	1.7	–5.7	–1.5	1.0	0.5	...	...	...	...
House prices *(euro / m² - valuation)*	10.4	8.3	6.9	6.0	6.2	...	8.0	8.8	...
Services									
Foreign tourists *(cumulative over 12 months)*	7.8	–75.7	–57.6	–75.7	–86.3	...	–84.4	–80.3	...
Confidence indicator in services *(value)*	12.9	–21.6	–37.8	–19.5	–19.1	–9.9	–16.8	–10.3	–2.6
Consumption									
Retail sales	4.4	–3.0	–1.1	–1.9	–7.5	...	25.8	15.6	...
Coincident indicator for private consumption	2.1	–5.7	–7.5	–5.4	–2.2	...	0.5	1.6	...
Consumer confidence index *(value)*	–8.0	–22.4	–26.9	–26.2	–24.4	–17.3	–21.0	–16.7	–14.2
Labour market									
Employment	1.2	–1.9	–3.1	–1.2	–1.3	...	1.3	3.5	...
Unemployment rate (*% labour force*)	6.6	7.0	8.0	7.3	7.1	...	7.0	7.2	...
GDP	**2.5**	**–7.6**	**–5.6**	**–6.1**	**–5.3**	**...**	**...**	**...**	**...**

Prices

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

	2019	2020	Q3 2020	Q4 2020	Q1 2021	Q2 2021	04/21	05/21	06/21
General	0.3	0.0	0.0	–0.2	0.4	0.9	0.6	1.2	0.5
Core	0.5	0.0	–0.1	–0.1	0.5	0.4	0.1	0.6	–0.2

Foreign sector

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

	2019	2020	Q3 2020	Q4 2020	Q1 2021	Q2 2021	04/21	05/21	06/21
Trade of goods									
Exports *(year-on-year change, cumulative over 12 months)*	3.6	–10.2	–7.8	–10.2	–8.0	...	–0.5	...	...
Imports *(year-on-year change, cumulative over 12 months)*	6.0	–15.1	–12.0	–15.1	–15.6	...	–9.5	...	...
Current balance	**0.8**	**–2.4**	**–2.2**	**–2.4**	**–2.2**	**...**	**–2.3**	**...**	**...**
Goods and services	1.6	–3.6	–3.0	–3.6	–3.3	...	–3.2	...	...
Primary and secondary income	–0.7	1.2	0.8	1.2	1.1	...	0.8	...	...
Net lending (+) / borrowing (–) capacity	**2.6**	**0.3**	**0.3**	**0.3**	**0.3**	**...**	**0.1**	**...**	**...**

Credit and deposits in non-financial sectors

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

	2019	2020	Q3 2020	Q4 2020	Q1 2021	Q2 2021	04/21	05/21	06/21
Deposits [1]									
Household and company deposits	5.2	10.1	9.2	10.1	10.6	...	10.6	9.9	...
Sight and savings	14.8	18.8	18.4	18.8	18.5	...	18.7	17.3	...
Term and notice	–2.9	1.4	0.4	1.4	2.4	...	2.1	1.9	...
General government deposits	5.6	–21.2	–13.8	–21.2	–23.6	...	–13.3	–7.6	...
TOTAL	**5.2**	**9.0**	**8.2**	**9.0**	**9.4**	**...**	**9.8**	**9.4**	**...**
Outstanding balance of credit [1]									
Private sector	–0.1	4.6	2.1	4.6	5.1	...	5.4	4.7	...
Non-financial firms	–3.7	10.5	4.4	10.5	11.0	...	11.0	8.4	...
Households - housing	–1.3	2.1	0.7	2.1	2.6	...	2.9	3.1	...
Households - other purposes	16.5	–1.2	1.3	–1.2	–1.0	...	0.2	0.5	...
General government	–4.7	–4.3	–5.7	–4.3	–5.1	...	–3.9	–1.8	...
TOTAL	**–0.3**	**4.2**	**1.8**	**4.2**	**4.7**	**...**	**5.1**	**4.4**	**...**
NPL ratio *(%)* [2]	**6.2**	**4.9**	**5.3**	**4.9**	**4.6**	**...**	**...**	**...**	**...**

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 Datastream.*

Structural reforms in the EU: promises of future prosperity

The launch of the Next Generation EU (NGEU) programme[1] marks the opening of the clearest window of opportunity for reform in years, if not decades, in Spain and other EU countries. Part of this hope comes from the structural investments that are to be financed, but also key are the economic reforms associated with the programme. However, European countries' agendas for reform do not stop at those initiated «from Brussels». In this article, we will explore the content of the structural reform agendas proposed by EU countries, whether they emanate from the Union itself or at the national level, and why they take the form that they do. This exercise will be very helpful in painting a picture of what kind of future Europe is pursuing.

Structural reforms: a definition

Let us start with a simple question: what are structural reforms? If this question had been posed to economists at the beginning of the 1990s, the most likely answer would have been some variant of «any intervention in the economy that generates an increase in long-term growth». If we were to repeat the question two decades later, around 2010, in addition to the aforementioned efficiency objective, this consensus would probably have included a reference to such interventions helping to reduce inequality. Today, a third element would likely be added to the response, in that this growth should also be environmentally sustainable. Thus, the current view is that structural reforms are actions which allow the economy's efficiency, equity and sustainability to be improved, thereby generating greater future well-being for more people.

This hypothetical question is intended to highlight a key element which is not always evident: the agenda of structural reforms is not set in stone, but rather depends on the particular moment in history at which they arise. The reason for this is twofold. Firstly, key trends affecting the economy vary, especially demography and technology. Secondly, political and social determining factors also evolve over time. Reforming a country which is in the midst of a demographic boom, the transition to industrialisation and is governed by an undemocratic regime (i.e. Spain's development of the 1960s) is not the same as doing so in a country that is immersed in a digital revolution, is internationally open, has full democracy and a rapidly ageing population, like the Spain of today.

The factors determining the reform agenda

So what agenda do Spain and Portugal need right now? Although we sometimes tend to think in highly idiosyncratic terms, and in some respects this is justified, the fact is that most EU countries share a common core of necessary structural reforms. This is logical, since we have said that the economic trends and the political and social determining factors are similar, if not common, in most European countries. So what conditions should a European reform agenda be capable of responding to?

Firstly, not only should it facilitate adaptation, but it should also help to make the most of the opportunities presented by rapid technological change, as well as respond to the demands of the demographic transition, in particular the implications of population ageing and a longer life expectancy. Secondly, such an agenda should be tailored to a very specific international context, which derives from being part of the EU. Finally, the reforms would be adopted and implemented in a group of countries which share certain traits, such as full democracy, albeit with increasing polarisation, and a tendency to have little faith in the future, which translates into a certain defensive view of the broader European status quo.

Let us leave aside for the moment this latter element, which has a lot to do with how to implement proper reforms, the subject of the next article in the Dossier,[2] and let us focus on the first two issues, which are related. Being a member of the EU means having a certain shared concept of what kind of society and economy we wish to achieve. What shape does it take? The NGEU documents themselves use a series of adjectives which clearly describe this vision: the EU of the future wishes to be green, digital, inclusive, cohesive (both territorially and socially), sustainable, resilient and future-oriented.

But being part of the EU also implies another requirement for the reforms which is not spelt out: they must serve to strengthen European integration and, in particular, its economic dimension. At the outset, the very existence of the NGEU instrument, insofar as it represents a leap in spending capacity and new financing options, is a federalising factor of the first order. Let us remember that, in order to fund the programme, there will be a significant increase in the EU budget's own resources ceiling and European debt will be issued. Moreover, and as has happened in the past with other instruments, the fact that NGEU has a definite timetable does not mean that it cannot be reactivated in the future in the event of adverse economic shocks. Ultimately, NGEU will generate a legacy in the form of higher incomes and, potentially, higher future spending and investment capacity if necessary.

1. For more details on NGEU, see the article «NGEU: capacity for transformation and macroeconomic impact» in this same Dossier.
2. See the article «Quality reform: mission impossible?» in this same Dossier.

A second aspect that is not generally mentioned is that, when NGEU-related reforms are developed, the euro area will be able to function better as a monetary area. For instance, reducing labour-market rigidities will make it easier for responses to future shocks to take the form of wage reductions rather than job cuts, as is the case right now.[3]

The NGEU programme thus has a two-pronged objective: accelerating towards achieving a more efficient, equitable and sustainable future EU, and making a qualitative leap in European integration. This double hope, as we said earlier, pivots on two different axes, a series of investments with a structural purpose, on the one hand, and a series of structural reforms on the other. The latter differ from country to country, but they actually share a common conception (you guessed it – reflecting those similar economic, political and social determining factors already mentioned above). However, the structural reforms currently on the table are not just those proposed by Brussels; Member States also have their own strategies.

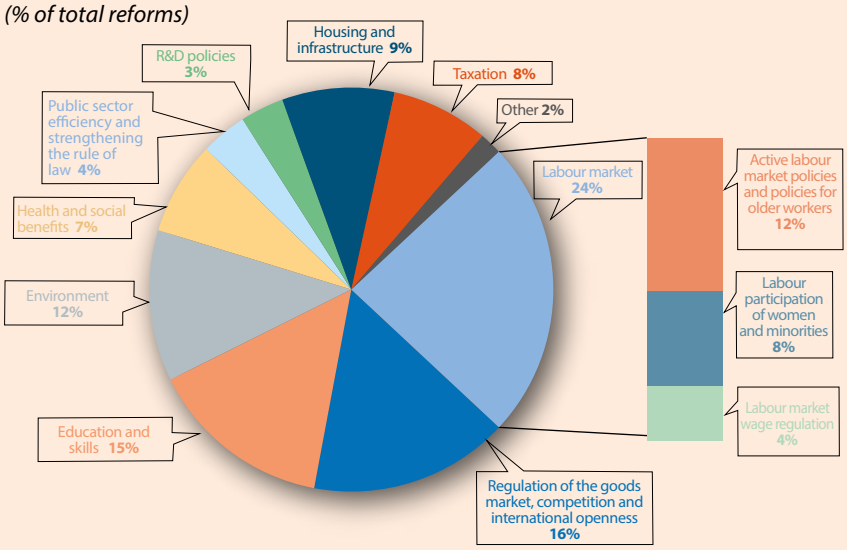
Inferring a model national reform agenda: from the specific to the common

It is therefore important to identify a shared model national agenda. This is not a simple exercise, and the ideal approach would be to infer a number of shared elements based on what advanced countries propose to do in terms of reforms. This «bottom-up» approach would give us the peace of mind of filtering out political, sectoral, social, cultural and national differences before reaching a shared vision.

This is precisely the methodology proposed by the OECD in a recent study, and it has the virtue of clarifying what is currently being considered in advanced societies on the topic of reform.[4] The attached chart, which is drawn up using OECD data but groups the categories together in order to better define the different structural areas which the reforms aim to activate, is particularly illustrative. Almost three quarters of advanced countries' structural reforms focus on four areas. The first, which is fundamental in any modern society, is the labour market. Only an efficient labour market can create the underlying conditions required to tackle inequality, at one of its key points. Here, countries propose a triple strategy: improving active policies, with particular emphasis on retraining older workers; increasing the participation of women and also minority groups; and finally, changes to the minimum wage.

Developed countries: structural reform agenda

(% of total reforms)



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

The second area is the core of any competitive economy: ensuring fair competition, both internally (product markets, competition policy) and externally (international openness). The third area is education, in the broad sense. Here they seek to boost the accumulation of human capital, a key factor for long-term growth, addressing both education in a more formal sense and the availability of key skills. Finally, the fourth priority area is the environment, which includes aspects such as cutting pollution, incorporating environmental externalities into the prices of goods and assets, and accelerating the rate of investment in green infrastructure. The remaining third of structural actions are related to areas such as health and social benefits (a reflection of the times we are living in, marked by the pandemic), public sector efficiency, improving institutional rules (i.e. the rule of law) and boosting research and innovation policy.

This is a reasonable menu which is a reflection of the times and addresses the objectives of the structural reforms that have been added in each period: efficiency, equity and sustainability. The challenge now is turning this prototype agenda into reality, which involves addressing the difficult part: how to reform. In other words, it is time to focus on the science and art of good reform. It is precisely this fundamental topic that will be the subject of our next article.

Àlex Ruiz

3. In academic terms, the euro area will be somewhat closer to what is referred to as an Optimal Monetary Area.
4. OECD (2021). «Going for growth 2021: Shaping a Vibrant Recovery».

Quality reform: mission impossible?

Why is it so difficult to carry out reforms? Why, if structural reforms tend to improve the future prospects for the majority of the population, is it so difficult to adopt them? The difficulty lies precisely in two of the aforementioned words, future and majority. Reforms promise benefits in the future, but tend to generate costs today. They promise benefits for many, but not for all. In more formal terms, the costs and benefits are distributed asymmetrically among the population and over time. This is problematic, because if something diffusely benefits many but harms a few, the latter are highly incentivised to organise themselves in the form of a lobby. It is also problematic that the costs of reforms are concentrated in the short term while the benefits are spread out in the future. This means that the politicians who will have to push them through face the dilemma of suffering the political costs of their adoption without being able to capitalise on their benefits in the immediate electoral cycle.

Reforms, in Spain? Indeed

In this respect, it is no surprise that reforms are the eternally pending topic in many countries. However, there is no need to fall into a kind of historical pessimism. In particular, we must refrain from a defeatist vision of Spain's ability to implement reform. Contrary to what is sometimes believed, Spain has been active when it comes to structural reforms. The results have sometimes been somewhat irregular, such as in the case of labour reforms. On other occasions, however, the effects have been significant, such as with the 1959 Stabilisation Plan, the 1977 Moncloa Pacts, joining the EU in 1986, the European Single Market in 1993 and integration into the EMU in 1999.

What do these successful attempts tell us about the conditions in which reforms are most likely to be undertaken? The context in which all these reforms were launched shares some common traits. Firstly, the decision to reform was taken in difficult, or very difficult, economic times. These include the time when Franco's autocracy was on the verge of collapse due to a lack of foreign currency to pay for oil, when inflation threatened the transition to democracy, when Spain faced joining the EU with its industry undergoing a transformation and unemployment sky high, or when the public finances needed rebalancing and key sectors of the economy were being privatised in the midst of a post-Olympic recession.

A second element these reforms have in common is the fact that, at least in democratic times, the government has enjoyed a comfortable majority. This is the case with the Moncloa Pacts, EU membership and joining the euro. Finally, a third element is the presence of what we could generally refer to as an external benchmark or obligation. That was the role of the IMF in the 1959 Stabilisation Plan, of the examples of income policy set by Italy and Germany which inspired the Moncloa Pacts, and of commitment to the EU in joining and entering the euro area.

In short, successful structural reforms in Spain have been adopted when there has been external pressure, when there have been strong governments, and when the country has endured difficult times. Is this only the case in Spain? No, the fact is that there is abundant empirical literature confirming that these three determining factors tend to coincide in the launch of structural reforms in many other locations and eras, and it applies to different types of reform too.[1] After all, a key issue is that the reforms mentioned are those referred to in the economic literature as a change of framework, affecting elements that define how the economy functions (the typical liberalisation programmes, for example). But the truth is that reforms in specific areas, such as labour reforms or those in the product market, are also more likely to occur when the three above factors are combined.

Reforms are launched in difficult times because in this context the main groups affected often have less bargaining power, and the relative costs for the public decision-maker are often limited: if the current situation is bad, politicians may perceive that inaction is more costly in electoral terms than taking tough decisions, even if that means confronting organised lobbies. Similarly, if there is external pressure, for example in the form of international commitments, politicians are able to «shift» part of the cost of reform to that area. Finally, a strong government has what we could call greater «political capital». This is a conceptual metaphor that seeks to capture the fact that governments have a certain degree of popularity and support which they can devote to different policies: only when this capital is plentiful it is reasonable to consider investing in something politically costly as reforms.

1. See K. Masuch, R. Anderton, R. Setzer and N. Benalal (2018). «Structural policies in the euro area». ECB Occasional Paper, (210). And V. Galasso, T. Dang, J. Hoj and G. Nicoletti (2006). «The Political Economy Of Structural Reform: Empirical Evidence From Oecd Countries». OECD Economics Department Working Papers nº 501.

From the adoption of structural reforms to their effects

So far, we have established three factors that increase the likelihood of structural reforms being adopted. Let us now turn to a second key question, that of their effects. We began the article by stating that reforms tend to generate long-term benefits. However, there is one additional element that is critical in this outcome: the expected benefits will be different depending on the economic situation, at least with certain types of reforms. For instance, it is fairly well established that labour reforms tend to yield better results when they are adopted during good economic times. Here, an apparently unsolvable problem jumps into view. For example, adopting a reform that makes the labour market more flexible is more likely in the midst of a crisis, but if it is adopted, it can lead to greater job destruction in the short term.

Is it possible to reconcile this tension and not simply reform but manage to reform well, with effective results? This is not easy and not always possible, but the evidence points to a partial solution. Many reforms act on the supply side of the economy to generate their benefits, but their costs stem from the effects on short-term demand. The solution, in these cases, is to act by combining reforms with an expansive economic policy, usually through an increase in expenditure or investment, which helps to partly offset these negative short-term impacts on demand. Tempering the short-term costs can improve the situation and, to some extent, help to produce effects more in line with those expected from implementing the same reform in good times.

Other elements of good reform include three additional key aspects: credibility, institutional quality and compensation for those who lose out.[2] Let us firstly address credibility. It is difficult to identify an element in the implementation of good reforms that is both so critical and so elusive. Not in vain, credibility increases if reforms are genuine reforms. In other words, it is particularly harmful to announce a battery of small changes as though they were decisive actions. It has also been shown to be critical to provide as much technical evidence as possible. Doing so helps to distance reforms from overly politicised readings (the latter are associated with benefits for one party, not for all) and also provides transparency, another key attribute.

A second element, as we said, is institutional quality. States that function well from an institutional point of view implement better reforms. In particular, they are able to «protect» reforms from future political changes and ensure that the expected benefits end up materialising. In this regard, good reforms in certain areas sometimes involve prior political reforms, which ensure that the former can bear fruit.

The third element concerns the compensation of the groups which lose out due to the changes introduced by the reforms. There are many ways to approach this, from direct compensation to more strategic methods. History has shown that one of the most fruitful options is to make simultaneous and typically comprehensive reforms that allow acceptable exchanges to be offered. This would be the case, for example, in labour frameworks which act simultaneously both in the sphere of flexibility (e.g. making layoffs more adaptable) and in that of security (offering active policies, which boost employability, and incomes, to meet peoples' needs during the transition to their new job). This was the case, for instance, when designing Denmark's so-called *flexisecurity* policy.

We have reached the end, and you, the reader, may pose the big question: are European countries likely to adopt ambitious and effective reforms this time round, in the context of the window of opportunity offered by NGEU? We cannot provide a comprehensive answer, but there is reason for hope. The starting conditions are similar in two major respects in most countries: we are in difficult economic times, and there is an element imposing external discipline in the form of the conditions attached to the disbursement of NGEU funds. Moreover, – and this is a stark difference compared to many other attempts at reform – we are going through an almost unprecedented period of economic stimulus, which should help alleviate some of the short-term costs on the demand side. In conclusion, there is nothing stopping us from paying attention to credibility, from taking care to properly compensate the losers in the status quo, or from institutionally shielding the reforms. However, it must be recognised that political polarisation could prove to be a burden for reformist momentum. Nevertheless, if all the factors are taken into account, we are inclined to be optimistic and believe that, perhaps this time, we could witness a new case of successful reform in many EU countries – including Spain.

Àlex Ruiz

2. See S. Khemani (2017). «Political economy of reform». World Bank Policy Research Working Paper 8224.

NGEU: capacity for transformation and macroeconomic impact

The Recovery Plans and their capacity to transform the economy

As we write these lines, the European Commission is ratifying the Recovery and Resilience Plans (RRPs) of the EU Member States. This represents the starting pistol for the distribution of the funds from the Recovery and Resilience Mechanism (RRM), the main component of the Next Generation EU Recovery Fund (NGEU), which will provide 312.5 billion euros in grants and 360 billion in loans. But receiving the funds does not mean having access to a free money bar: from the first disbursement, the Commission will monitor the execution of the projects and the implementation of the reforms set out in the RRPs, and will determine whether or not the funding will continue to reach each country.

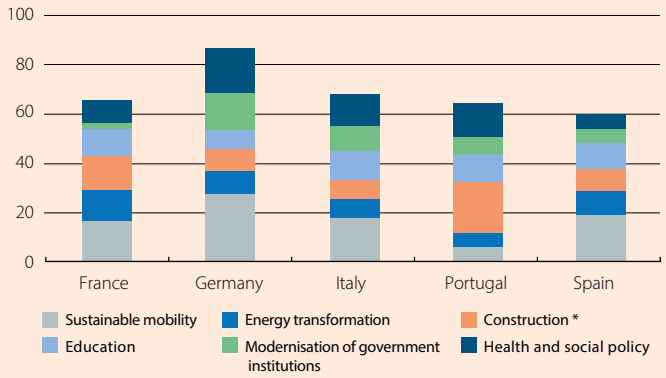
It is therefore key that the projects are executed in line with the measures and deadlines set out in the RRPs, the main characteristics of which are summarised in the first table for the four biggest economies and Portugal. The disparity in the figures reflects the unequal access to resources from the RRM, which is designed to ensure greater financial support for the countries hardest hit by the COVID-19 crisis. This explains why Italy, Spain and Portugal are the countries to benefit the most in the distribution. With regard to the application for loans and grants, Spain only discloses in its RRP the use of the latter, leaving open the possibility of applying for loans from 2022, unlike Germany and France, which have ruled out requesting them. Italy, meanwhile, foresees making full use of both the grants allocated to it and the loans, while Portugal's Plan incorporates the full amount of the grants but only 20% of the total loans it could access. As for how the funds will be spent, the Commission imposed a requirement that at least 37% must be allocated to projects for the green transition and 20% to digital transformation projects. While the various plans all meet these requirements, there are differences between them.

For instance, Germany will allocated 52% on digitalising its economy (more than twice as much as Brussels demands), followed by Spain (28%), while France will focus on the transition to a green economy (46%).

The investments proposed to achieve the various targets also differ from country to country, although some overarching trends are apparent, as reflected in the chart. Sustainable mobility projects will receive the largest share of funds (between 28% in Germany and 16% in France). The exception is Portugal, which will allocate almost 20% of the funds to construction (including new construction and programmes to support access to housing, as well as energy-related renovations of existing buildings). On the other hand, both Spain and Italy are the only countries contemplating investments to modernise and boost the competitiveness of the tourism sector (5.0% and 2.0% of the total, respectively), which has been one of the hardest hit and accounted for around 12-13% of GDP in both countries prior to the pandemic.

Main areas of investment of the national RRPs

(% of the total funds)



Note: ** Refers to expenditure on energy-related building renovations, except in Portugal, which also includes expenditure on new construction.*
Source: *CaixaBank Research, based on data set out in the RRPs and estimates by Bruegel.*

The RRPs also include reforms based on recommendations by the European Semester which seek to address major structural challenges and correct macroeconomic imbalances. The German Plan is the most scarce in terms of reforms, which include the modernisation and digitalisation of general government institutions and the removal of barriers to investment. In the other four countries, one of the priorities is to improve the state of the public finances: France proposes a spending rule; Spain plans to undertake a fiscal reform in 2023 which will increase revenues and reform the pension system (with the agreement of all the social stakeholders); Italy will focus on combating tax fraud, will review its public expenditure annually between 2023 and 2025 and will audit all general government institutions, while Portugal proposes measures to improve the performance of public corporations. Another common challenge involves combating unemployment through active policies in most cases. It should be noted, however, that France will also reform the unemployment benefit system in order to incentivise the unemployed to search for work, while Spain will convert its ERTE furlough schemes into a permanent internal adjustment mechanism for businesses.

National Recovery and Resilience plans

		Germany	France	Italy	Spain	Portugal
	Plan amount (EUR millions)	27.9	41.0	191.5	69.5	16.6
	(%) of 2019 GDP	0.8	1.7	10.7	5.6	7.8
Financing from the Recovery and Resilience Mechanism (EUR millions)	Grants	25.6	39.4	68.9	69.5	13.9
	Loans	No	No	122.6	Maybe	2.7
Main spheres of action (% of total Plan)*	Green transformation**	42	46	44	40	38
	Digital transformation***	52	21	25	28	22

Notes: ** The data correspond to the percentages published by the European Commission, after approving the RRPs in June. Therefore, in some cases there may be small differences relative to what was published in the national RRPs. ** Minimum required by Brussels: 37. *** Minimum required by Brussels: 20.*
Source: *CaixaBank Research, based on the national RRPs and the European Commission.*

What will the macroeconomic impact of NGEU be?

The uncertainty surrounding the potential impact of the NGEU programme is high. The economic literature does not provide a reliable benchmark on the effects of discretionary fiscal measures. Moreover, the situation in which it will be implemented is exceptional and we do not yet know all the details about the programmes it will finance or the reforms they will serve to strengthen. In spite of this, we shall analyse how powerful the Plan could become for the major European economies. In order to build impact scenarios, we will make assumptions about how much GDP will be generated for each euro invested – the so-called multiplier – as well as about countries' capacity to absorb the funds. Furthermore, we will focus on the grants, since some countries have not yet decided whether they will make use of the loans, others will not request them at all, and those who do use them will face a major challenge in terms their capacity to absorb them.

The multiplier remains an unresolved problem, despite enormous efforts dedicated to identifying it.[1] In the case of NGEU, there are specific reasons to expect high multipliers: i) it is primarily an investment Plan; ii) it will be supported by structural reforms, which provide opportunities to move towards more flexible regulatory regimes (e.g. in the labour market and the goods and services market) and to achieve lasting effects beyond the execution period;[2] iii) the timing is right to make the most of the funds, given the high idle productive capacity following the shock of COVID-19 and the environment of very low interest rates,[3] and iv) it represents a coordinated shock across Europe and an additional positive impact can be expected as a result of positive spillovers between countries.[4]

Conservative scenario: low multipliers and low persistence

(pp difference in GDP versus a scenario without NGEU funds)

	2021	2022	2023	2024	2025	2026
Euro area	0.41	0.54	0.60	0.66	0.30	0.20
Germany	0.11	0.14	0.16	0.18	0.08	0.05
Spain	0.92	1.22	1.36	1.49	0.66	0.44
France	0.26	0.35	0.39	0.43	0.19	0.13
Italy	0.62	0.82	0.91	1.00	0.45	0.30
Portugal	1.03	1.36	1.51	1.65	0.73	0.48

Note: *Absorption of grants in 4 years (25% per year, starting in 2021).*
Source: *CaixaBank Research.*

To assess the effects of NGEU, therefore, we have projected two scenarios: (i) a high-impact scenario with high multipliers and long-term persistence, assuming that the recovery plans are implemented effectively such that the impact per euro invested should be in the upper range of the usual estimates;[5] and (ii) a more conservative scenario with low multipliers and limited persistence.[6] In addition, since each economy can plan where to invest the funds, they will be efficiently channelled and a much higher absorption is to be expected than in the case of other European programmes (less than 50%, on average); in our scenarios we assume that it will reach 100%.[7] The results obtained are presented in the second and third tables. In our more conservative scenario, the NGEU Plan could lead to an annual increase in euro area GDP of between 0.4% to 0.7% up until 2024. This range rises to 0.9%-1.6% in Spain and Portugal, and to 0.6%-1.0% in Italy, while it would be limited to 0.3%-0.4% in France and to 0.1%-0.2% in Germany. In the high-impact scenario, the annual increase in euro area GDP could be between 0.5% and 1.2%, reaching a range of 1.4%-2.9% in Portugal and of 1.2%-2.6% in Spain. These calculations only take into account the part of NGEU associated with grants, although some countries have already applied for part of the loans as well (Italy and Portugal). Also, they do not include the potential effect of the associated reforms, which could have an even more significant long-term impact than that of the investments of the European funds and differentiated by country.

High-impact scenario: high multipliers and high persistence

(pp difference in GDP versus a scenario without NGEU funds)

	2021	2022	2023	2024	2025	2026
Euro area	0.54	0.87	1.07	1.19	0.78	0.55
Germany	0.14	0.23	0.28	0.32	0.21	0.15
Spain	1.23	1.98	2.39	2.62	1.70	1.19
France	0.35	0.56	0.69	0.77	0.51	0.36
Italy	0.82	1.33	1.61	1.78	1.17	0.82
Portugal	1.37	2.20	2.65	2.90	1.88	1.31

Note: *Absorption of grants in 4 years (25% per year, starting in 2021).*
Source: *CaixaBank Research.*

In any case, the estimates leave little doubt that NGEU is a powerful anti-cyclical policy, but many doubts about its potential scope and long-term legacy. If high-quality programmes are chosen, effectively developed and accompanied by useful reforms (the conditions attached to the disbursements could play an important role), a very high impact and potentially even permanent benefits could be achieved. If not, the boost to growth will be only fleeting. All in all, there is much at stake.

José Manuel Martínez Martínez and Rita Sánchez Soliva

1. For an in-depth review of the literature on multipliers, see A. Ramey (2019), «Macroeconomic Consequences of Infrastructure Investment».
2. See Albrizio and Geli (2021). «Scaling up NGEU, the role of institutions and investment Project selection». Bank of Spain Working Paper.
3. See ECB (2021). «The macroeconomic impact of the Next Generation EU instrument on the EMU». And Canova and Pappa (2021), «What are the likely macroeconomic effects of the EU Recovery plan?».
4. See Alloza, Burriel and Pérez (2018). «Fiscal Policies in the euro area: revisiting the size of spillovers».
5. We will place it slightly above 2 in the fifth year, in cumulative terms.
6. In cumulative terms, close to 1 in the third year and practically stable from then on (the positive effect is almost completed three years after the investment).
7. In both scenarios, with regard to the timing of the distribution of funds, we will assume that they are fully distributed during the period 2021-2024 at a rate of 25% each year.

The Recovery Plan and inequality: moving towards a more inclusive economy

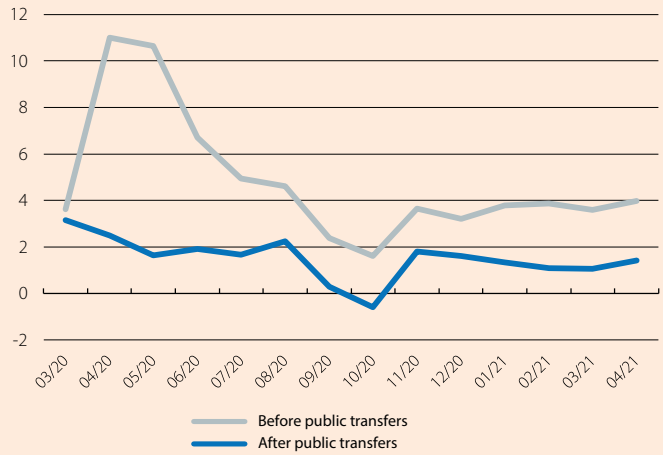
Social cohesion, together with the ecological and digital pillars, constitute the key spheres of action of the Recovery, Transformation and Resilience Plan (RTRP). This is a plan which outlines the roadmap for a robust, inclusive and resilient economic recovery, not only to tackle the crisis triggered by the COVID-19 pandemic but also to respond to the challenges of the next decade.

The impact of the crisis on inequality

Besides being a health and economic crisis, the COVID-19 pandemic has also been a social crisis, with a highly asymmetric impact among the different segments of society. It has deepened the differences in labour income which had persisted since the 2008 financial crisis, with a greater impact on young workers, on the sectors hardest hit by the restrictions (mostly services), and on those with fewer skills and on temporary contracts. These are groups with below-average wages, so the wage gap has widened and the percentage of households living close to the poverty line and at risk of exclusion has increased. Furthermore, the destruction of jobs has been concentrated among the most disadvantaged groups, exacerbating income differences.

Spain: change in the Gini index since the start of the pandemic

Change in index compared to February 2020 (pps)



Notes: *The Gini index is the benchmark index for analysing the level of wage inequality. It can take values on a scale between 0 and 100. Higher numbers reflect higher levels of inequality and vice versa. The change in the Gini index compared to February 2020 is corrected to account for the seasonal variations experienced during the same period two years earlier.*
Source: *CaixaBank Research, based on internal data.*

While official statistics on inequality in Spain during this pandemic are not yet available, the CaixaBank Research Inequality Tracker[1] allows us to observe how inequality has changed over the past few months. The fluctuations in the Gini index show the significant impact of COVID-19 on income inequality before public sector transfers, with a historical increase of 11 points between February and April 2020 and a partial correction in the months that followed. However, in April 2021 the index was still 4 points above pre-pandemic levels, although automatic stabilisers, public transfers and the mechanisms put in place to mitigate the impact of the crisis have greatly damped the rise in inequality and reduced this increase in the Gini index to 1.4 points.

Moving towards a more inclusive form of growth

In this context, the Recovery and Resilience Facility (RRF), which is at the heart of the Next Generation EU Recovery Fund, includes inclusive growth and greater social and territorial cohesion among its objectives.

This objective of inclusive growth, understood as greater well-being for the whole of society, is not only included for equity reasons, but also efficiency reasons. Inequality can be harmful not only in terms of social justice, but also economic justice: it makes growth more fragile, it results in a suboptimal use of human capital and talent, it reduces cohesion and it increases social conflict.

In this vein, Spain's Recovery Plan includes among its objectives the reduction of inequality and greater social inclusion and cohesion, addressing it in two ways: protecting the most vulnerable and providing opportunities for development. Measures in the first category include protective or «mitigation» measures, such as the modernisation and bolstering of social services and inclusion policies, which mitigate the inequality that already exists, as well as affecting secondary incomes.[2] The second category, with a longer-term vision, would focus on preventive actions such as tackling inequality *ex-ante* where it is generated, within primary incomes. To tackle it, it will be essential to address the gaps that cause it in the first place, such as the digital, territorial, educational and generational divides... all closely interrelated.

Inequalities begin to develop from the moment life begins, and they feed into each other and thus accumulate over the years. Inequalities in education are transferred to the labour market and wages, and ultimately to pensions. In this respect, the increase in child poverty in Spain is very worrying, as it is a sign of greater inequality in future generations to come. Therefore, reducing the gaps that prevent a higher degree of equal opportunity for development and thus avoiding the pitfalls of poverty is essential to tackling inequality at its source.

1. www.inequality-tracker.caixabankresearch.com.
2. Primary income includes income from work, investment income and other primary income. Secondary income includes current transfers, current taxes, social security contributions and benefits, etc.

Closing gaps

The RTRP includes spheres of action which aim to tackle a variety of issues, affecting inequality, such as actions in the field of education, digitalisation, territorial cohesion and the labour market, among others.

Measures in the field of **education** are the cornerstone for bolstering equal opportunities from the ground up. They include investments worth 1,646 million euros, with the creation of 65,000 places in child eduction – thereby addressing a key stage for achieving equal opportunities – and a new skills-based curriculum. Improving educational outcomes is the best tool for achieving long-term lasting progress in terms of inequality and represents an essential lever for achieving improvements in productivity and the transformation of the Spanish economy.

Linked to the educational measures, **digitalisation** also plays an important role. It is estimated that 15 million Spaniards lack basic digital skills. The RTRP allocates 3,590 million to improving digital skills and to the digitalisation of education, including investments in digital infrastructure, connectivity and support for the digitalisation of economic sectors such as tourism, industry and agrifood, and the digitalisation of SMEs. The aim of these actions is to ensure digital inclusion through training in digital skills, to improve employability and working conditions and, ultimately, to obtain productivity gains.

Digitalisation is both a challenge and an opportunity for reducing inequality. On the one hand, the existence of a digital divide in access to and knowledge of digital technology creates a vicious circle in which inequality feeds back on itself. However, at the same time digital technologies open a window of opportunity for improving access to education and teaching formats, creating new jobs, improving working conditions and obtaining productivity gains.

Also, measures aimed at bolstering **territorial cohesion** and reducing differences between the development levels of different regions will address another focus of inequality, namely the rural-urban divide, which has been widened by demographic dynamics such as ageing and depopulation. In all, the Plan sets out 130 measures aimed at rural areas and small towns, ranging from economic diversification and boosting innovation to full digital connectivity and support for entrepreneurship.

Another key focus for combating inequality is the correction of the imbalances which persist in the **labour market** (high rate of structural unemployment, temporary employment and job insecurity), which amplify some of the problems mentioned above. While labour reform is subject to agreement between the various social stakeholders, it is essential to improve the effectiveness of public employment services and active employment policies, and to reconcile the need for flexibility with security in the labour market.

Impact of the RTRP on inequality

According to estimates contained in the RTRP itself, it is expected to mitigate income inequality by reducing the Gini index to 31.3 points 10 years from now, compared to 33.2 points prior to the pandemic[3] (30.8 on average in the EU). Such a reduction would bridge two-thirds of the gap with the EU.

The Plan is also expected to have a positive effect on regional convergence through ensuring that public investment has a greater impact on GDP growth in the regions that lie in the lowest income per capita percentiles. Thus, a region with a GDP per capita that lies 1% below the national average will generate a 1.1% higher average annual growth,[4] which is to be achieved by reducing differences in employment and productivity.

Re-activating the social ladder

One of the differential features of this Plan is its broad scope and comprehensive vision, with measures that reinforce one another and will contribute to address the dynamics that fuel inequality.

The objectives of digitalisation, resilience and inclusive growth are complementary. Achieving a more resilient economy that reduces the intensity of recessions – precisely the times when inequality increases – also weakens the cyclical component of inequality, thereby ensuring that the achievements of expansionary phases are not undone in times of crisis. Moreover, improving the quality of human capital not only reduces inequality, but also promotes greater economic growth and job growth through higher productivity.

If recovering from the severe shock caused by the pandemic is the most pressing issue, then what is important is that the implementation of the Plan lays the foundations for the transformation of the Spanish economy. The weaknesses that afflict it are well known, but taking measures to treat it must not be delayed and we must activate the social ladder through education, digitalisation and employment.

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3. Data from Eurostat for 2018.
4. In the RTRP it is estimated that, in the absence of the NGEU, growth in these regions would be 1.1% below the average.

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J. Templeton.

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