MR12

MONTHLY REPORT • ECONOMIC AND FINANCIAL MARKET OUTLOOK
NUMBER 462 | DECEMBER 2021

2022

ECONOMIC & FINANCIAL ENVIRONMENT

DOSSIER: 2022 OUTLOOK

CaixaBank Research

MONTHLY REPORT - ECONOMIC AND FINANCIAL MARKET OUTLOOK
December 2021

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

CaixaBank Research
www.caixabankresearch.com
research@caixabank.com
Enric Fernández
Chief Economist
José Ramón Díez
Head of International Economies and Financial Markets
Oriol Aspachs
Head of Spanish Economy
Sandra Jódar
Head of Strategic Planning
Clàudia Canals and Nuria Bustamante
Monthly Report coordinators
Javier Garcia-Arenas
Dossier coordinator

BPI Research (UEEF)
www.bancobpi.pt /
http://www.bancobpi.pt/grupo-bpi/estudos-e-mercados/mercados-financeiros
deef@bancobpi.pt
Paula Carvalho
Chief Economist

Date this issue was closed:
30 November 2021

INDEX

Big companies

It would be very beneficial for the population as a whole if there were more big companies. For years, if not decades, many economists have been trying to convince business leaders and economic policymakers that actions must be taken to stimulate business growth. They have the overwhelming support of the empirical evidence, yet the attempts by economists have not yielded results. There are still few large companies in Spain, especially when compared to the major developed countries. This is undoubtedly one of the main reasons why the productivity of the Spanish economy remains relatively low. In other words, this is one of the main reasons why GDP per capita in Spain, or many Spaniards' purchasing power, remains far from the benchmark countries. Will COVID succeed where economists have failed?

Allow me to briefly point out the relationship between enterprise size and productivity. The proportion of large enterprises in an economy is relevant because they tend to be much more productive. In figures: sales per employee in companies with more than 250 workers more than double those of smaller firms. This is a pattern we see across the board in all developed countries. The productivity level is similar for companies of equal size. What changes is the relative weight of different-sized companies in each country. In Spain, for instance, only 0.13% of companies have more than 250 workers, while in Germany this figure is 0.3 pps higher. This difference may seem small, but the impact it has on the distribution of employment and on production is profound. In Germany, the proportion of people working in large enterprises is 10 pps higher, with significant ramifications in terms of productivity at the aggregate level.

Bigger companies are more productive, partly because they have been the best at adapting their structure to their customers' needs. They were already more productive when they were small, which is what allowed them to grow. But moreover, their larger size has enabled them to exploit economies of scale and thus further improve their productivity. Thanks to their larger size they can also invest more in innovation, both in terms of technology and in intangible assets, and they can train their workers and offer them better working conditions. The employment they offer is generally better quality (for example, the proportion of permanent contracts is clearly higher), and the remuneration is substantially higher (50% higher than in smaller firms).

So, will COVID act as a catalyst for increasing the proportion of large enterprises? It is likely. There were three latent factors pushing in this direction prior to the pandemic, which have accelerated in recent months. The first is the digitalisation of companies. The enormous investment this entails in some sectors, such as banking, acts as a driver for concentration at the sector level. The digitalisation of sales channels also multiplies the potential market that businesses can access. We have seen this during the pandemic with SMEs that have pursued the online sales channel to cushion the impact of the restrictions. Once these restrictions are lifted, sales through this channel continue to grow at double-digit rates.

The structure of global enterprises is likely to change over the coming years as well, requiring companies of a larger size. The pandemic has highlighted the importance of having a more resilient production structure, and this will surely lead companies to diversify the geographical location of their production sites, while simultaneously seeking to be closer to the end customer. In short, this will lead to a more complex structure which will likely require a larger size of business to achieve optimal performance.

Finally, the pandemic has also increased the demands of business' various stakeholders. For instance, customers, workers, investors, and in some sectors also regulation, have increasingly high demands in relation to climate change and environmental issues. The investment needs that this will entail in many sectors are also likely to push up the optimal operating size.

These are just a few examples of forces that have been operating for years, but which the pandemic has accelerated. The financial environment, and also the fact that large enterprises have faired much better during the crisis triggered by the pandemic, are factors that give additional impetus to the increase in the company size. A clear reflection of this is the number and volume of mergers and acquisitions, which globally are at a record high.

In this context, the Spanish government has just passed the Create and Grow Act which, among other things, aims to improve the regulatory environment in order to promote business growth. To achieve this, it is essential to ensure there are no substantial changes in companies' labour, tax or accounting costs when they surpass certain thresholds (such as the number of workers or their turnover). Sometimes, actions which pursue a desirable goal (for example, to help smaller firms) can have counter-productive effects. And those which affect business growth end up being very damaging for the population as a whole.

Oriol Aspachs
December 2021

Chronology

NOVEMBER 2021

13 The COP26 Climate Summit closes with a new deal on climate.
15 Migration crisis on the border between Belarus and Poland.
22 New mobility restrictions in Europe and spread of the Omicron variant.

SEPTEMBER 2021

1 The crisis affecting Chinese real estate firm Evergrande intensifies.
17 Moody's upgrades Portugal's rating (from Baa3 to Baa2).
26 Elections in Germany, bringing an end to the 16-year Merkel era.

JULY 2021

6 Iran informed the International Atomic Energy Agency of its uranium enrichment activities, a decision quickly condemned by several countries.
15 The COVID-19 delta variant rapidly spreads around the world.
23 The 2020 Tokyo Olympic Games are held without any crowds in the stands.
30 First sentence in Hong Kong under the controversial national security law.

OCTOBER 2021

3 The International Consortium of Investigative Journalists publishes its investigation into accounts in tax havens: the Pandora Papers.
15 The delta plus variant of COVID-19 begins to spread.
30 G-20 summit at which the global minimum corporate tax is endorsed.

AUGUST 2021

1 The withdrawal from Afghanistan by the US and its European allies accelerates and the Taliban regain power.
9 The UN's Climate Change report talks of mankind's responsibility in relation to global warming and warns of changes that are irreversible for centuries.
17 The European Commission disbursed the first 9 billion euros of the NGEU funds to Spain.

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.

Agenda

DECEMBER 2021

2 Spain: registration with Social Security and registered unemployment (November).
10 Spain: Fitch rating.
Portugal: turnover in industry (October).
14-15 Federal Open Market Committee meeting.
16 Governing Council of the European Central Bank meeting.
16-17 European Council meeting.
17 Spain: quarterly labour cost survey (Q3).
22 Spain: loans, deposits and NPL ratio (October and Q3).
23 Spain: quarterly national accounts (Q3).
Spain: balance of payments and NIIP (Q3).
Spain: state budget execution (November).
Portugal: home prices (Q3).
Portugal: household savings rate (Q3).
30 Spain: CPI flash estimate (December).
Spain: household savings rate (Q3).
Portugal: NPL ratio (Q3).
31 Portugal: CPI flash estimate (December).

JANUARY 2022

3 Portugal: tourism activity (November).
4 Spain: registration with Social Security and registered unemployment (December).
7 Portugal: employment and unemployment (November).
Euro area: economic sentiment index (December).
10 Portugal: turnover in industry (November).
11 Spain: financial accounts (Q3).
21 Spain: loans, deposits and NPL ratio (November).
24 US: GDP (Q4 and 2021).
25-26 Federal Open Market Committee meeting.
27 Spain: labour force survey (Q4).
Euro area: economic sentiment index (January).
28 Spain: GDP flash estimate (Q4).
31 Spain: CPI flash estimate (January).
Portugal: GDP flash estimate (Q4).
Portugal: industrial production (December).
Euro area: GDP (Q4).

A stop on the road

The economic activity cycle is facing its umpteenth test in the months ahead, taking into account: the emergence of the new variant in the pandemic (Omicron), the mobility restrictions announced in countries of central Europe, the accumulation of negative surprises related to inflation and the continuing deterioration of industry due to supply chain disruptions. The sensation is that the forecasts for at least Q1 of next year will need to be revised down, as we are facing a new mini-cycle in which the limitations on the movement of goods and people will increase. Right now there is still a lot we do not know, from the reproduction rate of the Omicron variant (initial estimates place it slightly above the delta variant) to the extent to which the vaccines will prove effective (opinion is split in the health industry). In any case, it is still too early to estimate what the net effect on economic activity will be, and it should be noted that economic agents' and authorities' capacity to respond has been improving with each new episode of COVID-19 mutation, as part of a continuous adaptation and learning process.

What is new on this occasion is that the Omicron variant has emerged at a time when we are seeing a string of negative surprises in prices. In November, inflation in the euro area rose once again to 4.9% (2.6% for core inflation), reaching the highest level in decades in countries such as Germany (6%) and Spain (5.6%), while industrial prices continue to climb to levels not seen since the oil shocks of the 1970s (+32% in Spain and +19% in Germany in October). Thus, even in the most favourable scenarios, a turning point in inflation is not anticipated until well into next year. As the Federal Reserve chairman (Jerome Powell) has just acknowledged, the transitory hypothesis is beginning to lose credibility, given that there is no immediate end to the problem in sight. This is especially the case in the US, where the price increases in the most volatile components are filtering down to the rest, and job turnover ratios (The big quit) are already at 3% of the workforce (7% in sectors such as hospitality), causing labour shortages in many segments of the labour market. We expect inflation in the US to peak at around the 7% mark in late Q1 2022, but more importantly, core inflation at that point will be approaching 6%, and this could force the Fed to intensify the tapering process with a view to raising interest rates before the summer if necessary.

In this context, the question is: how might the new variant of the virus affect price behaviour? Judging from the experience of what happened in 2020, the drop in demand should reduce pressure on production markets and lead to a fall in prices, starting with commodities. However, this time may be different, as with global logistics already strained, any further disruption (closure of ports in China, etc.) could introduce new restrictions on the functioning of value chains, complicating stock management and entrenching tensions in the price formation process. This would complicate the incipient process of monetary normalisation, as central banks would find themselves stuck between a rock and a hard place, trying to keep financial conditions very lax while facing a longer-than-expected period of inflation deviating sharply from the targets. The most fragile part of the scenario will remain emerging countries, especially those dependent on tourism and with high short-term funding needs.

Therefore, the recovery will have to face a new hurdle in the short term. While this should not change its trajectory, it could once again cloud the economic landscape over the coming weeks, at least until we have all the necessary information to refine the health and economic policy responses. The expectations of businesses and consumers will determine the impact in the short term. In the medium term, the factors that have been consolidating the revival in recent quarters continue to apply: the effectiveness and adaptability of the vaccines, high levels of savings, and highly expansionary monetary and fiscal conditions. We are facing a new stop on the road, after which the business cycle should continue on the path of recovery.

José Ramón Díez Guijarro

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

Financial markets

	Average 2000-2007	Average 2008-2018	2019	2020	2021	2022	2023
INTEREST RATES							
Dollar							
Fed funds (upper limit)	3.43	0.68	1.75	0.25	0.25	0.75	1.50
3-month Libor	3.62	0.90	1.91	0.23	0.15	0.83	1.65
12-month Libor	3.86	1.40	1.97	0.34	0.30	1.24	1.95
2-year government bonds	3.70	0.96	1.63	0.13	0.40	1.00	1.60
10-year government bonds	4.70	2.61	1.86	0.93	1.75	2.15	2.45
Euro							
ECB depo	2.05	0.26	–0.50	–0.50	–0.50	–0.50	–0.50
ECB refi	3.05	0.82	0.00	0.00	0.00	0.00	0.00
Eonia	3.12	0.47	–0.46	–0.47	–0.48	–0.48	–0.48
1-month Euribor	3.18	0.58	–0.45	–0.56	–0.55	–0.51	–0.48
3-month Euribor	3.24	0.74	–0.40	–0.54	–0.53	–0.46	–0.40
6-month Euribor	3.29	0.88	–0.34	–0.52	–0.50	–0.41	–0.28
12-month Euribor	3.40	1.07	–0.26	–0.50	–0.46	–0.35	–0.15
Germany							
2-year government bonds	3.41	0.45	–0.63	–0.73	–0.70	–0.40	–0.15
10-year government bonds	4.30	1.69	–0.27	–0.57	–0.20	0.00	0.20
Spain							
3-year government bonds	3.62	1.87	–0.36	–0.57	–0.29	–0.02	0.31
5-year government bonds	3.91	2.39	–0.09	–0.41	–0.12	0.15	0.45
10-year government bonds	4.42	3.40	0.44	0.05	0.40	0.60	0.85
Risk premium	11	171	71	62	60	60	65
Portugal							
3-year government bonds	3.68	3.66	–0.34	–0.61	–0.43	–0.05	0.34
5-year government bonds	3.96	4.30	–0.12	–0.45	–0.21	0.21	0.54
10-year government bonds	4.49	5.03	0.40	0.02	0.40	0.65	0.90
Risk premium	19	334	67	60	60	65	70
EXCHANGE RATES							
EUR/USD (dollars per euro)	1.13	1.28	1.11	1.22	1.14	1.15	1.19
EUR/GBP (pounds per euro)	0.66	0.84	0.85	0.90	0.85	0.84	0.82
OIL PRICE							
Brent ($/barrel)	42.3	81.5	65.2	50.2	80.0	65.0	63.0
Brent (euros/barrel)	36.4	62.9	58.6	41.3	70.2	56.5	52.9

Forecasts

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

International economy

	Average 2000-2007	Average 2008-2018	2019	2020	2021	2022	2023
GDP GROWTH							
Global	4.5	3.4	2.8	–3.1	6.0	4.5	3.8
Developed countries	*2.7*	*1.4*	*1.7*	*–4.5*	*5.1*	*3.9*	*2.4*
United States	2.7	1.6	2.3	–3.4	5.4	3.5	2.6
Euro area	2.2	0.8	1.6	–6.5	5.1	4.7	2.4
Germany	1.6	1.3	1.1	–4.9	2.6	4.5	2.2
France	2.2	0.9	1.8	–8.0	6.8	4.0	1.9
Italy	1.5	–0.4	0.4	–9.0	6.2	4.5	2.5
Portugal	1.5	0.3	2.7	–8.4	4.3	4.9	2.6
Spain	3.7	0.5	2.1	–10.8	4.4	5.9	3.5
Japan	1.4	0.5	0.0	–4.7	1.8	2.4	1.1
United Kingdom	2.9	1.2	1.7	–9.7	6.8	4.9	1.9
Emerging and developing countries	*6.5*	*5.0*	*3.7*	*–2.1*	*6.9*	*5.1*	*4.9*
China	10.6	8.2	6.0	2.3	8.3	5.7	5.4
India	7.2	6.9	4.8	–7.0	9.2	7.3	7.5
Brazil	3.6	1.7	1.4	–4.1	5.3	2.2	2.5
Mexico	2.4	2.1	–0.2	–8.3	6.2	3.0	2.3
Russia	7.2	1.1	1.3	–3.1	3.8	2.5	2.0
Turkey	5.4	4.9	0.9	1.6	8.3	3.3	3.9
Poland	4.2	3.5	4.8	–2.5	5.3	4.9	3.0
INFLATION							
Global	4.1	3.7	3.5	3.2	4.4	4.1	3.1
Developed countries	*2.1*	*1.6*	*1.4*	*0.7*	*3.0*	*3.0*	*1.6*
United States	2.8	1.8	1.8	1.2	4.6	4.7	1.9
Euro area	2.2	1.4	1.2	0.3	2.5	2.4	1.4
Germany	1.7	1.4	1.4	0.4	3.0	2.7	1.5
France	1.9	1.3	1.3	0.5	2.1	2.4	1.4
Italy	2.4	1.5	0.6	–0.1	1.8	2.3	1.4
Portugal	3.0	1.2	0.3	0.0	1.2	1.4	1.4
Spain	3.2	1.4	0.7	–0.3	2.9	2.6	1.3
Japan	–0.3	0.4	0.5	0.0	–0.2	0.8	0.7
United Kingdom	1.6	2.4	1.8	0.9	2.3	2.6	1.6
Emerging countries	*6.7*	*5.6*	*5.1*	*5.1*	*5.5*	*4.9*	*4.1*
China	1.7	2.6	2.9	2.5	1.0	1.7	1.4
India	4.5	7.7	3.7	6.6	5.0	5.5	4.5
Brazil	7.3	5.9	3.7	3.2	7.3	4.5	3.5
Mexico	5.2	4.2	3.6	3.4	5.4	3.9	3.5
Russia	14.2	8.2	4.5	4.9	6.3	4.4	4.1
Turkey	27.2	9.1	15.5	14.6	17.3	14.2	11.0
Poland	3.5	1.9	2.1	3.7	4.9	5.3	3.2

Forecasts

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

Spanish economy

	Average 2000-2007	Average 2008-2018	2019	2020	2021	2022	2023
Macroeconomic aggregates							
Household consumption	3.6	–0.1	0.9	–12.2	4.6	5.7	3.6
Government consumption	5.0	1.0	2.0	3.3	3.1	0.8	–0.4
Gross fixed capital formation	5.6	–1.9	4.5	–9.5	3.6	7.1	5.3
Capital goods	4.9	0.0	3.2	–12.9	14.4	6.5	4.3
Construction	5.7	–3.8	7.1	–9.6	–2.7	7.5	5.9
Domestic demand (vs. GDP Δ)	4.3	–0.3	1.3	–9.1	4.5	4.9	3.0
Exports of goods and services	4.7	2.9	2.5	–20.1	11.4	9.2	5.5
Imports of goods and services	7.0	0.1	1.2	–15.2	11.1	6.3	4.2
Gross domestic product	**3.7**	**0.5**	**2.1**	**–10.8**	**4.4**	**5.9**	**3.5**
Other variables							
Employment	3.2	–0.7	2.6	–7.6	6.5	4.3	2.3
Unemployment rate (% of labour force)	10.5	20.0	14.1	15.5	15.1	14.0	13.1
Consumer price index	3.2	1.4	0.7	–0.3	2.9	2.6	1.3
Unit labour costs	3.0	0.3	3.1	5.0	1.5	0.6	1.1
Current account balance (% GDP)	–5.9	–0.5	2.1	0.7	1.5	1.6	1.7
External funding capacity/needs (% GDP)	–5.2	–0.1	2.6	1.1	1.7	1.8	1.9
Fiscal balance (% GDP)[1]	0.4	–6.3	–2.9	–11.0	–7.7	–5.3	–3.9

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

Forecasts

Portuguese economy

	Average 2000-2007	Average 2008-2018	2019	2020	2021	2022	2023
Macroeconomic aggregates							
Household consumption	1.7	0.3	3.3	–7.1	4.4	4.4	2.4
Government consumption	2.3	–0.5	2.1	0.4	4.4	0.5	0.2
Gross fixed capital formation	–0.3	–1.2	5.4	–2.7	5.3	7.4	8.0
Capital goods	3.2	2.7	1.6	–6.2	11.5	7.8	8.1
Construction	–1.5	–3.5	7.7	1.6	2.7	5.7	4.3
Domestic demand (vs. GDP Δ)	1.3	–0.2	3.0	–5.6	4.8	4.4	3.2
Exports of goods and services	5.2	4.0	4.1	–18.7	7.5	11.9	5.7
Imports of goods and services	3.6	2.5	5.0	–12.2	8.4	9.7	6.8
Gross domestic product	**1.5**	**0.3**	**2.7**	**–8.4**	**4.3**	**4.9**	**2.6**
Other variables							
Employment	0.4	–0.6	1.2	–1.9	2.7	0.7	0.2
Unemployment rate (% of labour force)	6.1	11.8	6.6	7.0	6.6	6.5	6.4
Consumer price index	3.0	1.2	0.3	0.0	1.2	1.4	1.4
Current account balance (% GDP)	–9.2	–3.2	0.4	–1.2	–0.7	–0.5	–0.4
External funding capacity/needs (% GDP)	–7.7	–1.9	1.2	0.1	1.2	1.8	1.9
Fiscal balance (% GDP)	–4.6	–5.5	0.1	–5.8	–4.3	–2.9	–1.5

Forecasts

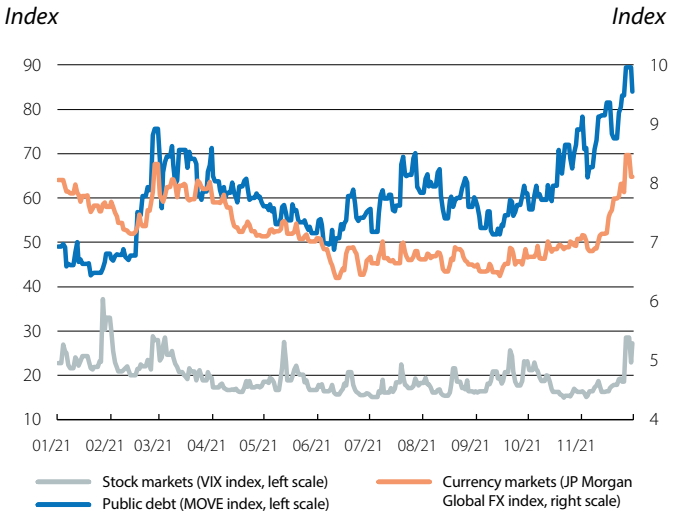
Inflation and Omicron in investors' spotlight

Greater volatility in the face of doubts over the duration of the inflation rally and the risk posed by Omicron. Signs of stress in inflationary pressures and the possible implications for monetary policy were once again the dominant issues in the markets. The credibility of the central banks' narrative regarding the transitory nature of the inflation rally was dented by the persistence of the bottlenecks, the high energy prices, and the signs that these pressures are spreading to other components of the CPI. Meanwhile, the discovery of the new COVID variant, Omicron, raised fears among investors about the impact it could have on economic growth, given the risk of it leading to new restrictions and exacerbating the distortions in supply. Not surprisingly, in this context volatility has increased somewhat more markedly among fixed-income assets and currencies. In the case of equities, the uncertainty triggered by the Omicron variant led to substantial declines in the stock markets at the end of the month.

Investors count on two rate hikes by the Fed in 2022. In the US, inflation expectations and sovereign debt yields resumed an upward trend, following the higher-than-expected CPI figure for October and the strength of the labour market. However, this pattern was interrupted in the final sessions of the month by the shock generated by Omicron and investors' resulting flight to safety. Thus, the 10-year Treasury closed the month of November with an 11-bp fall, bringing it to 1.44%. Another important factor as we approach the end of the year will be the approval (or suspension) of a new debt ceiling before 15 December. In the money markets, it is assumed that the Fed will respond with two official rate hikes in 2022 following the completion of the tapering process, which is due to reach its conclusion by the middle of the year according to the plan set out at the November meeting. Our forecasts also foresee two rate hikes in 2022. Meanwhile, US President Joe Biden announced that Jerome Powell will remain at the head of the Fed for a second term.

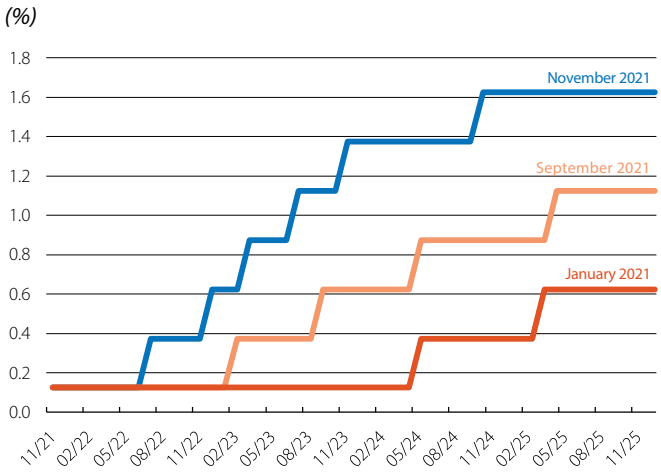
The ECB, firm in its discourse of transitory inflation. The speeches given by the members of the Governing Council confirmed a firm position on their view of the price rally as being transitory, while official rate hikes in 2022 are ruled out. In contrast, the markets are assuming that the first increase in depo rates (10 bps) will occur between the end of that year and the beginning of 2023. At the December meeting, the ECB is likely to prolong the TLTROs with less favourable conditions than the current ones and to announce that the end of the PEPP next March could be partially offset by higher purchases under the APP. The ECB's firmness on the transitory nature of inflation on the one hand, coupled with the deterioration in the health emergency on the other, has been reflected in a considerable weakening of the euro against the dollar.

Implicit volatility in the financial markets



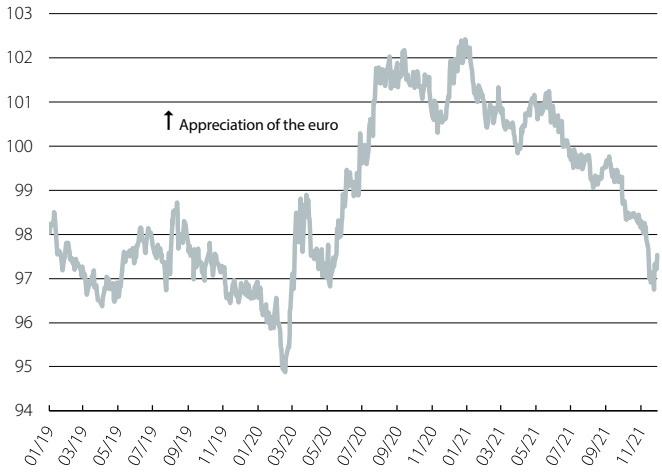
Source: *CaixaBank Research, based on data from Bloomberg.*

Expectations of the Fed's benchmark interest rates



Note: *Forwards on the OIS rate derived from market yield curves.*
Source: *CaixaBank Research, based on data from Bloomberg.*

Nominal effective exchange rate of the euro



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

Sovereign bond yields have also registered widespread declines.

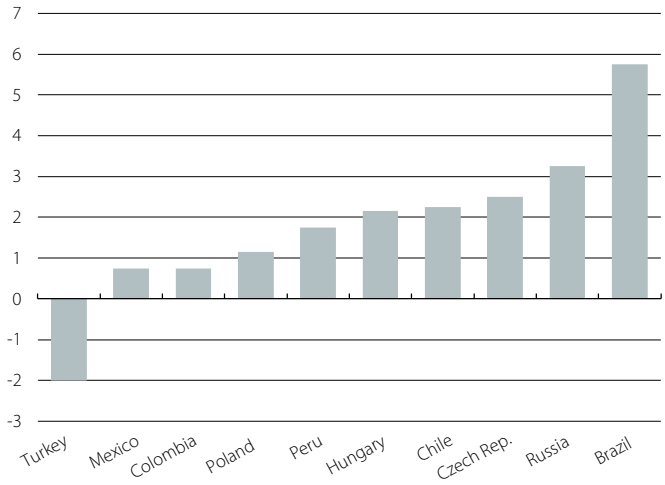
Emerging markets accelerate the rate hikes. The strength of the dollar and investors' expectations of a more aggressive withdrawal of the stimulus by the Fed has added to the pressure on many emerging-country central banks to approve a new round of official rate hikes. However, these measures were not enough to prevent their currencies from depreciating, a trend which continues to exert upward pressure on their respective inflation rates. Thus, according to the Institute of International Finance, net portfolio flows to emerging economies moderated in October to 24.9 billion dollars (compared to 31.8 billion in September). However, Turkey remains the major exception. Its central bank lowered the official rate by 100 bps for the third consecutive month, weakening the lira to historic lows.

The return of the ghost of natural gas and the slump in the oil price. After showing signs of stabilisation in October, the price of natural gas resumed its upward trend and closed the month with a 42% rise (based on the Dutch TTF). The major factors driving this pattern included, on the one hand, the German authorities' decision to temporarily suspend certification of the Russian Nord Stream 2 gas pipeline and, on the other, the lack of a significant increase in supply to Europe by Russia's Gazprom. In the oil market, the price of a barrel of Brent behaved erratically, driven by fears of how the Omicron variant might impact demand over the coming months, as well as by the possibility of OPEC revising its rate of supply at its December meeting. This triggered the price to drop to 70 dollars at the end of November, a level not seen since August.

Omicron interrupts the good times in the stock markets. The market shock which began on Black Friday, with the news of Omicron, was enough to undo the gains registered during the month in the international stock markets following the positive Q3 corporate earnings campaigns on both sides of the Atlantic. In fact, for the third consecutive quarter, corporate earnings among companies of the S&P 500 exceeded the analyst consensus forecasts. On balance, the main stock market indices closed the month with marked declines, of 1% in the case of the S&P 500 and of around 4% both in Europe (–8% for the Ibex 35) and in emerging markets. For the time being, caution has taken precedence among investors, who are waiting for new information to weigh up the risk that Omicron could pose for their earnings forecasts.

Change in official interest rates in 2021

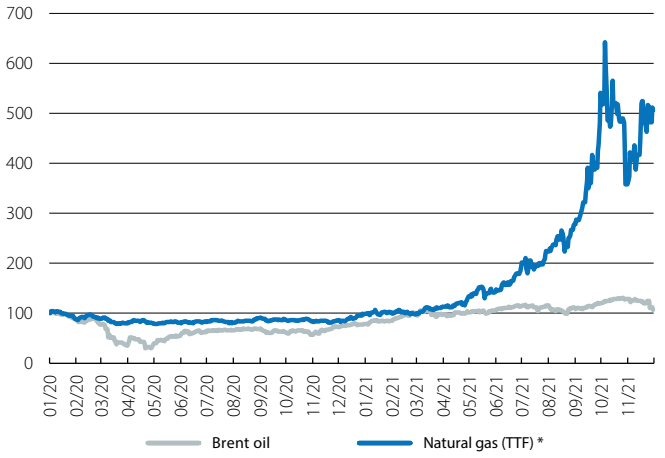
(pps)



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

Brent oil and natural gas prices

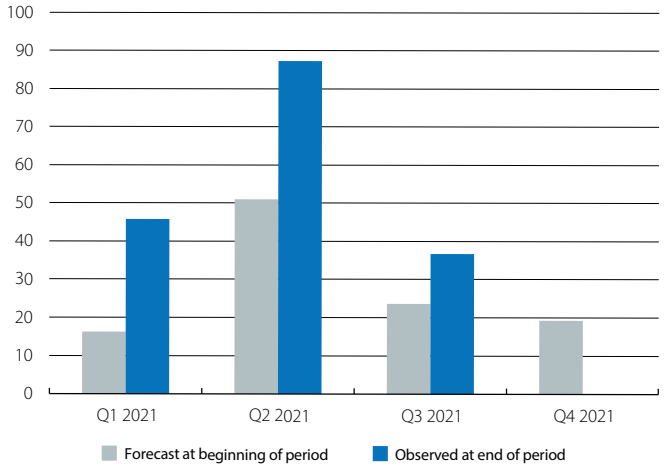
Index (100 = January 2020)



Note: ** TTF natural gas is the benchmark gas price used in Europe.*
Source: *CaixaBank Research, based on data from Bloomberg.*

S&P 500 corporate earnings

Year-on-year change (%)



Note: *Data corresponding to earnings per share (EPS).*
Source: *CaixaBank Research, based on data from Bloomberg.*

Interest rates (%)

	30-November	31-October	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	–0.57	–0.55	–2	–2.8	–4.7
1-year Euribor	–0.51	–0.46	–5	–0.6	–1.8
1-year government bonds (Germany)	–0.79	–0.65	–14	–7.4	–11.0
2-year government bonds (Germany)	–0.74	–0.59	–15	–3.7	–1.9
10-year government bonds (Germany)	–0.35	–0.11	–24	22.0	17.9
10-year government bonds (Spain)	0.40	0.61	–21	35.2	28.0
10-year government bonds (Portugal)	0.33	0.52	–19	30.0	25.4
US					
Fed funds (upper limit)	0.25	0.25	0	0.0	0.0
3-month Libor	0.17	0.13	4	–6.5	–5.9
12-month Libor	0.38	0.36	2	4.1	4.9
1-year government bonds	0.22	0.12	10	11.4	11.7
2-year government bonds	0.57	0.50	7	44.4	39.9
10-year government bonds	1.44	1.55	–11	53.1	51.8

Spreads corporate bonds (bps)

	30-November	31-October	Monthly change (bp)	Year-to-date (bp)	Year-on-year change (bp)
Itraxx Corporate	57	51	7	9.6	10.8
Itraxx Financials Senior	68	58	9	8.6	10.4
Itraxx Subordinated Financials	130	113	16	18.8	22.3

Exchange rates

	30-November	31-October	Monthly change (%)	Year-to-date (%)	Year-on-year change (%)
EUR/USD (dollars per euro)	1.134	1.156	–1.9	–7.2	–6.1
EUR/JPY (yen per euro)	128.320	131.770	–2.6	1.7	1.9
EUR/GBP (pounds per euro)	0.853	0.845	0.9	–4.6	–5.2
USD/JPY (yen per dollar)	113.170	113.950	–0.7	9.6	8.5

Commodities

	30-November	31-October	Monthly change (%)	Year-to-date (%)	Year-on-year change (%)
CRB Commodity Index	564.2	571.2	–1.2	27.1	32.1
Brent ($/barrel)	70.6	84.4	–16.4	36.2	48.8
Gold ($/ounce)	1,774.5	1,783.4	–0.5	–6.5	–2.2

Equity

	30-November	31-October	Monthly change (%)	Year-to-date (%)	Year-on-year change (%)
S&P 500 (USA)	4,567.0	4,605.4	–0.8	21.6	24.7
Eurostoxx 50 (euro area)	4,063.1	4,250.6	–4.4	14.4	15.3
Ibex 35 (Spain)	8,305.1	9,057.7	–8.3	2.9	2.0
PSI 20 (Portugal)	5,433.1	5,732.0	–5.2	10.9	18.4
Nikkei 225 (Japan)	27,821.8	28,892.7	–3.7	1.4	3.9
MSCI Emerging	1,212.4	1,264.8	–4.1	–6.1	–0.9

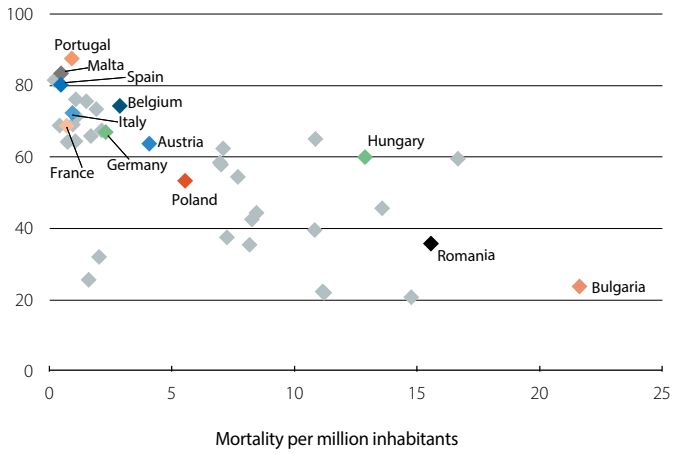
The global economic recovery: the game of hot and cold

New variant, same message: it is important that the vaccination reaches everyone. Over the past two years, the pandemic has taught us that, although it seems that all countries are facing the same phenomenon, its impact is not the same for all of them. On the cusp of the Christmas season and the cold months in the northern hemisphere, Europe is facing a new wave of infections and is confirming the impact of the vaccines: the surge in infections and mortality is proving much more pronounced in countries and regions with lower vaccination rates. Also, the new variants of coronavirus are showing no signs of calling a truce in other regions of the world. Different economic structures, uneven progress in the vaccination programmes and differentiated health policies lead us to anticipate that their impact will be felt over the coming months. Thus, the virus will remain the main risk to the economic outlook, whether in terms of its implications for changing consumption, leisure and working habits or in relation to the impact it could continue to have on global supply chains. An additional factor is the energy crisis which, together with the logistical problems, adds pressure to an already stressed inflation. Although we were right a year ago to anticipate that the vaccinations would provide a boost to economic activity, their undoubted positive effect has also failed to provide an economic miracle, particularly given their uneven deployment. Thus, between the northern and southern hemispheres, advanced and emerging economies, more and less vaccinated populations, the picture we find as we enter the festive season is as varied and multi-coloured as the Christmas lights.

ADVANCED ECONOMIES

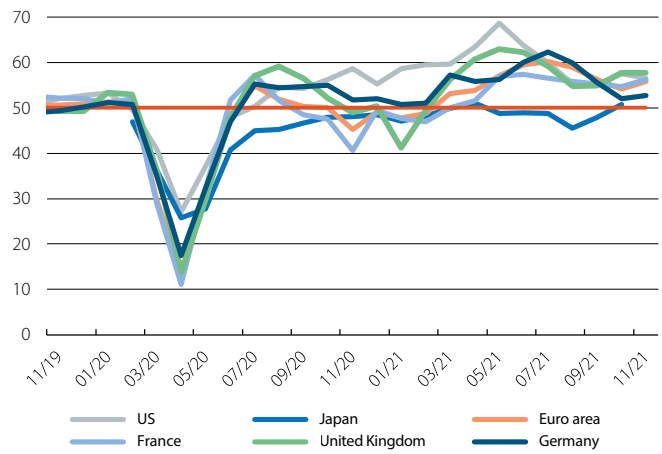
The US economy, somewhere between vitality and overheating. Following a sharp slowdown in Q3 (after registering 1.6% quarter-on-quarter growth in Q2, the US economy grew by a modest 0.5% in Q3), some indicators for Q4 were better than expected, particularly the data related to business sentiment and the labour market. In the latter sphere, 531,000 jobs were created in October, while the unemployment rate continued to fall, reaching 4.6%. The composite Purchasing Managers' Index (PMI), meanwhile, remained in expansionary territory in November, marking a modest decline compared to October (56.5 vs. 57.6). Despite confirming the favourable winds in the US economy, the survey points to significant increases in production costs, which sooner or later will translate into higher consumer prices, and it also confirms the supply-side tensions caused by shortages of supplies and available labour. Wage dynamics (wages rose by 4.9% year-on-year in October) highlight concerns about the economy's overheating. In this context, Congress gave its final approval to the infrastructure portion of Biden's investment plan, to the tune of 1.2 trillion dollars. The House of Representatives also approved the 1.75-billion-

Europe: vaccination and mortality in November 2021
Fully vaccinated population (%)



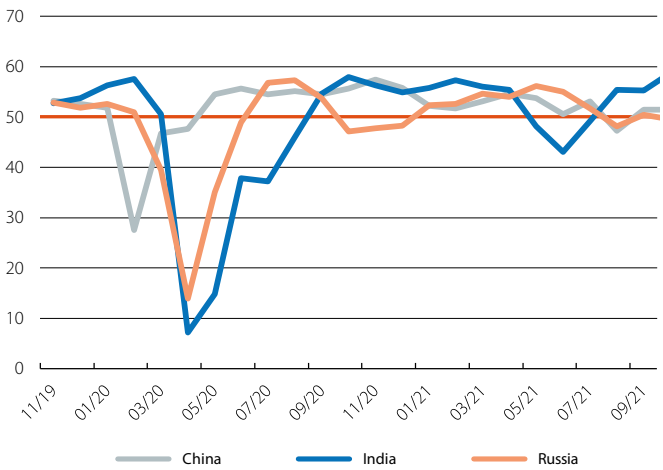
Source: *CaixaBank Research, based on data from Our World in Data, the University of Oxford.*

Advanced economies: composite PMI
Level



Note: *The index for November corresponds to the flash estimate. The data for Japan are up to October.*
Source: *CaixaBank Research, based on data from Markit.*

Emerging economies: composite PMI
Level



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

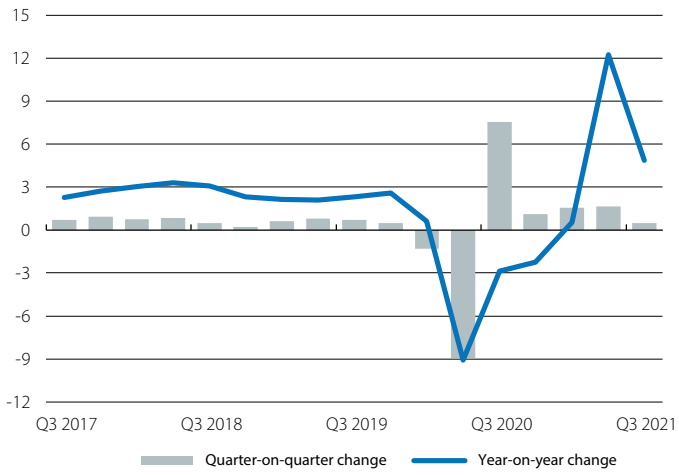
dollar social and climate spending package. This proposal, however, must now go to the Senate and will likely return to the House, so the path that lies ahead before its final approval remains long.

Warming inflation in the US is a source concern, while in the euro area signals are tepid. US inflation was once again higher than expected, rising by 0.8 pps in October to 6.2%, while core inflation stood at 4.6%. Of particular note was the widespread increase in prices across virtually all components. This is the most obvious symptom of the supply shortages, caused by the difficulties in supply chains and the «Great Resignation», at a time when the rigidity of the supply of jobs following the pandemic is exacerbating the pressures on prices. The latest data suggest that these pressures will persist during the first half of 2022, which leads us to substantially increase our inflation forecasts for the US (from 3.6 to 4.6% for headline inflation, and from 3.2 to 4.3% in the case of core inflation in 2022). In this environment, the Federal Reserve should begin to raise rates during the course of 2022 (twice, according to our latest forecasts). In Europe, meanwhile, the inflationary outlook gives us a somewhat different picture, despite sharing some common factors with the US such as high energy prices and the global bottlenecks. In particular, headline inflation in the euro area stood at 4.9% in November, while core inflation reached 2.6%. Not only are labour-market pressures not yet occurring in the euro area, but a part of the current inflation will fade for mechanical reasons beginning in January 2022, once the base effect of the temporary VAT cut in Germany in the second half of 2020 has been undone. In this regard, we will have to wait until 2023 to see rate hikes from the ECB (see the Financial Markets economic outlook article for more details).

The climate cools, but economic sentiment in Europe keeps warm. With the rise in infections in several European countries causing concern, millions of citizens are back in widespread lockdowns. Nevertheless, European confidence indicators show signs of improvement: November's PMIs were higher than expected in Germany (52.8 vs. 52.0), in France (56.6 vs. 54.7) and for the euro area as a whole (55.8 vs. 54.2). However, these indicators do not yet reflect the impact of the tightening of health restrictions. What they do reflect is the upward price pressures, as expectations for production costs are at an all-time high, partly driven by the crisis in global supply chains. In this regard, the bottlenecks in these chains are particularly affecting the «German engine», given its high exposure to the industrial sector and the automotive industry in particular, which is highly integrated into global value chains. Also, the Ifo Business Climate Index for Germany has registered yet another decline (its fifth in a row, bringing it to 96.5 points), signalling significant downside risks to Germany's economic growth in the coming quarters. Indeed, for the euro area as a whole, the risks for our growth forecasts are also skewed to the downside (5.1% in 2021, 4.7% in 2022), as a result of the new outbreaks and the persistent global supply problems.

US: GDP

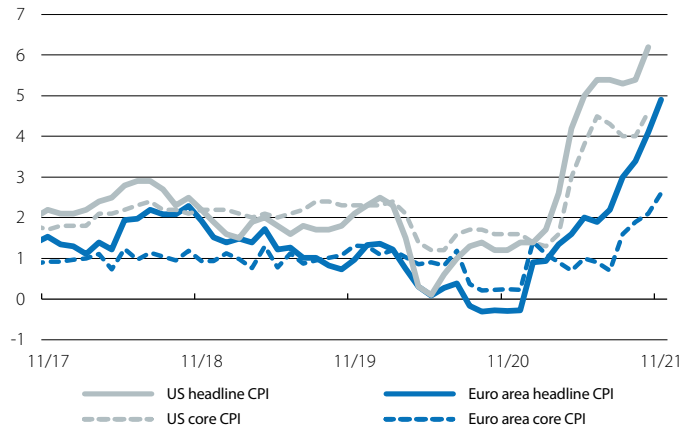
Change (%)



Source: *CaixaBank Research, based on data from the Bureau of Economic Analysis.*

US and euro area: CPI

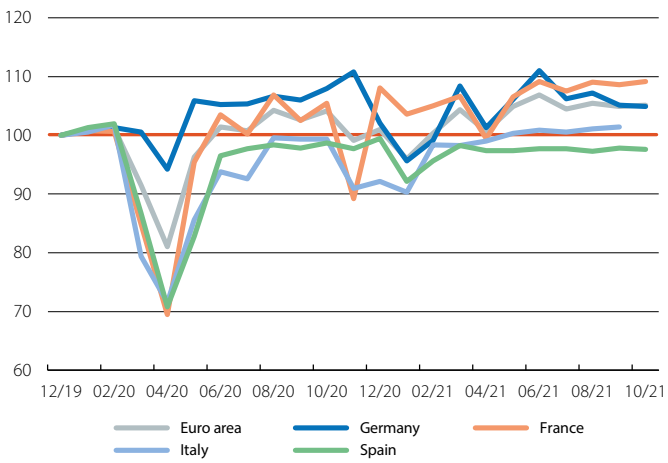
Year-on-year change (%)



Notes: *The November data for the euro area correspond to the flash estimate. For the US, the data are up to October.*
Source: *CaixaBank Research, based on data from the Bureau of Labor Statistics and Eurostat.*

Euro area: retail sales

Index (100 = December 2019)



Note: *Seasonally adjusted series.*
Source: *CaixaBank Research, based on data from Eurostat.*

The Japanese economy is back in contractionary territory. Japan's economic activity in 2021 is experiencing a year marked by ups and downs, dependent on developments in the pandemic and the obstacles in global supply chains. Japanese GDP fell by 0.8% quarter-on-quarter in Q3 (+1.4% year-on-year), following a modest 0.4% quarter-on-quarter advance in Q2 (and a 1.1% fall in Q1). Nevertheless, the recent reopening of numerous economic activities should return the country's activity to expansionary territory in Q4.

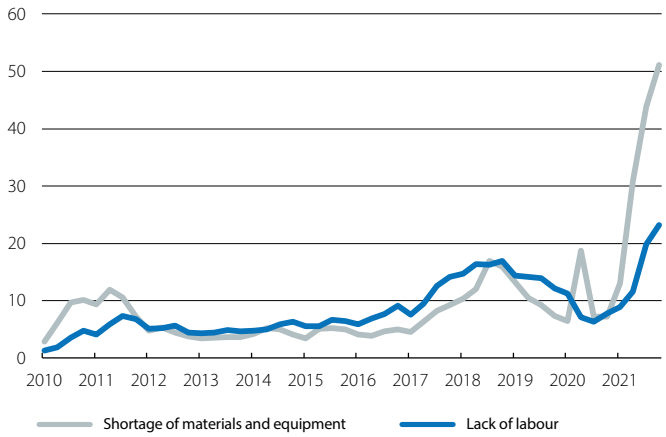
EMERGING ECONOMIES

China faces a front of cold air mass from the real estate sector. The Chinese economy continues to give mixed signals, between the outbreak of the crisis in the real estate sector and the recovery in industrial production and retail sales, and as supply-side pressures caused by the energy crisis and the health restrictions subside. Nevertheless, the real estate sector continues to hamper the progress of China's economic activity, and this continues to affect investment, which fell in October in the case of fixed assets (–2.5% year-on-year compared to –1.7% in September). In a regulatory environment that is particularly unfavourable for companies with high debt ratios, the crisis in the sector will continue to pose a significant risk to the economy, given the sector's significant knock-on effect. However, China's authorities are already taking steps to contain the effects of this crisis, as evidenced by the relaxation of some regulations in the real estate and mortgage market and the increase in issues of debt by local governments. Despite some short-term turbulence, China's growth is expected to remain at around 5% in 2022.

Emerging economies are particularly exposed to the heat of inflation. Although almost all emerging economies will likely recover their pre-pandemic GDP levels during the course of 2022, the surge in inflation continues to weigh down on their economic outlook, as it is affecting financial flows to these economies as well as triggering a tightening of their monetary policies. Despite the significant disparity between countries, the fiscal response and the GDP declines associated with the pandemic caused the levels of public debt in emerging economies to increase by around 10 pps (from 54.7% of GDP in 2019 to 64.3% in 2021, according to the IMF). Furthermore, the discrepancy in monetary policies this year was also clear. For instance, while Brazil was «ahead» of the yield curve in 2021, with its central bank implementing significant rate hikes, the risk of fiscal imbalances is a source of concern in the medium term. On the other hand, in Turkey, despite its low levels of debt, the recent interest-rate cuts have intensified the sharp depreciation of the Turkish lira, and in the event of a further surge in inflation they could force a U-turn in monetary policy during 2022. In this environment, central banks' tapering in advanced economies, political instability and China's slowdown will also continue to weigh on the economic outlook.

Euro area: factors limiting manufacturing output

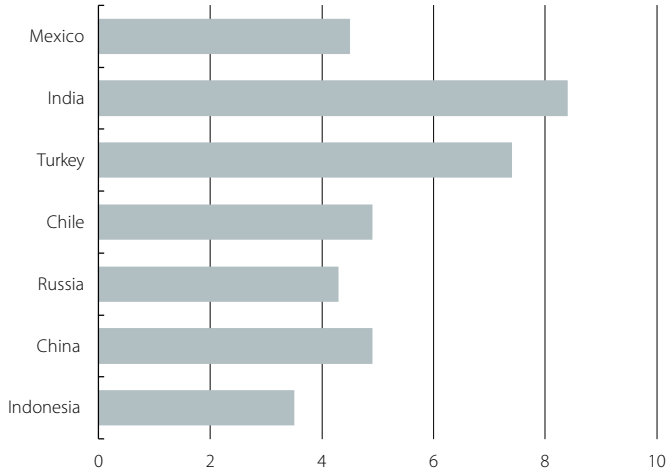
(% of affirmative responses)



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

Emerging economies: GDP in Q3 2021

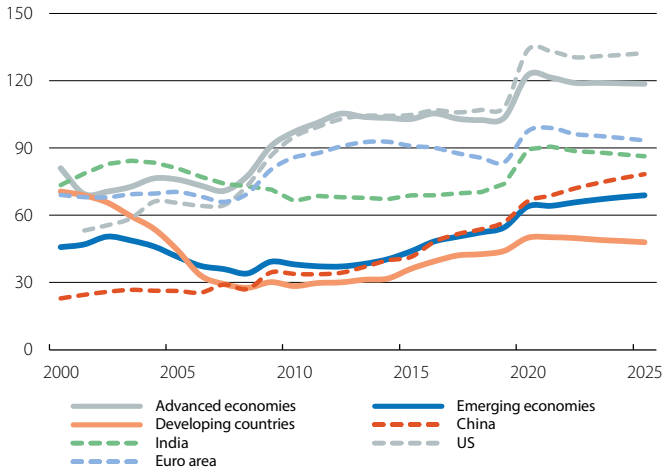
Year-on-year change (%)



Source: *CaixaBank Research, based on data from national statistics institutes.*

World: public debt

(% of GDP)



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

Economic structure and resilience against shocks in the euro area

As is well known, the COVID-19 pandemic was an unprecedented health, social and economic shock, with a highly uneven impact across countries, despite the decisive economic policies implemented to soften the blow. These disparities can be largely explained by the severity of the restrictions that were imposed, the sectoral structure of the different economies, their starting point, and even the quality of their institutions.[1]

From the difficulties experienced by the service sectors which rely on social interaction...

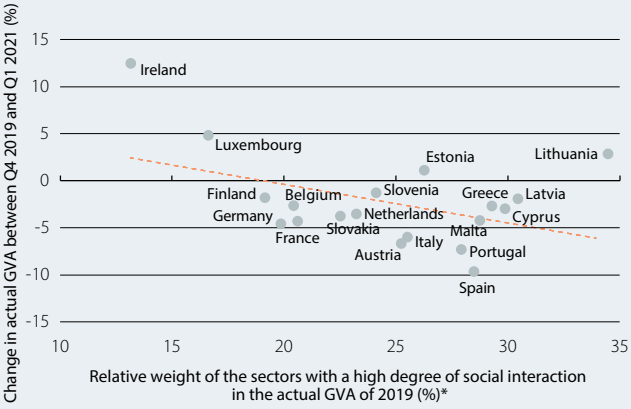
With regard to the sectoral composition, the nature of the measures imposed to curb the spread of the virus dealt a particularly heavy blow to activities with a high component of social interaction (tourism, hospitality, entertainment, etc.).[2] In fact, at the height of the crisis (from Q4 2019 to Q1 2021), the most pronounced drops in economic activity occurred where these sectors account for a larger portion of GVA. Focusing on the big four EU economies, only in Germany these branches had a relative weight clearly below the euro area average in 2019 (19.8% versus 22.4%), while in France it stood around the average (20.6%), and in Italy and Spain it was clearly above the average (25.5% and 28.5%, respectively).

It is true that these sectors experienced a significant recovery beginning in Q2 2020, once the restrictions began to be lifted, but the punishment endured as a result of the «great lockdown» has left somewhat more persistent scars. Over a year after the crisis began, activity in the retail, hospitality, catering and entertainment sectors in the euro area is still more than 11% below its pre-crisis level. In contrast, industry (excluding construction), financial services, communications and the public sector have already exceeded their pre-crisis levels since Q2 2021.

This uneven behaviour among the various sectors of the economy has also affected employment, an impact which would have been even greater if it were not for the important economic policies implemented (such as temporary employment reduction mechanisms), as reflected in the behaviour of employment and the volume of hours worked. According to data from Eurostat, between Q4 2019 and Q2 2021 in the more «social» sectors, the number of jobs fell by 5.2%, while the decrease in the

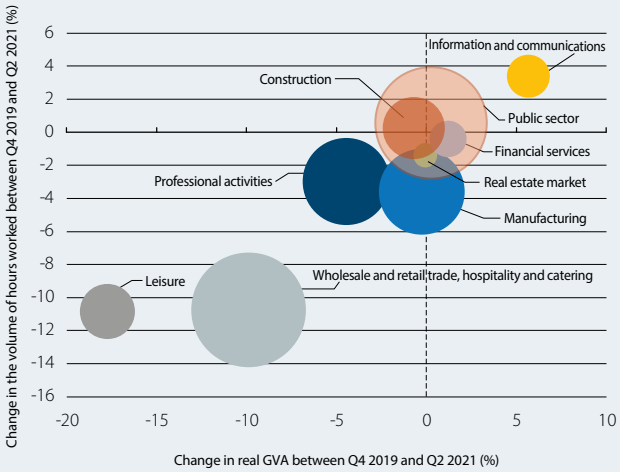
1. See the Bruegel report (2020). «Why has Covid-19 hit different European Union economies so differently». Policy Contribution. Issue nº 18, September.
2. See ECB (2021). «The heterogeneous economic impact of the pandemic across euro area countries». ECB Economic Bulletin. Issue 5/2021.

Euro area: sectoral composition and economic impact



Note: ** Wholesale and retail trade, transportation, catering, hospitality, leisure and culture.*
Source: *CaixaBank Research, based on data from Eurostat.*

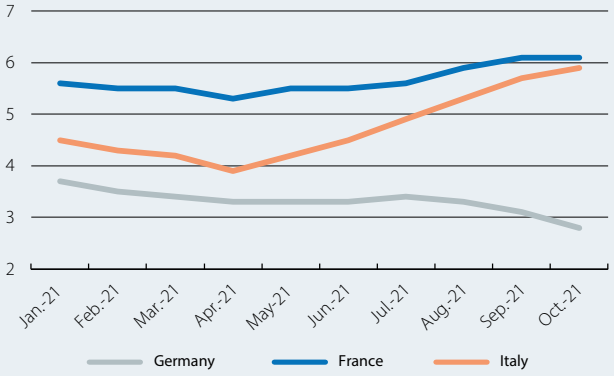
Euro area: hours worked and economic activity by sector



Note: *The size of the bubble represents the volume of hours worked in each sector in Q2 2021.*
Source: *CaixaBank Research, based on data from Eurostat.*

*Euro area: GDP growth forecast for 2021 **

Annual change (%)



Note: ** Growth forecast published in each month.*
Source: *CaixaBank Research, based on data from the Consensus Forecast.*

volume of hours worked more closely resembles the decline suffered in their economic activity (10.8%).

Analysing the behaviour of the hospitality, catering and leisure sectors in the four major economies, the same pattern of behaviour is observed, albeit with different degrees of intensity. In Germany, the combined activity of these sectors in Q2 2021 was 8.0% below its pre-COVID level, compared to the marked correction experienced in Spain (22% below) and France (15% below). In Italy, meanwhile, these sectors achieved a significant recovery in Q2 2021, ending up just 9.7% below their pre-crisis level (compared to 18% in Q1 2021). This differentiation is largely explained by the differing importance of international tourism in each country.

The evolution of the volume of hours worked in these more social sectors, meanwhile, also reflects the different economic pattern of each country. Thus, in France between Q4 2019 and Q2 2021, the volume of hours worked in the most social sectors fell by more than 14%, accounting for around 75% of total volume of lost hours in the economy as a whole; in Italy and Spain, hours worked fell by 12% and 9.0%, respectively, explaining in both cases around 90% of the total drop in hours. In Germany, meanwhile, despite the hours worked in these sectors falling by around 10%, they account for just 60% of the total loss of hours.

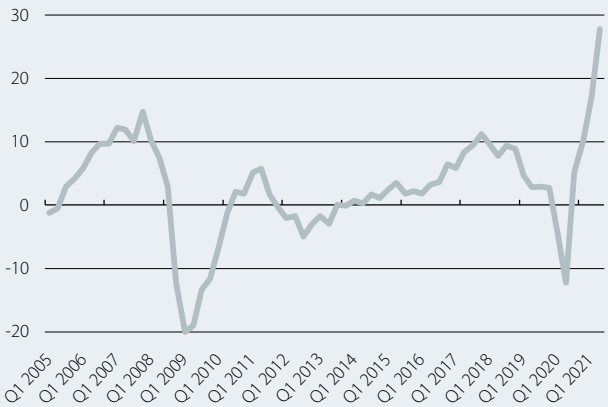
...to the troubles in industry over the mismatches in global supply

With these data, it could be assumed that economies in which these «social» sectors play a smaller relative role were better positioned to overcome the ravages of the crisis, and in this regard Germany was well in the lead... until the summer. While the significant role of its industry initially limited the impact of the crisis, now the lack of supplies caused by the disruptions in global supply chains are having a particularly harsh impact.

In Q2 and Q3 2021, Germany's growth was already lower than expected, while France and Italy performed better than anticipated. It is no coincidence that in the latter cases the relative weight of industry in their economies (14% and 20%, respectively) is lower than in the case of Germany (26%). Moreover, the importance of German's automotive sector (representing over 20% of the country's industry) also plays against it: almost 90% of German car manufacturers acknowledged experiencing supply problems in October. To date, and according to estimates by the Ifo, the losses caused by these bottlenecks in German industry as a whole amount to around 40 billion euros, more than 1% of annual GDP. And not only that: according to the Ifo, these supply problems could last another eight months for the whole industry, and almost 10 months in the chemical and automotive industries. If this prediction becomes a reality, industry would suffer losses of around 2.0% of annual GDP in 2022, a significant downside risk for Germany's growth forecasts.

Germany: industrial orders with respect to production capacity

(%)



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

It is true that the supply problems are affecting all euro area countries, and this explains the sharp slowdown that is expected across the board in Q4. Nevertheless, Germany's economic structure makes it much more vulnerable to these bottlenecks, which explains the deterioration in its growth outlook.

The good news is that this situation is temporary, and once the supply mismatch is resolved German industry will be able to return to full capacity. This is especially apparent given that demand is currently in excellent health: industrial orders in Germany exceed current production capacity by more than 30%, the highest mismatch ever recorded.

On balance, all the indicators suggest that growth in the euro area will experience a notable slowdown in Q4 due to the bottlenecks, although for the time being we are confident that the quarter-on-quarter growth rates will still be above their long-term average. In any case, uncertainty is still very high and the risks are largely skewed to the downside. Indeed, the rapid spread of the virus in Europe has forced countries to take drastic measures: Austria has placed the entire country under lockdown for at least 20 days, and Germany could introduce a law prohibiting non-vaccinated people from carrying out certain activities. If these measures become widespread, euro area growth over the coming months would be markedly affected, which could have ramifications for the ECB's current roadmap.

Rita Sánchez Soliva

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

UNITED STATES

	2019	2020	Q4 2020	Q1 2021	Q2 2021	Q3 2021	08/21	09/21	10/21
Activity									
Real GDP	2.3	–3.4	–2.3	0.5	12.2	4.9	–	–	–
Retail sales (excluding cars and petrol)	4.0	2.1	4.7	11.9	26.2	13.8	14.7	13.4	14.9
Consumer confidence *(value)*	128.3	101.0	93.8	99.1	122.1	116.7	115.2	109.8	113.8
Industrial production	–0.8	–7.2	–4.3	–1.6	14.7	5.6	5.6	4.6	5.1
Manufacturing activity index (ISM) *(value)*	51.2	52.5	59.0	61.4	60.8	60.2	59.9	61.1	60.8
Housing starts *(thousands)*	1,295	1,396	1,575	1,599	1,588	1,555	1,573	1,530	1,520.0
Case-Shiller home price index *(value)*	217	228	239	249	262	...	274	...	...
Unemployment rate *(% lab. force)*	3.7	8.1	6.8	6.2	5.9	5.1	5.2	4.8	4.6
Employment-population ratio *(% pop. > 16 years)*	60.8	56.8	57.4	57.6	58.0	58.5	58.5	58.7	58.8
Trade balance [1] *(% GDP)*	–2.7	–3.2	–3.2	–3.6	–3.7	–3.7	–3.7	–3.7	...
Prices									
Headline inflation	1.8	1.2	1.2	1.9	4.8	5.3	5.3	5.4	6.2
Core inflation	2.2	1.7	1.6	1.4	3.7	4.1	4.0	4.0	4.6

JAPAN

	2019	2020	Q4 2020	Q1 2021	Q2 2021	Q3 2021	08/21	09/21	10/21
Activity									
Real GDP	0.0	–4.7	–0.8	–1.3	7.7	1.3	–	–	–
Consumer confidence *(value)*	38.9	31.1	33.0	33.3	35.4	37.3	36.7	37.8	39.2
Industrial production	–2.7	–10.6	–4.2	–1.5	19.9	5.9	7.1	–2.3	–3.2
Business activity index (Tankan) *(value)*	6.0	–19.8	–10.0	5.0	14.0	18.0	–	–	–
Unemployment rate *(% lab. force)*	2.4	2.8	3.0	2.8	2.9	2.8	2.8	2.8	2.7
Trade balance [1] *(% GDP)*	–0.3	0.1	0.1	0.2	0.7	0.4	0.6	0.4	0.2
Prices									
Headline inflation	0.5	0.0	–0.9	–0.5	–0.7	–0.2	–0.4	0.2	0.1
Core inflation	0.6	0.2	–0.4	0.0	–0.9	–0.5	–0.5	–0.5	–0.7

CHINA

	2019	2020	Q4 2020	Q1 2021	Q2 2021	Q3 2021	08/21	09/21	10/21
Activity									
Real GDP	6.0	2.3	6.5	18.3	7.9	4.9	–	–	–
Retail sales	8.1	–2.9	4.6	34.0	14.1	5.1	2.5	4.4	4.9
Industrial production	5.8	3.4	7.1	24.6	9.0	4.9	5.3	3.1	3.5
PMI manufacturing *(value)*	49.7	49.9	51.8	51.3	51.0	50.0	50.1	49.6	49.2
Foreign sector									
Trade balance [1,2]	421	524	524	621	607	635	602	634	661.0
Exports	0.5	3.6	16.6	48.9	30.7	24.4	25.6	28.1	27.1
Imports	–2.7	–0.6	5.7	29.3	43.8	25.9	33.1	17.6	20.6
Prices									
Headline inflation	2.9	2.5	0.1	0.0	1.1	0.8	0.8	0.7	1.5
Official interest rate [3]	4.2	3.9	3.9	3.9	3.9	3.9	3.9	3.9	3.9
Renminbi per dollar	6.9	6.9	6.6	6.5	6.5	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	Q4 2020	Q1 2021	Q2 2021	Q3 2021	08/21	09/21	10/21
Retail sales *(year-on-year change)*	2.4	–0.9	1.6	2.6	12.6	2.4	1.5	2.5	...
Industrial production *(year-on-year change)*	–1.3	–8.6	–1.5	3.6	23.6	5.9	4.9	5.2	...
Consumer confidence	–7.0	–14.3	–15.6	–13.7	–5.5	–4.6	–5.3	–4.0	–4.8
Economic sentiment	103.7	88.2	91.4	95.3	114.3	118.1	117.6	117.8	118.6
Manufacturing PMI	47.4	48.6	54.6	58.4	63.1	60.9	61.4	58.6	...
Services PMI	52.7	42.5	45.0	46.9	54.7	58.4	59.0	59.0	...
Labour market									
Employment (people) *(year-on-year change)*	1.3	–1.5	–1.8	–1.8	1.9	...	–	–	–
Unemployment rate *(% labour force)*	7.6	7.9	8.2	8.1	8.0	...	7.5	7.4	...
Germany *(% labour force)*	3.2	3.9	4.1	3.9	3.6	...	3.4	3.4	...
France *(% labour force)*	8.4	8.0	8.0	8.0	8.2	...	8.0	7.7	...
Italy *(% labour force)*	10.0	9.3	9.9	10.1	9.8	...	9.3	9.2	...
Real GDP *(year-on-year change)*	1.6	–6.5	–4.4	–1.2	14.2	3.9	–	–	–
Germany *(year-on-year change)*	1.1	–4.9	–2.9	–3.0	10.0	2.5	–	–	–
France *(year-on-year change)*	1.8	–8.0	–4.3	1.5	18.8	3.3	–	–	–
Italy *(year-on-year change)*	0.4	–9.0	–6.6	–0.6	17.1	3.9	–	–	–

Prices

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

	2019	2020	Q4 2020	Q1 2021	Q2 2021	Q3 2021	08/21	09/21	10/21
General	1.2	0.3	–0.3	1.1	1.8	2.8	3.0	3.4	4.1
Core	1.0	0.7	0.2	1.2	0.9	1.4	1.6	1.9	2.1

Foreign sector

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

	2019	2020	Q4 2020	Q1 2021	Q2 2021	Q3 2021	08/21	09/21	10/21
Current balance	2.4	2.1	2.1	2.8	3.0	3.1	3.0	2.9	...
Germany	7.4	7.0	7.0	7.1	7.6	7.5	7.2	7.1	...
France	–0.3	–1.9	–1.9	–1.8	–1.6	–1.3	–0.8	–0.8	...
Italy	3.2	3.8	3.8	3.8	4.4	4.3	4.0	3.8	...
Nominal effective exchange rate[1] *(value)*	92.3	93.8	95.5	95.3	94.9	93.9	93.9	93.8	92.9

Credit and deposits of non-financial sectors

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

	2019	2020	Q4 2020	Q1 2021	Q2 2021	Q3 2021	08/21	09/21	10/21
Private sector financing									
Credit to non-financial firms[2]	3.8	6.3	7.0	6.4	2.3	1.8	1.5	2.1	2.5
Credit to households[2,3]	3.4	3.2	3.1	3.1	3.9	4.1	4.2	4.1	4.1
Interest rate on loans to non-financial firms[4] *(%)*	1.2	1.2	1.3	1.1	1.2	1.3	1.2	1.3	...
Interest rate on loans to households for house purchases[5] *(%)*	1.5	1.4	1.4	1.3	1.3	1.3	1.3	1.3	...
Deposits									
On demand deposits	8.0	12.9	15.2	16.1	12.4	11.4	11.4	11.5	11.1
Other short-term deposits	0.3	0.6	1.4	1.0	–0.6	–2.0	–1.5	–2.5	–1.6
Marketable instruments	–1.9	8.1	15.5	13.8	12.2	9.6	12.1	6.8	11.1
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 securiti ation. 3. Including NPISH. 4. Loans of more than one million euros with a floating rate and an initial rate fixation period of up to one year. 5. Loans with a floating rate and an initial rate fixation period of up to one year.*

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

The Spanish economy rides out the storm clouds in the closing stages of the year

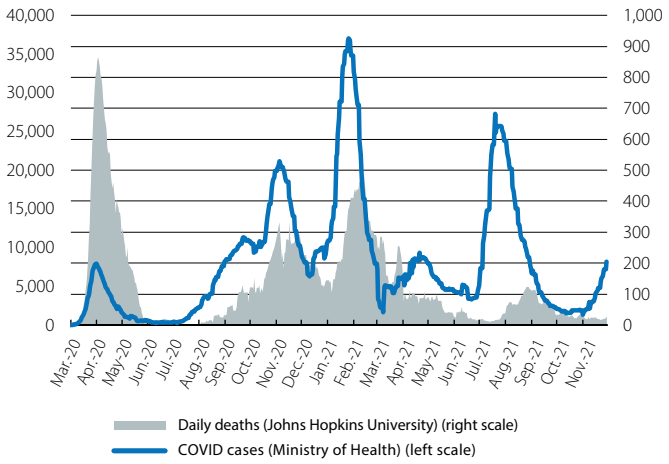
Despite the new Omicron variant, the pandemic in Spain remains under control. The emergence of the new variant has led to a rebound in uncertainty, a tightening of global restrictions, and volatility in the financial markets. In addition, there has been an increase in infections in Europe. Despite these adverse developments, the epidemiological situation in Spain remains under control and better than in other European economies with lower vaccination rates, where the cumulative incidence is increasing more sharply (such as in Germany or Austria). However, the indicators for national infections and hospital pressure are picking up slightly, although they remain at moderate levels. Thus, the cumulative incidence at the end of November stood at around 200 infections per 100,000 inhabitants (moderate level of risk). The mortality rate, meanwhile, remains very low thanks to the great success of the vaccination campaign. Although we can talk about a «sixth wave», the high vaccination percentage among the population means that this wave will be less virulent than the previous ones. It is true that some restrictions, of a precise and selective nature, could be imposed in some autonomous community regions with a view to ensuring a relatively normal Christmas, but we will not see a return to the widespread mobility restrictions that were in place during the state of emergency. In addition, booster doses have already begun to be administered among the most at-risk groups. On the economic front, the current global epidemiological situation could have a certain impact on our economy through the aforementioned rebound in uncertainty or disruption to global trade and tourist flows.

The recovery continues and will be consolidated in 2022. Following the encouraging GDP figure for Q3 (a notable 2.0% quarter-on-quarter growth, albeit lower than expected), we expect the economy to continue to grow at a good pace over the coming quarters. However, the fact that the Q3 figure was lower than expected as well as the factors currently affecting the economy – rising inflation due to the energy component and supply chain disruptions – lead us to revise our 2021 GDP growth forecast down to 4.4%. Looking ahead to 2022, we expect that in Q1 the economy will still be somewhat hampered by the energy storm and bottlenecks, but the situation should improve beginning in Q2 with the recovery in tourism and the boost from NGEU. We anticipate growth of 5.9%, such that GDP will return to its pre-pandemic level by the end of 2022.

The economic indicators continue to show a clean bill of health. In particular, the data coming from the labour market are especially promising: effective employment – excluding those on furlough – has already recovered to pre-pandemic levels. The recovery in the labour market is even showing greater vigour than that of GDP. Thus, while employment in Q3 approached the pre-COVID level, GDP was still 6.6% below (–0.5% in the euro area). This divergence has led to a drop in productivity, which should be corrected in 2022. Industrial production, meanwhile, remains fairly stagnant, eroded by

Spain: daily infections and deaths

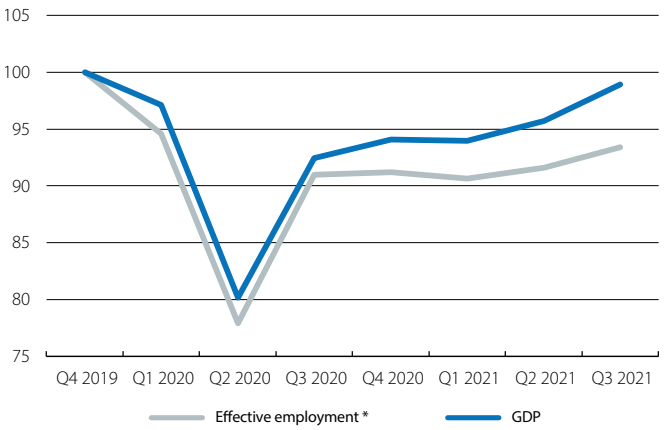
Daily infections *Daily deaths*



Notes: *Seven-day averages of infections and deaths. Data by notification date.*
Source: *CaixaBank Research, based on data from the Ministry of Health.*

Spain: GDP and employment

Level (100 = Q4 2019)



Note: ** «Effective employment» equates to workers registered with Social Security who are not on furlough, in seasonally adjusted terms.*
Source: *CaixaBank Research, based on data from the National Statistics Institute and the Ministry of Social Security.*

Spain: industrial production

Change versus the same month in 2019 (%)

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

the supply crisis that is particularly affecting durable goods. Added to this is the pressure that some industries are suffering due to the increase in energy costs, which in many cases they are unable to pass on to consumers. The PMIs remain in an expansionary territory. That said, in the current context marked by supply problems and low stocks of some products, the data should be interpreted with caution. Finally, the tourism sector continues to emit positive signals, and domestic tourists already exceeded pre-COVID levels by 8.4% in October. This stands in contrast to the level of foreign tourists (–33.5%), although the trend is one of rapid recovery (–47% in September). Let us hope that the rise in infections in Europe and the new Omicron variant will not truncate this very positive dynamic.

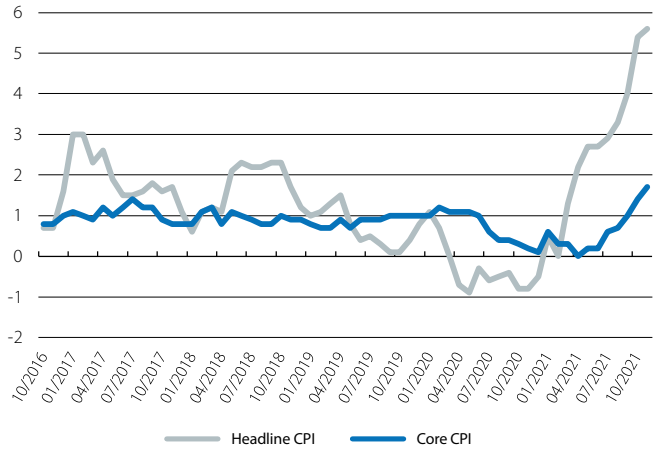
Inflation continues to rise and we revise our 2022 forecast upwards. In November, headline inflation rose to 5.6% (5.4% in October), its highest level since September 1992. Core inflation, meanwhile, continued to climb and reached 1.7% (1.4% in October). The high electricity prices (which have increased almost five-fold compared to November 2020) remain the main cause of inflation, although they have moderated in the last month (–3.3% compared to October). Of particular note is the rise already observed in November in food prices (an energy-intensive sector), and over the coming months the increase in energy prices could also affect services and industrial goods. For 2022, we expect inflation to remain above 4% until Q2, when it will begin to quickly moderate due the comparison with the rise in the latter stages of 2021. Thus, we expect the annual average in 2022 to be around 3%. Core inflation will continue to rise until mid-2022, and we expect it to average around 2% in 2022.

The public finances are on course for a reduction of the deficit. The public deficit in 2021 will still be very considerable, although the high tax collections – tax revenues for the year to date are clearly above forecasts and grew by 13.9% year-on-year to Q3 and by 4.4% compared to 2019 – will allow it to fall below 8.0% of GDP (10.1% in 2020 excluding Sareb). As early as 2022, the deficit will fall to slightly above 5.0% thanks to the cyclical improvement in the economy. Despite this improvement, public debt will remain high in 2022, well above 115% of GDP, hence the need to continue to reduce the deficit and clean up the public accounts in the medium term. The European Commission's forecasts do not differ much from this scenario and also show that the structural deficit will remain high. However, the Commission has given the green light to the 2022 budget plan presented by the Spanish government, in a context marked by the suspension of the fiscal rules.

The Spanish real estate market is thriving. The valuation price of unsubsidised housing rose by a significant 0.8% quarter-on-quarter in Q3 2021 (2.6% year-on-year), thus exceeding the pre-crisis level (+0.5% compared to Q4 2019). It should be noted that home sales were also highly buoyant, largely because of the effect of pent-up demand created during the pandemic. On the other hand, the supply of housing has joined the recovery, albeit at a slower pace, and has plenty of room to expand in 2022. It is also noteworthy that this good market performance is framed by sound fundamentals (without excessive levels of supply or debt).

Spain: CPI

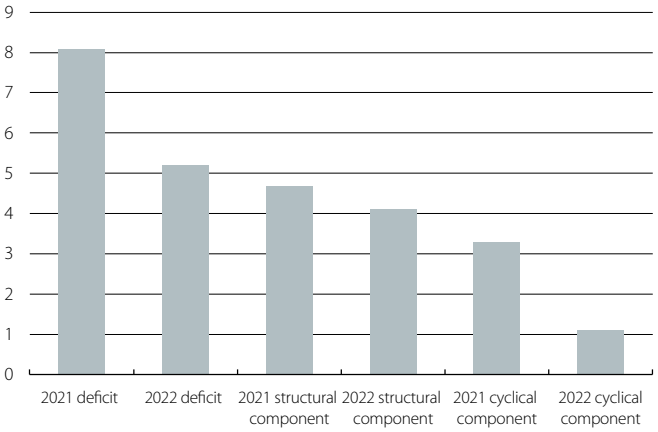
Year-on-year change (%)



Note: *The latest data refer to the flash indicator.*
Source: *CaixaBank Research, based on data from the National Statistics Institute.*

Spain: European Commission public deficit forecasts

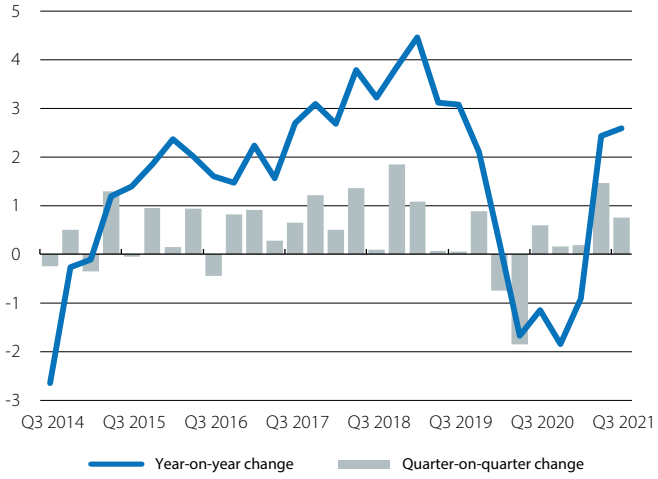
(% of GDP)



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

Spain: housing prices

Change (%)



Source: *CaixaBank Research, based on data from the Ministry of Transportation, Mobility and Urban Agenda.*

The impact of the rise in electricity prices on the Spanish economy

The price of electricity, something that would usually barely catch the reader's attention, has populated the headlines and been a topic of dinner conversations since the middle of the year. This change is not a trivial one: the price of electricity soared beginning in July, and by October it had almost quadrupled the average for 2018-2019. What is the reason for this increase and what impact will it have on the economy?

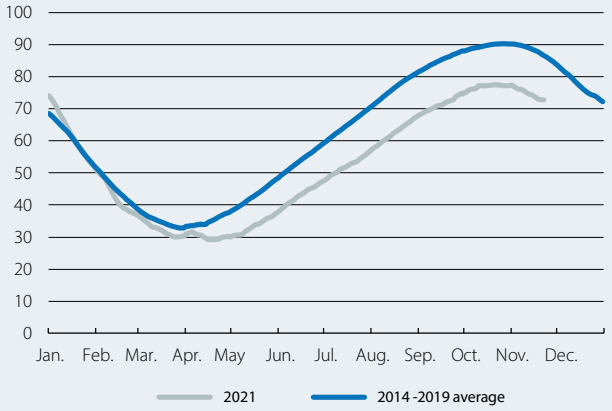
What is behind the rise in electricity prices?

There are a number of factors behind the rise in the price of electricity and, although they are not necessarily related to each other, they have coincided to form an explosive cocktail. The determining factor has been the increase in the price of natural gas. It should be recalled that natural gas, besides its use in heating our homes, is also used to generate electricity. The increase in the price of natural gas, in turn, has largely been due to the relatively low reserves held on the European continent to cope with this winter (see first chart).

Once again, there are several reasons why these reserves are low. Firstly, there have been geopolitical problems with countries that supply gas: Russia, on the one hand, and Algeria and Morocco, on the other. Secondly, supply-side disruptions, such as those experienced in Texas at the beginning of the year or those related to the gradual closure of the Groningen extraction plant in the Netherlands, have also contributed to the shortages. Thirdly, China's economy is undergoing a transition from a coal-based economy to a more natural-gas-based one, as the latter is a cleaner energy source, and this process has led to the emergence of a huge competitor in the demand for liquefied natural gas. This has had repercussions for Europe, as importing liquefied natural gas has traditionally been a mechanism for accommodating peaks in demand, only on this occasion there has been much greater competition. Finally, these factors have been compounded by the gradual but steady increase in the price of carbon emission allowances, as European decarbonisation policies have become stricter.

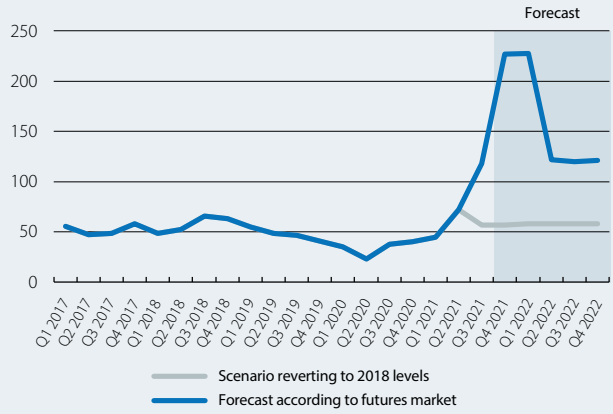
All these elements have contributed to a sharp surge in the price of electricity, and this trend looks set to persist throughout the winter. Nevertheless, once temperatures begin to rise in the spring, demand for natural gas will moderate and the pressure on electricity prices should also ease. This moderation is unlikely to bring about a return to the electricity prices of 2018 or 2019. We believe that prices will stabilise slightly higher, as there are structural factors that will keep the price of natural gas above pre-crisis levels, such as the increased demand from China and the higher emissions prices.

Europe: gas reserves
(% of capacity)



Source: *CaixaBank Research, based on data from Gas Infrastructure Europe.*

Spain: electricity price
(€/MWh)



Note: *Quarterly average of the daily data.*
Source: *CaixaBank Research, based on data from OMIE and OMIP.*

What will be the economic impact of the increase in electricity prices?

To estimate the impact that the increase in electricity prices will have on economic activity, we take the price forecast according to the futures market (see second chart). As can be seen, according to this forecast prices will remain in line with current levels through to Q1 2022 and will normalise beginning in Q2 2022, but still remain higher than in 2019, as mentioned above.

An energy price shock has a major impact on household spending.[1] In particular, if the price of electricity behaves as expected by the futures markets, we estimate that household spending in 2022 could be 0.6% lower than it

1. Estimate based on the weight of household spending on electricity relative to total expenditure, and the sensitivity of electricity demand to changes in price.

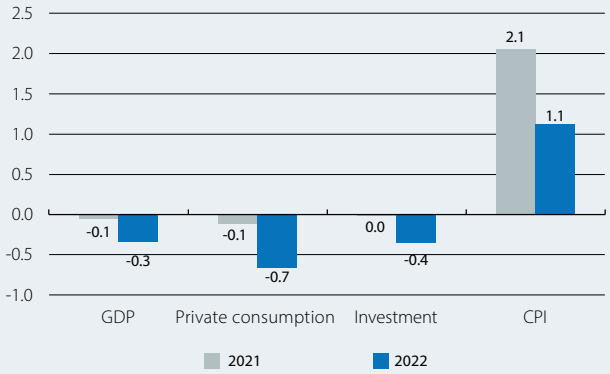
would have been if the price had returned to 2018 levels as early as Q3 2021. Electricity accounts for a relatively small portion of the average household's outgoings (around 3.5%), but the price increase is so large that the impact ends up becoming significant. Moreover, this estimate only takes into account the direct impact of the rise in the price of electricity on household expenditure, so the final impact on the economy as a whole would be greater.

If we consider the impact of the electricity price shock not only on household consumption, but also on investment (companies may be forced to postpone their investment decisions due to rising production costs), as well as the second-round effects that all of this would have on economic activity, then the impact is clearly greater.[2] Specifically, GDP growth in 2021 and 2022 would be 0.1 and 0.3 pps lower, respectively (see third chart). And this would be the result of both lower growth in consumption and lower investment growth. Inflation, meanwhile, would rise significantly, by 2.1 and 1.1 pps in 2021 and 2022, respectively.

Oriol Carreras and Eduard Llorens i Jimeno

Spain: macroeconomic response to the rise in electricity prices

Impact on annual growth (pps)



Source: *CaixaBank Research, based on «Modelo semiestructural de CaixaBank Research para España», Working Paper 01/21 (content available in Spanish).*

2. Estimate based on CaixaBank Research's semi-structural model. For further details, see «Modelo semiestructural de CaixaBank Research para España», Working Paper 01/21 (content available in Spanish).

Activity and employment indicators

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

	2019	2020	Q4 2020	Q1 2021	Q2 2021	Q3 2021	09/21	10/21	11/21
Industry									
Industrial production index	0.7	–9.4	–2.2	3.0	28.0	2.1	1.2	...	...
Indicator of confidence in industry *(value)*	–3.9	–14.0	–11.0	–7.3	2.5	2.1	2.7	5.4	2.4
Manufacturing PMI *(value)*	49.1	47.5	51.1	53.0	59.2	58.9	58.1	57.4	...
Construction									
Building permits *(cumulative over 12 months)*	17.2	–12.8	–19.9	–19.1	–1.8	...	...	...	...
House sales *(cumulative over 12 months)*	3.6	–12.5	–17.2	–17.3	0.6	22.2	26.5	...	...
House prices	5.1	2.1	1.5	0.9	3.3	...	–	–	–
Services									
Foreign tourists *(cumulative over 12 months)*	1.4	–36.9	–72.7	–85.5	–81.3	–52.7	–34.6	...	...
Services PMI *(value)*	53.9	40.3	43.0	44.3	58.8	59.6	56.9	56.6	...
Consumption									
Retail sales	2.3	–7.1	–3.0	–0.4	20.5	–0.3	–0.1	...	...
Car registrations	–3.6	–29.2	–13.2	12.7	661.0	–24.5	–15.7	–20.5	...
Consumer confidence index *(value)*	–6.3	–22.8	–26.3	–22.1	–11.1	–9.1	–8.6	–6.8	–12.5
Labour market									
Employment [1]	2.3	–2.9	–3.1	–2.4	5.7	4.5	...	...	...
Unemployment rate (% labour force)	14.1	15.5	16.1	16.0	15.3	14.6	...	...	...
Registered as employed with Social Security [2]	2.6	–2.0	–2.0	–1.4	3.9	3.8	3.5	3.7	...
GDP	**2.1**	**–10.8**	**–8.8**	**–4.2**	**17.5**	**2.7**	–	–	–

Prices

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

	2019	2020	Q4 2020	Q1 2021	Q2 2021	Q3 2021	09/21	10/21	11/21
General	0.7	–0.3	–0.7	0.6	2.6	3.4	4.0	5.4	5.6
Core	0.9	0.7	0.2	0.4	0.1	0.8	1.0	1.4	1.7

Foreign sector

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

	2019	2020	Q4 2020	Q1 2021	Q2 2021	Q3 2021	09/21	10/21	11/21
Trade of goods									
Exports *(year-on-year change, cumulative over 12 months)*	1.8	–10.0	–10.0	–8.1	8.7	15.2	15.2	...	...
Imports *(year-on-year change, cumulative over 12 months)*	1.0	–14.7	–14.7	–14.0	3.3	13.5	13.5	...	...
Current balance	**26.2**	**9.3**	**9.3**	**8.3**	**9.2**	**...**	**...**	**...**	**...**
Goods and services	36.5	16.5	16.5	16.0	16.8	21.4	21.4	...	...
Primary and secondary income	–10.3	–7.3	–7.3	–7.6	–7.7	...	...	...	...
Net lending (+) / borrowing (–) capacity	**30.4**	**13.7**	**13.7**	**12.7**	**15.5**	**...**	**...**	**...**	**...**

Credit and deposits in non-financial sectors [3]

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

	2019	2020	Q4 2020	Q1 2021	Q2 2021	Q3 2021	09/21	10/21	11/21
Deposits									
Household and company deposits	5.4	7.5	8.7	8.9	4.9	4.8	5.0	4.9	...
Sight and savings	10.7	12.3	13.7	14.1	9.2	8.9	8.7	8.7	...
Term and notice	–13.4	–16.5	–17.1	–20.4	–23.5	–26.0	–26.4	–27.6	...
General government deposits	8.8	1.0	11.8	11.2	16.3	15.1	19.9	20.1	...
TOTAL	**5.6**	**7.1**	**8.9**	**9.1**	**5.5**	**5.5**	**5.9**	**5.8**	**...**
Outstanding balance of credit									
Private sector	–1.5	1.2	2.4	2.3	–0.4	–0.7	–0.6	–0.6	...
Non-financial firms	–3.4	4.9	7.9	7.8	–0.7	–1.9	–1.9	–1.9	...
Households - housing	–1.3	–1.8	–1.5	–1.0	0.0	0.6	0.7	0.7	...
Households - other purposes	3.2	0.8	–0.1	–1.8	–0.7	–1.2	–0.8	–0.9	...
General government	–6.0	3.0	8.8	9.5	17.4	22.7	23.3	16.7	...
TOTAL	**–1.7**	**1.3**	**2.7**	**2.7**	**0.6**	**0.7**	**0.8**	**0.5**	**...**
NPL ratio (%)[4]	**4.8**	**4.5**	**4.5**	**4.5**	**4.5**	**4.4**	**4.4**	**...**	**...**

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.*

Portugal: two years of growth at the mercy of the pandemic

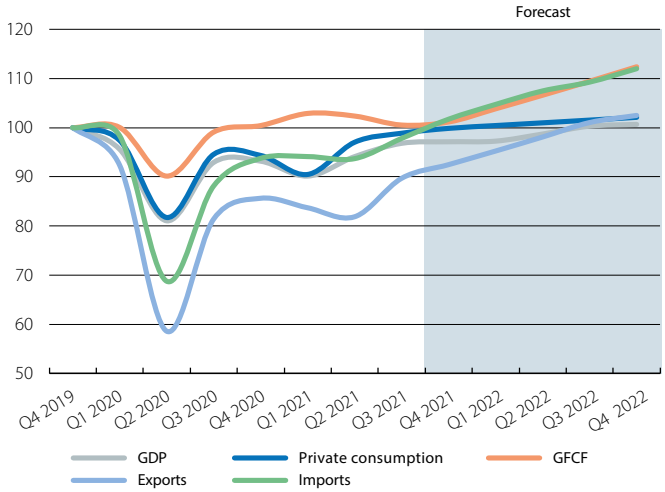
Recovery of pre-crisis GDP by mid-2022. The successive waves of the pandemic and the restrictions imposed have marked the year that is now ending, giving rise to dynamic GDP growth, which we estimate to be 4.3%. In Q3, the economy grew more than expected, driven by private consumption and exports. However, the information available for Q4 suggests a moderation in economic activity following two quarters of strong growth. On the one hand, the data on air traffic, electronic payment card spending and electricity consumption are looking strong compared to the same periods in 2019 and 2020, while on the other hand the confidence indicators are showing a deterioration. This decline reflects uncertainty associated with the domestic political situation (early elections on 30 January 2022) and greater caution in the face of the energy crisis and bottlenecks. In turn, the recent developments in the pandemic and the emergence of a new, more aggressive variant could weigh down confidence levels in the coming months, despite the low pressure on hospitals. In this context, the government has decreed a state of emergency from 1 December, accompanied by some measures aimed at facilitating detection but without significantly restricting economic activity. The aforementioned limitations will continue to condition 2022 and will potentially be more pronounced in the first few months of the year. Even so, the country will register significant growth next year – we project GDP growth of 4.9% – and this will allow pre-pandemic levels to be recovered. The recovery in tourism, the receipt of European funds and the pent-up savings will be the drivers of this growth and should offset the above unfavourable factors. This outlook remains subject to some uncertainty, heightened by the recent fears related to the pandemic. But the outcome could also be favourable if the supply bottlenecks dissipate more quickly and/or the pandemic situation improves.

The labour market weathered the pandemic better than expected. The lockdown imposed in early 2021 and the very gradual lifting of restrictions have not prevented the labour market from emerging from this crisis surprisingly unscathed. Employment has not only recovered pre-crisis levels, but it has remained at the highs of the historical series, which began in 1995. However, the recovery has been uneven by sector, and employment remains below pre-pandemic levels in the accommodation, catering and construction sectors. This pattern is due not only to the lack of recovery of pre-pandemic activity levels, such as in the case of accommodation and catering, but also to the shortage of labour. In fact, unfilled job vacancies have reached their highest values since 2017. This may reflect not only vocational retraining, but also the reduction in the number of immigrants, who are often employed in these more labour-intensive sectors such as hospitality. At the same time, the unemployment rate has fallen to around 6%, reaching its lowest levels since 2002 and surpassing our expectations. As a result, we have revised down our unemployment rate forecasts for 2021 (6.6%) and 2022 (6.5%).

The real estate market continues to thrive. Although the national statistics institute's data on the price of housing in Q3 are not yet known, the available data show a clear advance in

Portugal: GDP and components

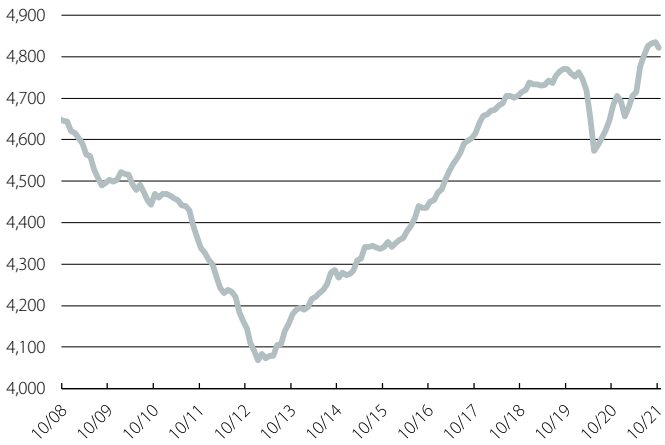
Index (100 = Q4 2019)



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

*Portugal: evolution of the population in employment **

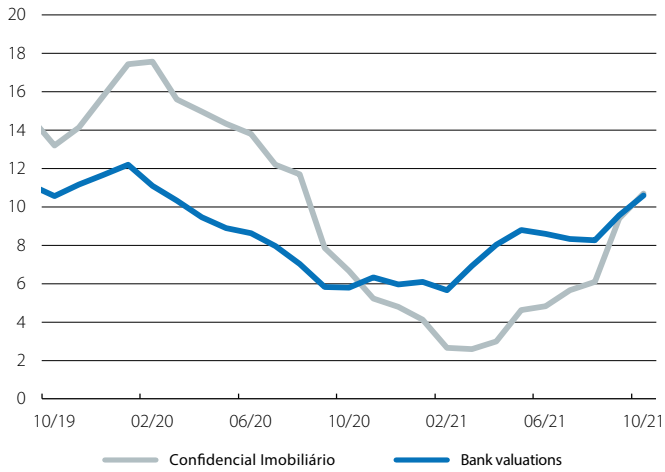
(Thousands of people)



Note: ** Data not seasonally adjusted.*
Source: *CaixaBank Research, based on data from the National Statistics Institute of Portugal.*

Portugal: housing prices

Year-on-year change (%)



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

the market. This leads us to place the CaixaBank Research forecast for housing price growth in 2021 above 6%. The residential price index produced by Confidencial Imobiliário increased by 10.7% year-on-year in October. This year-end boost may be linked to the golden visa programme, as it will no longer cover the purchase of residential properties in Lisbon and Porto in 2022. The bank valuation figures for mortgage loans support this trend, registering an increase in October of 10.6% year-on-year.

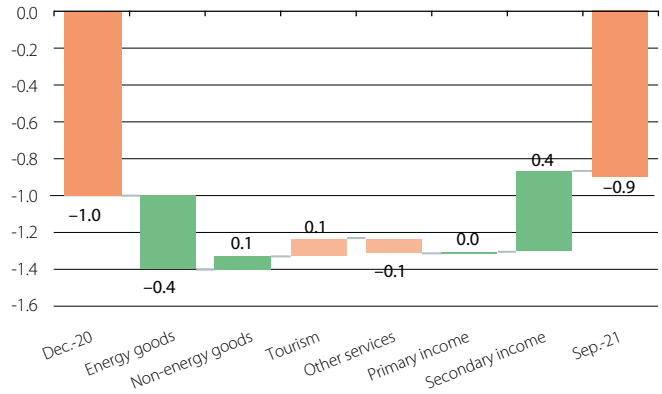
Slight improvement in the current account deficit. In the last 12 months to September, the current account deficit stood at 1,905 million euros (0.9 % of GDP), representing a 1-decimal-point improvement compared to the 2020 year end. One important factor in this trend has been the increase in transfers of European funds, with an impact of +0.4 pps and offsetting the 0.3-pp deterioration in the balance of goods and services. This deterioration was, in turn, driven by the worsening of the energy deficit (of 4 decimal points to 2% of GDP) resulting from the rise in oil prices, and was only partially offset by a slight improvement in the tourism balance. In fact, in the three strongest months for the sector (July, August and September), the number of tourists visiting Portugal doubled compared to 2020, with a 53% increase in tourism revenues in the period.

The political uncertainty should not substantially affect the public accounts. The lockdown at the beginning of the year led to a strengthening of the support measures for households and businesses and an increase in health costs (over 5.1 billion euros up to October), which have served as an important buffer against the blow which the pandemic has dealt to the economy. Nevertheless, the growth of current primary spending, which is more difficult to adjust in the future, is still worrying; by October it will have reached 37.8% of GDP, approaching the levels observed during the sovereign debt crisis (41.9% in 2013). Even so, we do not anticipate there being significant pressure on the public accounts next year, even in the context of early elections and the likely persistence of a budget in twelve parts during the first half of the year. Although this means spending will be limited to what was set out in the 2021 general state budget (which is 5.8 billion euros less than under the 2022 draft), there is some scope to execute the necessary expenditures in an adverse scenario of new variants of COVID-19.

Limited impact of the pandemic on the banking sector. One of the measures with the greatest impact on households and businesses was the application of loan moratoria, which allowed principal and interest payments to be postponed, providing a boost to these groups' liquidity at the height of the pandemic. Indeed, in September 2020 the volume of loans under moratorium reached 17.1% and 34.1% of all household and business loans, respectively, falling to 0.3% and 3.6% in October after the moratoria came to an end. The stock of loans to the non-financial private sector has increased significantly (+4.2% year-on-year in October). Similarly, the low-interest-rate environment, the strength of the labour market and the high level of savings have contributed to the buoyancy of new mortgage lending (which grew by 40.7% year-on-year up to September). Despite the end of the moratoria, there has not been any substantial deterioration in the NPL ratio. Delinquency rates remain at minimum levels, and phase 3 loans, referring to those showing indications of impairment, accounted for between 7% and 13% of all the loans under moratorium in some banks in September.

Portugal: current account balance and contribution by components

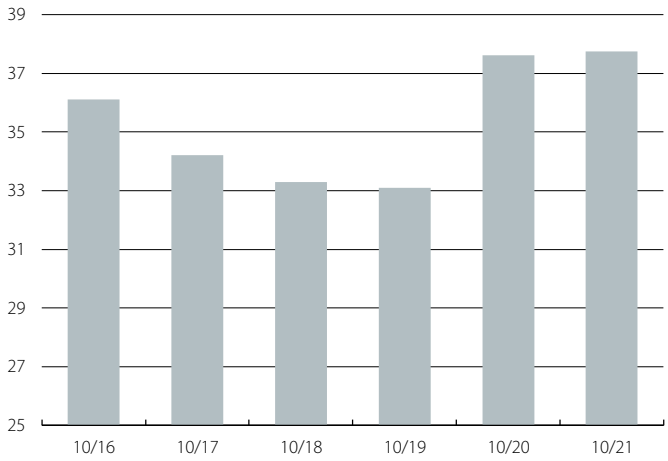
(% of GDP)



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

*Portugal: general government balance **

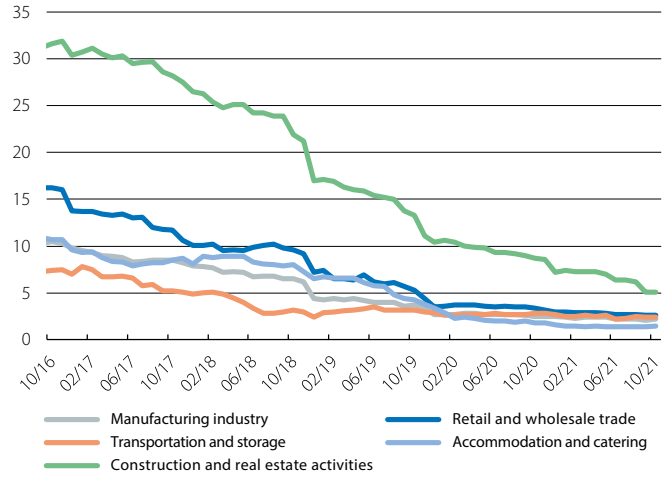
(% of GDP)



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

Portugal: loans under moratorium

(% of the total loans of each segment)



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

Inflation in Portugal: driven by electricity?

After several years in which it has been possible to combine low inflation with a highly dovish monetary policy, inflationary problems seemed to be dormant. However, with euro area inflation persistently above 2% in recent months, and even reaching 4.1% in October, alarm bells have been triggered. This opens the debate about when the ECB should reduce the level of complacency in its policy, bearing in mind that its ultimate objective is price stability.

Which components have caused inflation to rise?

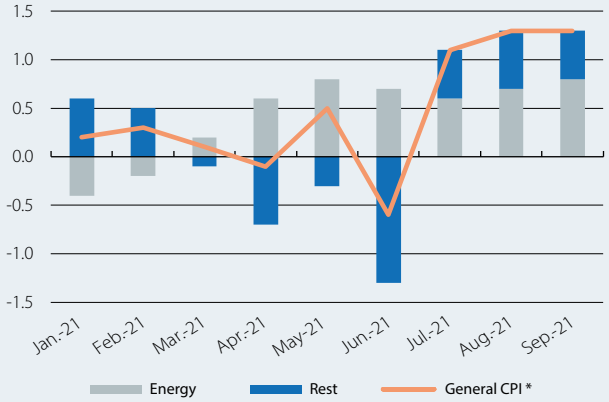
Clearly, the energy component stands out as the major factor. In the case of Portugal, in the most recent months of 2021 for which we have data, the energy component accounts for more than 50% of the increase in inflation. Similar behaviour is observed in the euro area, where movements in energy prices are responsible for 2.1 pps of the 4.1% year-on-year change in the headline HICP in October. In September, the year-on-year change in the energy component in Portugal was 10.9%, while it reached an extraordinary 17.6% in the euro area (deteriorating in October to 23.5%).

The rise in energy prices is most clearly apparent in electricity. In the Iberian electricity market, the MIBEL, the average price between July and September was EUR 122.8/MWh, compared to the average price of EUR 39.6/MWh during 2020. This rally continued in October, reaching a peak of EUR 288.3/MWh on the 7th of the month. There are several factors behind this price rally, most notably the rise in the price of CO_2 emission allowances and the price of natural gas (the fuel used in combined-cycle plants). Generating one MWh of electricity at a gas-fired power plant requires between 1.7 and 2.0 MWh of natural gas and emits 0.4 tonnes of CO_2.

The rise in the price of gas in Europe has been influenced by the strong post-COVID economic revival, the prospect of the onset of winter with low gas reserves compared to previous years, as well as the uncertainty surrounding just how much of this commodity Russia will supply over the winter. Also, the lack of wind in many regions did not allow wind power to respond to the increased demand for electricity (the rate of electricity production from wind power is set by nature and not necessarily consumption), which intensified demand for gas as an alternative energy source. Finally, the way in which prices are formed in wholesale electricity markets has also played a part: the closing market price is that of the marginal power plant, that is, the price which is charged by the last power plant needed to meet demand, and thus the highest. Specifically, it is the gas-fired combined-cycle power plants that are setting this marginal price.

Portugal: breakdown of the harmonised index of consumer prices (HICP)

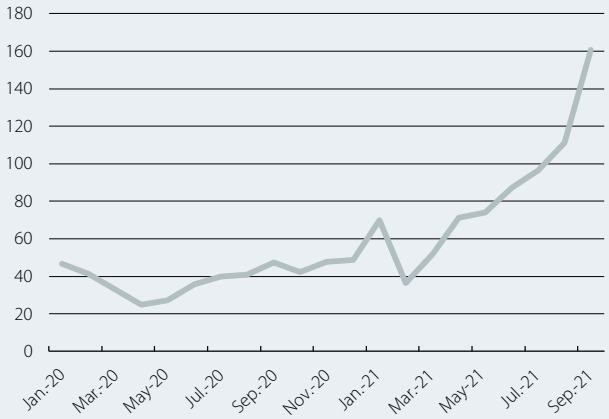
Year-on-year change (%) and contribution (pps)



Note: ** Year-on-year change in the CPI. The other two series show the contribution to the year-on-year change in the CPI.*
Source: *CaixaBank Research, based on data from Eurostat.*

Portugal: average monthly price of electricity in the MIBEL

(Eur/MWh)



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

While these reasons for rising energy prices have affected the whole of the euro area, in Portugal the impact on overall inflation has been more moderate, since the rise in consumer electricity prices has been more contained. In September, the HICP for electricity rose by 2.3% in Portugal, while in the euro area it jumped by 10.9%.

What is the explanation for this Portuguese «electric miracle»?

There have been two main reasons: the way the regulated electricity market works and the payment

of overruns to renewables. In Portugal, the price is regulated by the state and remains fixed throughout the year, although it can be revised mid-way through the year if prices in the MIBEL are not in line with the regulator's forecasts. Although most Portuguese consumers are on liberalised market tarrifs, the fact that transit to the regulated market can be carried out without limitations, combined with the regulated market tariffs (BTN)[1] which remain in force until 2025, reduces volatility and serves as a benchmark for the liberalised market price. On the other hand, around 40% of a consumer's energy bill (excluding taxes) is related to the component of overruns from the PRE.[2] This is an overrun associated with the purchase of renewable energy (which has a guaranteed tariff, usually higher than the selling prices on the wholesale market). The investments in renewables in recent decades were made with the guarantee that, for all the electricity produced during a given period, the developers would be paid at prices above market rates (FITs,[3] which in the case of wind power are around EUR 90/MWh). Under «normal» circumstances, the market price in the MIBEL is below EUR 90/MWh, and consumers would pay the MIBEL price plus the differential for the FIT in the energy portion of their electricity bills. Now, however, the opposite is happening, and this has protected consumers from the rise in prices in the wholesale market.

What can we expect next year in terms of electricity prices?

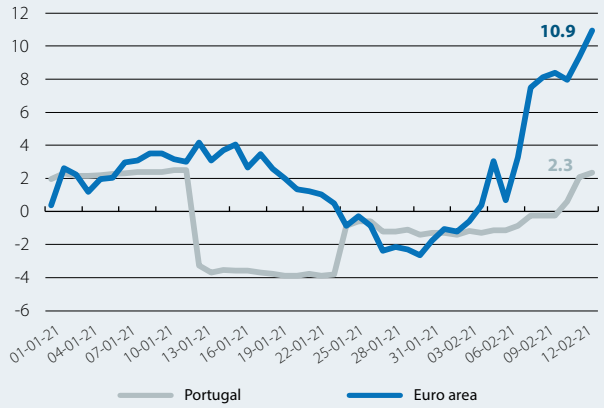
Despite a 0.2% increase in the tariff due to be applied in 2022 for small consumers, the regulator indicates that this increase will be more than offset by the lower payment to renewables, which in 2022 is expected to provide a figure on the order of 1.7 billion euros in consumers' favour.[4] On the other hand, gas futures contracts, such as the Dutch TTF,[5] indicate a price for April 2022 of EUR 45/MWh (the price for December 2021 is currently around EUR 78/MWh). With the current price of CO_2 allowances, this would translate into an electricity price of EUR 114/MWh in the spring of 2022, still above the average MIBEL price in 2021 up to September (EUR 84.3/MWh). In addition to this, we must consider the tense relations between Algeria and Morocco that threaten the flow of supplies through the Maghreb-Europe pipeline, the main source of natural gas to the Iberian peninsula. It seems clear that there are opposing trends looming on the horizon: the component of overruns from renewables will follow a favourable trend, but the pressure on electricity prices on the wholesale market will still be felt, as has been the case in the last few months.

Tiago Belejo Correia

1. A Portuguese acronym for ordinary low voltage (i.e. the type used by domestic consumers).
2. A Portuguese acronym for electricity production under the special scheme (by means of solar, wind, biomass, etc.).
3. Feed-in tariffs.
4. See ERSE. «Proposta de Tarifas e Preços para a Energia Elétrica em 2022».
5. Title Transfer Facility, the benchmark gas contract in Europe.

Portugal: harmonised index of consumer prices (HICP) for electricity

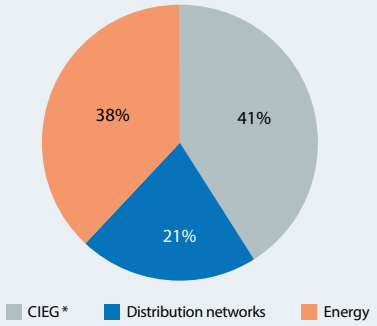
Year-on-year change (%)



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

Portugal: electricity bill breakdown

(%)



Notes: *Example for a BTN (ordinary low voltage) consumer with a contracted capacity of less than or equal to 20.70 kVA in 2021, excluding the relative weight of taxes.*
** CIEG: a Portuguese acronym for costs of general economic interest, including taxes, fees and subsidies for renewables.*
Source: *CaixaBank Research, based on data from EDP.*

Activity and employment indicators

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

	2019	2020	Q4 2020	Q1 2021	Q2 2021	Q3 2021	09/21	10/21	11/21
Coincident economic activity index	0.9	–5.4	–5.0	–2.5	1.7	3.8	3.9	3.8	...
Industry									
Industrial production index	–2.2	–6.9	–2.1	–0.8	25.0	–4.8	–5.6	–6.7	...
Confidence indicator in industry *(value)*	–3.2	–15.8	–14.7	–13.6	–5.0	–1.5	–3.3	–3.4	–2.7
Construction									
Building permits - new housing (number of homes)	15.4	0.7	12.8	45.1	–28.0	–5.0	12.0	...	...
House sales	1.7	–5.7	1.0	0.5	58.3	...	...	...	...
House prices *(euro / m² - valuation)*	10.4	8.3	6.0	6.2	8.5	8.7	9.6	10.6	...
Services									
Foreign tourists *(cumulative over 12 months)*	7.8	–76.2	–76.2	–86.7	–74.2	–38.7	–38.7	–9.9	...
Confidence indicator in services *(value)*	12.9	–21.6	–19.5	–19.1	–9.9	5.5	7.2	9.8	11.8
Consumption									
Retail sales	4.4	–3.0	–1.9	–7.5	16.0	2.8	2.6	3.2	...
Coincident indicator for private consumption	2.2	–6.1	–5.4	–1.0	4.3	6.7	6.8	6.5	...
Consumer confidence index *(value)*	–8.0	–22.4	–26.2	–24.4	–17.3	–13.6	–12.9	–10.9	–13.3
Labour market									
Employment	1.2	–1.9	–1.2	–1.3	4.5	4.7	4.1	2.9	...
Unemployment rate (*% labour force*)	6.6	7.0	7.3	7.1	6.7	6.1	6.4	6.4	...
GDP	**2.7**	**–8.4**	**–6.8**	**–5.7**	**16.1**	**4.2**	**–**	**–**	**–**

Prices

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

	2019	2020	Q4 2020	Q1 2021	Q2 2021	Q3 2021	09/21	10/21	11/21
General	0.3	0.0	–0.2	0.4	0.8	1.5	1.5	1.8	2.6
Core	0.5	0.0	–0.1	0.5	0.2	0.9	0.9	1.1	1.8

Foreign sector

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

	2019	2020	Q4 2020	Q1 2021	Q2 2021	Q3 2021	09/21	10/21	11/21
Trade of goods									
Exports *(year-on-year change, cumulative over 12 months)*	3.6	–10.3	–10.3	–8.0	9.5	13.5	13.5	...	...
Imports *(year-on-year change, cumulative over 12 months)*	6.0	–14.8	–14.8	–15.7	1.7	10.1	10.1	...	...
Current balance	**0.9**	**–2.2**	**–2.2**	**–2.1**	**–1.5**	**–1.9**	**–1.9**	**...**	**...**
Goods and services	1.7	–3.6	–3.6	–3.5	–3.8	–4.2	–4.2	...	...
Primary and secondary income	–0.7	1.3	1.3	1.4	2.3	2.3	2.3	...	...
Net lending (+) / borrowing (–) capacity	**2.8**	**0.0**	**0.0**	**0.1**	**0.5**	**1.2**	**1.2**	**...**	**...**

Credit and deposits in non-financial sectors

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

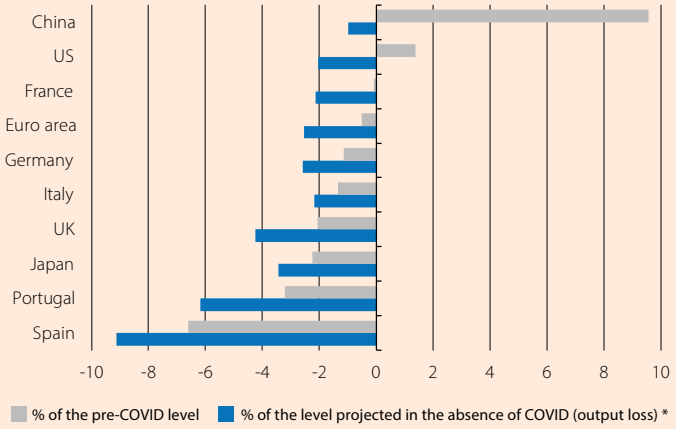
	2019	2020	Q4 2020	Q1 2021	Q2 2021	Q3 2021	09/21	10/21	11/21
Deposits [1]									
Household and company deposits	5.2	10.1	10.1	10.6	8.7	8.7	8.7	8.5	...
Sight and savings	14.8	18.8	18.8	18.5	15.3	15.5	15.5	15.1	...
Term and notice	–2.9	1.4	1.4	2.4	1.3	1.0	1.0	1.0	...
General government deposits	5.6	–21.0	–21.0	–23.6	–15.0	–5.2	–5.2	–5.3	...
TOTAL	**5.2**	**9.0**	**9.0**	**9.4**	**7.8**	**8.2**	**8.2**	**8.1**	**...**
Outstanding balance of credit [1]									
Private sector	–0.1	4.6	4.6	5.1	4.4	4.2	4.2	4.2	...
Non-financial firms	–3.7	10.5	10.5	11.0	7.2	5.8	5.8	5.6	...
Households - housing	–1.3	2.1	2.1	2.6	1.0	1.6	1.6	1.7	...
Households - other purposes	16.5	–1.2	–1.2	–1.0	9.4	9.4	9.4	9.8	...
General government	–4.7	–4.2	–4.2	–5.1	4.5	4.1	4.1	4.8	...
TOTAL	**–0.3**	**4.2**	**4.2**	**4.7**	**4.4**	**4.2**	**4.2**	**4.2**	**...**
NPL ratio *(%)* [2]	**6.2**	**4.9**	**4.9**	**4.6**	**4.3**	**...**	**...**	**...**	**...**

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.*

2022: return to normality?

For much of the crisis that has been crippling the international economy since the beginning of 2020, we have longed for a return to normality and, with it, a recovery in GDP levels and economic trends to those which were present in the now distant Q4 2019. In doing so, we have overlooked the fact that the economic landscape of two years ago was not exactly idyllic either (risk of secular stagnation) and, above all, that COVID is accelerating structural changes which we all saw coming on the horizon but were unable to assign a date to. So, if the question is when will we recover the «economic normality» lost in the last two years, then the answer is probably never. Soon enough, we will be back to producing the same amount of goods and services as we did at the end of 2019 (China, the US and much of the OECD has already done so), and we will even close the gap with where we should have been in the absence of the pandemic based on the long-term trend (see first chart). However, that gross domestic product will be achieved with a combination of different production factors and with a composition, on both the demand and the supply side, which will also differ from that which existed pre-COVID. These differences can be seen in the shape which the revival in employment is taking in countries like Spain, which, in addition to sound economic policy responses (furlough schemes, etc.), clearly reflects the particular idiosyncrasy of the recovery phase in which we are now immersed.

Cumulative change in real GDP up to Q3 2021
(%)



Note: ** Output loss corresponds to the difference in GDP level versus the OECD projections before the start of the pandemic (October 2019).*
Source: *CaixaBank Research, based on data from the OECD.*

In this regard, at the end of the crisis there will be winners and losers and we will not return to the exit gate, as the classic process of creative destruction which occurs in any recession is proving even more acute this time. This is the case both due to the particularly disruptive nature of the pandemic and because it is coinciding with the disruption caused by digitalisation and the need to improve the sustainability of our production model. If a crisis occurs when «the old is dying and the new cannot yet be born», then there is no better definition to describe the current moment, which is especially convulsive and complex, given that we are witnessing the biggest mismatch between supply and demand since China joined the global production chain. The peculiar nature of this crisis, as an economic shutdown linked to mobility restrictions rather than a drastic adjustment in financial or real asset prices (balance-sheet recession), has led to an intense recovery in demand after the lockdowns, and this has pushed value chains to their limits while also showing us that, sometimes, sophistication also comes with fragility.

Thus, while the underlying trends that will characterise the post-COVID economy are gradually taking shape (changing consumption patterns, reconsideration of the role of the public sector, new central bank strategies, etc.), economic activity over the next 12 months will continue to depend on: how the pandemic evolves and how it affects mobility, the restoration of supply chain functions and, finally, the adaptation of economic policy to this new phase of the economic cycle. In other words, the dynamics of the recovery will be determined by the rebalancing of global supply and demand, which in turn will depend on how flexible production proves to be in adapting to a demand that will continue to be stimulated by extremely expansive financial conditions as well as by the constraints of the fiscal stimulus plans set in motion on both sides of the Atlantic. Everything rides on the capacity of supply to respond, having been hampered for the past decade both by the absence of reforms to make the economic structure more flexible and by weak public and private investment. If the adjustment occurs in the first half of the year, then the latent macroeconomic imbalances will be absorbed and we will return to a reflation scenario, albeit with the global economy making a soft landing as it converges towards its potential growth rates.

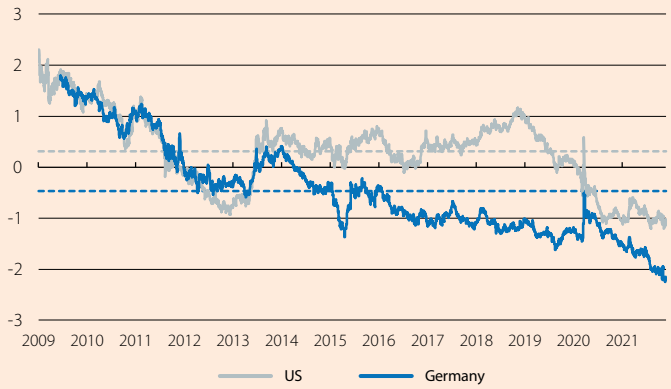
In this baseline scenario, the world economy will continue to show buoyant growth in 2022 (4.5%), albeit some 1.5 pps lower than this year. Much of the slowdown will be explained by the loss of momentum in both the US (3.5% in 2022 vs. 5.4% in 2021) and China (5.7% vs. 8.3%), both of which will already have left the period of recovering the GDP lost during the crisis well behind them and will be gradually approaching their long-term trend levels of growth. In the case of the euro area, the cruising speed will not change much (4.7% vs. 5.1%), both because of the maintenance of the monetary and fiscal stimuli (with NGEU funds) and due to the «rebound effect» which can be expected in countries of the region which performed relatively worse in the latter half of 2021

(Germany and Spain), assuming that industry and tourism recover as expected.

Beyond the potential for new variants of the virus such as Omicron to distort economic activity, the outlook will ultimately be shaped by how inflation behaves, the central banks' exit strategies and how the financial markets assess the suitability of the financial conditions that are in place at any given time. The biggest risk is that the supply chain problems persist throughout the coming year, or that the disruptions in labour markets such as that of the US become more than a temporary feature. In that case, it is very unlikely that the price rallies in the more volatile components of the consumer price index will remain contained without filtering down to the other components to some extent, given that industrialised countries will be very close to closing the output gap by the end of next year. This would call into question the hypothesis being defended by many monetary authorities, namely that the current inflation rally is of a transitory nature.

Real yield on 10-year sovereign debt in the US and Germany

(%)



Notes: *Corresponds to the generic 10-year inflation-indexed bond. The dotted lines show the average since 2009.*
Source: *CaixaBank Research, based on data from Bloomberg.*

With real interest rates at historical lows (see second chart), if we are to avoid threats to financial stability it is essential that the credibility of the central banks is upheld at all times. This will involve keeping a close eye on inflation expectations, and thus avoiding falling behind the curve for too long. However, differences in countries' cyclical position (the recovery is proving highly asymmetric), as well as in the very credibility of the central banks themselves, are already resulting in very different rates of monetary normalisation between emerging and developed countries. This lack of monetary coordination could end up causing mismatches in exchange rate behaviour, another potential medium-term risk. The key, therefore, remains to keep the financial channel free from potential tensions in order to avoid the problems of the Great Recession of 2009.

In short, the starting point for next year is a global economy that is recovering much of the growth lost during the pandemic, thanks to the success of the vaccines and an extraordinary revival in demand for durable goods that has not been met by supply, creating bottlenecks that have ended up distorting value chains and leading to an unexpected surge in inflation. The economy, like football, is a short blanket. If you prioritise growth at all costs, you will most likely end up with economic imbalances if your supply lacks the capacity and flexibility to respond. So, on the cusp of a new year, we cannot rule out the possibility that the ingredients laid before us will expose us to unexpected emotions: new mutations of the virus, inflation above central bank targets, mismatches between supply and demand, bottlenecks in a production chain that we thought was infallible, rising inequality, accelerated digitalisation, very high levels of debt, etc. In that sense, it does not look like we will be returning to the old normal. And as is well known, exceptional times call for exceptional measures.

José Ramón Díez

Bottlenecks: from the causes to how long they will last

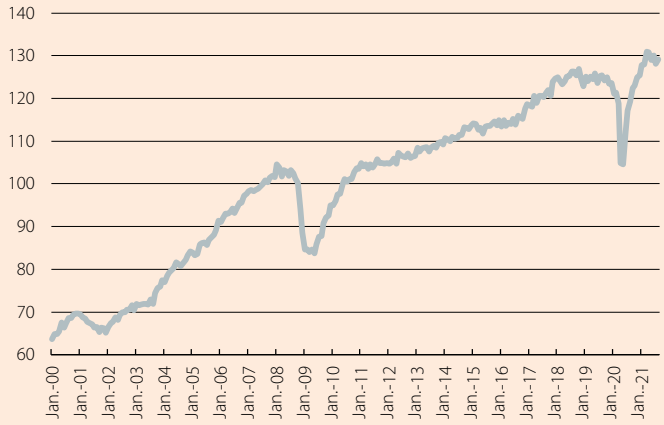
News related to the supply problems (or bottlenecks) within global value chains have been a permanent fixture of recent months. The temporary shutdown of some car plants due to the lack of chips and difficulties in the Black Friday or Christmas campaigns due to delays in the arrival of shipping containers are some of the best known examples. In this article, we analyse what is causing these problems and, looking ahead to 2022, how long they could last.

Demand: uneven increase by product and region

The strength of demand is a key element behind this phenomenon. In particular, the pandemic has led to a shift in the type of goods and services we consume towards greater consumption of goods, especially those of a durable nature. Businesses and households had to adapt their environment to teleworking and remote education, resulting in increased demand for technological goods. Similarly, restrictions on more social leisure activities led to an increase in savings (the famous pent-up or forced savings), which in recent months are being channelled towards greater consumption of these durable goods. Finally, this increase in demand has occurred mainly in the large advanced countries. Not in vain, the economic policies introduced in these economies to soften the blow of the COVID-19 crisis on households and businesses were both profound and rapid (especially in the US). For instance, in October 2021, consumption of durable goods in the US was 22% above pre-pandemic levels, compared to 1.3% below in the case of consumption of services.[1]

International trade in manufactured goods *

Index (100 = 2010)



Note: ** Monthly volume.*
Source: *CaixaBank Research, based on data from the CPB World Trade Monitor (Merchandise).*

These types of goods are highly traded, unlike services (which are mostly not). Thus, this high demand has been reflected in a sharp rebound in the international trade of manufactured goods, having ground to a halt during the months of strict lockdown. In particular, following the drop in the spring of 2020, global flows were back at pre-pandemic levels in just over six months, and by August 2021 they were already just over 6% above the levels of February 2020[2] (see first chart).[3]

Supply: insufficient response and logistical problems

Supply has attempted to respond to the enormous demand for these durable goods. As an example, exports of electronic components from Taiwan (one of the leading producers/exporters of high-end chips) have gone from growing by around 10% a year in the last 20 years to an annual rate of just over 25% in the last year and a half. However, the increased production of many of these products has fallen short of the mark, as revealed by the forced stoppages at many car plants which we mentioned at the beginning.

Also, the uneven distribution of the increase in demand, with the US being one of the main hot spots, has led to congestion at its major seaports, resulting in delays to thousands of anticipated trade flows around the world. The reason: with around half a million containers waiting aboard the hundreds of cargo ships anchored at the ports of Los Angeles and Long Beach, ships and containers have become a scarce commodity worldwide.[4] In this situation, the huge increase in shipping costs per container registered in recent months should not come as any surprise (see second chart).

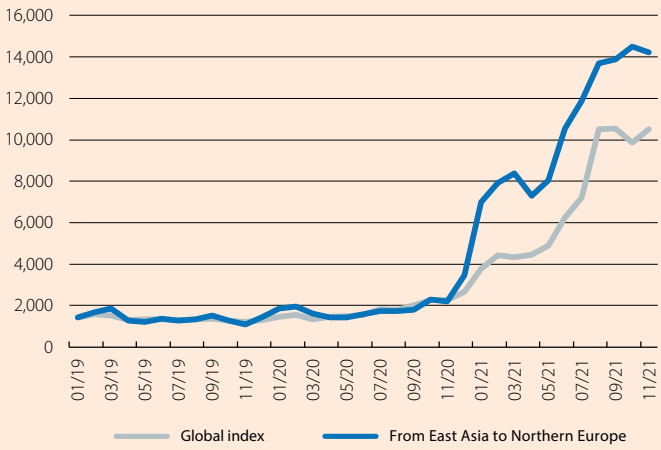
Finally, the zero-tolerance COVID-19 policies adopted in China and other Asian economies (which play a central role in major global manufacturing chains) have applied added pressure on supply since mid-summer. For instance, in August, part of China's Ningbo-Zhoushan port (the world's third busiest port) was closed after a positive case of COVID-19.

1. According to data from the Bureau of Economic Analysis on Personal Consumption Expenditure (PCE) in real terms.
2. In contrast, in 2009, following the sharp contraction of international trade flows, they did not recover to pre-crisis levels until some two years later.
3. According to statistics from the CPB World Trade Monitor and in real terms.
4. Data referring to the situation as of late October and early November. Right now, the congestion at these ports has reduced, but has not yet normalised.

What the future holds

In the medium term, the moderation in the demand for goods, together with the gradual resolution of problems in logistics centres and an adaptation of supply to changing consumption patterns, should solve the current mismatch. In particular, various factors will bring on a slowdown in demand: (i) the pent-up savings, which have favoured the consumption of goods, will be gradually exhausted; (ii) as restrictions are lifted, we should see a rebalancing towards greater consumption of services (especially those of a more social nature) versus goods, and (iii) the growth rate of economic activity should normalise as economies reach pre-pandemic GDP levels. On the supply side, progress in the vaccination campaigns will support fewer stoppages at factories and logistics centres caused by outbreaks. In addition, many countries have already put in place plans to increase the supply of certain products that are considered key to global production (such as the famous chips).

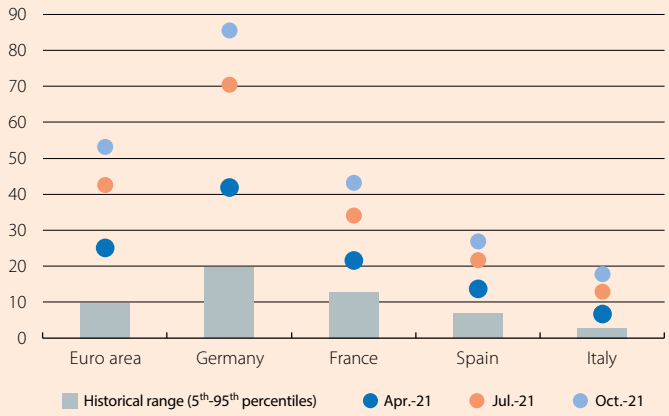
Container shipping costs
(USD per 40-ft container)



Source: *CaixaBank Research, based on data from Freightos (Refinitiv).*

However, it is likely that in the first half of 2022 these mismatches between supply and demand will still be active, with a high risk of them being further prolonged, for several reasons. Firstly, this is because the release of some of the pent-up demand still has some scope to continue, especially in Europe (not so in the US).[5] Secondly, the measures implemented to alleviate the US' logistical problems (such as ports remaining open and operating 24 hours a day, 7 days a week) are not considered adequate to solve the problem in the very short term, as they require a greater number of port workers who need very specific training. Lastly, under China's zero-tolerance policy we could see further closures at the country's factories and ports if the Omicron variant ends up being highly contagious and escapes the effectiveness of the vaccines.

Factors limiting production: shortage of materials or equipment
(%)



Note: *Companies that give an affirmative response as to whether the shortage of materials or equipment is limiting their production.*
Source: *CaixaBank Research, based on data from the European Commission (business and consumer survey).*

Finally, there are three elements of the current mismatch which concern us. Firstly, it will not affect all countries equally. Within the euro area, for example, Germany – an economy heavily integrated into global value chains due to its potent automotive sector (which accounts for slightly over 20% of German manufacturing output, compared to 11% on average in the euro area) – is already feeling the impact of the supply crisis more than others (see third chart).[6] Secondly, the bottlenecks in technology sectors may delay the implementation of some digital initiatives being pursued in the EU with Next Generation EU funding. Remember that the digital transformation, alongside the green transformation, represents one of the fundamental levers for change in the European production system.[7] Finally, these distortions are pushing up production prices. This is a dynamic still in its early stages and it could intensify in the future, exacerbating one of the most significant risks threatening the economy today, namely that of inflationary tensions, which are already evident in consumer prices in many economies (particularly the US).[8]

Clàudia Canals

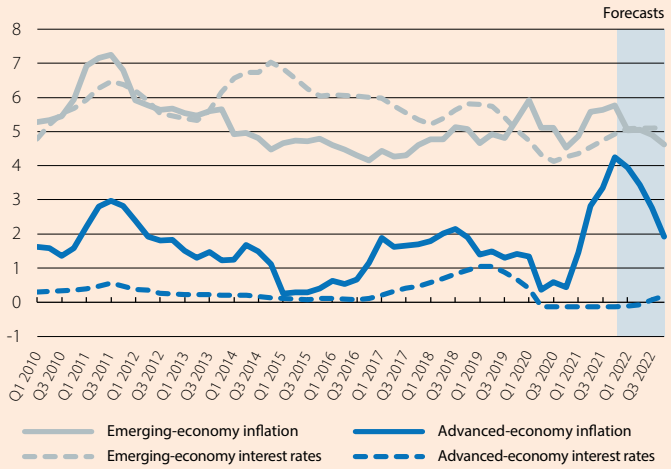
5. The savings rate among US households was already back at pre-pandemic levels in October 2021 (7.3% of disposable income, following the peaks of over 30% in April 2020 and 27% in March 2021). In the euro area, meanwhile, the savings rate in Q2 2021 (latest available data) was slightly below 20%, compared to around 13% in 2019. In addition, in the articles of the Dossier «The recovery in consumption» in the MR11/2021, we analyse consumption in Spain using internal data and conclude that it will remain buoyant and above the historical average during 2022.
6. See the Focus «Economic structure and resilience against shocks in the euro area» in this same *Monthly Report* for a somewhat more detailed analysis of the case of Germany.
7. Green initiatives, such as the electric car, could also be affected by the bottlenecks.
8. In the article «Central banks' response to the rebound in inflation (and the ECB's inaction)» of this same Dossier, we talk about these inflationary tensions and the response from monetary institutions.

The central banks' response to the rebound in inflation (and the ECB's inaction)

In 2021, inflation has reached peaks not seen in many years in most advanced and emerging economies. For example, we need to trace back to 1990 to find US inflation above last October's 6.2%, while in the euro area November's 4.9% is the highest level since the series began. This phenomenon is attracting the full attention of the current economic debate, mainly because of the implications it has for monetary policy. Our view, which is shared by the major central banks, is that the factors behind these high inflation rates are transitory in nature and should fade during the course of 2022.

Inflation and interest rates in advanced and emerging economies

(%)



Notes: *Internal inflation forecasts. For interest rates, we use the interest rates implicit in the financial markets where possible, as well as Bloomberg's analyst consensus.*
Source: *CaixaBank Research, based on data from Bloomberg and the IMF.*

What lies behind the rebound in inflation?

On the one hand, global energy prices have increased significantly and account for most of the rise in inflation. The main reason for this has been a perfect storm in the gas market caused by several factors, such as colder than normal temperatures, a lack of wind, lower hydroelectric generation, other one-off disruptions in the supply of gas in various countries, and increased demand for gas, especially in China. Individually, these factors would have had only a minor impact on the price of this fossil fuel, but together they have caused the price of gas to rise by +350% so far this year. This rise has pushed up the price of electricity in most countries, and given its magnitude and persistence this trend has also ended up affecting other fossil fuels, such as oil and coal. Prices in the financial markets reflect expectations that this situation could persist for a few more months still, but with the end of winter and the reduction in seasonal demand the energy markets will be less strained.

The mismatch between the demand and supply of many goods, which is visible in the bottlenecks caused by the sharp growth in demand around the world, is a second element also pushing up prices.[1] Despite high uncertainty, this dynamic looks set to persist for several more months yet, and it could keep inflation high during the first half of the year. Nevertheless, it should fade during the course of 2022 as supply normalises and pent-up demand runs out. However, the emergence of new, mutated variants of the virus, such as Omicron, is a latent risk that could intensify the bottlenecks.

The central banks get to work...

In the face of rising prices, a number of central banks have already begun to withdraw the monetary stimulus deployed after the outbreak of the pandemic. In particular, in many emerging economies the monetary authorities have already begun to raise rates, as these are countries where energy and commodity prices tend to have a more direct effect on inflation, given their greater relative weight in the price index. Thus, in 2021 the central banks of Russia, Brazil and Poland have raised interest rates by 5.75, 3.25 and 1.15 pps, respectively, and are expected to continue the cycle of rate hikes in 2022. In developed economies, rate hikes have been more contained and selective, and only the central banks of Norway, New Zealand and South Korea have raised rates (by 0.25 pps).

We believe that 2022 will be the year in which most central banks will withdraw the monetary stimulus and raise interest rates, both in advanced and in emerging economies, provided the new variants of the virus allow it. Thus, the financial markets anticipate four rate hikes by the Bank of England and that of Canada, three in the case of Australia and up to seven for New Zealand. Two 0.25-pp rate hikes are expected from the Federal Reserve, in line with our own forecasts, while in Frankfurt no interest rate changes are anticipated as explained below.

1. For more details, see the article «Bottlenecks: from the causes to how long they will last» in the Dossier of this same *Monthly Report*.

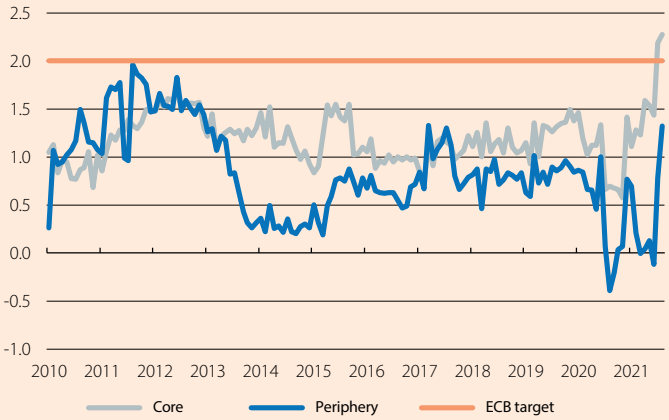
... although the ECB is moving at a different pace

As we discussed in a recent article,[2] the euro area economy, like that of Japan, is at a different point in the business cycle compared to the other economies mentioned above. Its core inflation, which excludes the energy and food components, stands at 2.6%, a far cry from New Zealand's 4.8% or the US' 4.6%. In addition to a widely varying core inflation, which is clearly higher in the core economies than in the periphery (see second chart), there is another peculiar feature: the base effect of the temporary VAT reduction applied in several countries in the second half of 2020. This factor is placing current inflation (both headline and core) at artificially high rates, and this will cease to be the case from January 2022.

In this context, the ECB insists that the rebound in inflation is transitory and that it will not act to counteract it as long as it continues to believe that the second-round effects[3] will be moderate and the aforementioned elements fade during 2022. Moreover, following the ECB's strategic review and the shift in its forward guidance proposed in July, with the medium-term inflation target of 2%, it is highly unlikely that we will see a rate hike before the end of 2023.

Euro area: core inflation

(%)

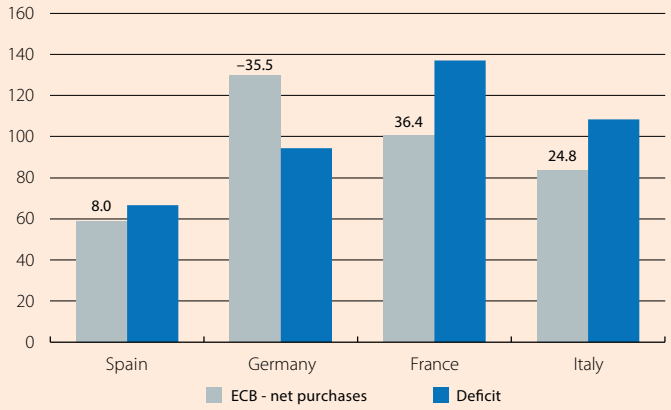


Notes: *The countries of the core are Austria, Belgium, Finland, France, Germany, Luxembourg and the Netherlands. In the periphery we have Cyprus, Estonia, Greece, Ireland, Italy, Latvia, Lithuania, Malta, Portugal, Slovakia, Slovenia and Spain. We weight each economy according to its GDP.*
Source: *CaixaBank Research, based on data from Eurostat.*

Yet the ECB is not isolated from global inflationary dynamics and, together with the fact that the euro area economy will reach pre-pandemic GDP levels in Q1 2022, we believe it will also withdraw some of the monetary stimulus in 2022. Specifically, we estimate that net asset purchases in 2022 will amount to around 570 billion euros.[4] This is a very considerable volume, even if it is 520 billion less than the purchases carried out in 2021, a year still heavily conditioned by the pandemic. These purchases, together with reinvestments of the assets at maturity, will enable the ECB to maintain an accommodative financial environment with which to support economic growth and continue to meet Member States' funding needs. It should also be noted that in 2022 the issuer limits will no longer be such cause for concern as they were in the pre-pandemic world. With the rise in public debt following the outbreak of the pandemic, the ECB has scope to maintain the rate of purchases which we expect to see up until the end of 2023 without exceeding these limits.

Euro area: funding needs in 2022

(EUR billions)



Notes: *We assume that the ECB will purchase 150 billion euros of assets during Q1 2022 under the PEPP, and 60 billion under the APP. For the remainder of the year, we assume it will purchase 360 billion euros under the APP, resulting in net purchases of 570 billion euros for 2022 as a whole. The figure shown above the grey bars is the amount of net debt issues that the ECB would not cover.*
Source: *CaixaBank Research, based on data from the European Commission and the ECB.*

This whole scenario, however, is subject to much uncertainty. New variants of the virus, such as Omicron, will continue to weigh on the ECB's balance of risks and could condition economic activity in 2022, along with inflation.

Ricard Murillo Gili

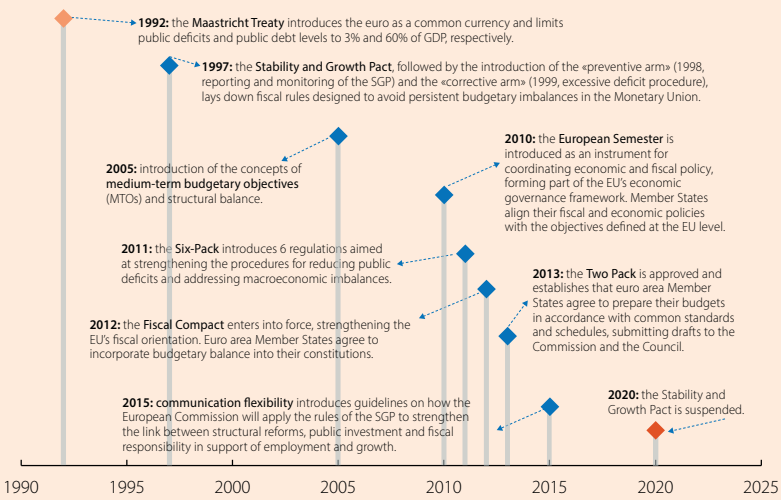
2. See the Focus «On the normalisation of monetary policy» in the MR10/2021.
3. I.e. how high inflation rates today could translate into higher inflation rates in the future. Some studies suggest that second-round effects have lost relevance in recent years, although it is true that the particular nature of the crisis and the economic recovery triggered by the COVID-19 pandemic could lead to a change in this dynamic. See, for example, C. Borio, *et al.* (2021). «Second-round effects feature less prominently in inflation dynamics».
4. Specifically, we believe that net asset purchases under the PEPP during Q1 will be at a slower pace than in the last quarter of 2021 and will cease in March. We believe that the APP will then take on a more prominent role and that the net monthly purchases could go from the current level of 20 billion euros to 40 billion. In addition, there is speculation that the ECB could incorporate some flexibility into the level of purchases under the APP, announcing a target for the volume of purchases to be made throughout the year as a whole rather than a monthly purchase rate.

The EU in 2022: fiscal rules reform back on the table

The severe deterioration in the public finances as a result of the pandemic has reopened the debate about the need to reform EU fiscal rules. The current public debt and deficit targets date back to 1992, when the Maastricht Treaty set the requirements for access to the single currency, and these were also incorporated into the Stability and Growth Pact (SGP) when it was adopted in 1997. The public debt ceiling was set at 60% of GDP (coinciding with the European average in the 1990s), a target that was expected to be met in the medium term if the public deficit ceiling was set at 3% of GDP, as nominal growth at that time was around 5.0%. That is, the SGP was approved against a backdrop of high economic growth and low levels of debt, a far cry from the present situation.

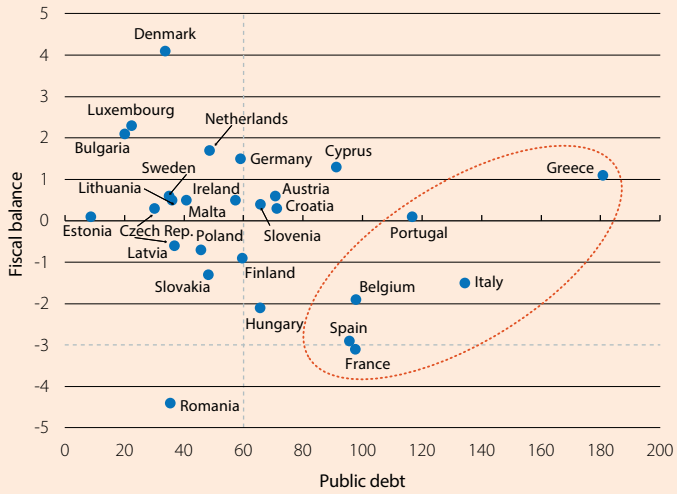
Indeed, one of the decisive moments for the SGP was the global financial crisis of 2008, which forced Brussels to adopt a set of legislative proposals known as the Six-Pack and the Two-Pack. However, these «tweaks» failed to solve the main problems of the SGP: its lack of flexibility to adapt to each Member State's own business cycle and situation, its lack of transparency, its excessive complexity and the absence of mechanisms to ensure compliance. Even the European Commission itself recognised that these reforms aggravated the above problems by introducing new budgetary procedures and criteria that were difficult to measure in the short term.[1]

The evolution of the EU fiscal rules framework



Source: *CaixaBank Research.*

European Union: public accounts in 2019
(% of GDP)



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

The last expansionary cycle (2014-2019) highlighted the enormous challenge that some Member States face in meeting the objectives of the SGP. Overall, Member States managed to bring their public deficit to GDP ratios down below 3.0% in 2019 (Spain and France passed by the skin of their teeth), while the primary balance (which excludes interest payments) also improved significantly in most cases, although Spain was not one of them. This improvement reduced pressure on government debt ratios, which fell over the period, although in 2019 they were still well above the 60% target in many countries (see second chart).

Even in the pre-pandemic macroeconomic context, the effort that was required of some countries to bring their debt within the limits set under the Fiscal Compact was enormous. Assuming that the long-term interest rates and the nominal GDP growth rate achieved in 2019 had remained stable, Greece would have needed to register a primary surplus of over 6.0% for 20 years; in the case of Italy and Portugal, this figure was around 3.0%, while in Spain, France and Belgium, it was around 2.0%.[2] This does not seem feasible, especially given countries' systematic failure to comply with the fiscal rules in the past. As the evolution of the structural deficits shows,[3] some economies lack the tools or the political will to comply with the European recommendation to cut their structural deficit ratios by 0.5 pps per year in order to bring them closer to the established structural targets,[4] even in expansionary periods (see third chart).

1. See the Focus «A step towards a reform of the fiscal rules in Europe?», in the MR03/2020.
2. See the Focus «European fiscal rules: an end to the 60% limit?», in the MR03/2021.
3. The structural deficit is estimated to be the part of the public deficit which is not affected by the business cycle or by temporary exceptional expenditure. Effectively, it offers an estimate of the permanent (structural) imbalance in the financing of the public accounts and provides an idea of their long-term sustainability.
4. Brussels states that the «golden rule» of budgetary balance, with a structural deficit limit of 0.5% of potential GDP (if public debt is less than 60% of GDP, this limit is set at 1% of GDP), must be enshrined in national legislation, preferably at the constitutional level. However, this is one of the most controversial objectives. On the one hand, the concept of «structural deficit» is itself an estimate, not an observed variable. On the other hand, it is fixed in terms of potential GDP, which is another variable estimated using different methods, and this explains the differences in the potential GDP figures published for the same country by different entities such as the IMF, the European Commission and the OECD.

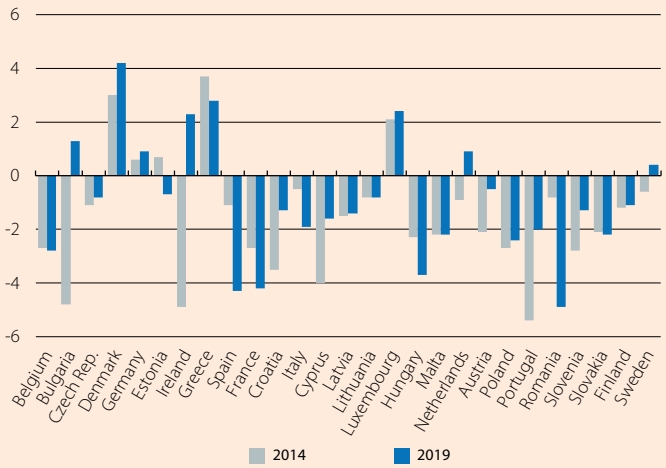
The reform of fiscal rules in the EU: more flexibility, less complexity?

The COVID-19 crisis exacerbated the existing problems by making it clear that the current fiscal rules would likely be inadequate for the new reality. The exceptional nature of the situation led to the temporary suspension of the SGP (from March 2020 until, foreseeably, 2023) and revived the debate about the reform of fiscal rules. The discussion can be divided into three schools of thought: (i) those who argue that the current framework does not need reform; (ii) those who acknowledge that the fiscal rules need to be adapted, but within the current framework; and (iii) those who demand a complete overhaul of the rules and even the replacement of the numerical targets included in the European treaties. An immediate return to the rules of the Fiscal Compact could be detrimental for the euro area as it would require a very sudden and clearly unworkable fiscal adjustment, while a complete overhaul seems complicated, requiring unanimity among Member States. Thus, the option of reform within the current framework is the clear winner.

Among the potential solutions, one of the most promising is to shift the focus from rules based on the structural deficit to an expenditure-based rule. This could be easily adapted to each country's individual macroeconomic conditions (primarily, the level of public debt) and could include exceptions which, among others, would affect public investment in order to limit the «anti-public investment» bias of the current system[5] (see fourth chart). In addition, it is essential to improve the transparency of these rules, reduce their complexity and strengthen the role of institutions responsible for fiscal supervision[6] by creating incentives and mechanisms to promote compliance.

European Union: structural balance

(% of potential GDP)

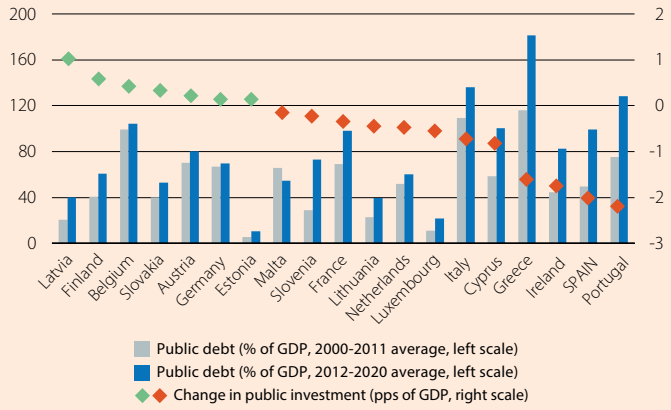


Source: *CaixaBank Research, based on data from the European Commission.*

Although adopting an expenditure-based rule adds transparency and predictability to the European fiscal framework, it is important to highlight the difficulty in naming exceptions (i.e. which items of public expenditure should be excluded from the expenditure rule and which should not?), as well as the need to set clear limits on the scope of action of the various institutions involved in the process. In the end, a reform of the fiscal rules should be capable of addressing the shortcomings already identified and should enable us to emerge from this crisis with a simple and credible mechanism for fiscal control and coordination. Such a mechanism should also give Member States a sufficiently solid architecture with which to tackle the EU's main challenges: making Europe the first climate-neutral continent, adapting it to the digital age, reducing inequality, and mitigating the effects of population ageing... all this without jeopardising the long-term sustainability of public debt. These challenges will require significant levels of public investment, which are infeasible under the current budgetary rules, so a thorough rethink of the fiscal strategy will be key.

Euro area: public debt and investment

(% of GDP) *(pps)*



Notes: *The change in public investment is calculated as the difference between the average of the periods 2000-2011 and 2012-2020. The green diamonds correspond to an increase in public investment between the two periods, while the red diamonds indicate a reduction.*
Source: *CaixaBank Research, based on data from Eurostat.*

Furthermore, despite the pertinence of the debate on fiscal rule reform, we must not loose sight of other important elements. Let us not forget, for example, that countries must also make individual progress in carrying out the necessary structural reforms to ensure the sustainability of their public finances.[7] In addition, when it comes to fiscal rules, there does not appear to be any silver bullet for easily and simultaneously achieving a simpler, more flexible and predictable application. Even so, the EU also has other heavy ammunition: the mechanisms developed during recent crises (such as the European Stability Mechanism, the SURE instrument and NGEU funds) make it possible to fine-tune the aim of the EU's fiscal artillery. Overall, a well-established system of fiscal rules and a permanent fiscal capacity in the EU would encourage key investments during a period of ecological and digital transition, while reinforcing positive conditionality. Boosting confidence among Member States, as well as in EU institutions and rules, will be the key.

Luís Pinheiro de Matos and Rita Sánchez Soliva

5. The fiscal consolidation in the last expansionary cycle was largely achieved via a drastic reduction in investment, when investment contributes to medium-term growth.
6. These institutions include the European Fiscal Board and national fiscal supervision institutions, such as the AIReF. In this regard, a mechanism for resolving fiscal disputes between Member States and the European Commission should also be established, increasing the responsibilities of the European courts of justice.
7. See OECD (2021). «The long game: Fiscal outlooks to 2060 underline need for structural reform».

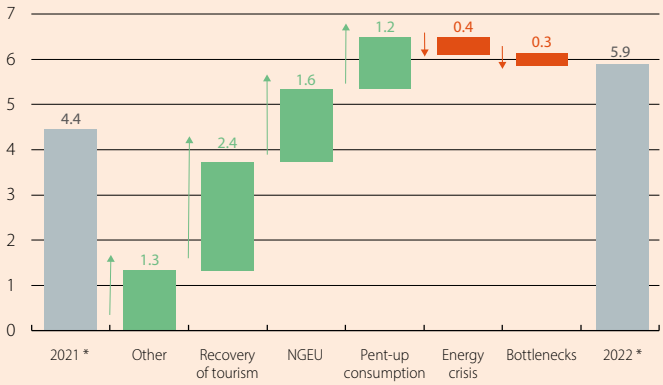
Spain 2022, a key year for the consolidation of the recovery

The architects of growth in 2022

2021 may be remembered as the year of the vaccines. After getting the vaccination roll-out underway in Q1, albeit with a few setbacks, the campaign accelerated rapidly beginning in Q2 such that, as we approach the end of the year, practically 90% of the population over the age of 12 has now been vaccinated. This speed of the vaccination roll-out allowed most of the restrictions on activity to be lifted in Q2 and paved the way for a recovery in economic activity which intensified in Q3 thanks to the revival of tourism activity. Thus, GDP is expected to grow by 4.4% in 2021. Although a relatively high growth rate, at the end of the year this still leaves us 5.2% below the level of Q4 2019.

The economic recovery is expected to be consolidated in 2022, with GDP growth accelerating to around 6.0%. The pandemic could still generate new waves, either through the emergence of new, more contagious variants or due to the arrival of the cold, but we expect that their impact on the health system would be limited thanks to the progress made with the vaccines and that reimposing severe restrictions on activity would not be necessary. Nevertheless, new waves could generate spikes in uncertainty, which ought to dissipate as the efficacy of the vaccines is confirmed. The emergence of new variants of the virus with greater resistance to the vaccines poses the main latent risk threatening the outlook.

GDP in 2022: contributions to growth
(pps)



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

Growth in 2022 will be largely supported by three main drivers: the recovery of the tourism sector, the impact of European funds and pent-up demand (see the first chart).

The driver that will provide the greatest contribution is tourism. This sector, hit hard by the pandemic, began to recover during the summer of 2021, driven mainly by the buoyancy of domestic and European tourism. The flows of visitors from outside Europe were still very contained.[1] For 2022, the recovery in international tourism is expected to be more vigorous, driven mainly by flows of tourists from the United Kingdom, the US and Latin America, and this will allow the sector to recover activity levels similar to those registered in 2017.

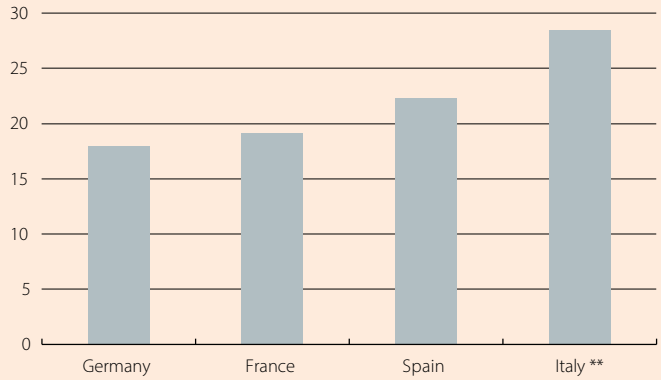
The other major protagonist of 2022 will be the European Funds under the NGEU programme. The Spanish government plans to spend some 27 billion euros in 2022, mainly on R&D&I and digitalisation (19.6% of the total), industry and energy (17.5%) and infrastructure and transportation (14.2%). Overall, we expect the NGEU funds to contribute 1.6 pps to GDP growth in 2022.[2]

Household consumption will also play an important role in 2022, although less than tourism and NGEU. During 2020, the restrictions on activity forced consumption to fall, and this, together with the income protection policies that were implemented (mainly the ERTE furlough schemes), generated pent-up savings of around 45 billion euros. This stock of savings has already begun to materialise during 2021, but it will continue to drive the recovery in consumption and economic activity during 2022.

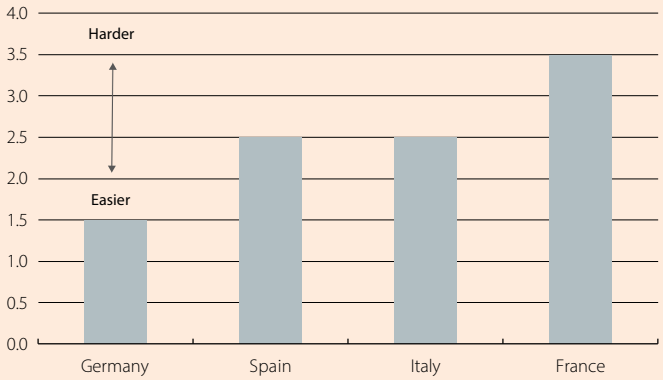
Finally, 2022 will not be free of factors restricting economic activity. On the one hand, the current energy crisis in Europe, compounded by the start of the winter season, has led to sharp increases in energy prices which reduce households' purchasing power and put pressure on business margins. The impact of this crisis, although acute, should be temporary and its effects ought to moderate after the winter.[3] On the other hand, the disruptions to global supply chains will continue to hamper the industrial sector's ability to recover, especially during the first half of 2022.[4] However, we expect that the energy crisis and the logistical problems will end up having a relatively contained impact compared to the magnitude of the factors driving growth. Finally, we cannot forget the risk of new variants of the virus emerging, such as the recent Omicron. New variants could trigger episodes of uncertainty, affecting trade and tourism flows, although the progress of the vaccines at the global level and the ability to adapt the existing vaccines, if necessary, should prevent them from causing persistent problems for economic activity.

1. For instance, in August 2021, 5.2 million international tourists arrived. Although slightly more than double the number that came in August 2020, this is still 49% less than in August 2019.
2. The lower-than-expected execution in 2021 will mean that part of the contribution in 2022 will come from investments which were planned for 2021 but the macroeconomic impact of which will not be reflected until 2022.
3. For more information, see the Focus «The impact of the rise in electricity prices on the Spanish economy» in this same *Monthly Report*.
4. For more details, see the article «Bottlenecks: from the causes to how long they will last» in the Dossier of this same *Monthly Report*.

Average compensation after unfair dismissal
Number of monthly salaries (20 years of service)



Ease of renewing and extending temporary contracts *
Index (0-6)



Notes: ** Based on the maximum number of times a temporary contract can be renewed in a row and the maximum cumulative duration (in months) of temporary contracts according to each country's labour legislation. **For Italy, only large corporations.*
Source: *CaixaBank Research, based on data from the OECD.*

2022, a crucial year for NGEU and reforms

Beyond the economic impact of the investments that are planned, NGEU represents a unique window of opportunity to develop reforms that will modernise the Spanish economy. Indeed, the investments and reforms must go hand in hand, because when reforms are made with the right goal in mind, investments have a greater impact on growth.[5]

The key reforms envisaged include the labour reform (the bulk of this reform must be finalised before the end of 2021 and it is one of the conditions required for the payment of 12 billion euros in grants in June 2022), as well as the outstanding pension reforms (to promote company pension plans, changes in the social security contributions of self-employed workers, the extension of the period considered in calculating the pension,[6] and the plan to increase the maximum contribution base amount), and the modernisation of the general government administrations.[7]

The labour reform is essential within the framework of NGEU to address the endemic problems of the Spanish labour market, namely: the high incidence of temporary employment and the market's duality, and the mismatches between the qualifications that are most popular among students and those that are most sought after by companies.[8]

The issue of temporary employment is a pressing problem given its high prevalence in Spain. It particularly affects the most vulnerable workers, such as young people, as the pandemic has once again highlighted.[9] To address this issue, it will be important to implement measures that will facilitate the more widespread use of permanent contracts and discourage the excessive use of very short-term contracts.

This issue cannot be addressed without also tackling another endemic evil in Spain's labour market: the duality or segmentation that exists between highly protected workers and others with few rights. This is reflected in a wider gap, compared to many European counterparts, between the contractual conditions of those with permanent contracts and those with temporary work (see second chart).

Finally, the decoupling between job seekers' training and qualifications and the profiles that companies are seeking is another aspect that is essential to improve. A quick and permanent implementation of an internal adjustment mechanism, like the ERTE furlough schemes, would be very welcome. In this regard, it is encouraging to see that the labour reform includes forms of furlough that allow workers to be recycled and to shift to other sectors when structural changes occur. To reduce the decoupling, of course, it will also be important to redouble efforts to improve Spain's supply policies, such as strengthening active policies, modernising vocational training, giving education centres the autonomy to manage themselves, and enhancing synergies between the education system and the businesses that form the productive fabric of the economy. Moreover, such policies will need to be developed without lowering the standards of the education model.

Oriol Carreras and Javier Garcia-Arenas

5. See S. Albrizio and J.F. Geli (2021). «Un análisis empírico de los factores que pueden potenciar la efectividad del programa Next Generation EU». Economic Bulletin, Bank of Spain, nº 4 (content available in Spanish).
6. In principle, according to the recovery plan, to benefit workers with discontinuous careers and income fluctuations.
7. A law on the evaluation of public policies will be enacted.
8. In Spain, 83% of companies state that they face serious problems in hiring candidates for certain positions due to constraints in candidates' professional profiles. See M.L. Blázquez, R. Masclans and J. Canals (2020). «Las competencias profesionales del futuro: un diagnóstico y un plan de acción para promover el empleo juvenil después de la COVID-19». IESE (content available in Spanish).
9. See the article «Employment, the key factor for reducing inequality» in the Dossier of the MR10/21.

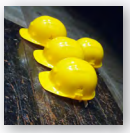
Through our studies, we help to stimulate debate and the exchange of views among all sectors of society, as well as to promote the dissemination of the major themes of the socio-economic environment of our time. Both the *Monthly Report* and the rest of CaixaBank Research's publications are available at: www.caixabankresearch.com

We recommend:

The recovery in consumption

In the November Dossier, we analyse the rebound in consumption in Spain, driven by the improved outlook and the pent-up demand accumulated at the height of the pandemic.

Spain: the mismatch between labour supply and demand



In addition to the disruptions in global supply chains, another factor which could also limit the speed at which economic activity will recover is the mismatch that is beginning to emerge in the labour market.

Brief Notes on Economic and Financial Developments

Assessment of the main macroeconomic indicators for Spain, Portugal, the euro area, the US and China, as well as of the meetings of the European Central Bank and the Federal Reserve.

COVID-19 tracker

Weekly report on the evolution of the COVID-19 pandemic and the vaccination campaign both in Spain and around the world: cumulative incidence, pressure on hospitals, new cases and deaths, infections by age, rate of vaccination, and so on.

Agrifood Sector Report 2021

Find out about the current situation and future outlook for the agrifood sector in Spain, its commitment to sustainability and how the pig and wine sectors are responding to the crisis triggered by the pandemic.

Tourism Sector Report 2S 2021

In this special edition on the summer season, we note that the situation of the tourism sector in Spain improved significantly, beating the forecasts of many companies in the sector.

Follow us on: www.caixabankresearch.com @CABK_Research Newsletter CaixaBank

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

CaixaBank Research