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MONTHLY REPORT • ECONOMIC AND FINANCIAL MARKET OUTLOOK

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CaixaBank Research

MONTHLY REPORT - ECONOMIC AND FINANCIAL MARKET OUTLOOK
October 2022

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Entering an area of turbulence

The tightening of financial conditions triggered by the actions of the central banks in recent weeks, the high uncertainty associated with a murky energy outlook, the rising financial instability and the early signs of a cooling in consumption all offer a glimpse of the obstacles that the business cycle will face over the coming quarters, especially in the euro area. The sudden shift in monetary policy that has occurred since the summer reflects the fact that tackling the inflationary pressures will require more than simply placing interest rates in neutral territory. This represents a major change in the assumptions on which the economic forecasts are based, particularly in Europe, and combined with the tensions in the gas market these developments demand a revision of the forecasts. In our case, we have revised our forecast for average euro area growth in 2023 down to 0.2% (1% in Spain), while we apply an upward revision of 1.4% to our inflation forecast, placing it at 5.1% (4.5% in Spain). This deterioration in the growth/inflation mix merely reflects the persistence of the significant imbalances between supply and demand, which are taking longer than expected to be diluted. The good news is that the gap ought to gradually narrow as the interest rate hikes cool demand and the bottlenecks are gradually cleared (something we are already seeing signs of). This in turn should lead to an improvement in the pattern of prices and economic agents' purchasing power beginning in the spring, especially if this cooling phase does not come at a significant cost in terms of jobs (as currently seems to be the case) and if economic policy can avoid contagion to the financial channel.

In this regard, it will be essential to maintain a balance between monetary and fiscal policy, while remaining aware that the financial markets will continue to be affected by high volatility and uncertainty in the coming months – a perfect breeding ground for episodes of increased financial instability, such as the one recently seen in the United Kingdom. The announcement of a mini-budget with significant tax cuts (amounting to 45 billion pounds), in a context of increased government spending to soften the blow of high energy bills, triggered a sharp correction in the sovereign debt markets and in the value of the pound – something more typical of an emerging economy than a market as liquid and established as the United Kingdom. It was only the Bank of England's intervention by announcing a two-week bond-buying programme, coupled with the British government's U-turn on the most controversial part of the measures, that calmed the waters. This episode reminded us just how easy it is to lose credibility, especially at the beginning of a government's term in office, often at a very high price in terms of risk premium. This should serve as a warning to the new government currently being formed in Italy.

So, with investor sentiment on tenterhooks, it seems that now is not the time for fiscal policy to throw stones in the path of the demanding process which the central banks are currently facing, especially when the monetary authorities' purchasing programmes are being wound down and variables such as the structural budget deficit will soon be back on the financial markets' radar. Thus, the phase of «Coffee for all» and «Do whatever it takes but keep the receipts» (IMF *dixit*) will give way to a fiscal policy of surgical precision aimed at helping the sectors and agents that are most vulnerable to the shifting financial and energy conditions, while trying not to compromise medium- and long-term budgetary balances. We are entering an area of turbulence, where volatility and uncertainty are on the rise, macroeconomic stability is back in focus and pilot error comes at a high price. It is at times like these that one appreciates the shelter provided by the euro's umbrella.

José Ramón Díez
October 2022

Chronology

SEPTEMBER 2022

8 Queen Elizabeth II dies after a 70-year reign.
16 The death of Mahsa Amini sparks a wave of mass protests in Iran.
27 Sabotage on the Nord Stream 1 and 2 gas pipelines.
30 The European Council approves measures to reduce energy demand.

JULY 2022

7 Boris Johnson resigns as prime minister of the United Kingdom.
8 Assassination of Shinzō Abe, former Japanese prime minister.
28 Mario Draghi resigns as prime minister of Italy.

MAY 2022

7 The Taliban make the Islamic face veil compulsory for women.
22-26 World Economic Forum in Davos.
25 Mass shootings at a US elementary school.

AUGUST 2022

Summer 2022 Heat waves and drought in Europe and other countries around the world.
Summer 2022 Disruptions in the supply of Russian energy to Europe.
31 Mikhail Gorbachev, the last president of the USSR, dies.

JUNE 2022

26 G7 summit in Germany where the war in Ukraine and energy were top of the agenda.
28 NATO summit in Madrid where Russia is identified as the greatest direct threat.
30 Russia makes gains in establishing control of the Donbas.

APRIL 2022

1-31 The Russia-Ukraine war continues as Russia suspends gas supplies to Bulgaria and Poland.
China places numerous cities in lockdown to curb the new COVID outbreak.
24 Emmanuel Macron is re-elected president of France.

Agenda

OCTOBER 2022

3 Portugal: industrial production (August).
4 Spain: registration with Social Security and registered unemployment (September).
6-7 European Council meeting.
10 Spain: financial accounts (Q2).
11 Portugal: turnover in services (August).
18 China: GDP (Q3).
20-21 European Council meeting.
24 Spain: loans, deposits and NPL ratio (August).
Portugal: non-financial sector debt (August).
27 Spain: labour force survey (Q3).
Governing Council of the European Central Bank meeting.
US: GDP (Q3).
28 Spain: GDP flash estimate (Q3).
Spain: CPI flash estimate (October).
Portugal: CPI flash estimate (October).
Portugal: Fitch rating.
Euro area: economic sentiment index (October).
31 Portugal: GDP flash estimate (Q3).
Euro area: GDP (Q3).

NOVEMBER 2022

1-2 Federal Open Market Committee meeting.
3 Spain: registration with Social Security and registered unemployment (October).
Portugal: new lending (September).
4 Spain: industrial production (September).
9 Portugal: employment (Q3).
15 Japan: GDP (Q3).
17 Portugal: coincident indicators (October).
18 Portugal: Moody's rating.
25 Spain: loans, deposits and NPL ratio (September).
29 Spain: CPI flash estimate (November).
Euro area: economic sentiment index (November).
30 Spain: state budget execution (October).
Portugal: GDP breakdown (Q3).
Portugal: CPI flash estimate (November).

The three keys to the new outlook for the Spanish economy

The current changing economic and geopolitical environment has forced us once again to revise our forecast scenarios. Broadly speaking, there are three key factors which define the new macroeconomic picture of the Spanish economy that we have elaborated here at CaixaBank Research, and which are shared by most of the institutions that have updated their forecasts. Firstly, the pace of growth will be slower than previously expected, but we do not anticipate a recession, and much less a deep or long one. Secondly, the impact of the energy crisis on the Spanish economy, while significant, is less pronounced than it will be for the euro area as a whole. Thirdly, uncertainty is, and will remain, very high, and although this term has become somewhat of a catchword, it is nonetheless loaded with content. Let us take a closer look at each factor.

The forecast for a slower growth rate is mainly the result of the intensification of the energy crisis and the expectation that it will be more persistent than expected a few months ago. This is an exogenous shock which is difficult to predict, but right now it looks likely to drive up inflation more than previously expected (we place inflation for 2023 at 4.5%). Furthermore, it is already forcing the ECB to increase the pace of its interest rate hikes.

The combination of these three factors – the energy shock, inflationary pressures and tightening financial conditions – will curb the pace of growth most notably during the second half of this year and in Q1 2023. The indicators for Q3 are already pointing in this direction. Household consumption has weakened, mainly because of the loss of purchasing power that comes with rising prices. At the aggregate level, however, this is being offset by the strong performance of the foreign sector, especially tourism. Thus, GDP growth is likely to be just above 0% this quarter, and is expected to remain at around 0% in the closing stages of the year and early next year.

The speed at which the economy will begin to recover in the spring is difficult to anticipate. During September, gas price futures have indicated that tensions will remain high throughout 2023, and the ECB has made it clear that it will continue to raise interest rates well into the year. For this reason, our scenario assumes that the recovery will be gradual and places the growth of the Spanish economy for the 2023 as a whole at around 1%, almost 1 pp above that of the euro area.

The lower impact of the energy crisis on the Spanish economy is largely due to the country's low dependence on Russian gas, the high diversification in its suppliers and, above all, its high capacity to convert liquefied natural gas back into natural gas (Spain has 34% of the EU's installed capacity for regasification), which reduces pressure on its gas import prices. Thus, although the Mibgas benchmark gas price in Spain has registered a significant increase, it has not been as pronounced as that of the TTF benchmark price in northern Europe (on average, the Mibgas was 35% below the TTF in September). If we take this situation to the extreme, the likelihood that selective gas cuts will have to be imposed in Spain is very low, while in northern Europe this possibility is much more real, with everything that entails in terms of uncertainty.

Finally, it is worth reiterating the difficulty in predicting how the main factors determining the outlook will evolve, as well as their impact on the economy as a whole. The uncertainty surrounding the course of the geopolitical conflict between Russia and NATO countries, as well as its impact on energy prices, especially in the case of gas, is evident on a daily basis. But the evolution of the inflationary pressures is equally uncertain. It is difficult to predict the magnitude and persistence of the indirect effects that the rising energy and other commodity prices will have on other consumer goods, as well as the potential second-round effects that could occur if wage growth ends up being higher. Developed countries have little recent experience in this area, so there are no precedents to refer to. Moreover, all this makes it very difficult to predict what policy the central banks should follow. To a large extent, this explains the high volatility in interest rate expectations over the past few months.

Even if the term «uncertainty» seems to be a catchword we repeatedly use to crown our analyses of the current economic situation and future outlook, it must continue to be taken seriously. It is one of the main attributes that define the economic outlook, and it could have significant implications for the formulation of economic policy, as well as for decision-making on spending and investment.

Oriol Aspachs

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	4.50	4.75
3-month Libor	3.62	0.90	1.91	0.23	0.21	4.75	4.75
12-month Libor	3.86	1.40	1.97	0.34	0.52	4.90	4.50
2-year government bonds	3.70	0.95	1.63	0.13	0.62	4.20	4.00
10-year government bonds	4.70	2.61	1.86	0.93	1.45	3.80	3.50
Euro							
ECB depo	2.05	0.26	–0.50	–0.50	–0.50	2.00	2.50
ECB refi	3.05	0.82	0.00	0.00	0.00	2.50	3.00
€STR	–	–	–0.54	–0.56	–0.58	1.92	2.47
1-month Euribor	3.18	0.58	–0.45	–0.56	–0.60	2.03	2.53
3-month Euribor	3.24	0.74	–0.40	–0.54	–0.58	2.14	2.59
6-month Euribor	3.29	0.88	–0.34	–0.52	–0.55	2.35	2.66
12-month Euribor	3.40	1.07	–0.26	–0.50	–0.50	2.56	2.73
Germany							
2-year government bonds	3.41	0.45	–0.63	–0.73	–0.69	1.75	2.00
10-year government bonds	4.31	1.70	–0.27	–0.57	–0.31	2.00	2.70
Spain							
3-year government bonds	3.62	1.87	–0.36	–0.57	–0.45	2.23	2.77
5-year government bonds	3.91	2.39	–0.09	–0.41	–0.25	2.47	3.04
10-year government bonds	4.42	3.40	0.44	0.05	0.42	3.30	3.80
Risk premium	11	171	71	62	73	130	110
Portugal							
3-year government bonds	3.68	3.66	–0.34	–0.61	–0.64	2.41	3.02
5-year government bonds	3.96	4.30	–0.12	–0.45	–0.35	2.70	3.28
10-year government bonds	4.49	5.03	0.40	0.02	0.34	3.35	3.85
Risk premium	19	334	67	60	65	135	115
EXCHANGE RATES							
EUR/USD (dollars per euro)	1.13	1.28	1.11	1.22	1.13	1.00	1.05
EUR/GBP (pounds per euro)	0.66	0.84	0.85	0.90	0.85	0.86	0.85
OIL PRICE							
Brent ($/barrel)	42.3	81.6	65.2	50.2	74.8	95.0	94.0
Brent (euros/barrel)	36.4	62.9	58.6	41.3	66.2	96.0	92.1

Forecasts

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

International economy

	Average 2000-2007	Average 2008-2018	2019	2020	2021	2022	2023
GDP GROWTH							
Global	4.5	3.4	2.9	–3.1	6.1	3.2	2.8
Developed countries	*2.6*	*1.4*	*1.8*	*–4.5*	*5.2*	*2.4*	*1.1*
United States	2.7	1.6	2.3	–2.8	5.9	1.6	1.1
Euro area	2.2	0.8	1.6	–6.2	5.3	3.1	0.2
Germany	1.6	1.3	1.1	–4.1	2.6	1.6	–0.2
France	2.2	0.9	1.9	–7.9	6.8	2.5	0.6
Italy	1.5	–0.4	0.5	–9.1	6.6	3.4	–0.2
Portugal	1.5	0.3	2.7	–8.4	4.9	6.3	0.5
Spain	3.7	0.5	2.0	–11.3	5.5	4.5	1.0
Japan	1.4	0.5	–0.4	–4.6	1.7	1.5	1.7
United Kingdom	2.6	1.3	1.7	–9.3	7.4	3.5	–1.3
Emerging and developing countries	*6.5*	*5.0*	*3.7*	*–2.0*	*6.8*	*3.6*	*4.0*
China	10.6	8.2	6.0	2.2	8.1	3.0	5.2
India	7.2	7.0	4.5	–6.7	9.0	7.3	6.0
Brazil	3.6	1.7	1.2	–3.9	4.6	1.8	0.9
Mexico	2.4	2.1	–0.2	–8.1	4.8	1.9	1.4
Russia	7.2	1.2	2.2	–2.7	4.8	–8.1	–3.2
Turkey	5.5	4.9	0.8	1.9	11.4	3.1	3.0
Poland	4.2	3.5	4.8	–2.1	6.0	5.6	2.6
INFLATION							
Global	4.1	3.7	3.5	3.2	4.7	7.9	5.1
Developed countries	*2.1*	*1.6*	*1.4*	*0.7*	*3.1*	*6.8*	*3.6*
United States	2.8	1.8	1.8	1.3	4.7	8.0	3.4
Euro area	2.2	1.4	1.2	0.3	2.6	8.1	5.1
Germany	1.7	1.4	1.4	0.4	3.2	8.1	5.2
France	1.9	1.3	1.3	0.5	2.1	5.9	4.1
Italy	2.4	1.5	0.6	–0.1	1.9	7.7	4.8
Portugal	3.1	1.2	0.3	0.0	1.3	7.9	5.7
Spain	3.2	1.4	0.7	–0.3	3.1	9.1	4.5
Japan	–0.3	0.4	0.5	0.0	–0.2	2.2	1.9
United Kingdom	1.6	2.4	1.8	0.9	2.6	8.8	5.5
Emerging countries	*6.7*	*5.6*	*5.1*	*5.2*	*5.9*	*9.7*	*7.0*
China	1.7	2.6	2.9	2.5	0.9	2.0	1.9
India	4.5	7.7	3.7	6.6	5.1	6.6	5.3
Brazil	7.3	5.9	3.7	3.2	8.3	10.5	5.1
Mexico	5.2	4.2	3.6	3.4	5.7	7.2	4.7
Russia	14.2	8.2	4.5	3.4	6.7	14.7	7.5
Turkey	22.6	9.1	15.2	12.3	19.6	69.3	36.4
Poland	3.5	1.9	2.1	3.7	5.2	11.2	7.0

Forecasts

Change in the average for the year versus the prior year average (%), 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	–12.4	6.1	–0.1	–0.7
Government consumption	5.0	1.0	1.9	3.5	2.9	–1.3	1.0
Gross fixed capital formation	5.6	–1.9	4.5	–9.7	0.9	5.1	1.8
Capital goods	4.9	0.0	2.1	–13.3	6.3	5.0	–1.3
Construction	5.7	–3.8	7.2	–10.2	–3.7	4.9	3.9
Domestic demand (vs. GDP Δ)	4.6	–0.4	1.9	–8.6	4.3	0.7	0.2
Exports of goods and services	4.7	2.9	2.2	–19.9	14.4	18.5	2.6
Imports of goods and services	7.0	0.1	1.3	–14.9	13.9	7.0	0.7
Gross domestic product	**3.7**	**0.5**	**2.0**	**–11.3**	**5.5**	**4.5**	**1.0**
Other variables							
Employment	3.2	–0.7	2.6	–7.6	6.6	3.2	0.5
Unemployment rate (% of labour force)	10.5	20.0	14.1	15.5	14.8	12.8	13.1
Consumer price index	3.2	1.4	0.7	–0.3	3.1	9.1	4.5
Unit labour costs	3.0	0.3	3.1	5.0	0.7	1.1	2.7
Current account balance (% GDP)	–5.9	–0.5	2.1	0.8	0.9	0.1	1.3
External funding capacity/needs (% GDP)	–5.2	–0.1	2.4	1.2	1.9	1.1	2.2
Fiscal balance (% GDP)[1]	0.3	–6.9	–3.1	–10.3	–6.9	–5.0	–4.8

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	4.5	4.6	0.5
Government consumption	2.3	–0.5	2.1	0.4	4.1	1.8	–0.2
Gross fixed capital formation	–0.4	–1.3	5.4	–2.7	6.4	3.0	3.5
Capital goods	3.2	2.7	1.6	–6.2	13.2	–	–
Construction	–1.5	–3.6	7.7	1.6	4.0	–	–
Domestic demand (vs. GDP Δ)	1.3	–0.2	3.0	–5.6	5.2	4.2	0.9
Exports of goods and services	5.2	3.9	4.1	–18.6	13.1	17.2	4.6
Imports of goods and services	3.6	2.4	4.9	–12.1	12.9	11.0	5.5
Gross domestic product	**1.5**	**0.3**	**2.7**	**–8.4**	**4.9**	**6.3**	**0.5**
Other variables							
Employment	0.4	–0.6	1.2	–1.9	2.8	1.6	–0.3
Unemployment rate (% of labour force)	6.1	11.8	6.6	7.0	6.6	5.9	6.4
Consumer price index	3.1	1.2	0.3	0.0	1.3	7.9	5.7
Current account balance (% GDP)	–9.2	–3.2	0.4	–1.2	–1.1	–2.2	–1.1
External funding capacity/needs (% GDP)	–7.7	–1.9	1.2	0.1	0.7	2.1	2.1
Fiscal balance (% GDP)	–4.6	–5.6	0.1	–5.8	–2.8	–1.9	–1.4

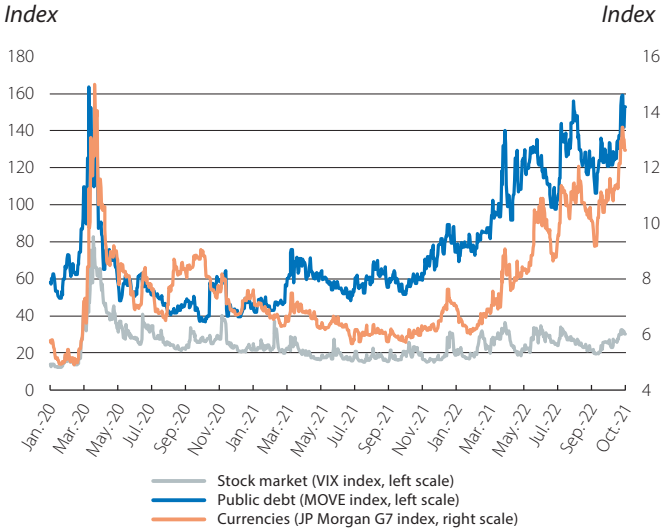
Forecasts

Period of turbulence in the financial markets

Volatility intensifies. The return after summer was marked by a sharp rebound in volatility in the financial markets, in a context of high uncertainty and reduced risk appetite. In addition to the escalation of the conflict with Russia and the rapid deterioration of macroeconomic indicators around the world, the announcement of a fiscal stimulus plan in the United Kingdom set off alarm bells among investors over the coordination of economic policy and the sustainability of sovereign debt. It is feared that a shift in bias towards an expansionary fiscal policy may need to be offset with further monetary policy tightening. In this regard, the central banks continued to focus on the inflationary risk, introducing substantial rate hikes and giving indications of further hikes to come in the coming months. Thus, implicit interest rates in the money markets reflected a rise in official rate expectations in September, triggering a widespread tightening of financial conditions, which was most notable in the sharp rally in sovereign debt yields and the strengthening of the dollar. The turbulence and disruption in some markets led to unexpected interventions by some monetary authorities.

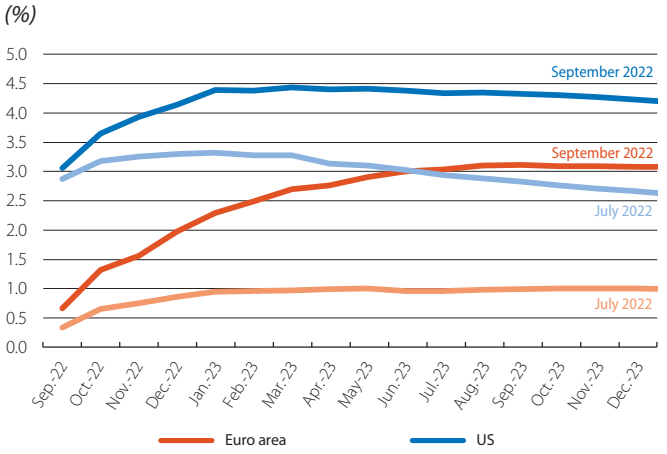
The ECB and the Fed tighten the tone and raise interest rates significantly. Following the continued inflationary pressures during the summer, investors' attention was even more focused than before on the ECB and Fed's September meetings. On the one hand, the European institution decided to raise official interest rates by 75 bps, a move unprecedented in its history. It justified the rise with the euro area's high inflation and the expectation that it will remain above 2% for a long time, which was also the reason why Christine Lagarde anticipated «more than two but less than five» additional rate hikes in the coming months. The tightening of financial conditions was accompanied by a significant downward revision of the euro area's economic forecasts for the second half of 2022 and Q1 2023. The Fed, meanwhile, also unanimously decided to raise interest rates by 75 bps (up to the 3.00%-3.25% range), moving into restrictive territory (above 2.5%, the level which the central bank considers neutral). It expects inflationary pressures to remain very high over the coming months, and under the commitment to restore price stability Jerome Powell reiterated the Fed members' resolute determination to continue tightening monetary policy until there is a clear downward trend in prices, even if it could stunt economic growth. According to the average FOMC voter, rate hikes of 1.25 pps this year and of 0.25 pps in 2023 would be needed to reach the desired level of monetary tightening. In other advanced economies, the central banks of England, Switzerland, Canada and Sweden also opted to raise their interest rates (by 50, 75 and 100 bps, respectively), in an attempt to curb the rally in

Implicit volatility in the financial markets



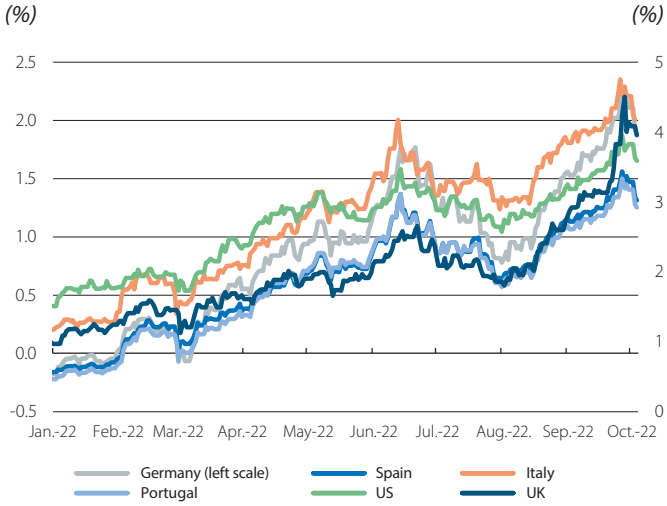
Note: *Data as of 3 October.*
Source: *CaixaBank Research, based on data from Bloomberg.*

Expectations for ECB and Fed reference interest rates



Notes: *Forwards on the EFFR and the OIS of the euro area derived using market yield curves. Data as of 30 September.*
Source: *CaixaBank Research, based on data from Bloomberg.*

Yields on 10-year sovereign debt



Notes: *US, UK, Spain, Italy and Portugal, right-hand scale. Data as of 3 October.*
Source: *CaixaBank Research, based on data from Bloomberg.*

consumer prices and avoid further depreciation of their currencies against the dollar.

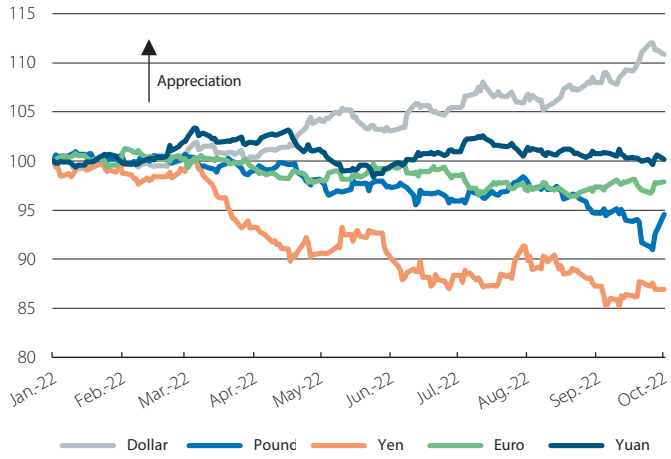
Sovereign yields rise amid the volatility. The confirmation of the more aggressive monetary plans in the US and the euro area shook the bond markets. In both cases, the sovereign yield curves rose significantly in September, particularly in the shorter terms (+79 bps to 4.28% in the case of 2-year treasuries and +56 bps to 1.76% for the 2-year German Schatz, in September), driven by investors' expectations regarding the scale and speed of the central banks' rate hikes. In the euro area, the risk premia remained relatively stable, despite a widening of the Italian spread in the sessions following the presidential elections. In Europe, much of the attention was still focused on the sharp decline in British bond prices following the government's announcement of a historic tax cut over the next five years (amounting to 160 billion pounds). In the face of the growing perception of economic and financial instability generated by the announcement, the Bank of England intervened in the bond market by committing to buy long-term sovereign bonds (gilts) to the tune of 65 billion pounds. In the first sessions of October, this action and the worsening of some economic activity data in the US helped to alleviate the upward pressure on global sovereign yield curves.

The dollar extends its rally. The rise in the fed funds rate, the deterioration of the global growth outlook due to the war in Ukraine, as well as the energy crisis, continued to fuel the strength of the dollar, which has been trading at its highest levels for nearly two decades. This led several central banks to intervene in order to curb the depreciation of their currencies, including the Bank of Japan (for the first time since 1998) and the Bank of England, which managed to provide some support for the pound through bond purchases. Emerging-country central banks have also become increasingly vigilant in the face of the depreciation of their currencies, and the People's Bank of China has even warned of possible intervention to defend the stability of the yuan.

Stock markets and oil amass further declines. In this context, risk aversion dominated the markets and the major stock market indices ended September with further declines for the month as a whole (S&P 500 –24.8% and EuroStoxx 50 –22.8%, in the year), as a result of the impact which the tighter financial and economic conditions will have on corporate margins. In the commodity markets, doubts surrounding global economic growth and the resilience of the dollar also led to declines in the Brent barrel price, bringing it to pre-war levels. Similarly, the increase in natural gas reserves in the EU ahead of winter allowed natural gas prices (Dutch TTF) to moderate, despite supplies through Nord Stream 1 being cut off. However, in early October, the first signs of a slowdown in the US economy nudged investor sentiment towards risky assets, given the possibility that the Fed may have to contain the pace of its interest rate hikes.

Currencies: effective nominal exchange rates

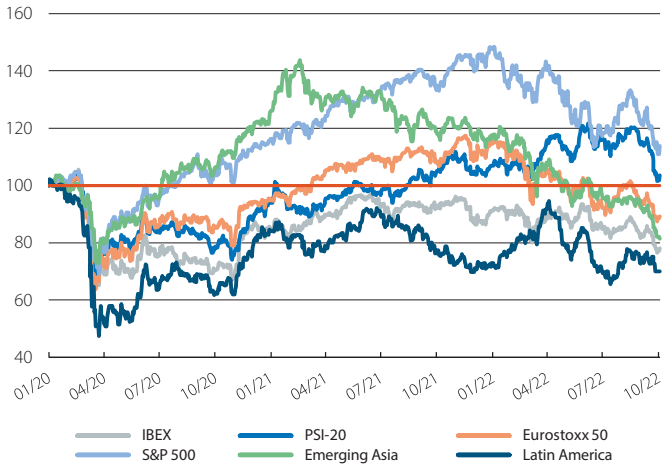
Index (100 = January 2022)



Note: *Data as of 3 October.*
Source: *CaixaBank Research, based on data from Bloomberg.*

Main international stock markets

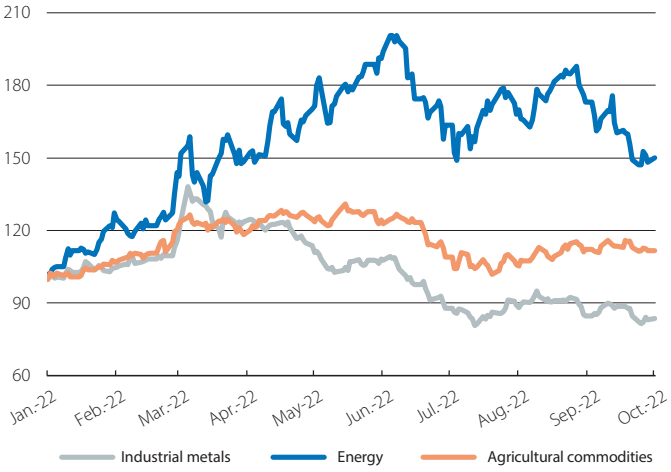
Index (100 = January 2020)



Note: *Data as of 3 October.*
Source: *CaixaBank Research, based on data from Bloomberg.*

Commodity price index

(100 = January 2022)



Note: *Data as of 3 October.*
Source: *CaixaBank Research, based on data from Bloomberg.*

Central banks and digital currencies: a look at the future of cash

An increasing number of central banks are considering issuing their own digital currency (CBDC).[1] In 2021, according to a BIS survey, nine out of ten central banks were actively exploring CBDCs (see first chart). In addition, CBDC projects are at increasingly advanced stages of development, and 26% of central banks are already conducting pilot tests (in 2018, this figure stood at 8%).

Why are central banks exploring the idea of issuing CBDCs?

Firstly, for central banks, issuing their own digital currency is seen as a way to preserve monetary sovereignty and financial stability. Specifically, the emergence of widely accepted digital currencies that are controlled by foreign countries or companies (such as the digital yuan in China or a private stablecoin with high adoption potential) would erode the central bank's ability to control the money supply and interest rates.[2]

Secondly, in some jurisdictions (such as the EU), issuing a CBDC as a payment instrument could help to boost autonomy in the payments industry – a strategic sector in which the key infrastructure is controlled by foreign suppliers.

Thirdly, with the digitalisation of the economy, the use of cash as a means of payment has been significantly reduced in favour of electronic payment solutions (see second chart). In the euro area, according to ECB data, in 2021 cash accounted for 30% of all retail payments (compared to 45% a decade earlier). Faced with this trend, which the pandemic has accelerated,[3] issuing a CBDC would be a way to ensure that citizens and businesses continue to have access to money issued by their central bank in the digital age.

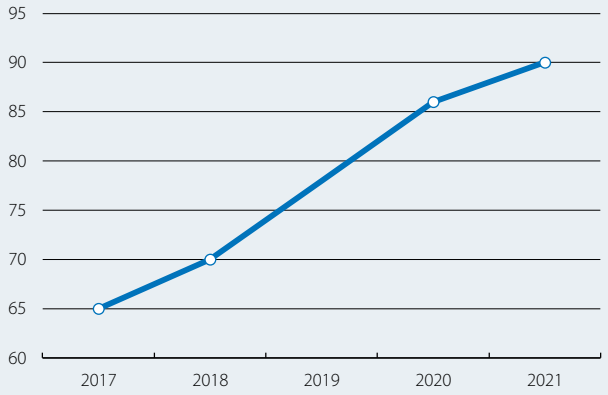
Fourthly, in emerging economies, the interest in CBDCs is largely driven by the issue of financial inclusion-related motivations. In particular, CBDCs could be specifically designed to address some of the barriers to financial inclusion. For instance, they could incorporate interfaces designed specifically for the most underserved groups (smart cards, offline functionality), or they could facilitate domestic and cross-border interoperability with other payment methods (thus increasing payment options and reducing costs for users).

Finally, and especially in emerging economies, central banks believe that CBDCs could help to improve how international payments are processed, both in terms of efficiency and cost. Specifically, central banks believe CBDCs could alleviate some of the weaknesses in current payment systems, such as time constraints (CBDCs would be accessible 24/7) and long intermediation chains.

CBDCs in Europe: the arrival of the digital euro

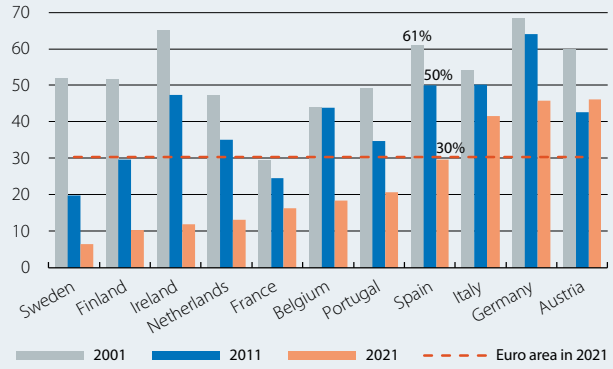
In Europe, the ECB is also considering issuing a CBDC as a complement to cash, and envisages a possible launch in 2025-2026. In particular, the ECB is studying the benefits

Proportion of central banks with a digital currency (CBDC) project



Note: ** Research project, proof of concept or pilot.*
Source: *CaixaBank Research, based on data from «BIS surveys on central bank digital currencies».*

Proportion of retail payments made in cash *
(%)



Note: ** Amount of cash withdrawals at ATMs, as a percentage of total cash withdrawals at ATMs and card payments registered on POS terminals.*
Source: *CaixaBank Research, based on data from the ECB.*

1. Central Bank Digital Currency. This is money issued by the central bank, in digital form, denominated in a country's unit of account, which differs from other electronic means of payment (such as cards) because it represents a liability of the central bank rather than of a private institution.
2. See the article «The e-monetary policy of the new digital economy» in the Dossier of the MR10/2019.
3. According to an ECB study (2020), 41% of respondents said they had reduced the use of cash during the pandemic and most said they would continue to pay less in cash in the future.

and risks of issuing a digital euro, outlining basic elements of its design and assessing how it could be distributed to the general public and what use cases it could serve. Once the current research phase has been completed (October 2023), the ECB will decide whether to begin developing a digital euro.

Meanwhile, publications and speeches by members of the ECB's Executive Board provide some clues as to what it might look like. As with cash, the digital euro would represent a right to collect payment directly from the central bank (as opposed to commercial banks, as in the case of deposits). On the other hand, like deposits, it would be in digital form, thus allowing users to make payments in both physical and digital environments using smart devices (e.g. a wallet on a mobile phone or a smart card).

The ECB also envisages that authorised intermediaries (including banks) would be responsible for distributing and safeguarding their customers' digital euros. Also, in an initial launch phase, the ECB foresees four possible use cases for the digital euro. The first one (offline peer-to-peer payments) would be comparable to the exchange of cash, involving only the payer and the recipient of the money, without any third party validating the transaction (it is still unknown how this would work in practice). The other use cases proposed are comparable to those already covered by today's digital payment solutions: peer-to-peer online payments validated by a third party, e-commerce payments and payments at physical points of sale in retail establishments. In addition, depending on the final design, the digital euro could incorporate more advanced functionalities (such as programmability to make scheduled payments).

In addition, the ECB is exploring options to ensure a certain degree of privacy, in line with cash. In this regard, full user anonymity has been ruled out, since this would make it very difficult to prevent money laundering. However, a variable degree of traceability of transactions and users is being considered, depending on the design and use case. For example, in offline peer-to-peer payments or online transactions up to a certain threshold, it is proposed that transactions could be carried out without recording the parties' identities.

Finally, the ECB must also design the digital euro so as to minimise the risks to financial stability. By representing a right to collect payment from the ECB rather than from commercial banks, the digital euro will be a risk-free asset. This feature, together with its ability to be used in digital environments, would make it a good alternative to bank deposits for customer liquidity. In this regard, if competitor divert part of their income and operations from their bank deposits in favour of their digital euro wallet, this could have significant implications for the financial system. In particular, banks' ability to provide credit to the economy could be limited (because of higher financing costs and due to their reduced capacity to assess customer risk, given the loss of information on customer transactions). Moreover, at times of uncertainty, their could be a flight of deposits towards the digital euro, leading to episodes of financial instability. That said, the adoption of the digital euro and the magnitude of the transfer of deposits will depend on its usability as a means of payment (which use cases it covers, how it compares with current payment solutions, etc.) and its capacity as a store of value.

The ECB is aware of these risks and is seeking to prevent the digital euro from being used as an investment vehicle, in order to limit transfers from deposits and ensure the transmission of monetary policy. To this end, it has two tools at its disposal. On the one hand, it could offer a lower remuneration for the digital euro compared to that available to bank deposits. On the other hand, it could impose limits, both on the balances held in digital euros and on the convertibility of bank deposits to digital euros within a given period. According to the ECB, the final design of the digital euro is likely to include a combination of these tools.

In short, CBDCs are making headway in various parts of the world, including Europe. While there are still many aspects yet to be determined and its launch is by no means imminent, we can expect the digital euro project to materialise in the medium-term.

Roser Ferrer

Interest rates (%)

	30-September	31-August	Monthly change (bp)	Year-to-date (bp)	Year-on-year change (bp)
Euro area					
ECB Refi	1.25	0.50	75	125.0	125.0
3-month Euribor	1.17	0.65	52	174.5	172.0
1-year Euribor	2.56	1.78	78	305.7	304.4
1-year government bonds (Germany)	1.71	0.67	104	235.0	237.3
2-year government bonds (Germany)	1.76	1.20	56	237.9	246.2
10-year government bonds (Germany)	2.11	1.54	57	228.5	233.2
10-year government bonds (Spain)	3.29	2.74	55	272.4	286.6
10-year government bonds (Portugal)	3.18	2.63	55	271.0	285.4
US					
Fed funds (upper limit)	3.25	2.50	75	300.0	300.0
3-month Libor	3.75	3.10	66	354.6	362.2
12-month Libor	4.78	4.22	56	419.7	454.6
1-year government bonds	3.93	3.48	45	355.7	385.9
2-year government bonds	4.28	3.49	79	354.7	401.5
10-year government bonds	3.83	3.19	64	231.9	236.7

Spreads corporate bonds (bps)

	30-September	31-August	Monthly change (bp)	Year-to-date (bp)	Year-on-year change (bp)
Itraxx Corporate	135	120	16	87.6	85.3
Itraxx Financials Senior	148	129	19	93.6	91.7
Itraxx Subordinated Financials	272	241	31	163.6	161.0

Exchange rates

	30-September	31-August	Monthly change (%)	Year-to-date (%)	Year-on-year change (%)
EUR/USD (dollars per euro)	0.980	1.005	–2.5	–13.8	–15.5
EUR/JPY (yen per euro)	141.880	139.700	1.6	8.4	10.2
EUR/GBP (pounds per euro)	0.878	0.865	1.4	4.3	2.5
USD/JPY (yen per dollar)	144.740	138.960	4.2	25.8	30.3

Commodities

	30-September	31-August	Monthly change (%)	Year-to-date (%)	Year-on-year change (%)
CRB Commodity Index	559.5	585.0	–4.4	–3.3	0.6
Brent ($/barrel)	88.0	96.5	–8.8	13.1	32.4
Gold ($/ounce)	1,660.6	1,711.0	–2.9	–9.2	–5.7

Equity

	30-September	31-August	Monthly change (%)	Year-to-date (%)	Year-on-year change (%)
S&P 500 (USA)	3,585.6	3,955.0	–9.3	–24.8	–17.7
Eurostoxx 50 (euro area)	3,318.2	3,517.3	–5.7	–22.8	–17.8
Ibex 35 (Spain)	7,366.8	7,886.1	–6.6	–15.5	–16.3
PSI 20 (Portugal)	5,302.8	5,995.2	–11.6	–4.8	–3.2
Nikkei 225 (Japan)	25,937.2	28,091.5	–7.7	–9.9	–9.8
MSCI Emerging	875.8	994.1	–11.9	–28.9	–29.7

Winds of recession

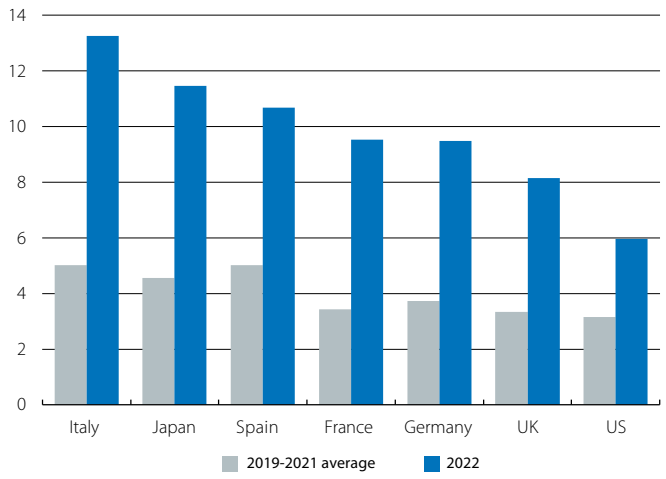
The global economy faces a difficult winter. Global growth may still have been positive in Q3 2022, thanks to an expected rebound in China following the lockdowns imposed during Q2 2022. However, the substantial deterioration apparent in the main business climate and opinion surveys at the global level points towards a much bleaker picture for the coming months. Financial conditions have been significantly stressed as a result of the response from the major central banks in their attempt to curb inflation, which stands close all-time highs in many developed economies, and we are likely to see further rate hikes in the coming months. The housing market is beginning to feel the impact of this increase in rates, and higher mortgages will make a dent in households' spending decisions, which are already constrained by higher energy bills and prices of other goods. For the time being, the labour market is holding up and in most developed economies the unemployment rate is at its lowest rate in around 20 years. However, we are beginning to see signs of moderation in the pace of job creation, and in Europe the ECB itself has already pointed out that rate hikes will have an adverse effect on the labour market. Also, among emerging markets, China continues to show much lower growth rates than we have been accustomed to, in a context of a sharp deterioration in its housing market.

The United States sees an increase in the risks to growth in the coming months. The GDP declines registered in the first half of the year were largely due to a fall in inventories – a highly volatile component which ought to make a positive contribution in the second half of the year. In contrast, the strength of the labour market, household spending and various industrial activity indicators confirmed the resilience of domestic demand. However, the deteriorating global context, the strength of the dollar and the additional rate hikes will significantly increase the downside risks for next year, making the prospect of a «real» recession in the country more likely. Thus, we lower our forecast for 2022 as a whole (to 1.6%) and reassert our position in anticipating modest growth of 1.1% in 2023. Although for now we are still confident that the economy will be able to maintain positive growth rates, we anticipate that they will be modest and well below potential for the next year and a half. As for inflation, we estimate a rate of 3.4% on average for 2023, virtually unchanged since the previous report.

Europe will be unable to avoid entering a recession in the coming months. The total cut-off of Russian gas supplies via Nord Stream 1, the main supply route, coupled with the zero probability that supplies will be resumed in the coming months due to the rupturing of the Nord Stream 1 and 2 pipelines, will intensify the energy crisis that Europe is already experiencing. The region's economies have been preparing for a cut-off for several months now, and this has translated into average gas reserves in the EU reaching 90% of total capacity by the end of September, two months ahead of the November target.

The energy crisis at the heart of Europe's deterioration. However, this significant level of reserves already reached barely covers three months of consumption at the current rate, which explains why the Commission continues to insist on the need to save in order to avoid energy rationing during the winter. Indeed, according to CaixaBank Research estimates, a 7%

Global: energy expenditure
(% of GDP)

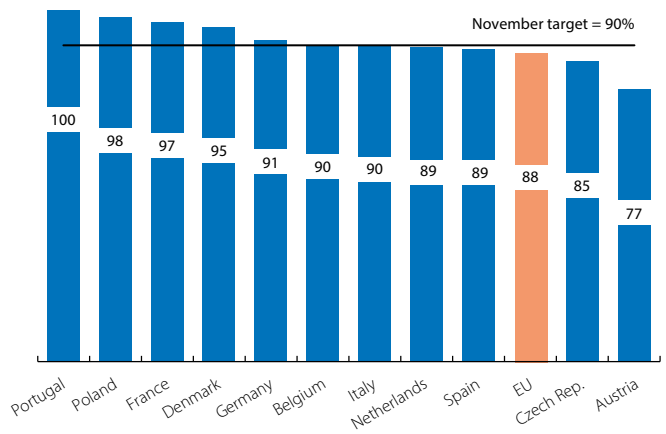


Source: *CaixaBank Research, based on data from the OECD.*

Global: composite PMI
Level

Source: *CaixaBank Research, based on data from PMI™, via Refinitiv.*

*EU: gas storage **
(% of total capacity)



Note: ** Data as of 11 September 2022.*
Source: *CaixaBank Research, based on data from the Aggregated Gas Storage Inventory.*

reduction in energy consumption would allow the EU to make it through to March 2023 with its reserves still at 10% (see the article «The outlook for gas supplies in Europe: a balancing act» in the Dossier of this report). Moreover, this substantial stockpiling of gas has been achieved at the cost of paying extraordinarily high prices for alternative supplies to Russian gas. Governments are also still implementing measures aimed at mitigating the impact of high energy prices on households and businesses, and this will have a negative impact on the public accounts, which are already under pressure due to the measures implemented during the COVID-19 pandemic.

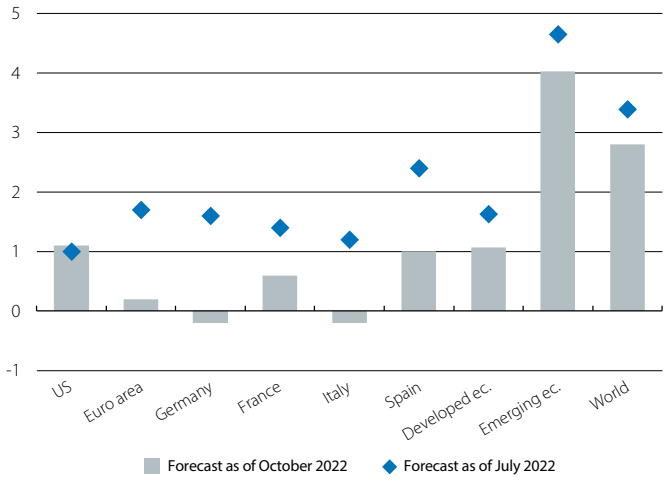
Given the seriousness of the situation, the Commission has designed a common strategy to reduce energy bills. The measures envisaged include establishing a cap on the gas price which «marginal» energy producers can charge, as well as levying a 33% windfall tax on the excess profits of fossil fuel companies. The extra funds obtained through these two initiatives (estimated at around 140 billion euros) would be redirected by each Member State to the households and businesses hardest hit by the rise in energy prices.

New macroeconomic outlook for Europe: lower growth and higher inflation. The context for Europe appears to have deteriorated substantially since the summer, reflected in the sharp declines in the main business climate indicators, in most cases, to levels compatible with a contraction in economic activity. As a result, we have made a substantial downward revision to expected growth for the euro area, working on the assumption that GDP will fall in Q4 2022 and Q1 2023 and that the recovery that will follow beginning next spring will be very modest and fragile. Specifically, for the euro area as a whole, and following 3.1% growth in 2022, our new scenario envisages an average growth rate of 0.2% in 2023 (1.5 pps below our summer forecast). Moreover, there will be significant differences from country to country: among the large economies, Germany and Italy will lead the falls in economic activity in the coming quarters, while France and Spain will be much less affected. On inflation, we revised our estimate significantly upwards, following the recent rises in gas prices, with a fairly similar increase anticipated among different countries.

The United Kingdom announces the biggest tax cut in 50 years. The government of the new prime minister, Liz Truss, has presented an ambitious «growth plan» which aims to place growth at a trend rate of 2.5%, based on three pillars: reforms aimed at boosting supply, fiscal responsibility and tax cuts. In fact, it proposes tax cuts amounting to 160 billion pounds up to 2027, mainly through (i) the cancellation of the corporation tax increase (it remains at 19%, well below the OECD average of 23.5%) and (ii) the reversal of the 1.25-pp increase in social security contributions. In addition, an expenditure of around 60 billion pounds will be approved for the next six months to compensate businesses and households for the sharp rise in energy bills, which will substantially raise the fiscal deficit in 2022-2023. The significant impact this plan will have on the dynamics of UK debt has generated major turbulence in the European debt markets and sunk the pound to an all-time low against the dollar (see the Markets section). In short, the outlook for the economy has deteriorated significantly, and we expect GDP to fall by 1.3% in 2023.

Global: GDP in 2023

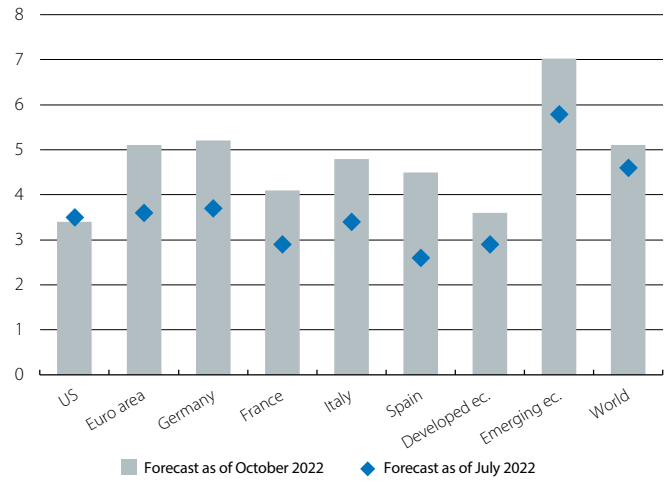
Year-on-year change (%)



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

Global: inflation in 2023

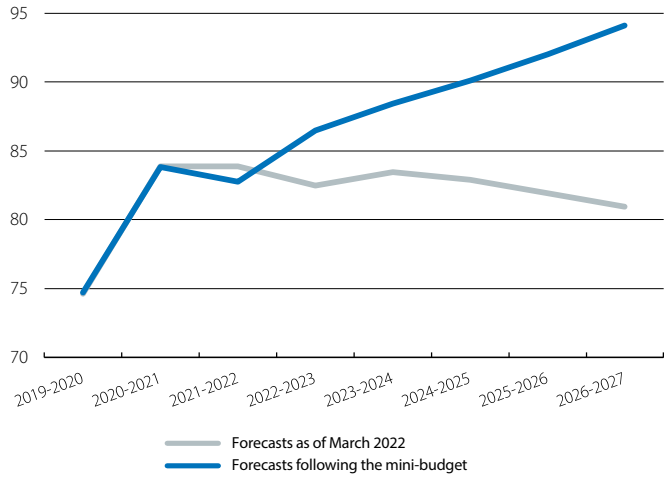
(%)



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

United Kingdom: public debt

(% of GDP)



Source: *CaixaBank Research, based on data from the Institute for Fiscal Studies.*

US inflation: definitions and factors

With inflation rates above 8% in the last six months, the Fed has embarked on an accelerated cycle of interest rate hikes. Prices began to rise in early 2021, and while for a few months most analysts were anticipating a transitory rebound as a result of the reopening of the economy in the wake of the pandemic, the fact is that the persistent rise in prices caught us all by surprise. In this Focus we analyse the pattern in the various inflation measures and their short-term outlook.

Inflation measures: CPI, PCE and PPI

When we talk about inflation, we usually refer to the trend in prices of the typical basket of consumer goods (CPI, for consumer price index). In the US, inflation according to the CPI stood at 8.3% in August. Although down from the June peak of 9.1% (partly due to the sharp fall in gasoline prices), this is still very high.

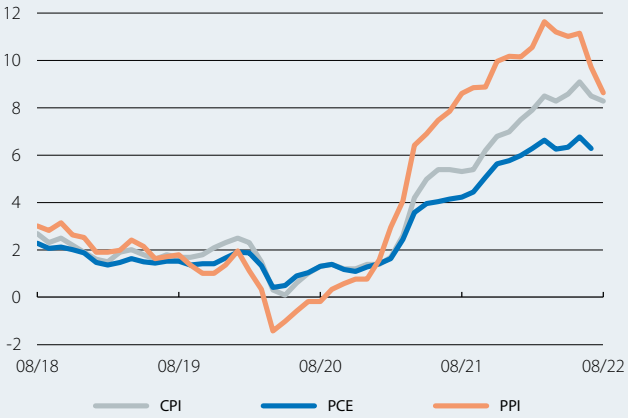
However, in the US there is another measure of consumer prices which the Fed tends to pay close attention to and for which it makes forecasts, namely, the inflation of personal consumption expenditure (PCE). These two series have followed a very similar pattern since the year 2000: with slightly higher rates in the case of the CPI (around 0.3 percentage points higher). However, since the beginning of the pandemic, the divergence between the two has become evident, with the CPI standing around 2 pps higher so far this year (CPI of 8.3% versus PCE of 6.3% in July). Thus, while both series are well above the Fed's 2% inflation target, the fact is that the PCE reflects a more contained rally in prices (see first chart). One reason for this recent divergence is that the PCE index does a better job of capturing the way in which many households are substituting certain goods with cheaper alternatives.[1]

On the other hand, it is worth mentioning other price measures that may be of interest, especially because of their power to predict the prices of the final goods we consume. In particular, the producer price index (PPI) is usually a good candidate (see first chart). This index measures the change in prices received by domestic producers for the goods and services which they sell. Using a simple econometric model which correlates the CPI with the PPI, and taking into account that the PPI has declined in recent months, the year-on-year price variation captured by the CPI should fall to around 6% by the end of this year.[2,3]

1. This better capturing of the substitution effect is due to the fact that the PCE index is calculated using a Fisher index, while the CPI uses a Laspeyres index.

US: price indices

Year-on-year change (%)



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

Short-term stress and relief factors

A number of factors will determine the path of inflation over the coming months: (i) commodity prices (especially energy and food), (ii) the resolution of the bottlenecks in global supply chains, (iii) the cycle of monetary policy tightening, and (iv) second-round effects.

With regard to commodity prices, US natural gas prices will remain high (relative to their pre-pandemic levels), affected by the rallies registered in the European gas benchmarks in recent weeks. However, the high level of reserves in Europe and the measures proposed by the European Commission to reduce consumption will help to contain upward pressures in Europe, and this should have a positive knock-on effect on the US gas benchmark.[4]

Food and industrial metal prices, meanwhile, have declined since Q2, so they should take pressure off both the PCE and the CPI in the coming months, both in the US and in other regions such as Europe (see table). In the case of metals, China's slowdown and the crisis which its real estate sector is suffering have played a decisive role. In the case of food, meanwhile, the resolution of some of the problems in Eastern European ports (affected by the war in Ukraine) and a better harvest in some large producers such as the US are behind the recent fall in agricultural prices.[5]

2. We correlated the month-on-month growth rates of the CPI with different lags in the month-on-month increases in the CPI. In our CaixaBank Research forecasts, the decline in CPI inflation is somewhat more gradual than this simple model would imply.
3. Other price indicators, such as the sub-components of the ISM business indices, have also declined in recent months.
4. In the US, the benchmark price for natural gas is that marked by the Henry Hub index, while in Europe one of the key benchmarks is the TTF.
5. See the Focus «The dance continues in the commodity market» in the MR09/2022.

Commodities

	Measure	Price	Change in the quarter, month, or year (%)					
			Q1	Q2	July	August	September	Year to date
Commodities	Index	117.3	25.5	–5.9	4.1	–0.2	–3.6	18.3
Energy	Index	49.5	47.8	6.7	12.2	0.7	–10.2	60.1
Brent	$/barrel	90.4	38.7	6.4	–4.2	–12.3	–6.3	16.2
WTI	$/barrel	83.5	28.8	7.8	–2.5	–6.6	–6.2	18.7
Natural gas (US, Henry Hub)	$/Mmbtu	7.7	56.1	–5.8	51.7	11.2	–15.4	110.0
Natural gas (Europe, TTF)	€/MWh	189.8	79.0	14.8	32.1	25.7	–20.9	169.8
Industrial metals	Index	152,6	22.6	–26.6	1.5	–2.9	–0.6	–11.8
Aluminium	$/mt	2,202.5	24.3	–29.9	1.8	–5.2	–6.6	–21.5
Copper	$/mt	7,690.0	6.7	–20.4	–4.1	–1.5	–1.4	–20.9
Agriculture	Index	70.4	19.8	–6.0	–2.2	3.3	1.8	15.8
Wheat	$/bushel	907.0	30.5	–13.6	–7.0	0.2	12.1	17.7

Note: *Data for September up to the 21st.*
Source: *CaixaBank Research, based on data from Bloomberg and the BEA.*

As for the bottlenecks, the latest information shows a clear improvement. For instance, the cost of container ships has been falling since the beginning of 2022, following the peaks reached in the second half of 2021 (see second chart). This should also exert some downward pressure on inflation rates. The main risk in this area remains China's zero-COVID policy, as the country is central to a large number of global supply chains.

In the sphere of monetary policy, the Fed's more hawkish stance, with faster interest rate hikes which are resulting in higher rates than were expected a few months ago, ought to take pressure of inflation by curbing demand, especially that of durable goods, which have been hardest hit by the bottlenecks.

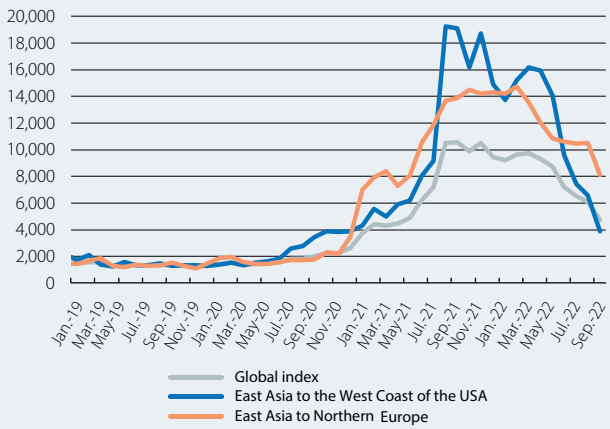
Finally, although long-term inflation expectations remain close to the target (see third chart), a stressed labour market, with wage growth slightly above 5% year-on-year, underscores the risks of second-round effects for the US economy.

In short, there are factors on both the supply and demand sides which give cause to expect a shift in the inflation trend in the coming months, although it is still too early to claim victory.

Clàudia Canals

Cost of shipping a container

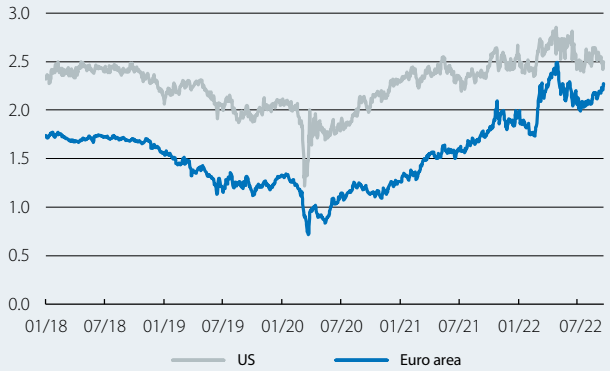
(Dollars for a 40-foot container)



Note: *Data for September up to the 21st.*
Source: *CaixaBank Research, based on data from Freightos, via Refinitiv.*

Euro area and US: 5Y5Y inflation expectations *

(%)



Notes: ** Inflation expectations based on 5-year 5-year forward inflation swaps.*
Data for September up to the 21st.
Source: *CaixaBank Research, based on data from Bloomberg.*

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

UNITED STATES

	2020	2021	Q3 2021	Q4 2021	Q1 2022	Q2 2022	07/22	08/22	09/22
Activity									
Real GDP	–3.4	5.9	5.0	5.7	3.7	1.8	–	–	–
Retail sales (excluding cars and petrol)	2.1	17.5	14.1	16.2	11.2	7.9	9.1	7.6	...
Consumer confidence *(value)*	101.0	112.7	116.7	112.9	108.1	103.4	95.3	103.6	108.0
Industrial production	–7.2	4.9	4.9	4.5	4.8	4.6	3.8	3.7	...
Manufacturing activity index (ISM) *(value)*	52.5	60.6	60.0	60.1	57.8	54.8	52.8	52.8	50.9
Housing starts *(thousands)*	1,396	1,605	1,569	1,679	1,720	1,647	1,404	1,575	...
Case-Shiller home price index *(value)*	228	267	274	283	299	315	315	...	...
Unemployment rate *(% lab. force)*	8.1	5.4	5.1	4.2	3.8	3.6	3.5	3.7	...
Employment-population ratio *(% pop. > 16 years)*	56.8	58.4	58.6	59.2	59.9	60.0	60.0	60.1	...
Trade balance [1] *(% GDP)*	–3.2	–3.6	–3.6	–3.6	–3.9	–4.0	–4.0	...	...
Prices									
Headline inflation	1.2	4.7	5.3	6.7	8.0	8.6	8.5	8.3	...
Core inflation	1.7	3.6	4.1	5.0	6.3	6.0	5.9	6.3	...

JAPAN

	2020	2021	Q3 2021	Q4 2021	Q1 2022	Q2 2022	07/22	08/22	09/22
Activity									
Real GDP	–4.6	1.7	1.2	0.5	0.6	1.6	–	–	–
Consumer confidence *(value)*	31.0	36.3	37.5	38.3	34.8	33.1	30.2	32.5	30.8
Industrial production	–10.6	5.6	6.6	1.1	–0.6	–3.6	–1.2	3.4	...
Business activity index (Tankan) *(value)*	–19.8	13.8	18.0	18.0	14.0	9.0	–	–	–
Unemployment rate *(% lab. force)*	2.8	2.8	2.8	2.7	2.7	2.6	2.6	2.5	...
Trade balance [1] *(% GDP)*	0.1	–0.3	0.3	–0.3	–1.0	–2.0	–3.1	–3.6	...
Prices									
Headline inflation	0.0	–0.2	–0.2	0.5	0.9	2.4	2.6	3.0	...
Core inflation	0.2	–0.5	–0.5	–0.7	–0.9	0.8	1.2	1.6	...

CHINA

	2020	2021	Q3 2021	Q4 2021	Q1 2022	Q2 2022	07/22	08/22	09/22
Activity									
Real GDP	2.2	8.1	4.9	4.0	4.8	0.4	–	–	–
Retail sales	–2.9	12.4	5.1	3.5	1.6	...	2.7	5.4	...
Industrial production	3.4	9.3	4.9	3.9	6.3	0.6	3.8	4.2	...
PMI manufacturing *(value)*	49.9	50.5	50.0	49.9	49.9	49.1	49.0	49.4	50.1
Foreign sector									
Trade balance [1,2]	524	680	636	680	728	822	867	887	...
Exports	3.6	30.0	24.4	23.1	15.7	12.9	17.8	7.0	...
Imports	–0.6	30.1	25.4	23.7	10.5	1.6	2.2	0.3	...
Prices									
Headline inflation	2.5	0.9	0.8	1.8	1.1	2.2	2.7	2.5	...
Official interest rate [3]	3.9	3.8	3.9	3.8	3.7	3.7	3.7	3.7	3.7
Renminbi per dollar	6.9	6.5	6.5	6.4	6.3	6.6	6.7	6.8	7.0

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

	2020	2021	Q3 2021	Q4 2021	Q1 2022	Q2 2022	07/22	08/22	09/22
Retail sales *(year-on-year change)*	–0.8	5.5	2.5	4.2	5.1	0.6	–0.9	...	...
Industrial production *(year-on-year change)*	–7.6	9.0	5.9	0.3	–0.2	0.4	–2.4	...	...
Consumer confidence	–14.2	–7.4	–4.2	–7.6	–13.6	–22.3	–27.1	–25.0	–28.8
Economic sentiment	88.3	110.8	117.4	115.9	111.2	104.1	98.5	97.3	93.7
Manufacturing PMI	48.6	60.2	60.9	58.2	57.8	54.1	49.8	49.6	48.4
Services PMI	42.5	53.6	58.4	54.5	54.1	55.6	51.2	49.8	48.8
Labour market									
Employment (people) *(year-on-year change)*	–1.5	1.4	2.3	2.3	3.0	2.7	–	–	–
Unemployment rate *(% labour force)*	8.0	7.7	7.5	7.1	6.8	6.7	6.6	6.6	...
Germany *(% labour force)*	3.7	3.6	3.5	3.3	3.1	3.0	3.0	3.0	...
France *(% labour force)*	8.0	7.9	7.8	7.4	7.3	7.6	7.4	7.3	...
Italy *(% labour force)*	9.3	9.5	9.1	9.0	8.5	8.1	7.9	7.8	...
Real GDP *(year-on-year change)*	–6.2	5.5	3.7	4.6	5.4	4.1	–	–	–
Germany *(year-on-year change)*	–4.1	2.8	1.8	1.2	3.5	1.7	–	–	–
France *(year-on-year change)*	–7.9	7.2	3.6	5.0	4.7	4.2	–	–	–
Italy *(year-on-year change)*	–9.1	7.0	4.0	6.4	6.3	4.7	–	–	–

Prices

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

	2020	2021	Q3 2021	Q4 2021	Q1 2022	Q2 2022	07/22	08/22	09/22
General	0.3	2.6	2.8	4.6	6.1	8.0	8.9	9.1	10.0
Core	0.7	1.5	1.4	2.4	2.7	3.7	4.0	4.3	4.8

Foreign sector

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

	2020	2021	Q3 2021	Q4 2021	Q1 2022	Q2 2022	07/22	08/22	09/22
Current balance	2.0	2.7	3.3	2.7	1.9	1.0	0.6	...	...
Germany	7.0	7.4	7.8	7.4	6.6	5.4	5.0	...	...
France	–1.8	0.4	–0.1	0.4	0.2	–0.4	–0.6	...	...
Italy	3.8	2.4	3.6	2.4	1.6	0.5	0.1	...	...
Nominal effective exchange rate [1] *(value)*	93.9	94.2	93.9	92.7	92.6	90.3	89.0	88.7	...

Credit and deposits of non-financial sectors

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

	2020	2021	Q3 2021	Q4 2021	Q1 2022	Q2 2022	07/22	08/22	09/22
Private sector financing									
Credit to non-financial firms [2]	6.3	3.5	1.8	3.3	4.4	6.1	7.6	8.7	...
Credit to households [2,3]	3.2	3.8	4.1	4.1	4.4	4.6	4.5	4.5	...
Interest rate on loans to non-financial firms [4] *(%)*	1.2	1.2	1.3	1.1	1.2	1.4	1.5	1.6	...
Interest rate on loans to households for house purchases [5] *(%)*	1.4	1.3	1.3	1.3	1.4	1.5	1.8	2.1	...
Deposits									
On demand deposits	12.9	12.6	11.4	10.5	9.1	7.7	6.7	6.8	...
Other short-term deposits	0.6	–0.8	–2.0	–1.5	–0.3	0.9	3.3	4.6	...
Marketable instruments	8.1	11.4	10.2	9.2	–0.2	1.3	0.7	2.6	...
Interest rate on deposits up to 1 year from households *(%)*	0.2	0.2	0.2	0.2	0.2	0.2	0.3	0.4	...

Notes: *1. Weighted by flow of foreign trade. Higher figures indicate the currency has appreciated. 2. Data adjusted for sales and securitization. 3. Including NPISH. 4. Loans of more than one million euros with a floating rate and an initial rate fixation period of up to one year. 5. Loans with a floating rate and an initial rate fixation period of up to one year.*

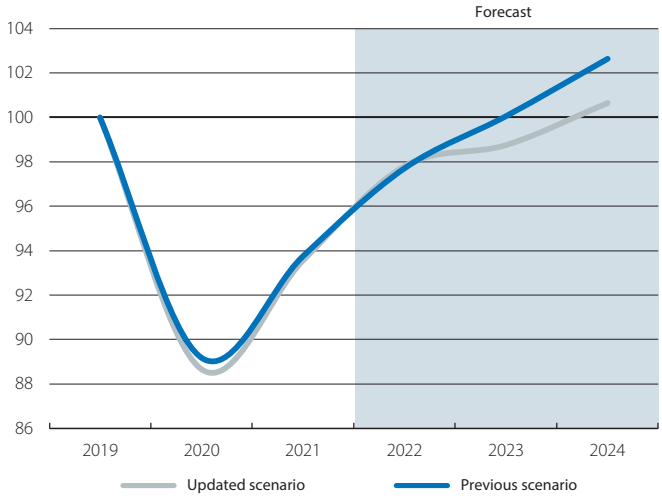
Source: *CaixaBank Research, based on data from the Eurostat, European Central Bank, European Commission, national statistics institutes and Markit.*

The energy crisis casts a shadow over the Spanish economy's growth outlook

Downward revision of the 2023 growth forecasts. The economic environment remains dominated by the energy crisis that erupted in the wake of Russia's invasion of Ukraine. This crisis deepened in the second half of August after Russia successively cut off gas supplies via the Nord Stream 1 pipeline, eventually leading to a total cut-off in early September. Whereas our forecast scenario in July was based on a TTF benchmark gas price of around €90/MWh for 2023 on average, throughout September the futures market fluctuated at around €200/MWh, more than double what was expected just two months ago. Also, in the face of the sharp rise in gas prices, the ECB has signalled its intention to ratchet up the pace of its interest rate hikes in response to the inflation rally. Spain is better placed than other major European economies to deal with the energy crisis: we are much less dependent on Russian gas than economies such as Germany or Italy (9% of our gas imports in 2021 came from Russia, compared to 65% in Germany and 43% in Italy in 2020) and our capacity to convert liquefied natural gas back into natural gas gives us greater ability to diversify gas imports. As a result, we are very unlikely to see episodes of gas rationing here in Spain, despite the cut-off of Russian gas supplies to northern Europe. That said, our economy is not immune to higher gas prices or sharper interest rate hikes. These dynamics lead us to revise our forecast scenarios. In the current context, we expect GDP growth to remain at around 0% in the closing stages of this year and in early 2023. For 2023 as a whole, we have revised our GDP growth forecast down from 2.4% to 1.0%. We have also revised our inflation forecast up to 4.5% for the 2023 average (previously 2.6%).

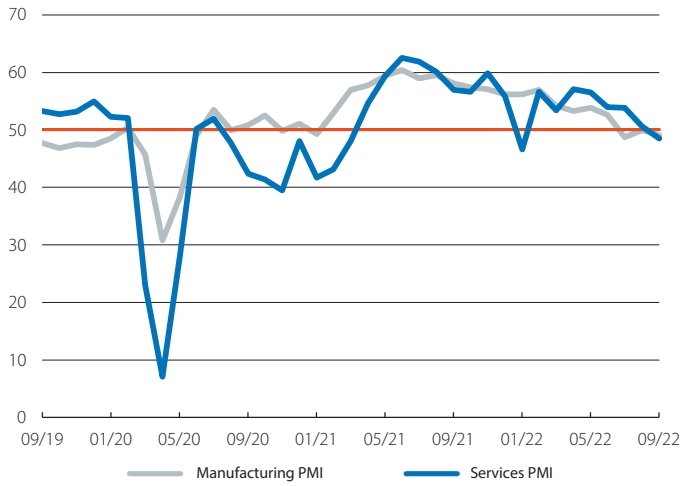
Economic activity weakens in Q3. Following a strong rebound in GDP growth in Q2 (1.5% quarter-on-quarter), the economic activity indicators point to a cooling in Q3. The services PMI has wavered during the quarter and in September fell into recessive territory (48.5 points). The manufacturing PMI entered the contractionary zone back in July and has remained there since (49 points in September). Furthermore, both the official indicators related to consumption – retail sales published by the National Statistics Institute, or the turnover data for large corporations published by the Treasury – and CaixaBank Research's domestic consumption indicator suggest that household consumption fell during Q3. In contrast, job creation has held up better than expected, and tourism-related indicators suggest a strong summer season (spending by foreign tourists in July-August was only 2.2% below the level of the same months of 2019, compared to –3.9% in Q2). Overall, we expect the economy to grow very moderately in Q3, at 0.2% quarter-on-quarter, although this estimate is subject to

Spain: GDP
Index (100 = 2019)



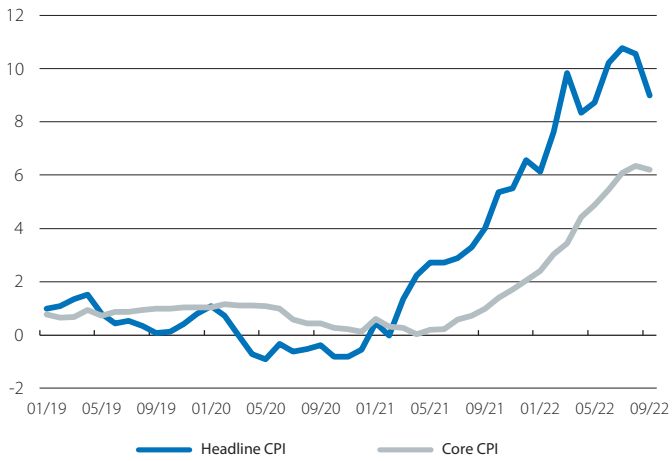
Source: *CaixaBank Research, based on data from CaixaBank.*

Spain: economic activity indicators
Level



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

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



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

significant uncertainty and the risks are skewed to the downside.

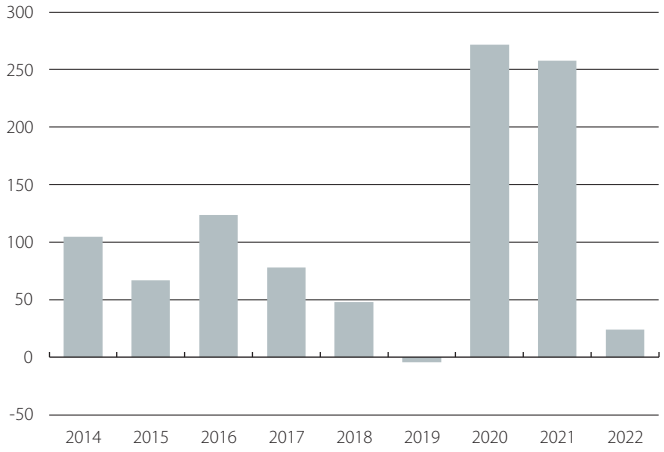
Job creation loses momentum in Q3 but remains positive. Social Security affiliation increased in September by 29,286 people, exceeding the average for the month of September in the period 2014-2019 (+14,300). However, despite a strong September, job creation for Q3 as a whole has moderated, with the average increase of 24,000 people falling short of pre-pandemic levels (average of 70,000 in the period 2014-2019). Considering the seasonally adjusted number of registered workers not on furlough, the growth compared to the previous quarter moderates to 0.7%, versus 1.0% in Q2.

Slight respite in the inflation data. While inflation remains very high, the September figure of 9% marks a notable reduction from the 10.5% registered in August. Core inflation also moderated, albeit more gently, to 6.2% (6.4% in August). This moderation is mainly due to the fall in energy prices. Electricity prices in particular have dropped sharply, as have fuel prices. Also, transport prices were affected by the subsidies introduced for public transport. Despite all this, to the extent that the moderation in inflation has been driven by energy prices, which have been highly volatile in recent months, it is still too early to rule out further rallies.

The house price rally moderated in Q2 2022. House prices based on valuations grew by a modest 0.4% quarter-on-quarter in Q2. This is well below the figure registered in the previous quarter (2.4%) and brings the annual rate down to 5.5% in Q2, compared to 6.7% in Q1. We believe that some of the factors that have been stimulating demand will gradually lose momentum (slower growth in real disposable household income, a climate of greater uncertainty, and rising interest rates). Thus, the July sales figure already shows signs – albeit faint – of a moderation in demand: the number of sales rose 8.0% year-on-year in July, whereas the figure for the first half of the year stood at 23.2%.

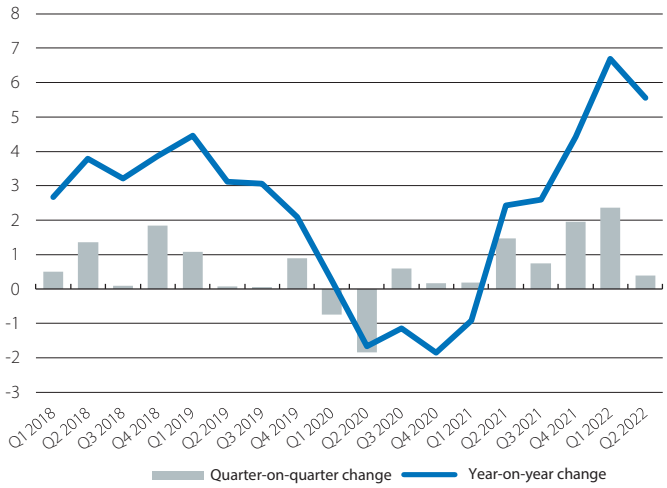
The general government deficit is substantially lower than last year. Up to June, the budget deficit excluding local public-sector corporations stood at 2.3% of GDP. This is lower than the 4.5% for the same period of 2021 and slightly above the 2.2% of June 2019. This improvement is the result of a significant increase in revenues, at 12.7% year-on-year in the first six months of 2022, compared with just a 1.3% increase in expenditure. On the revenue side, tax revenues registered far higher growth than social security contributions (16.5% versus 5.4%), favoured by the increase in prices on which taxes are calculated, especially in the case of taxes on production. On the expenditure side, the decrease in social benefits (linked to the gradual disappearance of COVID-related measures) is offset by the growth in employee remuneration (2.6% year-on-year) and intermediate consumption (7.5%). Interest expenditure, meanwhile, rose 13.8% year-on-year in a context of tightening financial conditions.

Spain: registered workers affiliated with Social Security
*Quarter-on-quarter change (in thousands) in Q3 of each year **



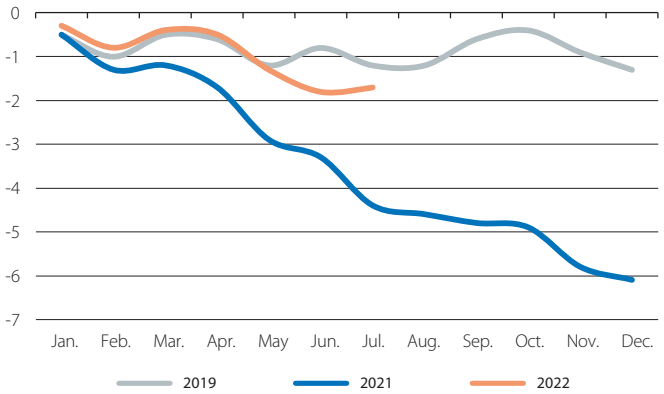
Note: ** Based on the average number of registered workers in July, August and September each year.*
Source: *CaixaBank Research, based on data from the Social Security Institute.*

Spain: home prices (valuations)
Change (%)



Source: *CaixaBank Research, based on data from the Ministry of transport, mobility and urban agenda (MITMA).*

Spain: consolidated general government net lending/borrowing (excluding local public-sector corporations)
(% of GDP)



Note: *Year-to-date up to the month of reference.*
Source: *CaixaBank Research, based on data from the General Comptroller of the State Administration (IGAE).*

Changes in the labour market in Spain

In the current context of uncertainty, one of the most encouraging aspects of the Spanish economy is the strong performance of the labour market. Despite some loss of momentum in recent months, job creation continues apace, with permanent hiring making particularly strong inroads, and this in turn is helping to bring down unemployment and temporary employment.

On the one hand, Social Security affiliation now far exceeds pre-pandemic levels and since April has stood above the 20 million threshold (20.18 million in September), while registered unemployment lies below 3 million – something not seen since late 2008 (2.94 million also in September).

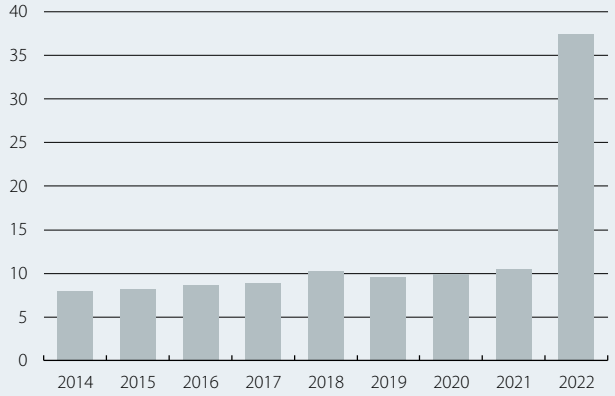
With regards to hiring on permanent contracts, it had already been showing an acceleration in its growth rates since mid-last year, but this trend intensified following the entry into force of the labour reform approved in December 2021,[1] and especially since April when the transition period for some changes to employment contracts ended.[2] The data paint a clear picture: the number of permanent contracts signed in the first nine months of the year exceeds 5.25 million. This is the highest figure in the series during this period and represents 37.0% of all contracts signed, compared to 9.0% before the pandemic (average for the months of January-September in 2014-2019).[3] As far as temporary contracts are concerned, just over 8.9 million were signed, the lowest figure in January-September since 1999. The reduction was particularly pronounced in the case of very short-term contracts (now penalised through higher social security contributions) and construction works and service contracts, which are eliminated under the new rules.

In terms of the stock of workers in the labour force, the number of registered workers with a permanent contract exceeds 11.82 million in September. This marks an all-time high and represents 74.7% of all workers registered under the General Scheme for social security, almost 13 points above the usual level for September prior to the pandemic. Consequently, the temporary employment rate within the General Scheme continues to fall, now standing at 16.9%, 12.5 points lower than in September 2019.

1. For further details, see the Focus «The Labour reform: a balancing act with a focus on temporary employment», in the MR02/2022.
2. Up until 30 March, temporary contracts could be created in accordance with the previous regulations.
3. By age bracket, and with data up to August, the growth in permanent hiring has been most pronounced among young people (under 25 years of age): 362% compared to 2019, versus an increase of 226% on average.

Spain: permanent contracts registered *

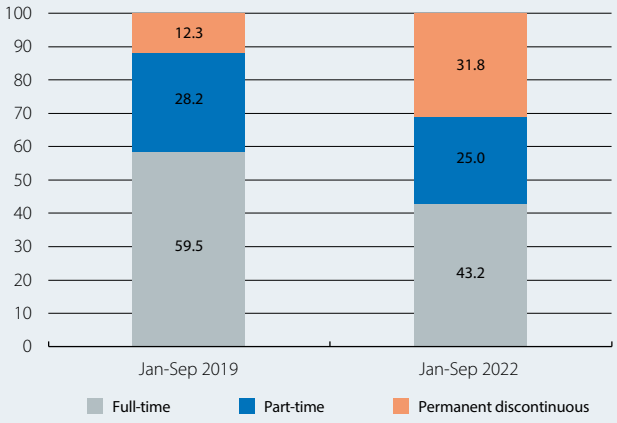
(% of total contracts registered in the period)



Note: ** Cumulative data from January to September.*
Source: *CaixaBank Research, based on data from the Ministry of Work.*

Spain: permanent contracts by type

(% of total permanent contracts in the period)



Source: *CaixaBank Research, based on data from the Ministry of Work.*

Is the labour reform responsible for the jobs boom?

It is too early to draw conclusions about the reform and its impact on the functioning of the labour market, and we will have to wait until more information is available. Firstly, we are seeing a certain «reclassification» of contracts: on the one hand, construction works contracts were previously considered temporary and are now permanent; on the other hand, many temporary contracts have now become permanent discontinuous contracts.[4] This latter shift is due to the elimination of construction works and service contracts, as well as greater restrictions on the use of temporary contracts,

4. Permanent discontinuous contracts, regulated by Article 16 of the Workers' Statute, are permanent contracts where the worker's activity is carried out intermittently over the course of the year, as is the case in agricultural or tourism-related activities. During periods of inactivity, these workers are not counted as unemployed, but rather as job seekers (DENO), just like workers on furlough (ERTE).

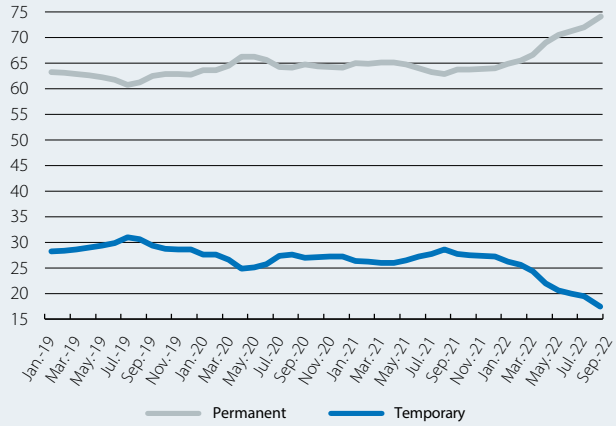
which has obliged certain sectors to use this format due to their seasonality. In this regard, of the permanent contracts signed up to September, almost 1.67 million were permanent discontinuous contracts. This is an unprecedented figure for this period of the year and represents 31.8% of the total (12.3% in 2019). Among registered workers with a permanent contract, meanwhile, the number of permanent discontinuous contracts reached 896,613 in September (7.6% of the total vs. 4.3% in 2019). This reclassification process will continue until the works and service contracts have fully expired.

One positive development since the labour reform came into force is the decline of very short-term contracts (seven days or less): they account for 19.7% of the contracts signed up to August, compared to 27.2% in the same period in 2019. By sector, these contracts are still used mainly in the hospitality sector, although the sector's dominance has reduced: in the first eight months of the year, this sector accounted for 24.4% of all such contracts, compared to 34.7% in the same period of 2019; it was followed by the manufacturing industry (13% of the total) and the artistic activities sector (11.5%), although in both cases their share of the total has increased with respect to 2019 (11.8% and 8.7%, respectively).

Nuria Bustamante and Sergio Díaz

Spain: registered workers by type of contract

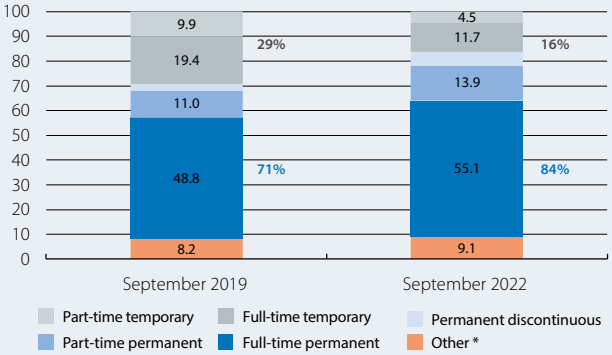
(% of the total number of workers registered under the General Scheme)



Source: *CaixaBank Research, based on data from the Ministry of Social Security.*

Spain: structure of registered workers by type of contract and working hours

(% of the total)



Notes: ** Learning, training, internships, registers workers without a contract (civil servants), non-professional carers, training programmes and non-employment work placements in companies, etc.*
Source: *CaixaBank Research, based on data from the Ministry of Social Security.*

Activity and employment indicators

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

	2020	2021	Q3 2021	Q4 2021	Q1 2022	Q2 2022	07/22	08/22	09/22
Industry									
Industrial production index	–9.5	8.8	1.9	1.7	1.6	4.6	5.3	...	...
Indicator of confidence in industry *(value)*	–13.6	0.6	2.6	5.0	6.8	0.4	–4.9	–5.5	–5.2
Manufacturing PMI *(value)*	47.5	57.0	58.9	56.9	55.8	53.2	48.7	49.9	49.0
Construction									
Building permits *(cumulative over 12 months)*	–12.8	4.7	15.0	24.6	31.6	18.8	10.8	...	...
House sales *(cumulative over 12 months)*	–12.5	9.6	22.4	32.5	41.8	33.6	25.9	...	...
House prices	2.1	3.7	4.2	6.4	8.5	8.0	–	–	–
Services									
Foreign tourists *(cumulative over 12 months)*	–77.3	64.7	–34.5	64.7	313.4	311.7	290.5	251.4	...
Services PMI *(value)*	40.3	55.0	59.6	57.4	52.2	55.9	53.8	50.6	48.5
Consumption									
Retail sales	–7.1	5.1	–0.3	0.7	0.4	1.1	–0.5	0.0	...
Car registrations	–29.3	158.0	–24.5	–17.1	–7.5	–10.3	–12.5	9.1	12.7
Consumer confidence index *(value)*	–22.7	–12.8	–8.8	–13.0	–17.6	–26.4	–35.1	–31.7	–32.9
Labour market									
Employment [1]	–2.9	3.0	4.5	4.3	4.6	4.0	–	–	–
Unemployment rate (% labour force)	15.5	14.8	14.6	13.3	13.6	12.5	–	–	–
Registered as employed with Social Security [2]	–2.0	2.5	3.8	3.9	4.5	4.8	3.8	3.5	3.3
GDP	**–11.3**	**5.5**	**4.2**	**6.6**	**6.7**	**6.8**	**–**	**–**	**–**

Prices

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

	2020	2021	Q3 2021	Q4 2021	Q1 2022	Q2 2022	07/22	08/22	09/22
General	–0.3	3.1	3.4	5.8	7.9	9.1	10.8	10.6	9.0
Core	0.7	0.8	0.8	1.7	3.0	4.9	6.1	6.4	6.2

Foreign sector

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

	2020	2021	Q3 2021	Q4 2021	Q1 2022	Q2 2022	07/22	08/22	09/22
Trade of goods									
Exports *(year-on-year change, cumulative over 12 months)*	–10.0	21.2	15.2	21.2	26.2	22.2	22.8	...	...
Imports *(year-on-year change, cumulative over 12 months)*	–14.7	24.8	13.5	24.8	36.1	35.2	36.6	...	...
Current balance	**6.8**	**11.5**	**11.7**	**11.5**	**8.5**	**9.6**	**8.5**	**...**	**...**
Goods and services	16.3	17.9	18.8	17.9	14.2	16.2	16.2	...	...
Primary and secondary income	–9.5	–6.4	–7.2	–6.4	–5.7	–6.7	–7.8	...	...
Net lending (+) / borrowing (–) capacity	**11.9**	**22.4**	**20.3**	**22.4**	**19.8**	**22.5**	**21.3**	**...**	**...**

Credit and deposits in non-financial sectors [3]

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

	2020	2021	Q3 2021	Q4 2021	Q1 2022	Q2 2022	07/22	08/22	09/22
Deposits									
Household and company deposits	7.5	6.1	4.8	5.8	5.2	5.4	5.3	5.4	...
Sight and savings	12.3	10.3	8.9	9.2	9.3	9.2	8.6	8.4	...
Term and notice	–16.5	–24.4	–26.0	–27.6	–26.8	–25.4	–21.9	–19.9	...
General government deposits	1.0	15.5	15.1	19.4	19.3	15.6	8.3	11.8	...
TOTAL	**7.1**	**6.7**	**5.5**	**6.6**	**6.0**	**6.0**	**5.5**	**5.8**	**...**
Outstanding balance of credit									
Private sector	1.2	0.3	–0.7	–0.1	0.2	0.8	1.2	1.6	...
Non-financial firms	4.9	1.1	–1.9	–1.0	–0.5	0.7	2.0	3.2	...
Households - housing	–1.8	0.2	0.6	1.0	1.3	1.4	1.1	1.1	...
Households - other purposes	0.8	–1.2	–1.2	–1.2	–1.1	–0.4	–0.9	–0.9	...
General government	3.0	15.3	22.7	11.6	3.4	1.9	–3.1	–3.7	...
TOTAL	**1.3**	**1.1**	**0.7**	**0.6**	**0.4**	**0.9**	**0.9**	**1.2**	**...**
NPL ratio (%)[4]	**4.5**	**4.3**	**4.4**	**4.3**	**4.3**	**4.1**	**3.8**	**...**	**...**

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: the outlook deteriorates

After a buoyant 2022, headwinds tarnish the outlook for 2023. The National Statistics Institute has revised GDP growth for the first half of 2022 upwards, virtually guaranteeing that growth for the year as a whole will exceed 6%. However, the latest available information shows signs of a weakening of economic activity: the coincident indicators show a slowdown, the daily economic activity indicator is down year-on-year in September, and the European Commission's economic sentiment indicator has fallen, approaching a level indicative of contraction. In a context marked by an energy crisis, high inflationary pressures and a tightening of monetary policy, we expect GDP to register a decline as early as Q4, with a significant slowdown in 2023, to around 0.5% for the year as a whole. In any case, the outlook remains subject to high uncertainty, largely associated with the supply of gas to Europe and the effectiveness of energy saving measures, although our baseline scenario does not envisage any periods of energy rationing.

Inflation gains momentum in September. The first CPI estimate for the month places it at 9.3% year-on-year (8.9% in August). This is in line with the new baseline scenario for this variable, which anticipates average inflation of 7.9% in 2022 and of 5.7% in 2023. Our forecast scenario suggests that the high inflation will be more persistent, due to the depreciation of the euro against the dollar, the continued tensions in logistics chains and the translation of the rise in energy prices.

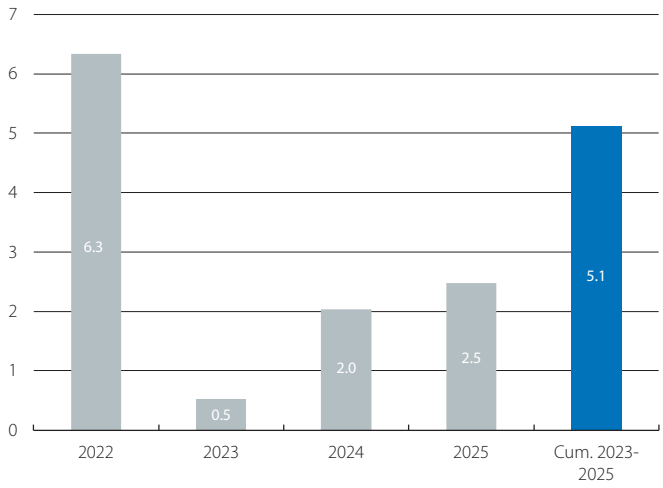
The labour market continues to perform well for the time being. Although the labour market is showing some resilience, and the unemployment rate remained at 6.0% in August, the weakening of economic activity and the deteriorating business conditions due to higher financing and energy costs will have a negative impact on hiring. In this scenario, we anticipate an increase in the unemployment rate, from an average of 5.9% in 2022 to 6.4% in 2023.

Energy costs exacerbate the current account deficit. In the first seven months of the year, the current account deficit reached 3,712 million euros, some 1,500 million more than in the same period of 2021. The rise in energy prices caused a deterioration in the energy balance, while the rise in the price of other imported goods also worsened the balance of non-energy goods; on the upside, the tourism surplus exceeded that of the same period last year by 6,000 million. We estimate that 2022 will end with a current account deficit of 2.7% of GDP, 1.6 points more than in 2021.

Home prices will slow considerably in 2023. Given the strong growth in real estate prices in the early part of 2022, we expect a significant increase for the year as a whole (+10.1%), but also a sharp slowdown in subsequent years (+1% in 2023 and 2.2% in 2024). Demand will slow in the face of the tightening of financial conditions, greater uncertainty and weak real household income. Nevertheless, there are two main factors which continue to support prices: the booming demand for housing among foreigners, mostly from outside the EU, and the scarce supply of new housing.

Portugal: GDP forecasts

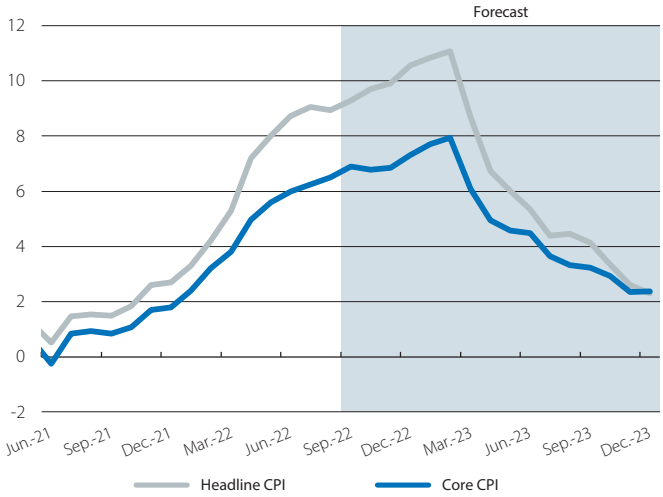
Annual growth (%)



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

Portugal: CPI

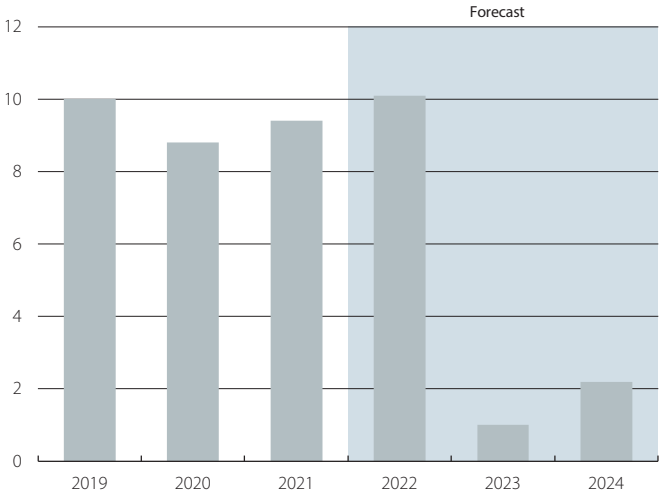
Year-on-year change (%)



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

Portugal: home price index

Change in the annual average (%)



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

Portugal: budgetary risks return for 2023

Next year will be a major challenge for Portugal's public finances due to the context of high inflation, worsening financial conditions and a sharp slowdown in the economy. In this environment, in addition to the likely reduced growth of tax revenues in the face of a slowdown in household and business incomes, there are risks surrounding the pattern of expenditures. In this article, we focus on estimating the impact of higher interest payments on public expenditure and that of inflation on staff and pension costs.

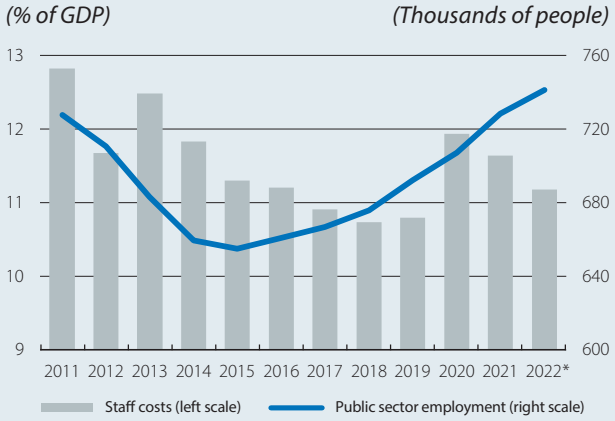
With regards to staff costs, it must be borne in mind that the decision on updating public sector wages lies with the government, as part of its preparation of the General Government Budget. It has already confirmed that such an update will depend on its payment capacity and on the wage negotiations with the unions. In this exercise, we assume a wage increase of 2% in 2023, in line with the target for the medium-term inflation rate (2%). In this context, and assuming 1% growth in the number of public sector workers,[1] staff costs would increase by 3% and the impact on expenditure would amount to around 0.3 pps of GDP (this calculation does not take into account the impact of career progress or other increases in the overall remuneration package). It should be noted that, should the government choose to update wages at the average inflation rate registered in the 12 months to November 2022,[2] as it has done in recent years, staff costs would increase by more than 8% compared to the forecast for 2022 and the impact on the public accounts could amount to 0.9 pps of GDP.

With regards to retirement pensions, taking into consideration the recently announced formula that will be applied in 2023,[3] we estimate that the impact on public expenditure will reach 0.6 pps of GDP (i.e. an increase of more than 1.4 billion euros).[4]

Finally, and in view of the ECB's expectations of additional interest rate hikes of at least 100 bps by 2023, it is reasonable to assume that sovereign interest rates will accompany this move, at least in part. Incorporating this increase in financing costs, we estimate an increase in public debt interest expenditure of between 0.2 and 0.3 pps, which would bring interest payments to 2.4%-2.5% of GDP. Also, the rise in rates will be felt gradually over the next few years, as the stock of debt is renewed and maturities are replaced with new, more expensive debt. Thus, it appears inevitable that interest charges on public debt will increase as a proportion of GDP and public expenditure over time, and this will act as an increasingly difficult restriction for fiscal policy and should be taken into account when designing future policies.

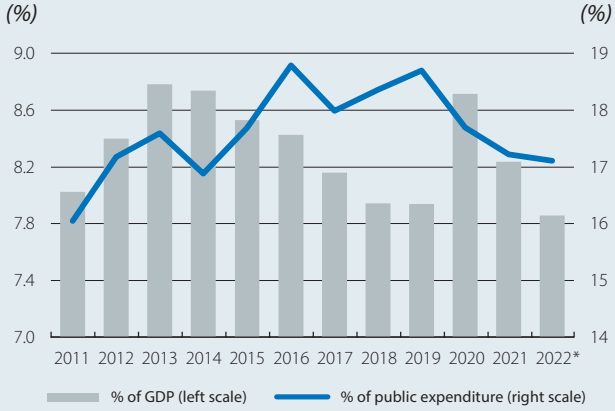
There are other factors that are likely to also push up public spending. These include the impact of inflation on new contracts for the supply of goods and services to government, the potential need to prolong and/or implement new measures to support households and businesses in mitigating the effects of the energy crisis, and the increase in food prices in their budgets and the

Portugal: staff costs



Notes: ** Government forecast for staff costs according to the 2022 General Government Budget. Average public sector employment registered in Q1 2022.*
Source: *CaixaBank Research, based on data from the DGAEP, the 2022 General Government Budget and the National Statistics Institute of Portugal.*

Portugal: Social Security pension expenditure



Note: ** Government forecast per the 2022 General Government Budget.*
Source: *CaixaBank Research, based on data from the 2022 General Government Budget and the National Statistics Institute of Portugal.*

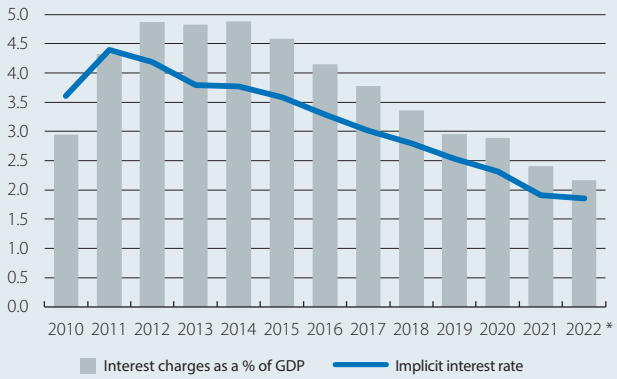
1. We assume that the number of public sector workers will grow at the average rate recorded between 2015 and 2019.
2. Based on CaixaBank Research forecasts for the monthly CPI.
3. For pensions up to 886 euros per month, the update is 4.4%; for pensions between 886 and 2,659 euros, the update is reduced to 4.1%; and for pensions over 2,659 euros, the update amounts to 3.5%.
4. It is assumed that the number of pensioners increases by the same proportion as that registered in the first half of 2022, i.e. by 0.6%.

updating of the social aid index, which would have the knock-on effect of driving up other social benefits such as that of unemployment.[5]

Despite these impacts and the residual effect that the «Families First» package will still have next year, the deficit in 2023 could be reduced from the 1.9% of GDP estimated by the government for 2022 to somewhere around 1.3% of GDP, supported by nominal GDP growth and the effect of inflation boosting revenues through higher tax bases. However, beyond other effects, it should be mentioned that our assessment does not consider the possibility of discretionary measures that may end up being included in the 2023 budget proposal, which will be made public in mid-October, or the possibility of better than expected results in the 2022 budget implementation.[6]

Vânia Duarte

Portugal: interest payments on public debt
(%)



Note: ** Government forecast per the 2022 General Government Budget.*
Source: *CaixaBank Research, based on data from the 2022 General Government Budget and the National Statistics Institute of Portugal.*

5. The update of the social support index (IAS) depends on real GDP growth and the average change in the CPI over the last 12 months, excluding housing.
6. For example, the Portuguese Public Finance Council (CFP) estimates a deficit of 1.3% in 2022, taking into consideration the impact of the measures included in the «Families First» package. Assuming that the deficit in 2022 is that stated by the CFP, and based on the impacts estimated in this article, the deficit would remain at around 0.7% of GDP in 2023.

Activity and employment indicators

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

	2020	2021	Q4 2021	Q1 2022	Q2 2022	Q3 2022	07/22	08/22	09/22
Coincident economic activity index	–5.5	3.1	6.1	6.9	7.0	...	6.6	6.4	...
Industry									
Industrial production index	–6.9	4.5	–1.5	–2.1	1.9	...	–0.1	...	...
Confidence indicator in industry *(value)*	–15.3	–5.3	–1.4	–0.1	–2.3	–4.7	–4.0	–4.7	–5.4
Construction									
Building permits - new housing (number of homes)	0.7	13.5	–6.9	44.7	–24.1	...	–8.3	...	...
House sales	–11.2	20.5	17.2	25.8	4.5	...	–	–	–
House prices *(euro / m² - valuation)*	8.3	8.6	11.0	11.5	14.2	...	16.1	15.8	...
Services									
Foreign tourists *(cumulative over 12 months)*	–76.2	51.5	51.5	259.9	298.1	...	296.8	269.9	...
Confidence indicator in services *(value)*	–19.0	0.1	12.0	13.0	21.1	17.9	20.5	18.9	14.4
Consumption									
Retail sales	–3.0	4.9	7.3	12.7	3.1	...	3.1	3.9	...
Coincident indicator for private consumption	–6.2	4.6	7.2	6.7	5.1	...	3.5	2.8	...
Consumer confidence index *(value)*	–22.4	–17.2	–13.5	–19.3	–30.5	–31.8	–31.2	–31.6	–32.7
Labour market									
Employment	–1.9	2.8	3.1	4.7	1.9	...	0.9	1.0	...
Unemployment rate (*% labour force*)	7.0	6.6	6.3	5.9	5.7	...	6.0	6.0	...
GDP	**–8.3**	**5.5**	**6.6**	**12.0**	**7.4**	**...**	**–**	**–**	**–**

Prices

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

	2020	2021	Q4 2021	Q1 2022	Q2 2022	Q3 2022	07/22	08/22	09/22
General	0.0	1.3	2.4	4.3	8.0	9.0	9.1	8.9	9.3
Core	0.0	0.8	1.5	3.1	5.5	6.4	6.2	6.5	6.9

Foreign sector

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

	2020	2021	Q4 2021	Q1 2022	Q2 2022	Q3 2022	07/22	08/22	09/22
Trade of goods									
Exports *(year-on-year change, cumulative over 12 months)*	–10.3	18.3	18.3	21.2	18.9	...	20.5	...	...
Imports *(year-on-year change, cumulative over 12 months)*	–14.8	22.0	22.0	33.3	31.3	...	31.8	...	...
Current balance	**–2.1**	**–2.5**	**–2.5**	**–4.3**	**–4.7**	**...**	**–4.0**	**...**	**...**
Goods and services	–3.9	–5.7	–5.7	–6.9	–6.4	...	–5.1	...	...
Primary and secondary income	1.8	3.2	3.2	2.7	1.7	...	1.1	...	...
Net lending (+) / borrowing (–) capacity	**–0.1**	**1.2**	**1.2**	**–0.8**	**–1.3**	**...**	**–1.9**	**...**	**...**

Credit and deposits in non-financial sectors

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

	2020	2021	Q4 2021	Q1 2022	Q2 2022	Q3 2022	07/22	08/22	09/22
Deposits [1]									
Household and company deposits	10.0	9.3	9.3	8.9	8.2	...	8.4	7.9	...
Sight and savings	18.8	16.3	16.3	15.3	12.9	...	12.9	11.6	...
Term and notice	1.2	1.2	1.2	1.1	2.3	...	2.8	3.1	...
General government deposits	–21.0	–4.1	–4.1	9.8	8.5	...	5.3	5.0	...
TOTAL	**8.9**	**9.0**	**9.0**	**8.9**	**8.2**	**...**	**8.3**	**7.8**	**...**
Outstanding balance of credit [1]									
Private sector	4.6	2.9	2.9	2.8	2.7	...	2.1	2.1	...
Non-financial firms	10.5	2.2	2.2	1.2	1.0	...	–0.3	–0.3	...
Households - housing	2.1	3.3	3.3	3.0	3.8	...	3.7	3.6	...
Households - other purposes	–1.1	3.1	3.1	6.4	3.3	...	3.0	3.2	...
General government	–4.2	3.8	3.8	5.3	–1.3	...	0.0	–0.3	...
TOTAL	**4.2**	**2.9**	**2.9**	**2.8**	**2.5**	**...**	**2.0**	**2.0**	**...**
NPL ratio *(%)* [2]	**4.9**	**3.7**	**3.7**	**3.6**	**3.4**	**...**	**–**	**–**	**–**

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

REPowerEU or how to accelerate the energy transition to survive in the new geopolitical context

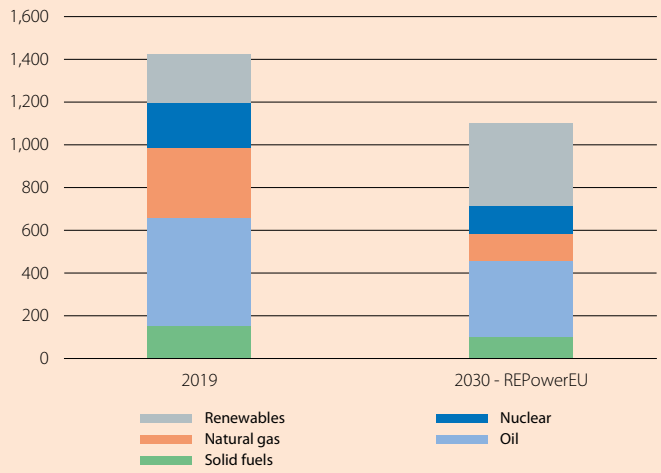
The war in Ukraine has marked a turning point in relations between the EU and Russia and has highlighted the serious implications of Europe's high dependence on energy imports from Russia, especially gas. Aware that energy dependence is a handicap for the EU, in May the Commission approved the REPowerEU plan, with measures aimed at accelerating the energy transition envisaged in the Green Deal and the Fit for 55 package.[1]

Ending reliance on Russian gas: a key objective of REPowerEU, but difficult to fully achieve in the short term

With the REPowerEU plan, in May the Commission presented a clear strategy to completely eliminate Europe's dependence on Russian fossil fuels by 2027. To this end, it envisaged a specific plan to completely replace EU imports of Russian gas (155 bcm[2] in 2021) by 2027, with a reduction target of two-thirds (over 100 bcm) by the end of 2022.[3] However, with data up to August 2022, the EU had already imported a total of 53 bcm of Russian gas, so the reduction in dependence on Russia this year will most likely fall short of the goal set under REPowerEU. In the short term, the Commission is mostly relying on liquefied natural gas (LNG) to replace Russian gas and estimates that imports could increase this year by 50 bcm,[4] a feasible target based on the available data. Brussels also hoped to replace at least a further 50 bcm in 2022 through various other means: higher gas imports via pipelines from other suppliers (primarily Norway, Algeria and Azerbaijan), coal, lower demand due to higher prices, energy savings,[5] and nuclear power plants. This additional 50 bcm was a rather ambitious goal; for example, replacing 10 bcm through increased imports of natural gas from other countries, excluding LNG, will not be easy to achieve (import data for the year to date indicate that these imports have not increased). Faced with obvious difficulties in replacing Russian gas in the short term, some countries (Germany, the Netherlands, Austria and France) are considering increasing the use of coal for their electricity generation, despite the harmful consequences in terms of climate change and the fact that it contradicts the emission reduction targets set by the Commission.

European Union: current sources of energy generation * and forecasts for 2030 according to REPowerEU

Megatons of oil equivalent



Notes: ** As defined by Eurostat, this refers to the sum of primary energy production, imports and changes in inventories, from which exports and the refuelling of vessels at sea must be subtracted. Thanks to improvements in energy efficiency, the total energy supply will be lower in 2030 than in 2019.*
Source: *European Commission REPowerEU documentation according to calculations by Eurostat (2019) and Primes (2030).*

Progress needs to be made in the EU's energy integration

The REPowerEU plan reignites the implementation of many energy projects which have been pending for some time and which make greater use of cross-border connections in order to achieve an integrated market that can guarantee energy supplies in all Member States.

In the short term, the plan focuses on European projects of common interest in order to build gas infrastructures with a capacity of 20 bcm per year in Eastern Europe and the Baltic states this year, as well as supporting Germany's plans to install seven floating LNG plants, three of which are expected to be operational this winter, joining the one which has been operational since the summer in the Netherlands. In the medium term, all European economies are expected to have access to three alternative sources of gas or to the global LNG market.

In addition, the plan envisages greater electrical interconnection between the Iberian peninsula and France through new cross-border projects. These include the laying of an underwater cable across the Bay of Biscay to connect Bilbao and Bordeaux, planned for 2025,[6] as well as other planned interconnections with Navarre and Aragon. On the other hand, the possibility of establishing gas interconnections with France or Italy has also recently been raised. The plan also advocates homogenising the way gas is treated in

1. The Green Deal is a plan presented in January 2020 with actions aimed at combating climate change and making Europe the first climate-neutral continent by 2050. One of the first targets in the plan is to reduce emissions by at least 55% compared to 1990 levels by 2030, and this requires new standards as well as an updating of existing EU legislation, as set out in the Fit for 55 package launched in June 2022.
2. Billion cubic metres. In 2019, Russian imports amounted to 195 bcm.
3. Although no intermediate targets between 2022 and 2027 have been set, imports of Russian gas would be gradually reduced over this five-year period until they are fully replaced in 2027.
4. A 60% increase over 2021.
5. Lowering thermostat settings in buildings by 1°C.
6. With this 400-kilometre cable, the interconnection rate between Spain and France would reach 5%. Currently, Spain can export 2.8% of the electricity it produces to the rest of the continent, via France, but the EU advised in 2002 that cross-border connections should transport 10% of each country's electricity production capacity.

order to enable interconnections with Central Europe (Spain and France use a different odorisation treatment process to the rest of Europe). Moreover, the plan opens the door for the peninsula to play an important role in the green hydrogen corridor: it recognises that it can take the leading role, making the most of its proximity to North Africa, although it does not provide specific details on how such a scheme would be deployed. These are major investments with a relatively long payback period, so the main risk to their development is that the pressing energy crisis could end up resulting in less money being allocated to them than is needed. The tension between the short and long term is clear.

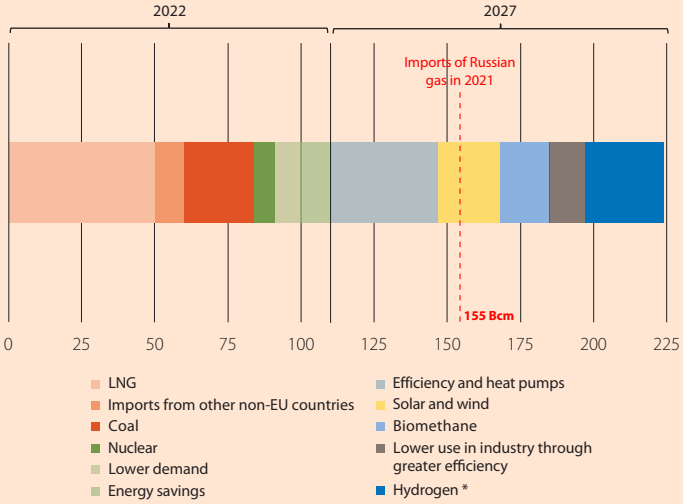
A boost to renewables with three major winners in the medium term: green hydrogen, biomethane and solar energy

It is apparent that, in the short term, achieving energy independence from Russia will not be such an easy task. However, one of the clear objectives of the REPowerEU plan is to accelerate the energy transition over the next eight years.

REPowerEU envisages an increased role of renewables in the EU's energy supply by 2030. Specifically, their share of the bloc's total energy is due to increase by 5 pps compared to the Fit for 55 energy plan, bringing it to 45% of the total, and this will come at the expense of a 7-pp reduction in gas, which will fall to 3.3% of the total. This increase is mainly based on the intention to boost renewable hydrogen and biomethane in the medium term, two renewable energies that will require significant investment in infrastructure and interconnections.

European Union: replacement of imports of Russian gas

(Bcm of gas)



Note: ** In the case of hydrogen, the amount shown in the chart would be replaced in 2030.*
Source: *CaixaBank Research, based on data from REPowerEU documentation.*

As for the installed energy capacity of renewables, the objective set under the REPowerEU plan is to increase it by 15.8% compared to the goal set in the Green Deal, primarily through a greater boost to solar energy. Thus, the total installed capacity of this energy source, which is currently enjoying a boom thanks to the significant reduction in production and installation costs, should quadruple between 2020 and 2030. In addition, the European Commission intends to speed up its deployment: it proposes cutting the time it takes to grant solar panel installation permits to three months (in some cases it currently takes up to a year), it suggests that Member States should cut VAT on solar panels and heat pumps, and it will make it easier to ensure new buildings are equipped with everything they need to produce solar energy. Thus, the Commission estimates that, under REPowerEU, within five years classical renewables (solar and wind) could replace 13.5% of the total amount of Russian gas that was imported by Europe a year before the war (155 bcm), while biomethane could replace 11%, and green hydrogen, 17.4% (within eight years in the latter case).

Funding: where the money to fund REPowerEU will come from

The REPowerEU plan will require vast investments: the Commission estimates the figure at 300 billion euros up to 2030, 210 billion of which will be between now and 2027, half of which would go to renewables. The new investments under the REPowerEU plan will come in addition to those already proposed in the recovery plans and will largely be financed via the loans which Member States have access to under the NGEU framework. Specifically, the Commission expects 225 billion euros to be financed through NGEU loans. The other 75 billion needed to cover the 300-billion total investment will be funded through grants from the cohesion funds (around 27 billion), new NGEU subsidies obtained from the sale of carbon emissions allowances under the EU emissions trading scheme (around 20 billion) and from the common agricultural policy (around 7.5 billion). At this point, it should be noted that the Commission is merely playing the role of coordinator in these energy policies, while the plan's true success will largely depend on the will of Member States.

The banking sector can play a crucial role in mobilising funds in order to achieve the goals of REPowerEU. It can help customers to recognise this opportunity and facilitate the financing of projects in the different areas covered by the plan as well as initiatives in adjacent sectors, thus helping to ensure the funds reach the entire productive fabric of the economy and all regions.

In short, the intention is to link REPowerEU closely with NGEU. However, the NGEU plan was designed to overcome a different type of crisis (COVID-19), with some of the funds already distributed and allocated, so it may not be enough. Further progress must be made in designing a common fiscal response if the NGEU and REPowerEU agendas are to be achieved.

Javier Garcia-Arenas and Rita Sánchez Soliva

The outlook for gas supplies in Europe: a balancing act

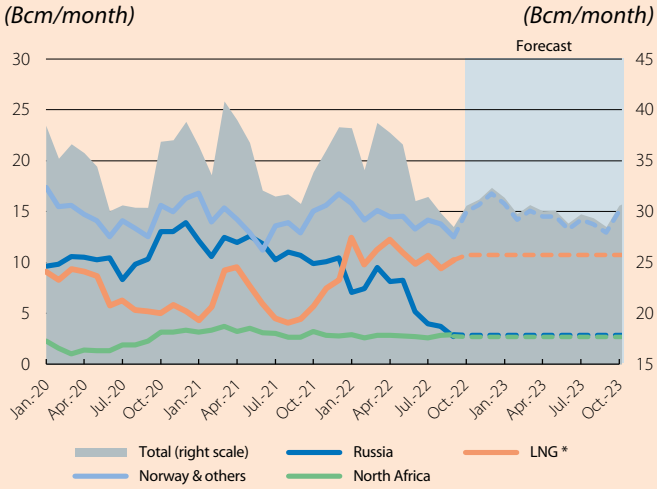
The major changes in relations between blocs that are taking place in 2022 are driving profound structural transformations in areas such as technology, defence and energy policy. Furthermore, gas, a key component of the energy transition, has recently become a political weapon, putting the many countries and industries that rely on this energy source on high alert.

Gas imports: partial replacement achieved

The EU is a net importer of gas, and its main suppliers have historically been those producers that are located the closest in geographical terms. In 2021, Russia was the EU's biggest supplier, accounting for 40% of all gas imports. Imports from northern Europe (mainly Norway) and north Africa accounted for 30% of the total. On the other hand, imports of liquefied natural gas (LNG) from other sources accounted for the remaining 30% of imports in 2021.[1]

The recent escalation of tensions with Russia has led to gas imports from the country falling to a record low: in September, monthly imports from Russia stood at 2.8 billion cubic meters (bcm), 8.0 bcm below the figure for September 2021. This fall has been offset by an increase in LNG imports, which grew by 5.8 bcm compared to September 2021, while other imports remained stable. Overall, despite the 74% year-on-year drop in imports of Russian gas in September, total natural gas imports are just 7.4% below the level recorded a year ago (see first chart).

European gas imports by origin and future outlook



Note: ** Liquefied natural gas imported from any country of origin.*
Source: *CaixaBank Research, based on data from Bloomberg.*

Nevertheless, despite the high degree of substitution achieved in 2022, the EU's ability to import more LNG in the short-term is limited by a number of factors. These include the limited regasification capacity in northern Europe, deficiencies in the interconnection between EU countries (e.g. low connectivity with the Iberian Peninsula, where around 35% of the EU's total regasification capacity is located), the limited global supply of LNG and the small number of LNG carriers available for transport.

Faced with a scenario in which imports of Russian gas are expected to remain no higher than their current record low,[2] but also with the short-term substitution of imports approaching its limits, we can project the outlook for gas supply in Europe by incorporating into the analysis the current level of gas reserves and the pattern of consumption.

Gas reserves: how long will they help us endure?

As of the end of September, the EU's reserves stood at around 90% of capacity, allowing for some cautious optimism. However, it is important to stress that the real room for manoeuvre is determined by what level of reserves are projected to remain at the end of winter, not before it like now. This is because gas imports during the cold months of the year are insufficient to cover the high demand for gas, so the reserves accumulated during the summer are also used. Historically, gas reserves peak at between 80% and 95% of capacity in October and fall to between 20% and 50% in March, depending mainly on the severity of the winter.

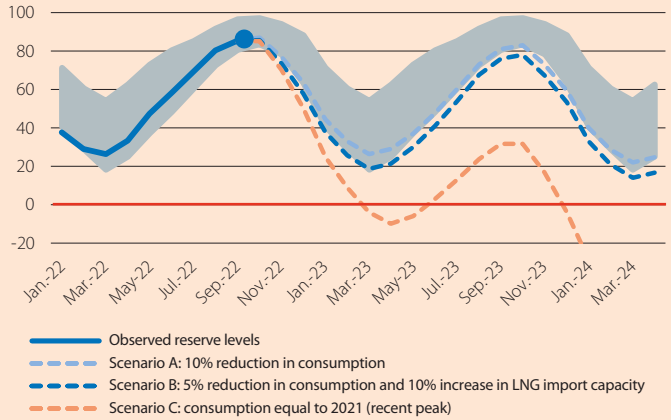
How far will Europe's gas reserves fall after winter given the decline in Russian imports? Keeping consumption in line with the previous year (a recent peak) and other imports at the average level of 2022 (see first chart), we can see that the current reserves would not be enough to last the whole winter, resulting in energy rationing (the orange line in the second chart). Moreover, given the supply-side limits, this situation could still deteriorate looking ahead to the winter of 2023-2024.[3] Therefore, in order to minimise the risks, it is necessary to propose measures aimed at reducing consumption, as the EU has done.

We will now analyse two additional scenarios, working on the assumption that, in the absence of any measures, the level of gas consumption would be the average of the last five years (excluding 2020). This is a way of assuming «average» weather conditions, which would be less extreme than those experienced last year. Next, we estimate what level of reduction in gas consumption or

1. The source of this gas varies from country to country. Some of the main global exporters of LNG include Australia, Qatar, the US and Nigeria. On the other hand, the majority of LNG carriers are produced in South Korea.
2. We assume that Nord Stream 1 will remain closed and that imports via Russia's main alternative gas pipelines to Europe, such as the Yamal-Europe and TurkStream pipelines, will remain at the current level of 2 bcm per month.
3. This deterioration would be due to the much lower capacity to fill reserves in the lead up to the winter of 2023-2024: they would start from a record low in March 2023 and the volume of imports would be lower.

*EU natural gas reserves, scenarios **

(% of total reserve capacity)



Notes: ** All scenarios assume that the current level of substitution of Russian imports is maintained. Reduction in consumption relative to the average consumption in 2017-2021 (excluding 2020). The shaded area represents the historical maximum-minimum level of reserves.*
Source: *CaixaBank Research, based on data from Eurostat and Bloomberg.*

increase in gas imports would be needed in order to keep gas reserves within the safety range (i.e. close to the historical lows, denoted by the bottom of the grey band in the second chart), thereby avoiding serious supply problems or strict rationing measures.

In a conservative scenario where the EU fails to increase gas imports, we estimate that a 10% cut in gas consumption would be required. This is a figure that seems achievable as early as this year, given that in the first half of 2022 some of the biggest European gas consumers, such as Germany, the Netherlands, France and Poland, cut their consumption by more than 5% compared to the historical average. It is also below the 15% voluntary reduction in natural gas demand which Member States committed to last July for the period between August 2022 and March 2023.

On the other hand, in a more benign scenario in which LNG imports increase by 10%,[4] this would be enough to keep European gas reserves within the safe range with just a 5% reduction in consumption.

Reducing consumption: a differing task from country to country

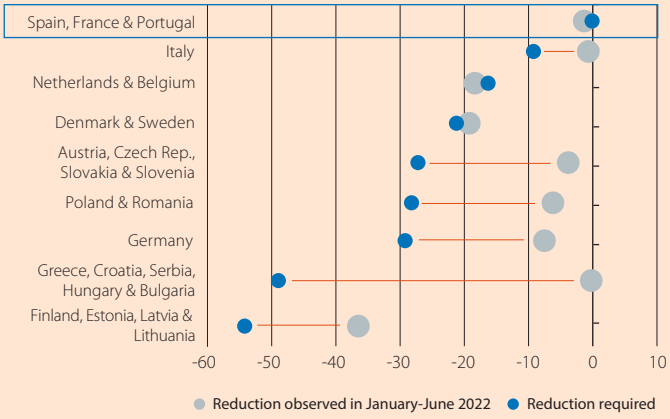
However, the situation will not be the same for all Member States, as indicated in the analysis carried out by McWilliams and Zachmann (2022).[5] The authors of this analysis look at what level of reductions in gas consumption would be needed in each country in a more severe scenario than the one we have used in this article (a complete cut off of Russian imports and lower substitution by other suppliers). Generally speaking, it is estimated that bigger reductions in consumption would be required in countries that are less well placed to substitute imports and which are more dependent on supplies from Russia. This group includes some Baltic and Eastern European countries, as well as Germany, which may have to make significant cuts in their consumption in order to maintain a stable level of reserves over the next two winters. On the other hand, countries with no access to the sea or low LNG import capacity, such as Poland or the Netherlands, may have to face reductions in consumption similar to those proposed by the European Commission. Finally, the countries that have been historically less dependent on Russian gas and which have greater LNG import capacity, including France, Italy, Spain, and Portugal, would find themselves in a more comfortable position over the coming winters without any need to reduce consumption, albeit with prices at historical highs.

A few months ago, Italy's outgoing prime minister and former ECB president Mario Draghi asked his fellow citizens rhetorically whether they preferred «air conditioning or peace» in Europe. It is clear that, while the effort will be asymmetrical, in times of war Europeans will have to use heating as a defensive weapon.

Javier Ibáñez de Aldecoa Fuster and Luís Pinheiro de Matos

Observed and required reduction in natural gas consumption

*Change versus the baseline level (%) **



Notes: ** See McWilliams and Zachmann (2022), «European Union demand reduction needs to cope with Russian gas cuts», Bruegel Blog, 7 July. The baseline level for natural gas consumption is the average over the period 2017 to 2021 (excluding 2020). The required reduction in consumption is that which would allow a stable level of reserves to be maintained for two winters. The authors estimate that the required reduction in consumption for the EU is 15%, somewhat higher than our estimate of 10%.*
Source: *CaixaBank Research, based on data from Eurostat and Bruegel estimates.*

4. 10% increase versus the baseline scenario (see first chart). The capacity to increase imports will depend on the availability of LNG on the global market, the installation of new storage and regasification plants in Europe and the continuation or otherwise of LNG imports from Russia. In this context, the Netherlands (the main hub for LNG imports in Europe) has two floating plants installed, while Germany plans to install two floating plants in 2022 and three additional plants in 2023-2024.
5. See McWilliams, Zachmann (2022). «European Union demand reduction needs to cope with Russian gas cuts». Bruegel Blog, 7 July. In their analysis, the authors work with a more pessimistic scenario than the one we use in this article: (i) they assume a 100% drop in Russian imports, versus a 75% drop in our scenario (due to the TurkStream and Yamal-Europe pipelines), (ii) they assume a flow of non-Russian imports that is 19% lower than in our scenario and (iii) they estimate that reserves in September would stand at 70% of capacity (vs. the 90% actually achieved).

Europe and the mission to decouple from Russian oil: an achievable goal in the short-term

Since the outbreak of the war in Ukraine, the West has set itself the objective of reducing its dependence on imports of fossil fuels (coal, oil and natural gas) from Russia.[1] In addition to a desire to reduce energy dependence on a single major supplier, this goal was set with the aim of weakening the Russian economy.[2] The first steps were taken by the US and Canada by imposing a veto on imports of Russian oil and gas in March. In Europe, however, it took longer to reach a decision, given that Europe has historically been Russia's main market for oil and gas exports (30% and 40%, respectively). Finally, in June, all EU Member States signed a sanctions package[3] which included a ban on the purchase, import or transfer of oil and certain petroleum products from Russia to the EU. The restrictions will be applied gradually, between December and February 2023, and will affect 90% of the crude oil and refined products which Russia delivers to the European bloc. However, a temporary exception was also agreed upon for imports of crude oil supplied via pipeline to some Member States (such as Hungary, the Czech Republic and Slovakia) which are highly dependent on Russian supplies and which lack viable alternatives in the short-term. In addition, at the end of September, the proposal for an eighth package of sanctions on Russia was discussed within the EU, which envisages setting a cap on the price of Russian oil.

OECD Europe: dependence on Russian oil

(%)

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

How have EU crude oil imports evolved?

During the first six months of the war, the EU remained the main buyer of Russian fossil fuels, although its share of imports of fossil fuels from Russia gradually reduced from 70% in March to 54% in August. This decline has been largely driven by a reduction in gas purchases, which intensified in August with the slowdown and subsequent cut-off of supplies through Nord Stream 1, as well as lower purchases of coal, which has been the subject of an embargo by EU countries also since August.[4] Similarly, in the case of oil, Europe's dependence on imports from Russia has been gradually declining. According to data from the International Energy Agency (IEA), the imports of Russian crude oil as a proportion of the total oil imports of European OECD countries have gone from a peak of 26% in March, driven by fears of supply shortages, to 15% in June, as a result of the financial and trade sanctions imposed on Russia. Thus, the share of Russian oil imports averaged 19.6% in the first half of 2022 (21.4% in the first half of 2021).

It should be noted that, with the lower purchases by Europe, there has been a reorganisation of the international trade in Russian fossil fuels. The latest data suggest that China has displaced Germany as the main buyer of Russian oil and coal. Also, countries such as India and Egypt, which imported hardly any oil from the Urals before the war, have emerged as major trading partners,[5] having imported more Russian oil than even the major euro area countries in the two-month period of July to August.

This redistribution in the trade of Russian crude oil flows has also been reflected in the evolution of Russia's income from the sale of fossil fuels to the rest of the world. Despite the Western restrictions and the moderation in global economic activity, the participation of these new buyers has allowed the country's daily revenues from oil exports to remain above pre-war levels in a context of high prices on the international markets, despite their decline compared to March when the Brent barrel price peaked (128 dollars).

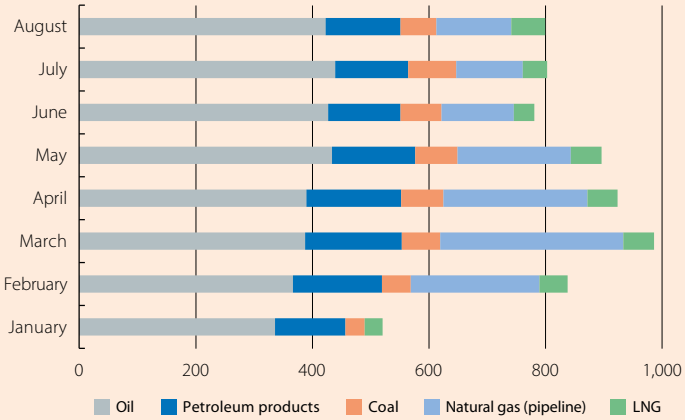
1. Russia is one of the leading global powers when it comes to the production and export of fossil fuels, ranking among the top three countries in the world.
2. Up until 2021, 40% of Russia's Federal Budget was fed by revenues generated by taxes and export tariffs on gas and oil.
3. Sixth EU sanctions package on Russia (June 2022). See Publications Office (europa.eu).
4. Fifth EU sanctions package on Russia (April 2022). See Publications Office (europa.eu)
5. According to data from the Centre for Research on Energy and Clean Air (CREA), India and Egypt are engaged in the practice of refining the oil they buy from Russia before then exporting it to the rest of the Western world, to countries such as the US and Australia.

Following the embargo on Russian oil, what options does Europe have?

EU efforts to reduce gas consumption are being offset by a larger aggregate consumption of oil and coal (8% and 7% year-on-year in the first half of the year, respectively, according to Eurostat). This increase has occurred in a context in which imports from Russia have been gradually reduced and even banned, as in the case of coal, so purchases of energy supplies from other countries have increased. For example, South Africa and Colombia have become the main suppliers of coal. In the case of oil, meanwhile, in July daily imports from Saudi Arabia and Iraq increased by 90% compared to January 2022, while imports from the US were at peak levels. In the coming months, dependence on Russian oil will continue to be reduced: it is estimated that with the embargo on Russian crude oil coming into force, by the end of this year EU oil imports from Russia will fall to 600,000 barrels a day, compared with 3 million barrels a day prior to the conflict and 2.3 million in July. Despite this, all the indicators suggests that Europe's oil needs will be met in the short and medium-term. Not in vain, unlike gas, which is critically dependent on physical infrastructure for its transportation, oil can be transported easily by sea, which makes it easier to replace Russian imports in the short-term. In addition to the supply of oil from OPEC countries and the US, international associations such as the IEA have shown their willingness to re-release some of their strategic crude oil reserves, as they did at the beginning of the war. As for the implications for prices, the fact that there are alternatives on the supply side does not necessarily mean we will see them fall. Indeed, OPEC countries have expressed a desire to maintain prices at around 80 to 90 dollars a barrel, which is above the historical average and will keep the upward pressure on global inflation rates.

Russia: fossil fuel revenues in 2022

(EUR millions per day)



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

In the longer term, it is clear that the energy crisis has served as an incentive within the EU to accelerate the transition to energy sources that are more environmentally friendly and less dependent on fossil fuels. However, this is seen as more of a medium-term goal, suggesting that crude oil imports will remain a major component of Europe's energy needs for several years to come.

Beatriz Villafranca

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