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MONTHLY REPORT • ECONOMIC AND FINANCIAL MARKET OUTLOOK

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ECONOMIC & FINANCIAL ENVIRONMENT

FINANCIAL MARKETS
Stormy waters in the UK, a warning to seafarers

INTERNATIONAL ECONOMY
US: controlled slowdown or hard landing in the housing market?

SPANISH ECONOMY
Real-time economics: the new portal by CaixaBank Research

The public accounts in 2023: increase in revenues and also in expenditure

DOSSIER: 2023 OUTLOOK

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Outlook for Spain: 2023, a year fraught with challenges

CaixaBank Research

MONTHLY REPORT - ECONOMIC AND FINANCIAL MARKET OUTLOOK
November 2022

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Geopolitics, geopolitics and, for dessert, geopolitics

Economic prosperity and the transformation of societies has been indisputably linked to technological revolutions. Today, in the midst of the Fourth Industrial Revolution and an intense geopolitical battle that is likely to lead to a multi-polar world, the major economies must choose their game-play strategy. This is a strategy that will be developed on many fronts, and where we are already seeing a prominent role for the public sector, even in countries which for decades had most clearly exemplified economic liberalism, such as the US.

Indeed, a few days ago, the Biden administration increased restrictions on the purchase of American chips by Chinese companies and individuals. Limiting the use of advanced technologies is an effective way to curb other countries' growth capacity, at least in the short term. And the US has made clear that this technological constraint is one of the practices it will employ to curtail the geostrategic importance of China – a country with a markedly different political, social and economic system from that advocated by the Western world.

In Europe, first the pandemic and then the war in Ukraine have highlighted our great dependence on Chinese manufacturing and Russian energy. The goal now is to reduce this dependency at all costs, as the policy of «strategic autonomy» or «strategic sovereignty» advocated by the EU spreads beyond the spheres of security and defence which it initially encompassed.

Today, the policy of greater autonomy also encompasses the need to bolster the resilience of global supply chains by reducing dependence on particular foreign products and/or countries, especially those that are «less friendly», as well as the need to defend democratic values in all practices of the Union.

These are spheres of action in which the EU is working not only individually but also in conjunction with the US, through instruments such as the Trade and Technology Council, launched in June 2021. In general terms, this Council has been established as a forum for both regions to discuss and agree on a common agenda on aspects in the spheres of trade and technology, always from a perspective that supports the democratic values they share. More specifically, one of the Council's working groups focuses on enhancing the security of global value chains, after the COVID-19 pandemic highlighted their vulnerabilities.

A key question now is whether the EU will continue its more moderate approach in its relations with the rest of the world (including China) in order to achieve its objectives of strategic autonomy, or whether, on the contrary, it will adopt a more belligerent position, hand in hand with its renewed transatlantic ally. While it is still too early to know the position our Union will take, we can begin to see a certain shift towards a greater tolerance for confrontation.

A more confrontational attitude in areas such as technology or trade could have enormous negative effects in terms of short- and medium-term economic growth. After all, we live in a highly globalised world, more than at any other time in history. In the case of the EU, for example, the European economy is more dependent today on China and its «electronic footprint» than it is on Russia's «energy footprint». And in the case of the US, the links with China in the electronics or machinery sector are even deeper than those of the EU with the Asian giant.

A confrontational position can have significant unwanted effects on the economy. Yet, what would it entail for the future of our liberal and democratic political model if the West gave a weak response to the current siege of the international liberal order?

Clàudia Canals
November 2022

Chronology

OCTOBER 2022

5 OPEC agrees to cut crude oil production by 2 million barrels a day compared to August 2022 levels.
23 Xi Jinping receives a third term as general secretary of the Chinese Communist Party.
27 The ECB raises official interest rates by 75 bps.

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.

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.

Agenda

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).

DECEMBER 2022

2 Spain: rating Fitch.
Spain: registration with Social Security and registered unemployment (November).
Portugal: industrial production (October).
13-14 Federal Open Market Committee meeting.
15 Governing Council of the European Central Bank meeting.
15-16 European Council meeting.
16 Spain: quarterly labour cost survey (Q3).
23 Spain: quarterly national accounts (Q3).
Spain: loans, deposits and NPL ratio (October and Q3).
Spain: balance of payments and NIIP (Q3).
Spain: state budget execution (November).
Portugal: home prices (Q3).
Portugal: household savings rate (Q3).
29 Portugal: NPL ratio (Q3).
30 Spain: CPI flash estimate (December).
Spain: household savings rate (Q3).
Portugal: CPI flash estimate (December).

Turning points

The global economy is in the midst of a transition, as it leaves behind the resilient growth of the summer and slips into the decline in economic activity anticipated by the rapid deterioration in economic agents' expectations (which was particularly pronounced in October) and tightening financial conditions. Moreover, there are risks that could move the needle, such as China's zero-COVID policy and the geopolitical tensions.

The key for the coming months will be to reach the turning point in the pattern of inflation, at which point an end will be in sight for the most aggressive cycle of interest rate hikes in the last 40 years, and this in turn ought to reduce volatility in the financial markets. For the time being, however, there are no signs of this happening and the barrage of negative surprises continues (with some exceptions, such as Spain): euro area inflation rose in October to 10.7%, driven by sharp rallies in countries such as Germany (11.6%), Italy (12.8%) and the Netherlands (16.8%). Almost two years after the inflationary process began, we continue to witness new peaks month after month, while the various supply-side shocks have been filtering through to all sectors, as demonstrated by the fact that around 60% of the components of the CPI basket in the euro area (45% in the case of the core CPI) are showing annual price increases in excess of 5%. However, most importantly, we are still a long way from understanding the mutation that inflation is currently undergoing and its potential medium-term implications for growth, equilibrium interest rates, and so on.

In the short term, the incipient signs of falling transport costs (containers, etc.) and the recovery of inventories could be an indication that the bottlenecks are gradually clearing, and this would pave the way for improvements in the early stages of the price formation process, which is precisely where the problems began two years ago. In addition, gas price futures for 2023 have fallen by 25% in recent weeks and reflect progress in the energy policy responses in Europe and the high levels of gas reserves reached (95% of storage capacity).

In other words, the turning point in the pattern of headline inflation in industrialised countries should not lie too far away, as the improvement in the supply-side restrictions will be joined by the intense cooling of economic activity anticipated over the next six months. The big question is how quickly prices will return to central banks' target rates. Inflation expectations according to the financial markets anticipate that inflation could fall below 5% from next summer in Europe and the US, but according to these readings it will be almost another two years before it approaches the 2% mark. Thus, the first section of the path towards the target could be covered within the next six months, but from there onwards the path will become steeper, taking into account structural factors such as de-globalisation, geopolitical risk and the energy transition. All this could test monetary authorities' tolerance of deviations of 1 or 2 pps relative to the target rate, especially if there is a high price to pay in terms of jobs or risks to financial stability. It could even reopen the debate regarding the appropriateness of a set of targets which were designed in an economic context quite different from the current one.

For now, following the doubts in 2021, global interest rates have risen by 3 pps in 2022, placing them in restrictive territory in most cases. The question even at this point in the year is what effects this sudden monetary tightening will have on economic activity and employment in the short term, bearing in mind that the time it takes for monetary policy to affect real variables may also be changing. For this reason, going forward we can expect to see a moderation in the intensity of the interest rate hikes, which will need to be properly coordinated with the balance sheet reduction programmes, in an environment with the financial markets still on tenterhooks. The most important thing, however, will be to gain a proper understanding of what lies behind the recent inflation dynamics, to monitor the normalisation path towards target rates, and to try to anticipate whether we will see a regime change in price behaviour once the storm dissipates – above all, to avoid unnecessary and painful overreactions.

José Ramón Díez

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

Financial markets

	Average 2000-2007	Average 2008-2019	2020	2021	2022	2023	2024
INTEREST RATES							
Dollar							
Fed funds (upper limit)	3.43	0.81	0.25	0.25	4.50	4.75	3.50
3-month Libor	3.62	1.01	0.23	0.21	4.75	4.75	3.50
12-month Libor	3.86	1.48	0.34	0.52	4.90	4.50	3.50
2-year government bonds	3.70	1.04	0.13	0.62	4.20	4.00	3.00
10-year government bonds	4.70	2.57	0.93	1.45	3.80	3.50	3.00
Euro							
ECB depo	2.05	0.20	–0.50	–0.50	2.00	2.50	2.00
ECB refi	3.05	0.75	0.00	0.00	2.50	3.00	2.50
€STR	–	–0.54	–0.56	–0.58	1.92	2.47	2.17
1-month Euribor	3.18	0.50	–0.56	–0.60	2.03	2.53	2.23
3-month Euribor	3.24	0.65	–0.54	–0.58	2.14	2.59	2.29
6-month Euribor	3.29	0.78	–0.52	–0.55	2.35	2.66	2.40
12-month Euribor	3.40	0.96	–0.50	–0.50	2.56	2.73	2.51
Germany							
2-year government bonds	3.41	0.35	–0.73	–0.69	1.75	2.25	2.25
10-year government bonds	4.31	1.54	–0.57	–0.31	2.00	2.70	2.70
Spain							
3-year government bonds	3.62	1.69	–0.57	–0.45	2.23	2.77	2.80
5-year government bonds	3.91	2.19	–0.41	–0.25	2.47	3.04	3.05
10-year government bonds	4.42	3.17	0.05	0.42	3.30	3.80	3.70
Risk premium	11	164	62	73	130	110	100
Portugal							
3-year government bonds	3.68	3.33	–0.61	–0.64	2.41	3.02	3.08
5-year government bonds	3.96	3.94	–0.45	–0.35	2.70	3.28	3.30
10-year government bonds	4.49	4.68	0.02	0.34	3.35	3.85	3.75
Risk premium	19	314	60	65	135	115	105
EXCHANGE RATES							
EUR/USD (dollars per euro)	1.13	1.26	1.22	1.13	1.00	1.05	1.10
EUR/GBP (pounds per euro)	0.66	0.84	0.90	0.85	0.87	0.86	0.85
OIL PRICE							
Brent ($/barrel)	42.3	80.1	50.2	74.8	95.0	94.0	83.0
Brent (euros/barrel)	36.4	62.5	41.3	66.2	95.0	89.5	75.5

Forecasts

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

International economy

	Average 2000-2007	Average 2008-2019	2020	2021	2022	2023	2024
GDP GROWTH							
Global	4.5	3.3	–3.0	6.0	3.1	2.7	3.3
Developed countries	*2.6*	*1.4*	*–4.4*	*5.2*	*2.4*	*1.0*	*1.6*
United States	2.7	1.7	–2.8	6.0	1.6	1.1	1.7
Euro area	2.2	0.8	–6.2	5.3	3.1	0.2	1.6
Germany	1.6	1.2	–4.1	2.6	1.6	–0.2	1.2
France	2.2	1.0	–7.9	6.8	2.5	0.6	1.5
Italy	1.5	–0.3	–9.1	6.6	3.4	–0.2	1.1
Portugal	1.5	0.5	–8.3	5.5	6.3	0.6	2.3
Spain	3.7	0.6	–11.3	5.5	4.5	1.0	1.9
Japan	1.4	0.4	–4.6	1.7	1.5	1.7	1.2
United Kingdom	2.6	1.3	–9.3	7.4	3.5	–1.3	–0.4
Emerging and developing countries	*6.5*	*4.9*	*–1.9*	*6.6*	*3.5*	*4.0*	*4.5*
China	10.6	8.0	2.2	8.1	3.0	5.2	5.0
India	7.2	6.8	–6.7	9.0	7.3	6.0	6.7
Brazil	3.6	1.6	–3.9	4.6	1.8	0.9	1.8
Mexico	2.4	1.9	–8.1	4.8	1.9	1.4	2.5
Russia	7.2	1.3	–2.7	4.8	–8.1	–3.2	3.0
Turkey	5.5	4.5	1.9	11.4	3.1	3.0	3.2
Poland	4.2	3.6	–2.1	6.0	5.6	2.6	3.4
INFLATION							
Global	4.1	3.7	3.2	4.7	8.6	6.0	4.1
Developed countries	*2.1*	*1.6*	*0.7*	*3.1*	*7.1*	*4.0*	*2.0*
United States	2.8	1.8	1.3	4.7	8.0	3.4	2.0
Euro area	2.2	1.4	0.3	2.6	8.1	5.1	2.1
Germany	1.7	1.4	0.4	3.2	8.2	5.2	2.2
France	1.9	1.3	0.5	2.1	5.9	4.1	2.0
Italy	2.4	1.4	–0.1	1.9	7.7	4.8	2.0
Portugal	3.1	1.1	0.0	1.3	7.9	5.7	2.2
Spain	3.2	1.3	–0.3	3.1	9.1	4.5	2.3
Japan	–0.3	0.4	0.0	–0.2	2.2	1.9	1.0
United Kingdom	1.6	2.3	0.9	2.6	8.9	5.5	2.3
Emerging countries	*6.7*	*5.6*	*5.1*	*5.9*	*9.7*	*7.4*	*5.6*
China	1.7	2.6	2.5	0.9	2.0	1.9	1.6
India	4.5	7.3	6.6	5.1	6.6	5.3	5.0
Brazil	7.3	5.7	3.2	8.3	10.5	5.1	4.0
Mexico	5.2	4.2	3.4	5.7	7.2	4.7	3.8
Russia	14.2	7.9	3.4	6.7	14.7	7.5	6.8
Turkey	22.6	9.6	12.3	19.6	69.3	36.4	29.0
Poland	3.5	2.0	3.7	5.2	11.2	7.0	3.7

Forecasts

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

Spanish economy

	Average 2000-2007	Average 2008-2019	2020	2021	2022	2023	2024
Macroeconomic aggregates							
Household consumption	3.6	0.0	–12.4	6.1	–0.1	–0.7	2.5
Government consumption	5.0	1.1	3.5	2.9	–1.3	1.0	0.7
Gross fixed capital formation	5.6	–1.4	–9.7	0.9	5.1	1.8	2.0
Capital goods	4.9	0.1	–13.3	6.3	5.0	–1.3	3.0
Construction	5.7	–2.9	–10.2	–3.7	4.9	3.9	1.4
Domestic demand (vs. GDP Δ)	4.6	–0.2	–8.6	4.3	0.7	0.2	1.9
Exports of goods and services	4.7	2.9	–19.9	14.4	18.5	2.6	1.9
Imports of goods and services	7.0	0.2	–14.9	13.9	7.0	0.7	2.0
Gross domestic product	**3.7**	**0.6**	**–11.3**	**5.5**	**4.5**	**1.0**	**1.9**
Other variables							
Employment	3.2	–0.4	–6.8	6.6	3.2	0.5	1.4
Unemployment rate (% of labour force)	10.5	19.5	15.5	14.8	12.8	13.1	12.8
Consumer price index	3.2	1.3	–0.3	3.1	9.1	4.5	2.3
Unit labour costs	3.0	0.6	7.7	0.3	0.5	3.2	2.1
Current account balance (% GDP)	–5.9	–0.3	0.6	1.0	0.5	1.3	1.6
External funding capacity/needs (% GDP)	–5.2	0.1	1.1	1.9	1.5	2.3	2.5
Fiscal balance (% GDP)[1]	0.3	–6.5	–10.3	–6.9	–4.5	–4.3	–3.6

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

Forecasts

Portuguese economy

	Average 2000-2007	Average 2008-2019	2020	2021	2022	2023	2024
Macroeconomic aggregates							
Household consumption	1.7	0.5	–6.9	4.7	5.0	0.5	2.0
Government consumption	2.3	–0.3	0.4	4.6	2.0	–0.2	–0.2
Gross fixed capital formation	–0.4	–0.7	–2.2	8.7	1.7	3.8	8.4
Capital goods	3.2	2.6	–5.4	13.9	–	–	–
Construction	–1.5	–2.6	1.0	5.5	–	–	–
Domestic demand (vs. GDP Δ)	1.3	0.1	–5.3	5.8	4.0	0.9	2.9
Exports of goods and services	5.3	4.0	–18.8	13.5	16.5	4.3	6.6
Imports of goods and services	3.6	2.7	–11.8	13.3	10.1	5.0	7.8
Gross domestic product	**1.5**	**0.5**	**–8.3**	**5.5**	**6.3**	**0.6**	**2.3**
Other variables							
Employment	0.4	–0.5	–1.9	2.8	1.6	–0.3	0.5
Unemployment rate (% of labour force)	6.1	11.4	7.0	6.6	5.9	6.4	6.1
Consumer price index	3.1	1.1	0.0	1.3	7.9	5.7	2.2
Current account balance (% GDP)	–9.2	–2.9	–1.2	–1.1	–2.7	–2.3	–1.7
External funding capacity/needs (% GDP)	–7.7	–1.6	0.1	0.7	2.1	2.1	2.3
Fiscal balance (% GDP)	–4.6	–5.1	–5.8	–2.9	–1.5	–1.3	–0.7

Forecasts

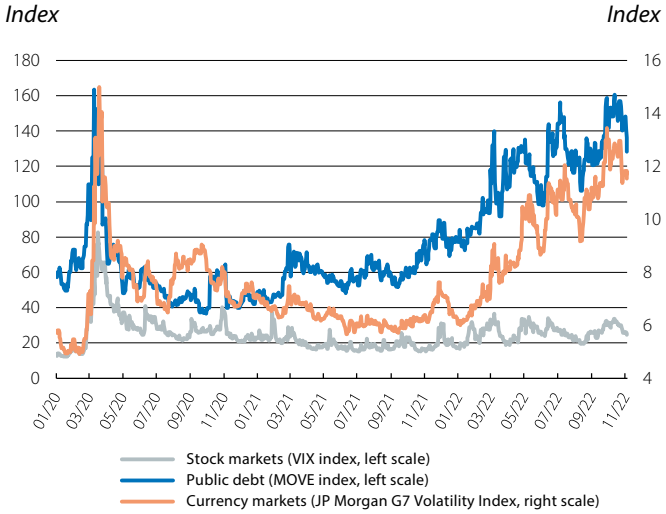
Weeks of ups and downs in the financial markets

October: a negative first half; a positive second half. Q4 began with a continuation of the tone of volatility and uncertainty in the financial markets, albeit with an improvement during the course of October. The first few weeks of the month were marked by a renewed tightening of financial conditions, driven by signs of persistent inflationary pressures, escalating geopolitical tensions and the crisis triggered by the announcement of a fiscal stimulus plan in the United Kingdom. Subsequent sessions saw a marked improvement in investor sentiment, allowing the main risk assets to close October with gains. Among other factors, the optimism of the second half of the month was driven by the possibility that, in light of the marked slowdown reflected in the economic data, the central banks might decide to reign in the pace of their rate hikes. However, this prospect faded after the Fed's meeting in the US in early November.

United Kingdom, in the eye of the storm. The resolution of the political crisis in the UK was also a factor favouring risk appetite in the second half of October. The financial markets welcomed Rishi Sunak's election as prime minister, and in particular his decision to keep Jeremy Hunt as Chancellor. Expectations that the new government would remain on the path of fiscal rectitude, following the cancelation of the measures announced by the recently deposed Liz Truss, allowed most of the losses in the pound sterling and British bonds to be recovered. In our view, this episode of financial stress in the United Kingdom serves as a warning that, in a context of tightening monetary policy, the margin for manoeuvre of fiscal policy will once again be heavily influenced by the scrutiny of the financial markets (see the Focus «Stormy waters in the UK, a warning to seafarers» in this same report).

The ECB maintains the pace of its rate hikes and assesses its balance sheet reduction strategy, which will be discussed at the upcoming December meeting according to President Christine Lagarde. Thus, the official rate on the deposit facility increased in October by 75 bps to 1.50%. Lagarde confirmed that the next adjustments will be decided upon meeting by meeting and on the basis of the economic data. In addition, the ECB decided to change the conditions applicable to TLTROs beginning in November. Overall, the dovish tone of the last meeting led to a downward revision in implicit rates in the money markets and a decline in sovereign debt yields, although these movements were partially reversed at the beginning of November. In Italy, the risk premium has fallen to around 210 bps (on 4 November), following the formation of the new government under Giorgia Meloni, who confirmed the intention not to deviate from the reform programme agreed with Brussels. Another positive factor

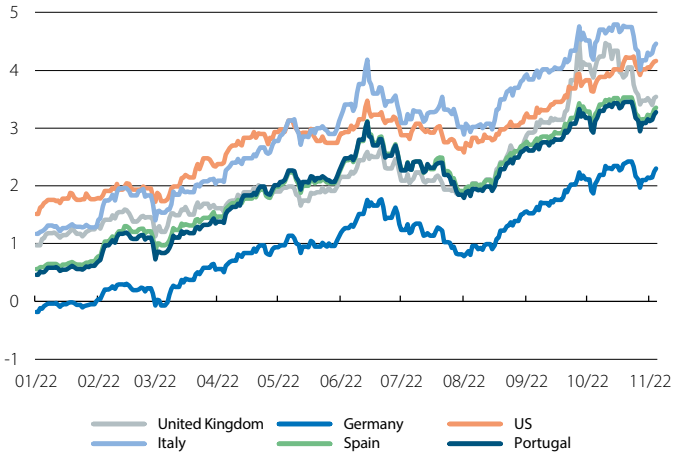
Implicit volatility in the financial markets



Note: *Data as of 4 November.*
Source: *CaixaBank Research, based on data from Bloomberg.*

Yield on 10-year sovereign debt

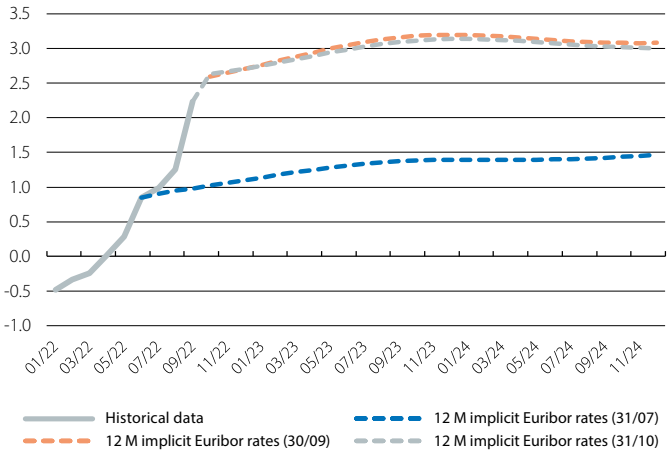
(%)



Note: *Data as of 4 November.*
Source: *CaixaBank Research, based on data from Bloomberg.*

12-month Euribor, historical data and implicit rates in the money markets

(%)



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

for peripheral debt was the announcement that the German government would be in favour of a new loan fund financed with EU debt.

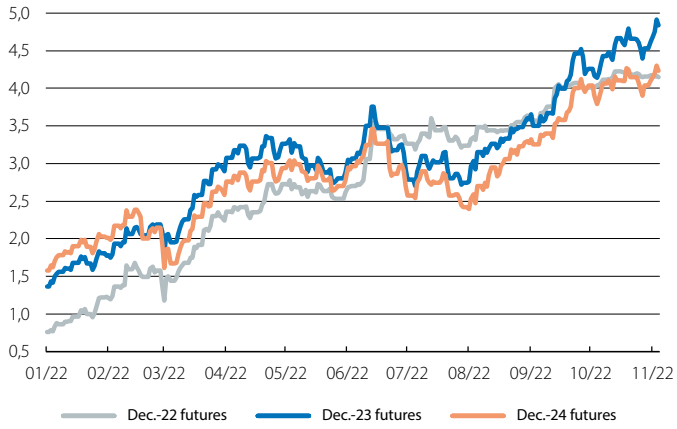
The Fed also raised rates by 75 bps, although it anticipates a slower pace of rate hikes going forward. At its meeting in early November, the central bank decided to maintain the pace of its rate hikes in order to place the official interest rate in the 3.75%-4.00% range. In his his official statement, the Fed chair Jerome Powell emphasised that the central bank could temper the pace of its rate adjustments as early as December. That said, he also made clear that it is too early to consider a pause in rate hikes and that they will most likely have to raise interest rates above the level envisaged at the September meeting (4.50%-4.75%, according to the dot plot). Other central banks in some advanced countries had already announced lower rate hikes, including in Canada (50 bps to 3.75%), Norway (25 bps to 2.50%) and Australia (25 bps to 2.85%). Meanwhile, the Bank of Japan reiterated its intention to maintain the ultra-accommodative bias in its monetary policy, accentuating the yen's weakness against the dollar.

(Temporary) rally in the euro and equities, except in China. The increased risk appetite in the second half of October was reflected in a weakening of the US dollar, which ended October almost at parity with the euro. However, this pattern was reversed in early November after the Fed's meeting. The equity indices, meanwhile, shortened the declines registered so far this year. In addition to the aforementioned factors, these assets found support in the corporate earnings season which, with the exception of some sectors (such as technology), did not deviate far from the expectations of the consensus. The exception was China: the benchmark stock market indices in Shanghai and Hong Kong registered significant losses in October following a ratcheting up of the authoritarian discourse during the 20th National Congress of the Chinese Communist Party and the deteriorating health situation.

The gas bubble deflates, albeit with ups and downs. Favourable weather in the northern hemisphere, the increase in gas inventories in Europe (up to 95% of total reserve capacity), as well as an increase in the supply of liquefied natural gas from the US favoured a reduction in European gas prices (the Dutch TTF) to four-month lows at the end of October, although this trend reversed slightly at the beginning of November. The implementation of measures to cut usage in most EU countries, coupled with progress in the negotiations to establish a cap on the price of gas, also contributed to this correction. The price of a barrel of Brent oil, in contrast, ended October around 10% up, despite remaining highly volatile. In addition to the easing of the exchange rate against the dollar, the prospect of a possible relaxation of the zero-COVID policy in China improved the outlook for future crude oil demand, in a context marked by production cuts by oil-producing countries and as the date for the application of the EU embargo on Russian oil in December draws closer.

Federal Reserve benchmark interest rate futures

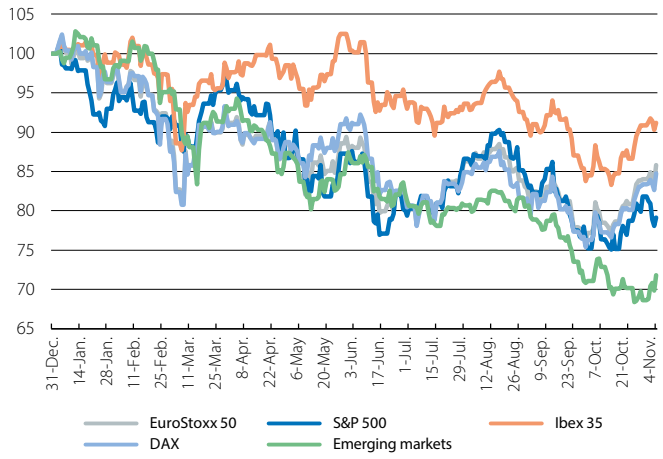
(%)



Note: *Data as of 4 November.*
Source: *CaixaBank Research, based on data from Bloomberg.*

Main stock market indices

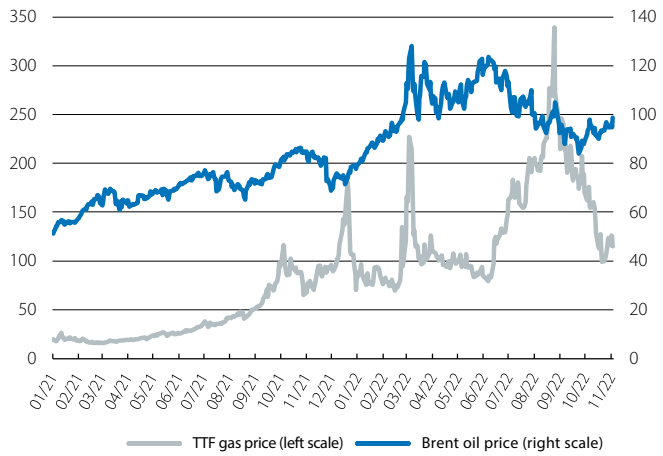
(100 = 31 December 2021)



Note: *Data as of 4 November.*
Source: *CaixaBank Research, based on data from Bloomberg.*

Oil and gas prices

(Euros per MWh) *(Dollars per barrel)*



Note: *Data as of 4 November.*
Source: *CaixaBank Research, based on data from Bloomberg.*

Stormy waters in the UK, a warning to seafarers

An inevitable consequence of the monetary policy normalisation and tightening process is that, after years of anaesthesia through the central banks' battery of stimulus policies, the markets regain some of their power to scrutinise – and thus to discipline – the design and execution of economic policy, both in the monetary sphere and, above all, in the fiscal sphere.

Unsurprisingly, in a context of high volatility and low visibility over the economic scenario, any announcement that raises doubts over the sustainability of public finances or increases the likelihood of default is punished by the «market vigilantes» with heavy losses in the benchmark assets involved – a risk which, in an extreme case, could threaten the stability of the financial system.

We thus find ourselves in a period of extreme fragility in which, more than ever, it seems essential to avoid any misalignment between fiscal policy and monetary policy in order to minimise the risk of financial panic. The fact that the latest incident of this kind took place in the United Kingdom – a country with deeply liquid markets and whose currency still serves as an international benchmark – serves as a stark warning to seafarers that the seas are rough and the skies are clouded.

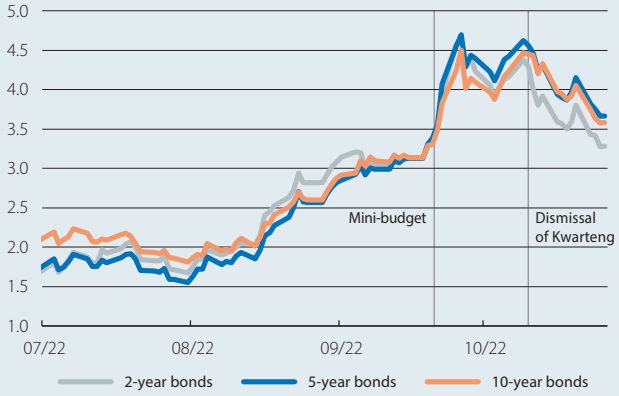
The United Kingdom and its short-lived fiscal stimulus

The Growth Plan of the (former) prime minister Liz Truss, announced in the September mini-budget, aimed to tackle the crisis caused by rising energy costs by approving the biggest tax cut in the country's history: 146 billion pounds up to 2027. This figure would be achieved mainly by cancelling the already-announced rise in corporation tax to 25% (currently at 19%, well below the OECD average of 23.5%) and by cutting the rate applicable in some personal income tax brackets. It also proposed cancelling the increase in national insurance (social security) contributions approved by Boris Johnson's cabinet. In addition, the plan included additional specific measures aimed at mitigating the impact of the rise in energy bills: the Energy Bill Relief Scheme, up until March 2023, and the Energy Price Guarantee, up until 2024.[1]

All in all, the fiscal strategy aimed to raise the trend growth of the British economy to 2.5%, from the 1.5% registered in recent years. Its Achilles heel, however, was that it failed to set out compensatory measures to counter the potential deterioration in the fiscal metrics. Indeed, the UK's Institute for Fiscal Studies warned that

United Kingdom: yields on government bonds

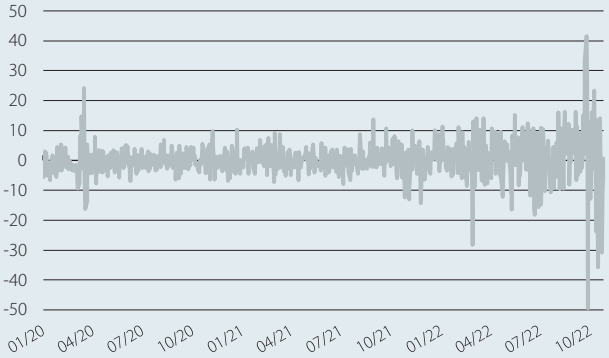
(%)



Note: *Data as of 27 October.*
Source: *CaixaBank Research, based on data from Bloomberg.*

United Kingdom: day-to-day change in sovereign debt yields

(bps)



Notes: *Yield on 10-year bonds. Data as of 27 October.*
Source: *CaixaBank Research, based on data from Bloomberg.*

the debt-to-GDP ratio would increase to concerning levels and could even exceed 94% of GDP by 2027, compared to 84% in 2021.[2] In addition, the targeted measures aimed at addressing the rising energy prices would push the budget deficit to above 9.0% of GDP in the 2022-2023 fiscal year (versus the 4.0% estimated by the Office for Budget Responsibility in April).

Doubts about the Truss cabinet's commitment to the stability of the public finances, coupled with fears that inflation could soar, led to a sharp negative reaction from the financial markets: the pound slumped to its lowest value against the dollar since the 1980s, while debt securities fell so spectacularly that there were even fears over the stability of private pension funds, which were

1. Households' energy bills would be limited to 2,500 pounds a year up until 2024, which could cost around 100 billion over the next two years.

2. See (2022). «Reversing NICs and corporation tax rises would leave debt on an unsustainable path». The Institute for Fiscal Studies, September.

forced to dump assets in order to meet margin calls and sure up their asset portfolios (see first and second charts). Against this backdrop, the Bank of England was forced to intervene by announcing a government bond-buying programme with no limit in value, but with a cut-off date of 14 October, although this still failed to allay fears over the stability of the medium-term bond markets.

The insurmountable pressure from the markets, coupled with criticism of the plan from institutions such as the IMF, forced a change of course: Kwasi Kwarteng, the Chancellor of the Exchequer behind the plan, was sacked in mid-October, and his replacement, Jeremy Hunt, presented a proposal which reversed 113 billion of the 146 billion in tax cuts initially announced.

This U-turn helped calm the markets and allowed the central bank to return to its monetary policy normalisation strategy. However, the reputational damage was done and Liz Truss herself was compelled to resign, making her tenure as prime minister the shortest in British history. Her recently elected replacement, Rishi Sunak, opted to keep Jeremy Hunt as chancellor and endorsed the strategy of greater fiscal belt-tightening, although the true size of the fiscal gap remains unclear in the face of the deteriorating economic outlook and rising financing costs.

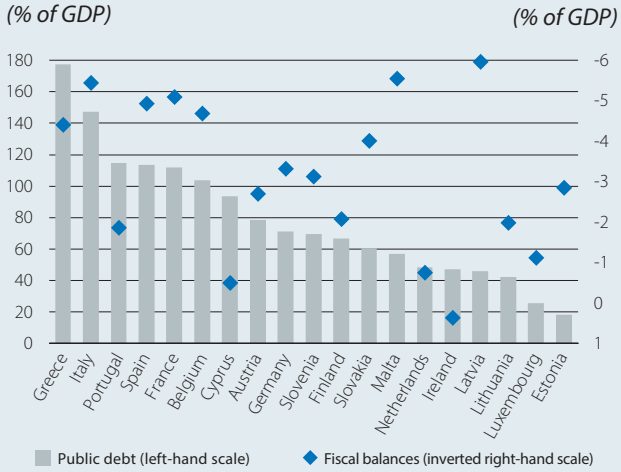
Europe, the weakest link among advanced economies

Putting emerging markets aside, in advanced economies the risks of a British-style financial turmoil tend to be higher in those countries which have greater external financing needs (reflected in current-account deficits), a less robust fiscal position (see third chart) and a less favourable economic growth outlook.

Among these, some European countries look particularly vulnerable, as they face the energy crisis with a marked upturn in inflation, public accounts that are exhausted by the pandemic, and a particularly weak economic outlook in a context of global economic cooling.

Since October last year, governments have been implementing various measures aimed at protecting households and businesses, which we estimate represent around 5.0% of GDP to date on average for the euro area, albeit with significant differences from country to country. Nevertheless, the deteriorating situation since the summer is putting pressure on them to implement additional measures, which, if done indiscriminately, could prove counter-productive. It is not unreasonable to imagine that excessively expansionary fiscal measures could exacerbate the inflationary pressures, and this would likely force the ECB to approve more aggressive rate hikes, leading to higher financing costs and a sharper cooling of the economy.

Euro area: public debt and fiscal balance in 2022



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

In this regard, and in line with the IMF's statements in its Fiscal Monitor, the fiscal policies adopted to alleviate the current crisis must be designed so as to interfere as little as possible with the central banks' objective, while also taking into account the vulnerabilities arising from large public debts. Moreover, the measures implemented must be agreed upon by all countries in order to prevent those with greater fiscal room for manoeuvre from adopting more far-reaching measures.[3]

Among euro area countries, Italy remains on investors' radar, as it is currently in the process of forming a new government following the landslide victory of the right-wing coalition, led by the party of Giorgia Meloni. The new cabinet inherits a difficult financial situation: alongside Germany, Italy is one of the countries hardest hit by the cut-off of Russian gas. The country appears to be in recession, after more than a decade of low economic growth.

In this regard, the Meloni administration faces the challenge of implementing measures to alleviate the growing social unrest, but which at the same time can ensure the stability of the fiscal accounts in order to bring public debt, which stood at 150% of GDP in 2021, down over the coming years. It must also keep up with the reform agenda agreed upon by the EU in order to continue receiving EU funds and, implicitly, to continue to enjoy the ECB's protection through its anti-fragmentation TPI instrument, if necessary. *Buona fortuna, Giorgia!*

Antonio Montilla and Rita Sánchez

3. Germany is working on an emergency plan with a budget of some 200 billion euros (over 5.0% of GDP), which has arisen some criticism among its European partners given that, in the absence of a common fiscal tool, the plan increases the risk of fragmentation in the bloc.

Interest rates (%)

	31-October	30-September	Monthly change (bp)	Year-to-date (bp)	Year-on-year change (bp)
Euro area					
ECB Refi	2.00	1.25	75	200.0	200.0
3-month Euribor	1.70	1.17	53	227.6	227.7
1-year Euribor	2.63	2.56	7	313.1	311.2
1-year government bonds (Germany)	2.08	1.71	37	271.7	276.9
2-year government bonds (Germany)	1.94	1.76	18	255.6	259.0
10-year government bonds (Germany)	2.14	2.11	3	231.9	231.0
10-year government bonds (Spain)	3.23	3.29	–6	266.0	270.4
10-year government bonds (Portugal)	3.15	3.18	–3	268.3	272.3
US					
Fed funds (upper limit)	3.25	3.25	0	300.0	300.0
3-month Libor	4.46	3.75	71	425.1	432.1
12-month Libor	5.45	4.78	67	486.5	509.1
1-year government bonds	4.60	3.93	67	422.6	444.7
2-year government bonds	4.48	4.28	20	375.0	401.7
10-year government bonds	4.05	3.83	22	253.8	244.4

Spreads corporate bonds (bps)

	31-October	30-September	Monthly change (bp)	Year-to-date (bp)	Year-on-year change (bp)
Itraxx Corporate	114	135	–22	65.7	63.1
Itraxx Financials Senior	123	148	–25	68.4	65.8
Itraxx Subordinated Financials	220	272	–51	112.1	110.1

Exchange rates

	31-October	30-September	Monthly change (%)	Year-to-date (%)	Year-on-year change (%)
EUR/USD (dollars per euro)	0.988	0.980	0.8	–13.1	–14.9
EUR/JPY (yen per euro)	146.970	141.880	3.6	12.3	11.0
EUR/GBP (pounds per euro)	0.862	0.878	–1.8	2.5	1.6
USD/JPY (yen per dollar)	148.710	144.740	2.7	29.2	30.4

Commodities

	31-October	30-September	Monthly change (%)	Year-to-date (%)	Year-on-year change (%)
CRB Commodity Index	549.6	559.5	–1.8	–5.0	–3.3
Brent ($/barrel)	94.8	88.0	7.8	21.9	15.7
Gold ($/ounce)	1,633.6	1,660.6	–1.6	–10.7	–7.7

Equity

	31-October	30-September	Monthly change (%)	Year-to-date (%)	Year-on-year change (%)
S&P 500 (USA)	3,872.0	3,585.6	8.0	–18.8	–16.9
Eurostoxx 50 (euro area)	3,617.5	3,318.2	9.0	–15.8	–16.1
Ibex 35 (Spain)	7,956.5	7,366.8	8.0	–8.7	–11.9
PSI 20 (Portugal)	5,718.3	5,302.8	7.8	2.7	0.5
Nikkei 225 (Japan)	27,587.5	25,937.2	6.4	–4.2	–6.5
MSCI Emerging	848.2	875.8	–3.2	–31.2	–32.8

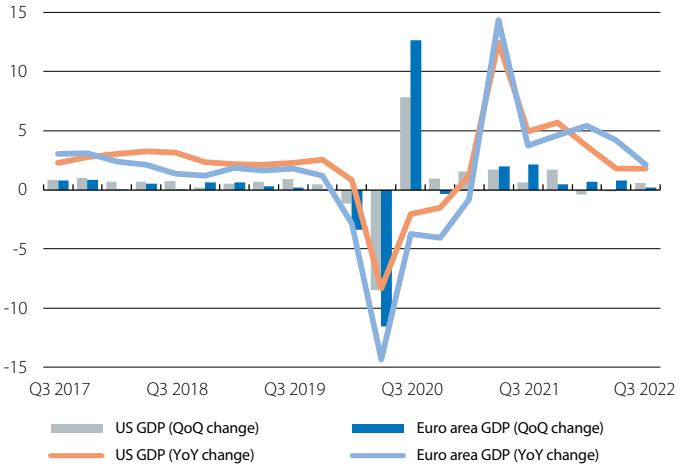
Where is the eye of the storm?

The impact of monetary policy and the energy crisis is beginning to be felt in advanced economies. Euro area GDP growth in Q3 2022 was better than expected, but the likelihood of contractions in the coming months is high. Specifically, GDP grew by 0.2% in quarter-on-quarter terms (*vs*. 0.8% in Q2), corresponding to a year-on-year increase of 2.1%. The most positive surprises came from the German economy, which managed to avoid a contraction with 0.3% quarter-on-quarter growth, and from Italy, which registered 0.5% quarter-on-quarter growth in the quarter. This stamina in some of the euro area's biggest economies can be explained by the strong performance of the services sector over the summer. However, although the breakdown by component is not yet available, the main economic activity indicators suggest a declining trend during the course of the quarter. In the US, GDP grew by 1.8% year-on-year and by 0.6% compared to the previous quarter, following two consecutive quarters of decline in Q1 and Q2 (–0.4% and –0.1% quarter-on-quarter, respectively). Although the overall figure was positive, the breakdown by component reveals a slowdown in private consumption and a collapse in property investment. These are two clear signs of weakening domestic demand, in the midst of the strongest cycle of monetary contraction by the Fed in more than 40 years, which has already raised interest rates by a total of 375 bps since March (see the Financial Markets Economic Outlook section).

Economic activity experiences a «significant» slowdown in autumn, inflation less so. The first economic activity indicators point towards a clear deterioration in the economic situation beginning in September. In the euro area, where the ECB has already raised interest rates by a total of 200 bps since July, with two consecutive 75-bp rate hikes in September and October, the composite business PMI continued to fall, reaching 47.3 points (*vs*. 48.1 in September). This marks its lowest level in almost two years and is consistent with a steady loss of buoyancy since Q2. In the words of ECB President Christine Lagarde, economic activity is showing a «significant» slowdown, which may intensify with the loss of households' purchasing power and deteriorating confidence. In the US, the composite PMI fell back down to 48.2 points in October, after a brief improvement in September (49.5 points *vs*. 44.6 in August). Although in the case of the US the ISM indices were still in expansionary territory (above 50 points), the fact is that they have also deteriorated. Meanwhile, inflation is still showing no sign of abating. In the euro area, it rose once again in October, reaching 10.7% (*vs*. 9.9% in September), driven by price increases in food, energy and industrial goods. September's inflation figure was also higher than expected in the US, with a sharp month-on-month increase in the core index, which stood at 6.6% year-on-year (8.2% for the headline index). Taken together, with the strength still demonstrated by the labour market on both sides of the Atlantic and the inertia of some of these price components, these figures may be a sign

US and euro area: GDP

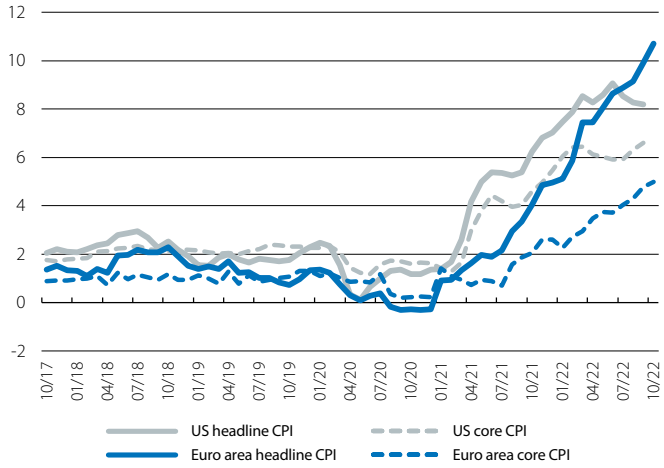
(%)



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

US and euro area: CPI

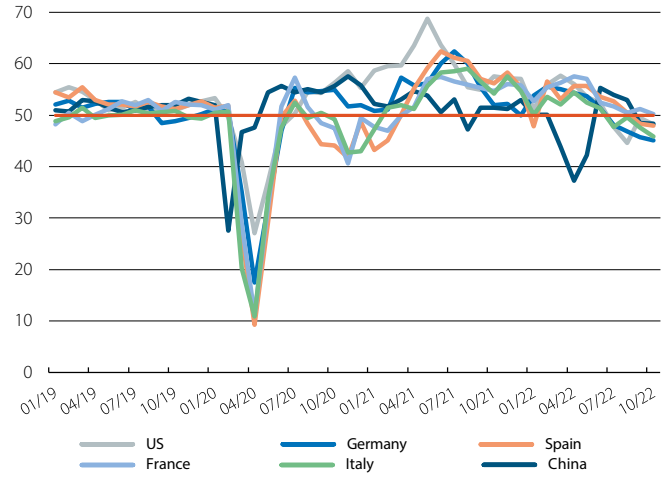
Year-on-year change (%)



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

Global: composite PMI

Level



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

that a longer period of high prices and restrictive monetary conditions lies ahead.

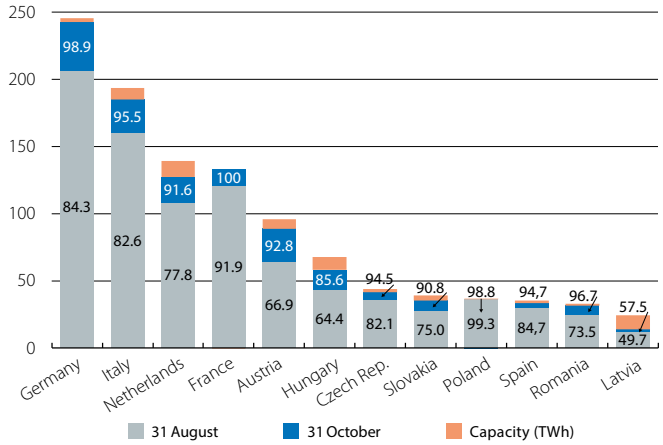
The European energy market remains calm while the weather and reserves allow it. The average gas futures price for 2023 fell by 18% in October (€155/MWh *vs*. €189/MWh in September) in the Dutch TTF, the market that serves as the main benchmark for Europe. Despite being seven times above the historical average, the decline in prices was mainly due to the high level of reserves, which stood at 95% of capacity at the end of October, compared to 80% at the end of August. In this context, in recent weeks there have been reports of LNG carriers waiting to unload at the main European ports. This situation of an easing of prices and oversupply may, however, be temporary. Two key variables to follow are the reductions in consumption achieved by EU countries and the level of reserves. With no end in sight for the war in Ukraine, the 2023-2024 winter will also be to play for over the coming months.

Macrofinancial risks, fiscal policies and the real estate market. As the slowdown in the global economy and the tighter monetary policies persist for longer than expected, it will be particularly important to keep an eye on national fiscal plans and the real estate market. In the euro area, home prices have risen by 20% compared to the pre-pandemic level (Q4 2019), with gains of around or even greater than 30% in many countries. In the US, the rally has been close to 40% (see the Focus «US: controlled slowdown or hard landing in the housing market» in this same report), while China continues to face a severe housing crisis and is among the G20 economies where home prices have grown the least over this period. Another source of macrofinancial risk will be fiscal policy, in both emerging and advanced economies. As the recent turbulence in the markets and the political crisis in the United Kingdom have demonstrated, there will be zero tolerance for fiscal plans with «the shelf-life of a lettuce» (see the Focus on «Stormy waters in the UK, a warning to seafarers» in this same report). The public accounts of countries with newly elected governments will be under intense scrutiny: presidents Giorgia Meloni and Lula da Silva should take note.

In China, will the short-term prosperity last in the long term? China's GDP was higher than expected in Q3 2022, with 3.9% growth versus Q2 (3.9% year-on-year as well), thus more than recovering from the crash registered in Q2. However, the strength of the recovery seems to have tempered in autumn. The data already available for October indicate a marked deterioration in the services sector, following the surge in cases and new lockdowns imposed in the country, as well as a slowdown in exports. The weakness of the Chinese economy could intensify in the coming months, as a result of the intermittent stops and starts imposed due to the zero-COVID policy and the cooling of global demand. In the medium term, the main messages coming out of the 20th National Congress of the Chinese Communist Party have been clear: security and self-sufficiency will be undisputed priorities. It remains to be seen how the new policy direction will materialise in the development of the domestic market and foreign policy.

Europe: gas reserves

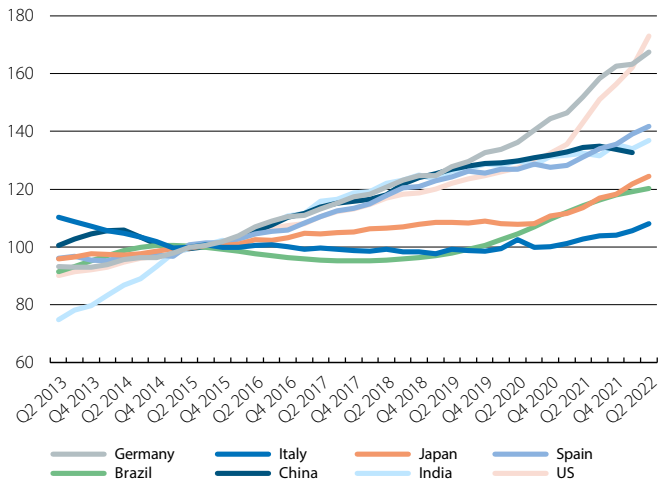
Storage level (TWh and % of total capacity)



Note: *Gas reserves as of 31 October. The chart shows the sum of the percentages corresponding to the storage levels at each date relative to each country's total capacity.*
Source: *CaixaBank Research, based on data from Gas Infrastructure Europe.*

Global: home prices

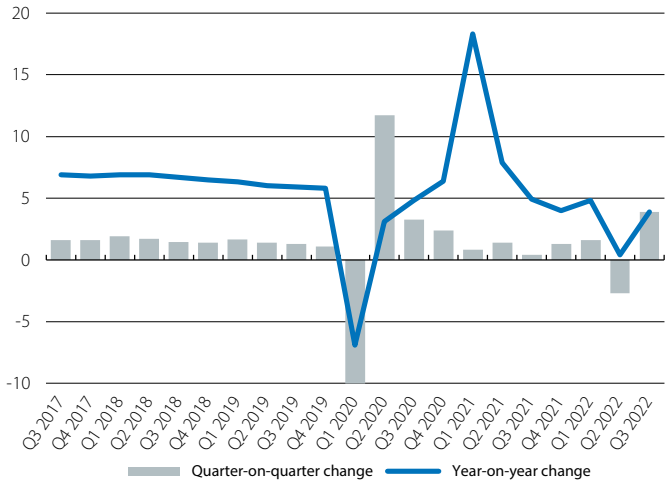
Index (100 = 2015)



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

China: GDP

Change (%)



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

US: controlled slowdown or hard landing in the housing market?

The tightening shift in the Fed's monetary policy in an attempt to combat inflation already seems to be having a negative impact on the country's real estate sector. This should come as no surprise: after all, the Fed's intention is precisely to control inflation by cooling demand. And the latter is achieved, in large part, through the real estate channel: higher rates lead to a reduction in the demand for housing, which translates into less construction activity, which in turn indirectly reduces demand for other goods and services. The key question here is: will we see a controlled slowdown or will it be a hard landing?

Recent context: soaring prices and slowdown in sight

Since the outbreak of the pandemic, we have seen a rise in the price of housing in the US. In particular, between February 2020 and August 2022 the increase exceeded 40%, representing an average annual growth rate of 15% in nominal terms. This is extremely high, exceeding even the growth registered in the years leading up to the global financial crisis (GFC), when it stood at around 10% (see first chart).[1]

However, with the rising interest rates, some indicators in the sector have already begun to slow down. This is the case for the number of home sales, which registered double-digit drops in year-on-year terms as early as the summer (see second chart). The rate at which new housing construction projects are being started has also slowed in recent months (with year-on-year declines as well). After all, the interest rate on the average 30-year fixed-rate mortgage stood at around 7% at the end of October, a level not seen since mid-2006, before the financial crisis (see third chart).

More generally, real residential investment has contracted by more than 10% so far this year. These downward pressures on the real estate sector will persist over the coming quarters and will weigh down economic activity, while also helping to reduce inflationary pressures.

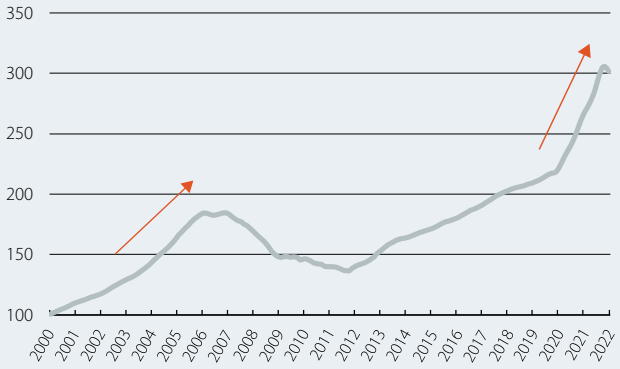
Imbalances and nuances

The sharp rise in home prices in recent years has translated into a clear deterioration in many housing

1. Between January 2000 and June 2006. Case-Shiller US National Home Price Index. Similar results are produced using the Case-Shiller 20-City Composite Home Price Index. In real terms (using the Dallas Fed's home price index), the average annual increase over the past two and a half years has been around 9%, compared to just over 5% before the global financial crisis.

US: home prices *

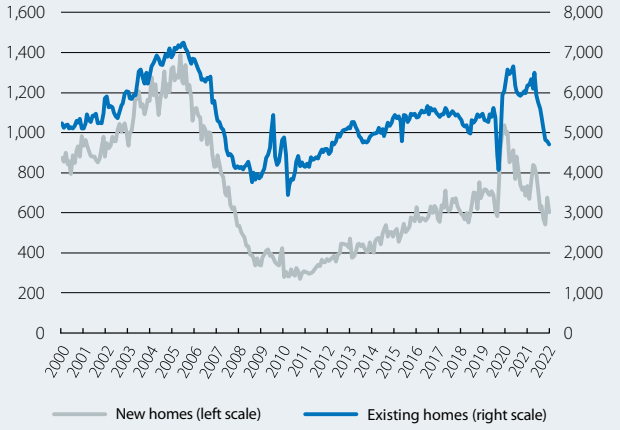
Index (100 = January 2000)



Note: ** Case-Shiller US National Home Price Index. This is a weighted index of repeat sales, which means it corrects for the quality of the homes sold.*
Source: *CaixaBank Research, based on data from S&P Case-Shiller, via Refinitiv.*

US: home sales

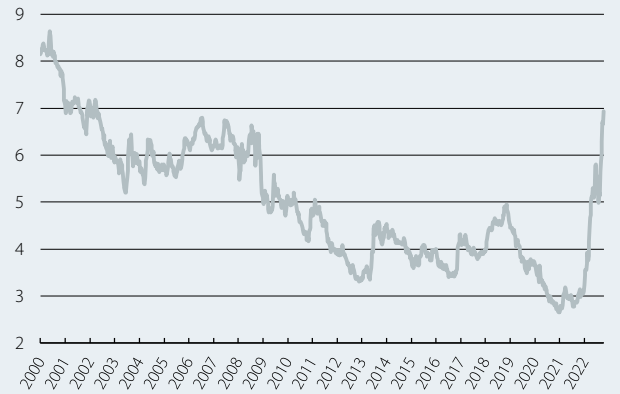
(Thousands of homes) *(Thousands of homes)*



Source: *CaixaBank Research, based on data from the National Association of Realtors.*

US: 30-year fixed-rate mortgage average

(%)



Source: *CaixaBank Research, based on data from the Federal Reserve Bank of St. Louis (FRED), via Refinitiv.*

affordability indices. If we look at the evolution of the ratio between home prices and household income (a simple and commonly used measure for capturing households' ability to afford a home), we note that not only is this ratio above the historical average since January 2000, but it also exceeds the levels reached just prior to the global financial crisis (see fourth chart). Similarly, the various models developed by the Dallas Fed, which measure the potential imbalances in real-estate prices in different countries, also place the US market in overheating territory.[2]

That said, there are some elements that clearly differentiate the current environment from the global financial crisis, suggesting that the risk of an episode of financial feedback like the one which occurred at that time is less likely now. For instance, many of the mortgage owners will not be affected by the recent rate hike, since most buyers have purchased their homes at fixed rates, and in recent years those rates have been very low.[3]

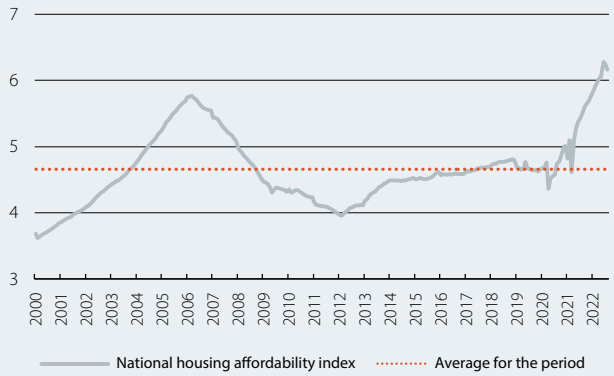
Secondly, the conditions for granting mortgages have been more stringent than in the past, thereby reducing these financial risks. For instance, the Mortgage Credit Availability Index, which captures the stringency of standards in the granting of mortgages, indicates that mortgage approval criteria are currently sound.[4] In the same vein, the Housing Credit Availability Index, which calculates the percentage of mortgaged homes that could go into arrears, is also very low right now.

Finally, another important nuance to bear in mind when considering the current imbalance in prices is the fact that households' finances are in a healthier position now than they were in 2007, with a debt ratio of around 75% of GDP in mid-2022. This is in line with the levels of 2001 and a far cry from the peaks reached in 2007-2008 (around 100% of GDP). Moreover, the current low level of unemployment, which stood at 3.5% in September (a 50-year low in the series, which had been reached just before the outbreak of the pandemic), is an additional element of strength for households' current financial situation.

Continuing with the analysis of the various imbalances that could affect the real estate market, we should mention the shortage of housing supply in the country. For illustrative purposes, the number of single-family homes available for sale is at its lowest level in 40

US: national housing affordability index

*Price over income **



Note: ** Based on median household incomes and home prices measured using the national Case-Shiller index.*
Source: *CaixaBank Research, based on data from the American Community Survey and the National Association of Realtors, via Refinitiv.*

years.[5] This shortage goes beyond the construction delays caused by the recent global supply problems, and is partly due to strict zoning policies in the US which favour the construction of single-family homes, as opposed to buildings with more tenants which would allow for greater supply.

As a result, although the growth in home prices will slow (and possibly fall) in the coming quarters, this adjustment will be less pronounced than we might expect in view of the Fed's rapid and sharp rise in interest rates.

Clàudia Canals

2. Dallas Fed, International House Price Database: https://www.dallasfed.org/institute/houseprice.
3. See R.J. Kish (2022). «The Dominance of the US 30-Year Fixed Rate Residential Mortgage». Journal of Real Estate Practice and Education, 24(1), 1-16.
4. Index produced by the Mortgage Banker Association.

5. According to data from the National Realtor Association: Total inventory single family, which has a historical series beginning in 1982.

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

UNITED STATES

	2020	2021	Q4 2021	Q1 2022	Q2 2022	Q3 2022	08/22	09/22	10/22
Activity									
Real GDP	–3.4	5.9	5.7	3.7	1.8	1.8	–	–	–
Retail sales (excluding cars and petrol)	2.1	17.5	16.2	11.2	7.9	8.2	8.0	7.5	...
Consumer confidence *(value)*	101.0	112.7	112.9	108.1	103.4	102.2	103.6	107.8	102.5
Industrial production	–7.2	4.9	4.5	4.8	4.5	4.4	3.9	5.3	...
Manufacturing activity index (ISM) *(value)*	52.5	60.6	60.1	57.8	54.8	52.2	52.8	50.9	50.2
Housing starts *(thousands)*	1,396	1,605	1,679	1,720	1,647	1,461	1,566	1,439	...
Case-Shiller home price index *(value)*	228	267	283	299	314	...	310	...	...
Unemployment rate *(% lab. force)*	8.1	5.4	4.2	3.8	3.6	3.6	3.7	3.5	3.7
Employment-population ratio *(% pop. > 16 years)*	56.8	58.4	59.2	59.9	60.0	60.1	60.1	60.1	60.0
Trade balance [1] *(% GDP)*	–3.2	–3.6	–3.6	–3.9	–4.0	–3.9	–3.9	–3.9	...
Prices									
Headline inflation	1.2	4.7	6.7	8.0	8.6	8.3	8.3	8.2	...
Core inflation	1.7	3.6	5.0	6.3	6.0	6.3	6.3	6.6	...

JAPAN

	2020	2021	Q4 2021	Q1 2022	Q2 2022	Q3 2022	08/22	09/22	10/22
Activity									
Real GDP	–4.6	1.7	0.5	0.6	1.6	...	–	–	–
Consumer confidence *(value)*	31.0	36.3	38.3	34.8	33.1	31.2	32.5	30.8	29.9
Industrial production	–10.6	5.6	1.1	–0.6	–3.6	4.0	4.2	9.7	...
Business activity index (Tankan) *(value)*	–19.8	13.8	18.0	14.0	9.0	8.0	–	–	–
Unemployment rate *(% lab. force)*	2.8	2.8	2.7	2.7	2.6	2.6	2.5	2.6	...
Trade balance [1] *(% GDP)*	0.1	–0.3	–0.3	–1.0	–2.0	–4.1	–3.6	–3.9	...
Prices									
Headline inflation	0.0	–0.2	0.5	0.9	2.4	2.9	3.0	3.0	...
Core inflation	0.2	–0.5	–0.7	–0.9	0.8	1.5	1.6	1.8	...

CHINA

	2020	2021	Q4 2021	Q1 2022	Q2 2022	Q3 2022	08/22	09/22	10/22
Activity									
Real GDP	2.2	8.1	4.0	4.8	0.4	3.9	–	–	–
Retail sales	–2.9	12.4	3.5	1.6	–4.9	3.5	5.4	2.5	...
Industrial production	3.4	9.3	3.9	6.3	0.6	4.8	4.2	6.3	...
PMI manufacturing *(value)*	49.9	50.5	49.9	49.9	49.1	49.5	49.4	50.1	49.2
Foreign sector									
Trade balance [1,2]	524	680	680	728	822	903	887	903	903
Exports	3.6	30.0	23.1	15.7	12.9	10.0	7.0	5.6	–0.6
Imports	–0.6	30.1	23.7	10.5	1.6	0.9	0.3	0.3	–0.7
Prices									
Headline inflation	2.5	0.9	1.8	1.1	2.2	2.7	2.5	2.8	...
Official interest rate [3]	3.9	3.8	3.8	3.7	3.7	3.7	3.7	3.7	3.7
Renminbi per dollar	6.9	6.5	6.4	6.3	6.6	6.9	6.8	7.0	7.2

Notes: *1. Cumulative figure over last 12 months. 2. Billion dollars. 3. End of period.*
Source: *CaixaBank Research, based on data from the Department of Economic Analysis, Bureau of Labor Statistics, Federal Reserve, Standard & Poor's, ISM, National Bureau of Statistics of Japan, Bank of Japan, National Bureau of Statistics of China and Refinitiv.*

EURO AREA

Activity and employment indicators

Values, unless otherwise specified

	2020	2021	Q4 2021	Q1 2022	Q2 2022	Q3 2022	08/22	09/22	10/22
Retail sales *(year-on-year change)*	–0.8	5.5	4.2	5.1	0.7	...	–2.0	...	...
Industrial production *(year-on-year change)*	–7.6	9.0	0.3	–0.2	0.4	...	2.5	...	...
Consumer confidence	–14.2	–7.4	–7.5	–13.7	–22.4	–26.9	–25.0	–28.8	–27.6
Economic sentiment	88.3	110.8	116.0	111.2	104.0	96.5	97.3	93.6	92.5
Manufacturing PMI	48.6	60.2	58.2	57.8	54.1	49.3	49.6	48.4	46.4
Services PMI	42.5	53.6	54.5	54.1	55.6	49.9	49.8	48.8	48.6
Labour market									
Employment (people) *(year-on-year change)*	–1.5	1.4	2.4	3.1	2.7	...	–	–	–
Unemployment rate *(% labour force)*	8.0	7.7	7.1	6.8	6.7	...	6.7	6.6	...
Germany *(% labour force)*	3.7	3.6	3.3	3.1	3.0	...	3.0	3.0	...
France *(% labour force)*	8.0	7.9	7.5	7.3	7.6	...	7.3	7.1	...
Italy *(% labour force)*	9.3	9.5	9.0	8.5	8.1	...	7.9	7.9	...
Real GDP *(year-on-year change)*	–6.3	5.5	4.8	5.5	4.3	2.1	–	–	–
Germany *(year-on-year change)*	–4.1	2.8	1.2	3.5	1.7	1.1	–	–	–
France *(year-on-year change)*	–7.9	7.2	5.1	4.7	4.2	1.0	–	–	–
Italy *(year-on-year change)*	–9.1	7.0	6.5	6.4	4.9	2.6	–	–	–

Prices

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

	2020	2021	Q4 2021	Q1 2022	Q2 2022	Q3 2022	08/22	09/22	10/22
General	0.3	2.6	4.6	6.1	8.0	9.3	9.1	9.9	10.7
Core	0.7	1.5	2.4	2.7	3.7	4.4	4.3	4.8	5.0

Foreign sector

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

	2020	2021	Q4 2021	Q1 2022	Q2 2022	Q3 2022	08/22	09/22	10/22
Current balance	1.8	2.6	2.6	1.8	0.7	...	–0.1	...	...
Germany	7.0	7.4	7.4	6.6	5.4	...	4.5	...	...
France	–1.8	0.4	0.4	0.1	–0.5	...	–1.0	...	...
Italy	3.9	3.1	3.1	2.1	0.9	...	–0.1	...	...
Nominal effective exchange rate[1] *(value)*	93.8	94.2	92.7	92.5	90.1	88.9	88.5	89.2	90.8

Credit and deposits of non-financial sectors

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

	2020	2021	Q4 2021	Q1 2022	Q2 2022	Q3 2022	08/22	09/22	10/22
Private sector financing									
Credit to non-financial firms[2]	6.3	3.5	3.3	4.4	6.1	8.4	8.8	8.9	...
Credit to households[2,3]	3.2	3.8	4.1	4.4	4.6	4.5	4.5	4.4	...
Interest rate on loans to non-financial firms[4] *(%)*	1.2	1.2	1.1	1.2	1.4	1.8	1.6	2.4	...
Interest rate on loans to households for house purchases[5] *(%)*	1.4	1.3	1.3	1.4	1.5	2.1	2.1	2.3	...
Deposits									
On demand deposits	12.9	12.6	10.5	9.1	7.7	6.3	6.8	5.5	...
Other short-term deposits	0.6	–0.8	–1.5	–0.3	0.9	5.3	4.6	8.1	...
Marketable instruments	8.1	11.4	9.2	–0.2	1.3	3.9	2.8	8.2	...
Interest rate on deposits up to 1 year from households *(%)*	0.2	0.2	0.2	0.2	0.2	0.4	0.4	0.6	...

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

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

The Spanish economy applies the brakes, but still shows signs of resilience

GDP growth practically stagnated in Q3. The preliminary GDP figure published for Q3 of this year shows a moderation in the Spanish economy's growth rate, suggesting an increasingly difficult macroeconomic environment, as we anticipated. GDP grew by 0.2% quarter-on-quarter (3.8% year-on-year), a much lower figure than in the previous quarter (1.5% quarter-on-quarter). On the one hand, this figure reflects the fact that the boost provided by the fading impact of the pandemic has been exhausted, while on the other hand it shows the difficult environment that the Spanish economy is currently enduring. This environment is marked, firstly, by high inflation rates; secondly, by a cycle of interest rate hikes that is more aggressive and abrupt than expected a few months ago; and, thirdly, by the deterioration in confidence relating to the economic outlook. Looking ahead to 2023, we forecast that the growth rate of the Spanish economy will slow to 1.0% year-on-year.

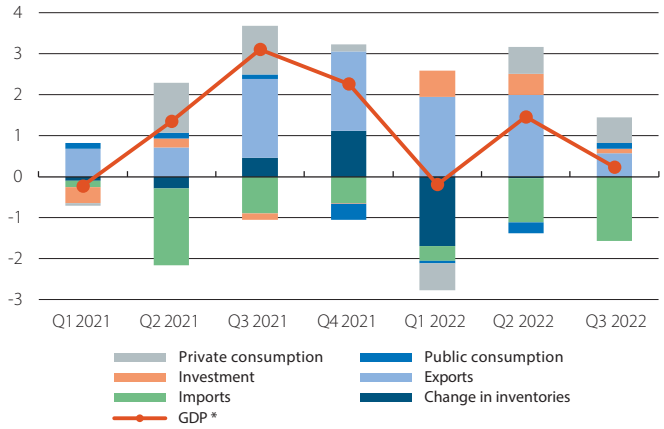
The tourism sector ended the summer season in very good shape. The summer quarter ended with a level of overnight stays in tourist accommodation establishments just 1.3% below that of the summer of 2019, compared to a gap of –27.7% in the summer of 2021. International tourism continued to improve rapidly, reaching a level of overnight stays and tourism spending that was just 5.9% and 3.1% below the same period of 2019, respectively. Domestic tourism reached a volume of overnight stays 6.6% higher than in 2019, although, with more people taking trips abroad, it was 5.2% lower than in the summer of 2021. With a view to 2023, we expect tourism activity to continue to grow and exceed the 2019 level, supported by an improvement in air mobility in Europe, overcoming the episode of airport saturation experienced in the summer, as well as by the recovery of long-haul tourism.

The labour market is holding up better than expected, although it will lose steam in 2023. The October data for social security affiliation show that the labour market remains resilient despite the challenging macroeconomic environment. In particular, the number of registered workers grew by 103,499 people in October, higher than the «usual» figure for October (on average, social security affiliation grew by 82,200 in the month of October between 2014 and 2019). On the other hand, the effects of the labour reform continued to be reflected in the change in the rate of temporary employment. Specifically, it fell to 15.7% (27.6% in October 2021), marking a new all-time low, thanks in part to the use of discontinuous permanent contracts rather than temporary ones. Registered unemployment fell by 27,027 people during October. This is a very encouraging development, given that unemployment usually tends to increase in October (by 69,000 people on average in 2014-2019).

Against this backdrop, we anticipate a slowdown in the labour market in 2023, albeit still with positive job creation (+0.5% compared to 2022). As for the unemployment rate, we expect a slight rise of 3 percentage points versus 2022, bringing it to 13.1%.

Spain: contribution to GDP growth by component

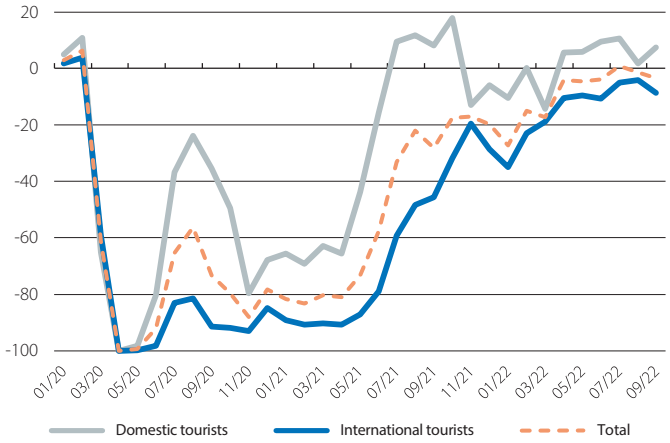
Contribution to the quarter-on-quarter change in GDP (pps)



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

Spain: overnight stays in tourist accommodation establishments

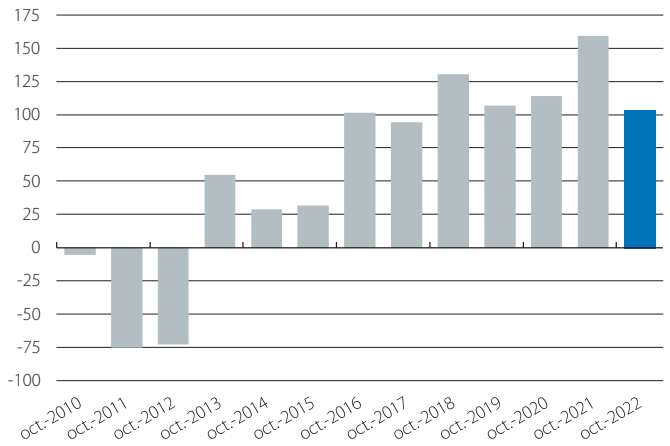
Change versus the same month in 2019 (%)



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

Spain: workers registered with Social Security in the month of October

Month-on-month change (thousands of people)



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

Inflation provides a respite thanks to the energy component, but it will remain high in 2023. According to the CPI flash estimate, headline inflation fell sharply in October and stood at 7.3%, 1.6 pps below the figure for September. Underlying inflation (excluding energy and unprocessed food), meanwhile, remained stable at 6.2% (the same figure as in September). The National Statistics Institute noted that the main reason for the moderation in inflation was the fall in electricity prices, which, according to data from the national grid operator Red Eléctrica de España, reached lows not seen since August 2021. This reduction in electricity prices has been driven by the collapse in the Iberian benchmark gas price (MIBGAS), which fell by 46% in October as a result of the filling of gas reserves and the low consumption due to the high temperatures. As temperatures begin to fall, we foresee a rebound in benchmark gas prices. Looking ahead to 2023, we expect inflation to remain high, at 4.5%, due to the persistence of core inflation.

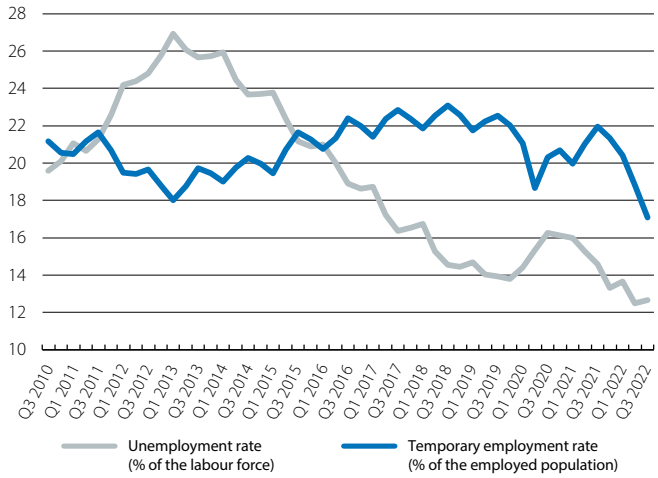
First signs of lower buoyancy in the housing market, which will experience a slowdown in 2023. Home sales remain high (640,000 in the last 12 months to August), but growth moderated to 15% year-on-year in August, compared to 23% in the first half of the year. In 2023, we expect the housing market to cool, although the absence of imbalances makes a sharp correction unlikely. Specifically, we expect sales to fall by just over 10% in 2023 (to around 480,000 homes), with a slowdown in prices (according to the index by the Ministry of transport, mobility and urban agenda) to an annual growth rate of 1.5%, which in real terms would be a considerable adjustment (–5.6% on a cumulative basis in 2022-2023).

On the other hand, housing supply remains limited: the number of planning permissions granted (108,000 units in the last 12 months to August) falls short of net household creation (180,000 per year to Q2 2022). One factor limiting the recovery of post-pandemic supply has been the sharp rise in construction costs. Recently, the upward trend in costs seems to have slowed (15.1% year-on-year in August, compared to a peak of 19.5% in May). The decline in industrial metal prices on the international markets suggests we will see more contained rises in construction costs going forward.

The Spanish government has presented the 2023 Draft General Government Budget and has sent its Budget Plan to Brussels. In terms of the general government deficit, a deficit of 3.9% of GDP is expected in 2023, which represents a 1.1 pp. reduction compared to the deficit projected for 2022. The bulk of this reduction is expected to be driven by the autonomous communities (deficit of 0.7 pps less in 2023), while Social Security would maintain a deficit of 0.5% in 2023. Due to the high uncertainty surrounding the outlook, the Budget Plan delivered to the European Commission included an additional scenario to accompany the 2023 General Government Budget. This second scenario is more in line with the budget execution data for this year and also incorporates more plausible assumptions (e.g. extension of the tax cuts on electricity during 2023). In this second scenario, government revenues are expected to increase by 35 billion euros in 2023 (+6.2% year-on-year), thanks to the strength of tax collections and social security contributions. On the expenditure side, public expenditure is projected to increase by 23.7 billion euros in 2023, 3.8% more than in 2022, due to a significant increase in structural expenditure (mostly on pensions) (see the Focus «The public accounts in 2023: increase in revenues and also in expenditure» in this same report).

Spain: unemployment rate and temporary employment rate

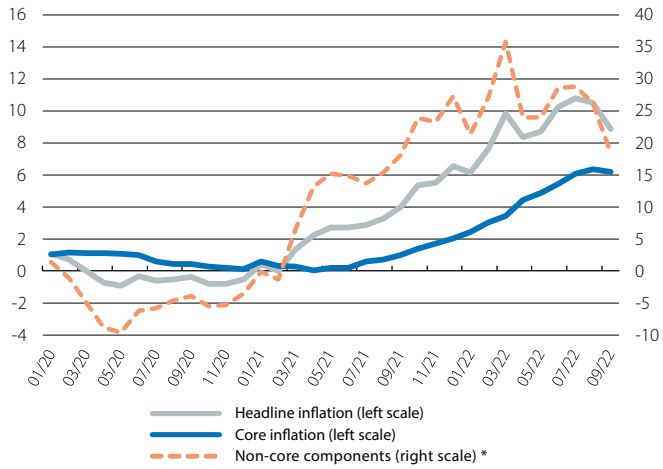
(%)



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

Spain: CPI

Year-on-year change (%) *Year-on-year change (%)*



Note: ** Aggregate of unprocessed foods and energy products.*
Source: *CaixaBank Research, based on data from the National Statistics Institute.*

Spain: 2023 Government Budget Plan

(% of GDP)

		Scenario 1		Scenario 2	
	2021	2022	2023	2022	2023
Public revenues	**43.7**	**42.1**	**42.3**	**42.9**	**43.0**
Indirect taxes (VAT, etc.)	12.2	12.2	12.2	12.6	12.3
Income & wealth taxes	11.9	11.8	12.2	12.2	12.8
Social security contributions	14.2	13.6	13.7	13.6	13.7
Public expenditure	**50.6**	**47.1**	**46.2**	**47.9**	**46.9**
Employee remuneration	12.2	11.6	11.4	11.8	11.4
Social benefits	21.8	20.6	20.8	20.7	21.1
Interest charges	2.2	2.2	2.4	2.2	2.4
Subsidies	1.5	1.8	1.2	2.2	1.4
Government balance	**–6.9**	**–5.0**	**–3.9**	**–5.0**	**–3.9**

Notes: ** The projections incorporate the macroeconomic impact of the NGEU plan, although the NGEU transfers themselves are excluded from the revenues and the expenditure. Scenario 2 incorporates a higher starting point for forecast tax collections in 2022 (+10.8 billion euros versus scenario 1), in line with budget execution data up to August. It also includes tax measures that are implemented outside the scope of the 2023 General Government Budget, and it assumes that the tax cuts on electricity are extended in 2023.*
Source: *CaixaBank Research, based on data from the Ministry of Finance.*

Real-time economics: the new portal by CaixaBank Research

While economists have been incorporating big data into their analyses for a number of years now, the COVID-19 pandemic has produced a veritable revolution in real-time economics. Having timely information was essential for management of the crisis and allowing quick decision-taking. For instance, using data from Google Mobility Report, it was possible to measure the impact that the COVID-19 pandemic had on people's mobility under lockdown and, thanks to data from Opportunity Insights (https://www.tracktherecovery.org/), the economic impact of the pandemic in the US. Here at CaixaBank Research, together with researchers from Pompeu Fabra University and the Institute of Political Economy and Governance (IPEG), we developed a pioneering tool for tracking inequality and the role of the welfare state in Spain in real time (https://inequality-tracker.caixabankresearch.com/en).

Real-time sources of information are generated both in the private sector (telephone and internet providers, financial firms, etc.) and within the public sector, which holds registry data that are an unparalleled source of economic information. The Spanish Tax Agency,[1] to name just one example, has the most detailed and up-to-date data on the performance of Spanish companies, thanks to the tax returns they file.

The information obtained from big data is supplemented with more traditional data such as surveys or economic experiments. However, the former offers a greater level of detail and is more instantaneous. Since big data is created for other purposes, it is readily available (i.e. it «only» has to be processed and analysed, without the need for surveys, for instance). The resulting economic information is therefore cheaper to produce and can lead to more representative and larger samples.

Real-time economics can also play an important role in the design and implementation of public policies. Big data allows economic policies to be designed more specifically, focusing on the groups most in need (so-called «smart policies»). They also enable the impact of any measures introduced to be monitored *a posteriori* – after their implementation – as well as making it possible to adjust them in real time when necessary.

The new contribution of the CaixaBank Research team[2] to this revolution is the Real-time economics website (https://realtimeeconomics.caixabankresearch.com), a pioneering project which aims to track developments in the Spanish economy through 12 indicators built with internal CaixaBank data, aggregated using big data techniques. The indicators are grouped into five areas: consumption, housing, tourism, wages and inequality. Each of these indicators can be broken down by a range of different categories, allowing differences to be identified between groups (age, gender, income level, sector), regions (autonomous communities, municipalities), etc. In total, we publish more than 800 time series, which we update monthly.

The Real-time economics portal enables the analysis of key issues in the current uncertain economic context. One of the major concerns is the degree of slowdown in private consumption as a result of the sharp rise in prices. CaixaBank Research's consumption indicator shows a downward trend and below-inflation growth, suggesting that consumption in real terms is falling. Specifically,

Indicators available on the Real-time economics portal

		Indicators	Definition	Breakdown categories
	Consumption	Total consumption, in-person consumption and e-commerce	Consumption based on payments and cash withdrawals carried out with debit and credit cards, including both Spanish and foreign cards	National, by autonomous community region, age, income level, expenditure type
	Housing	Housing affordability	Number of years of net employment income that the median household must allocate in order to purchase a home in a specific geographic area	National, by autonomous community region and provincial capital
	Wages	Wages	Monthly wage income calculated using payrolls paid into CaixaBank accounts	National, by autonomous community region, age, gender, economic sector, public/private sector
	Tourism	Domestic tourism, international tourism and spending abroad	Expenditure based on payments and cash withdrawals carried out with Spanish or foreign cards	National, by age, country, expenditure type
	Inequality	Gini index, income percentiles, income distribution, Lorenz curve	Wage inequality defined on the basis of payrolls paid into CaixaBank accounts as well as unemployment benefits	National, by autonomous community region, age, gender, country of birth

Note: *For further details on how the variables are built and their representativeness, see the Methodological Note (https://www.caixabankresearch.com/sites/default/files/content/file/2022/02/09/49/nota-metodologica_rte.pdf).*
Source: *CaixaBank Research, Real-time economics portal (www.realtimeeconomics.caixabankresearch.com).*

1. https://sede.agenciatributaria.gob.es/Sede/datosabiertos/catalogo/hacienda/Informes_Ventas_Empleos_y_Salarios_en_las_declaraciones_tributarias.shtml.

2. The website has been a collective effort involving Oriol Aspachs, Patricia Esteban, Alberto Graziano, Javier Ibáñez de Aldecoa, Eduard Llorens, Josep Mestres and Judit Montoriol.

in September, in-person spending using Spanish bank cards registered 7.0% year-on-year growth, the lowest rate in 2022 to date. The pattern varies widely between different expenditure categories. On the one hand, we find significant growth in leisure and catering (13.6% year-on-year), in line with the strength of the tourism sector, and in spending on essential goods (18.0% year-on-year), reflecting the sharp rise in food prices. On the other hand, spending on durable goods is showing much more timid growth (2.3% year-on-year), amid high uncertainty and a loss of household purchasing power.

Another concern in this context of strong inflationary tensions is the intensity of so-called second-round effects. CaixaBank Research's wage income indicator shows that wage growth has been contained to date. In September 2022, wage incomes in Spain rose by around 2.4% year-on-year, similar to the growth of the last six months. Breaking this figure down by category allows us to determine whether there are differences by sector or autonomous community region. For instance, wages rose at different rates in the tourism and non-tourism service sectors in 2022. In the former, wage incomes rose by over 5% year-on-year in May and June 2022, with a strong rebound after the pandemic, although this growth moderated to 3.5% in September 2022. In non-tourism services, meanwhile, the growth rate has been slower, at around 2.3% year-on-year in 2022 to date. By autonomous community, wages grew more in the Balearic Islands (2.9%) and less in Extremadura (2.0%), indicating limited differences between regions.

On the other hand, the Real-time economics portal also reveals the significant contribution of tourism to the growth in economic activity after the restrictions linked to the pandemic were lifted. According to CaixaBank Research's international tourism indicator, in September 2022 spending on foreign cards in Spain grew by 27.8% compared to the same month in 2017. Tourism from European countries was the first to recover, and long-haul tourism is also joining the trend. Despite the highly encouraging recovery in international tourism to date, it is unclear to what extent we will be able to continue to rely on this driver of growth, in a context in which the main source countries of tourists who visit Spain are in the midst of an economic slowdown. The website indicators will allow us to track these developments, month by month and instantaneously.

At CaixaBank Research we are committed to the dissemination of economic information as a valuable contribution to society. We perform research and analysis on our data in order to condense them in these indicators, which we make freely available to all in this Real-time economics webiste (www.realtimeeconomics.caixabankresearch.com), thereby providing relevant economic information that is instantly accessible and which can complement that of other sources.

Josep Mestres and Judit Montoriol

The public accounts in 2023: increase in revenues and also in expenditure

The Spanish government has presented to parliament the Draft General Government Budget for 2023 and has sent to Brussels its Budget Plan setting out a picture of the consolidated general government accounts. In terms of the general government deficit, a deficit of 3.9% of GDP is expected in 2023, which represents a 1.1-pp reduction compared to the deficit projected for 2022. The bulk of this reduction is expected to be driven by the Autonomous Communities (deficit of 0.7 pps less than in 2023), while Social Security would maintain a deficit of 0.5% in 2023. The latter implies that the government is counting on higher social security contributions and transfers from the state to cover an increase in pensions without altering the deficit (as a percentage of GDP).

With regard to the primary balance, which excludes interest payments, the government projects a reduction of 1.2 pps in 2023 to –1.6%, still greater than the –0.8% of 2019. As for public debt, a reduction of 3.0 pps is expected thanks to GDP growth in nominal terms (6.0%), although it will still remain high at around 112% of GDP.

Revenues: on the rise due to inflation

Due to the high uncertainty surrounding the outlook, the government has presented two scenarios. The first, built on the 2023 General Government Budget, is more conservative in terms of the forecast for 2022 tax revenue collections, projecting that they will be 9 billion euros below the figure we would obtain by extrapolating the budget execution data observed for the year to date up to August. The second scenario, which seems more plausible, incorporates an extra 10.8 billion in tax revenues in 2022 (which in turn leads to around 10 billion in extra revenues in 2023, due to the higher starting point) and assumes that the temporary tax cuts on electricity which are due to expire in December (and which reduced tax revenues by some 6 billion in 2022, according to AIReF) will be extended throughout 2023. Thus, in this second scenario public revenues grow by 6.6% in 2022. This is above the 4.6% in the first scenario, although still far from the 14.0% per the budget execution based on data up to July (which can be expected to moderate in the coming months). This extra increase in revenues in scenario 2 is expected to be used to increase expenditure by a similar amount. Thus, the forecasts for the general government deficit are the same in both scenarios.

If we focus on the second scenario, consolidated general government government revenues are forecast to grow by 6.2% year-on-year in 2023 (+35 billion euros), in line with the government's forecasts for nominal GDP growth (6.0%), which are in the high range of forecasts produced by different analysts. The main factors behind the higher revenues relative to 2022 are projected to include direct taxes (11.2% year-on-year, +16.3 billion euros), favoured by the price rally pushing up tax bases, and social

2023 Budget Plan

Item	2019 (% GDP)	2021 (% GDP)	Scenario 1				Scenario 2			
			2022 (% GDP)	2023 (% GDP)	2023-2019 (% change)	2023-2022 (% change)	2022 (% GDP)	2023 (% GDP)	2023-2019 (% change)	2023-2022 (% change)
Public revenues	**39.2**	**43.7**	**42.1**	**42.3**	**20.4**	**6.5**	**42.9**	**43.0**	**22.3**	**6.2**
Indirect taxes (VAT, etc.)	11.5	12.2	12.2	12.2	18.3	6.0	12.6	12.3	19.3	3.5
Income & wealth taxes	10.4	11.9	11.8	12.2	30.8	9.6	12.2	12.8	37.2	11.2
Capital taxes	0.4	0.5	0.5	0.4	11.5	-15.2	0.5	0.5	39.4	6.0
Social security contributions	12.9	14.2	13.6	13.7	18.4	6.8	13.6	13.7	18.4	6.8
Other revenues	4.0	5	4	3.8	5.9	0.7	4	3.7	3.1	-2.0
Public expenditure	**42.1**	**50.6**	**47.1**	**46.2**	**22.4**	**4.0**	**47.9**	**46.9**	**24.2**	**3.8**
Employee remuneration	10.8	12.2	11.6	11.4	17.7	4.2	11.8	11.4	17.7	2.4
Intermediate consumption	5.1	5.9	5.7	5.6	22.4	4.1	5.7	5.6	22.4	4.1
Social benefits	18.4	21.8	20.6	20.8	26.0	7.0	20.7	21.1	27.9	8.0
Interest expense	2.3	2.2	2.2	2.4	16.3	15.6	2.2	2.4	16.3	15.6
Subsidies	1	1.5	1.8	1.2	33.8	-29.3	2.2	1.4	56.1	-32.6
Capital expenditure (excl. NGEU)	2.8	4.8	3.4	3.2	27.2	-0.4	3.4	3.2	27.2	-0.4
Other expenditure	1.7	2.2	1.8	1.6	4.9	-5.8	1.9	1.8	18.1	0.4
Nominal GDP (EUR billions)	*1,245.5*	*1,206.9*	*1,310.3*	*1,388.7*	*11.5*	*6.0*	*1,310.3*	*1,388.7*	*11.5*	*6.0*

Notes: *The projections incorporate the macroeconomic impact of the NGEU plan, although the NGEU transfers themselves are excluded from the revenues and expenditure. In 2019 we exclude the portion of the deficit (2 percentage points of GDP) relating to Sareb.*
Source: *CaixaBank Research, based on data from the Ministry of Finance.*

security contributions (6.0% year-on-year, +12 billion euros). The latter is expected to be driven by an increase in the maximum base salaries of 8.6% – which is expected to contribute some 0.9 billion – and the 0.6-pp increase in the common contingencies scheme – which is expected to contribute some 2.7 billion euros. Indirect taxes, meanwhile, are expected to register a more contained growth (+3.5%).

The government expects that a part of the higher revenues will come from the new temporary tax measures (the temporary levy on energy and banking and the tax on high-net-worth individuals), which will be partially offset by other targeted measures intended to reduce the tax burden on low and low-middle income households (mainly, the extension of the lower income tax band for employment income from 18,000 to 21,000 euros of gross pay and raising the minimum taxation threshold from 14,000 to 15,000 euros). On aggregate, the government estimates that the new measures will bring in additional net revenues of 4 billion euros in 2023, although AIReF reduces this figure to 3.2 billion; the discrepancy is mainly due to the government anticipating 1.5 billion in revenues derived from the tax on high-net-worth individuals in 2023, while AIReF postpones this income to 2024.

Expenditure: structural increases

With regard to public expenditure (excluding the items related to the NGEU programme), there is a substantial increase in structural expenditure, especially focused on maintaining pensioners' purchasing power.

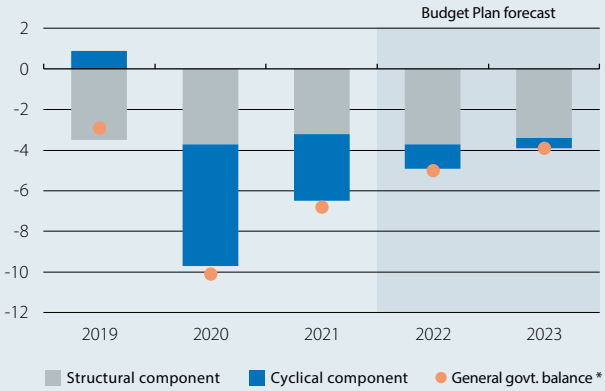
In particular, in scenario 2, public spending would increase by 3.8% year-on-year (+23.7 billion euros) in 2023, largely due to a 21.8-billion-euro increase in social benefits (mainly a 19.6-billion increase in pension spending) and the increase in interest charges (+4.5 billion euros). The items expected to fall include subsidies, which are down by 9.4 billion. Therefore, consolidated primary current expenditure would increase by 4.4%, below the government's forecast for nominal GDP growth.

Thus, structural expenditure, which does not directly depend on the business cycle, will increase significantly. Indeed, this is the primarily reason for the 117-billion-euro increase in consolidated public expenditure compared to 2019 (not counting any potential extraordinary spending measures that might materialise in 2023 to tackle inflation and the war in Ukraine): pensions, for instance, are projected to increase by 36.6 billion euros compared to 2019, and staff costs by 24 billion.

Although government revenues will have increased by some 100 billion euros compared to 2019, and much of that increase will be structural – due to inflation[1] and structural changes in the economy that have boosted revenues (such as workers previously operating in the submerged economy coming out of the shadows due to labour policies implemented under COVID)[2] – this margin is not expected to be used to reduce the structural deficit by any significant degree. In fact, the structural deficit of the Spanish economy, which was already rather high before the pandemic, will hardly shrink at all. Specifically, according to the estimates included in the Budget Plan, it could stand at around 3.4% of GDP in 2023, very similar to the pre-pandemic level (3.5% in 2019).

Javier Garcia-Arenas

Spain: government balance
(% of GDP)



Note: ** Excludes Sareb and losses for assistance provided to financial institutions.*
Source: *CaixaBank Research, based on data from the Ministry of Finance (10/2022) and the 2021-2024 Stability Programme.*

1. Even if inflation gradually moderates, the jump in prices versus 2019 is very likely to become consolidated, hence we consider it a structural factor.
2. According to the Budget Plan, the measures adopted during the COVID crisis have led to some 285,000 additional workers registering with the Social Security institute.

Activity and employment indicators

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

	2020	2021	Q4 2021	Q1 2022	Q2 2022	Q3 2022	08/22	09/22	10/22
Industry									
Industrial production index	–9.5	8.8	1.7	1.6	4.6	4.7	5.2	3.6	...
Indicator of confidence in industry *(value)*	–13.6	0.6	5.0	6.8	0.4	–5.2	–5.5	–5.2	–3.9
Manufacturing PMI *(value)*	47.5	57.0	56.9	55.8	53.2	49.2	49.9	49.0	44.7
Construction									
Building permits *(cumulative over 12 months)*	–12.8	4.7	24.6	31.6	18.8	...	9.7	...	...
House sales *(cumulative over 12 months)*	–12.5	9.6	32.5	41.8	33.6	...	22.9	...	...
House prices	2.1	3.7	6.4	8.5	8.0	...	–	–	–
Services									
Foreign tourists *(cumulative over 12 months)*	–77.3	64.7	64.7	313.4	311.7	208.4	251.4	208.4	...
Services PMI *(value)*	40.3	55.0	57.4	52.2	55.9	51.0	50.6	48.5	49.7
Consumption									
Retail sales	–7.1	5.1	0.7	0.4	1.1	–0.1	0.1	0.1	...
Car registrations	–29.3	158.0	–17.1	–7.5	–10.3	3.1	9.1	12.7	11.7
Consumer confidence index *(value)*	–22.7	–12.8	–13.1	–17.6	–26.4	–33.1	–31.6	–32.8	–31.8
Labour market									
Employment [1]	–2.9	3.0	4.3	4.6	4.0	2.6	–	–	–
Unemployment rate (% labour force)	15.5	14.8	13.3	13.6	12.5	12.7	–	–	–
Registered as employed with Social Security [2]	–2.0	2.5	3.9	4.5	4.8	3.5	3.5	3.3	3.0
GDP	**–11.3**	**5.5**	**6.6**	**6.7**	**6.8**	**3.8**	–	–	–

Prices

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

	2020	2021	Q4 2021	Q1 2022	Q2 2022	Q3 2022	08/22	09/22	10/22
General	–0.3	3.1	5.8	7.9	9.1	10.1	10.6	8.9	7.3
Core	0.7	0.8	1.7	3.0	4.9	6.2	6.4	6.2	6.2

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	08/22	09/22	10/22
Trade of goods									
Exports *(year-on-year change, cumulative over 12 months)*	–10.0	21.2	21.2	26.2	22.2	...	23.3	...	...
Imports *(year-on-year change, cumulative over 12 months)*	–14.7	24.8	24.8	36.1	35.2	...	37.3	...	...
Current balance	**6.8**	**11.5**	**11.5**	**8.5**	**9.6**	**...**	**7.8**	...	...
Goods and services	16.3	17.9	17.9	14.2	16.2	...	16.0	...	...
Primary and secondary income	–9.5	–6.4	–6.4	–5.7	–6.7	...	–8.2	...	...
Net lending (+) / borrowing (–) capacity	**11.9**	**22.4**	**22.4**	**19.8**	**22.5**	**...**	**20.8**	**...**	**...**

Credit and deposits in non-financial sectors [3]

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

	2020	2021	Q4 2021	Q1 2022	Q2 2022	Q3 2022	08/22	09/22	10/22
Deposits									
Household and company deposits	7.5	6.1	5.8	5.2	5.4	...	...	...	...
Sight and savings	12.3	10.3	9.2	9.3	9.2	8.2	8.4	7.6	...
Term and notice	–16.5	–24.4	–27.6	–26.8	–25.4	–19.4	–19.9	–16.3	...
General government deposits	1.0	15.5	19.4	19.3	15.6	6.6	11.8	–0.3	...
TOTAL	**7.1**	**6.7**	**6.6**	**6.0**	**6.0**	**...**	**...**	**...**	**...**
Outstanding balance of credit									
Private sector	1.2	0.3	–0.1	0.2	0.8	1.3	1.6	1.1	...
Non-financial firms	4.9	1.1	–1.0	–0.5	0.7	2.4	3.2	2.0	...
Households - housing	–1.8	0.2	1.0	1.3	1.4	1.1	1.1	1.0	...
Households - other purposes	0.8	–1.2	–1.2	–1.1	–0.4	–0.9	–0.9	–0.8	...
General government	3.0	15.3	11.6	3.4	1.9	–3.5	–3.7	–3.8	...
TOTAL	**1.3**	**1.1**	**0.6**	**0.4**	**0.9**	**1.0**	**1.2**	**0.8**	**...**
NPL ratio (%)[4]	**4.5**	**4.3**	**4.3**	**4.3**	**4.1**	**...**	**3.9**	**...**	**...**

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

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

The Portuguese economy held up well in Q3 2022

GDP growth in Q3 was higher than expected, with quarter-on-quarter growth of 0.4%, placing the year-on-year rate at 4.9%. However, the latest indicators suggest that in Q4 the Portuguese economy could contract. Notably, both car sales and ATM transactions fell in September. In October, meanwhile, consumer confidence fell to a level close to that registered at the height of the pandemic, reflecting the deteriorating outlook. Similarly, sentiment indicators across all sectors show a weakening of confidence in October and a less rosy outlook for economic activity over the coming months. Incorporating this information into our forecasts leads us to anticipate a quarter-on-quarter contraction in GDP in Q4 2022, although following the strong performance in Q3 we maintain our 6.3% growth forecast for 2022 as a whole.

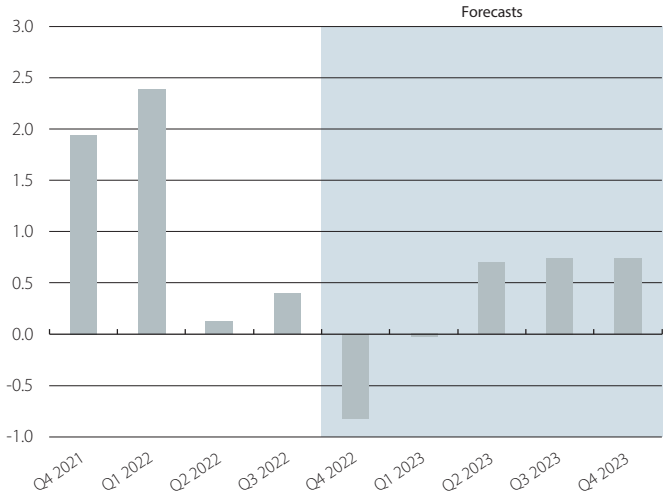
Inflation continues to climb and surpasses the 10% barrier in October. The October flash indicators suggest that inflation has risen to 10.2%, up from 9.3% in September. Unprocessed food (up 1.7% in the month) and, above all, the energy component (6.7% in the month) continue to push up prices. In the energy sphere, much of the increase is explained by the revision of regulated tariffs and prices in the electricity and natural gas markets, which came into force in October. Overall, our forecast of 7.9% average inflation in 2022 remains balanced, albeit with upside risks.

Signs of weakness in the labour market. Unemployment registered in job centres rose again in September for the second consecutive month. Specifically, it increased 1.6% in the month, reaching 287,240 people unemployed. This figure nevertheless remains much lower than before the pandemic (–4.7%, or –14,000 people unemployed), but it may indicate a change in the trajectory of the labour market. This increase is largely explained by the general government civil service sector, education, health and social support activities (+1,887 people unemployed).

We revise our housing price forecasts upwards for 2022 to 11.7% and downwards for 2023 (to –1.5%). The housing price data measured by the National Statistics Institute's IPH index for Q2 2022, as well as that of Confidencial Imobiliário's residential price index, continue to indicate significant growth. However, the outlook for next year is less optimistic: rising interest rates make financing more expensive, and the sector's expectations in terms of prices and number of transactions are about to enter negative territory. There is already a sharp slowdown in the volume of new mortgages being granted. The erosion of households' disposable income as a result of inflation and the growing burden of interest payments will dampen demand, and this will be reflected in prices.

Portugal: GDP

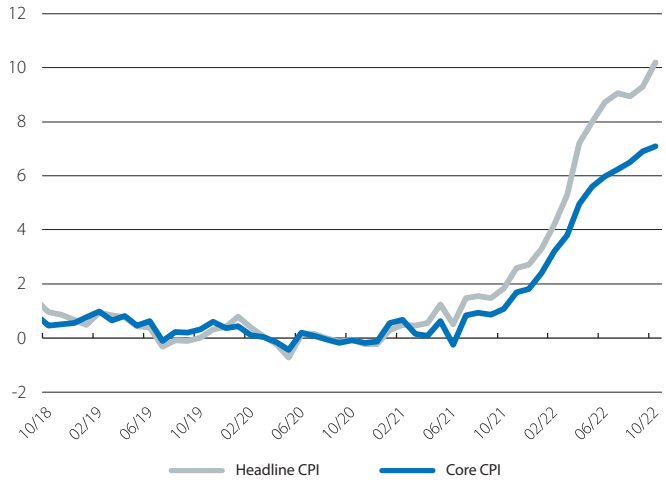
Quarter-on-quarter change (%)



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

Portugal: CPI

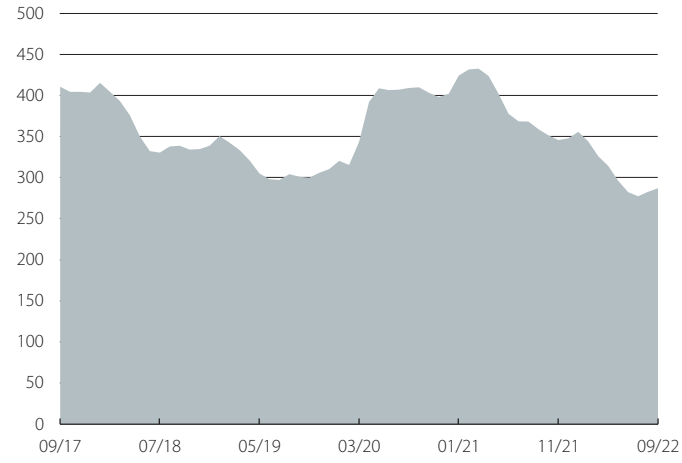
Year-on-year change (%)



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

Portugal: unemployment registered in job centres *

(Thousands of people)



Note: ** Data not seasonally adjusted.*
Source: *CaixaBank Research, based on data from the Institute for Employment and Vocational Training (IEFP).*

Habemus pactum: the agreement on wages and competitiveness will be the benchmark until 2026

The government and social agents[1] have reached an agreement to establish a medium-term plan to improve households' incomes and businesses' competitiveness. Some of the measures were already incorporated into the draft 2023 Government Budget presented in October. In this article, we will provide an overview of the main measures and goals of this plan.

As far as households are concerned, the objectives seem promising, insofar as the plan aims to offset the impact of rising prices and interest rates, as well as the potential deterioration of the labour market. With regard to wages, the target is for them to reach 48.3% of GDP by 2026, a 3-pp increase compared to 2019. To this end, the agreement incorporates a 20% increase in the average income per worker between 2022 and 2026, as well as a rise in the minimum guaranteed monthly income (national minimum wage) to 900 euros by the end of 2026.[2]

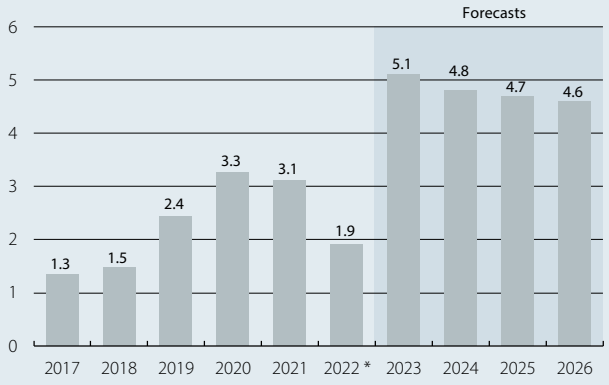
The first objective could prove to be a major challenge: if we take the historical trend in the average monthly gross base remuneration as a benchmark, fulfilling the agreement would require substantially higher increases than those seen in recent years (see first chart). As for the national minimum wage, this measure could potentially result in the percentage of workers who receive a remuneration equivalent to the minimum wage continuing to climb (as can be seen in the second chart).

In order to boost households' liquidity, the agreement also includes plans to raise the personal income tax bands by 5.1%, to guarantee fiscal neutrality in the wage updates (such that they do not result in workers falling into a higher income tax bracket, which would lead to a loss of income), as well as to bring tax withholding rates closer in line with the level of tax actually due (the degree to which this measure alters tax withholding rates could have significant ramifications for domestic demand in 2023; indeed, personal income tax reimbursements accounted for 2.2% of private consumption in 2021). It also includes an incentive to incorporate the long-term unemployed into the labour market and to boost overtime pay (from 100 hours upwards) by cutting the tax withholding rate by half. Finally, in the event of mass lay-offs or redundancy due to the elimination of a job position, the compensation is increased from 12 to 14 days.

1. Employers' confederations from industry, agriculture, tourism and the trade and services sector, as well as the UGT trade union.
2. The agreement establishes the following intentions for the minimum wage: 760 euros in 2023, 810 euros in 2024 and 855 euros in 2025. For the period 2022-2026, this represents a cumulative increase of almost 30%.

Portugal: average monthly base remuneration and objectives reflected in the agreement

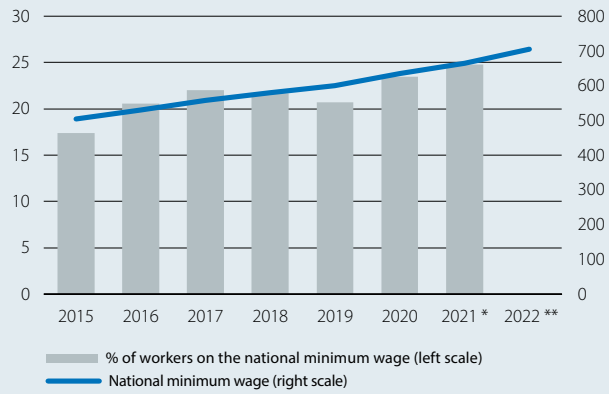
Year-on-year change (%)



Note: ** Gross base monthly average remuneration registered in 1H 2022.*
Source: *CaixaBank Research, based on data from the Wage Deal and the National Statistics Institute of Portugal.*

Portugal: workers on the national minimum wage

(% of total workers) *(Euros)*



Notes: ** Information available for 1H 2021 only. ** No information available for 2022.*
Source: *CaixaBank Research, based on data from the Portuguese Office of Strategy and Planning (GEP).*

As far as companies are concerned, it is not very clear what impact the measures might have, as on the one hand there will be an increase in personnel costs, but on the other, there will be tax relief measures and the intention to reduce administrative and transaction costs. In this regard, there will be bigger deductions in corporation tax due to the increase in wage costs for companies that meet certain milestones, such as hiring workers en masse, raising wages in accordance with the agreement and engaging in collective bargaining, as well as reducing wage inequality. Although the measure of wages as a proportion of GDP is still a far cry from the government's target, wages paid as a proportion of GVA has increased significantly since 2016: in the first half of

2022, they accounted for more than 60% of GVA, compared to 57% in 2016. On the other hand, it should also be noted that the level of non-financial firms' savings has been on the rise (over 20% of GVA), and this could prove an important buffer when it comes to dealing with the rise in costs associated with higher staff remuneration.

The agreement also includes measures which promote the capitalisation of companies, such as the creation of a tax scheme for incentivising business capitalisation, with the extension of the period during which it is possible to deduct share capital increases (from 6 to 10 years). In addition, corporation tax will be reduced for companies which invest in R&D, while the tax base limit for SMEs and companies located in the interior of the country will increase (from 25,000 to 50,000 euros), as it will for companies resulting from mergers (with the aim of promoting bigger company size). Various other tax relief/incentive measures are also adopted, such as lower taxes when buying hybrid plug-in vehicles and natural gas-powered vehicles, and the introduction of incentives to encourage the training of collaborators.

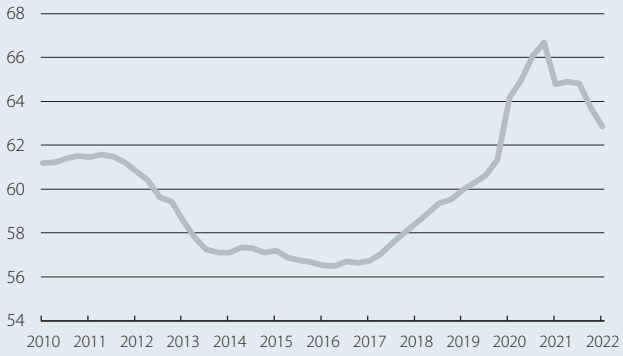
Finally, the agreement also includes measures aimed at minimising administrative costs and achieving a more favourable business environment, such as simplifying licensing, modifications to the Labour Compensation Fund (including the termination of contributions), an end to the obligation to file quarterly social security declarations for self-employed workers, new methods for making social security payments and the simplification of the process for obtaining licenses to produce energy through renewables.

This agreement is not binding or rigid: it merely contains a set of measures intended to guide the actions of social agents over the coming years, and it will be reviewed each year when the Government Budget is presented to parliament or as and when there is a change in economic and/or social conditions. A working group has been established to monitor and review the plan, composed of representatives from both the government and the social agents involved, and it will be supported by the Economic and Social Council.

Vânia Duarte

Portugal: wages as a proportion of the GVA of non-financial firms

(%)



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

Activity and employment indicators

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

	2020	2021	Q4 2021	Q1 2022	Q2 2022	Q3 2022	08/22	09/22	10/22
Coincident economic activity index	–5.3	3.5	6.6	7.4	7.3	6.5	6.5	6.2	...
Industry									
Industrial production index	–6.9	4.5	–1.5	–2.1	2.0	2.1	4.9	0.9	...
Confidence indicator in industry *(value)*	–15.3	–5.3	–1.4	–0.1	–2.3	–4.7	–4.7	–5.4	–6.3
Construction									
Building permits - new housing (number of homes)	0.7	13.5	–6.9	45.5	–23.5	...	–19.0	...	...
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	15.8	15.8	15.6	...
Services									
Foreign tourists *(cumulative over 12 months)*	–76.2	51.5	51.5	259.9	298.1	244.4	270.0	244.4	...
Confidence indicator in services *(value)*	–19.0	0.1	12.0	13.0	21.1	17.9	18.9	14.4	11.1
Consumption									
Retail sales	–3.0	4.9	7.3	12.7	3.1	3.2	4.0	2.3	...
Coincident indicator for private consumption	–6.2	4.7	7.4	6.8	5.2	2.9	2.9	2.3	...
Consumer confidence index *(value)*	–22.4	–17.2	–13.5	–19.3	–30.5	–31.8	–31.6	–32.7	–35.2
Labour market									
Employment	–1.9	2.8	3.1	4.7	1.9	...	1.0	...	...
Unemployment rate (*% labour force*)	7.0	6.6	6.3	5.9	5.7	...	6.0	...	...
GDP	**–8.3**	**5.5**	**6.6**	**12.0**	**7.4**	**4.9**	**–**	**–**	**–**

Prices

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

	2020	2021	Q4 2021	Q1 2022	Q2 2022	Q3 2022	08/22	09/22	10/22
General	0.0	1.3	2.4	4.3	8.0	9.1	8.9	9.3	10.2
Core	0.0	0.8	1.5	3.1	5.5	6.5	6.5	6.9	7.1

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	08/22	09/22	10/22
Trade of goods									
Exports *(year-on-year change, cumulative over 12 months)*	–10.3	18.3	18.3	21.2	18.9	...	21.6	...	...
Imports *(year-on-year change, cumulative over 12 months)*	–14.8	22.0	22.0	33.3	31.5	...	34.3	...	...
Current balance	**–2.1**	**–2.5**	**–2.5**	**–4.3**	**–4.7**	**...**	**–4.5**	**...**	**...**
Goods and services	–3.9	–5.7	–5.7	–6.9	–6.4	...	–5.5	...	...
Primary and secondary income	1.8	3.2	3.2	2.7	1.7	...	0.9	...	...
Net lending (+) / borrowing (–) capacity	**–0.1**	**1.2**	**1.2**	**–0.8**	**–1.3**	**...**	**–2.3**	**...**	**...**

Credit and deposits in non-financial sectors

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

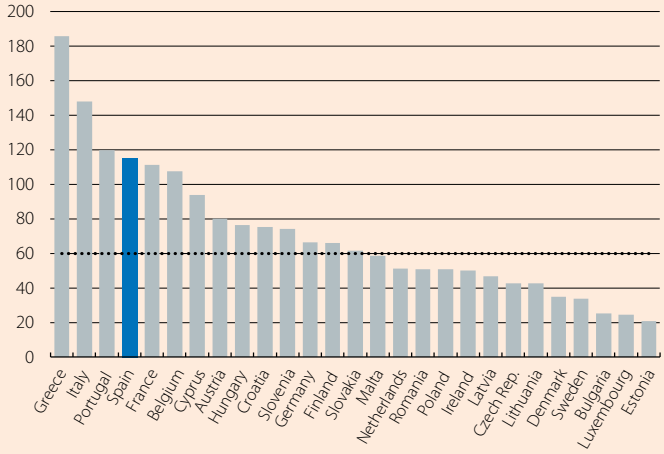
	2020	2021	Q4 2021	Q1 2022	Q2 2022	Q3 2022	08/22	09/22	10/22
Deposits [1]									
Household and company deposits	10.0	9.3	9.3	8.9	8.2	7.8	7.9	7.8	...
Sight and savings	18.8	16.3	16.3	15.3	12.9	11.2	11.6	11.2	...
Term and notice	1.2	1.2	1.2	1.1	2.3	3.3	3.1	3.3	...
General government deposits	–21.0	–4.1	–4.1	9.8	8.5	–0.1	5.0	–0.1	...
TOTAL	**8.9**	**9.0**	**9.0**	**8.9**	**8.2**	**7.5**	**7.8**	**7.5**	**...**
Outstanding balance of credit [1]									
Private sector	4.6	2.9	2.9	2.8	2.7	2.0	2.1	2.0	...
Non-financial firms	10.5	2.2	2.2	1.2	1.0	–0.2	–0.3	–0.2	...
Households - housing	2.1	3.3	3.3	3.0	3.8	3.3	3.6	3.3	...
Households - other purposes	–1.1	3.1	3.1	6.4	3.3	3.2	3.2	3.2	...
General government	–4.2	3.8	3.8	5.3	–1.3	–1.9	–0.3	–1.9	...
TOTAL	**4.2**	**2.9**	**2.9**	**2.8**	**2.5**	**1.8**	**2.0**	**1.8**	**...**
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.*

Winds of change

The starting point for the international economy in 2023, following the recent barrage of bad news, is all too familiar: heightened geopolitical risk, energy market disruptions, macroeconomic fragility, central banks' drastic response to the inflationary threat, and increased financial instability. This far from rosy picture is the result of the persistent imbalance between supply and demand that has been fuelled by the successive shocks we have faced in recent years (COVID, the war in Ukraine, bottlenecks, etc.). All this has driven the widespread rise in inflationary pressures and the sharp slowdown in growth which has been evident in the economic activity indicators since the summer. The big question is whether this process will culminate in a temporary drop in economic activity (a couple of quarters of negative growth) or whether we will face a deeper crisis that ends up affecting the labour market (stagflation?).

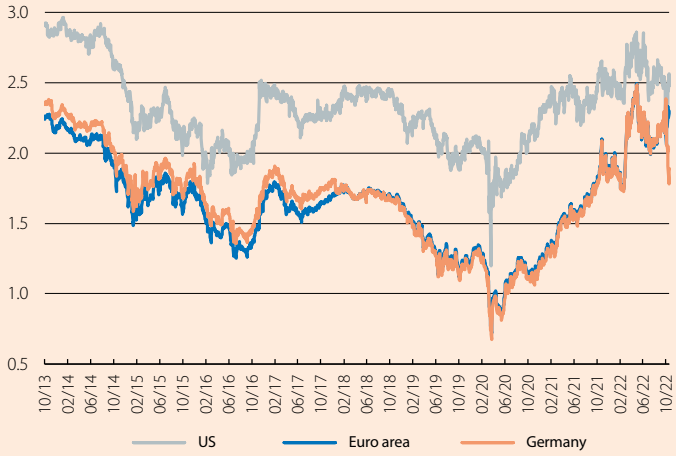
Public debt
(% of GDP)



Notes: *European Commission Spring Economic Forecast for 2022. The dotted line corresponds to 60% of GDP, the limit set by the European Treaties.*
Source: *CaixaBank Research, based on data from the AMECO database.*

Economic forecasting is a hazardous task at the best of times, but with the recent volatility in variables that are key to macroeconomic forecasting (energy prices, interest rates and exchange rates), the difficulty of incorporating geopolitical developments and their effects on expectations into the scenarios and, finally, the problem of gauging the monetary and fiscal policy response to the new challenges that are emerging almost daily, the task of making predictions for 2023 is proving particularly complicated. This is especially the case given that market sensitivity has been gradually increasing as global financial conditions have tightened over the past 12 months (+300 bps on average in advanced economies) – a trend spearheaded by the Fed, which after some initial hesitation has charged full steam ahead with no looking back.[1]

5y5y inflation swaps
(%)



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

Indeed, how this shift in monetary policy is digested by the markets, and thus the central banks' capacity (flexibility) to quell any episodes of financial instability, will be one of the key factors in determining the medium-term scenario. After all, the British mini-crisis which culminated in the resignation of Liz Truss has reminded us of the importance of fiscal policy being commensurate with the monetary challenge we face. Times are also changing for the optimal combination of economic policy that the economic situation demands. Ignoring budget tightening with a disorderly fiscal policy would distance us from the monetary authorities' target and increase the risk of financial accidents. In such a situation, the fiscal uncertainty could force the central banks to implement further interest-rate hikes, which would be akin to stepping on both the brake pedal and the accelerator at the same time, as the IMF reminded us at its latest half-yearly meeting.

Therefore, at a time when the goals of the fiscal and monetary sides are different, coordination between governments and central banks will emerge over the coming months as one of the key factors in determining how the business cycle will pan out in 2023. It is not easy to go from something resembling fiscal dominance to a regime in which short-term macroeconomic stability is once again a priority, especially with the noise that exchange-rate misalignments can generate. To a large extent, this process

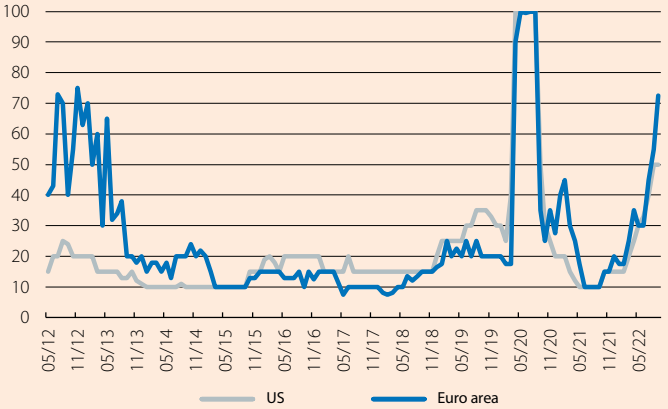
1. For further details, see the article «Is there light at the end of the tunnel? The outlook for monetary policy in 2023», in this same Dossier.

will determine the level at which the current cycle of rate hikes will culminate (the terminal rate), as well as how long it will take for inflation to once again converge on target rates.

In this context, the global economy could grow by 2.7% in 2023, with a sharp slowdown in average growth rates in both advanced countries (1% compared to 2.4% in 2022) and emerging economies (4% compared to 7% in 2022). With the current limited visibility, attempting to extrapolate what form the business cycle will take is a very difficult task. That said, it is logical to anticipate that the crisis will peak over the next six months for Europe, whereas in the case of the US the effects of the Fed's interest rate hikes are likely be felt more acutely in the spring, given the time it takes for monetary policy to affect economic activity. This cooling in demand in advanced economies up until the summer, together with the incipient improvement in the constraints on production, could lead to a gradual normalisation of the imbalances between supply and demand as the year progresses. This would allow for a moderation of inflation and a stabilisation of financial conditions, and it would lay the foundations for a return to potential growth rates beginning in the autumn of 2023, which are likely to be lower than those that existed prior to the pandemic. The question is what the short-term cost will be in terms of economic activity and jobs in order to tackle the inflation problem and, therefore, the fall in GDP over the next two quarters. This «sacrifice rate» will be determined by: the extent to which the energy commodity markets can be stabilised, central banks' credibility, and what happens with regards to second-round effects and thus whether the burden of the cost-of-living crisis we are seeing in so many countries can be shared equitably by increasing wages in line with inflation.

Probability of recession per the Bloomberg consensus

(%)



Notes: *Median among analysts participating in the Bloomberg consensus. Probability of recession in the next 12 months.*
Source: *CaixaBank Research, based on data from Bloomberg.*

The global economy will therefore continue to face major challenges in 2023, given the disruptive dynamics that continue to be present. With the unknowns regarding the performance of the Chinese economy and the evolution of the conflict in Ukraine, minimising the damage inflicted on the labour market by the current cycle of monetary tightening, as well as keeping the financial channel isolated from the noise, will be essential. It will be a year of transition, and the conditions must be laid for a return to a certain degree of normality beginning in 2024. However, there may be obstacles along the way, so economic policy must remain flexible and use surgical precision in order to make the most of an ever-shrinking margin for manoeuvre. In short, we will continue to be mired in that phase in which the old has not yet died and the new has not quite been born yet – hence the open debates on matters of such profound importance as: the suitability of current inflation strategies and targets, the role that China will play in the next decade, debt limits in the global economy, and the future of globalisation.

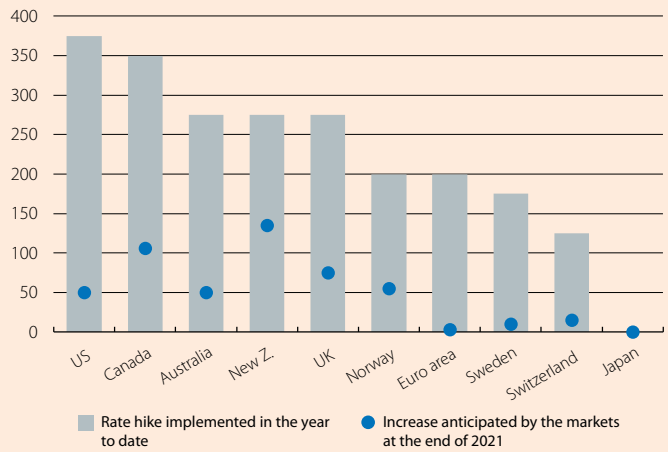
José Ramón Díez

Is there light at the end of the tunnel? The outlook for monetary policy in 2023

2022 will be remembered not only for the intensification and persistence of inflationary pressures but also for the sudden shift in the direction of monetary policy, bringing to an end more than a decade of low rates and ultra-dovish policies.

Official rate hikes announced from January to November 2022

(bps)



Notes: *Data as of 7 November. Market expectations according to the rates implicit in the OIS swaps curve.*
Source: *CaixaBank Research, based on data from Bloomberg.*

Indeed, as of early November, advanced-country central banks have, on average, approved official rate hikes of around 300 bps, marking the most aggressive adjustment since the 1980s and far exceeding what the implicit rates in the financial markets were anticipating at the beginning of the year (see first chart). The central banks have also agreed on an end to their net asset purchase programmes, and in some countries, such as the US, they have even embarked on the process of reducing the size of their balance sheets. As a result, financial conditions have tightened, which has been reflected in historical declines in the main stock indices.

Peak in sight, but at what height?

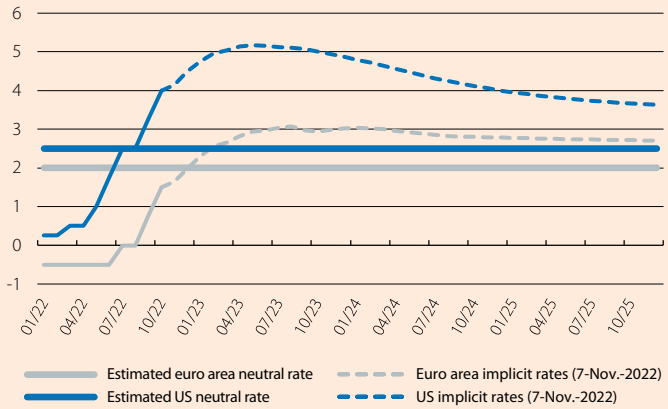
Following a tumultuous 2022, investors are betting that the current episode of monetary tightening will peak sometime in 2023.

Specifically, as of early November, the rates implicit in the markets were anticipating that official rates would peak this cycle in May in the case of the Fed and in September for the ECB, consistent with additional hikes of 125 bps to 5.0% and 150 bps to 3.0%, respectively. Even for the Bank of England, the official rate is expected to peak during the summer, at around 4.75%.

On the other hand, in the case of the Fed, the implicit rates were anticipating the first rate cuts beginning in September, while for the ECB rates are projected to stabilise in 2023, followed by modest cuts in 2024, in line with CaixaBank Research's baseline forecasts. In both regions, however, it is important to note that the official rates are likely to remain in restrictive territory – i.e. above the level considered neutral (which neither stimulates nor contracts the economy) – at least until the end of 2025 (see second chart). That said, there is a great deal of uncertainty about where these structural levels may actually lie.

Official rates and expectations according to the money markets

(%)



Notes: *Market expectations according to the rates implicit in the OIS swaps curve as of 7 November. The estimated neutral rate corresponds to central bank estimates.*
Source: *CaixaBank Research, based on data from Bloomberg.*

There are a number of factors which justify the expectations that the current cycle of rate hikes will end in 2023. Firstly, the effects of the monetary tightening introduced to date should become more palpable during the course of 2023, given that their impact on the economy is not immediate. Indeed, conventional econometric models estimate that a 100-bp rate hike in the euro area tends to be associated with a maximum impact on GDP after 12-24 months of between 0.7% and 0.9%.[1] Thus, the magnitude of the rate hikes already implemented in 2022 implies that euro area GDP growth in 2023 will be 1.0 to 1.5 pps lower than that expected in the absence of monetary tightening.[2] In any case, we must take these estimates with a large grain of salt, as they are historical averages and may not capture the uniqueness of the current context. For example, the

1. The response of the different variables to a standard monetary shock (+100-bp increase) in our model is very similar to that found in other benchmark models. For further details, see E. Llorens (2021), «Modelo semiestructural de CaixaBank Research para la eurozona», CaixaBank Research Working Paper 02/21 (content available in Spanish), and the speech by Phillip Lane entitled *The transmission of monetary policy* (11 October 2022).

higher share of new fixed-rate debt (82% in August 2022 for households in the euro area versus 57% in 2010) could mean that the increase in rates will have a smaller impact on the economy. However, the fact that the rate hike cycle has been so pronounced and unexpected, and the starting point so low, could amplify its adverse impact on growth.

Secondly, we do not believe that fiscal policy can, or should, compensate for monetary tightening, in a context of high public debt and higher financing costs. After all, pivoting to an excessively expansionary fiscal policy would likely be punished by the markets with more aggressive rate hikes, raising the risk of a resurgence of fears about the sustainability of public finances, as we saw in the United Kingdom in October.

The interaction of these elements, combined with other headwinds, explains our expectations of a sharp slowdown in the global economy next year, with below-potential growth in most countries. The resulting slowdown in the labour markets, as well as the reduction in inflation expectations, will help limit the risk of second-round effects on inflation and allow for a less reactive stance from the central banks.

As for the supply-side factors that lie behind the current high inflation, with the exception of the maintenance of zero-COVID policies in China endorsed at the recent Communist Party Congress, the disruptions to global supply chains seen throughout the pandemic are likely to continue to moderate. On the other hand, despite the high uncertainty surrounding the future of the war between Ukraine and Russia, the combination of less buoyant demand and the implementation of various containment measures[3] will likely pave the way for a relaxation of commodity prices over the next year, as suggested by the futures markets.

Balance of risks: which way could we go wrong?

It should be noted that there are risks pointing both ways in terms of the direction which monetary policy might take in 2023. On the one hand, we have the risk of inflationary shocks, which could extend the upward pressure on prices and result in more restrictive measures by the central banks. These include a potential escalation of the conflict with Russia, as well as other geopolitical events or natural disasters related to climate change. We also do not rule out further second-round effects, either through higher and more persistent wage increases or due to stronger fiscal stimulus measures.

For illustrative purposes, in a scenario with commodity prices increasing around 50% more than in our central forecast, euro area inflation could remain at the current levels throughout 2023 and not fall back down to 2% until 2026 (we are currently forecasting that this will occur at the end of 2024). In such a scenario, it would not be unreasonable to expect the ECB to raise official rates to around 5%.

On the other hand, there is the risk of disinflationary shocks, such as a de-escalation in geopolitical tensions or a sharper than expected contraction in the economy, whether due to disruptions in the financial markets or any other systemic event. In the event of a geopolitical de-escalation, while we expect the medium-term effect would be less upward pressure on prices, in the short term the positive demand shock – triggered by reduced uncertainty and lower energy prices – would delay the drop in inflation. In this scenario, central banks could respond with additional rate hikes at the beginning of the year (possibly of around 50 additional bps) before initiating a downward cycle thereafter. In the event of a sharp contraction in the economy, however, we would expect central banks to respond by reintroducing monetary stimulus measures, such as net asset purchases in order to stabilise the markets, and possibly even official rate cuts.

2022 has been a year marked by high uncertainty surrounding the economic outlook, both due to the decoupling between supply and demand following the pandemic and due to the war in Ukraine. This has led to substantial forecast revisions, both in relation to inflation and growth and with regard to the response of the central banks. Looking ahead, the forecast for the economy that we can be most sure of right now is that uncertainty will remain high in 2023.

Antonio Montilla and Ricard Murillo Gili

2. In the case of the US, the impact would be greater, considering not only the more aggressive pattern of rate hikes but also the Fed's balance sheet reduction plan. For the ECB, some voices within the Governing Council are already advocating a halt to the reinvestments of assets maturing under the asset purchase programme (APP) in 2023. In any event, the ECB's balance sheet will be reduced in 2023 due to the maturity of several rounds of TLTROs.
3. See the article «Economic policy in the face of the energy challenge: supporting the most vulnerable without distorting the economy» in this same Dossier.

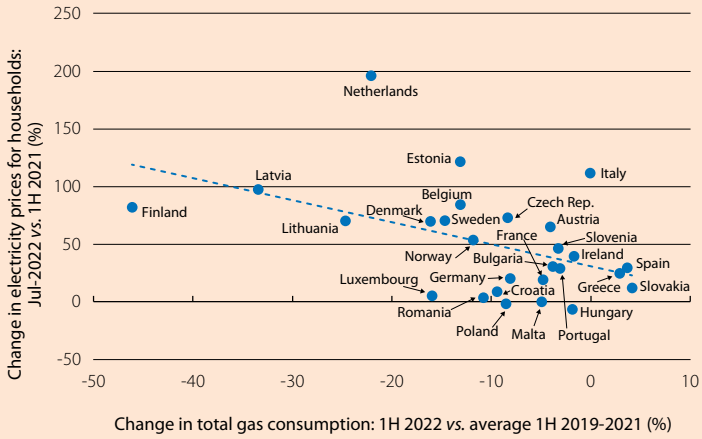
Economic policy in the face of the energy challenge: supporting the most vulnerable without distorting the economy

Economic policy is on a tightrope, as it faces the titanic task of mitigating the impact of the energy shock on households and businesses in a difficult context and with limited fiscal margin for manoeuvre, given that the public accounts have already been dented by the COVID-19 pandemic – indeed, public debt in the euro area surpassed 100% of GDP in 2020, and the deficit exceeded 5.0%. The test in 2022 has been demanding, but with the prospect of energy prices in 2023 still above those before the outbreak of the war in Ukraine, economic policy will once again be at the heart of the debate and will have to roll up its sleeves to propose recipes to cushion this protracted shock.

The line separating success from failure is thin, and success is not guaranteed. The theory is clear, but putting it into practice is not so simple. There are two types of action in the current situation: the first, providing aid through income policies such as direct subsidies; the second, through price interventions (price caps, reducing excise duties on energy and VAT, etc.), and both types of action can be either specific to certain groups or generalised across the wider population. Economists from the major economic institutions (OECD, IMF, etc.) advocate temporary measures that are highly targeted towards vulnerable households to ensure they do not bear the full brunt of the rise in energy prices. Thus, generalised measures – whether price controls or sweeping direct aid – are not recommended, for several reasons:

- They interfere with the inevitable reductions in demand due to the higher prices, which can lead to higher inflation in the medium term, as well as hindering the energy transition.
- They distort price signals, which are necessary to encourage energy saving and incentivise the transition towards a decarbonised economy.
- They can only defer the impact that the price rally will have on households, given that the prospect of a long war means that the current high inflation will persist for longer than initially expected.

Gas: household prices and total consumption



Note: *The HEPI gathers price data in the capital city of each country, and these are taken as an approximation for the price in the country as a whole as of July 2022.*
Source: *CaixaBank Research, based on data from Bloomberg and the HEPI.*

From theory to practice: price caps and less targeted forms of aid

Textbook theory is all very well, but governments then have to apply it in a context of social discontent that is essential to tackle. Moreover, it is not always easy to identify who the most vulnerable members of society are. In this regard, advanced economies have faced a veritable energy storm in 2022, and the response of most governments has been closer to that of France (the paradigm of generalist measures and price interventions) than to that of the United Kingdom under Boris Johnson (before its dissolution, his government's actions were close to the IMF's recommendations). As can be seen in the second chart, most of the support in 2022 has focused on economic policies for the entire population that prevent the rise in wholesale energy prices from being passed on to final consumers (price caps, reductions in levies on energy consumption and production, and VAT cuts for energy products, etc.), followed by generalised income policies (either affecting the whole population or very large groups irrespective of their income level, such as users of public transport or those in employment). The measures aimed at supporting vulnerable groups, on the other hand, have been much more limited.

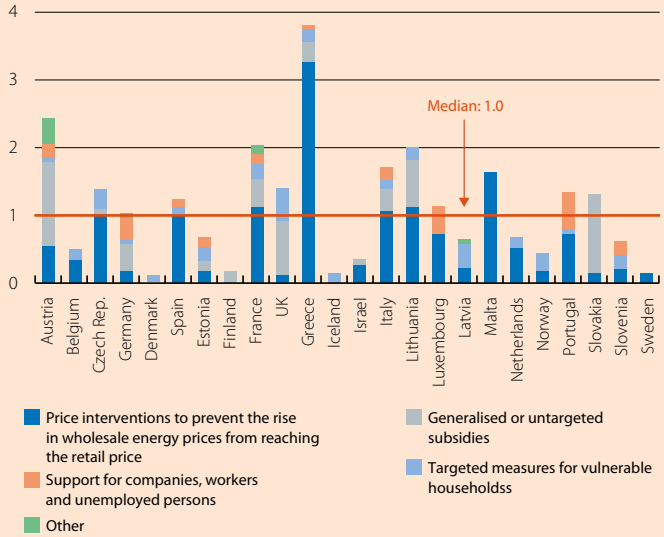
In this context, the proposal put forward by a German think tank contains some interesting elements. They suggest establishing a subsidy on 80% of households' gas consumption (70% for companies), which would result in considerable savings on gas bills.[1] At the same time, the scheme maintains the incentives proposed to reduce gas usage: market prices apply on the remaining

1. Of 40%, according to some estimates.

amount and, moreover, the subsidy would refer to the quantities consumed in 2021. However, they propose applying it to all consumers.

Nevertheless, the scale of the German plan (200 billion euros, slightly over 5% of GDP)[2] has caused a stir due to the risk of distorting the level playing field in the European single market. This brings us to the role that the EU must play, for Europe will better weather the crisis if it is united rather than disbanded.

Europe: fiscal cost of support measures announced in response to higher energy prices
(% of GDP, 2022)



Note: *Measures announced in the first half of 2022 to be deployed throughout the year.*
Source: *International Monetary Fund.*

European coordination

On the one hand, the EU can play a coordinating role in order to avoid negative externalities and exploit positive ones. As an example, with each government focused on securing its own gas supply, the EU could end up with substantial overcapacity in the medium term.[3] In addition, the instinctive national response has generally been to sustain demand with subsidies for gas and electricity consumption, which generates negative externalities and drives up prices across the EU. In the current crisis, however, European solidarity must focus on cutting energy consumption (rather than increasing common spending, as was the case during the pandemic): the key thus lies in coordinating the cuts in usage.[4] Thus, the European Commission's plan is a step in the right direction, insofar as it proposes reducing electricity and gas consumption (by 10% and 15%, respectively).[5] That said, there are some voluntary elements to these cuts and the plan is not free of exemptions.[6]

In the same vein, EU coordination is also important for ensuring the efficient flow of energy between countries. This applies in both the short and long term. In the long run, the decarbonisation of the economy and increased renewable production will lead to more variable power generation, increasing the benefits of a Europe-wide interconnected grid. Improving interconnections in the short term is also essential. The case of liquefied natural gas (LNG), which is key to replacing Russian gas in the current crisis, offers a prime example: 25% of the EU's LNG import capacity is located on the Iberian Peninsula, which in practical terms is disconnected from the large European market. In this regard, the recent agreement between Spain, France and Portugal for the construction of a sea pipeline between Barcelona and Marseille, which in the medium term could temporarily transport gas from the Iberian peninsula to the rest of the continent and in the long term will be used for green hydrogen, is a step in the right direction.

Finally, the EU must ensure a level playing field in the European single market. In particular, given the disparity in Member States' fiscal margin (which the powerful German package has only underscored), a European fund that guarantees a minimal level of support for businesses and households in all countries would make sense.[7] This could involve aid being provided subject to certain conditions being met in order to encourage cooperation between Member States and favour well-designed national policies (for instance, by penalising the implementation of policies that oppose energy saving or which limit international energy flows, and allocating more funds to countries that strive to increase supply, etc.).

Javier Garcia-Arenas and CaixaBank Research

2. This 200 billion euros will be distributed between 2023 and 2024, some 90 billion of which is set aside for the partial subsidy for household and company gas bills, while the funds earmarked for the complete nationalisation of the energy company Uniper amount to 30 billion.
3. Of between 30% and 45% of demand by 2030, according to McWilliams *et al.* (2022). «A grand bargain to steer through the European Union's energy crisis». Policy Contribution, Bruegel.
4. Similarly, fiscal and monetary policies must not act in uncoordinated isolation, and the former must not undo the latter's efforts to cool demand.
5. Europe has also approved a cap of €180/MWh on the income of infra-marginal producers (between December 2022 and June 2023) and a tax on the fossil fuel sector.
6. In particular, the 15% cut in gas usage between August 2022 and March 2023 is voluntary, although the European Council may make it mandatory if it activates an emergency clause. In addition, exemptions can be obtained by Member States with key industries that are critically dependent on gas, as well as countries with limited interconnectivity or which export gas at their full potential, among other cases. Moreover, the 10% cut in electricity usage between December 2022 and March 2023 is also voluntary, but it is mandatory to reduce it by 5% at peak times.
7. Taglapietra *et al.* (2022). «Does the European Union need an energy crisis fund?». Bruegel Blog.

Outlook for Spain: 2023, a year fraught with challenges

2022 recap

Russia's invasion of Ukraine has led to the most significant European energy crisis in recent decades. It has triggered a surge in gas prices in Europe, increased the climate of uncertainty, and led to a cycle of aggressive interest rate hikes by the ECB in an attempt to curb the inflation rally. Within the European context, Spain is comparatively well placed to deal with this crisis: our dependence on Russian gas is much lower than that of other major European economies, and our capacity to use liquefied natural gas by means of regasification terminals gives us a greater ability to diversify gas imports.[1] Thus, we are unlikely to see episodes of rationing in our country, despite the indefinite cut-off of Russian gas supplies to northern Europe since September 2022. Yet our economy is not immune to the rise in gas prices or to the sharper than expected interest rate hikes. Thus, although this demanding context has failed to slow the recovery of the tourism sector in 2022, it has nevertheless hampered the execution of the NGEU funds, owing at least in part to the drop in the demand for investment in the face of greater uncertainty, while the rise in inflation has eroded the buffer provided by the excess savings inherited from the pandemic.

For 2022 as a whole, we expect the economy to grow by 4.5%. However, behind this figure lies a declining trend. Whereas GDP growth in Q2 stood at 1.5% quarter-on-quarter, in Q3 the economy has grown by a mere 0.2% quarter-on-quarter and we anticipate a slight contraction in Q4.

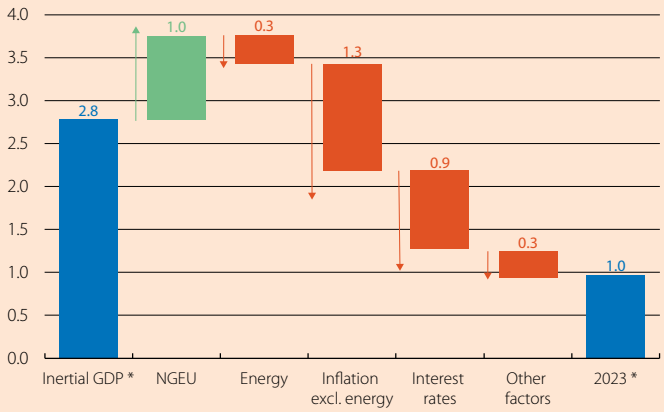
2023 will bring very modest growth

To illustrate what lies behind our outlook for the Spanish economy in 2023, we have broken down our 1.0% GDP growth forecast into the main contributing components (see first chart). In the absence of the geopolitical conflict, the outlook for 2023 would have been quite encouraging: the cyclical boost from the economic recovery effect and the impact of the European funds would have driven the economy to grow by around 4%.

However, the energy crisis has pushed up energy prices, led to a sharp rise in inflation and triggered a cycle of aggressive interest rate hikes. While we expect the adverse impact of the rise in energy prices on economic growth to have peaked in 2022, it is in 2023 that we expect the impact of the higher inflation and interest rates to reach its climax.

Starting with energy prices, the MIBGAS gas price has risen from an average of around €50/MWh in 2021 to one of around €110/MWh between January and September 2022 – slightly more than double. For 2023, we expect the price to continue to climb, albeit to a lesser degree.[2] Given that energy prices rose more sharply in 2022 than they are expected to in 2023, the increase in energy prices has had a greater impact in 2022 (when we estimate it subtracted just over 1 pp from GDP growth) compared to that expected in 2023 (–0.3 pps). It should be noted, however, that the recent fall in gas prices – due to the measures announced by the European Commission to impose a cap on the price, as well as the high temperatures this autumn – could mean lower energy prices in 2023 than those assumed in our scenario, and thus a lower impact of this factor on growth.

2023 GDP: breakdown of the anticipated growth
(pps)



Notes: ** Year-on-year change (%). Inertial GDP is calculated using a regression of the annual change in GDP against the first time-delay in GDP and the output gap of the previous year. The time-delay captures the usual inertia of GDP, while the output gap captures the momentum of the economy according to its position in the business cycle.*
Source: *CaixaBank Research, based on CaixaBank data.*

Secondly, inflation, excluding the energy component, is expected to remain high at around 5%, largely due to the indirect effect which the rise in energy prices has on other components of the consumer price index. According to our estimates, this channel could subtract around 1.3 pps from growth. To some extent, this assessment incorporates the rise in inflation accumulated from the previous year. Think in terms of expectations: if the inflation rally was initially assumed to be only

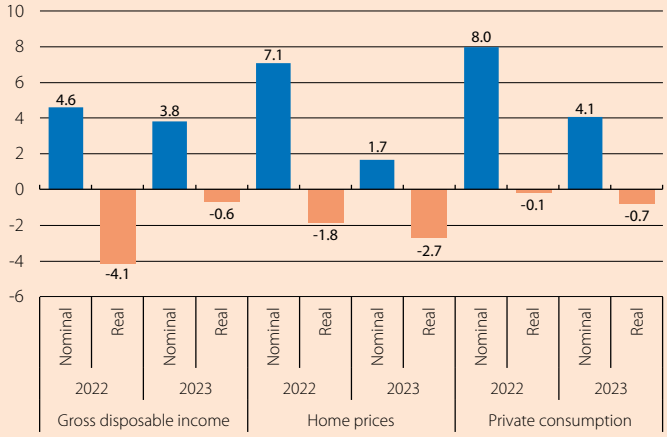
1. 9% of our gas imports in 2021 came from Russia, compared with 65% in the case of Germany and 38% for Italy.
2. The Brent barrel price rose from an average of around €60/barrel in 2021 to one of around €95/barrel between January and September 2022, but we expect the oil price to remain very close to this level in 2023, so its contribution to 2023 growth would be virtually nil.

transient, then the impact on growth in the early stages of the shock would have been limited, given that economic agents would not have significantly altered their spending decisions. However, as time passes and those agents witness the greater persistence of the price rally, they adjust their spending decisions more, resulting in a greater macroeconomic impact.

Finally, the cycle of rate hikes embarked on by the ECB in July 2022 will have its greatest impact in 2023, as it takes a few quarters for its effects to fully materialise, and this is expected to subtract around 1 pp from GDP growth in 2023. It should be recalled that the ECB is expected to raise rates by around 300 bps between July 2022 and March 2023; an increase of such magnitude and speed is unprecedented since the euro entered into circulation.

Growth projections for private consumption and its determining factors *

Year-on-year change (%)



Note: ** Forecast for 2022 and 2023 according to CaixaBank Research forecasts as of October 2022.*
Source: *CaixaBank Research, based on data from the National Statistics Institute.*

The high inflation and the rate hikes will take a toll on private consumption in 2023

We end our discussion by analysing the impact of inflation on purchasing power and how we can expect household consumption to evolve. As can be seen in the second chart, inflation is expected to have a substantial negative impact on household purchasing power, given that gross disposable income in real terms has fallen significantly in 2022 and we do not expect it to recover in 2023. Furthermore, the aforementioned rise in interest rates will also impact consumption, as households with loans exposed to interest rate fluctuations will have to allocate a larger portion of their income to servicing their interest payments. Thus, the loss of purchasing power and the rise in rates leads us to anticipate that real consumption will remain virtually stagnant in 2022 and will likely register negative growth in 2023, potentially exceeding –0.5%.[3] This decline would not only reflect the evolution of the factors which determine consumption in 2023, but it would also capture the change in expectations regarding the persistence of the shocks experienced in 2022.

All in all, 2023 looks set to be a year fraught with challenges. Growth is expected to slow as the economy adjusts to the energy crisis we are experiencing. Against this backdrop, we can only hope that all these adjustments will lead us towards an economy that is better prepared to face the challenges that lie ahead.

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3. This is a two-stage linear regression model. First, an estimate is made regarding the long-term relationship between consumption and its determining factors, namely: gross disposable income, net household financial wealth, housing prices and long-term sovereign interest rates (all variables in logarithms, except interest rates, deflated by the CPI). A regression is then estimated between the quarter-on-quarter growth rate of consumption and the quarter-on-quarter change in employment, wages and the remainder of the equation from the first stage. The first two factors capture the short-term impact that these variables have on consumption, while the latter factor captures the tendency that consumption has to revert to its long-term trend rate determined by its underlying factors.

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