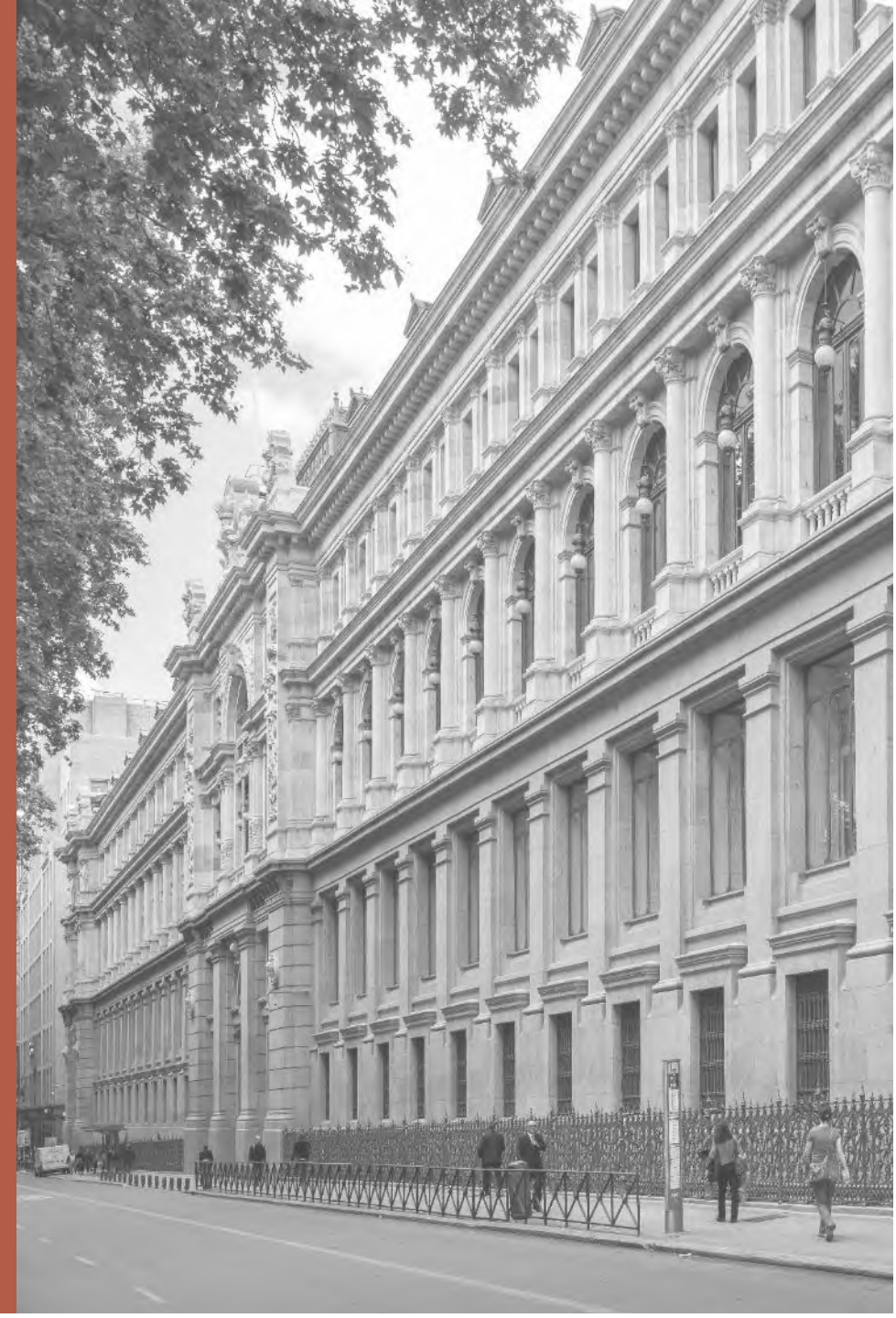


ECONOMIC DEVELOPMENTS IN THE CURRENT INFLATIONARY SETTING AND THE ECONOMIC POLICY RESPONSE

Pablo Hernández de Cos
Governor

BOARD OF THE CHAMBERS OF COMMERCE OF CASTILE-LA MANCHA

Toledo
26 September 2022



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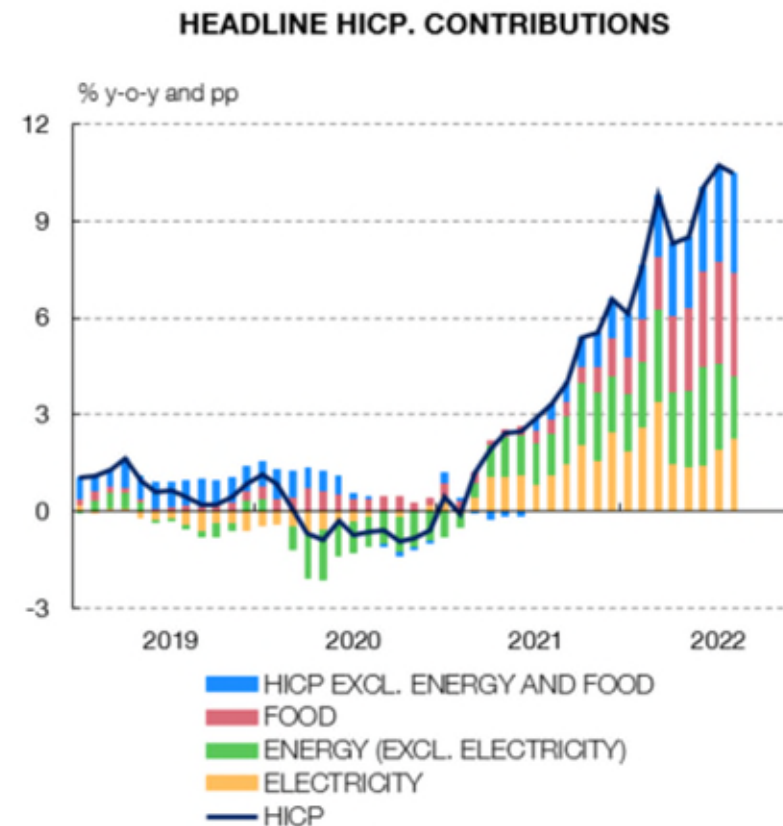
1. The main determinants of the current economic outlook
2. Recent developments and outlook
3. The economic policy response

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1. The main determinants of the current economic outlook
2. Recent developments and outlook
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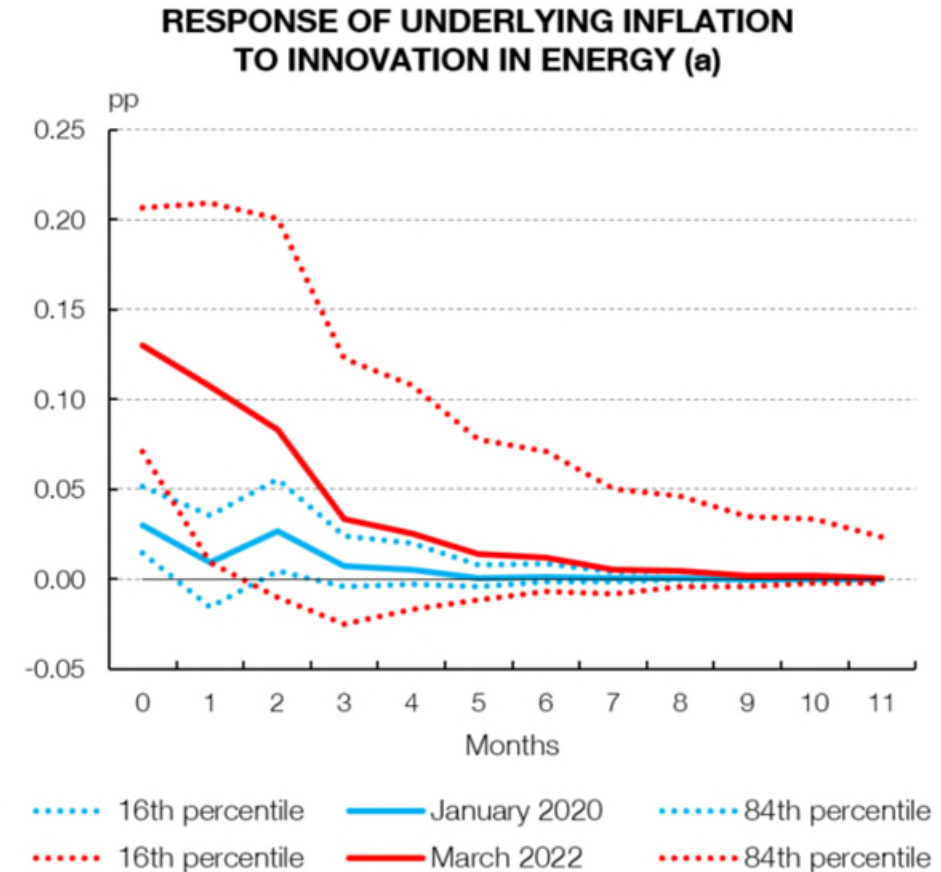
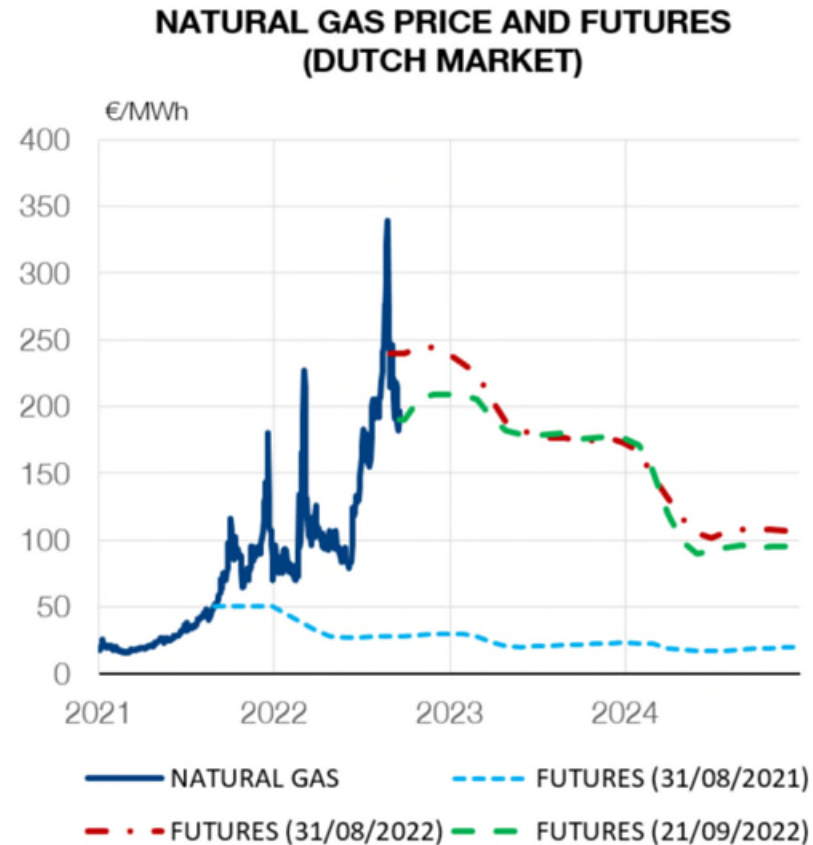
INFLATION REMAINS VERY HIGH GLOBALLY. IN EUROPE AND SPAIN THE ENERGY COMPONENT HAS PLAYED A VERY IMPORTANT ROLE IN INFLATION DEVELOPMENTS



SOURCE: INE. Latest observation: August.

a) Consumer price index (CPI) up to December 1996. Harmonised index of consumer prices (HICP) from January 1997.

IN A SETTING IN WHICH ENERGY MARKET STRAINS ARE MUCH MORE ACUTE AND PERSISTENT THAN WAS EXPECTED A YEAR AGO

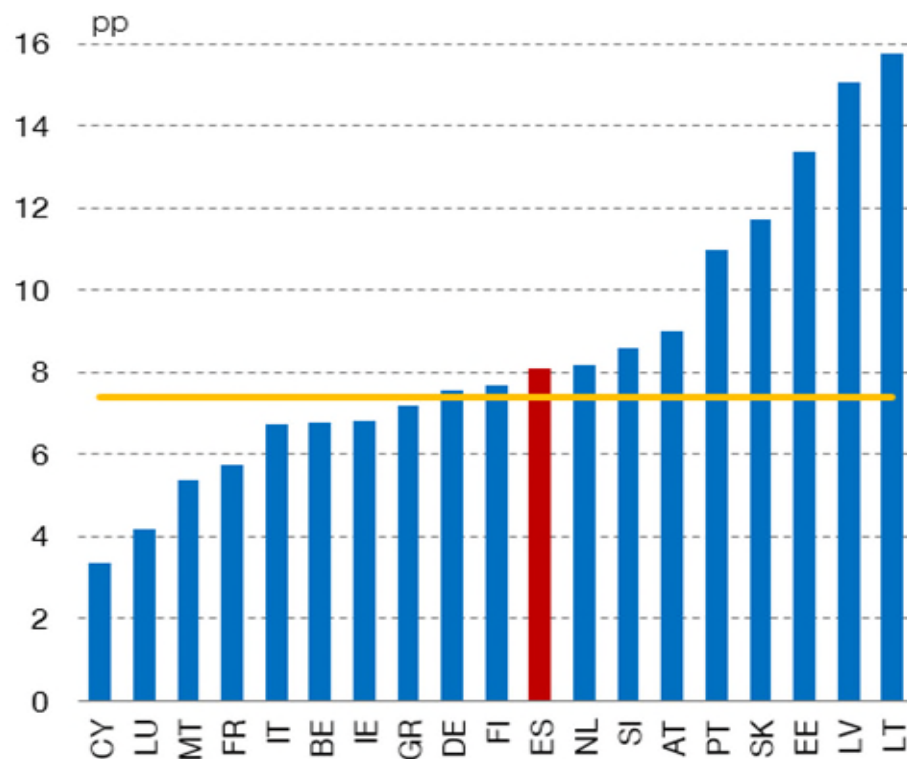


SOURCES: Refinitiv and Banco de España.

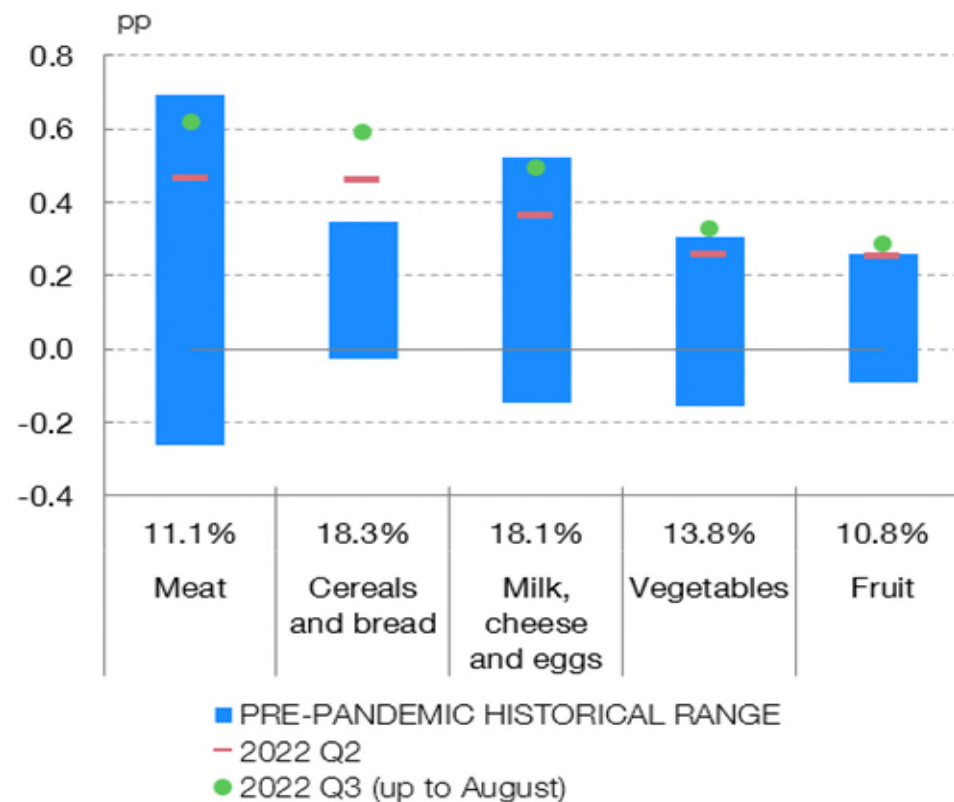
a. Effect of an unexpected increase of 1% in energy prices on underlying inflation. Results of estimating a VAR model with parameters that change over time following random walks. The model includes monthly inflation of the energy component and of the underlying component and the growth rate of a measure of monthly GDP. This model is estimated using a sample encompassing April 2004-March 2022. The structural innovations are obtained by means of the Cholesky decomposition. See J. M. González Mínguez, S. Hurtado, D. Leiva-León and A. Urtasun (2022). “De la energía al resto de componentes: la generalización del fenómeno inflacionista”, Artículos Analíticos, *Boletín Económico*, Banco de España, forthcoming.

FOOD PRICES HAVE ALSO RISEN PARTICULARLY SHARPLY, BOTH IN SPAIN AND IN THE EURO AREA

**ACCELERATION OF FOOD
IN THE HICP IN 2022 (a)**



**FOOD COMPONENTS WITH THE LARGEST
CONTRIBUTION TO HEADLINE INFLATION (b)**

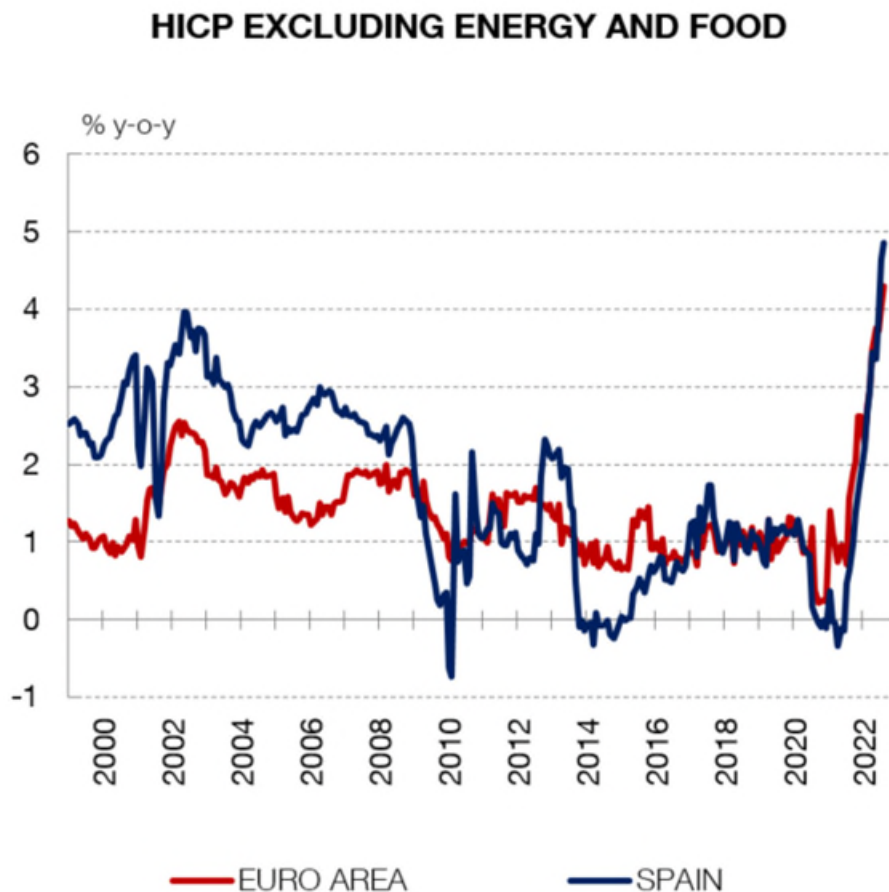


SOURCES: Eurostat, INE and Banco de España.

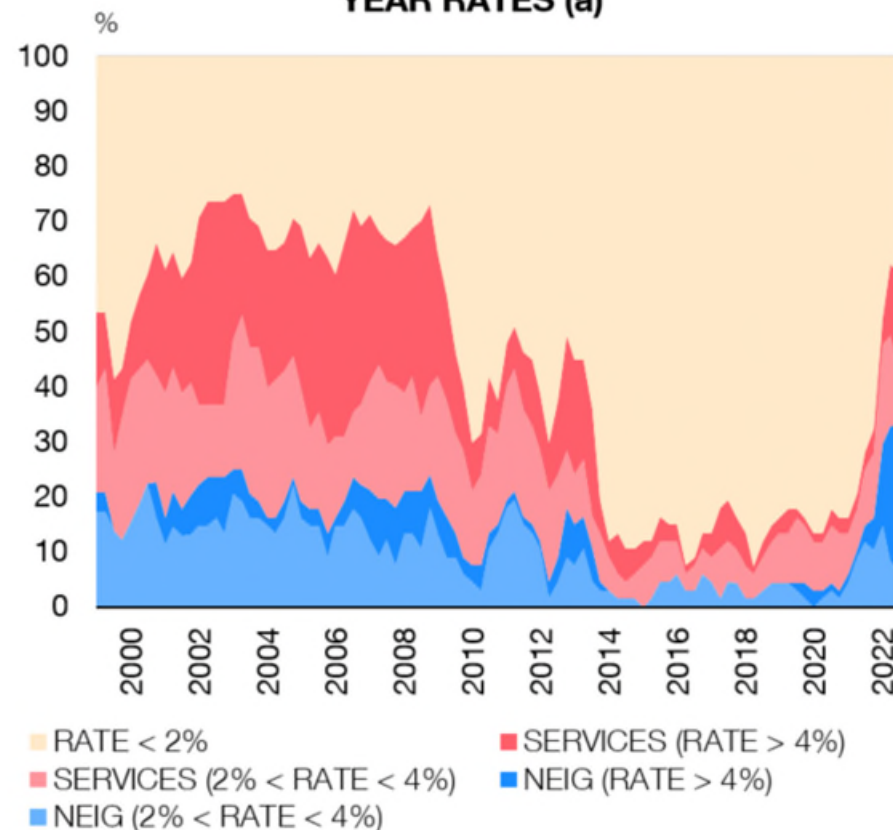
a) Increase in the year-on-year rate between December 2021 and August 2022.

b) Components ranked by their contribution to the headline inflation rate in 2022 Q3 (data up to August). The figure above each component denotes its respective inflation rate in 2022 Q3.

THE LESS VOLATILE CPI COMPONENTS ARE UNDER STRONG UPWARD PRESSURE, IN PART DUE TO THE INDIRECT EFFECTS OF ENERGY AND FOOD



PROPORTION OF UNDERLYING INFLATION COMPONENTS AT DIFFERENT INTERVALS OF YEAR-ON-YEAR RATES (a)

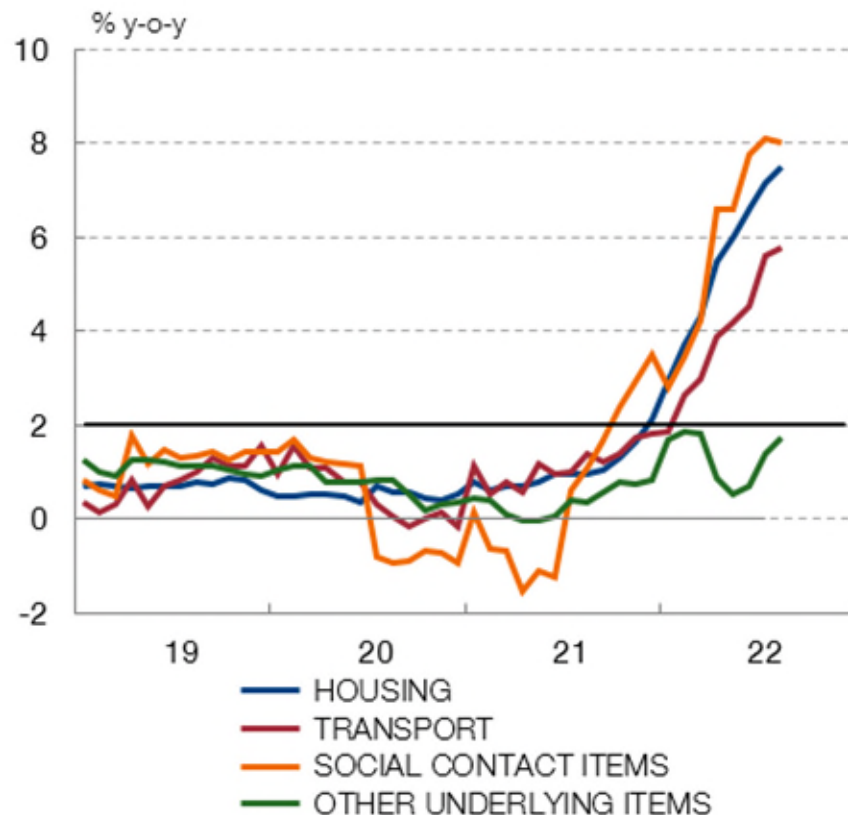


SOURCES: INE and Banco de España.

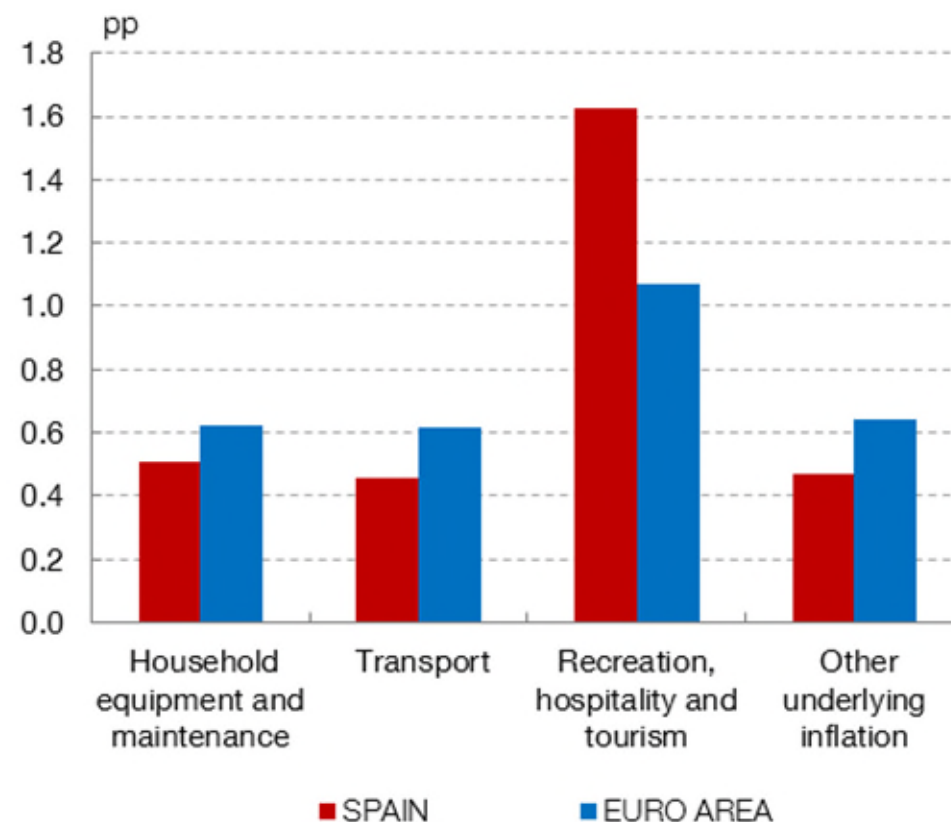
a) Quarterly HICP data. 2022 Q3 data refer to July and August. The NEIG category denotes non-energy industrial goods.

THE CONTRIBUTION OF SOME COMPONENTS, SUCH AS “RECREATION, HOSPITALITY AND TOURISM”, TO HEADLINE INFLATION IS PROVING ESPECIALLY STRONG IN SPAIN

**UNDERLYING INFLATION:
SUB-INDICES BY PURPOSE (a)**



**CONTRIBUTION TO HEADLINE INFLATION
AUGUST 2022**

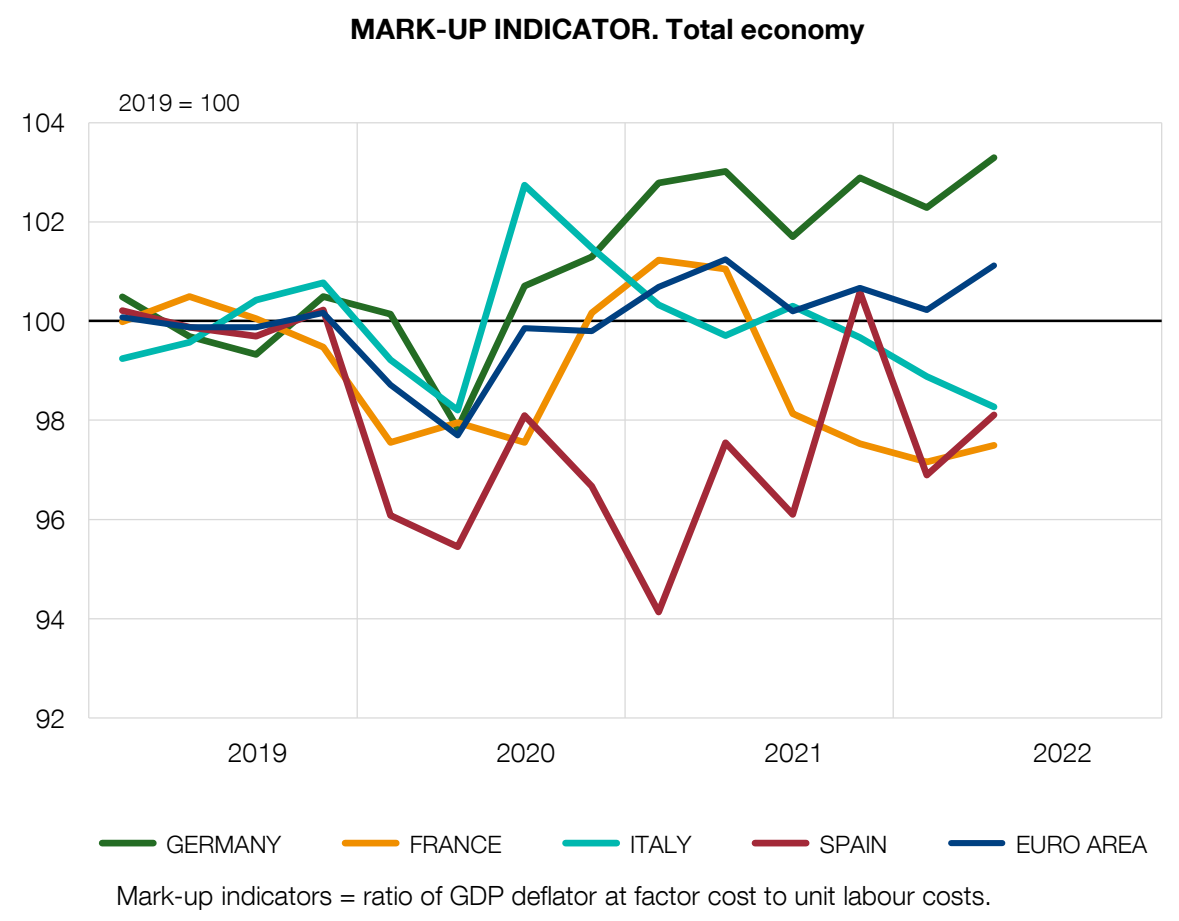
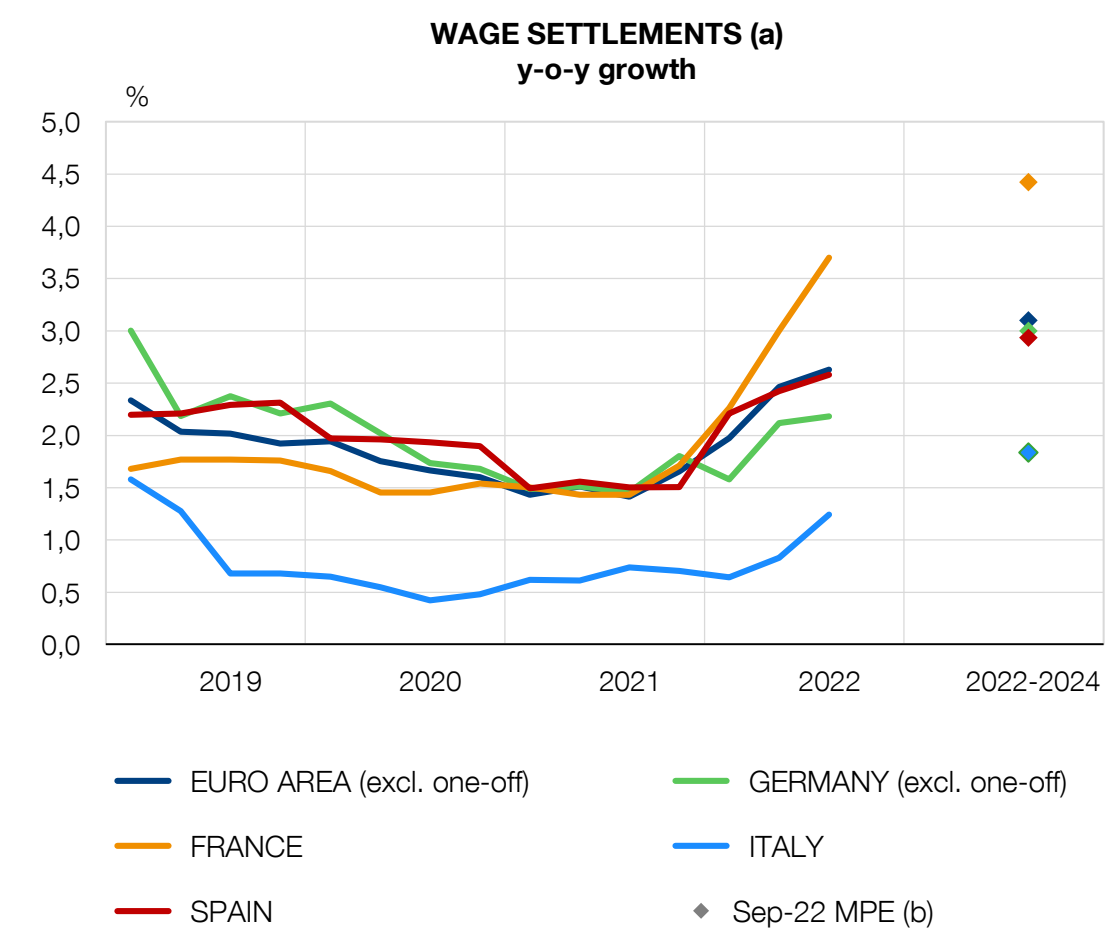


SOURCES: INE, Eurostat and Banco de España.

a) The “Other underlying items” sub-index includes “Clothing and footwear”, “Housing” (excluding energy and home maintenance expenditure), “Health”, “Communications”, “Education” and “Miscellaneous goods and services”. The sub-index includes rental of main residence, but not holiday rentals.

WAGE SETTLEMENTS CONTINUE TO RISE AT A MODERATE PACE, FAR BELOW INFLATION. MARK-UPS REMAIN BELOW THEIR PRE-PANDEMIC LEVEL, EXCEPT IN GERMANY

BANCO DE ESPAÑA
Eurosistema



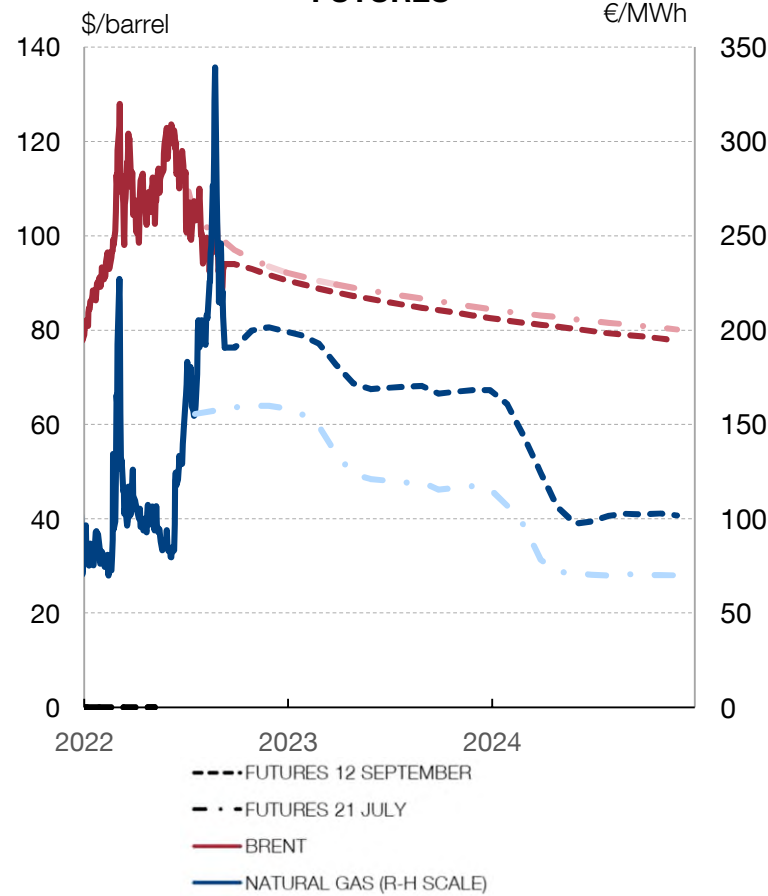
SOURCES: Eurostat, European Commission and ECB. Latest observation: June 2022 (euro area and France), July 2022 (Germany and Italy) and August 2022 (Spain).

a. Observed data refer to wage settlements in the total economy, except in France and Spain, where they refer to the market economy.

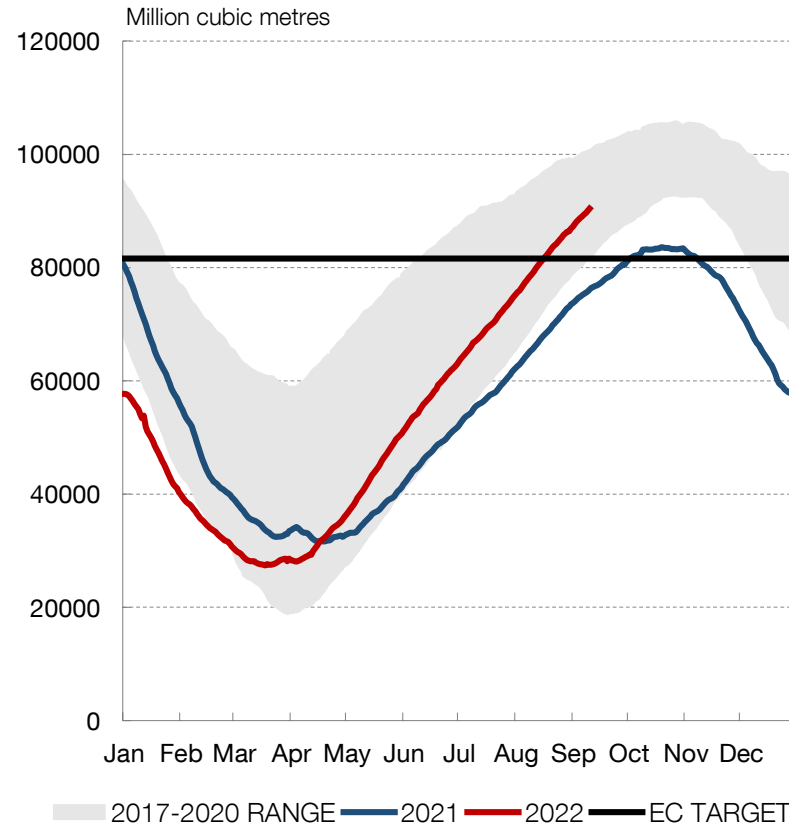
b. The forecasts refer to the total economy for all countries (except for Italy, where they refer to the private sector). Preliminary forecasts from the September 2022 MPE (except for the euro area, which are from the June 2022 BMPE). For France, they refer to compensation per employee adjusted for job retention schemes.

THE WAR IN UKRAINE AND ITS IMPACT ON GAS PRICES AND SUPPLIES ARE PLAYING, AND WILL CONTINUE TO PLAY, A CRITICAL ROLE IN THE ECONOMIC OUTLOOK

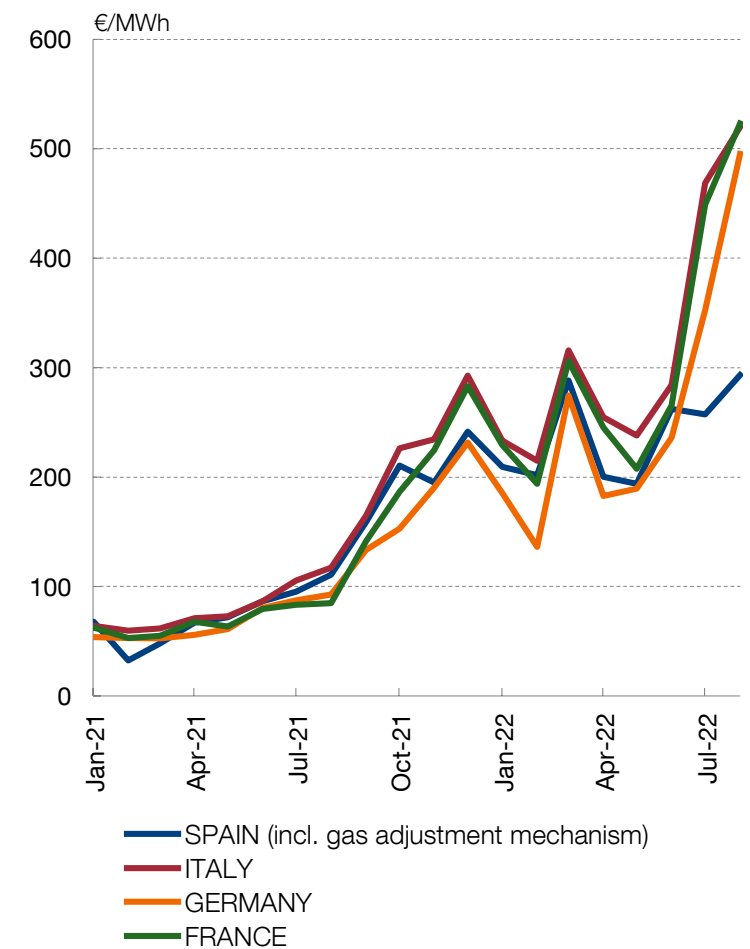
OIL AND NATURAL GAS PRICES AND FUTURES



NATURAL GAS INVENTORIES IN EUROPE



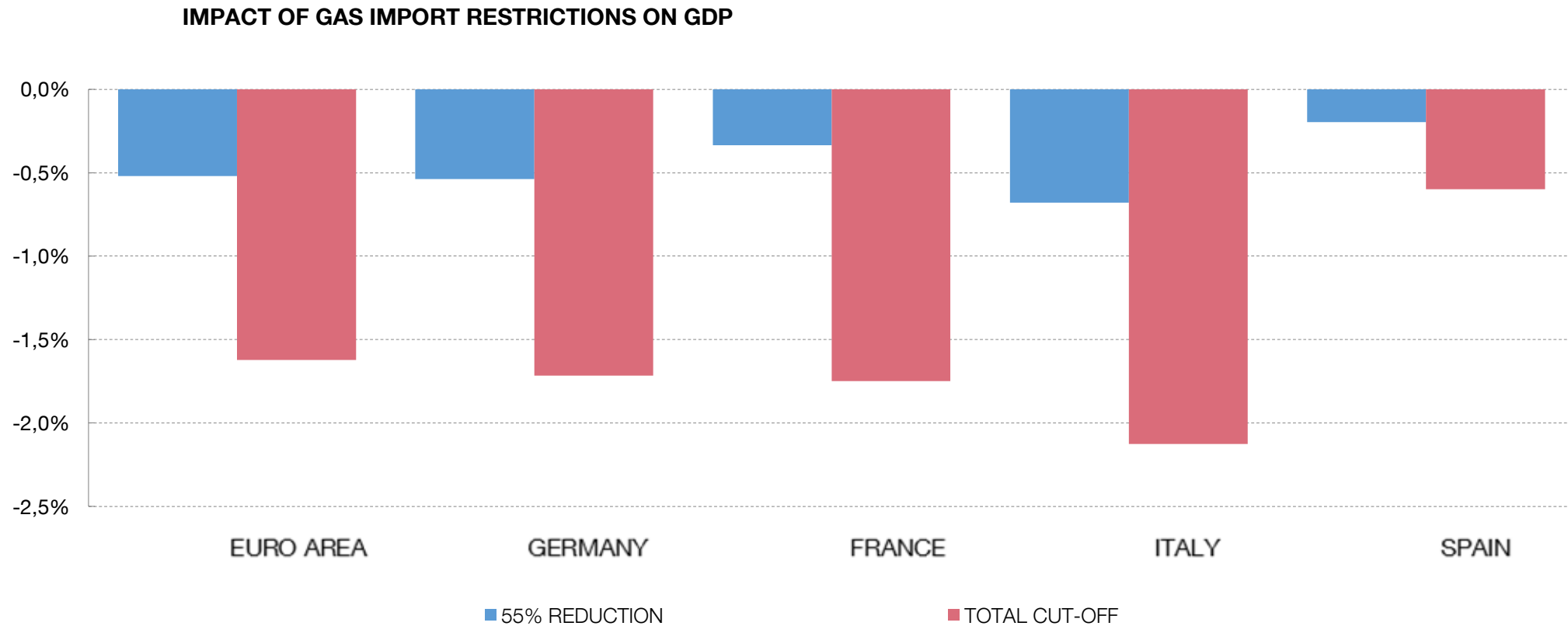
ELECTRICITY PRICE ON THE GENERATION MARKET



SOURCES: Refinitiv, IEA, Bloomberg and ENTSOG.

THERE IS MUCH UNCERTAINTY ABOUT THE MAGNITUDE OF THE POTENTIAL SLOWDOWN IN THE EVENT THAT RUSSIA CUTS OFF SUPPLIES

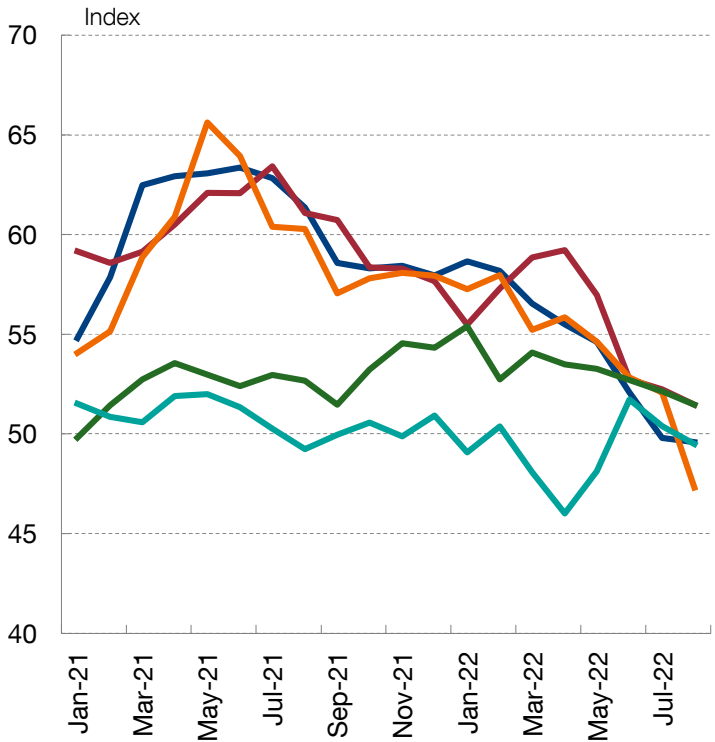
The Spanish economy would be hit by a total cut-off of gas supplies from Russia, but not as hard as other euro area countries would foreseeably be



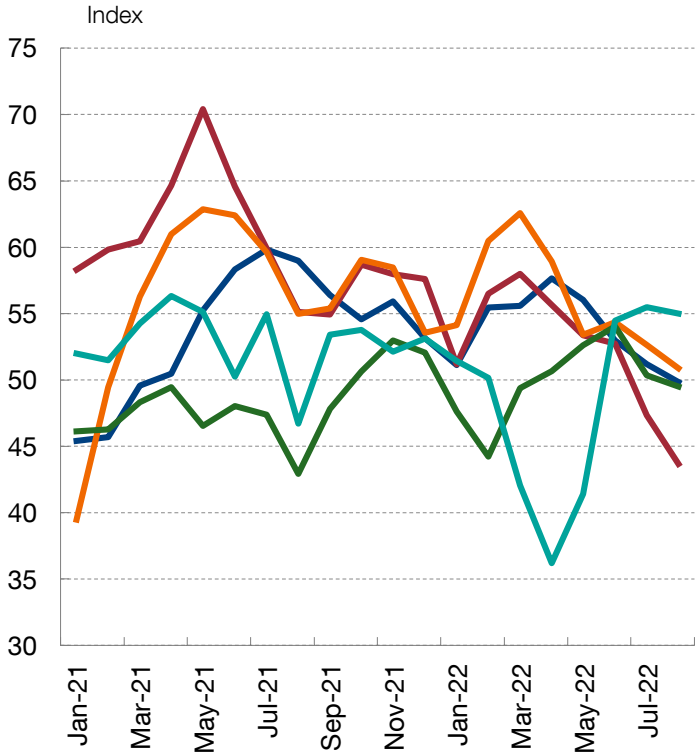
SOURCE: Izquierdo, Moral-Benito, Prades and Quintana (2022). "The propagation of worldwide sector-specific shocks", *Working Paper* No 2213, Banco de España.

ASIDE FROM HOW THE WAR UNFOLDS AND ITS IMPACT ON THE EUROPEAN ECONOMY, THE GLOBAL ECONOMIC OUTLOOK HAS ALSO WORSENE

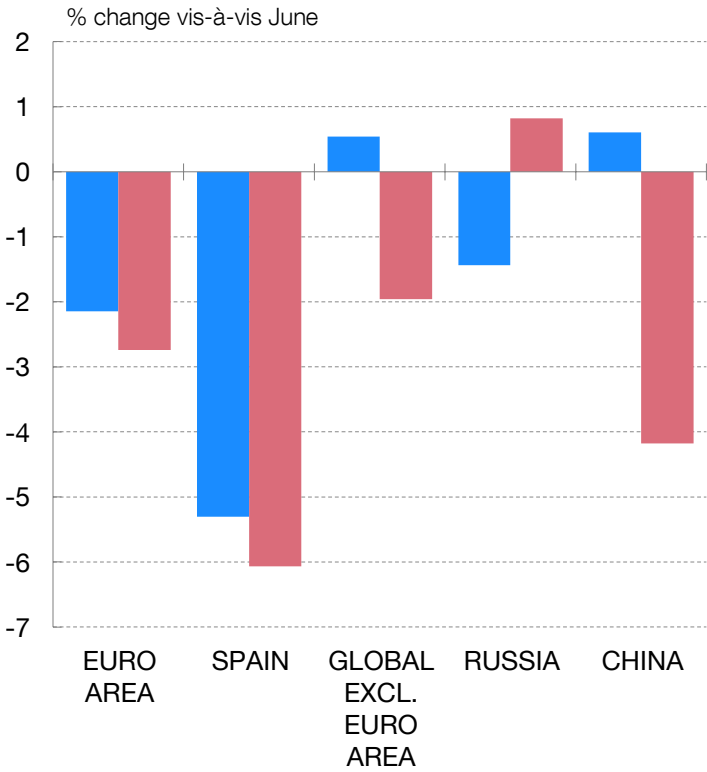
MANUFACTURING PMI



SERVICES PMI



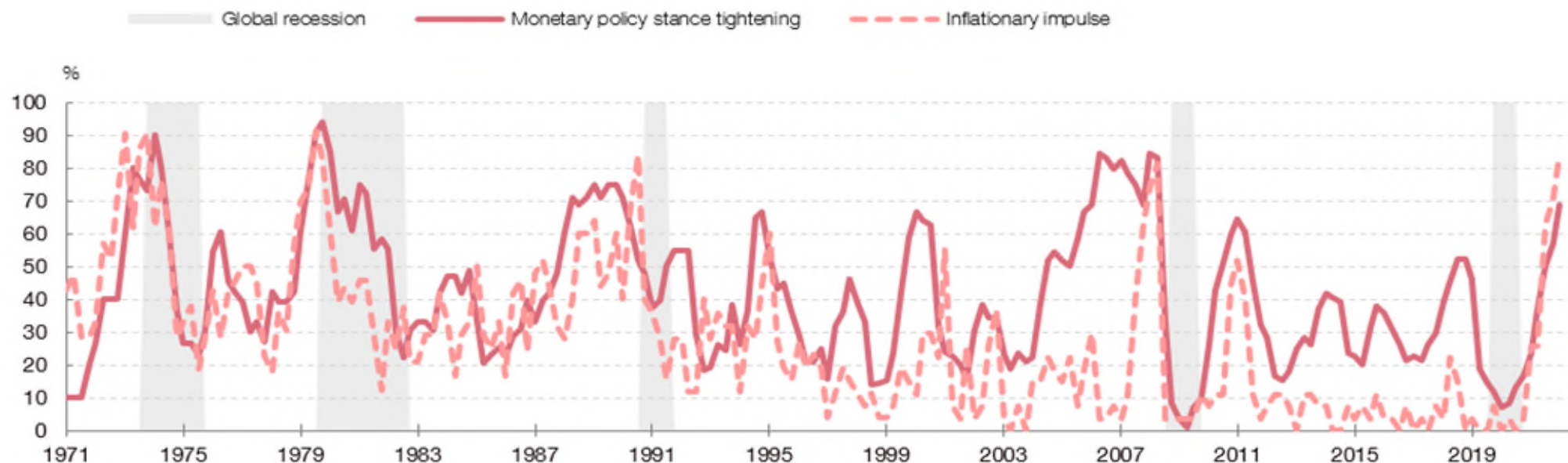
GOODS TRADE – ESTIMATED CUMULATIVE CHANGE FOR JULY-AUGUST



SOURCES: IHS Markit and Kiel Institute for the World Economy. Latest data: August (first two charts).

THE SIMULTANEOUS TIGHTENING OF MONETARY POLICY IN MANY JURISDICTIONS COULD LEAD TO AN EXCESSIVELY RESTRICTIVE STANCE WORLDWIDE

Percentage of countries with increases in inflation and policy interest rates hikes (a)



SOURCES: National statistics, BIS, IMF and Refinitiv.

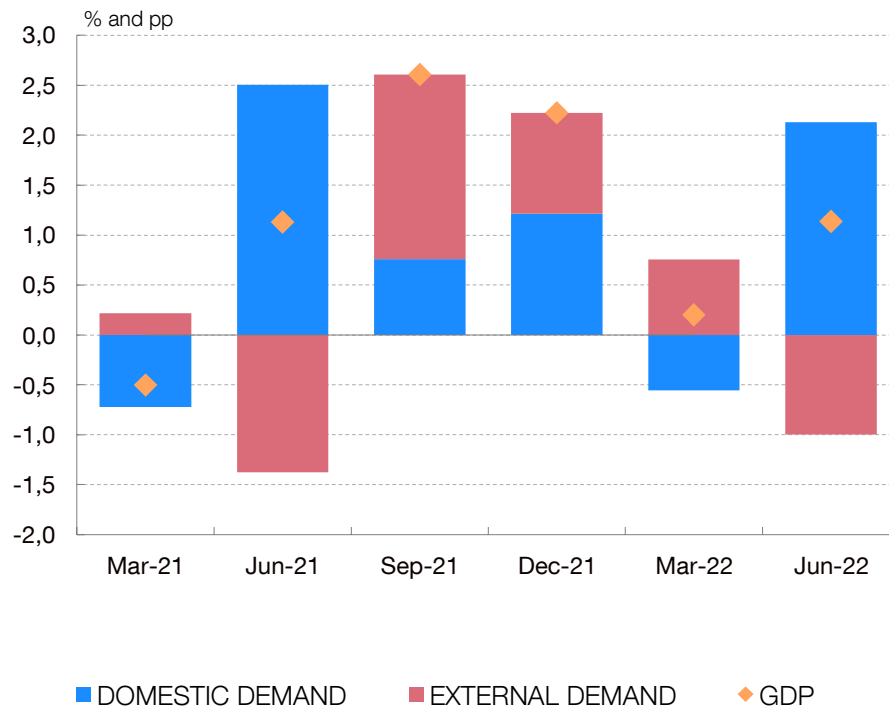
(a) The inflationary impulse depicts the percentage of countries that, in each quarter, simultaneously experience an inflation rate higher than that of the previous quarter and a level of inflation above its historical average (1984 Q1 to 2022 Q2). Monetary policy stance tightening shows the percentage of countries that are raising their interest rates each quarter. Global recession refers to periods in which global per capita GDP growth is close to 0 or negative. The number of countries included in these measures progressively increases to 28: Australia, Canada, Switzerland, Denmark, United Kingdom, Japan, South Korea, Norway, New Zealand, Sweden, United States and the euro area (advanced economies) and Brazil, China, India, Mexico, Malaysia, Poland, Russia, Saudi Arabia, Turkey, South Africa, Argentina, Chile, Colombia, Hungary, Indonesia and Peru (emerging market economies). The euro area data begin in 1999.

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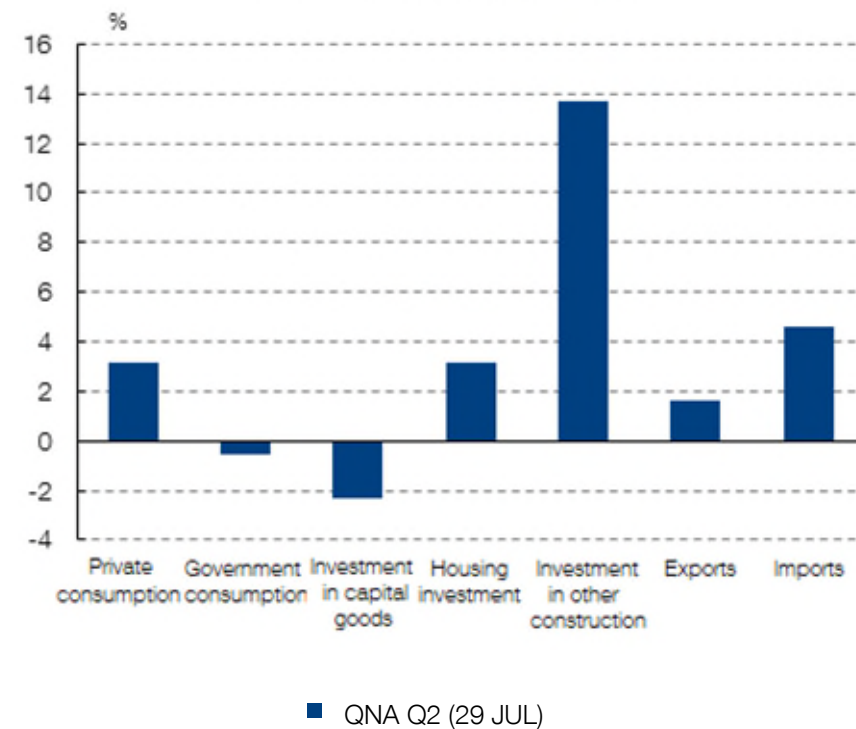
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THE SPANISH AND EURO AREA ECONOMIES BENEFITED FROM THE EASING OF COVID-19 RESTRICTIONS IN H1

QUARTER-ON-QUARTER REAL GDP GROWTH

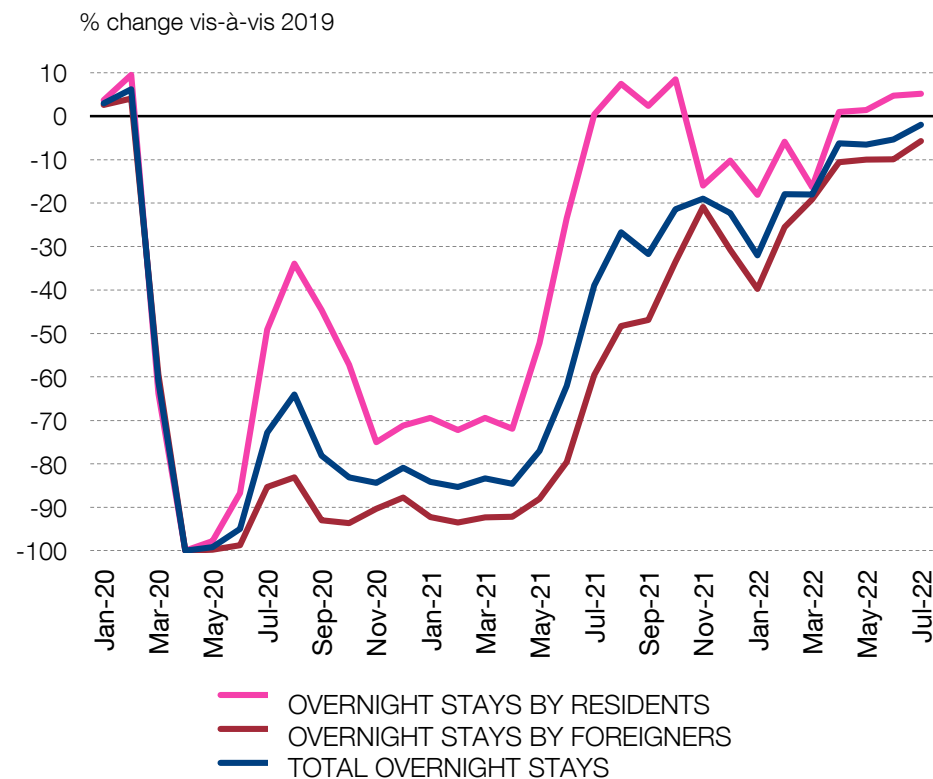


QUARTER-ON-QUARTER GROWTH IN DEMAND COMPONENTS

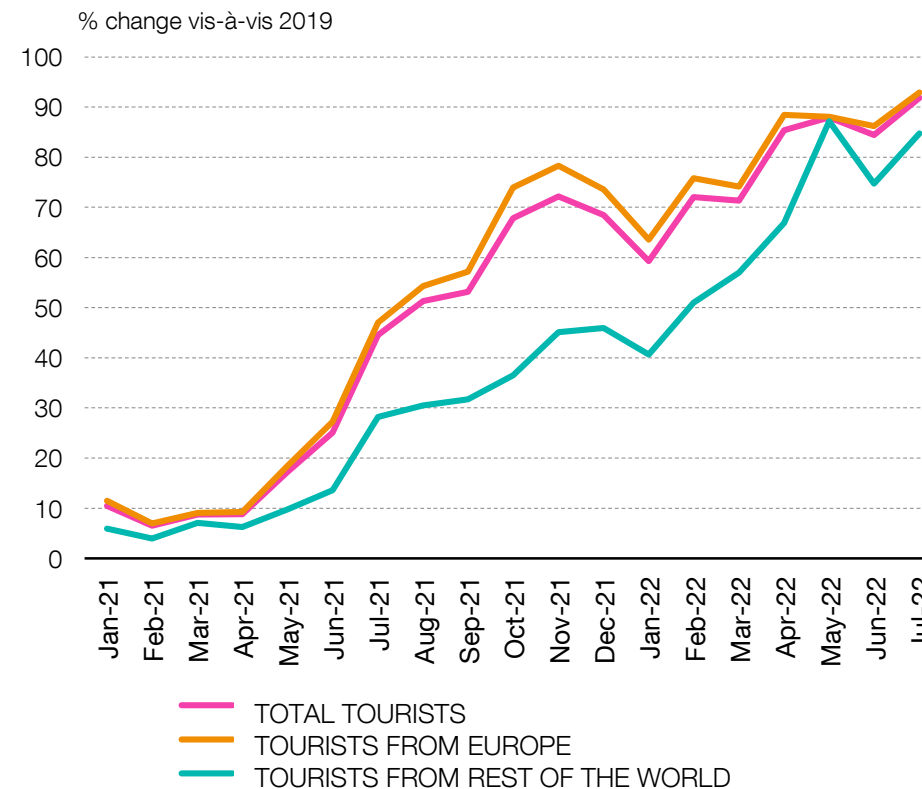


SOURCE: INE.

OVERNIGHT HOTEL STAYS



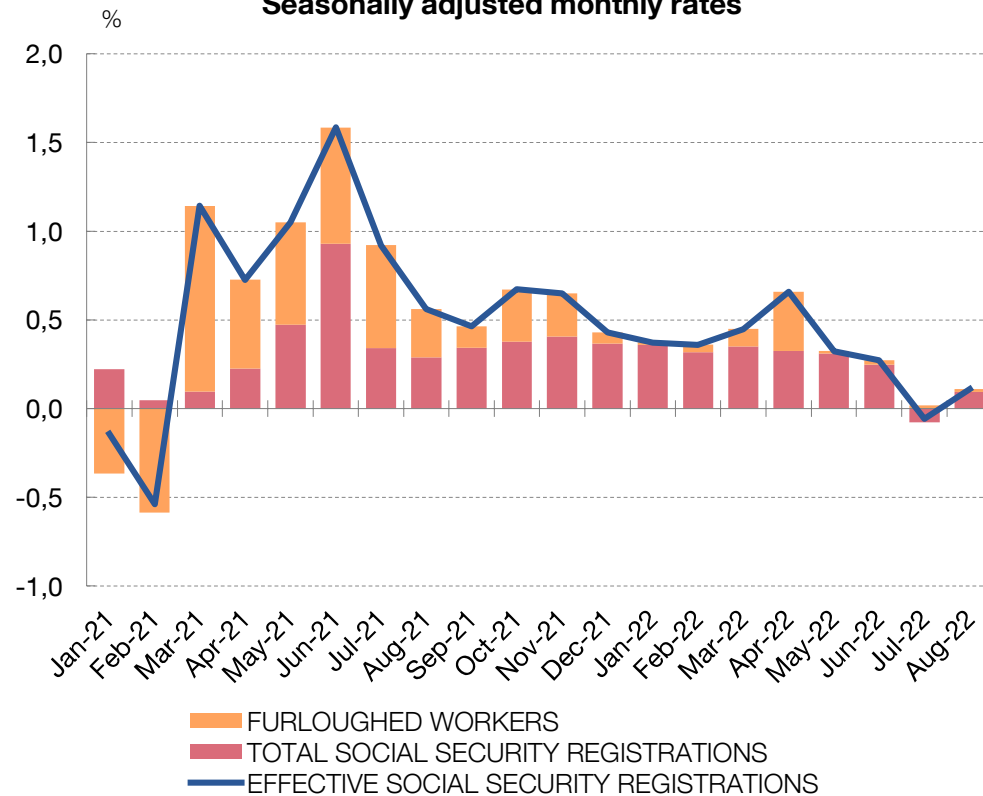
FOREIGN TOURIST ARRIVALS



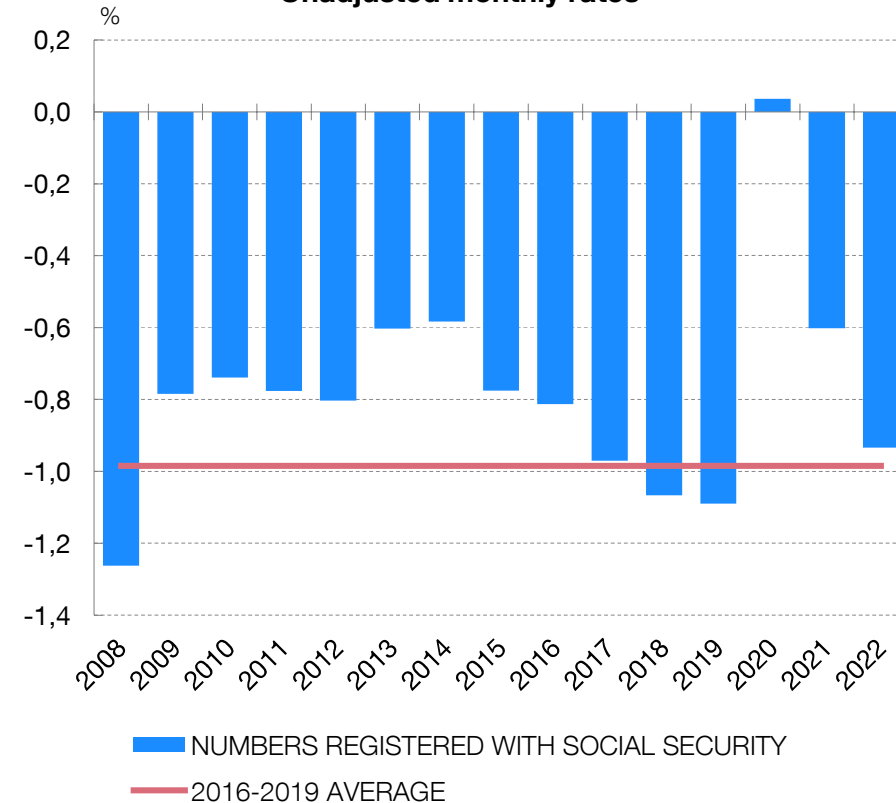
SOURCE: INE.

JOB CREATION HAS SUSTAINED GROWTH IN 2022, ALTHOUGH THE LATEST DATA POINT TO A SLOWDOWN

**TOTAL REGISTRATIONS, FURLOUGHED WORKERS
AND EFFECTIVE REGISTRATIONS**
Seasonally adjusted monthly rates



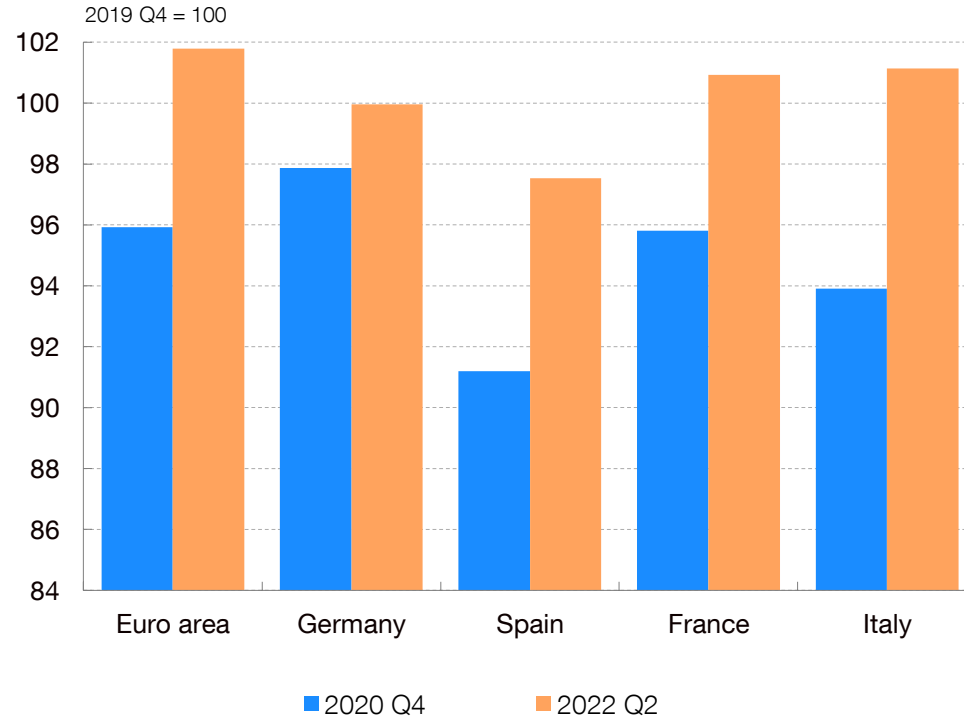
**MONTHLY CHANGE IN NUMBERS
REGISTERED WITH SOCIAL SECURITY IN AUGUST**
Unadjusted monthly rates



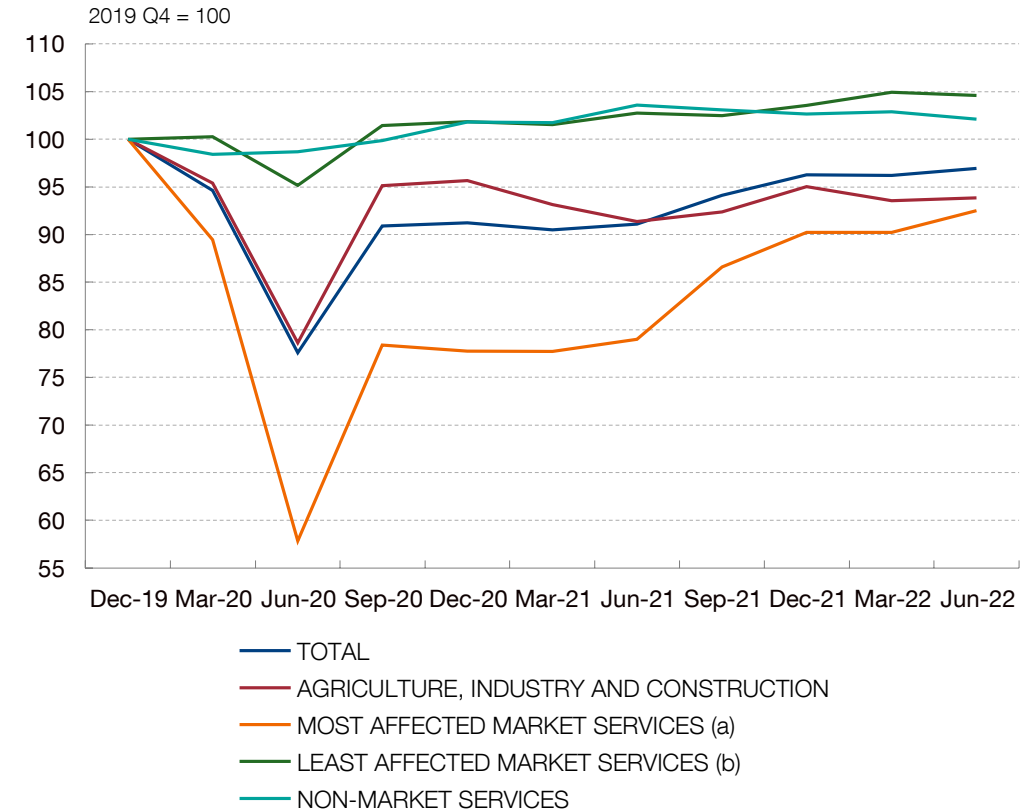
SOURCE: Ministerio de Inclusión, Seguridad Social y Migraciones.

IN ANY EVENT, THE RETURN TO PRE-PANDEMIC GDP LEVELS IS LAGGING FARTHER BEHIND IN SPAIN THAN IN THE EURO AREA AS A WHOLE. THE RECOVERY REMAINS INCOMPLETE AND UNEVEN ACROSS SECTORS

RETURN TO PRE-PANDEMIC GDP LEVELS



GROSS VALUE ADDED, BY SECTOR

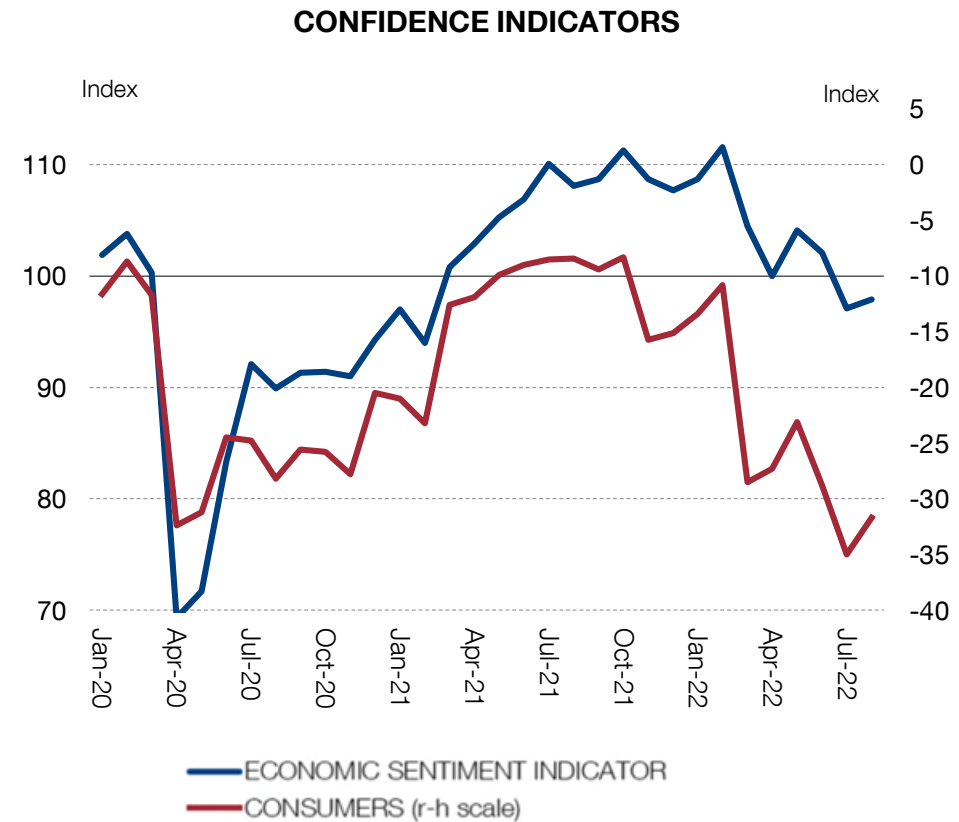
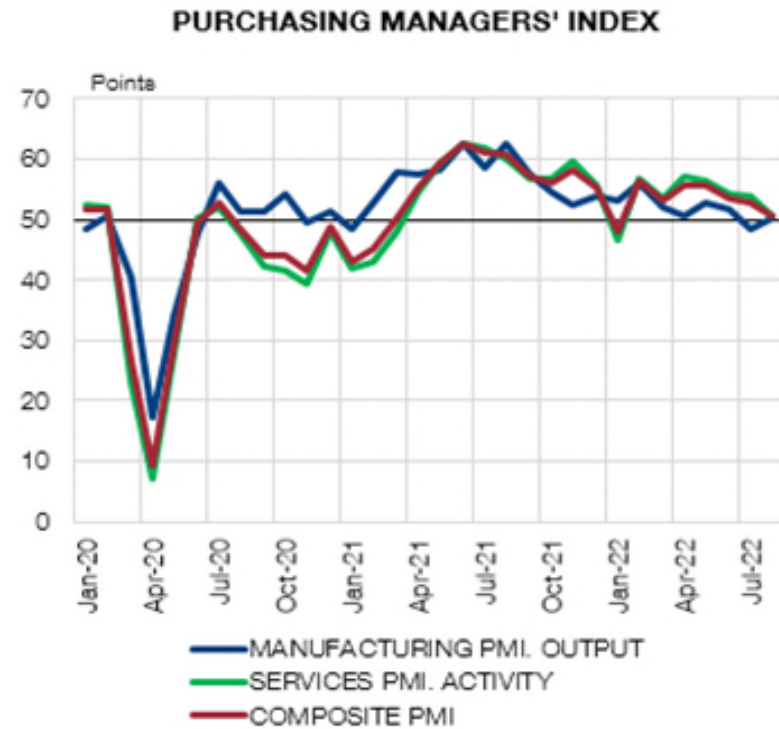


SOURCES: INE and Eurostat.

a) Trade, transportation and hospitality, professional, scientific and administrative activities and arts and recreation services.

b) Information and communication, financial and insurance activities and real estate activities.

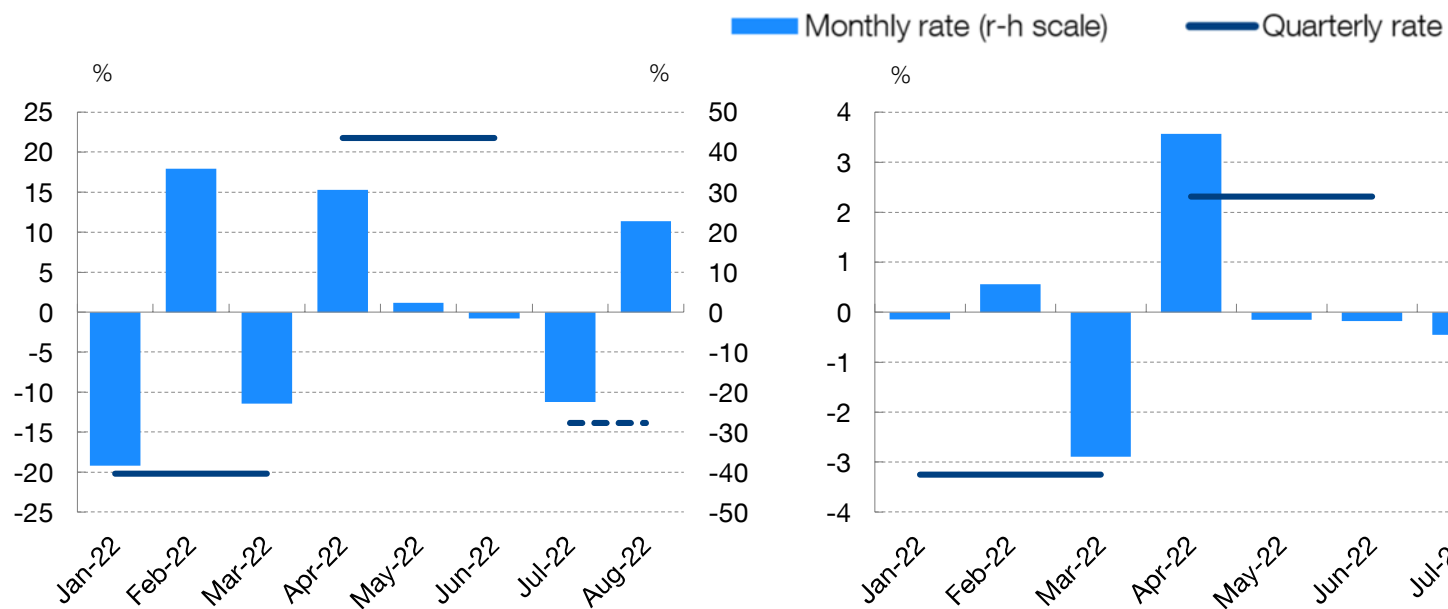
THE LATEST CONFIDENCE INDICATORS POINT TO WEAKER ACTIVITY AND SPENDING BY AGENTS



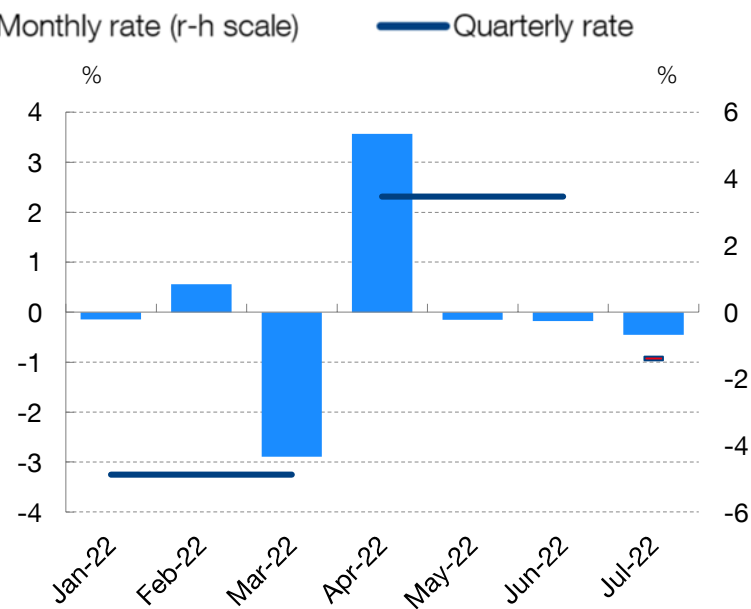
SOURCES: IHS Markit and European Commission. Latest observation: August.

AND SIGNS OF A SLOWDOWN IN THE MAIN CONSUMPTION AND INVESTMENT INDICATORS CAN ALREADY BE OBSERVED

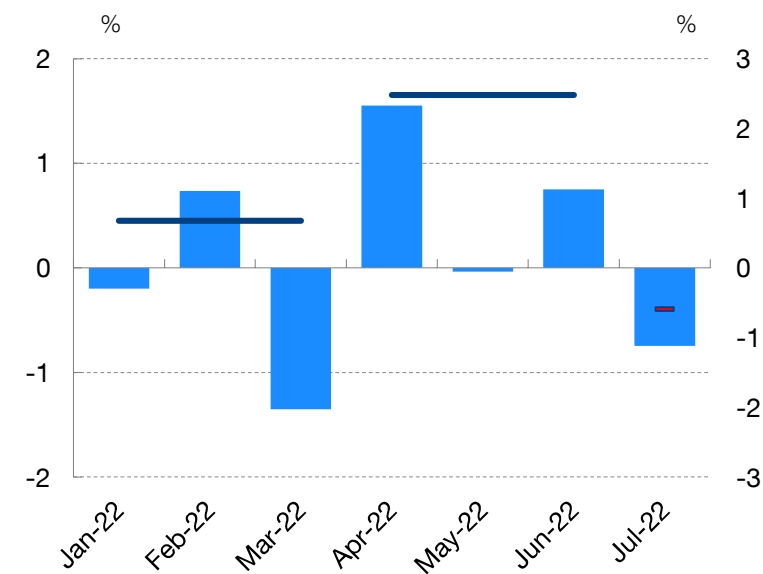
NEW PRIVATE CAR REGISTRATIONS



RETAIL TRADE INDEX



INDUSTRIAL PRODUCTION INDEX

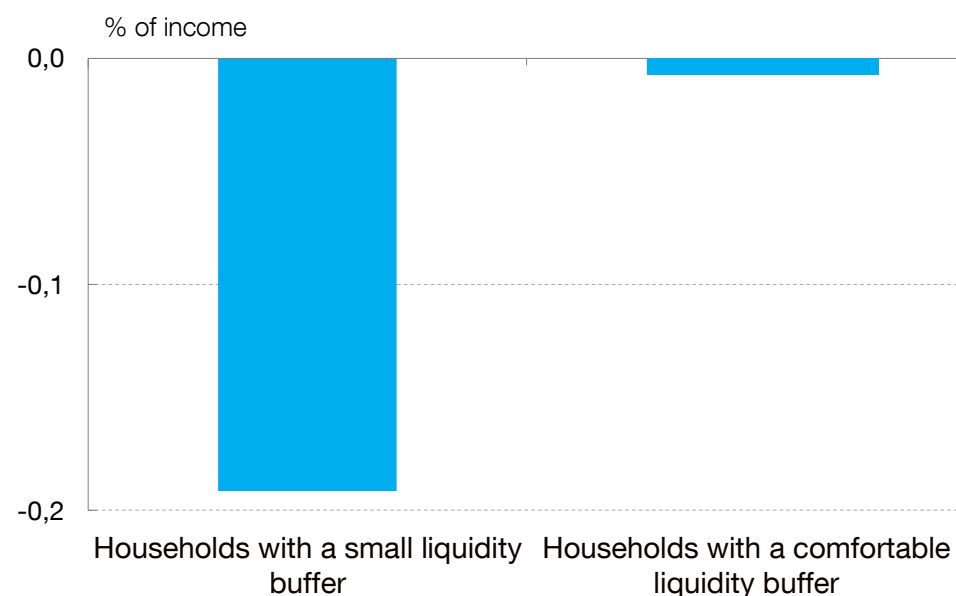


SOURCES: ANFAC, INE and Banco de España.

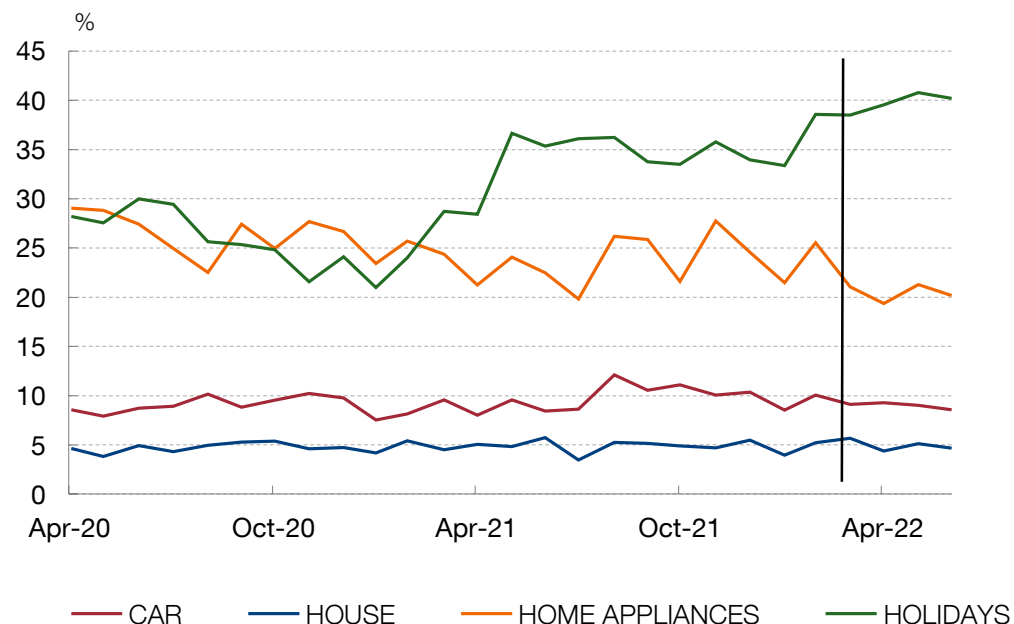
Seasonally adjusted time series. Quarterly rates calculated using the data available for Q3 compared with the Q2 average.

RIISING ENERGY PRICES FORESHADOW ADJUSTMENTS TO HOUSEHOLD SPENDING, WHICH WILL BE UNEVEN ACROSS INCOME LEVELS

ADJUSTMENT TO SPENDING ON NON-ENERGY GOODS AND SERVICES IN THE EVENT OF A 1 PP INCREASE IN THE RATIO OF ENERGY SPENDING TO HOUSEHOLD INCOME (a)



SHARE OF HOUSEHOLDS EXPECTING TO SPEND ON MAJOR CONSUMER ITEMS OVER THE NEXT 12 MONTHS

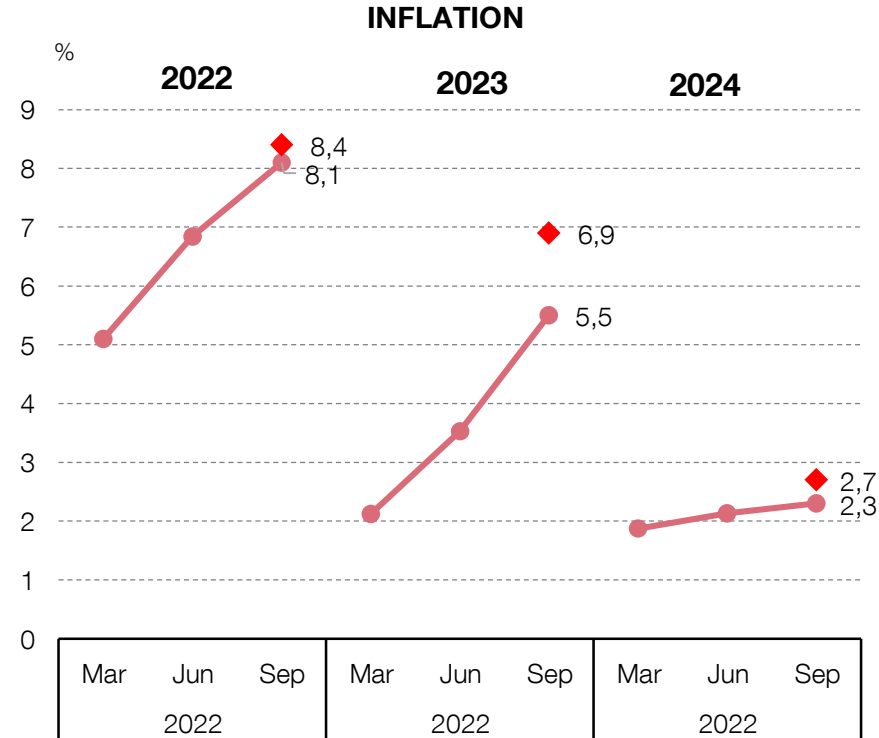
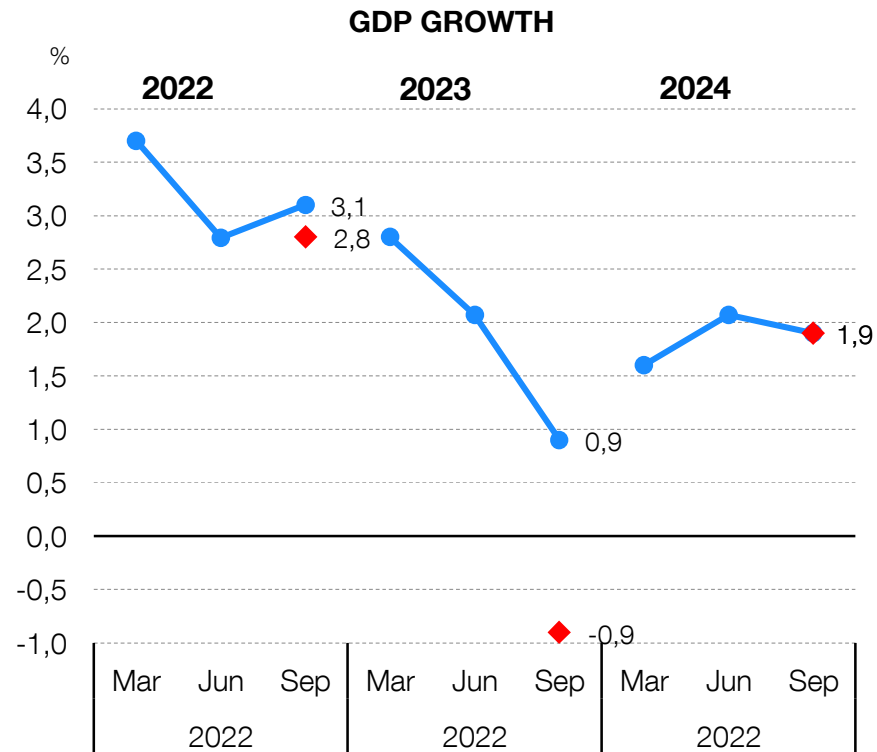


SOURCE: C. Martínez-Carrascal (2022). "The impact of the surge in inflation and the war on Spanish households' economic outlook", Analytical Articles, *Economic Bulletin* 3/2022, Banco de España.

a) Households with a small liquidity buffer are defined as those that do not have sufficient liquidity (or the means to obtain it) to cover an unexpected payment equal to one month of household income. Spending on energy is proxied by drawing on total spending on electricity, gas, water, sewerage, telephony and cable television, as the Consumer Expectations Survey on which the estimation is based groups spending on these items together.

THE ECB'S SEPTEMBER MACROECONOMIC PROJECTIONS REVISED EURO AREA GDP GROWTH IN 2023 DOWN AND INFLATION ACROSS THE ENTIRE PROJECTION HORIZON UP

MACROECONOMIC PROJECTIONS FOR THE EURO AREA (BMPE)



◆ ADVERSE SCENARIO

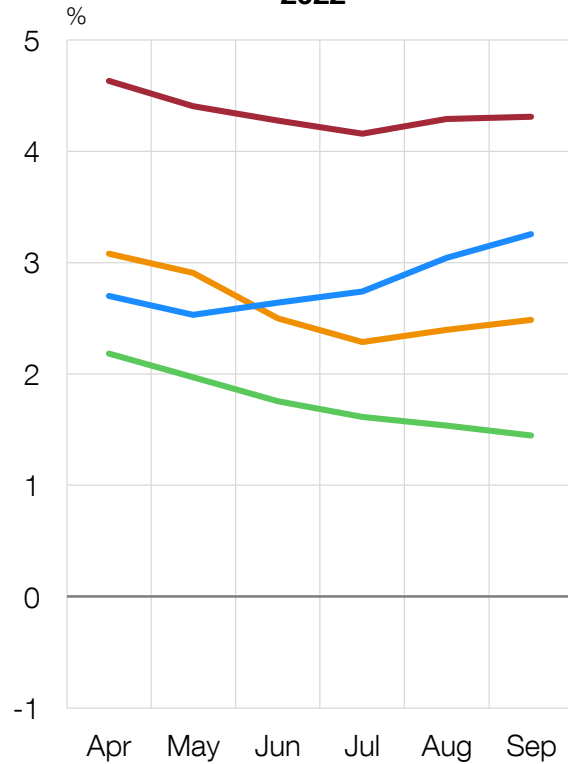
SOURCE: ECB.

THE DETERIORATION IN THE OUTLOOK IS PARTICULARLY MARKED IN THE GERMAN ECONOMY, WHICH COULD CONTRACT IN 2023. IN SPAIN, GROWTH IN 2023 IS REVISED DOWN AND INFLATION IS REVISED UP ACROSS THE ENTIRE HORIZON

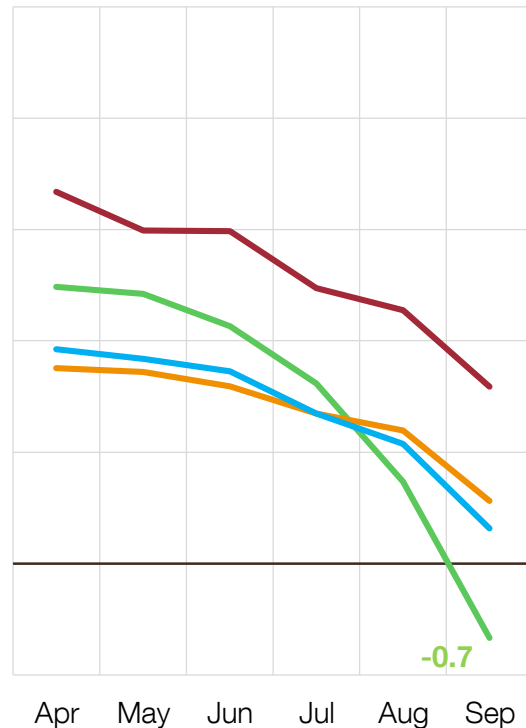
MONTHLY CONSENSUS FORECASTS FOR EURO AREA COUNTRIES

GDP

2022



2023



GERMANY

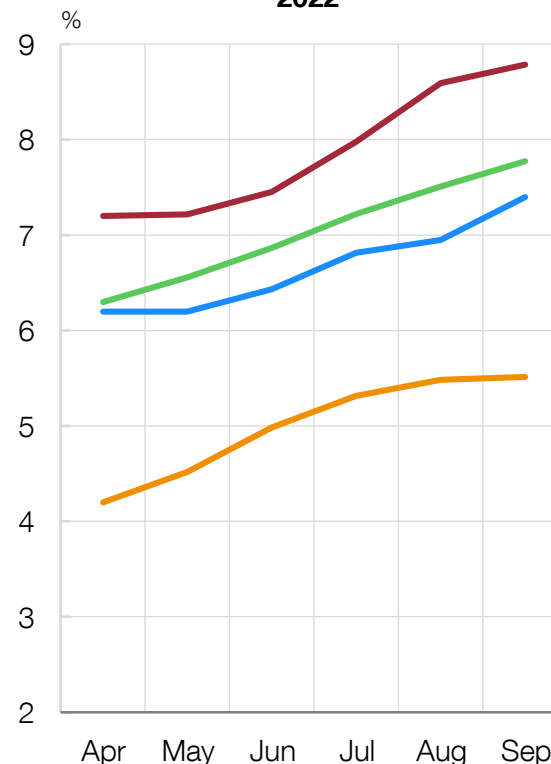
FRANCE

ITALY

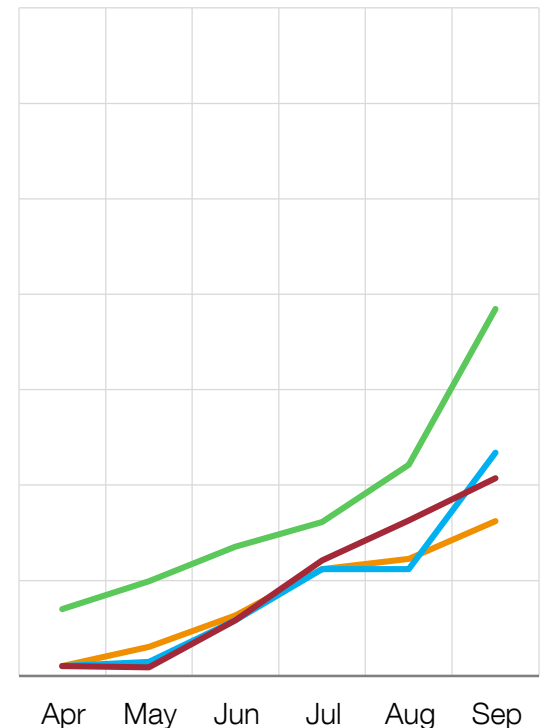
SPAIN

INFLATION

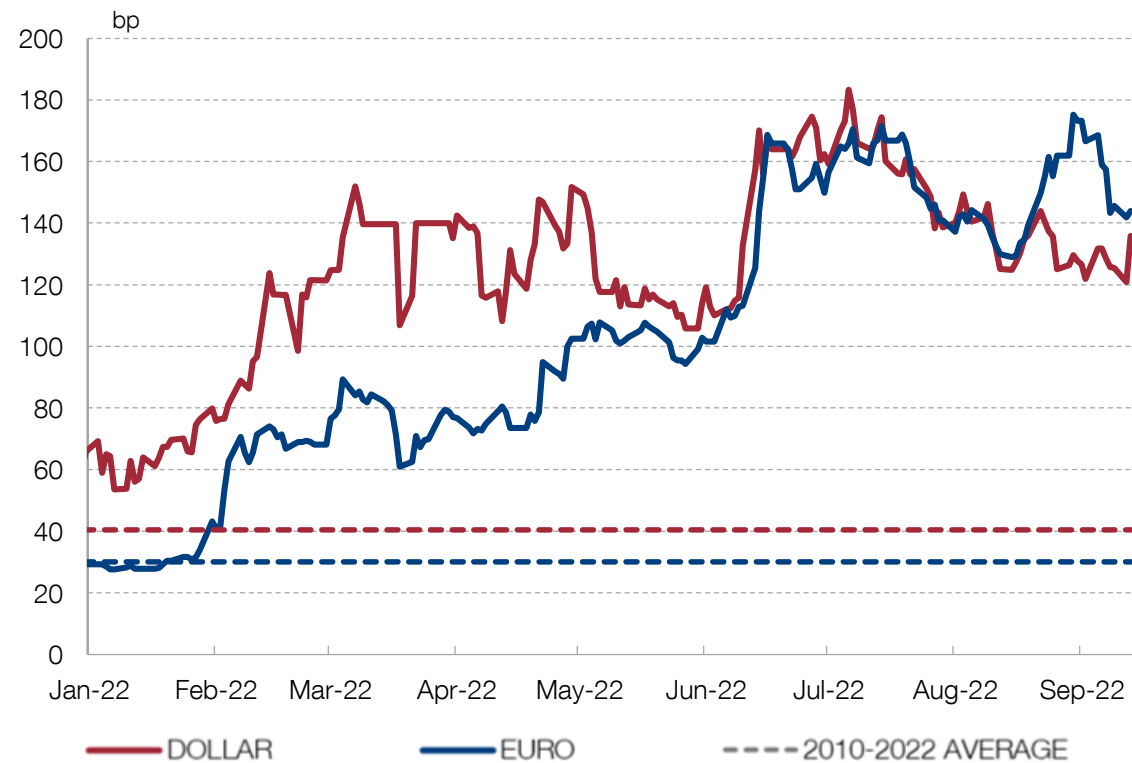
2022



2023

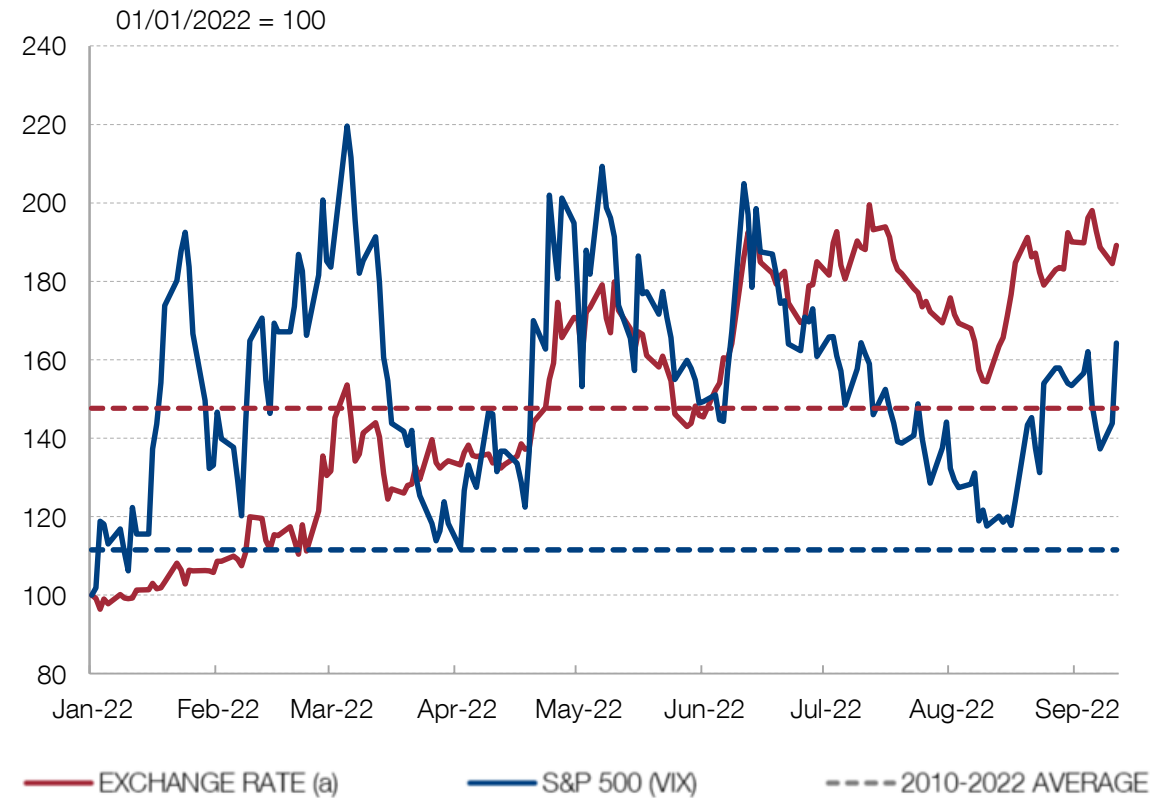


3M-1Y SWAP VOLATILITY (a)



SOURCE: Bloomberg Data License. Latest observation: 13/09/22.
(a) The chart shows the normalised volatility of three-month at-the-money options, whose underlying assets are one-year interest rate swaps that have a variable component of three-month EURIBOR (EUR) and LIBOR (USD).

IMPLIED VOLATILITIES



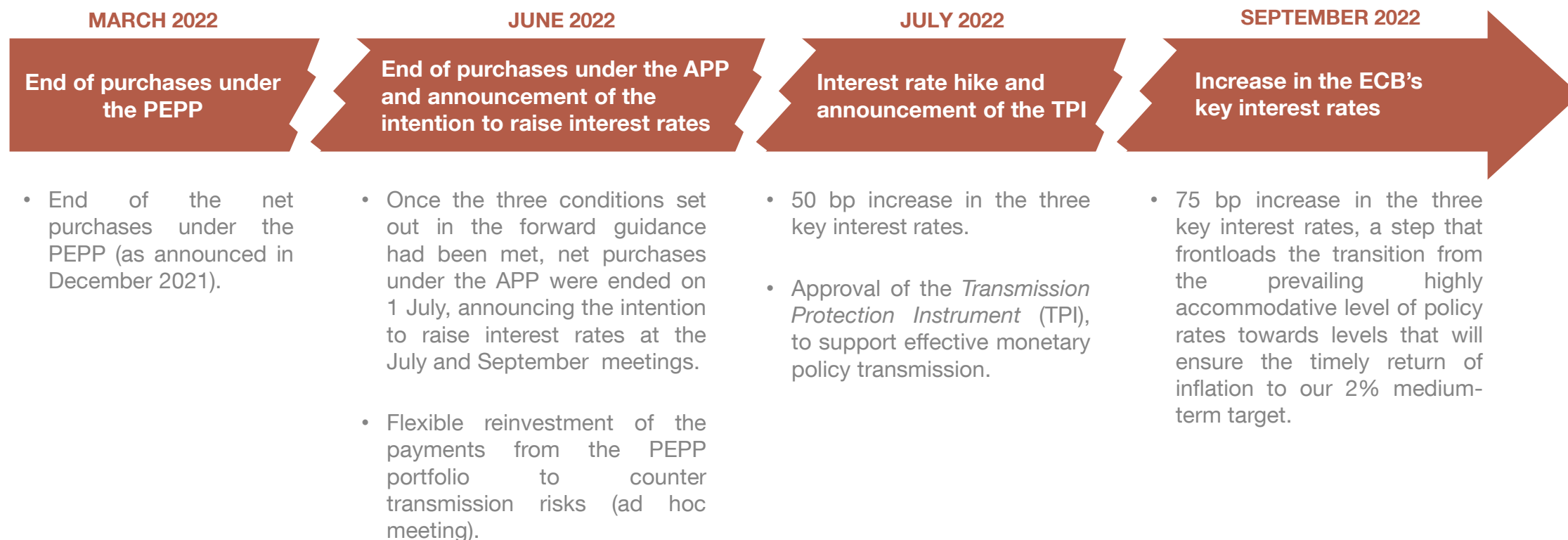
SOURCE: Refinitiv Datastream. Latest observation: 13/09/2022.
(a) Average implied volatility of three-month exchange rate options on USD/EUR, USD/GBP and JPY/USD.

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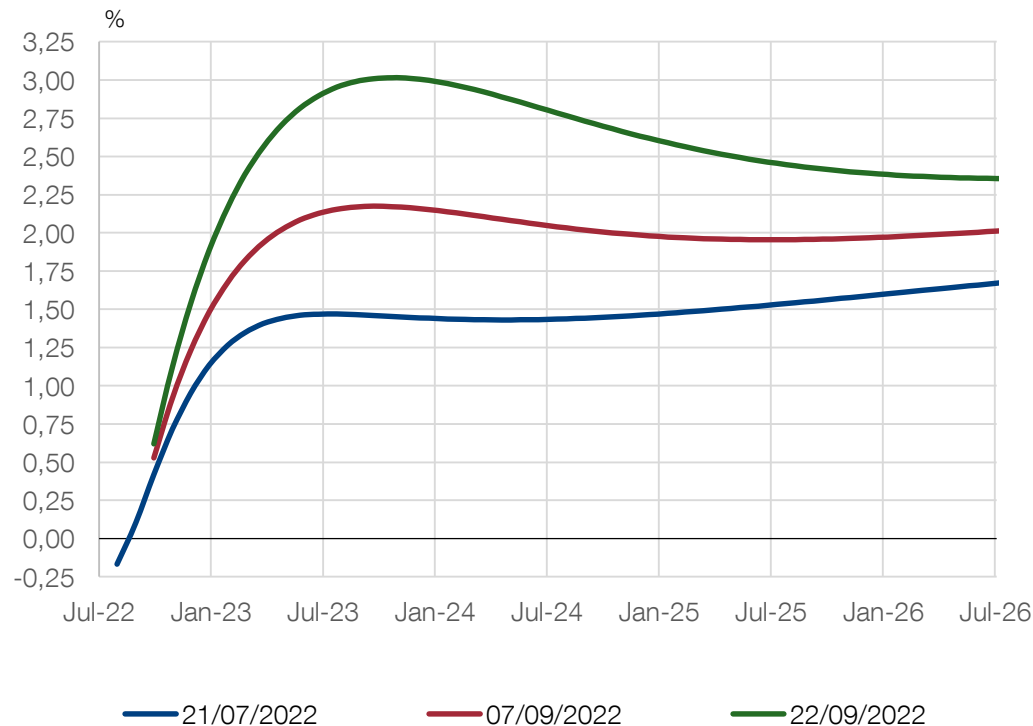
IN DECEMBER 2021 THE ECB EMBARKED ON A PROCESS OF MONETARY POLICY NORMALISATION IN RESPONSE TO THE CURRENT INFLATIONARY EPISODE

- July saw the first key interest rate hike in 11 years (50 bp), followed by the biggest hike at a single meeting in the history of the euro (75 bp) in September



Looking ahead, we will continue normalising monetary policy at a pace and to a level in a manner that is data-dependent and considers the impact on the return of inflation to our medium-term target.

INSTANTANEOUS FORWARD OIS €STR. EURO AREA



10-YEAR OIS €STR

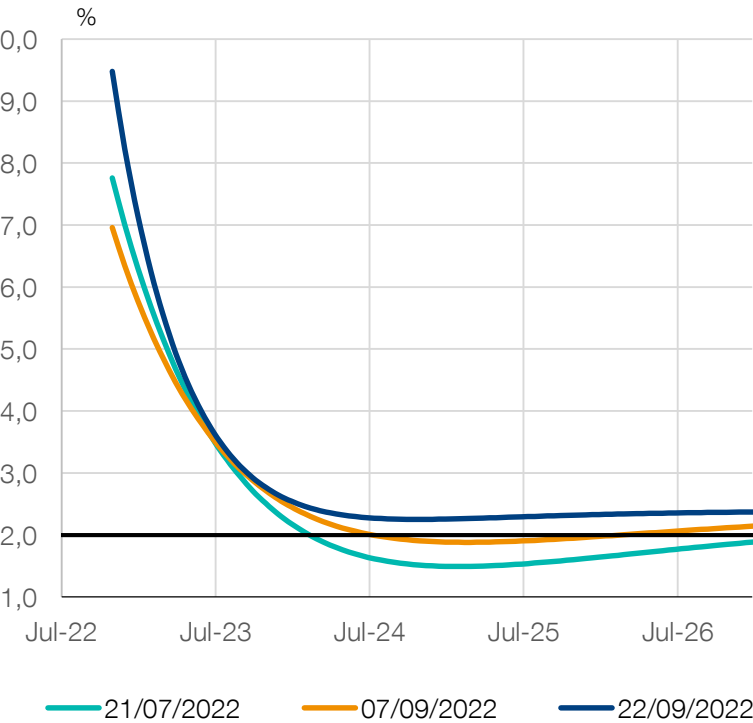


SOURCES: Refinitiv Datastream and Banco de España calculations.
Latest data: 22/09/2022.

SOURCE: Refinitiv Datastream. Latest observation: 22/09/2022.

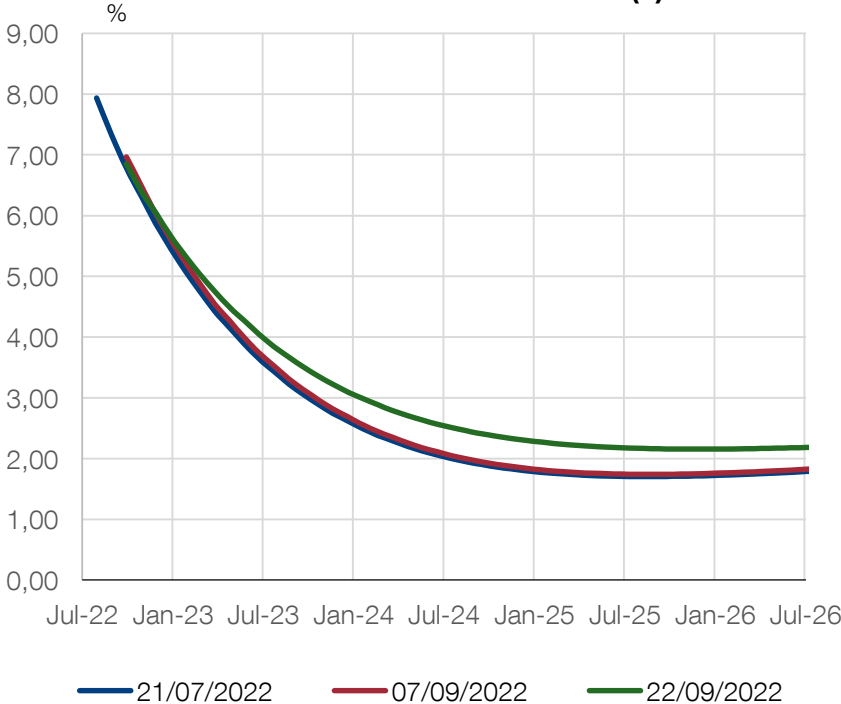
MEDIUM AND LONG-TERM INFLATION EXPECTATIONS HAVE ALSO RISEN

EURO AREA: INSTANTANEOUS FORWARD ILS



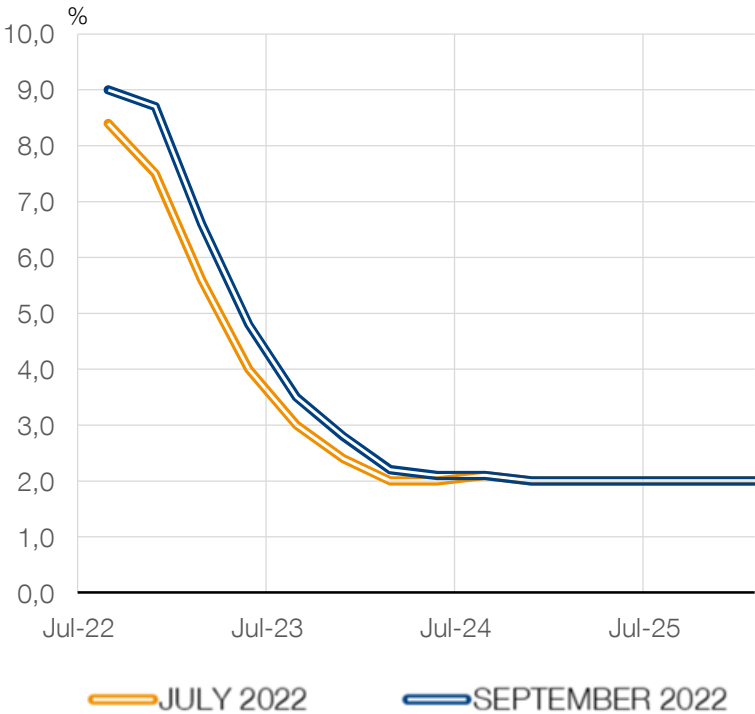
SOURCES: Bloomberg Data License and Banco de España calculations.
Latest data: 22/09/2022.

EURO AREA INSTANTANEOUS FORWARD ILS
ADJUSTED FOR RISK PREMIA (a)



SOURCES: Bloomberg Data License and Banco de España calculations.
Latest data: 22/09/2022.
(a) Banco de España calculations based on the model in Gimeno and Ortega (2022).

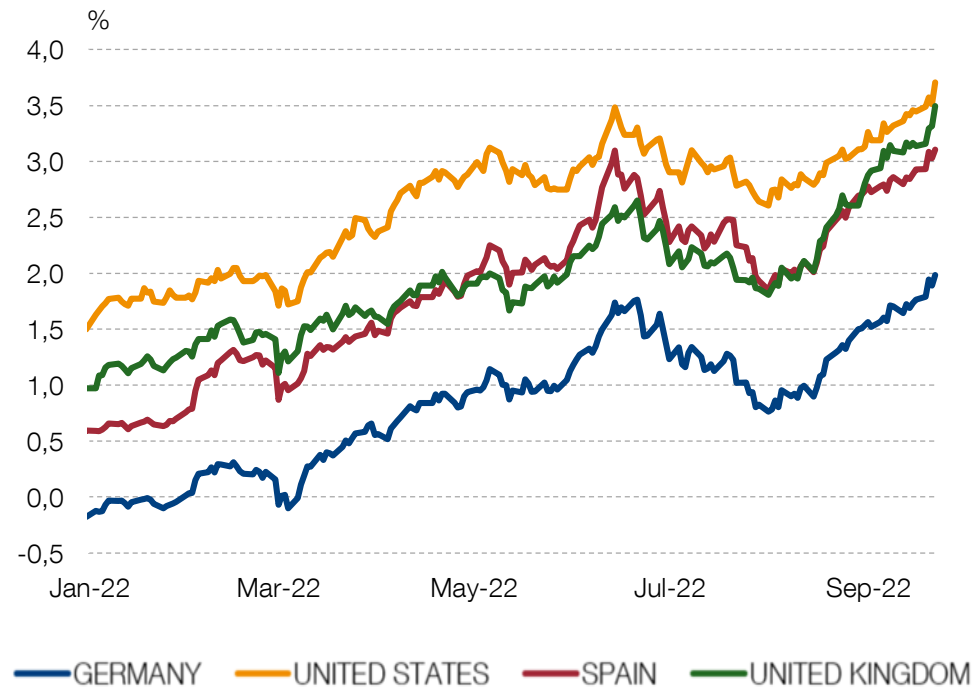
EURO AREA: INFLATION IN THE SMA (a)



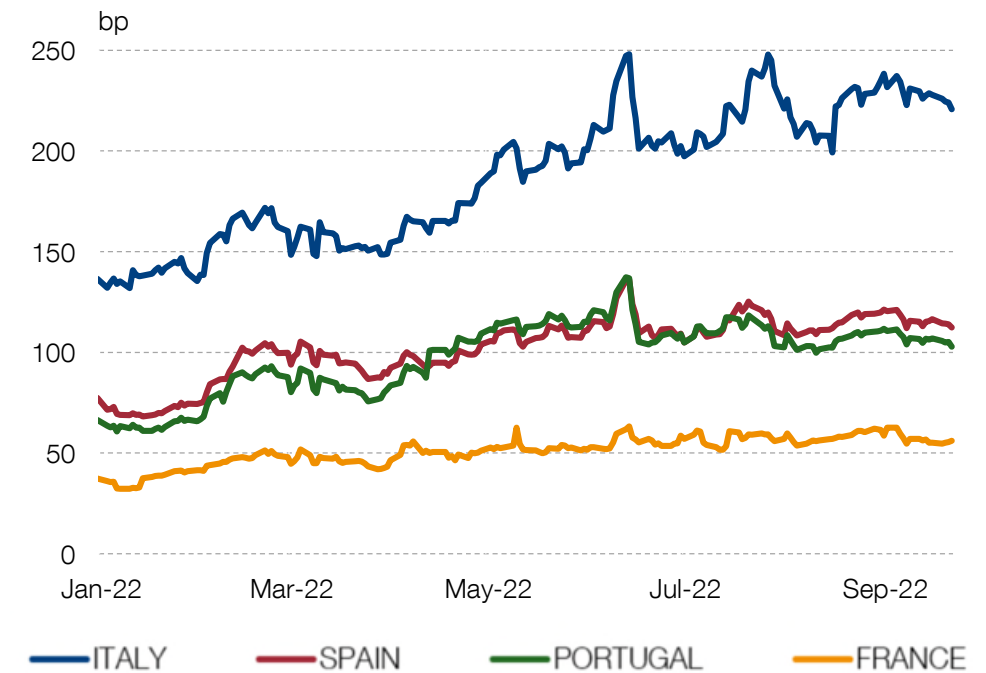
SOURCE: SMA.
(a) Median of the HICP data in the SMA.

MONETARY POLICY NORMALISATION HAS LED TO A SIGNIFICANT INCREASE IN THE YIELD ON LONG-TERM SPANISH PUBLIC DEBT...

10-YEAR SOVEREIGN YIELDS

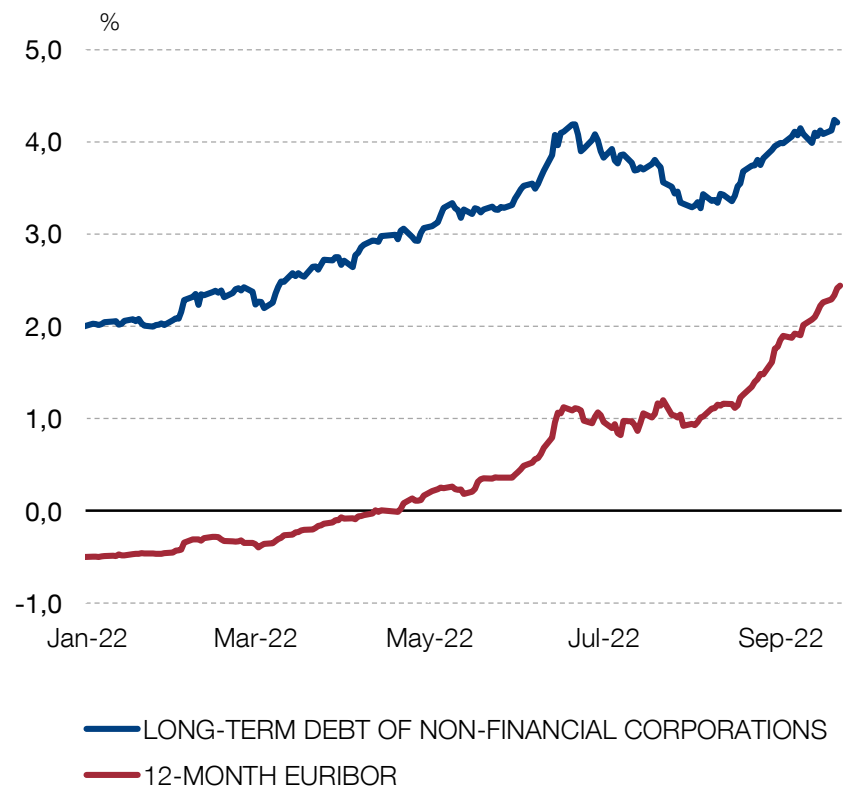


10-YEAR SPREADS AGAINST GERMANY

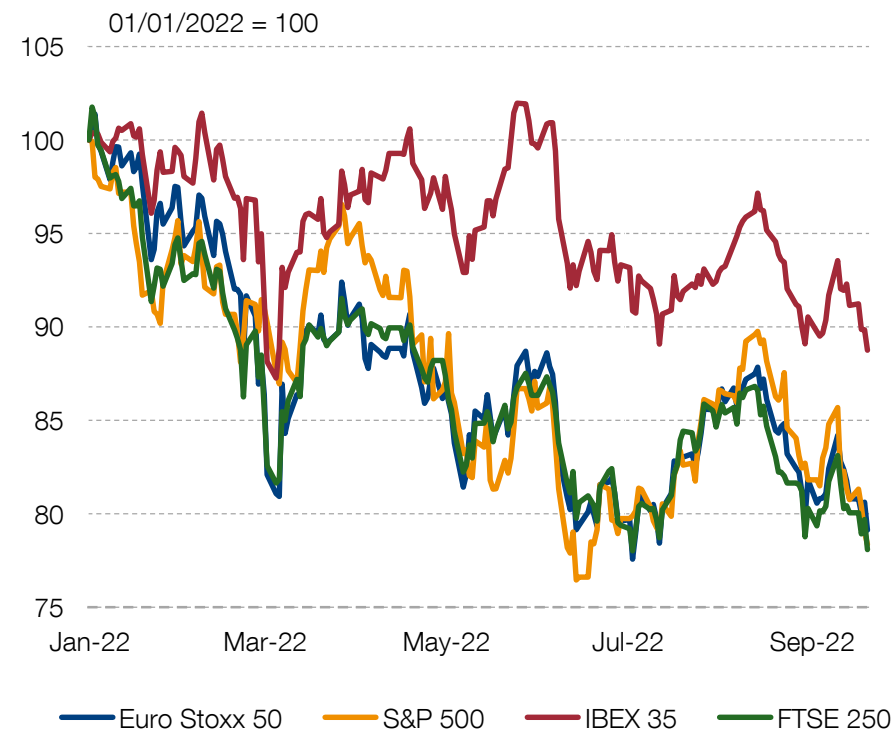


SOURCE: Refinitiv Datastream. Latest observation: 22/09/2022.

MARKET INTEREST RATES



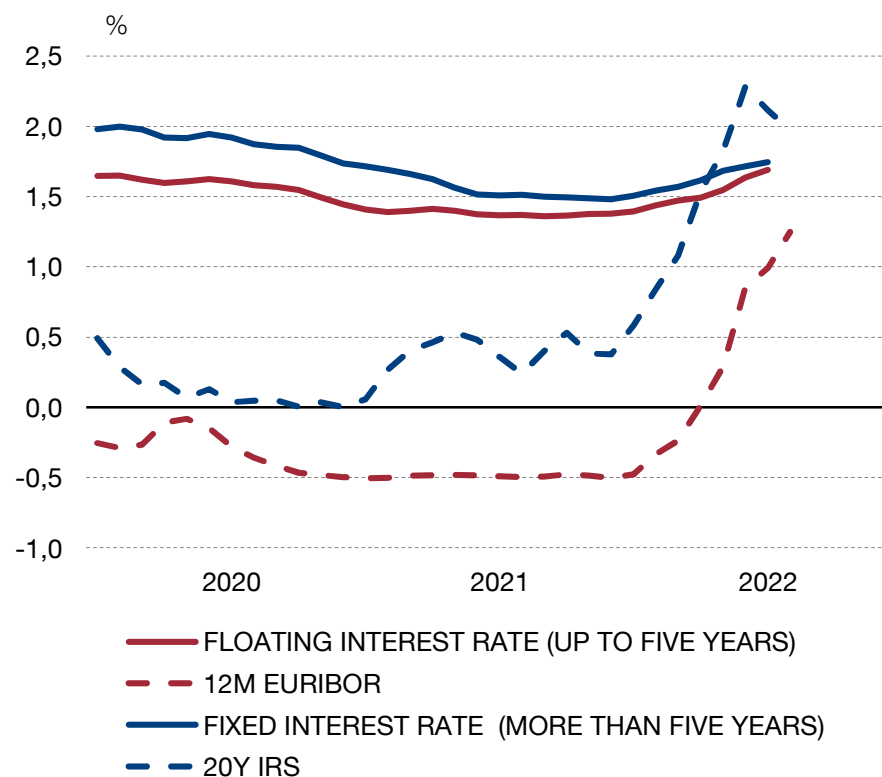
STOCK MARKET INDICES



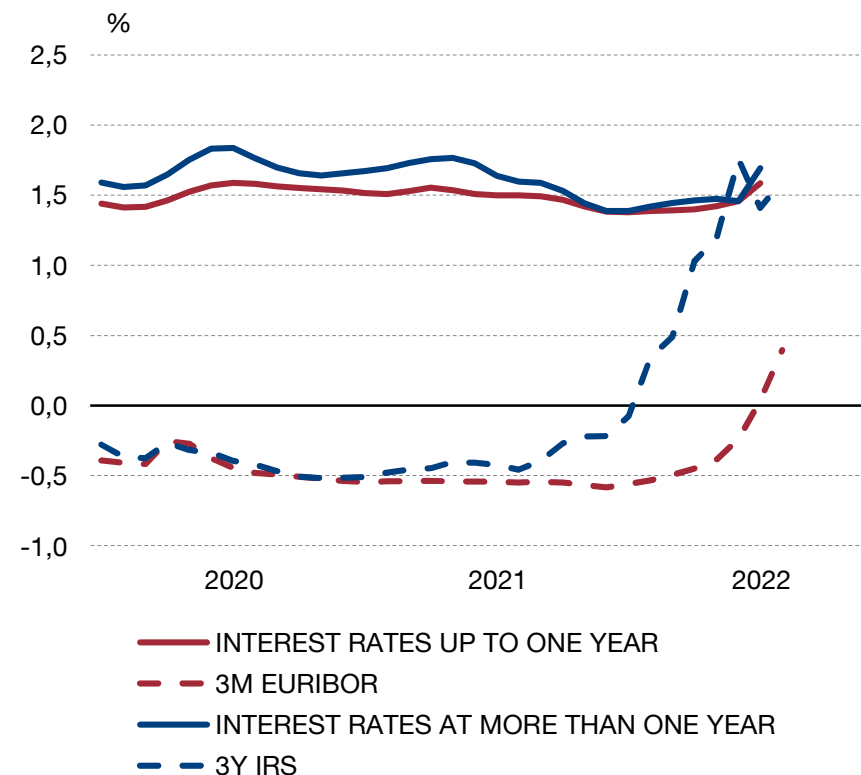
SOURCE: Refinitiv Datastream. Latest observation: 22/09/2022.

THE RISE IN MARKET REFERENCE INTEREST RATES IN GRADUALLY BEING PASSED THROUGH TO THE COST OF BANK LENDING

LOANS FOR HOUSE PURCHASE

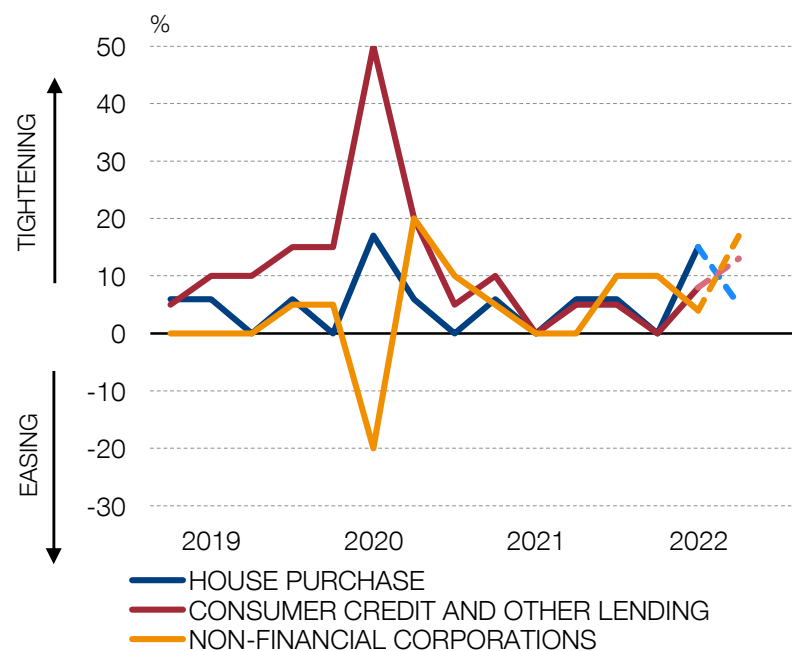


LOANS TO NON-FINANCIAL CORPORATIONS

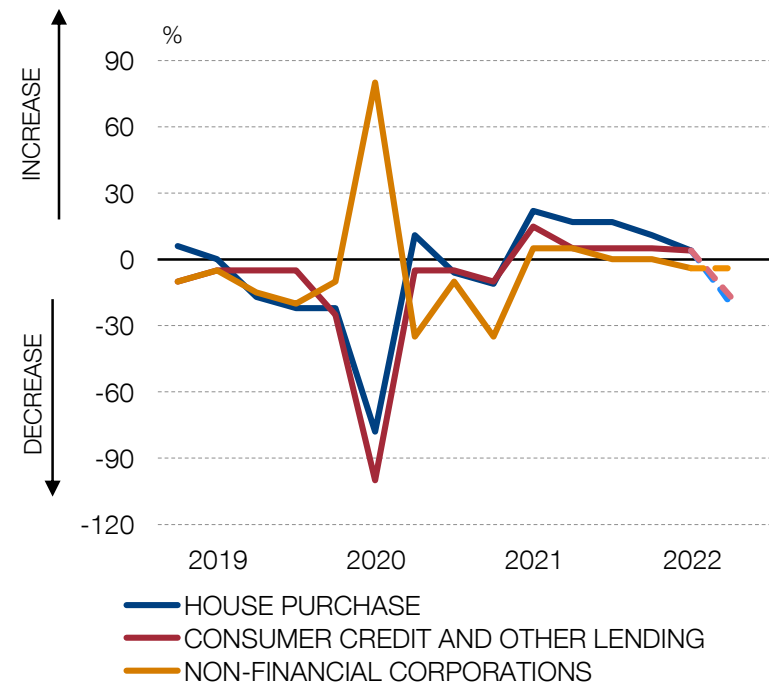


SOURCE: Banco de España. Latest observation: July (bank interest rates) and August (reference interest rates).

BLS: CHANGE IN CREDIT STANDARDS (a)



BLS: CHANGE IN DEMAND FOR CREDIT (b)

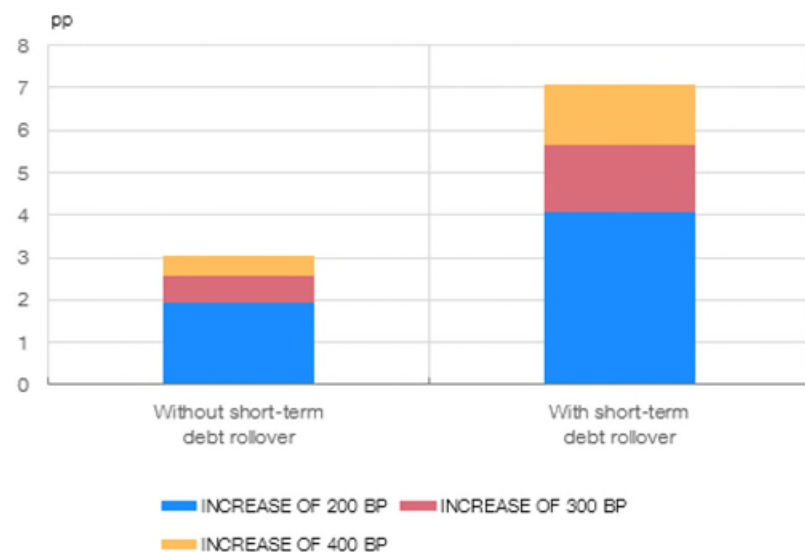


SOURCE: Banco de España. Latest observation: 2022 Q2.

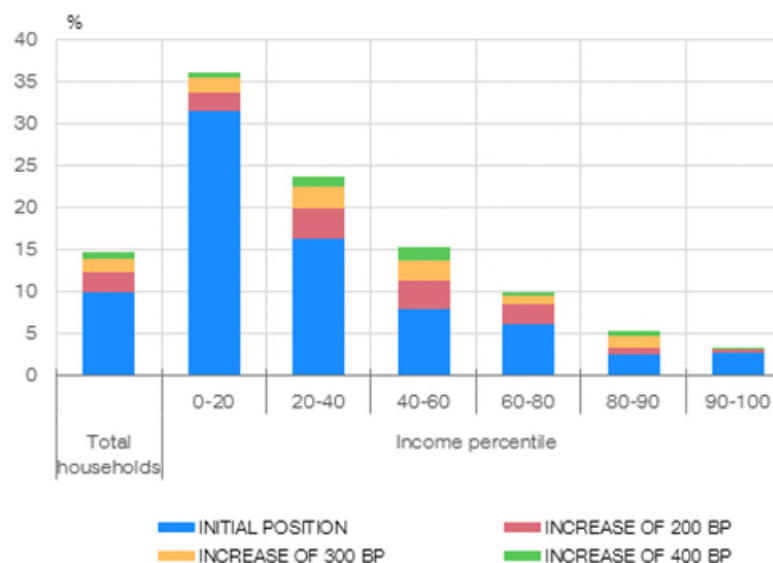
- Indicator = percentage of banks that have tightened their credit standards or terms and conditions considerably $\times 1$ + percentage of banks that have tightened their credit standards or terms and conditions somewhat $\times 1/2$ – percentage of banks that have eased their credit standards or terms and conditions somewhat $\times 1/2$ – percentage of banks that have eased their credit standards or terms and conditions considerably $\times 1$.
- Indicator = percentage of banks reporting a considerable increase $\times 1$ + percentage of banks reporting some increase $\times 1/2$ – percentage of banks reporting some decrease $\times 1/2$ – percentage of banks reporting a considerable decrease $\times 1$.

THE INCREASE IN MARKET INTEREST RATES WILL INCREASE THE DEBT BURDEN ON FIRMS, HOUSEHOLDS AND GENERAL GOVERNMENT

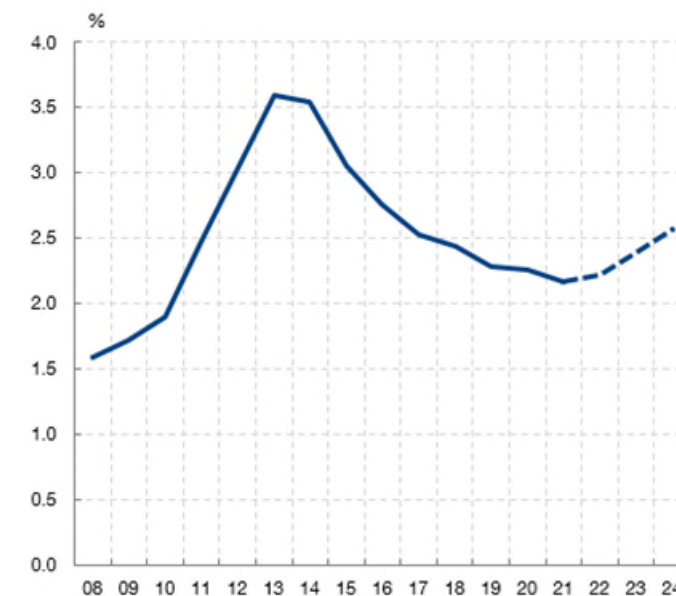
ESTIMATED INCREASE IN FIRMS' MEDIAN DEBT BURDEN AS A RESULT OF HIGHER INTEREST RATES (a)



IMPACT OF HIGHER INTEREST RATES ON THE PERCENTAGE OF HOUSEHOLDS WITH A HIGH NET DEBT BURDEN. BREAKDOWN BY INCOME PERCENTILE (b)



SPANISH GENERAL GOVERNMENT DEBT BURDEN (c)



SOURCES: Banco de España and Encuesta Financiera de las Familias (2017).

a. The debt burden is defined as financial costs / (gross operating profit + financial revenue). Firms with no financial costs are excluded.

b. The net debt burden is considered to be high when the ratio of (debt service expenses - interest income from deposits) / household income is higher than 40%. Households without debt are excluded from this calculation.

c. The projections are based on the June macroeconomic scenario and the interest rate curve at 8 September 2022.

- Under such an agreement, firms and workers would share the inevitable loss of income in the national economy that higher commodity import prices entail

What form should this agreement take?

MINDFUL OF THE UNEVEN IMPACT

The uneven impact of the current shocks among workers, firms and sectors must be taken into account, by avoiding overly sweeping measures that may prove excessively rigid for some groups of agents

WAGES

Arrangements that automatically link wages to past inflation or indexation clauses are also to be avoided

MULTI-YEAR

The agreement should envisage multi-year commitments concerning wage settlements – where the nominal benchmarks for wage bargaining should be based on the projected trend in underlying inflation – and job protection

PROFIT MARGINS

Explicit commitments to moderate profit margins

The fiscal policy measures should be targeted and temporary, given the limited fiscal leeway and high inflation. They should focus on lower-income households (who bear the brunt of inflation) and the firms most vulnerable to this shock, and significant distortions to price signals and the widespread use of automatic indexation clauses in government expenditure items should be avoided

A credible and gradual medium-term fiscal consolidation programme that provides a framework of stability for economic agents urgently needs to be designed

Supply-side policies are the most appropriate for responding to the current shocks; the NGEU funds could play a particularly important role in accompanying and funding such policies

Structural policies that foster the integration and interconnection of European markets (in particular energy markets) and strengthen the single market will not only generate greater resilience to shocks, but also drive competitiveness

Joint funding arrangements should be established to safeguard this common effort and avoid any excessive or highly unequal impact on national public finances. Common funding arrangements would enable financing for large-scale programmes based on shared quality standards and provide for a uniform approach for assessing programme execution

Headway must also be made in the expansion of the public and private risk-sharing arrangements in the EU. The euro area needs a permanent macroeconomic stabilisation mechanism – with revenue-raising and borrowing capacity – to complement the single monetary policy. It is also imperative that the banking union be completed with the establishment of a European deposit guarantee scheme. Lastly, we must press forward with constructing a capital markets union

After the recovery witnessed up to the summer, the information available points to a slowdown in the Spanish economy in the coming months, against a background of very high uncertainty and rising inflation

The inflationary pressures are mainly explained by global factors and affect the euro area as a whole. This prompted the ECB to embark on a process of monetary normalisation in December 2021. The ECB Governing Council will continue taking measures for as long as the information available suggests that inflation remains above the medium-term target

The incomes agreement is essential to avoid an inflationary spiral, which could have highly adverse effects on activity and employment. Under such an agreement, firms and employees would agree to share the loss of income in the national economy. The agreement should be of a multi-year nature and appropriately designed to take into account the uneven impact of the current shock on workers, firms and sectors

Other economic policies should focus on support for the most vulnerable, resolute supply-side reforms, a firm commitment to fiscal sustainability and the reinforcement of the European project