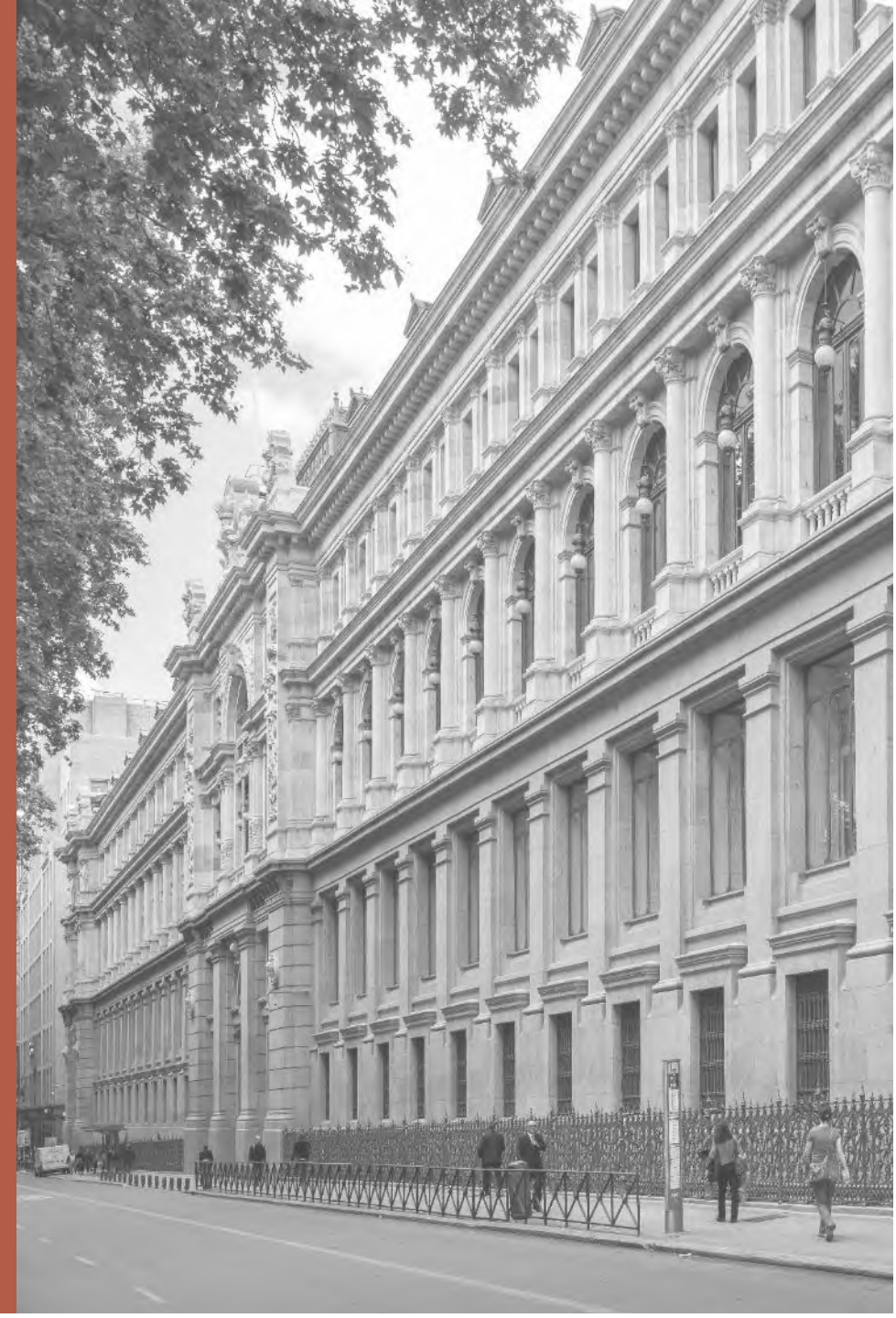


THE OUTLOOK FOR THE SPANISH ECONOMY IN A SETTING OF HIGH INFLATION AND WAR IN EUROPE

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50TH ANNIVERSARY OF THE FACULTY OF ECONOMICS AND BUSINESS STUDIES -
UNIVERSIDAD DE MÁLAGA

Malaga
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1. Global context

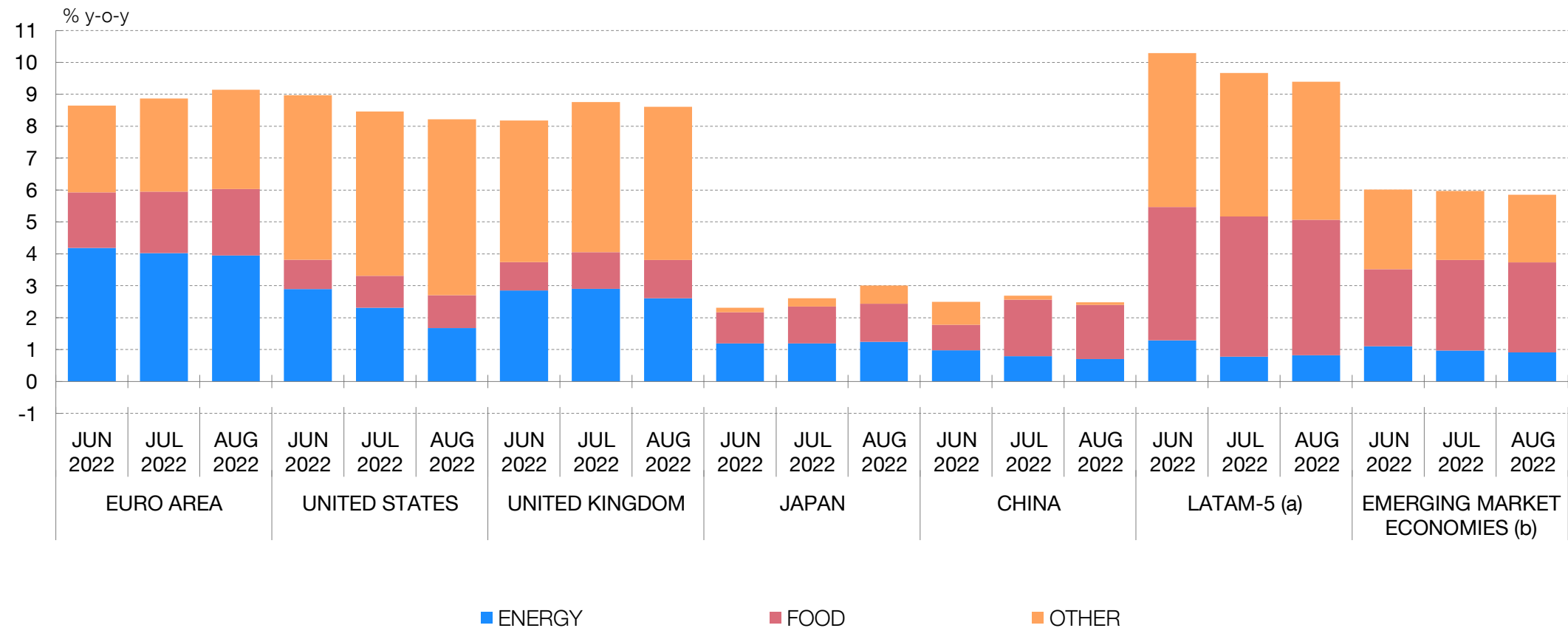
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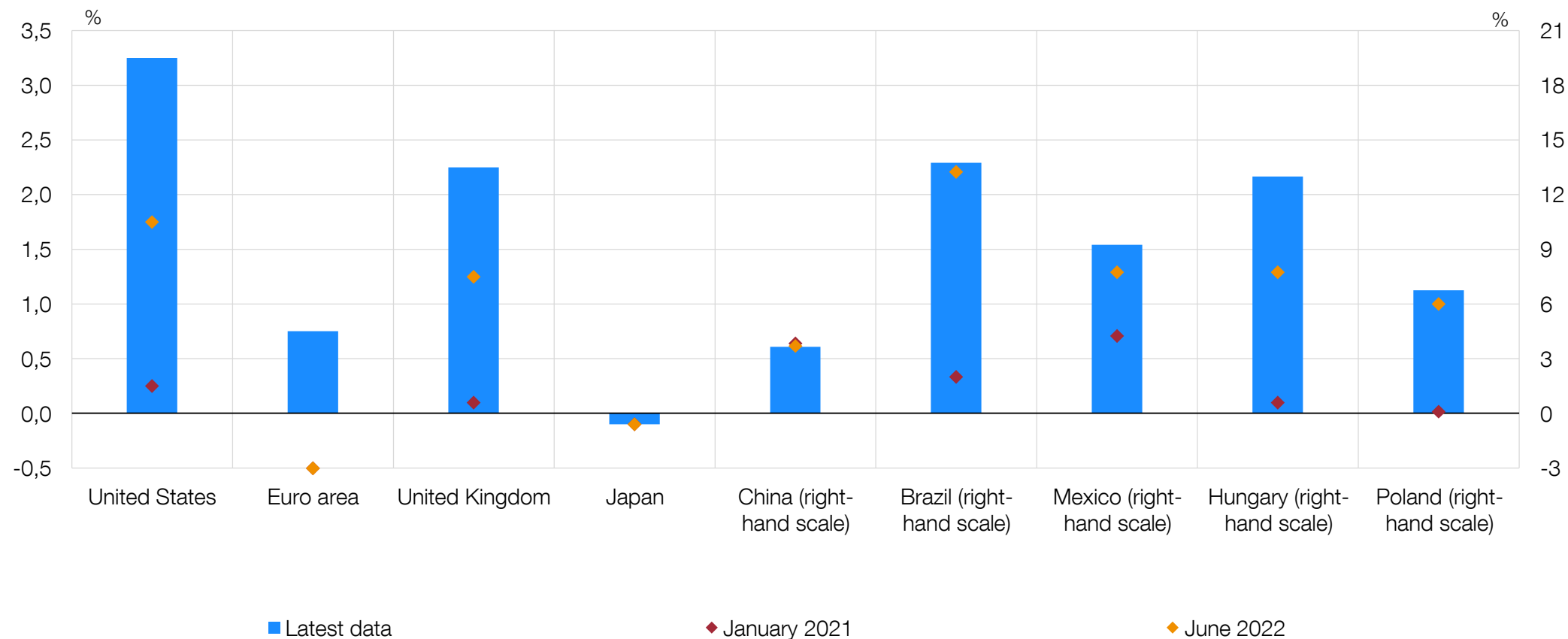
INFLATION HAS RISEN TO RATES NOT SEEN IN SEVERAL DECADES



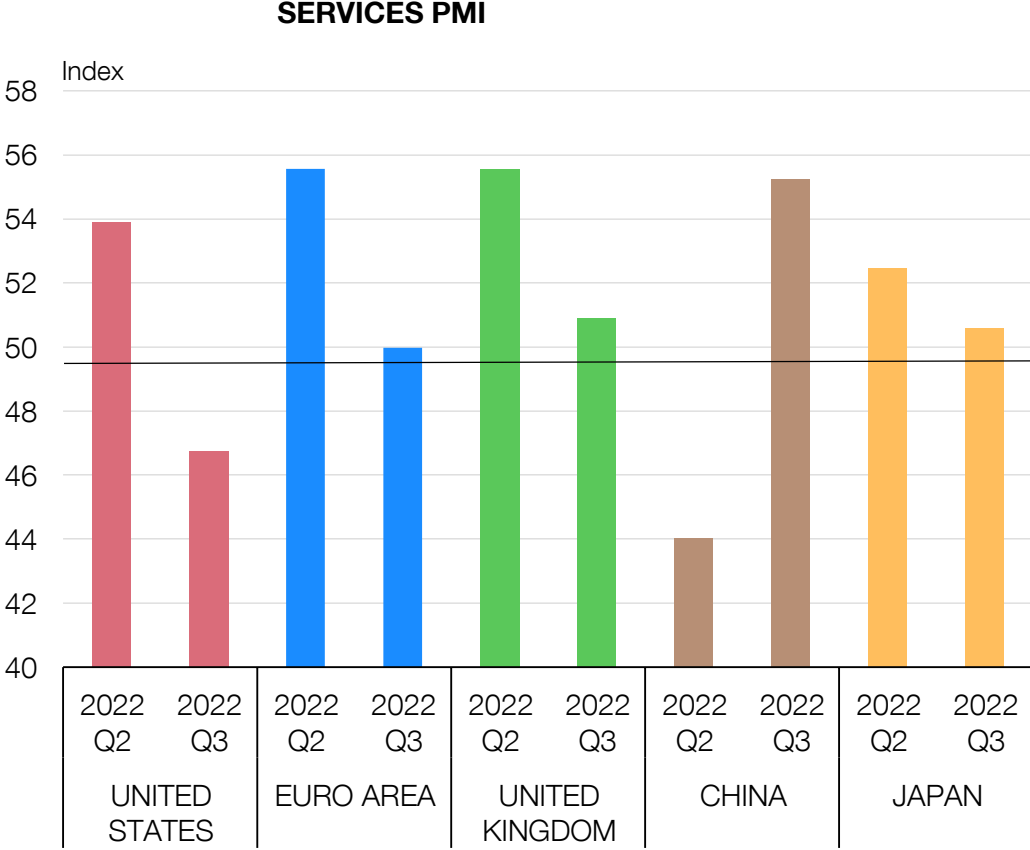
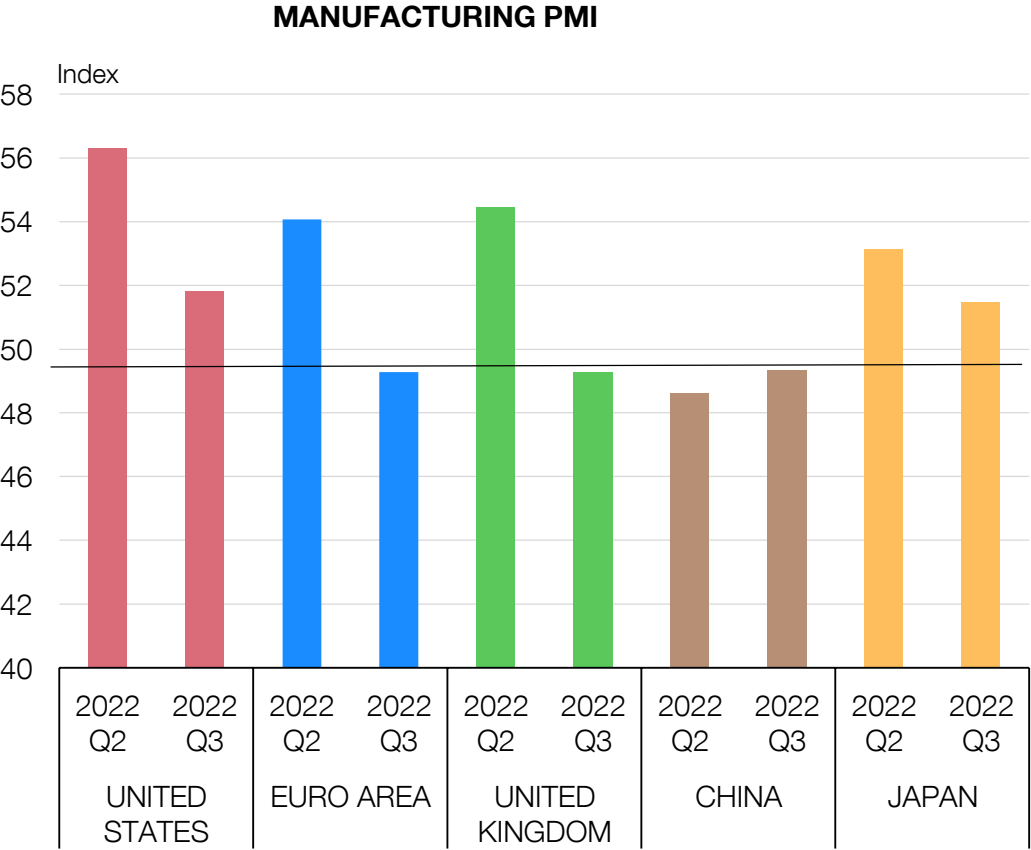
SOURCE: National statistics.
a) The LATAM-5 aggregate comprises Brazil, Chile Colombia, Mexico and Peru.
b) The aggregate comprises four geographical areas: China, Asia excluding China, LATAM-5 and Eastern Europe.

THERE HAS BEEN AN ACROSS-THE-BOARD MONETARY POLICY NORMALISATION IN RESPONSE TO PERSISTENTLY HIGH INFLATION


POLICY INTEREST RATES



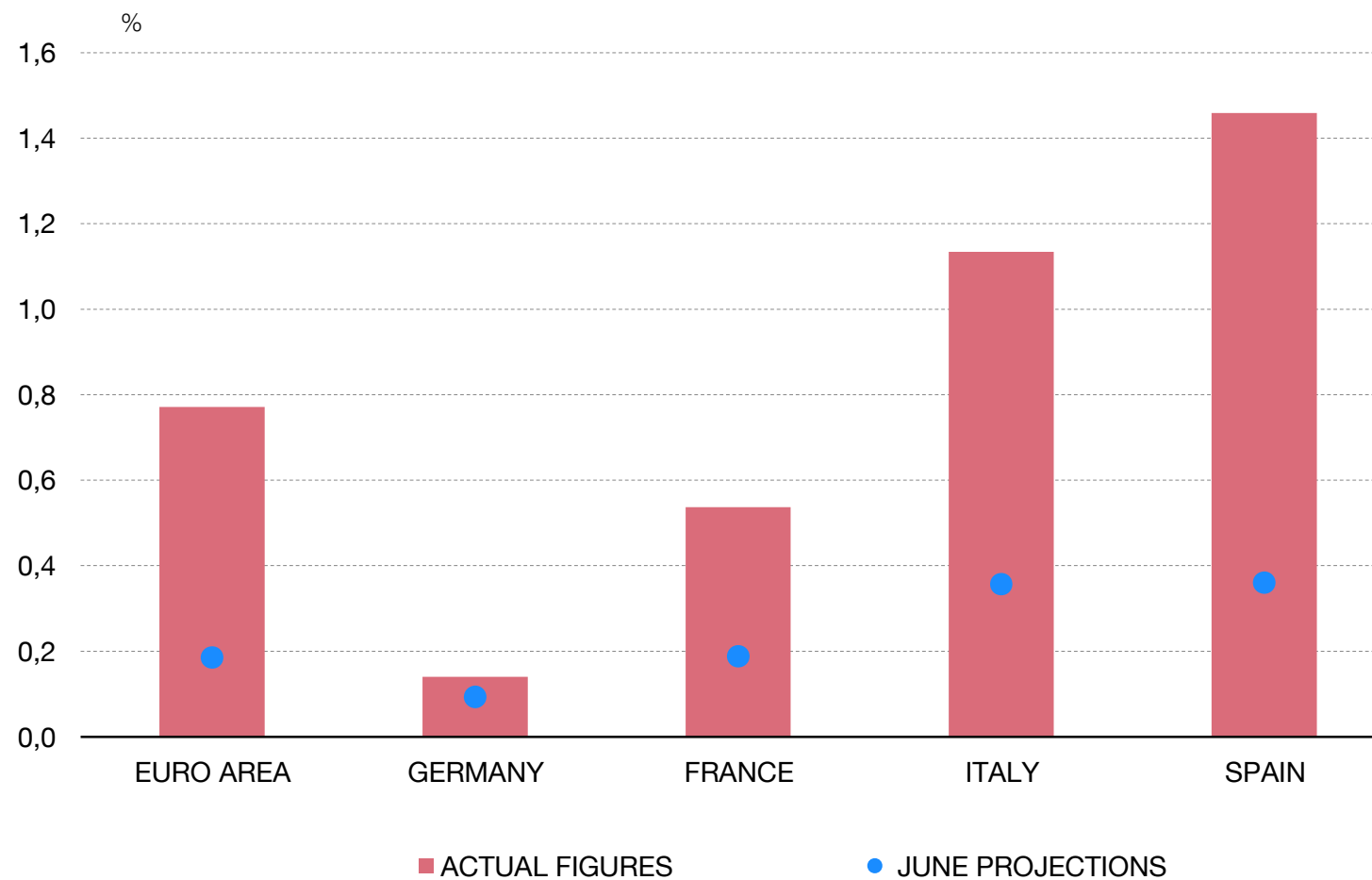
SOURCES: National central banks.



SOURCE: S&P Global.
Note: China’s Services PMI for Q3 refers to the July and August average; for the remainder the September flash estimate is used.

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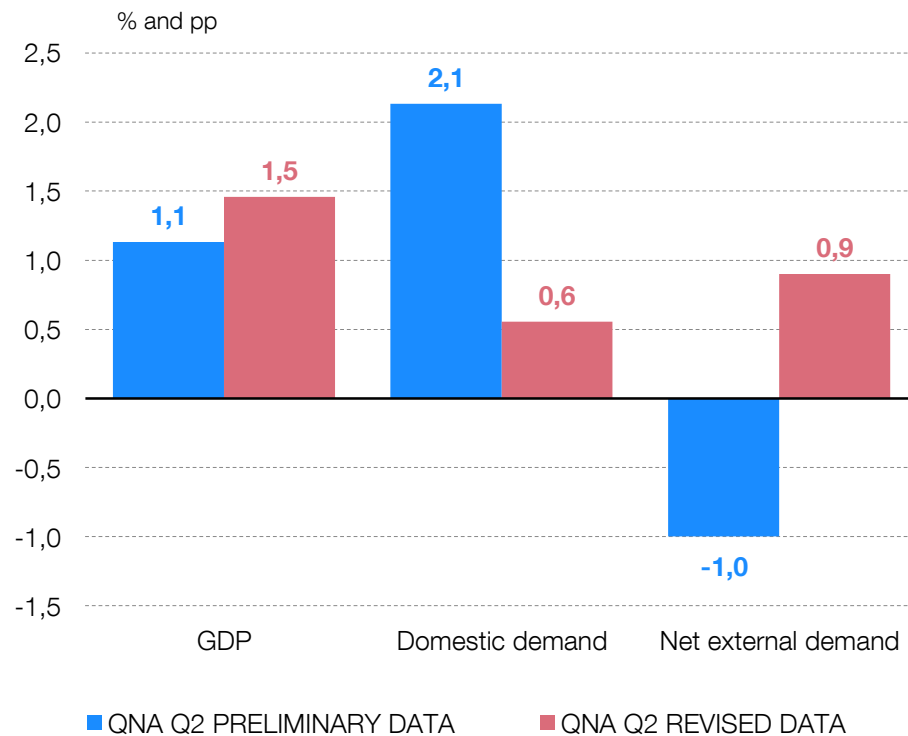
QUARTER-ON-QUARTER GDP GROWTH IN 2022 Q2



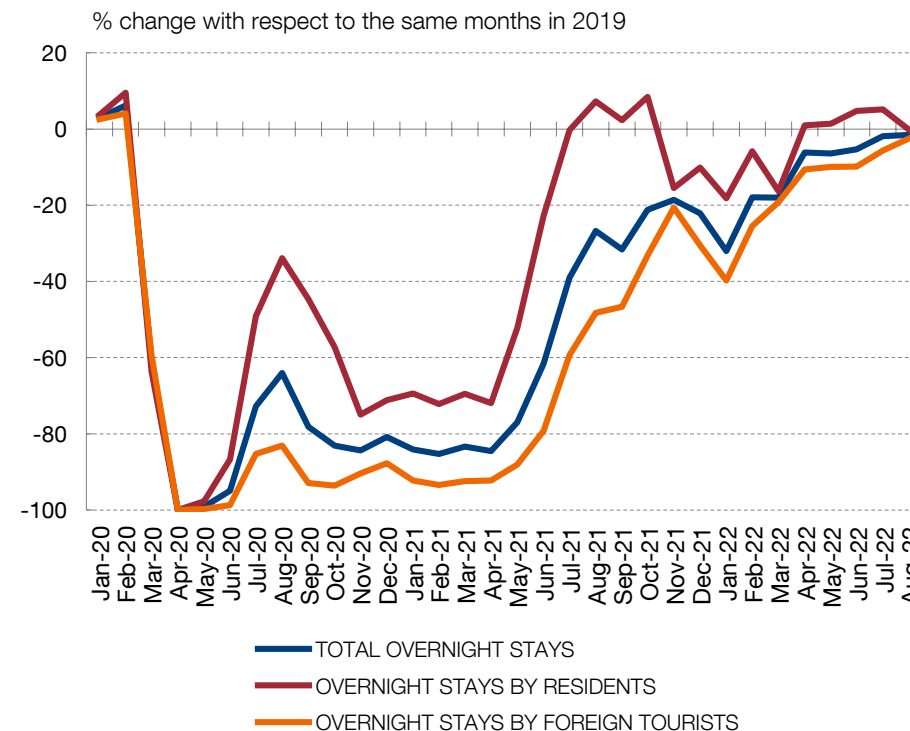
SOURCES: Eurostat, ECB and Banco de España.

IN H1 THE SPANISH ECONOMY BENEFITED FROM THE EASING OF COVID-19 RESTRICTIONS

QUARTER-ON-QUARTER GDP GROWTH (%) AND CONTRIBUTIONS (pp)



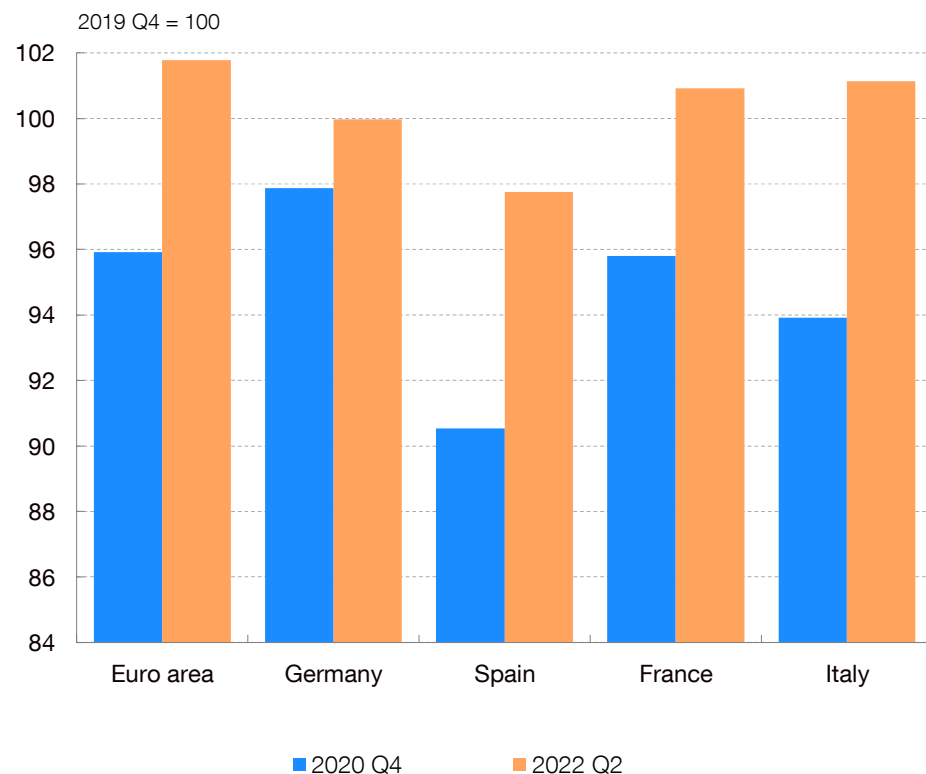
OVERNIGHT HOTEL STAYS



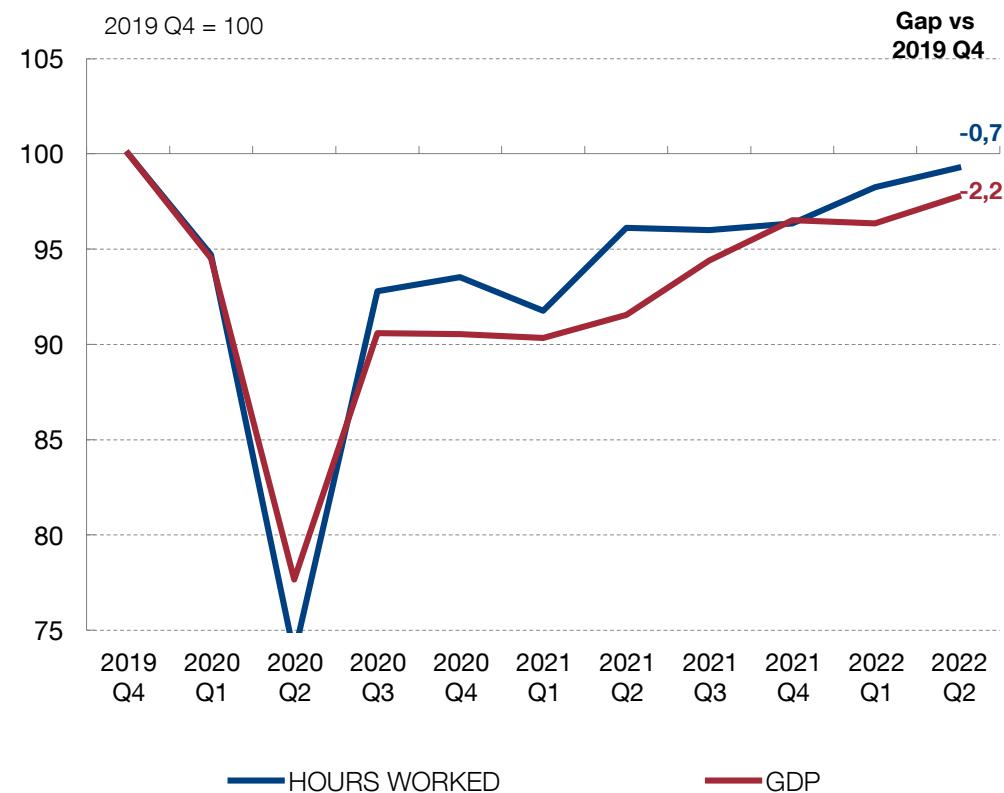
SOURCE: INE.

THE RECOVERY IN SPAIN REMAINS INCOMPLETE DESPITE THE RELATIVELY SOUND ECONOMIC PERFORMANCE IN Q2

RETURN OF GDP TO PRE-PANDEMIC LEVELS



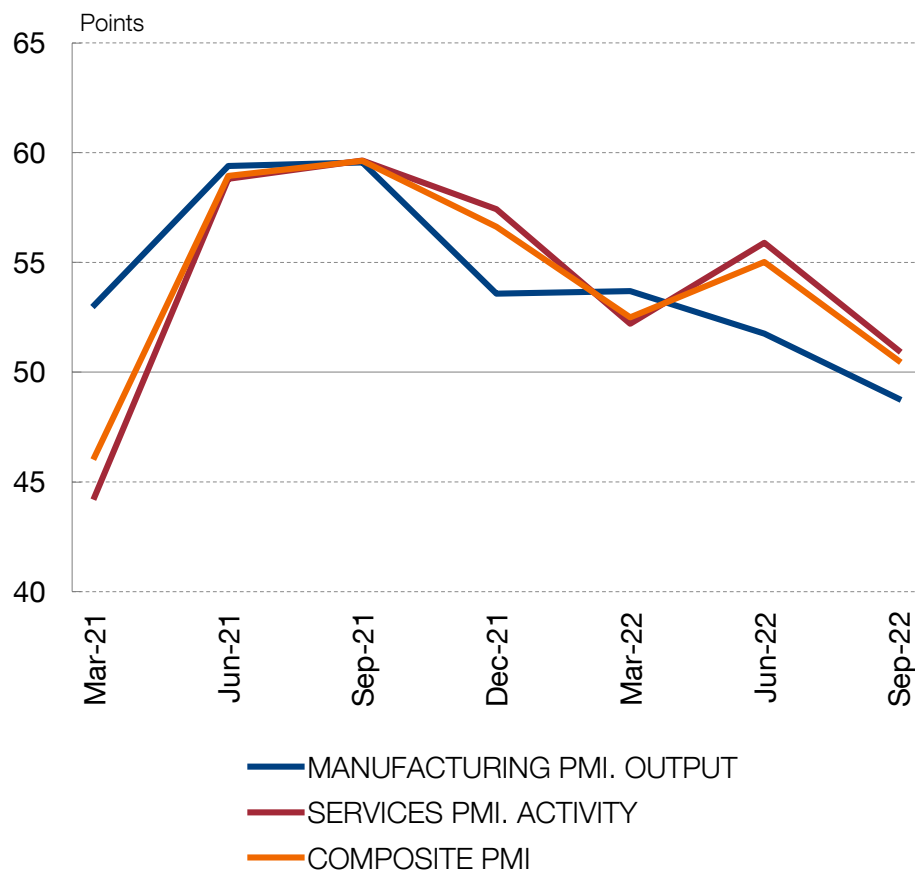
HOURS WORKED AND GDP IN SPAIN



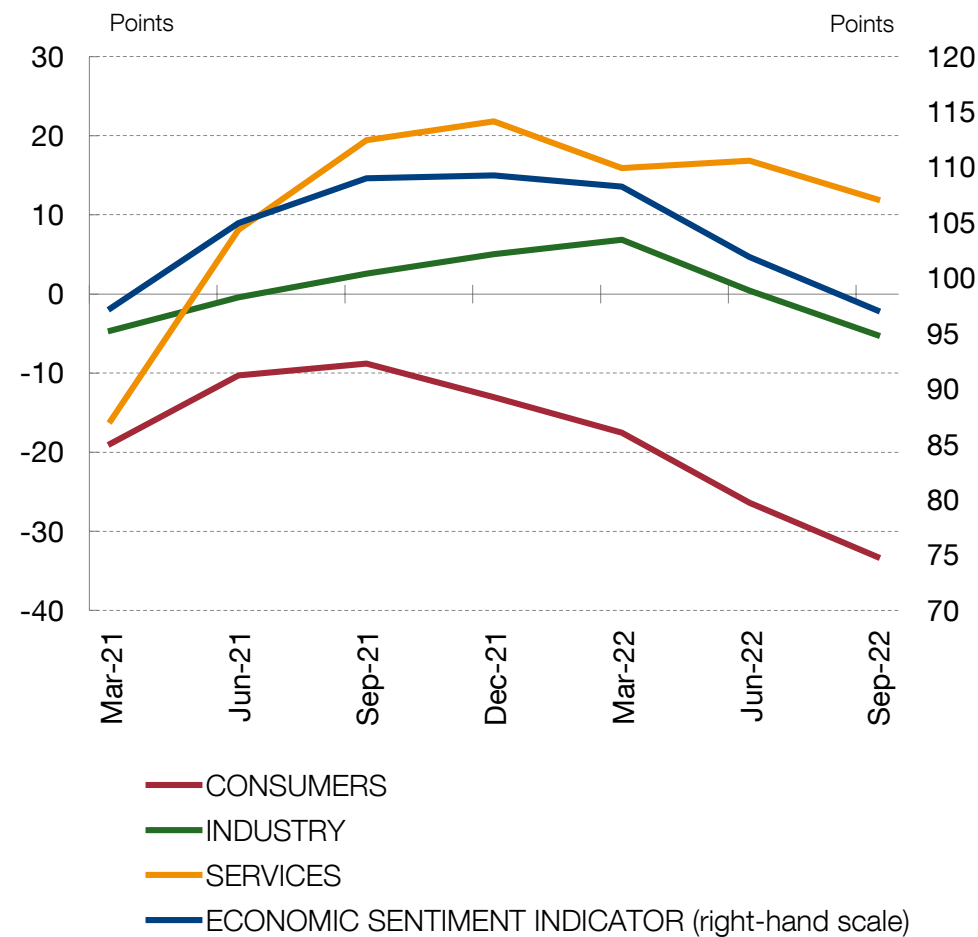
SOURCES: Eurostat and INE.

THE LATEST CONFIDENCE INDICATORS SUGGEST THAT ACTIVITY AND AGENTS' SPENDING HAVE LOST MOMENTUM

PURCHASING MANAGERS' INDICES

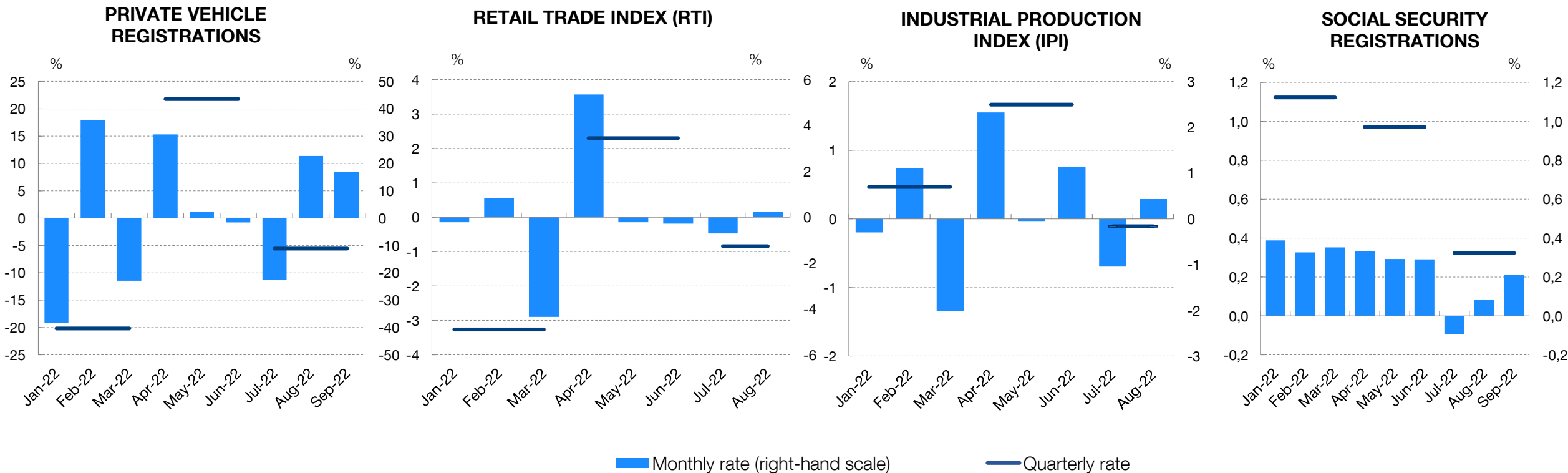


CONFIDENCE INDICATORS (a)



SOURCES: S&P Global and European Commission.
a) Quarterly averages.

VARIOUS QUANTITATIVE INDICATORS ALSO CONFIRM THE LOSS OF MOMENTUM IN ACTIVITY



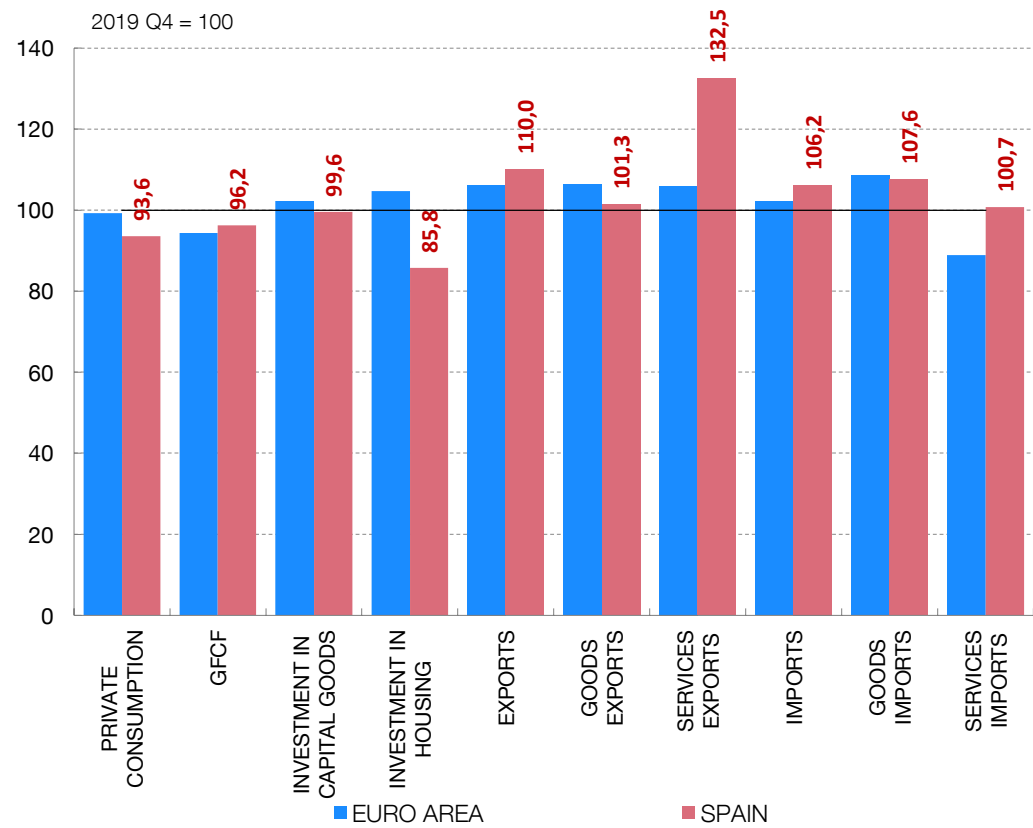
SOURCES: ANFAC, INE and Banco de España.

Latest observation: August for the RTI and IPI, September for private vehicle and social security registrations.

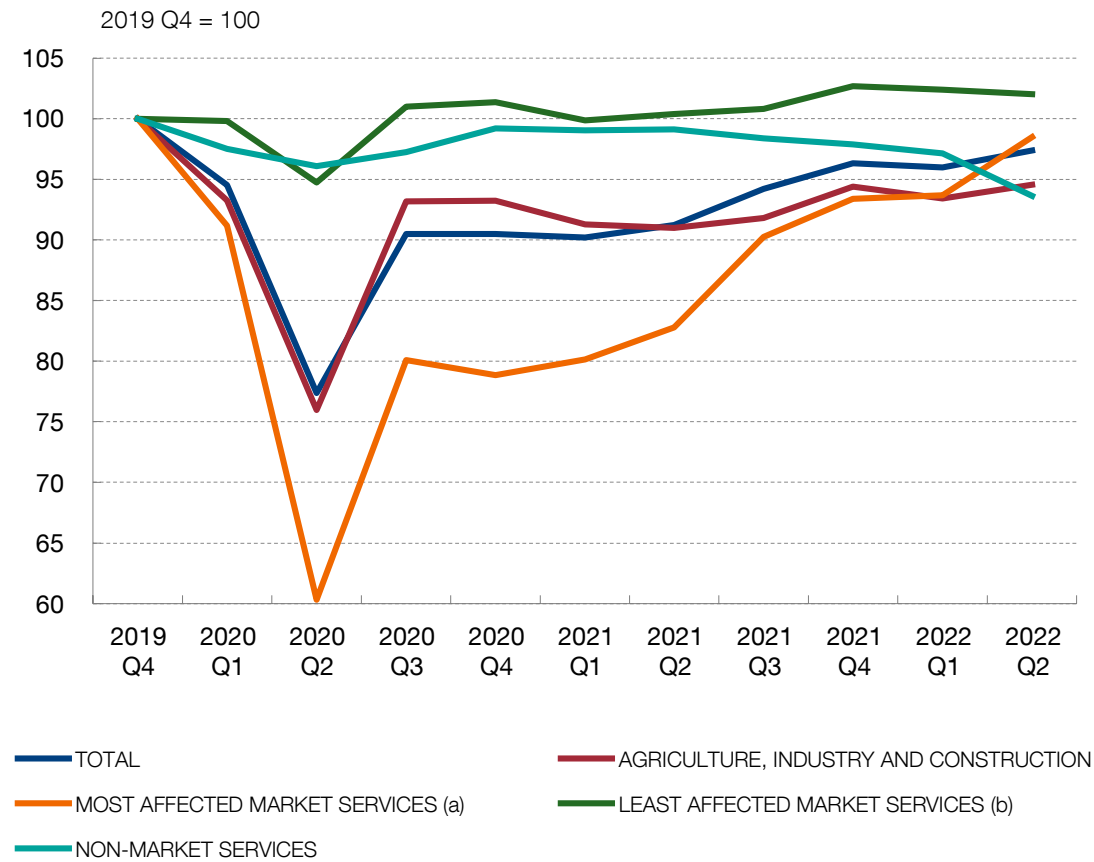
Seasonally adjusted series. Quarterly rates calculated using the information available for Q3 with respect to the Q2 average.

THE PERCEIVED DOWNTURN IN ACTIVITY IS UNEVEN ACROSS DEMAND COMPONENTS AND SECTORS

RETURN TO PRE-PANDEMIC LEVELS



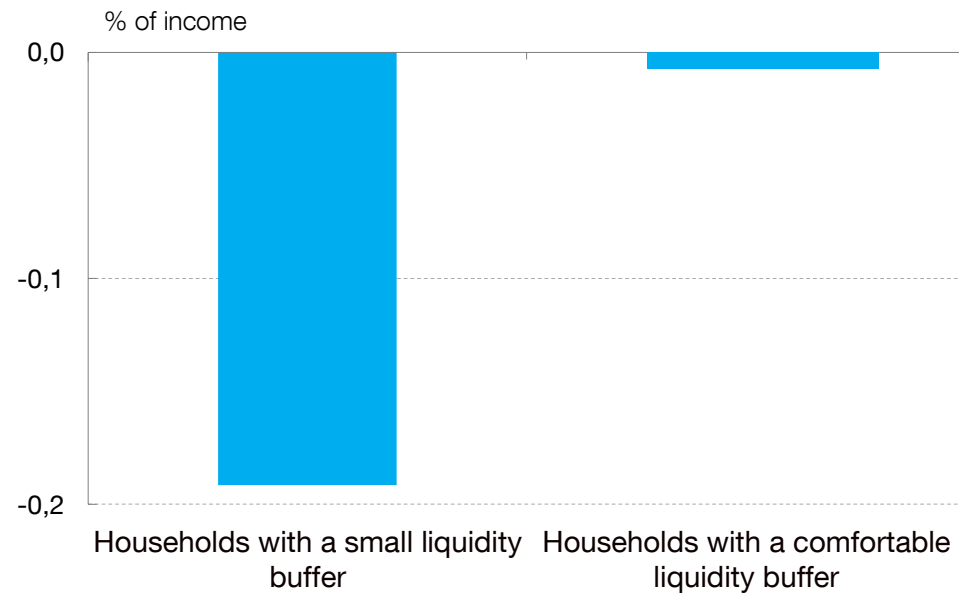
GROSS VALUE ADDED BY SECTOR



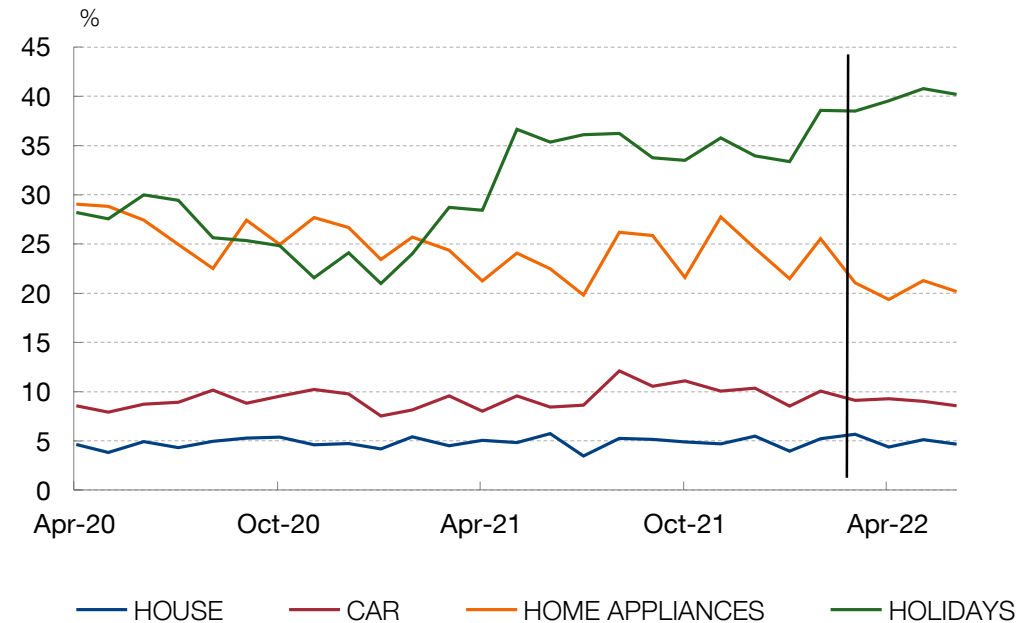
SOURCES: Eurostat, INE and Banco de España.

THE RISE IN ENERGY PRICES IS EXPECTED TO LEAD TO ADJUSTMENTS IN HOUSEHOLD SPENDING, ALBEIT UNEVENLY BY HOUSEHOLD INCOME LEVEL

REDUCTION IN SPENDING ON NON-ENERGY GOODS AND ON SERVICES IN RESPONSE TO A 1 PP INCREASE IN SPENDING ON ENERGY AS A SHARE OF HOUSEHOLD INCOME (a)



PROPORTION OF HOUSEHOLDS EXPECTING TO SPEND ON MAJOR CONSUMPTION ITEMS OVER THE NEXT 12 MONTHS

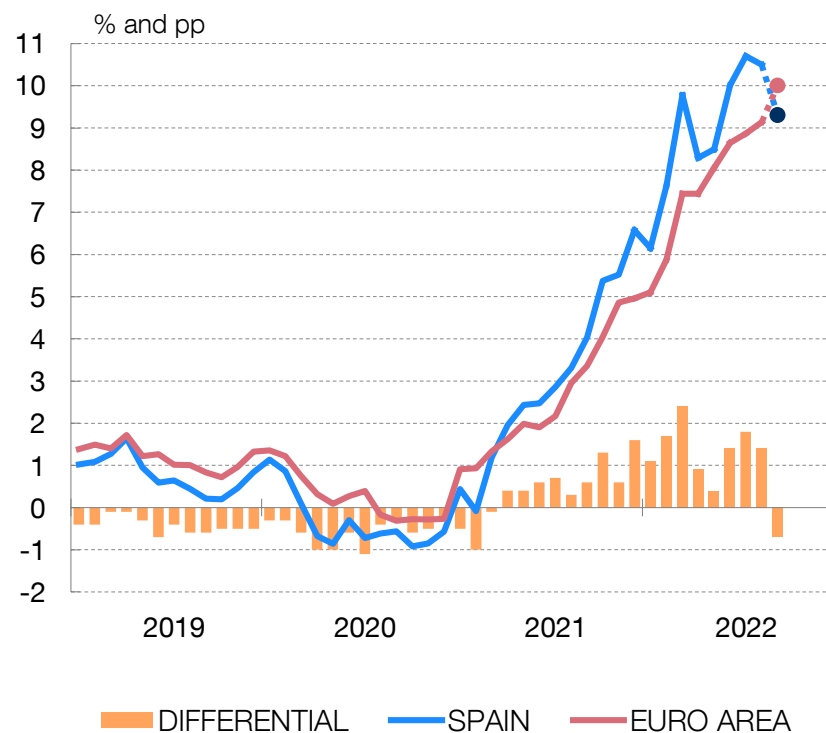


SOURCE: C. Martínez-Carrascal (2022). "The impact of the surge in inflation and the war on Spanish households' economic outlook", Analytical Articles, *Economic Bulletin* 3/2022, Banco de España.

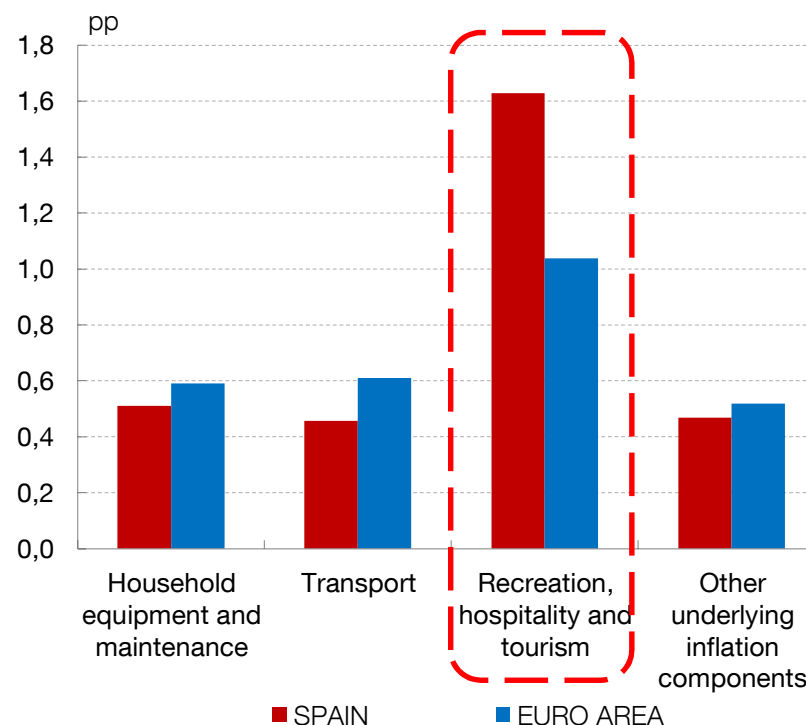
a) Households with a small liquidity buffer are defined as those that do not have sufficient liquidity (or the means to obtain it) to cover an unexpected payment equal to one month of household income. Spending on energy is proxied by drawing on total spending on electricity, gas, water, sewerage, telephony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

INFLATION HAS CONTINUED TO RISE, REACHING RATES OF OVER 10% IN JULY AND AUGUST, ALTHOUGH IT SLOWED DOWN IN SEPTEMBER

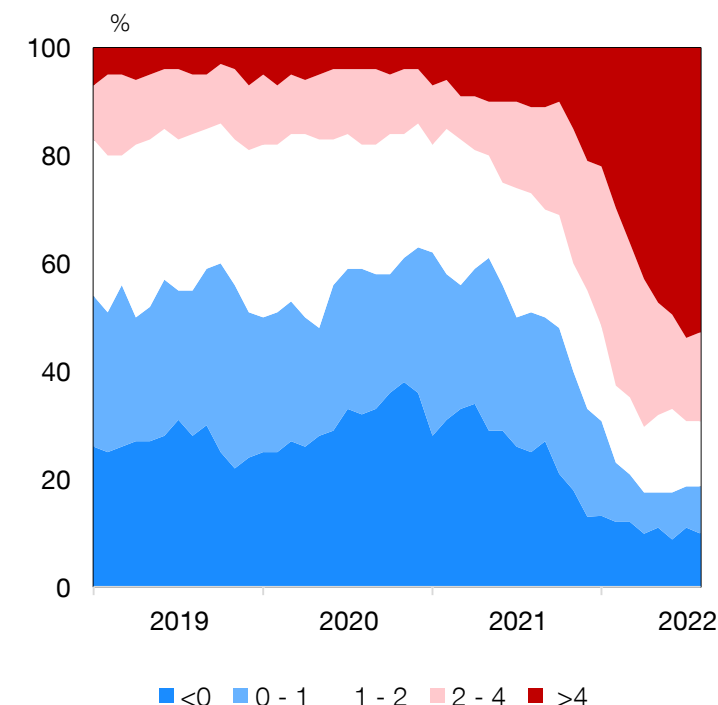
INFLATION DIFFERENTIAL BETWEEN SPAIN AND THE EURO AREA



CONTRIBUTION TO HEADLINE INFLATION AUGUST 2022

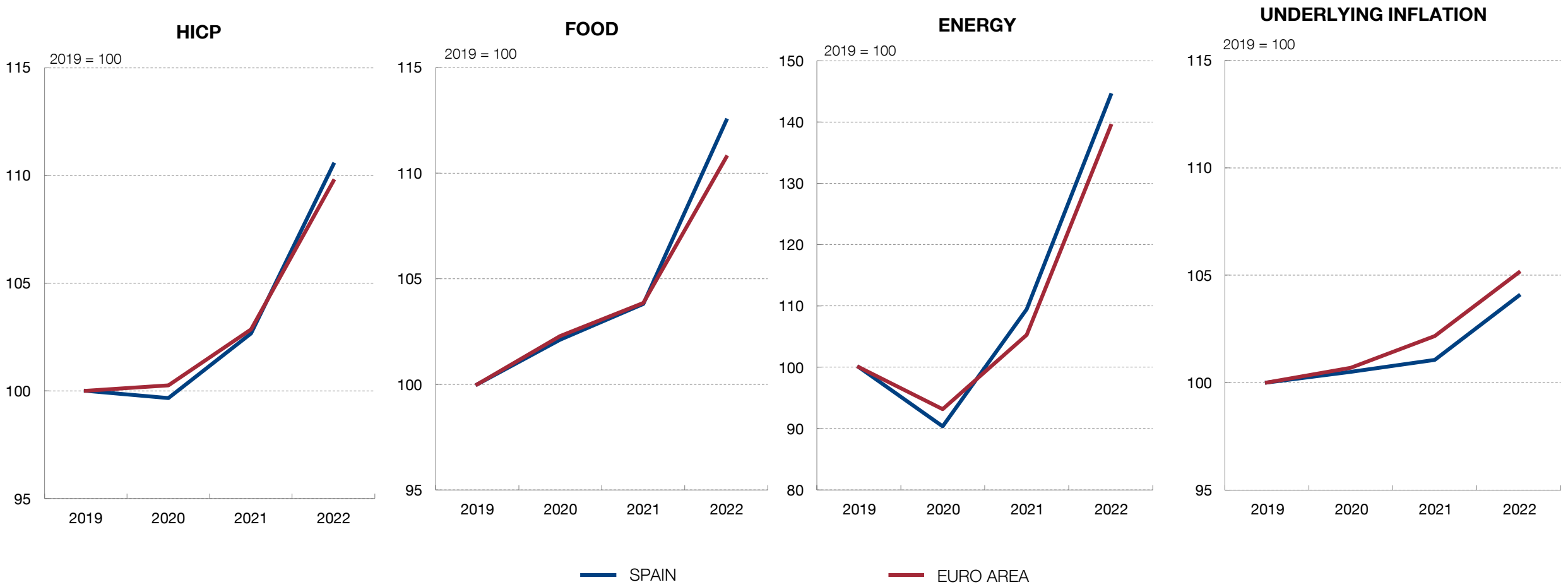


PERCENTAGE OF HICP CLASSES IN EACH GROWTH RANGE




SOURCES: INE, Eurostat and Banco de España. Latest observation: September HICP flash estimate for Spain and the euro area.

PRICE LEVELS HAVE INCREASED ACROSS THE BOARD

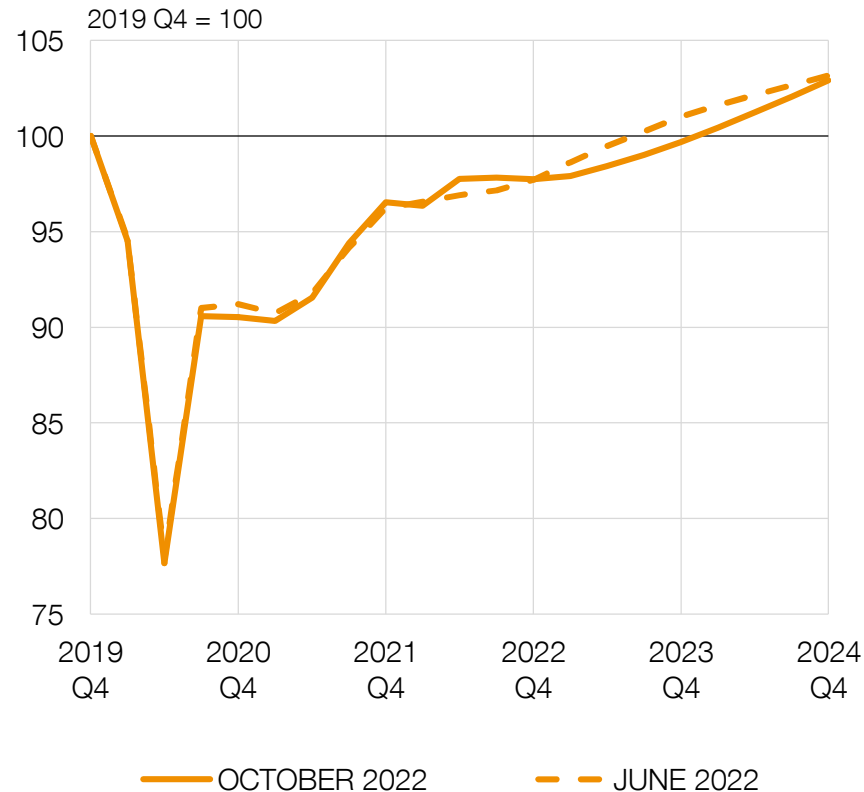


SOURCE: Eurostat. 2022 figure: average for the period January-August.

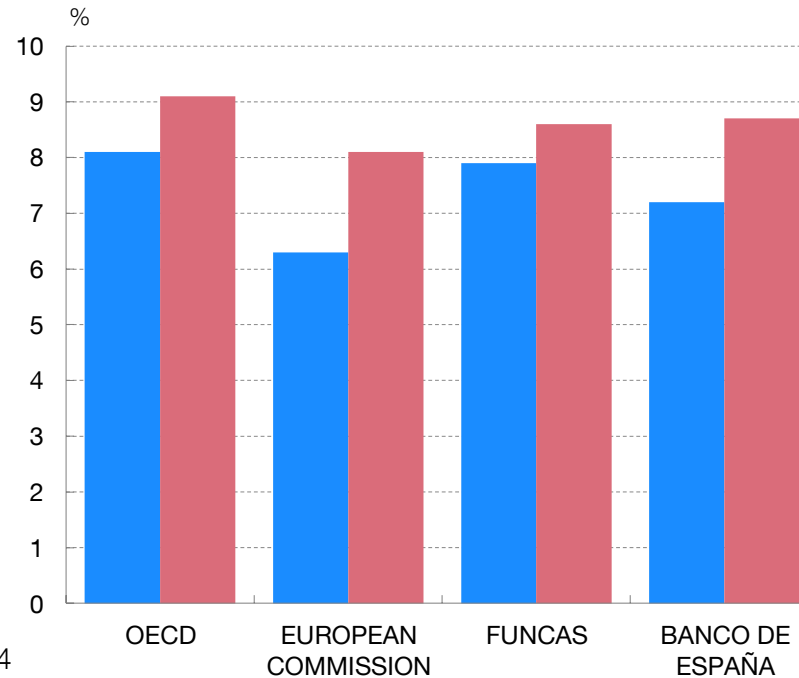
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AGAINST THIS BACKDROP, THE ECONOMIC PROJECTIONS HAVE BEEN CONSIDERABLY REVISED DOWN FOR GROWTH AND UP FOR INFLATION

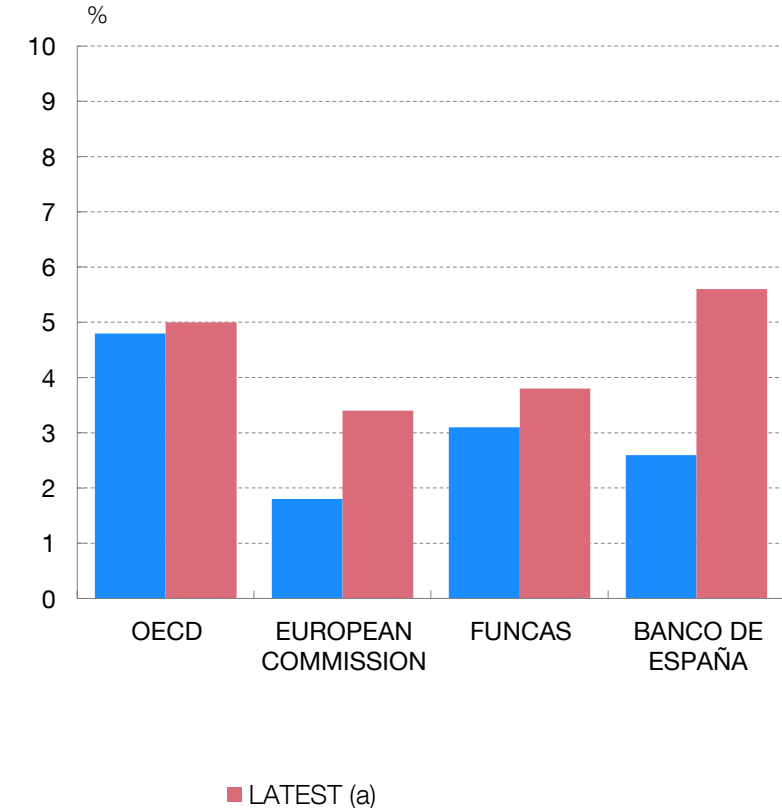
**GROSS DOMESTIC PRODUCT
(Chained volume index)**



INFLATION FORECASTS FOR SPAIN IN 2022



INFLATION FORECASTS FOR SPAIN IN 2023



SOURCES: INE, OECD, European Commission, FUNCAS, Banco de España and ECB.

a) The latest projections refer to July for the European Commission and to September for the other authorities. The previous projections refer to May for the European Commission and to June for the other authorities.

Main elements/assumptions characterising the baseline scenario

Vis-à-vis the June projection exercise:

- Positive **Q2 growth** surprise
- Repeated **upside inflation surprises**
- Suspension of practically all **Russian gas supplies** to Europe via pipelines
- Higher **interest rates**
- Higher future **energy costs**
- Lower **external demand**
- Further **euro** depreciation
- Smaller roll-out of **NGEU programme** in 2022 and 2023, but somewhat larger in 2024

Also:


- No severe **gas rationing** (moderate ability to substitute Russian gas in the near term)
- No further escalation of the **war in Ukraine**, but no early resolution of the conflict either, ...
- ... or of **bottlenecks** (very gradual improvement during 2023) ...
- ... or of the **energy crisis** (futures trajectory)
- No significant **second-round effects**
- Only with already approved **economic policy measures** and for the duration announced

AGAINST THIS BACKDROP, THE ECONOMIC PROJECTIONS HAVE BEEN CONSIDERABLY REVISED DOWN FOR GROWTH AND UP FOR INFLATION

			OCTOBER 2022 PROJECTIONS (a)			DIFFERENCE WITH THE JUNE PROJECTIONS		
	2020	2021	2022	2023	2024	2022	2023	2024
Annual rates of change (%), unless otherwise indicated								
GDP	-11.3	5.5	4.5	1.4	2.9	0.4	-1.5	0.4
Harmonised index of consumer prices (HICP)	-0.3	3.0	8.7	5.6	1.9	1.5	3.1	0.1
HICP excluding energy and food	0.5	0.6	3.9	3.5	2.1	0.7	1.3	0.1
Unemployment rate (% of labour force). Annual average	15.5	14.8	12.8	12.9	12.4	-0.2	0.2	-0.3
General government net lending (+) / net borrowing (-) (% of GDP)	-10.1	-6.9	-4.3	-4.0	-4.3	0.3	0.5	0.0
General government debt (% of GDP)	120.4	118.3	113.3	110.7	109.9	-1.6	-2.5	-2.6

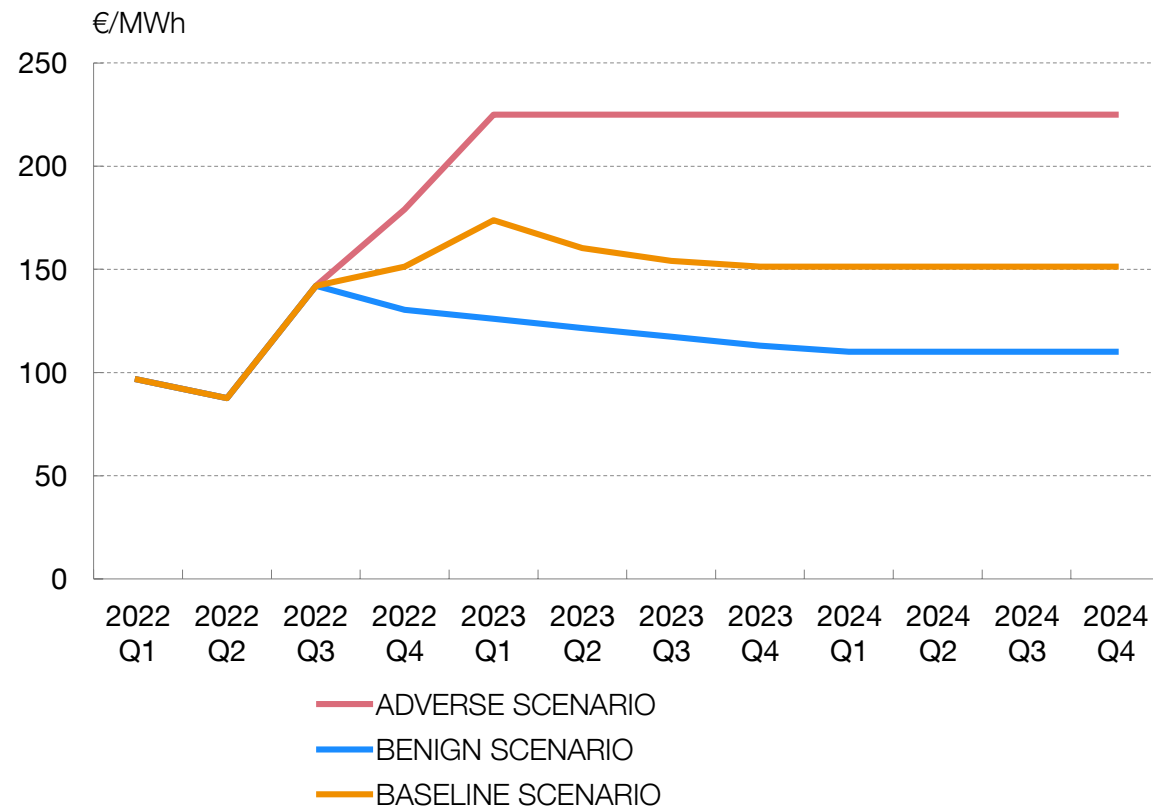
SOURCES: Banco de España and INE.

a) Projections cut-off date: 30 September 2022.

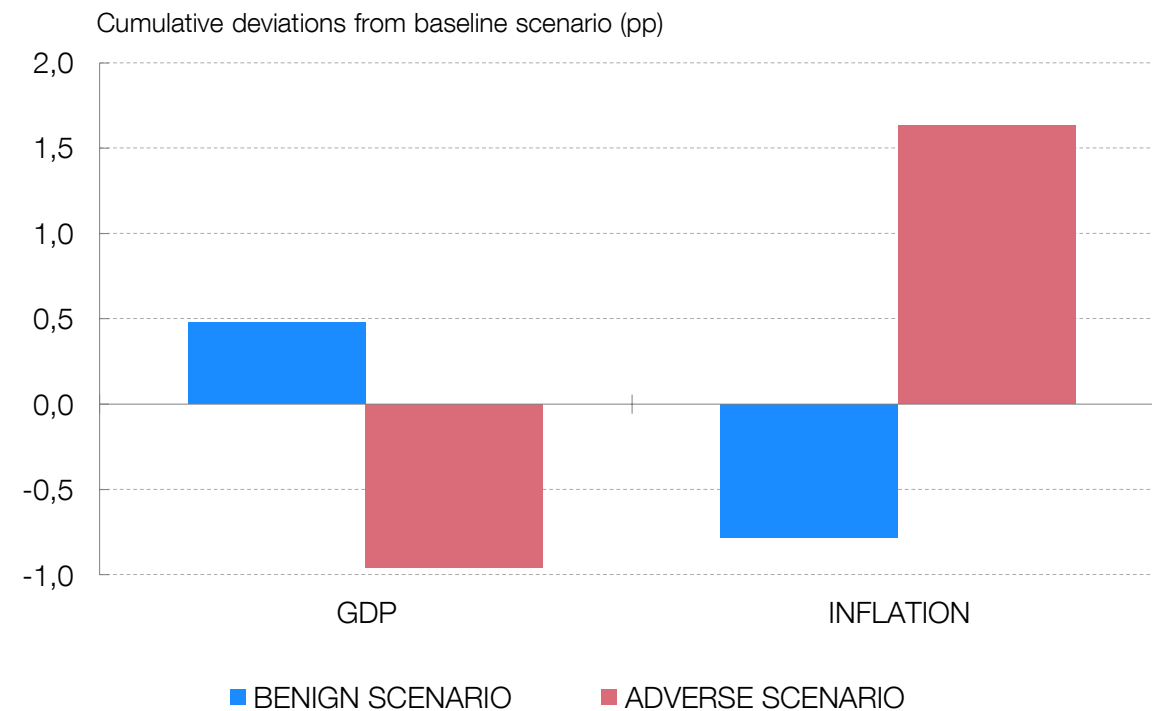
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WHAT WOULD HAPPEN TO GDP AND INFLATION IN SPAIN IF ENERGY PRICES WERE HIGHER OR LOWER?

GAS PRICES



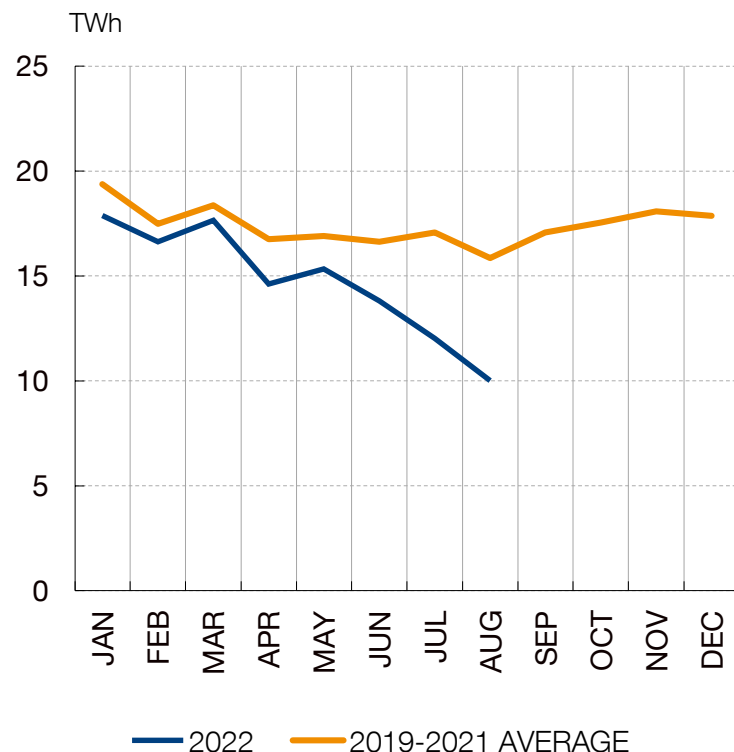
CUMULATIVE IMPACT ON GDP AND INFLATION IN THE PERIOD 2023-2024



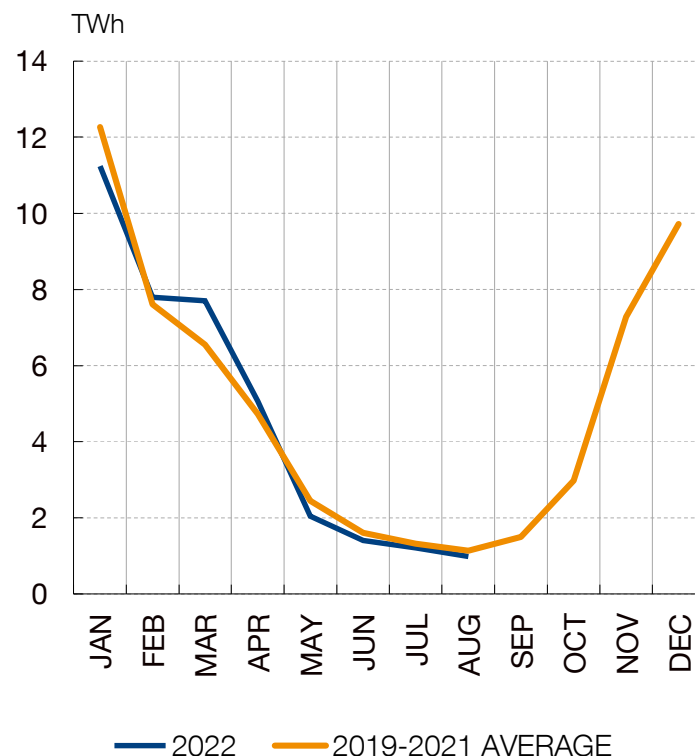
SOURCE: Banco de España.

HOW WOULD THE ECONOMY BEHAVE IF SUBSTITUTING RUSSIAN GAS IN THE MAIN EUROPEAN COUNTRIES PROVED HARDER THAN EXPECTED?

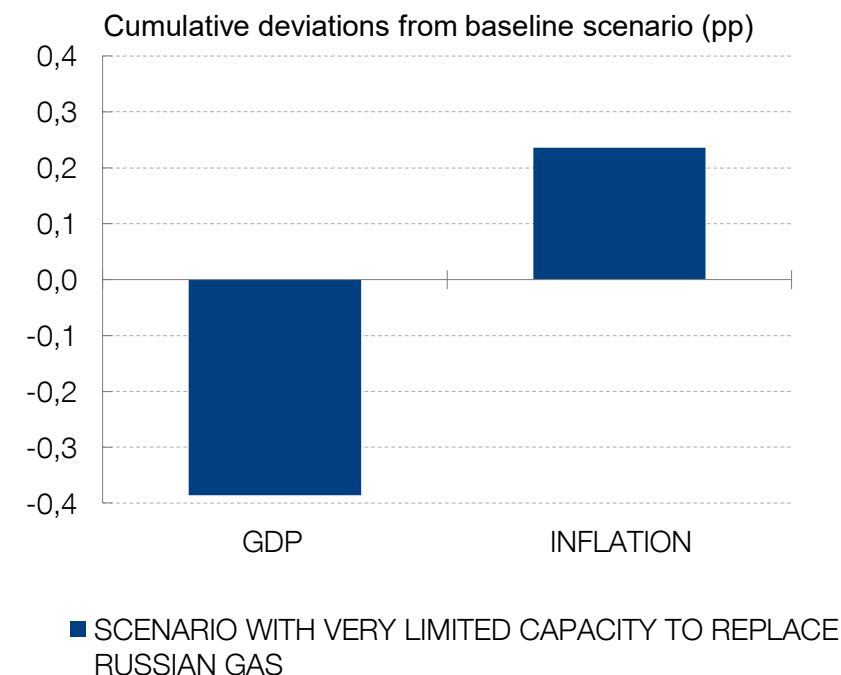
MONTHLY DEMAND FOR NATURAL GAS BY INDUSTRY IN MAINLAND SPAIN AND THE BALEARIC ISLANDS



MONTHLY DEMAND FOR NATURAL GAS BY HOUSEHOLDS AND SMEs IN MAINLAND SPAIN AND THE BALEARIC ISLANDS



CUMULATIVE IMPACT ON GDP AND INFLATION IN THE PERIOD 2023-2024 (a)



SOURCES: ENAGAS and Banco de España.

a) The chart depicts the differences between the baseline scenario (with moderate elasticity of substitution) and a scenario where the elasticity of substitution is in the lower part of the range considered in [Quintana \(2022\)](#).

The size of the indirect effects and the second-round effects on inflation → Competitiveness

Profit margins and wage settlements in collective bargaining agreements

The deployment and economic impact of NGEU funds → Potential growth

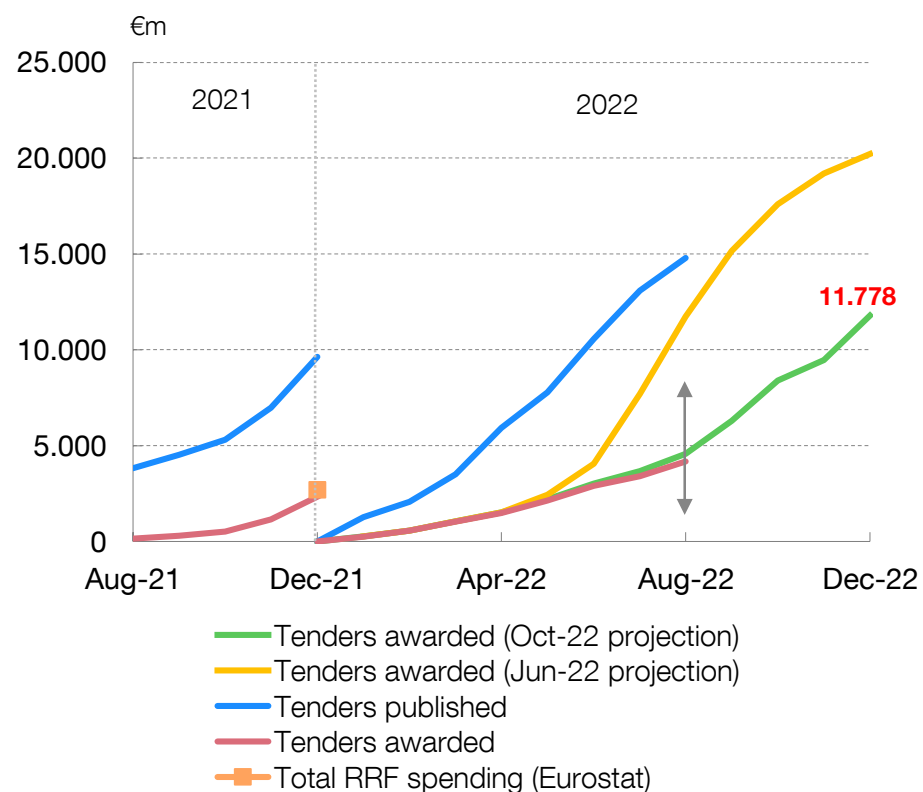
Government receipts and expenditure

Type of fiscal policy response in the current setting and medium-term fiscal plans

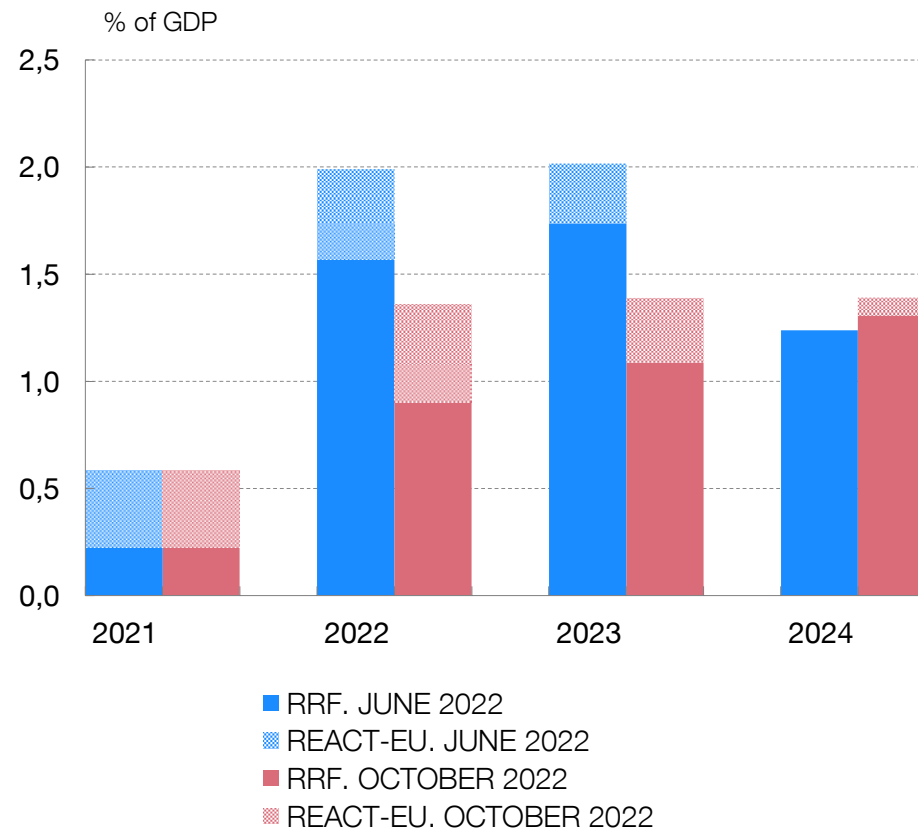
The impact of recently approved reforms

For example, the labour market reform and the reform of insolvency rules

RRF TENDERS (ACCUMULATED IN THE YEAR) (a) (b)



GOVERNMENT SPENDING FINANCED WITH NGEU




SOURCES: Website of the Spanish Recovery, Transformation and Resilience Plan (RTRP) and Banco de España.

a) Not including tenders in “forthcoming” status, those relating to government guarantees, those intended for other tiers of general government or those identified as REACT-EU.

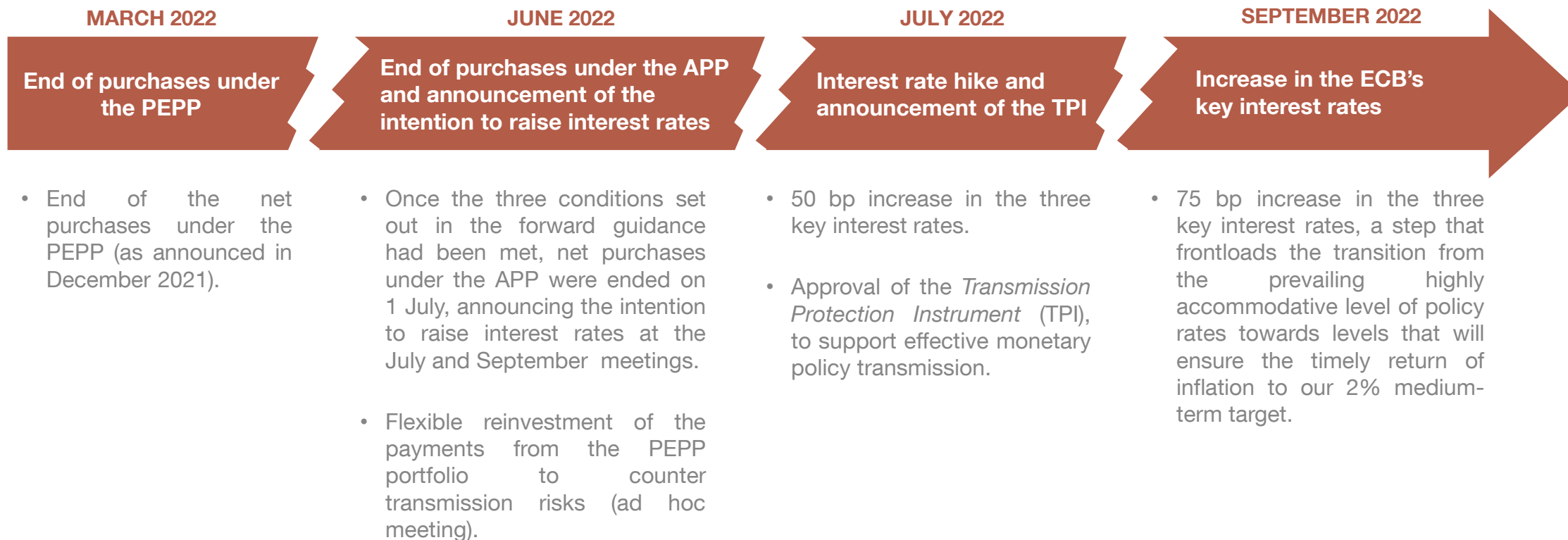
b) Tenders published on the RTRP website up to 15/09/2022, on a cumulative monthly basis.

c) The Next Generation EU (NGEU) programme has several components, of which the two most important are the Recovery and Resilience Facility (RRF) and REACT-EU.

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THE ECB IS CONTINUING THE MONETARY POLICY NORMALISATION PROCESS IT LAUNCHED IN DECEMBER 2021 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.



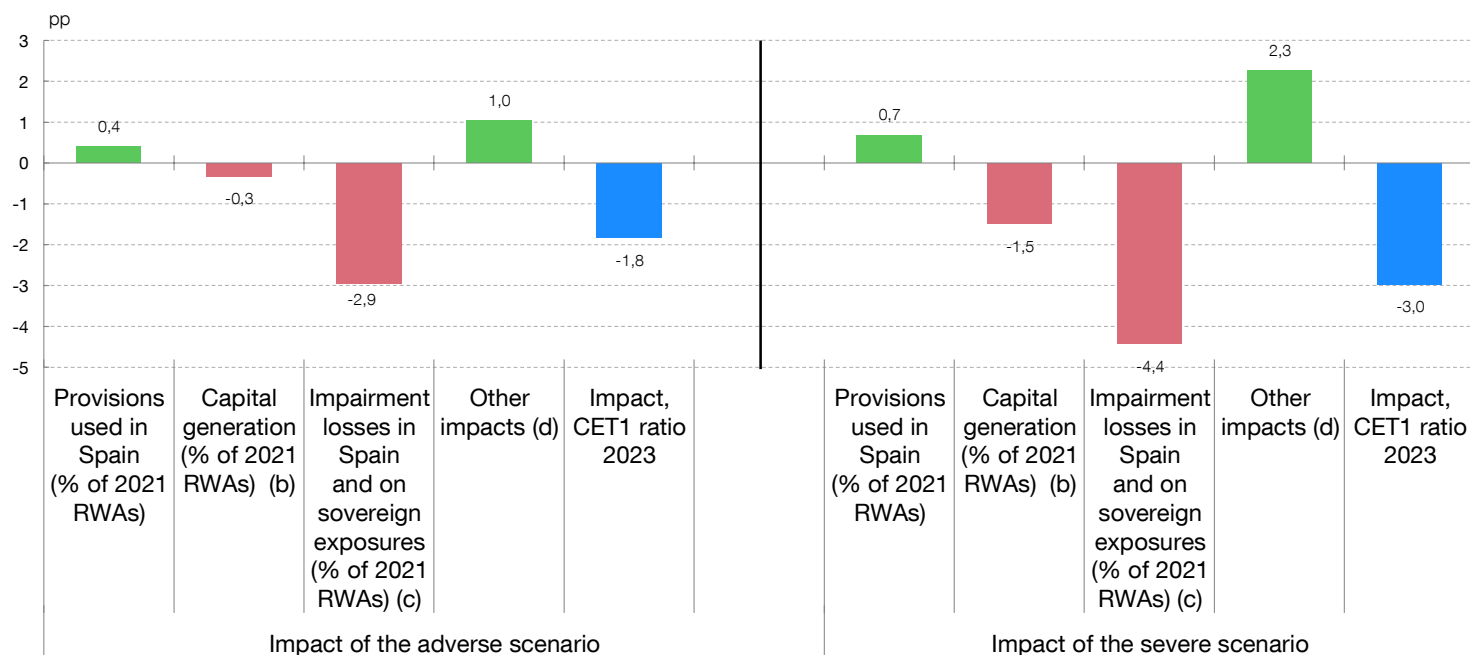
Looking ahead, decisions on interest rates will remain data-dependent and will follow a meeting-by-meeting approach: the normalisation process will continue until we reach an interest rate level that ensures inflation returns to our medium-term target of 2%

THE IMPACT OF THE POSSIBLE MATERIALISATION OF THE CURRENT RISKS ON THE BANKING SECTOR CALLS FOR MAXIMISING PRUDENCE

- Banks should be extremely cautious with their provisioning policy and capital planning in the coming quarters.

IMPACT ON BANK SOLVENCY OF THE RISK SCENARIOS IDENTIFIED AFTER THE OUTBREAK OF THE WAR IN UKRAINE (a)

Consolidated business



SOURCE: Banco de España.

a) The impacts are defined as the expected changes in the CET1 ratio in 2023 and in different financial flows in 2022-2023 (e.g. capital generation) stemming from the materialisation of the adverse changes in the macro-financial conditions envisaged in the scenarios described in Box 1.3.

b) The generation of loss-absorbing capital is determined by net operating income in Spain, which also includes the net profit generated abroad for banks with significant international activity.

c) Impairment losses on loans and foreclosed assets in operations in Spain, along with the impact on capital of the potential impairment of sovereign exposures at consolidated level.

d) Other consolidated gains and losses, taxes, currency translation differences, dividend distribution, coverage of losses from ICO-backed loans by the State and change in RWAs.

- 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

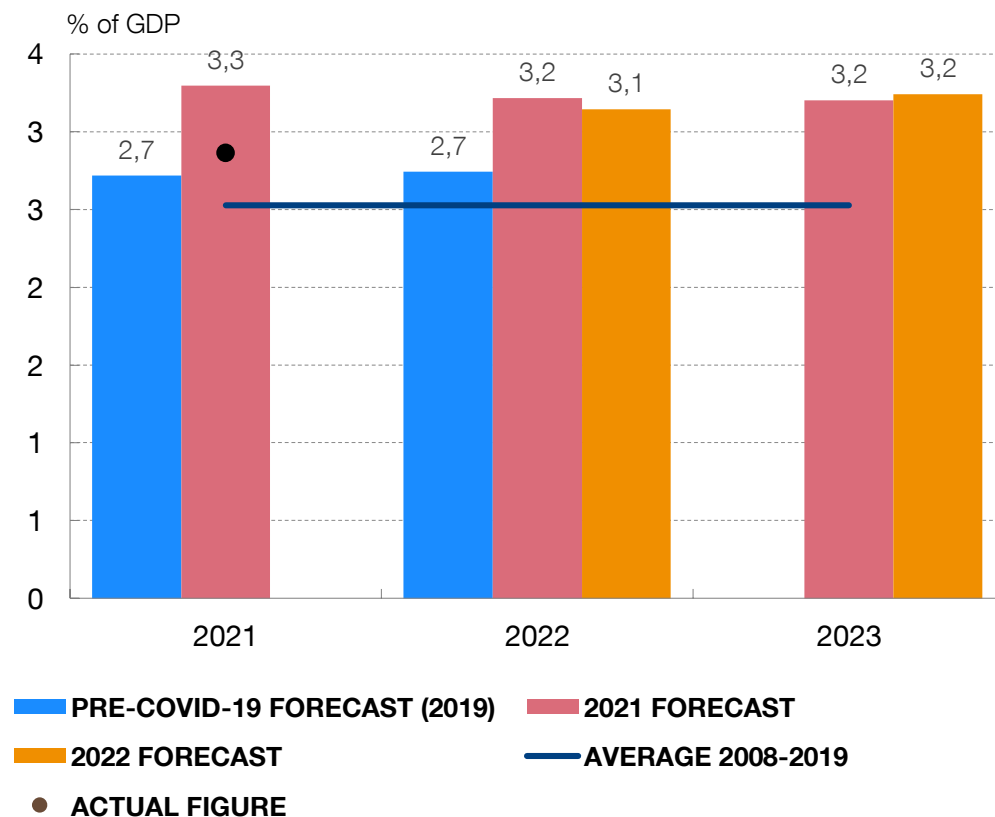
Explicit commitments to moderate profit margins

- **Fiscal policy** should play a key role in this setting, **avoiding an across-the-board fiscal impulse** which could exacerbate the existing inflationary pressures. **Automatic indexation clauses in government expenditure items** should also be avoided in order to accompany the private sector's incomes agreement.
- The measures adopted should be **temporary**, so as to avoid a further increase in the structural budget deficit, and **should target lower-income households** (who bear the brunt of inflation) and the firms most vulnerable to this shock.
- Fiscal policy should also **avoid significant distortions** to price signals.
- At the same time, making the public finances more sustainable requires the adoption of a medium-term strategy that starts by **immediately defining a multi-year fiscal consolidation plan** to be implemented once the economic effects of the pandemic and the war in the Ukraine are over. The plan should enjoy broad political support and be accompanied by an efficiency review of public spending and the tax system, involving all tiers of general government.
- **Defining this plan early would generate greater certainty and confidence**, which is particularly important amid the aforementioned monetary normalisation process.

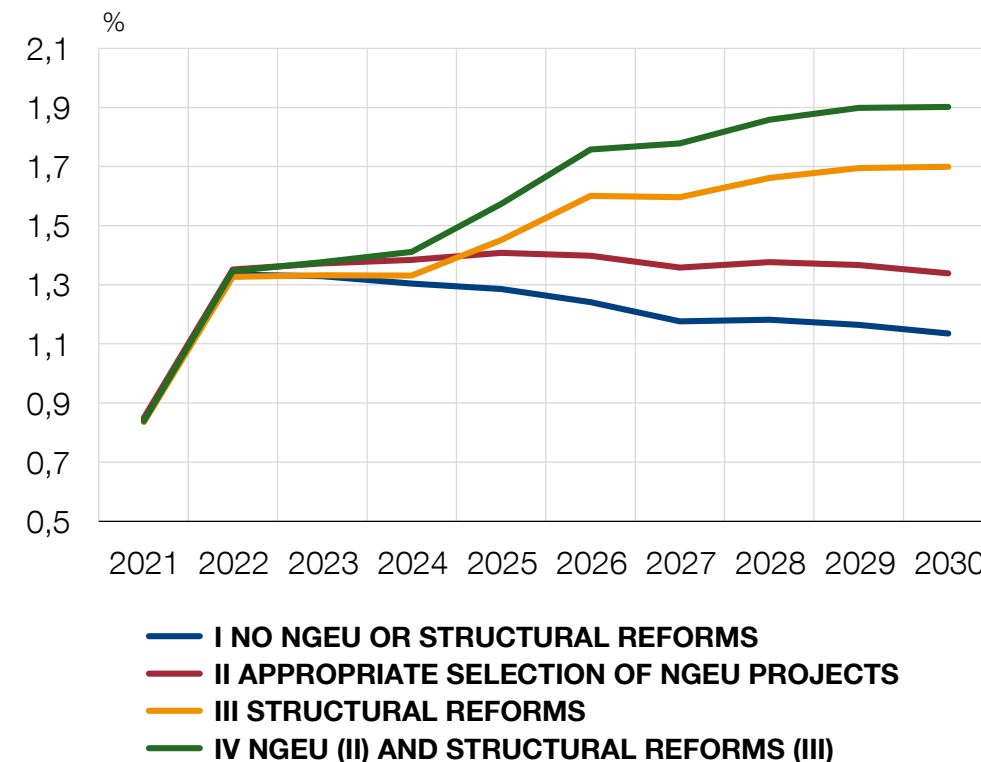
STRUCTURAL REFORMS ARE THE BEST ECONOMIC POLICY IN RESPONSE TO THE CURRENT SUPPLY SHOCK

- NGEU funds could play a key role in supporting and financing the necessary structural reforms.

**EURO AREA: PUBLIC INVESTMENT
STABILITY PROGRAMME FORECASTS (a)**



SPAIN: POTENTIAL GROWTH ESTIMATES



SOURCES: Banco de España and National Stability Programmes.

(a) Euro area-19 (except Greece). Forecasts made in spring of each year (date of publication of the Stability Programmes) for that year and subsequent years.

- This episode has shown us that **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 negative supply shocks, but also drive competitiveness.
- It is also necessary to establish **joint funding arrangements** to safeguard this common effort which do not put an excessive or highly unequal burden on national public finances or create competitive distortions that jeopardise competition in the single market, as well as 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**.
- Moreover, **it is imperative** that the banking union be completed with the establishment of a European deposit guarantee scheme and that **headway be made in constructing the capital markets union**.
- A framework that ensures fiscal sustainability is essential for the smooth functioning of the economic and monetary union. The European Commission is currently **reviewing the European fiscal rule framework**. This review should include simplifying the framework, by establishing a public expenditure growth rule and a debt-to-GDP ratio anchor, and reinforcing the capacity to build up fiscal buffers in good times for use in crises.

THANK YOU FOR YOUR ATTENTION

