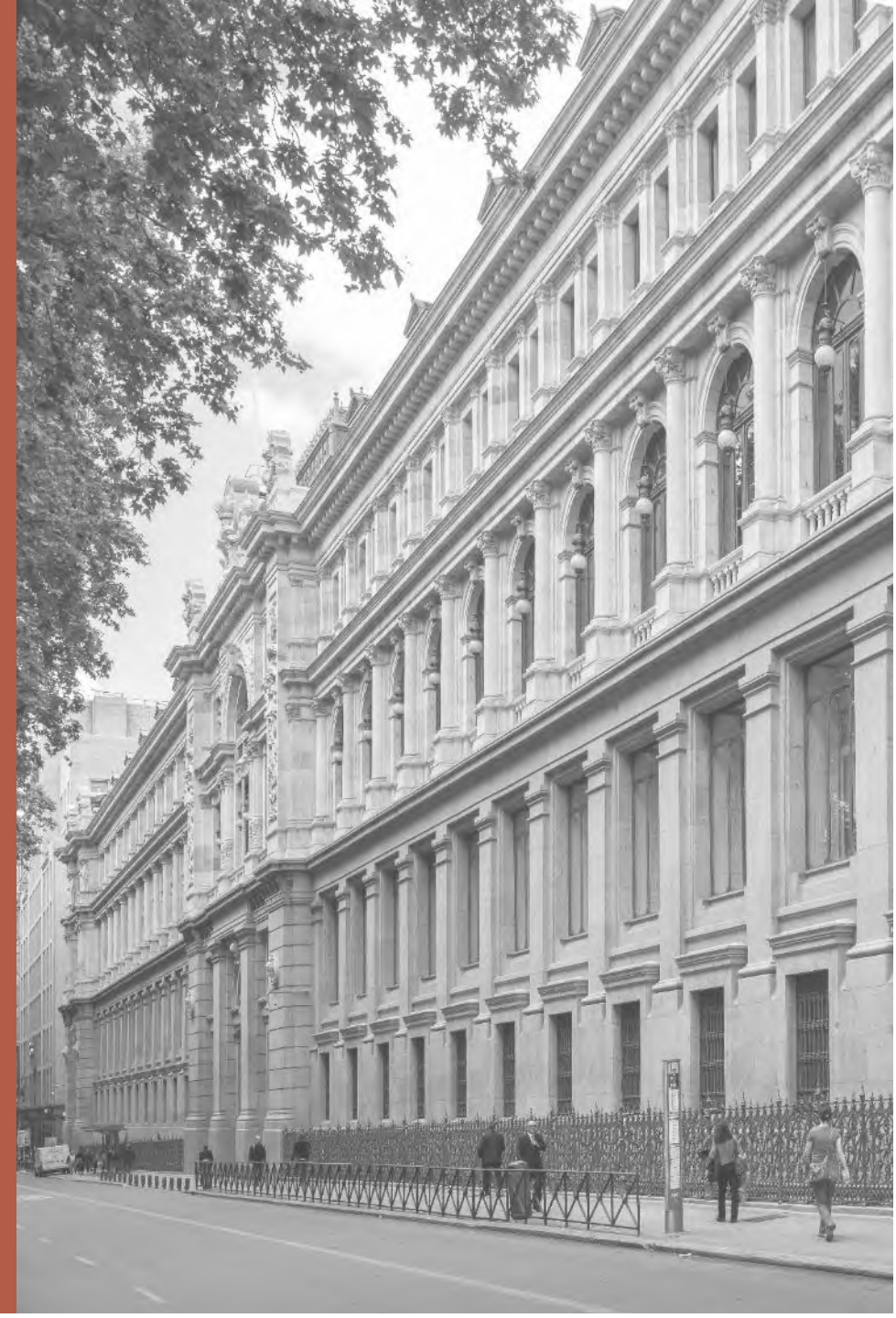


THE CURRENT UNCERTAIN ECONOMIC SITUATION AND THE ROLE OF ECONOMIC POLICIES

Pablo Hernández de Cos
Governor

“LA UNED Y LA PALABRA” CONFERENCE CYCLE – UNED CAMPO DE GIBRALTAR

Algeciras
26 April 2022



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1. The current economic situation
2. Economic policy responses
3. Conclusions

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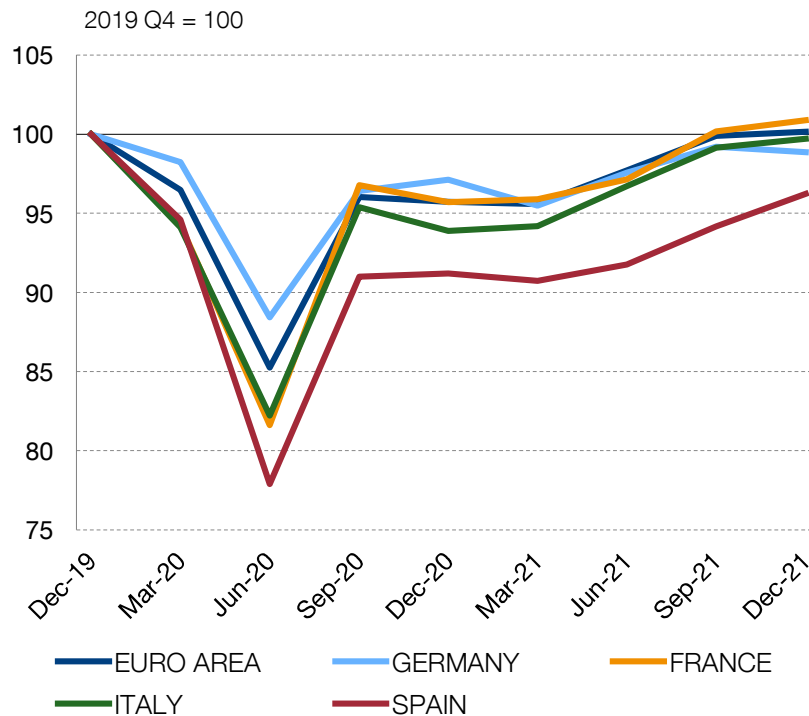
1. The current economic situation
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BEFORE THE WAR, THE WORLD AND EUROPEAN ECONOMIES WERE GRADUALLY RECOVERING, ALBEIT UNEVENLY ACROSS COUNTRIES AND SECTORS...

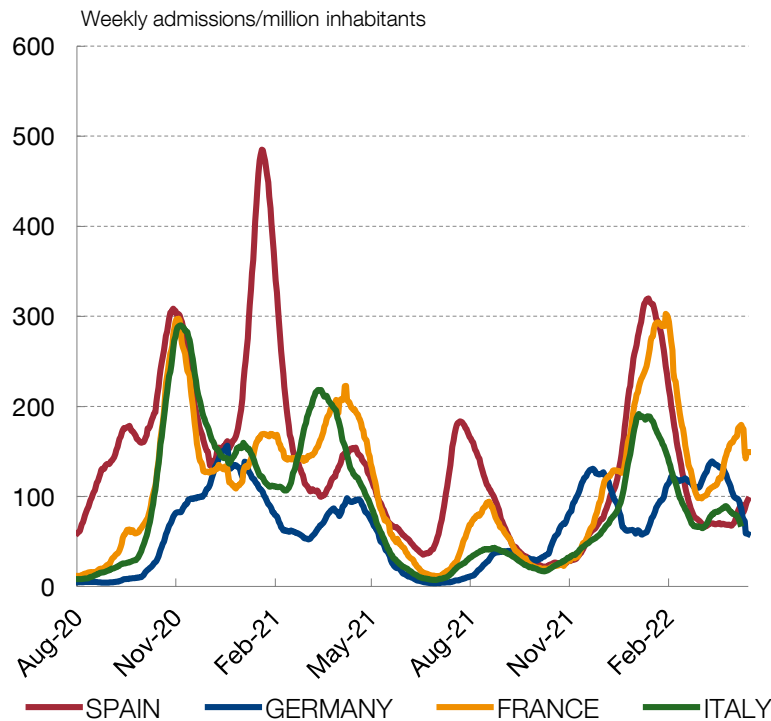
Prior to the invasion of Ukraine, analysts' forecasts broadly coincided in expecting a **moderate slowdown in Q1**, as a consequence of the – albeit limited – negative impact of the Omicron variant.

For the rest of the year, and conditional upon an improvement in the course of the pandemic, further progress in the recovery was **expected**, underpinned by a reduction in uncertainty, the progressive elimination of bottlenecks, the maintenance of favourable financing conditions and, in Europe, the gradual implementation of NGEU.

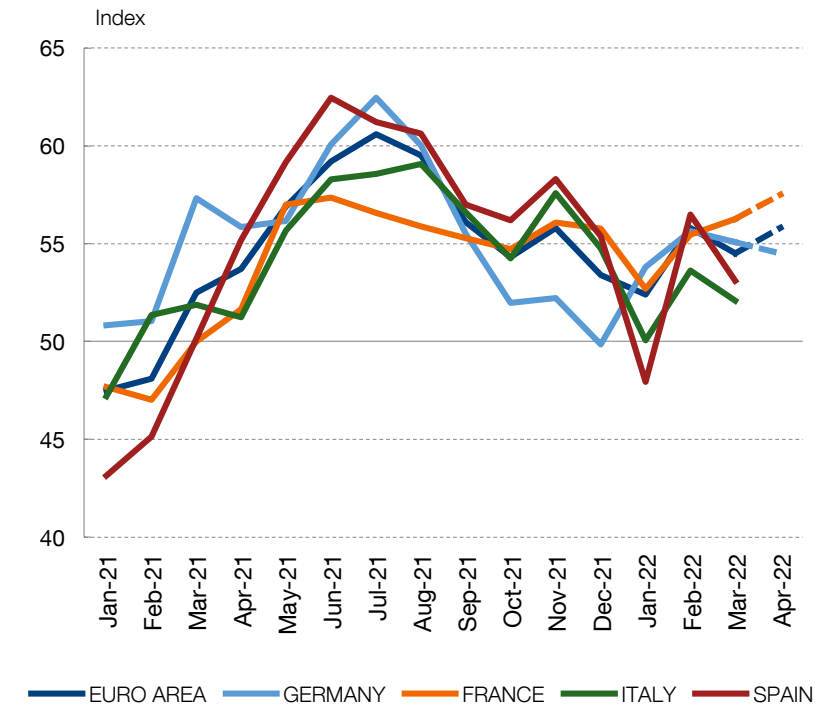
REAL GDP



COVID-19 HOSPITALISATIONS

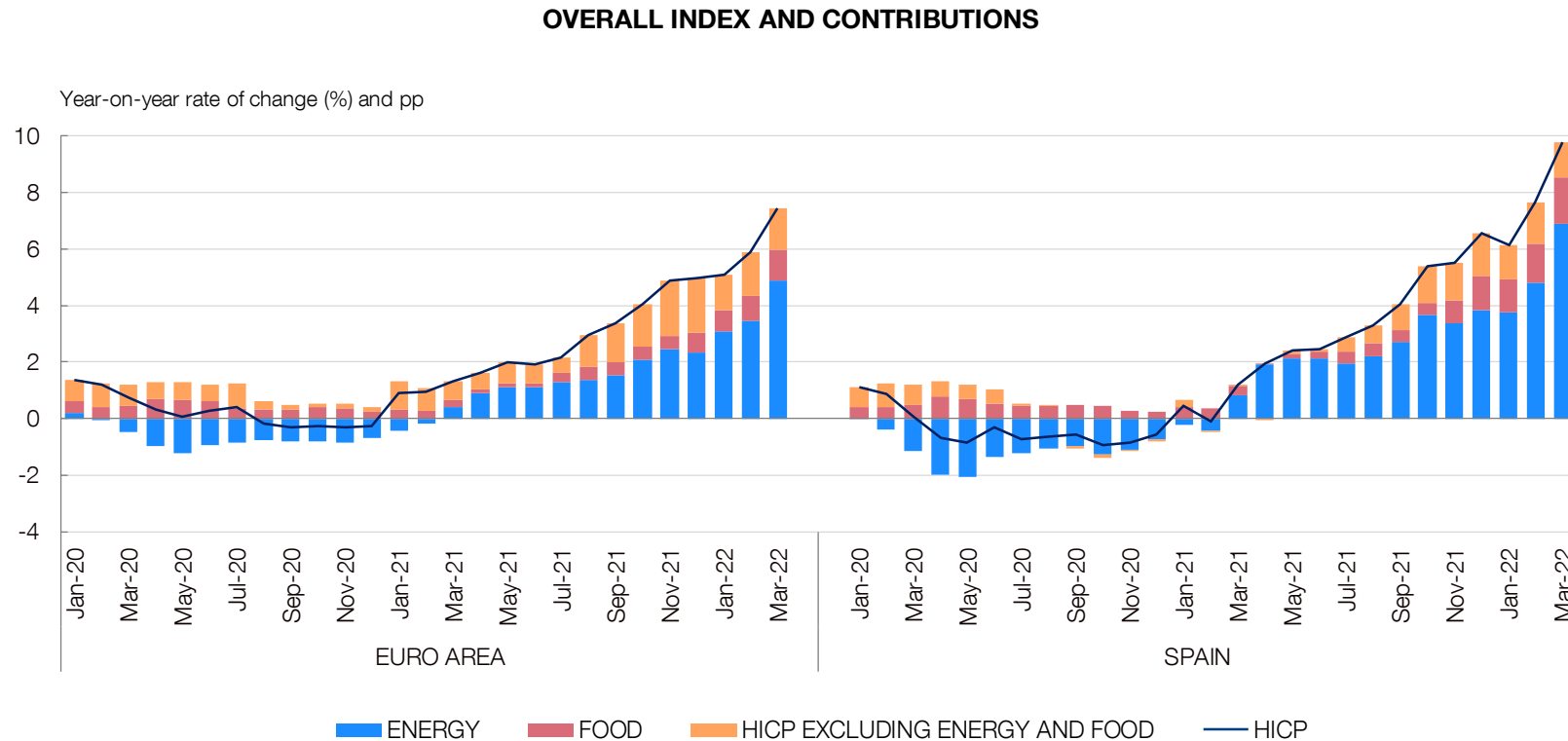


COMPOSITE PMI



Sources: Eurostat, Our World in Data and IHS Markit.

The rise in inflation has surprised on the upside in terms of its strength and persistence, including in the first few months of 2022.



Sources: Banco de España, Eurostat and INE. Latest observation: March 2022.

COMMODITIES CHANNEL

- Russia and, to a lesser extent, Ukraine, are among the main producers of certain (energy and non-energy) commodities
- Rising prices of these inputs and higher consumer inflation
- Possible supply problems

CONFIDENCE/UNCERTAINTY CHANNEL

- Tightening of financial conditions
- Postponement of households' and firms' consumption and investment decisions

TRADE CHANNEL

- Deterioration of the global economic outlook
- Worsening of bottlenecks in global value chains

COMMODITIES CHANNEL: THE EURO AREA IS HIGHLY ENERGY DEPENDENT ON RUSSIA, ALTHOUGH THIS DEPENDENCE VARIES SIGNIFICANTLY ACROSS COUNTRIES. IN SPAIN IT IS LIMITED

Russia accounted for around 20% of total euro area oil imports and 35% of total euro area gas imports in 2020. in Spain, only 6% of energy imports (4.5% of energy consumption) originated in Russia in 2019, but this figure is much higher in countries such as Germany and Italy (17% and 22%, respectively)

	Oil		Natural gas	
	Percentage (%) of final energy consumption (a)	Russia's share (%) of the national imports from outside the EU (b)	Percentage (%) of final energy consumption (a)	Russia's share (%) of the national imports from outside the EU (c)
EURO AREA	36.1		23.7	
Spain	45.0	0-25	19.1	0-25
Germany	34.9	25-50	26.8	50-75
France	37.1	0-25	20.6	25-50
Italy	31.3	0-25	30.9	25-50
Finland	23.7	75-100	3.0	75-100

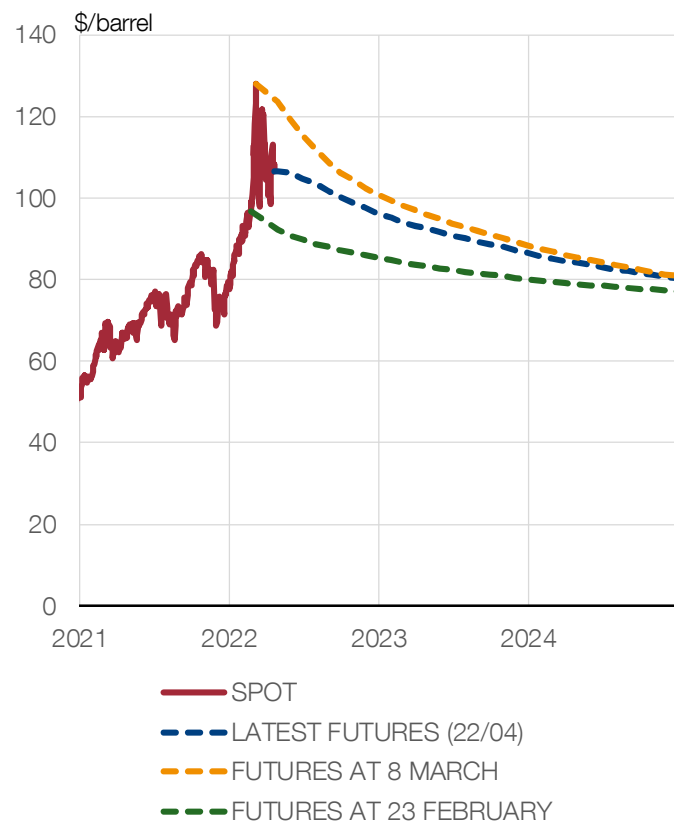
SOURCES: Eurostat and Suomen Pankki – Finlands Bank.

(a) Annual data for 2020.

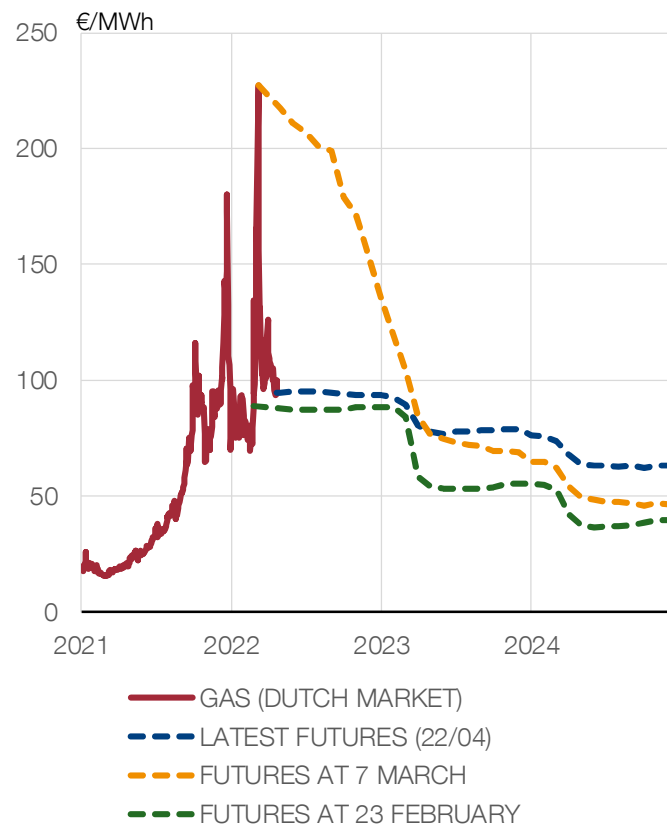
(b) Annual data for 2021.

(c) Six-monthly data for 2021 H1.

OIL SPOT AND FUTURES PRICES



GAS SPOT AND FUTURES PRICES

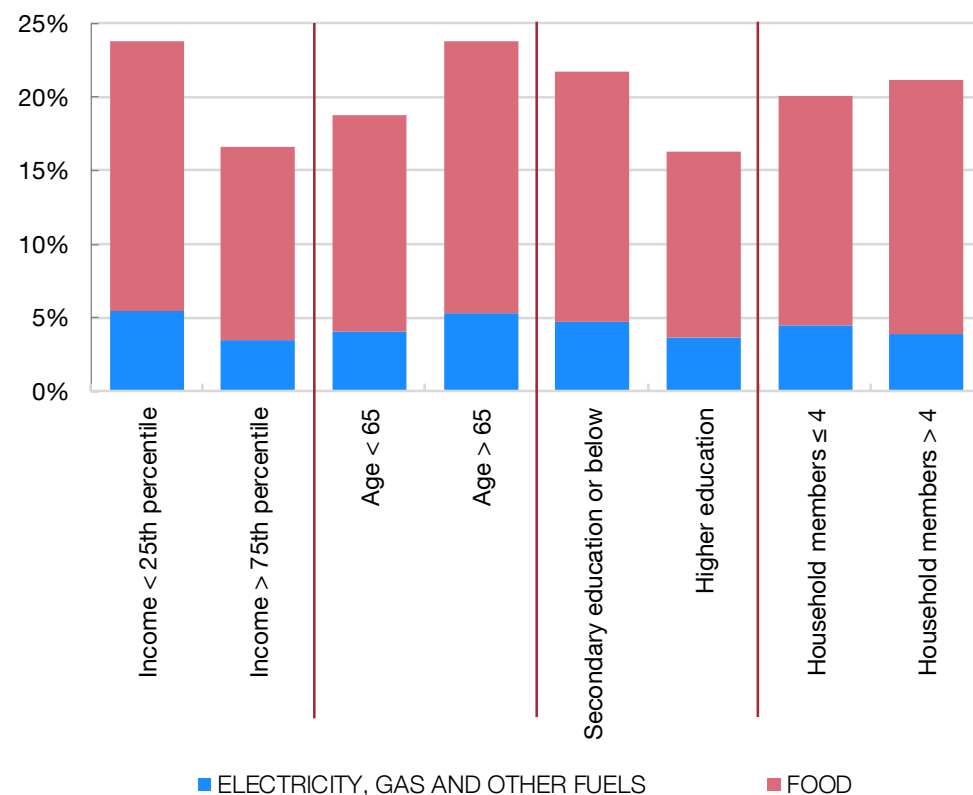


COMMODITY PRICES

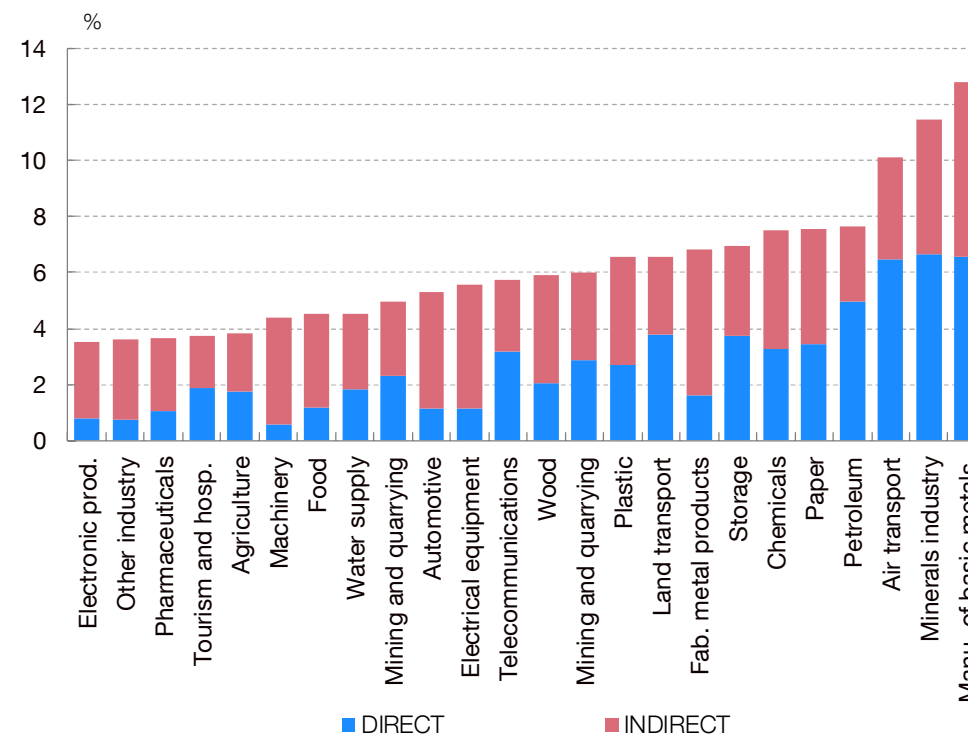


Source: Refinitiv. Latest data: 25 April 2022.

PROPORTION OF SPENDING ON FOOD AND ELECTRICITY,
GAS AND OTHER FUELS



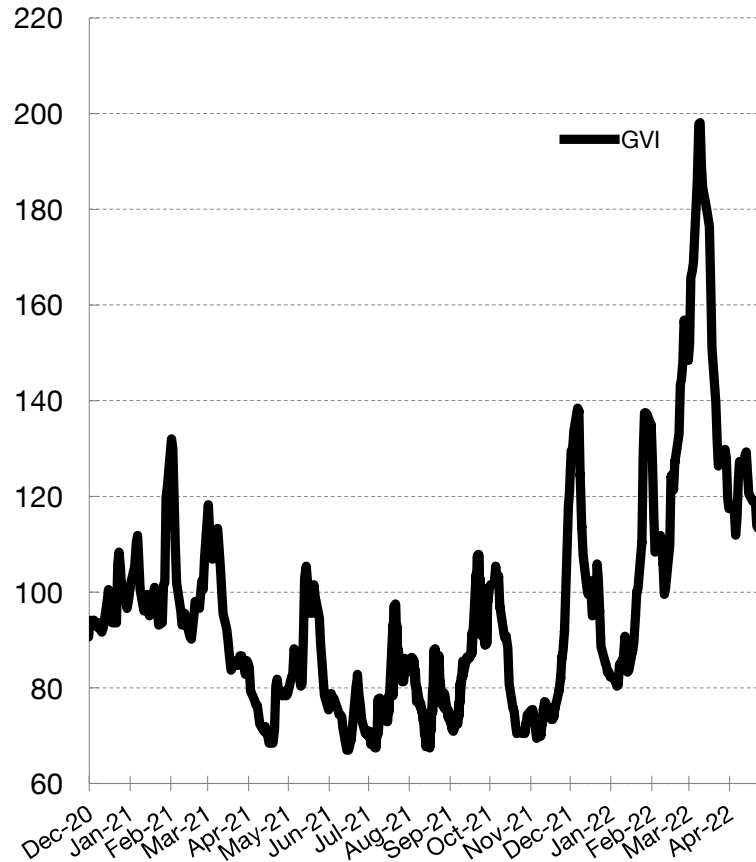
CONSUMPTION OF GAS AND ELECTRICITY (% OF OUTPUT)



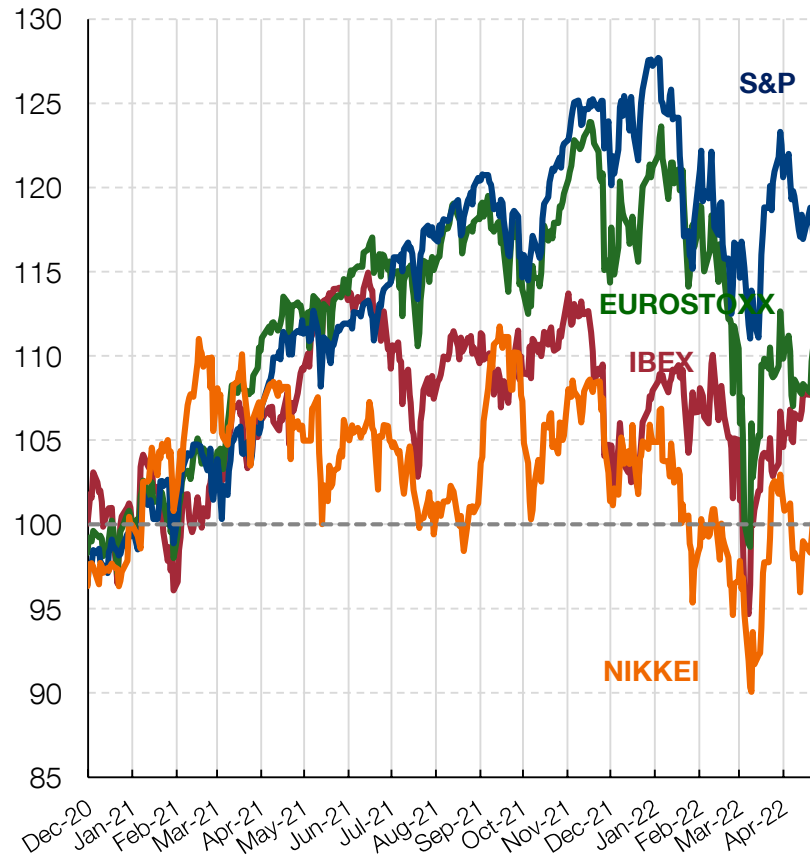
Sources: Banco de España and OECD (Inter-Country Input-Output)

CONFIDENCE/UNCERTAINTY CHANNEL: AFTER THE INITIAL STRONG ADVERSE IMPACT OF THE WAR ON THE MARKETS, THE SITUATION HAS RETURNED TO NORMAL

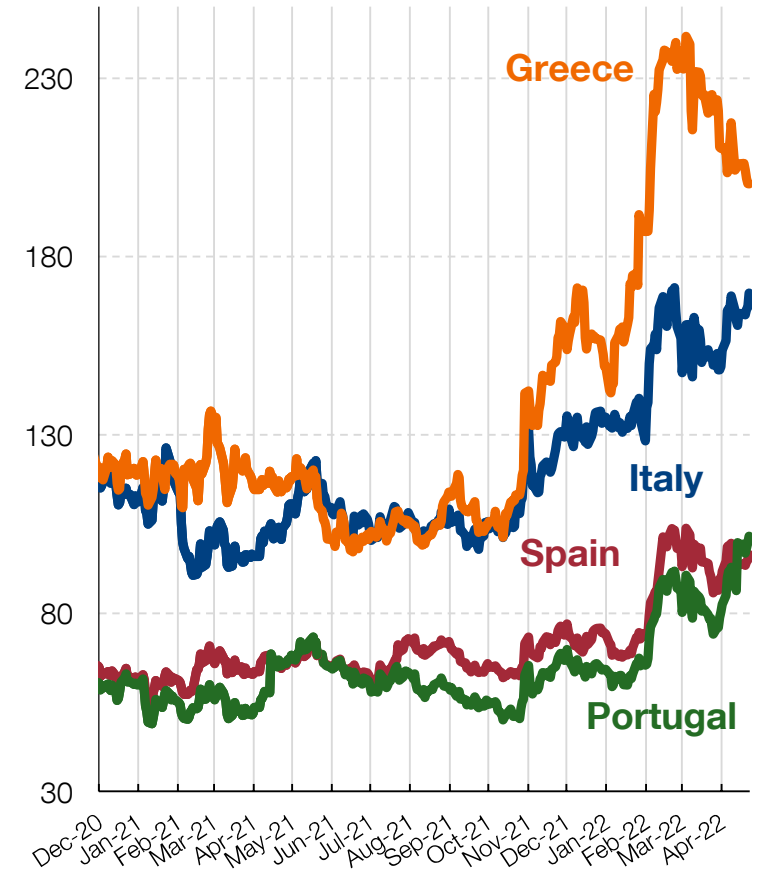
GLOBAL UNCERTAINTY (31/12/2020 = 100)



STOCK MARKETS (31/12/2020 = 100)



10-YEAR SOVEREIGN YIELD SPREADS AGAINST GERMANY (bp)

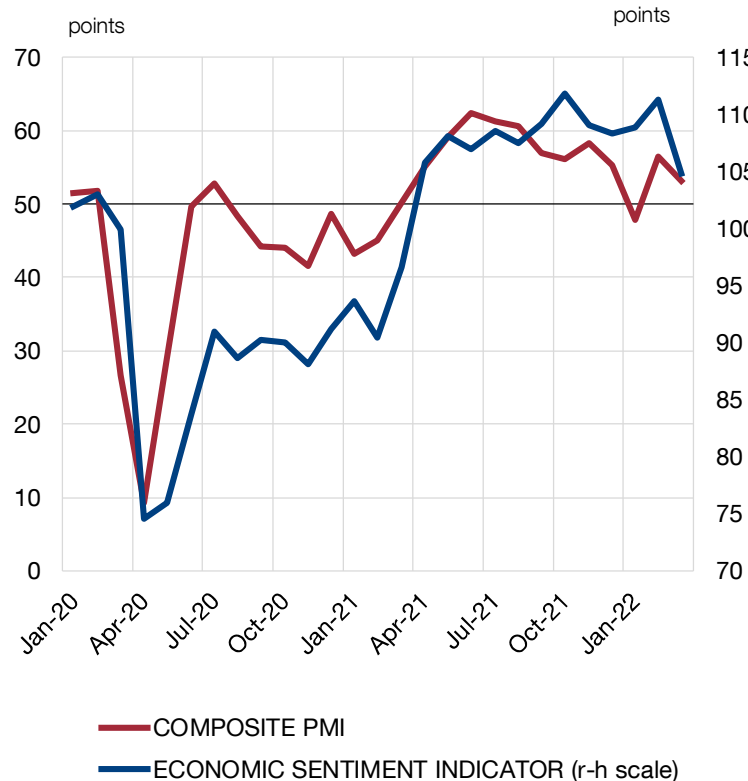


Source: Bloomberg.

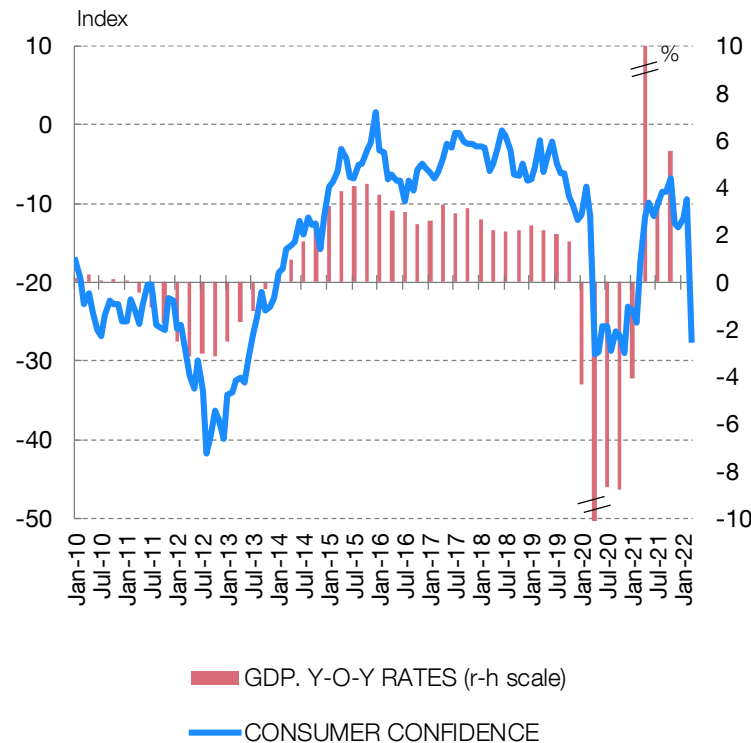
CONFIDENCE/UNCERTAINTY CHANNEL: THE ECONOMIC REPERCUSSIONS OF THE WAR THROUGH DETERIORATING CONFIDENCE COULD BE SIGNIFICANT

Households and firms will find it difficult to anticipate future economic developments, particularly as regards their income, which will weigh on their consumption and investment decisions.

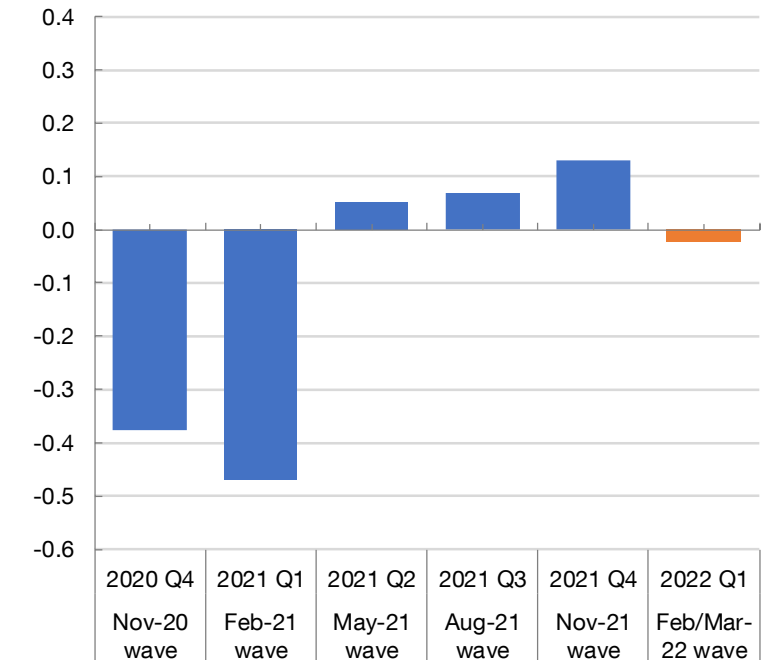
QUALITATIVE INDICATORS



CONSUMER CONFIDENCE AND GDP



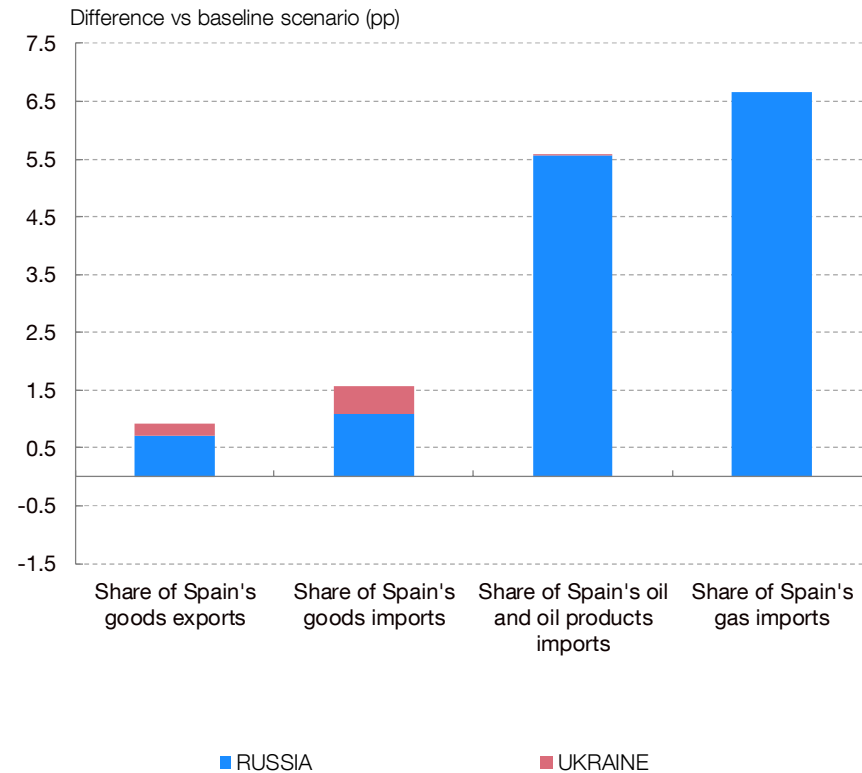
TURNOVER. QUARTERLY CHANGE (a)



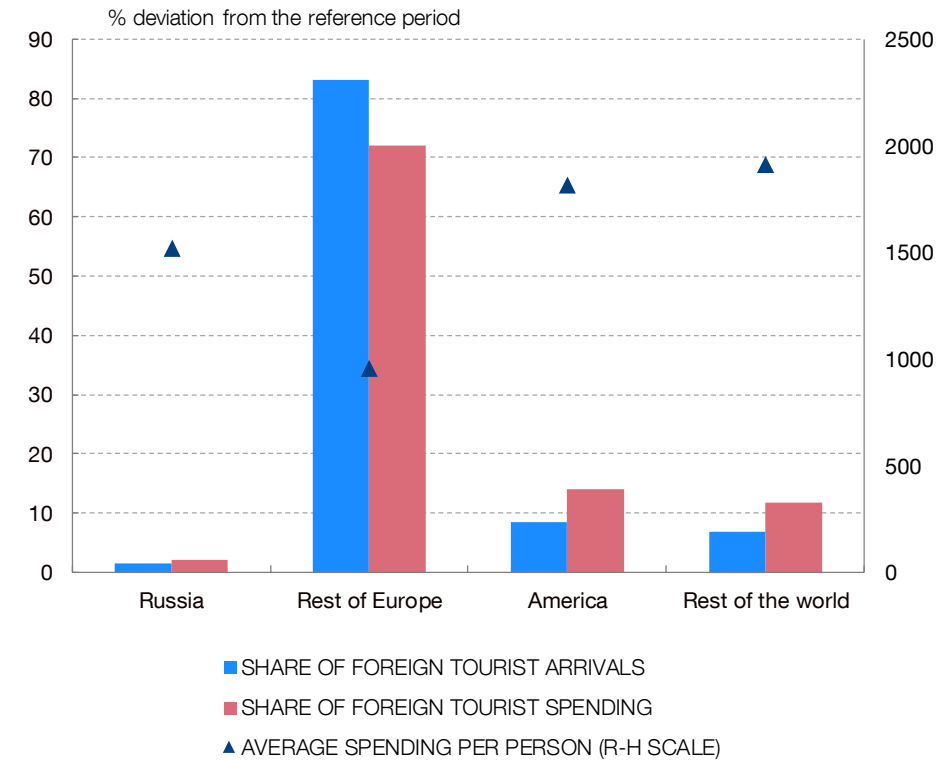
Sources: European Commission, IHS Markit, INE and Banco de España (EBAE).

(a) Index calculated as a Significant decrease = -2; Slight decrease = -1; Unchanged = 0; Slight increase = 1; Significant increase = 2.

FOREIGN TRADE IN GOODS EXPOSURE TO RUSSIA AND UKRAINE
(% of foreign trade in 2019)

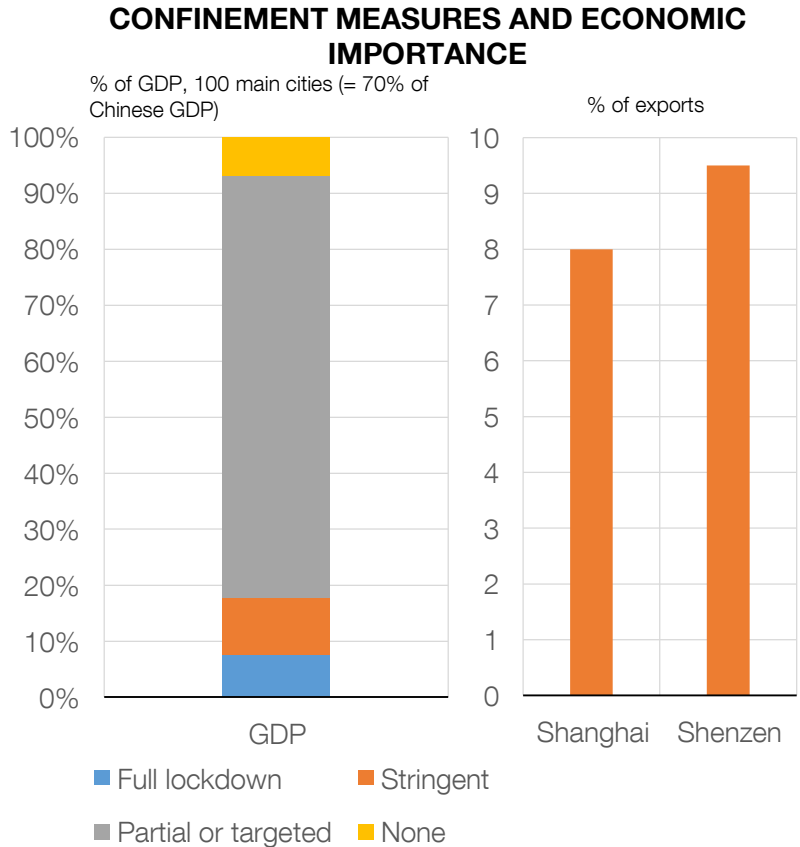
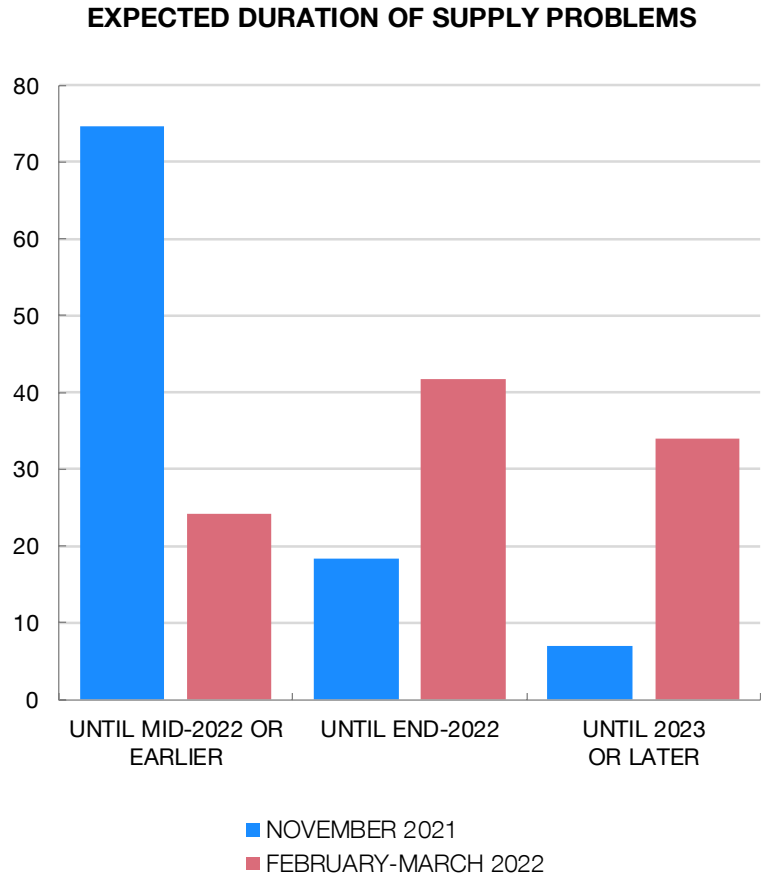
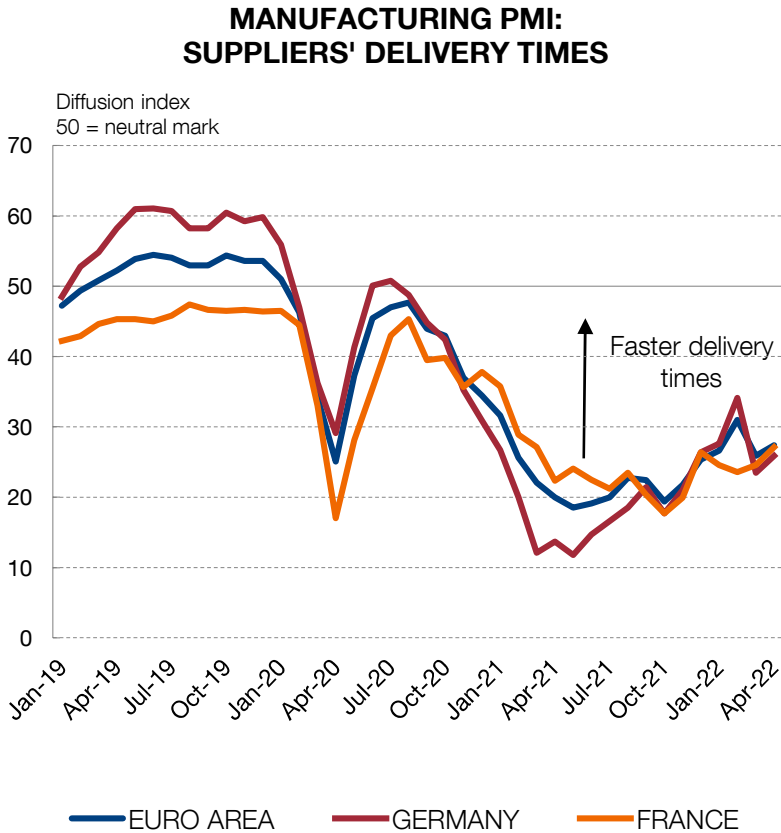


THE RUSSIAN SOURCE MARKET'S SHARE OF SPAIN'S FOREIGN TOURISM
(2019)



Sources: Departamento de Aduanas and INE.

... BUT THE INDIRECT EFFECTS MAY BE SIGNIFICANT: BOTTLENECKS HAVE INTENSIFIED RECENTLY, ALSO AFFECTED BY THE RESURGENCE OF THE PANDEMIC IN CHINA



Sources: IHS Markit, Banco de España (EBAE) and John Hopkins University.

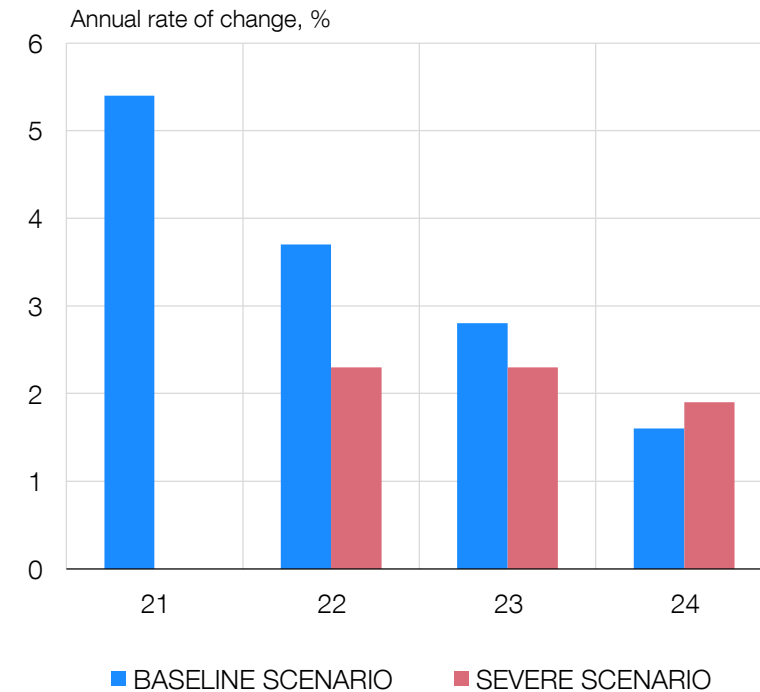
OVERALL, THE WAR REPRESENTS A NEW AND FORESEEABLY HIGHLY SIGNIFICANT SHOCK, WITH ADVERSE CONSEQUENCES IN TERMS OF A WEAKER ECONOMIC PERFORMANCE AND GREATER INFLATIONARY PRESSURES

As regards the magnitude of the impact, the ECB has drawn up three scenarios, with euro area **GDP growth** for 2022 revised downwards, compared with the December projections, **by between 0.5 pp (to 3.7%) and 1.9 pp (to 2.3%)** and **the average inflation rate for 2022 revised upwards**, again compared with the December projections, **by between 1.9 pp (to 5.1%) and 3.9 pp (to 7.1%)**.

HEADLINE INFLATION IN EURO AREA



REAL GDP IN EURO AREA

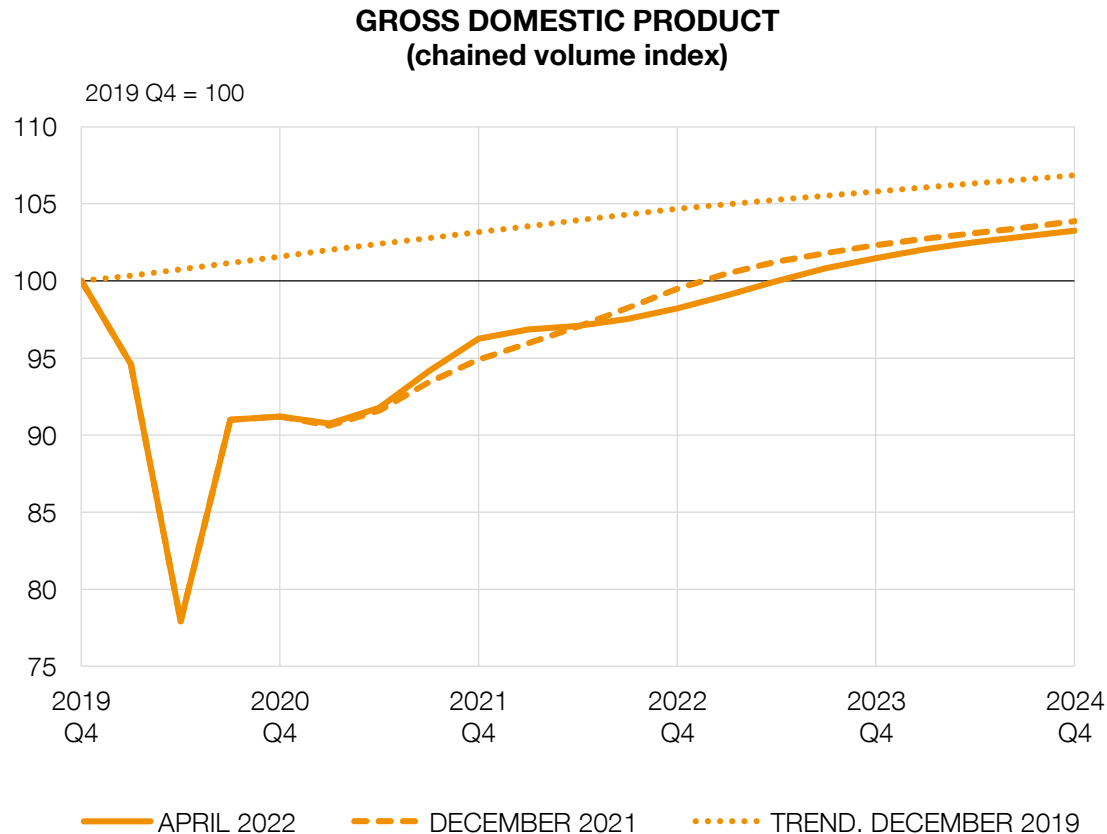


Source: ECB (March 2022 projections).

IN A SIMILAR VEIN, THE LATEST PROJECTIONS PUBLISHED BY THE BANCO DE ESPAÑA REFLECT THESE ADVERSE CONSEQUENCES ON ECONOMIC GROWTH AND INFLATION

			APRIL 2022 PROJECTIONS			DIFFERENCES VS DECEMBER PROJECTIONS		
Annual rate of change (%), unless otherwise stated	2020	2021	2022	2023	2024	2022	2023	2024
GDP	-10.8	5.1	4.5	2.9	2.5	-0.9	-1.0	0.7
Harmonised index of consumer prices (HICP)	-0.3	3.0	7.5	2.0	1.6	3.8	0.8	0.0
HICP excluding energy and food	0.5	0.6	2.8	1.8	1.7	1.0	0.4	0.1
Unemployment rate (% of labour force). Annual average	15.5	14.8	13.5	13.2	12.8	-0.7	0.3	0.4
General government net lending (+)/net borrowing (-) (% of GDP)	-10.3	-6.9	-5.0	-5.2	-4.7	-0.2	-1.2	-1.4
General government debt (% of GDP)	120.0	118.4	112.6	112.8	113.5	-3.1	-0.9	0.0

Sources: Banco de España and INE.



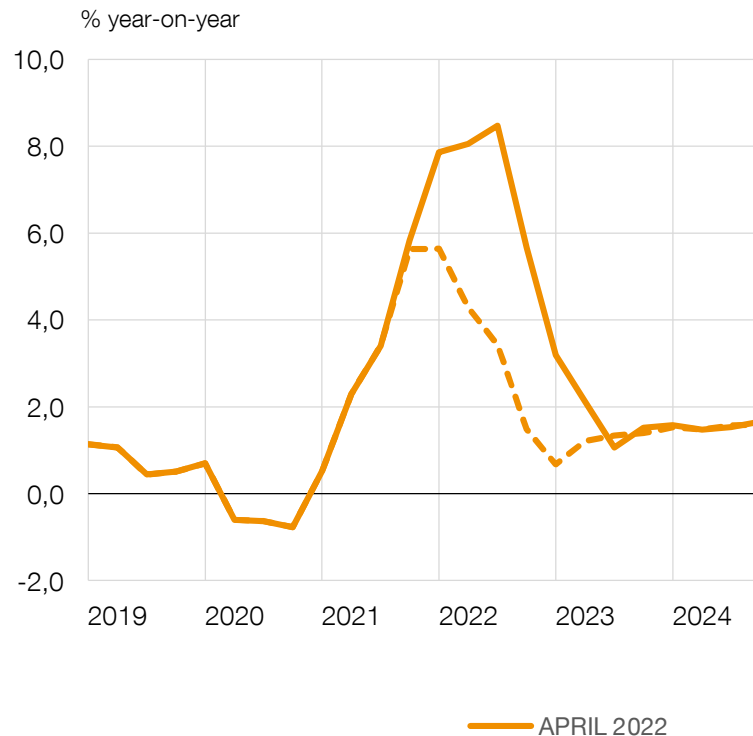
After 2021 H2 proved to be more buoyant than previously expected, most of the adverse impact of the war in Ukraine on activity will be felt in 2022 Q2

The war does not result in an appreciable worsening of potential growth: at the end of the projection horizon the economy will grow at rates similar to those forecast in December

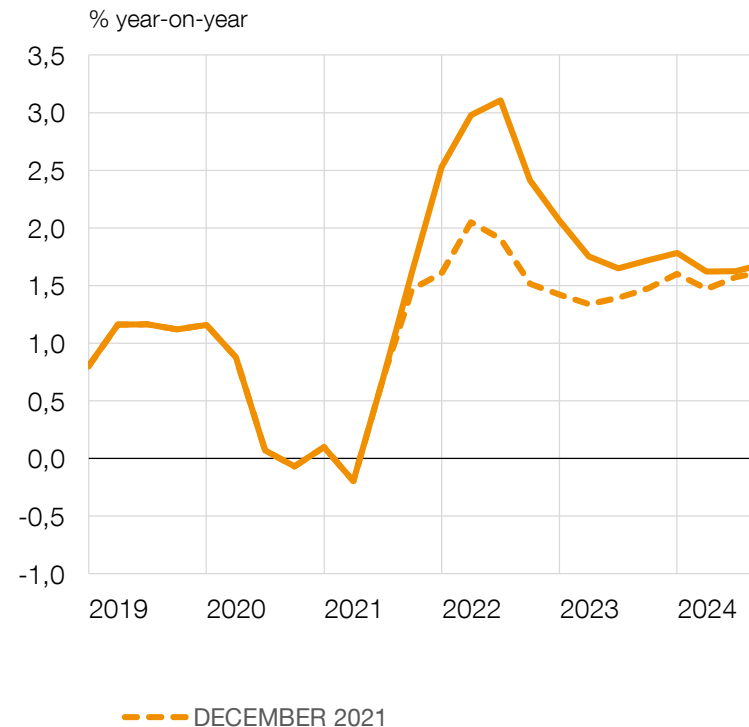
The Spanish economy will not recover its pre-pandemic GDP level until 2023 Q3

INFLATION FOR 2022 REVISED UP SHARPLY, ALTHOUGH A GRADUAL EASING IS EXPECTED IN THE MEDIUM-TERM

HEADLINE HICP



HICP EXCLUDING ENERGY AND FOOD



Headline inflation forecasts for 2022 have been revised up sharply owing essentially to stronger energy price growth

Underlying inflation forecasts have also been revised up, shaped particularly by the partial feed-through of rising input costs to consumer prices

No significant second-round effects on prices and salaries are envisaged, and inflation is therefore expected to return to more moderate levels from 2023

AN UNCERTAIN SCENARIO WITH MULTIPLE SOURCES OF UNCERTAINTY: THE BALANCE OF RISKS REMAINS TILTED TO THE DOWNSIDE FOR GROWTH AND TO THE UPSIDE FOR INFLATION

Duration and severity of the war in Ukraine and persistence of the possible geopolitical fall-out

Indirect and second-round effects on inflation

Take-up and economic impact of the European NGEU funds

Energy prices

Household consumption and recourse to stock of saving

Course of the pandemic

Bottlenecks in global production and supply chains

Impact of worldwide monetary policy normalisation on financial markets and financing conditions

Possible energy and fiscal policy measures in Spain and the European Union

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Boosting strategic autonomy and alleviating the impact of the crisis

- In the short term, action should focus on providing **support to the most vulnerable firms and cohorts** (temporarily easing the State aid framework for the business sector, establishing certain temporary limits on retail electricity prices, and increasing storage).
- Over the medium term, **Europe's strategic autonomy, particularly in energy and defence, needs to be boosted.** In energy, by further diversifying suppliers and reducing reliance on fossil fuels more swiftly.

Mutualising the cost

- Like the pandemic, the war represents a highly adverse, exogenous shock common to all European economies, but potentially one that will have asymmetric effects across countries, sectors and firms, given that the levels of exposure to and dependence on the Russian and Ukrainian economies vary widely, and the starting positions also differ across countries.
- **Joint European action, through the pooling of budgetary resources, is once again the most effective means** of funding the public expenditure arising as a result of the invasion.
- **It should prevent the war from being a source of financial fragmentation in Europe.**

Accelerating European integration

- Creation of a **permanent central fiscal capacity** in the euro area.
- Creation of a **European safe asset** (one step forward in this regard is the pan-European bond issuances to finance NGEU) and **deeper capital market integration** in the euro area.
- **Completion of the banking union:** establishing a European deposit insurance scheme and a common framework for resolving systemic crises.

INFLATIONARY CONTEXT	Inflation has risen significantly , driven chiefly by rising energy costs. Inflationary pressures have intensified in many sectors
WEIGHING RISKS IN DECISION- MAKING	<p>The decisions of the Governing Council (GC) will weigh the emerging risks to achieve the price stability objective:</p> <ul style="list-style-type: none">On the one hand, the war's near-term inflationary effect, stemming from trade disruptions and the marked rise in energy costs, increases the likelihood of second-round effects.On the other hand, the war's adverse effect and the associated uncertainty regarding euro area economic growth could reduce inflationary pressures in the medium term.Overall, the upside risks to the inflation outlook have intensified, particularly in the near term.Although various indicators of long-term inflation expectations drawn from financial markets and surveys of professional forecasters put inflation at around 2%, there are preliminary signs, which will have to be monitored carefully, of those indicators being revised to above-target levels.

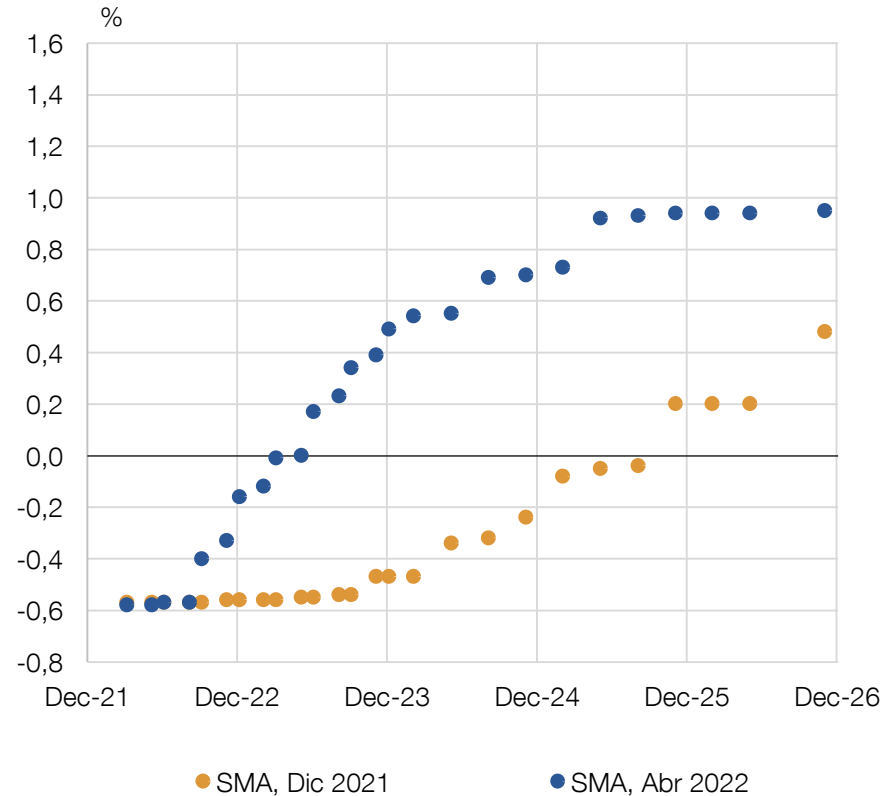
RECENT MONETARY POLICY DECISIONS

APP	The incoming data reinforce the GC's assessment that net asset purchases under the APP should end in 2022 Q3 . The reinvestments will continue for a prolonged period after policy rates begin to be raised.
PEPP	Net purchases under the PEPP were discontinued on 31 March . Reinvestments will continue at least until end-2024. In the event of market fragmentation , PEPP reinvestments can be adjusted flexibly across time, asset classes and jurisdictions.
INTEREST RATES	Any adjustment to ECB policy interest rates will take place some time after the end of the net purchases under the APP and will be gradual .

We stand ready to adjust all of our instruments within our mandate, incorporating flexibility if warranted, to ensure that inflation stabilises at its 2% target over the medium term.

SINCE DECEMBER, EXPECTATIONS OF POLICY RATE HIKES HAVE BEEN BROUGHT FORWARD AND LONG-TERM INTEREST RATES HAVE RISEN

EURO AREA: €STR EXPECTATIONS



Sources: ECB Survey of Monetary Analysts (SMA).

EURO AREA 10-YEAR OIS RATE



Source: Refinitiv Datastream. Latest observation: 22/04/2022.

**Domestic
fiscal policy**

- **Granular action** focused on the most vulnerable households, firms and sectors.
- The measures must be **temporary and selective**, given the marked increase in budgetary imbalances during the pandemic and in the current climate of high inflation, avoiding an across-the-board fiscal impulse.
- The instruments used must not skew price signals, which would hinder the necessary adjustment in demand.
- A **medium-term fiscal consolidation programme** should be designed in a timely fashion for implementation once the recovery takes hold, in order to gradually reduce the high government debt.
- Implementation of a **comprehensive and ambitious raft of reforms** that address Spain's structural problems and drive up potential output, also helping to reduce our government debt.
- **Acceleration of NGEU projects and reforms.**
- As part of the incomes agreement, **widespread use of automatic indexation clauses in public expenditure items** that might further fuel the current bout of inflation **should be avoided**.

An extraordinary and temporary rebate (between 1 April and 30 June 2022) on the retail price of fuel

A 36% reduction in energy system-related charges with respect to March (55% with respect to August 2021) until 31 December 2022

An extension until 30 June 2022 of the suspension of the tax on electricity generation and of the reduced rates for VAT on electricity (10%) and the excise duty on electricity (0.5%)

An extension of the cap on the April and July 2022 revisions of the regulated rate for small natural gas consumers (to a maximum increase of 5% for retail consumers)

A 2% cap on rent increases from 1 April to 30 June

Incomes agreement between employees and employers

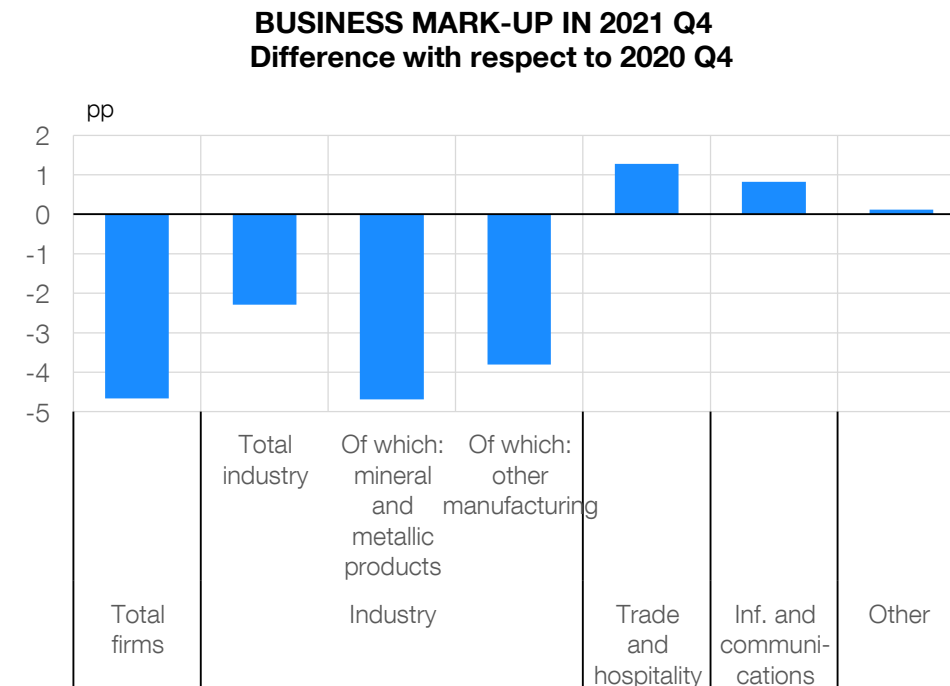
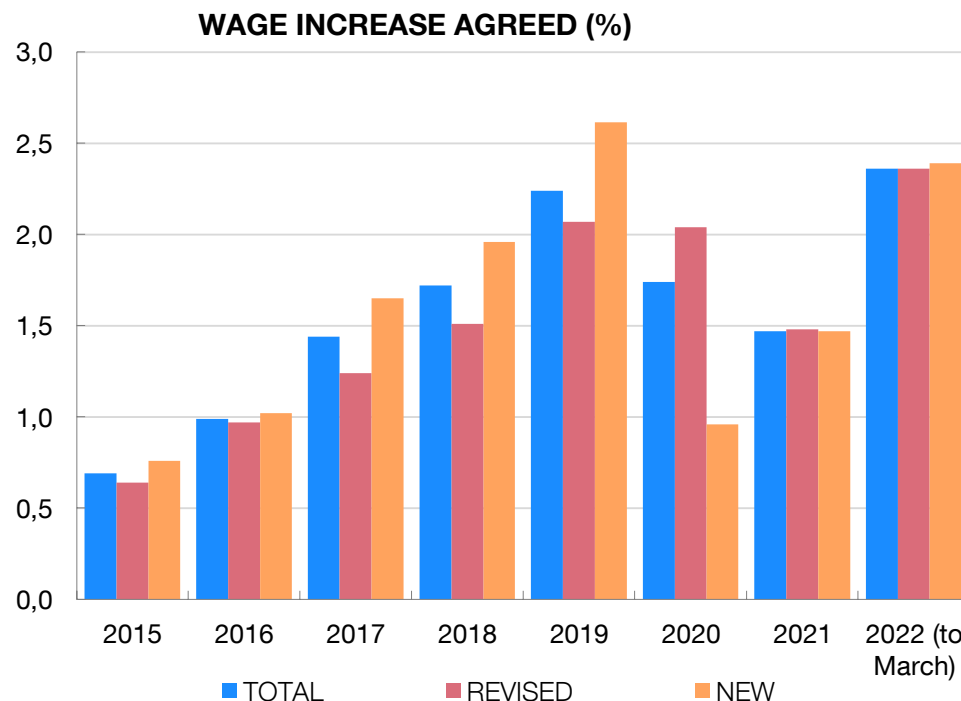
- The **loss of income** in the economy on account of rising energy costs, compounded by the invasion of Ukraine, **should be shared between employees** (fall in their purchasing power) **and firms** (reduction in their profit margins), to prevent an inflationary spiral.
- **Avoidance of measures that are broad or excessively rigid**, given the heterogeneity among sectors, firms and workers, to prevent the adjustment from being borne by the most vulnerable.
- **Avoidance of approaches that automatically link wages** to past inflation or indexation clauses, which, if applied, would increase second-round effects (inflation-wage growth spiral).
- **Multi-year commitments to wage increases** (e.g. to underlying inflation), complemented, where appropriate, by **job protection** commitments that provide certainty to agents in their consumption and investment decisions.
- **Profit-margin moderation commitments**, to ensure the competitiveness of Spanish firms and that economic growth is affected as little as possible.

THE COSTS OF THE UPWARD PRESSURE ON PRICES ARE BEING SHARED BETWEEN WORKERS AND FIRMS

As regards employees, in March the wage increase agreed for 2022 rose to 2.4% (from 1.5% for 2021), a percentage clearly below the inflation rates observed in recent months and those expected for 2022.

Firms have not been fully passing the increase in their costs through to the prices of their products:

- According to the [Banco de España Business Activity Survey \(EBAE\)](#), in 2021 Q4 three-quarters of Spanish firms experienced a rise in their costs, while only 30% increased the prices of their products.
- According to the [Central Balance Sheet Data Office Quarterly Survey](#), higher energy costs have dampened the recovery in earnings in the most energy-intensive sectors.

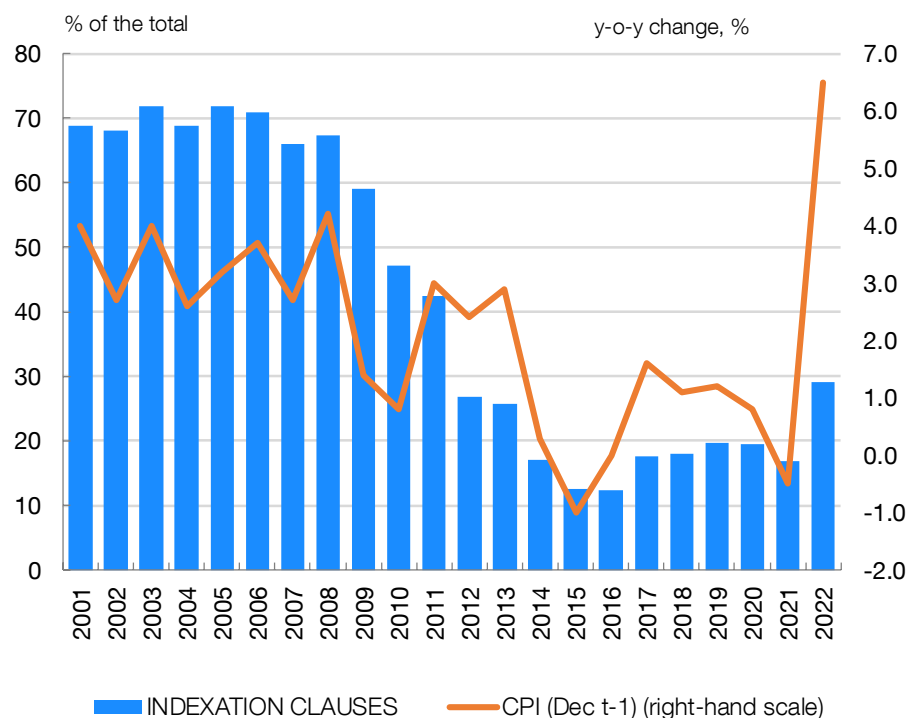


Sources: Banco de España and Ministerio de Trabajo y Economía Social. In the right-hand chart, mark-up is defined as the ratio between GVA and output.

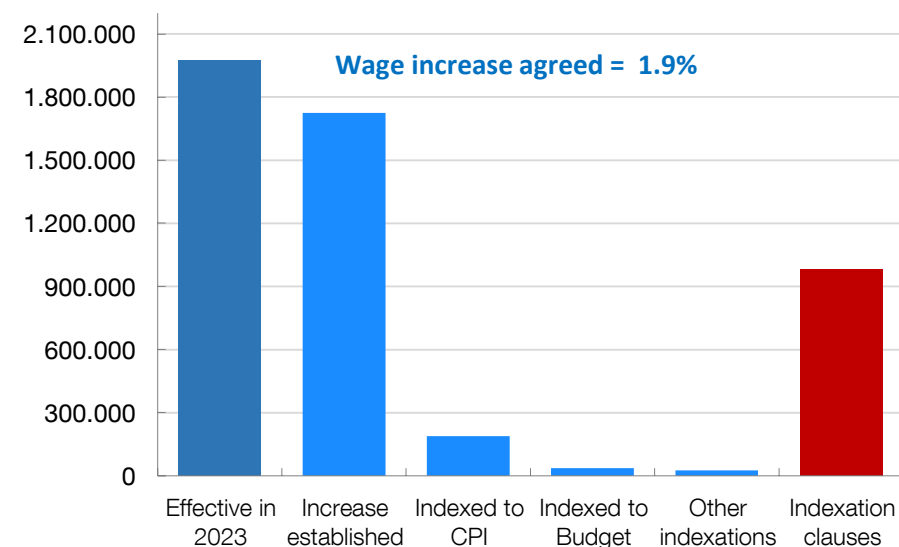
In the agreements recorded to March 2022, there has been an increase in the percentage of employees with indexation clauses (29.1%, compared with 16.9% in 2021).

The wage increase agreed for 2023 is expected to be in line with that agreed for 2022. However, for 10% of the employees concerned, this increase is indexed to inflation developments, and one-half of the employees affected have indexation clauses included in their agreements.

**PREVALENCE OF INDEXATION CLAUSES
RELATING TO INFLATION**



**EMPLOYEES SUBJECT TO COLLECTIVE
BARGAINING AGREEMENTS FOR 2023**

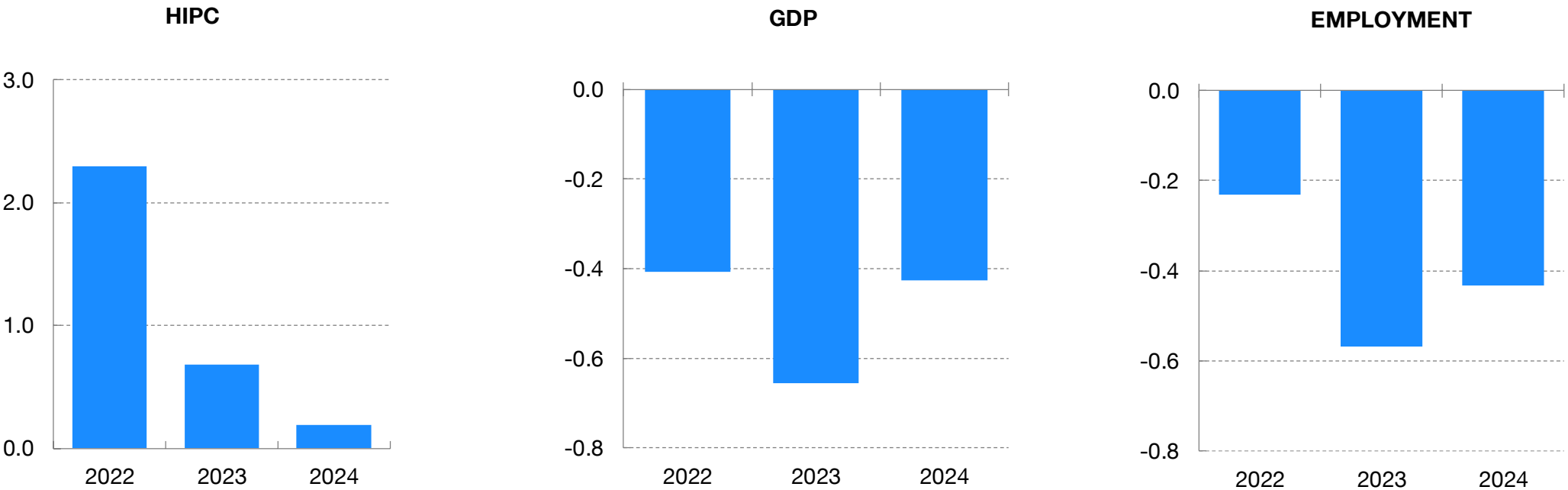


Source: Ministerio de Trabajo y Economía Social. Latest observation: March 2022.

Meanwhile, a scenario is envisaged in which business owners and workers look to increase their prices and wages in order to neutralise the initial impact of the energy shock on their income, triggering **second-round effects** on prices and wages.

The **overall adverse impact** on activity and employment, in terms of the divergence from the current projections, could be around 1.5 pp in 2024.

DIFFERENCES WITH RESPECT TO THE BASELINE SCENARIO (IN PP)



Sources: Banco de España and INE.

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3. **Conclusions**

The war in **Ukraine** constitutes a sizeable adverse shock when the Spanish economy had not yet fully recovered from the health crisis

- Sharp rise in **commodity prices**
- Negative impact on **agents' confidence** and financial dynamics
- Deterioration of **trade flows**

European economic and domestic fiscal **policies** must respond **decisively and flexibly**

- Targeted support for the most vulnerable households, firms and sectors affected

The **upsurge in the price of energy and other commodities** is a risk for price stability in the medium-term

- Prevent such inflationary tensions from lasting though to the medium-term in the form of second-round effects
- Approve an incomes agreement, calling for sacrifices in the short term
- Progressive and gradual normalisation of monetary policy, maintaining inflation expectation anchored at 2%

THANK YOU FOR YOUR ATTENTION

