QUARTERLY REPORT ON THE SPANISH ECONOMY

1 OVERVIEW

The coronavirus pandemic and the measures adopted to contain it have deeply impacted economic developments globally. The spread of the virus from China to the rest of the world from February progressively engulfed different world regions, leading to a swift increase in the number of infections and deaths. It also meant many countries' health systems had difficulty coping with providing the medical assistance needed. To reduce the speed of contagion, national authorities shut down several areas of economic activity, triggering a sharp and deep contraction in activity, demand and employment, exacerbated by the decline in confidence and the tightening of financial conditions.

The fall-off in trade has also been very pronounced. Merchandise trade has been most severely disrupted because of the partial shutdown of goods transport and the break in global supply chains. In the case of tourist services, flows have ground practically to a halt in some cases, against the backdrop of border closures and the suspension of air traffic.

The scale of the shock has also been very high in labour markets. Job losses have been particularly acute in the United States. In many European countries, the reduction in employment has been considerably alleviated by the extensive use of mechanisms which, with the resort to public financing, temporarily suspend contractual relationships.

The spread of the pandemic and the measures to check it led, to mid-March, to sharp declines in financial asset prices and to heavy capital outflows from the emerging economies. But these trends subsequently reversed. This improvement on financial markets was largely linked to the resolute response by economic policies, including monetary policy, to the crisis. However, corporate debt spreads have been seen to widen, more markedly so in the case of less creditworthy issuers, and of emerging market debt.

Recently, many countries – particularly in Europe – have embarked on gradual lockdown-easing strategies. The pandemic has abated in some areas of the world as a result of the lockdown measures, allowing such measures to be gradually withdrawn. As a result, economic activity has begun to resume a degree of normality. In April, confidence indicators had collapsed, alarmingly so in the case of the services sector. Indeed, services were affected to a greater extent by the shutdown in activity and the restrictions on people's movement. These indicators have improved to some extent in those countries at a more advanced stage in the process of exiting the lockdown, though they still remain at very low levels. The daily-frequency indicators, whose use became widespread following the onset of the crisis, have also begun to reflect the resumption of activity, with a high degree of cross-country heterogeneity. For example, the mobility indicators constructed using mobile telephony data have begun to show an increase in visits to retail and leisure sites and to workplaces.

Looking ahead, there will continue to be a degree of high uncertainty for some time until an effective medical remedy is found. In the absence of a vaccine or effective treatment against the disease, the risk of fresh outbreaks will remain. Until medical headway is made, combating the expansion of the virus will call for physical distancing and tools to trace and isolate the infected. Under these conditions, a return to economic activity will be incomplete in sectors where personal interaction plays a key role, as in the hospitality and leisure industries.

Severe declines in GDP are projected worldwide in 2020 despite the expected rebound in the second half of the year. For instance, the Eurosystem's June projections envisage, in their baseline scenario, a 4% drop in global GDP this year. For the euro area as a whole, under the assumption an effective medical solution will not be available this year, an 8.7% decline in GDP is expected under a scenario that assumes the possibility of partial fresh outbreaks of the disease. The decline would rise to 12.6% under an alternative scenario in which these hypothetical fresh bouts of COVID-19 were more acute and thus required the reintroduction of more stringent lockdown measures. The subsequent rebound in activity will not, at end-2022, prevent the level of euro area GDP from standing significantly below what it would have reached in the absence of the pandemic, particularly in the second of the foregoing scenarios.

The measures deployed by governments and central banks have shielded households and firms from the adverse consequences of the shutdown in activity. The authorities have generally acted swiftly and forcefully. Governments have transferred income to households and have alleviated firms' liquidity needs through various channels. These include reductions in their labour costs, tax moratoria and the granting of public guarantees to loans extended by financial institutions (a very powerful tool offering protection against the potential financial consequences of the real shock). Central banks, meantime, have implemented a broad range of monetary policy measures to prevent the real shock from becoming a financial one.

Since March, the ECB has enacted a very broad range of measures to mitigate the effects of the crisis on the euro area economy. The action taken can be grouped into two major categories. The first set of measures is geared to fomenting banks' access, in terms of volume and of cost, to the ECB's long-term liquidity-provision facilities. The aim is that banks should have sufficient funds to extend loans to households and firms whose cash flow has been harmed to a greater extent by the crisis, including in particular SMEs and the self-employed.

In this connection, the ECB announced in March, first, the launch of a series of longer-term refinancing operations (LTROs) and a recalibration of its targeted longer-term-term refinancing operations (TLTROs). Next, in April, TLTRO conditions were further enhanced, while a new series of pandemic emergency longer-term refinancing operations (PELTROs) was announced, in which liquidity is granted through fixed-rate full-allotment tenders.

The second group of measures has involved bolstering the purchase programmes of debt issued by euro area general governments and corporations. The purpose of these programmes is to improve these agents' financing conditions on securities markets. In March, the ECB had increased the volume of net purchases under its pre-existing asset purchase programme (APP) and, more significantly, it had announced the launch of a new asset acquisition programme, the Pandemic Emergency Purchase Programme (PEPP). The chief characteristic of the PEPP is, probably, its high measure of flexibility in terms of the distribution of purchases over time and, in the case of public assets, across countries, with the aim of combating any signs of financial fragmentation within the euro area. At its meeting on 4 June, the Governing Council decided, in light of the unfavourable outlook portrayed in the Eurosystem's projections, to increase PEPP capacity by €600 billion, to a total of €1.35 trillion, extending the horizon of the net purchases made under it to at least end-June 2021 and reinvesting the maturing principal repayments at least until end-2022.

In Spain, the easing of restrictions on people's movement and on economic activity under the state of alert has culminated on 21 June in the move to the so-called "new normal". The state of alert that came into force on 15 March extended to the whole of national territory its partial restrictions on personal movement and economic activity that had begun to be applied in some regions some days earlier. After a period of rapid expansion, the disease peaked in early April. The sustained reduction in the figures for new infections and deaths meant the start of the staggered move on 4 May towards the "new normal". Thereunder, different territories have begun moving forward unevenly on the basis of criteria such as epidemiological developments (in terms of parameters such as the contagion rate and the availability of diagnostic tests) and the capacity of the health system to face potential fresh outbreaks. The new normal, which will be in force for a period yet to be defined, will allow travel throughout national territory and the resumption of all economic activities. But some restrictions remain. These are geared, above all, to avoiding large gatherings and to maintaining some interpersonal distance, resulting in setting maximum capacity figures for leisure establishments, accommodation and retail premises. Any future outbreak could give rise to a renewal of the lockdown measures, in principle locally.

The seriousness of the pandemic and the lockdown measures applied, both in Spain and in most of our trading partners, have given rise to a deep recession. In Q1, GDP fell by 5.2% quarter-on-quarter, weighed down by the

Table 1
MAIN SPANISH MACROECONOMIC AGGREGATES (a)

			2019				2020		
	2018	2019	Q1	Q2	Q3	Q4	Q1	Q2	
National accounts								ER	GR
Quarter-on-quarter rate of change, unless otherwise indicated									
Gross domestic product	2.4	2.0	0.6	0.4	0.4	0.4	-5.2	-16.0	-21.8
Contribution of national demand (b)	2.6	1.5	0.5	0.0	0.8	-0.1	-5.0	-13.8	-18.8
Contribution of net external demand (b)	-0.3	0.5	0.1	0.4	-0.4	0.5	-0.2	-2.2	-2.9
Year-on-year rate of change									
Employment working hours	2.6	1.5	2.5	1.3	0.8	1.4	-4.2	-21.1	-25.9
Price indicators									
Harmonised index of consumer prices (HICP)	1.7	0.8	1.1	1.1	0.4	0.5	0.7	-0.7	-0.7
Harmonised index of consumer prices excluding energy and food	1.0	1.1	0.8	1.2	1.2	1.1	1.2	0.9	0.8

SOURCES: INE and Banco de España.

a Information available to 25 May 2020. The shaded cells in grey are Banco de España projections under the early recovery scenario (ER) and the gradual recovery scenario (GR)
b Contribution to the quarter-on-quarter rate of change of GDP, in percentage points.

collapse of private national demand in the last fortnight of March. This was the outcome of the restrictions associated with the state of alert, and also of the effects of the analogous measures adopted in the rest of the world (see Table 1 and Chart 1). The fall in activity during the lockdown is expected to have been greater in Spain compared with the euro area as a whole, owing to the greater stringency of the measures applied and to the greater weight of the activities most exposed to social interaction in Spain's sectoral structure.[1] Specifically, in the period from the entry into force of the state of alert on 15 March to the start of lockdown easing on 4 May, economic activity in Spain is estimated to have shrunk by around 30% in relation to what its level would have been in the absence of a pandemic. The exception to this would be during the time the shutdown in non-essential activities (from 30 March to 9 April) was in force, where the estimate for the reduction in output is around 50%.

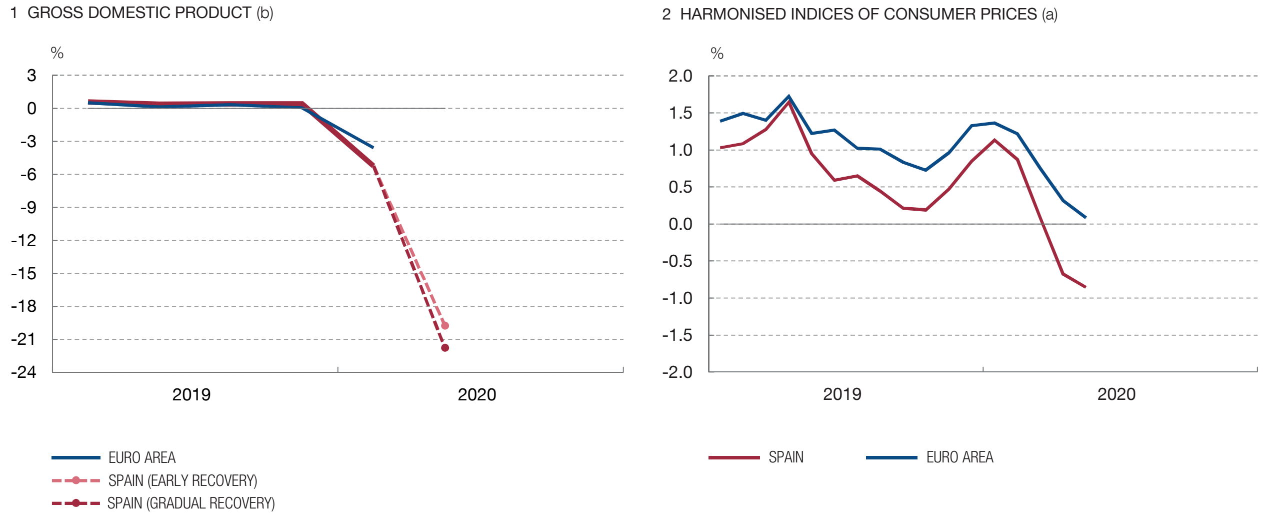
The decline in Spanish GDP is expected to have stepped up notably in Q2. It stands in a range whose mid-point is close to 20% quarter-on-quarter. The period from the start of the lockdown to the beginning of lockdown easing spans seven weeks, only the first two of which of which are in Q1, with the rest in Q2. Moreover, most of the period that non-essential activities were in shutdown, in

1 See Box 3, "The initial economic impact of the health crisis and the lockdown measures on the euro area countries" and Prades, E. and P. Tello, The heterogeneous economic impact of COVID-19 among euro area regions and countries, Banco de España, *Economic Bulletin* 2/2020, Analytical Articles.

Chart 1

THE COVID-19 CRISIS TRIGGERS A HISTORIC RECESSION (a)

GDP in the Spanish economy might post a quarter-on-quarter decline of around 20% in Q2. This will be a direct consequence of the pandemic lockdown measures. Moreover, the health crisis is significantly impacting consumer prices, which are slowing notably.



SOURCES: Eurostat, INE and Banco de España.

a Quarter-on-quarter rates of change based on the seasonally adjusted series in the case of GDP, and year-on-year rates of change on the original series, in the case of the consumer price indices.

b The figure for Q2 is a Banco de España projection.

DOWNLOAD

which the decline in output was more pronounced, also unfolded in Q2. And, finally, the lockdown-easing period has also been associated with losses in output relative to its usual level which, while diminishing, have held until the end of the quarter. Consequently, a notable step-up in the reduction in GDP in this period is to be expected.

The scenarios considered in the latest Banco de España macroeconomic projections differ, among other aspects, in their estimate of the fall in GDP in Q2.[2] In particular, under the early recovery scenario, regard is had to the fact that the developments in activity inferred by the information provided by the high-frequency indicators would be consistent with the losses in output in Q2 having been somewhat lower than the calibration based on the developments observed in the last fortnight of March would suggest. That might be due to an ongoing adaptation by firms of their activity to the lockdown restrictions. Conversely, the estimate of GDP growth in Q2 under the gradual recovery scenario would be based strictly on the calibration of the effects of the lockdown in the two weeks

2 See Macroeconomic projections for the Spanish economy (2020-2022): the Banco de España's contribution to the Eurosystem's June 2020 joint forecasting exercise for a detailed description of the calibration of the decline in GDP in Q2 under the two scenarios.

following the announcement of the state of alert. The resulting estimated rates of GDP growth are -16% under the early recovery scenario and -21.8% under the gradual recovery scenario.

The two scenarios envisaged in the projections consider very steep declines in GDP in Spain in 2020 as a whole. Specifically, GDP would fall, respectively, by 9% and 11.6% on average in the year under the early and gradual recovery scenarios. These two scenarios are complemented by a third, risk scenario in which the recovery will be at a very slow pace and the decline in GDP would amount to 15.1%. Only under the early recovery scenario would the GDP level at end-2022 exceed that prior to the crisis, which underscores the possibility that the consequences of the crisis incorporate a durable component.

Box 1

THE RECENT RECOVERY OF THE CHINESE ECONOMY DURING THE GRADUAL LIFTING OF THE COVID-19 LOCKDOWN

At the beginning of March, the Chinese government began to relax the most stringent of the measures taken to fight COVID-19 that had been in force since January, relaxing home confinement and the restrictions on movement of people and on the normal pursuit of economic and business activity. Given the disruption these containment measures involved for economic activity, the latter has been recovering since, as outlined by the latest data for April and May. Both the contraction of activity in the first few months of the year and its subsequent recovery have displayed geographically heterogeneous profiles, given the higher initial incidence of the disease in Hubei province, and its subsequent spread, on a smaller scale, in the form of localised outbreaks. This box describes the main features of the incipient recovery in the Chinese economy, which may provide an indication of the developments that can be expected in other economies, such as the Spanish one, that are lagging China by several months.

In China, unlike in other places, strict lockdown measures were imposed on only a small fraction of the national territory. Hubei, the province where the disease originated, and which accounts for around 4% of the country's population and GDP, was isolated from the rest of China on 23 January, when severe restrictions were also imposed on mobility within the province. Restrictions were introduced in more limited areas, at prefecture or district level, in some adjoining regions and in regions with significant outbreaks of the disease (which at the time accounted for around 10% of the population and 14% of GDP)[1] (see Chart 1). The lockdown measures were at their strictest in the second week of February, when they began to be relaxed somewhat, although unevenly. With the exception of Hubei, the government allowed business activity to be resumed between 3 and 10 February (at the discretion of local authorities), when the extended Chinese New Year holiday period was over. In Hubei, industry remained closed until 10 March and the lockdown was lifted at the end of that month.[2] As at the date of this report going to press, only this province, the region of Tibet and the city of Beijing maintain a high level of alert,[3] although certain smaller areas remain in lockdown as a result of recent outbreaks, as is currently the case in some districts of the capital.[4] Among other health measures, in general, the entry of foreign visitors to the country has been restricted since 28 March, temperature controls in public spaces have been maintained, individual prevention measures remain in force and recreational activities involving large gatherings are still restricted.

The translation of the different degrees of provincial lockdown to less movement of people in each territory is reflected in certain indicators, such as the traffic congestion indicator compiled by the company TomTom.[5] According to this index, both the initial reduction in mobility and its subsequent recovery to pre-epidemic levels show a clear correlation with the imposition and progressive easing of the restrictions to control the health crisis, when Hubei province, the other provinces in which lockdown measures were imposed and the rest of China are distinguished (see Chart 2). Even in these latter areas, in which no explicit quarantine measures have been implemented, mobility has still not reached the levels of the end of last year, after a persistent fall, possibly associated, among other factors, with the uncertainty of citizens regarding the course of the disease in the country and possible changes in behaviour, leading to greater individual prevention. In comparative terms, the course of mobility developments in the main Chinese cities (Beijing and Shanghai), after adjusting for the timing of events, is similar to the pattern observed in other capitals of the world affected by lockdown measures at a later point in time (see Chart 3).

The heterogeneity of lockdown measures across provinces and their gradual lifting is reflected in Chinese

1 The administrative divisions in China are, in descending order, provinces, prefectures, districts/counties, municipalities and communities/villages.

2 Except in the case of the city of Wuhan, were the lockdown was lifted after 11 weeks on 8 April.

3 In China there are four levels of health alerts. Level I (the highest) means that the provincial authorities, under central government coordination, may impose quarantines and close businesses. Under level II, controlled interprovincial travel is permitted. Under level III, control is at prefecture level. Finally, level IV corresponds to a situation of normality.

4 On 13 June, an outbreak was detected originating from one of the largest wholesale markets in Beijing, which has affected more than a hundred people. As a result of this episode severe containment measures were reimposed, such as selective isolation of residential complexes in certain districts, the suspension of face-to-face classes and restrictions on movement out of the capital.

5 Available at https://www.tomtom.com/en_gb/traffic-index/. Other measures of movement used, such as indices compiled by Google and Apple, are not available for China.

Box 1

THE RECENT RECOVERY OF THE CHINESE ECONOMY DURING THE GRADUAL LIFTING OF THE COVID-19 LOCKDOWN (cont'd)

Chart 1
SEVERITY OF THE LOCKDOWN IN CHINA

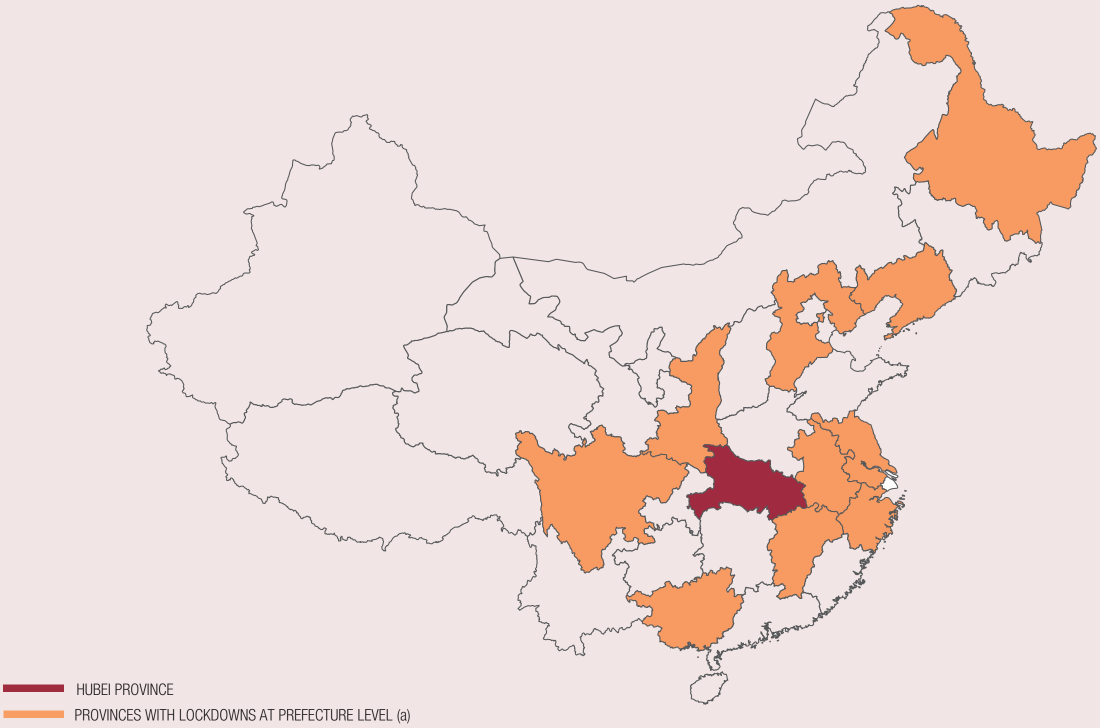


Chart 2
TRAFFIC CONGESTION INDICES IN CHINA

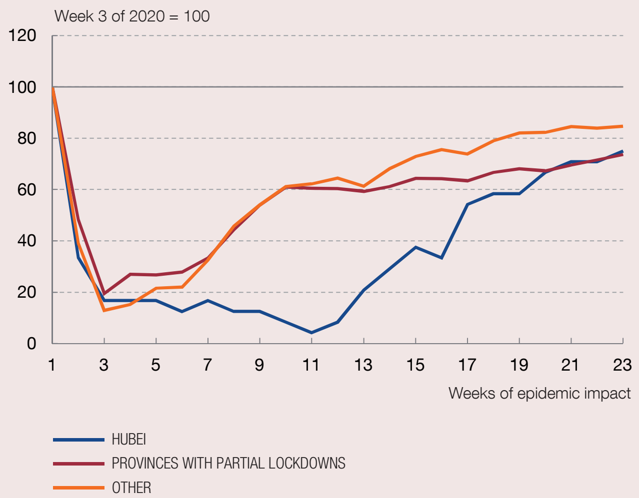
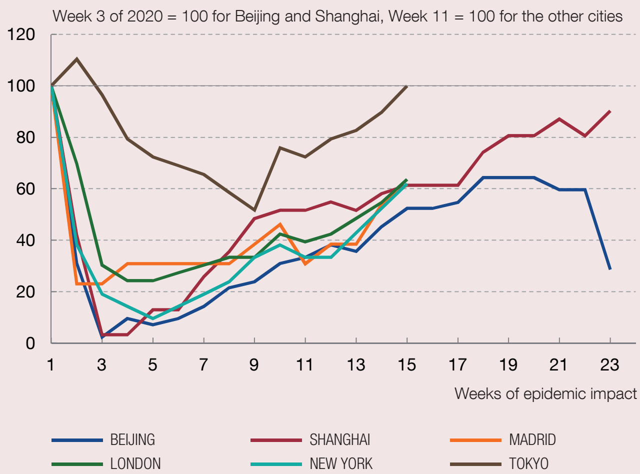


Chart 3
TRAFFIC CONGESTION INDICES IN THE MAIN CITIES



SOURCES: CEIC, TomTom and Banco de España.

a The lockdown was imposed at the provincial level for Jiangxi province.

Box 1
THE RECENT RECOVERY OF THE CHINESE ECONOMY DURING THE GRADUAL LIFTING OF THE COVID-19 LOCKDOWN (cont'd)

economic developments.[6] From the standpoint of production, the recovery in activity has been very visible in industry, which at national level, regained its pre-health crisis levels in April, following the significant contraction of January and February,[7] although its behaviour varied from one geographical area to another (see Chart 4). In Hubei province, where activity came to a complete standstill for six weeks, industrial production has recovered late, starting from April, while areas subject to partial lockdown and the rest of the country have behaved similarly, with a forceful recovery from March and a return to pre-health crisis levels of activity in the following months. It should be noted that the recovery in Chinese industry reflects certain idiosyncratic and possibly temporary factors, arising from its international specialisation in manufacturing and, within the latter, certain health products. As a result, Chinese industry has been able to supply the demand of many economies that have restricted their activity to contain the expansion of the virus. The pronounced growth in certain export segments (such as plastics, textiles and electronic equipment) point in this direction. Conversely, the contraction of world demand in this period has hampered the recovery of the Chinese economy.

In the labour market, the urban unemployment rate, which stood at 5.3% at the end of 2019, rose to 6.2% in February and then fell by 0.2 pp in the period to April (see Chart 5). The crisis's limited effect on unemployment could, in part, be due to the fact that many firms opted to reduce their employees' working hours rather than resort to dismissals. Furthermore, working from home, which has traditionally been limited in China,[8] appears to have become particularly important in the sectors in which it is feasible.

From an expenditure standpoint, the recovery has been slower owing to the reduced momentum of private consumption. Household disposable income shrank markedly in Q1, by -3.9% year-on-year, and a considerable increase in the saving rate was recorded (see Chart 6). This could largely be attributable to precautionary motives. In this regard, retail sales in China in May were still 10% below their pre-crisis levels, a phenomenon that was seen in all provinces, irrespective of the severity of the containment measures imposed on them (see Chart 7). By type of good, durables contracted markedly up to May, at which point they appear to have stabilised. Among durables, car sales are an exception, exhibiting a robust

Chart 4
INDUSTRIAL PRODUCTION BY AREA

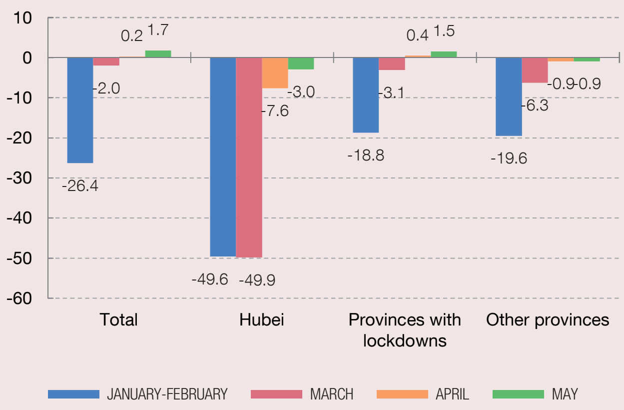
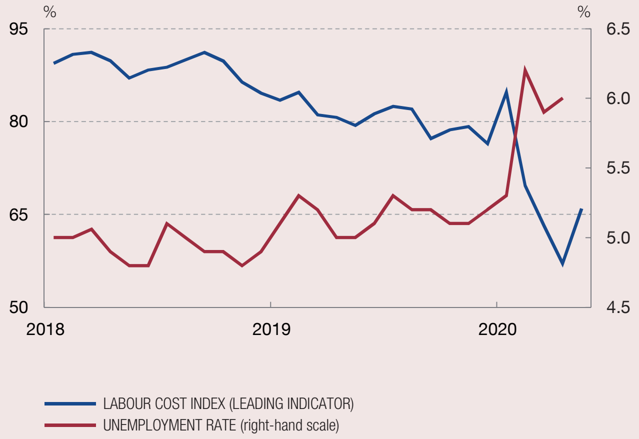


Chart 5
UNEMPLOYMENT AND LABOUR COSTS



SOURCES: CEIC and Banco de España.

6 Heterogeneity across provinces also depends on the degree of interconnection of economic activity between provinces, but there is no data available on this.

7 The activity data for January-February are published jointly to minimise the seasonal distortion caused by the Chinese New Year festivities.

8 In 2018, the penetration rate of working from home in China was 0.6%, compared with 19% in the United States and 13.5% in the EU-28.

Box 1
THE RECENT RECOVERY OF THE CHINESE ECONOMY DURING THE GRADUAL LIFTING OF THE COVID-19 LOCKDOWN (cont'd)

recovery in April and May, possibly supported by public subsidies. By distribution channel, the recovery has varied, with an increase in e-commerce, which was already widely established in China.

A slower recovery has also been recorded in the services sector, which displays asymmetries across the various activities. While real estate services have outstripped the level of activity recorded in December, accommodation and food services and passenger transport are still posting cumulative drops since January of 22% and 45%, respectively (see Chart 8). Only a partial recovery has been recorded in domestic tourism.[9] For example, during the public holidays of early May, tourism revenues fell by 60% year-on-year.

With respect to investment, the 25% year-on-year decrease recorded between January and February has been in the process of correction since March, at a slower rate in the case of capital goods than in that of construction

Chart 6
DISPOSABLE INCOME AND SAVING RATE

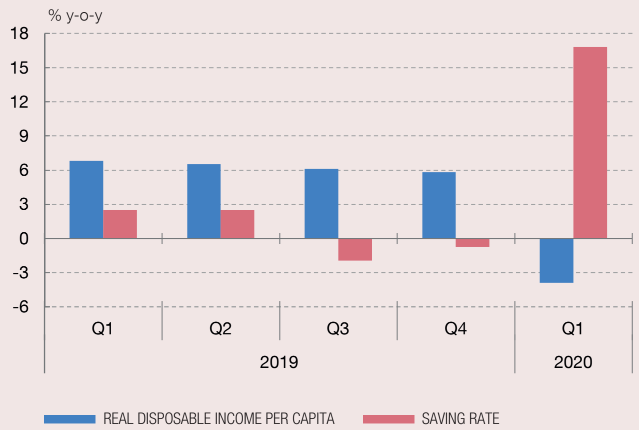


Chart 7
RETAIL SALES

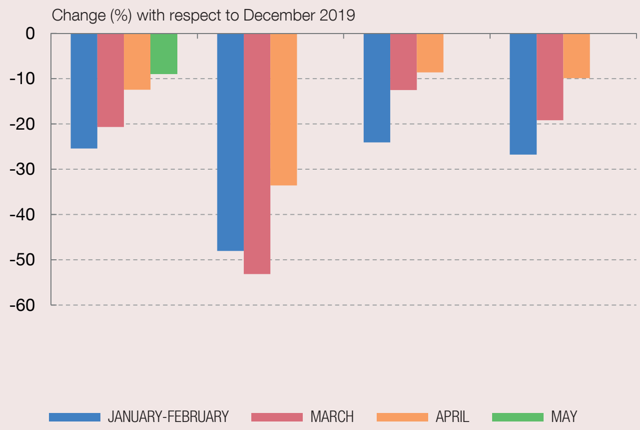


Chart 8
SERVICES

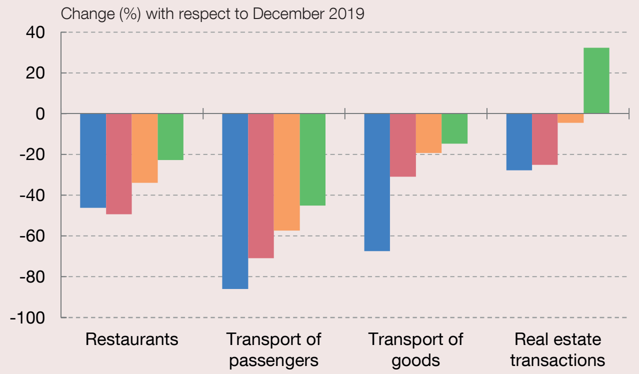
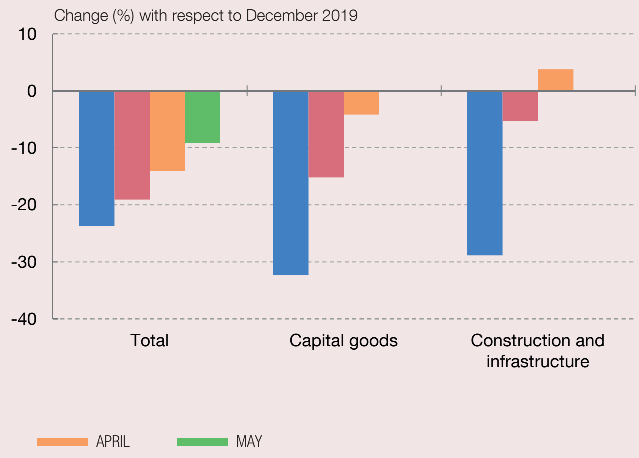


Chart 9
FIXED INVESTMENT (a)



SOURCES: CEIC and Banco de España.

a The changes in capital goods and construction and infrastructure are calculated using year-to-date data.

9 In international tourism, the restrictions have led to year-on-year falls of nearly 100% in inbound and outbound commercial flights.

and infrastructure (see Chart 9). The recovery in investment is largely explained by the pick-up in investment by state-owned enterprises, as part of the stimulus measures implemented by various authorities.

As regards consumer prices, it appears that the supply-side factors associated with the epidemic have had some impact on Hubei, where inflation stood above that recorded in the rest of the country until April, owing to the supply problems and the disruptions to production resulting from the containment measures (see Chart 10). In the rest of the country, the trend in prices has, during these months, been determined by the moderation of the food component – once the swine fever outbreak had been overcome – and of fuel. This reversed the upward trend recorded since mid-2019. The other CPI items are showing signs of the effect of the health crisis, with demand-side factors prevailing. For instance, the rise in the price of medical items and the drop in education, recreation and culture prices are noticeable. As a result of these developments, core inflation has fallen by 0.3 pp since December, to stand at 1.1% year-on-year in May (see Chart 11).

In conclusion, economic activity in most of China - with the exception of Hubei province, which is lagging somewhat - is at an advanced stage in the process of returning to normal. In any event, the experience of China shows that the movement of people gradually returns to normal after the strictest lockdown measures are lifted. However, people are still exercising some caution, and movement has not returned to its pre-epidemic levels. Industrial activity has recovered swiftly, albeit partly supported by factors that may prove to be temporary. As regards expenditure, consumption of durables and services is recovering much more slowly. A rise in the saving rate has also been recorded, which may be attributable to precautionary motives. Lastly, the epidemic has, for the time being, exerted downward pressure on inflation in the country as a whole, although certain supply-side factors, particularly in Hubei, appear to have exerted upward pressure.

Chart 10
HEADLINE INFLATION BY REGION

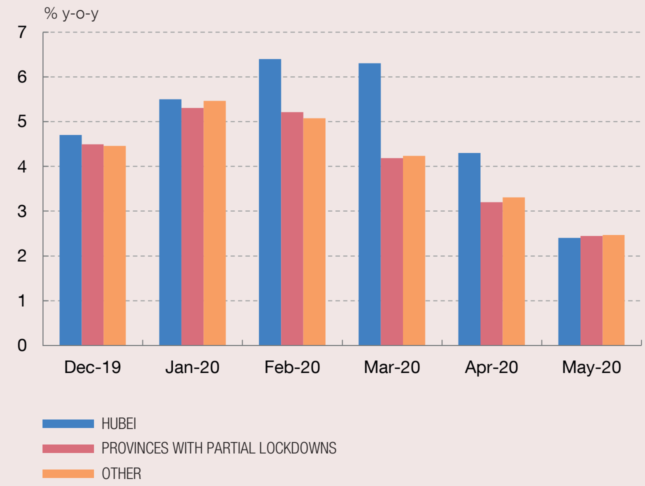
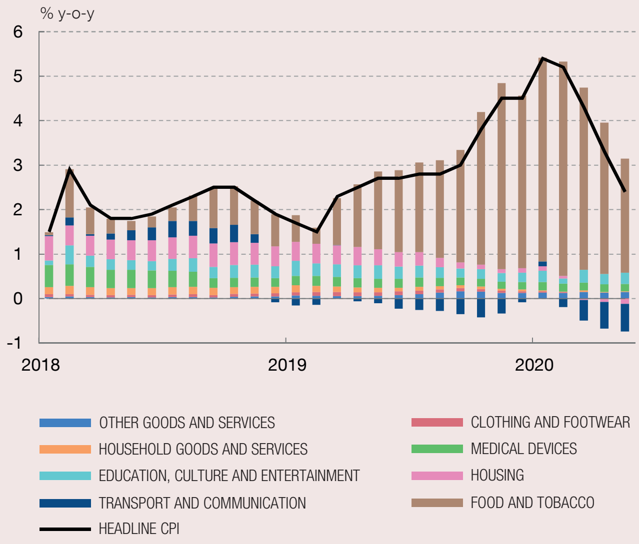


Chart 11
HEADLINE INFLATION AND COMPONENTS



SOURCES: CEIC and Banco de España.

Box 2

SUPPLY- AND DEMAND-SIDE FACTORS IN DETERMINING OIL PRICES AGAINST THE BACKGROUND OF THE COVID-19 CRISIS

This early-release box was published on 15 June

Since early 2020, oil prices have trended downward, accompanied by high fluctuations (see Chart 1). The price of a barrel of Brent thus fell by around 75% from mid-January to its mid-April low, at which point the West Texas Intermediate (WTI) price per barrel even turned negative. The sharpest declines came about as from March, when the pandemic nature of the health crisis became evident. That led to an interruption in global economic activity and, consequently, to a drastic reduction in the demand for crude. At that point too, the agreement on output curbs among the OPEC countries and its associates (OPEC+), led by Saudi Arabia and Russia, came undone (albeit only temporarily).

In other historical episodes, there have been comparable collapses in oil prices. This was the case, for example, on the occasion of the forceful contractions in global economic activity at the time of the 1997 Asian crisis and of the global financial crisis begun in 2008 (with oil prices respectively 40% and 75% cheaper), and at times of significant changes in OPEC strategy, such as those in 1986 and 2014.[1]

Set against these past events, what makes the collapse in oil prices this spring a singular episode is the coincidence in time of a sharp and swift decline in demand with a temporary increase in production. That has given rise to a rapid build-up in inventories worldwide. This box analyses the effect of these two simultaneous shocks on the oil market and the general macroeconomic environment, and the medium-term outlook for the sector.

As regards the first of these three issues, the strong fall-off in demand has been the main explanatory factor behind oil price dynamics in the January-April period. On estimates based on an econometric model,[2] this factor would be responsible for somewhat over 80% of the decline observed (see Chart 2). In the current episode, the traditional demand channel has been amplified by the impact of the lockdown measures globally. These have drastically reduced movement, particularly affecting the transport sector, which accounts on average for close to 65% of the OECD demand for oil (see Chart 3). By way of example, global consumption in the road and railway rolling stock and air transport sectors fell in April by 34% and 69% year-on-year, respectively,[3] compared with 13.5% for all other sectors.

On the supply side, the discrepancies between Saudi Arabia and Russia over the OPEC+ strategy prior to this organisation's March meeting resulted, after that meeting, in the lifting of any commitment to quotas as from April. This led to a significant and unexpected[4] month-on-month increase in OPEC+ production (2.4 million barrels per day, mb/d) and to the application of heavy discounts on selling prices by Saudi Arabia.[5] This supply-side shock would account for around 16% of the fall in oil prices between January and April, according to the model used (see Chart 2 once again).

This latest supply-side shock was, however, temporary; the agreement was swiftly put back in place under the aegis of the United States and the G20. Thus, in mid-April, OPEC+ agreed on a staggered programme of cuts, eyeing the stabilisation of the market in the medium term. The cuts included a most substantial one (of 9.7 mb/d) between May and June, which was later extended to July (see Chart 4). However, this announcement did not prevent either a massive increase in inventories or the one-off negative quoted price for WTI, the day before its May futures contract expired, given its obligation to physically settle these transactions and the lack of storage capacity at the point of delivery (the Cushing crude storage facilities in the United States). Derivatives holders were obliged to pay those parties that had capacity to receive the physical delivery.

Turning to the global macroeconomic effects of these shocks, the traditionally favourable impact of the fall in oil

1 These supply-side shocks usually reflect OPEC's attempts to maintain its market share. In 1986, Saudi Arabia increased its output by more than 40% in one year following an approximate two-thirds cut in output in the previous years. In 2014, OPEC decided to significantly increase its production in order to tackle competition from US shale producers, a strategy that was concluded in 2016. In the latest episode this year, the lack of consensus between Saudi Arabia and Russia led to a temporary breakdown in the OPEC+ agreements and to the setting of heavy discounts by Saudi Arabia.

2 Bayesian structural VAR model estimated with monthly data for the period from January 1980 to April 2020. The structural shocks are identified following a sign restrictions framework, which enables a distinction to be drawn between oil market supply-side, global demand, precautionary demand and idiosyncratic demand factor shocks.

3 See "COVID-19 Report 11th edition", Rystad Energy.

4 At that time, the market was expecting an announcement of an additional cut of 2% to total daily production.

5 The increase in OPEC+ production was, however, partly offset by the reduction in output by other countries, particularly the United States. As a result, the month-on-month increase to total supply was only 0.3%, far lower than the increases in production in previous episodes of broken OPEC agreements (1985 and 2014), which led to declines in oil prices of around 65% (see Chart 1).

Box 2

SUPPLY- AND DEMAND-SIDE FACTORS IN DETERMINING OIL PRICES AGAINST THE BACKGROUND OF THE COVID-19 CRISIS (cont'd)

Chart 1
BRENT PRICES (a)

Chart 2
HISTORICAL DECOMPOSITION OF OIL PRICES

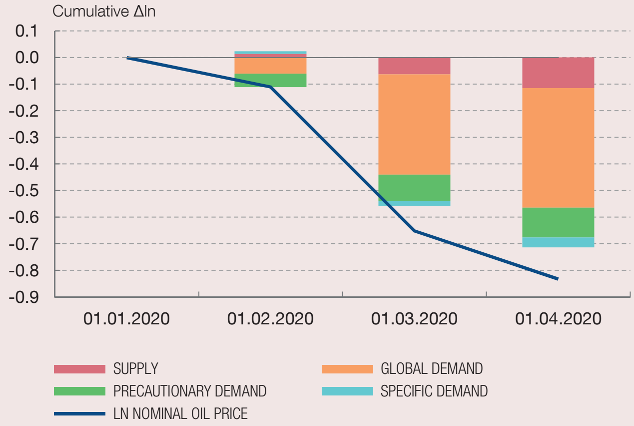


Chart 3
SECTORAL OIL DEMAND IN THE OECD, 2018

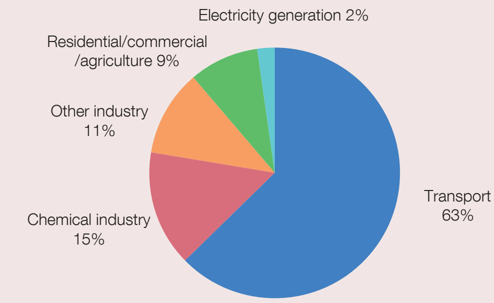


Chart 4
SUPPLY, DEMAND AND CHANGE IN INVENTORIES (b)

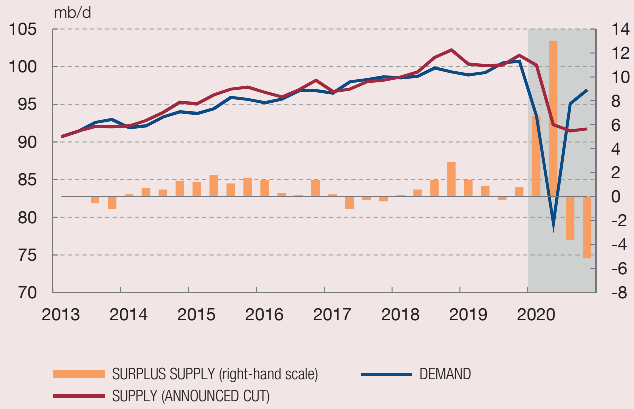
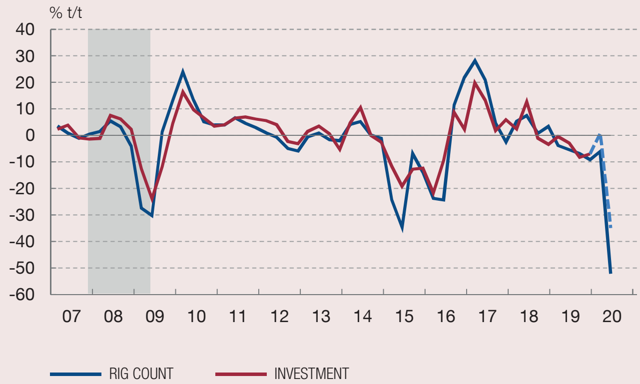


Chart 5
US: DRILLING ACTIVITY AND INVESTMENT IN OIL AND GAS (c)



SOURCES: IEA, IFS, World Bank, Federal Reserve Bank of Dallas and Banco de España.

a The figure reflects the decline in oil prices during the period of the shock indicated based on internal estimates.
b The shaded area reflects IEA supply and demand forecasts.
c The broken line reflects forecasts while the shaded area denotes recession in the United States.

prices on importing countries is estimated to have been lower than usual given that, owing to the lockdown, consumers will not have fully benefited from the lower prices. Meantime, the impact for exporting countries will be clearly negative and, in some cases, is translating into downgrades of the credit rating for these countries' sovereign issuers.[6]

As regards the oil industry, the crisis appears to be particularly affecting companies with higher extraction costs and heavy debt, specifically US shale oil producers,[7] but also conventional producers.[8] There have been significant declines in investment in exploration and production both in the United States (see Chart 5) and globally.

Finally, concerning the future outlook for the oil market, the re-establishment of the supply agreement and the incipient start of the economic recovery following the gradual exit from the most extreme lockdown situations have been accompanied by a mild increase in oil prices in May already. As a result, forward prices for 2021 are at similar levels to those of a period of moderate prices, such as in 2000-2006, though still far below those in January this year. The medium-term recovery in the demand for oil is still conditional upon two factors: first, the uncertainty over the path and intensity of the rebound in activity (which, according to the World Bank's baseline scenario, will be moderate, meaning that global GDP in 2021 would still be 5.9 pp below its January forecast[9]); and further, the potential changes in consumer patterns of behaviour in the post-pandemic scenario. On the supply side, the discrepancies in OPEC+ do not allow further disagreements to be ruled out when it comes to complying with the agreement reached before its expiry in August 2022. Grounds for this line of thought are both the modest degree of fulfilment of the agreement by Russia and the intrinsic fragility these types of agreements have evidenced in recent years.[10]

6 For instance, between March and April, Saudi Arabia, Angola, Kuwait, Congo, Gabon and Iraq were all subject to adverse rating actions (downgrade and/or worsening outlook). Outside OPEC, Mexico and Colombia also experienced downgrades, partly owing to the fall in oil prices.

7 According to Rystad Energy, many US operators will be on the verge of bankruptcy despite the partial recent recovery in the WTI price (see *"US bankruptcies and how to avoid them: The costs and benefits of saving E&Ps via royalty exemptions".* Press releases. Rystad Energy research and analysis, 20 May 2020).

8 According to the UK Oil and Gas industry Association, a quarter of UK upstream oil and gas companies are facing financial difficulties (see Coleman, *"Oil & Gas UK warns of 'increasingly grim' North Sea outlook, urges more support",* Market Insights. S&P Global Platts).

9 In its baseline scenario, the World Bank estimates growth for the global economy of -5.2% for 2020, a downward revision of 7.7 pp on its January forecasts, and growth of 4.2% for 2021. See World Bank. 2020. *Global Economic Prospects,* June 2020. Washington, DC.

10 Behind this fragility are factors such as the emergence of substitutes, enhanced efficiency and new suppliers (see World Bank Group. 2020. *Commodity Markets Outlook, April. Box 1"Set up to fail? The collapse of commodity agreements".* World Bank, Washington, DC).

Box 3

THE INITIAL ECONOMIC IMPACT OF THE HEALTH CRISIS AND THE LOCKDOWN MEASURES ON THE EURO AREA COUNTRIES

This early-release box was published on 17 June

To contain the spread and incidence of the COVID-19 pandemic, the governments of the euro area countries launched strict measures in March restricting people's movement and the normal pursuit of productive activities. Both the "stringency index" devised by the University of Oxford[1] and the indicators of people's movement, such as Google, show how strict containment measures were widespread from mid-March and extended throughout April and much of May (see Charts 1 and 2).

Chart 1
STRINGENCY INDEX OF PANDEMIC-CONTAINMENT MEASURES
UNIVERSITY OF OXFORD (a)

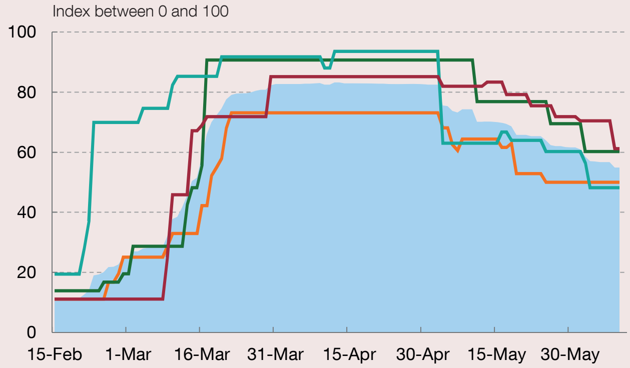
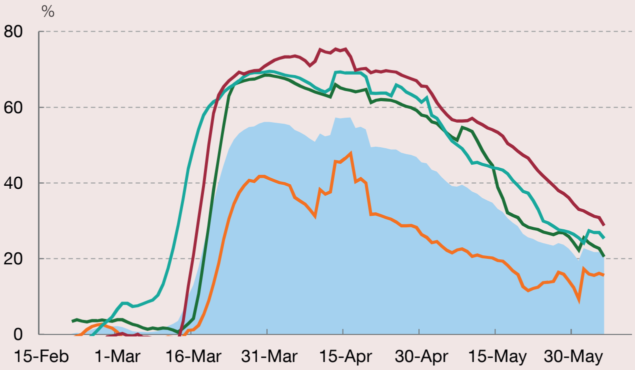


Chart 2
DECLINE IN MOBILITY TO WORKPLACES AND RETAIL SITES
GOOGLE INDEX (b)



EURO AREA GERMANY FRANCE ITALY SPAIN

Chart 3
REAL GROSS VALUE ADDED. 2020 Q1

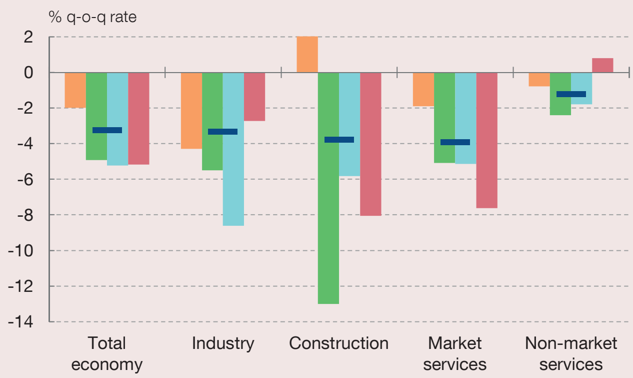
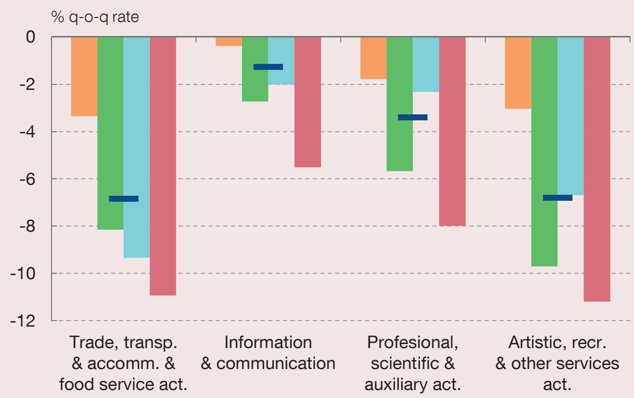


Chart 4
REAL GVA IN MARKET SERVICES BRANCHES. 2020 Q1



EURO AREA GERMANY FRANCE ITALY SPAIN

SOURCES: Google Community Mobility Reports, University of Oxford and Eurostat.

a See footnote 1 below. For calculation purposes, the euro area is a GDP-weighted average.
b Average of indices of mobility to "grocery and pharmacy", "retail and recreation" and workplaces. Daily data available from 15 February (omitting some public holidays). Percentage deviation from the base period (for each day of the week, the median between 3 January and 4 February). The euro area is a GDP-weighted average.

1 This indicator summarises the intensity of nine types of pandemic-containment measures and allows a systematic and consistent international comparison to be made. The index takes values between zero (absence of measures) and 100 (most extreme measures). See Hale, T., N. Angrist, B. Kira, A. Petherick, T. Phillips, S. Webster (2020), "Variation in Government Responses to COVID-19" Version 5.0. Blavatnik School of Government Working Paper.

These measures have given rise to a very abrupt and sharp decline in economic activity. The collapse in demand caused by the lockdown, the loss of jobs and uncertainty all compounded the fall in supply and the interruption of certain supply chains as a consequence of the obligatory shutdown of numerous productive activities. Moreover, these effects were heightened by the global nature of the shock and the high degree of interrelatedness of the different economies.

On National Accounts figures, the contraction in euro area gross value added (GVA) in Q1 was 3.2% quarter-on-quarter. Considering that the strict lockdown period was in the last fortnight of the quarter[2], euro area economic activity is estimated to have fallen in that period by approximately 20%.[3] Among the four biggest economies, France, Italy and Spain were most impacted, given the greater severity of the containment measures applied. In these countries, the observed reduction in GVA in Q1 is estimated to be consistent with a decline in the level of activity during the strict lockdown weeks of over 30%, compared with 13% in Germany. These figures are in line with those anticipated by some institutions on the basis of their direct interpretation of the lockdown rules, of surveys and of high-frequency economic indicators.[4]

The adverse impact on activity has been most asymmetrical across sectors. Charts 3 and 4 illustrate this, showing the quarter-on-quarter change in GVA in Q1. In addition, Table 1 offers sector-by-sector estimates of the decline in the level of activity during the strict lockdown in the second fortnight of March.

As can be seen, the market services sector, which accounts for close to 55% of the total of the euro area economy, declined by almost 4% in Q1, on National Accounts figures. That would be consistent with a fall in activity over 25% during the strict lockdown period. Such a sharp contraction reflects the significance of personal interaction in numerous services activities, which will have been directly affected by the pandemic-containment measures. The impact on services activity was notably higher than the average in Spain and lower than it in Germany, where services have a smaller relative weight, of around 50% of GVA in the economy, compared with 57% in Spain's case.

In the services industry as a whole, the two sectors most affected were that of retail and wholesale trade, transportation, and accommodation and food service activities (which accounts for 19% of the euro area economy), and that of artistic activities, leisure and other personal services (whose economic weight is much lower, at somewhat over 3%).[5] As Table 1 shows, these two sectors are expected to have undergone a loss of activity of more than 40% during the strict lockdown period in the euro area. The decline in the first of these two sectors was particularly severe in Italy and Spain (over 60% and 70%, respectively), where the weight of this activity in the economy is moreover greater. Specifically, hotels and restaurants, which were completely shut down, account for 3% of euro area GVA; but in countries where tourism is more important, such as Italy and Spain, their weight rises to 4% and 6% of GVA, respectively. The second of the two sectors is estimated to have shrunk more sharply in France (over 60%) and Spain (over 70%). The third services sector most affected is that of professional, scientific, technical and auxiliary services, with a decline in activity of around 20% in the euro area as a whole. The related fall was over 50% in Spain, and around 40% in France, where its weight in proportion to GVA is, moreover, relatively higher.

The initial impact of the crisis on euro area manufacturing production was very high, which also reflects the collapse

2 The start of the strict lockdown in March was on the 22nd in Germany, the 17th in France, the 10th in Italy and the 16th in Spain, although some lockdown measures were introduced in a staggered fashion prior to these dates, and did not always affect each country as a whole. See, for example, Flaxman, S. et al. (2020), Estimating the effects of non-pharmaceutical interventions on COVID-19 in Europe. Nature.

3 This calculation is made under the assumption that, during the first 11 weeks of the quarter, the level of economic activity was similar to that of late 2019 (i.e. a quarter-on-quarter change of 0%), meaning that the 20% decline in the two remaining weeks caused the fall of 3.2% observed in the quarter as a whole. The decline would rise to 22% under the alternative assumption that during the first 11 weeks of the quarter a similar growth rate had been maintained to that of the four quarters of 2019 as a whole (0.2%).

4 ECB (2020), "Alternative scenarios for the impact of the COVID-19 pandemic on economic activity in the euro area", Economic Bulletin, May, pointed to initial economic losses of 30% during the lockdown, depending on the country. INSEE (2020), "Point de conjoncture", 26 March, anticipated a 35% correction in economic activity in France at the height of the lockdown. The analysis by the Banco de España (2020), "Reference macroeconomic scenarios for the Spanish economy after Covid-19", Analytical Articles, 2/2020, suggested an approximate decline in production of 30% in Spain in each of the weeks the state of alert was in force.

5 The services comprising this sector are very heterogeneous and include sport activities, repair of computers, various personal services and activities of households as employers of domestic staff.

Box 3

THE INITIAL ECONOMIC IMPACT OF THE HEALTH CRISIS AND THE LOCKDOWN MEASURES ON THE EURO AREA COUNTRIES (cont'd)

in international trade. The decline in manufacturing GVA is estimated at close to 30% during the strict lockdown period in Q1.[6] The adjustment was more severe in Italy and France (60% and 40%, respectively) and, on the industrial production data for March, the poor performance in these two countries was practically across the board in all manufacturing sectors. The sector most affected was that of motor vehicle manufacturing, where productive activity had ground to a halt at some junctures. This industry is relatively significant in Germany, with a weight in GDP of over 5%, while the related figure does not exceed 2% in the other main countries. The data for March also indicate very sharp falls in the textile and furniture industries. Both are relatively labour-intensive, meaning that the pandemic-containment measures affected them to a greater extent. The weight of these industries in Italy is very high (around 3.5% of GVA in the economy, compared with 2% in the euro area).

Table 1
DECLINE IN ACTIVITY DURING THE STRICT LOCKDOWN PERIOD IN Q1
As a percentage of the pre-health crisis level. Weight of the sector as a percentage of nominal GVA

Sectors	Estimate of the decline in activity during the lockdown (a)					Weight of the sectors				
	Euro area	DE	FR	IT	ES	Euro area	DE	FR	IT	ES
Primary	-	-	-	-	-	1.7	0.9	1.8	2.2	2.9
Manufactures	-22	-29	-39	-59	-21	16.4	21.6	11.0	16.6	12.2
Motor vehicles						2.4	5.3	1.4	1.5	1.5
Energy	-	-	-	-	-	2.8	2.7	2.5	2.9	3.5
Construction	-25	-	-85	-38	-52	5.5	5.5	5.8	4.3	6.5
Market services	-26	-12	-33	-33	-50	54.7	50.5	57.0	57.5	56.8
Trade, transport, accommodation and food	-44	-22	-53	-61	-71	19.0	16.2	17.7	21.6	23.8
Trade						11.1	10.0	10.4	11.9	13.0
Retail trade						4.2	3.4	4.3	5.3	5.2
Transport						4.8	4.4	4.6	5.6	4.6
Accommodation and food service activities						3.0	1.6	2.8	3.9	6.3
Information and communications	-	-	-18	-13	-36	4.8	4.7	5.4	3.7	3.6
Financial and insurance act.	-	-	-	-	-	4.6	3.9	3.8	4.8	4.0
Real estate activities	-	-	-	-	-	11.3	10.5	12.9	13.7	11.6
Professional, scientific and auxiliary act.	-22	-12	-37	-15	-52	11.6	11.5	14.2	9.6	9.1
Artisitc, entert. and other personal services act.	-44	-20	-63	-44	-73	3.4	3.8	2.8	4.1	4.7
Artistic and entertainment act.						1.4	1.4	1.4	1.2	2.1
Non-market services	-	-	-16	-12	-	18.9	18.8	21.9	16.4	18.0
TOTAL ECONOMY	**-21**	**-13**	**-32**	**-34**	**-34**	**100**	**100**	**100**	**100**	**100**
Memorandum item										
Trade, transport, accommodation and food service, and artistic and entertainment activities						20.4	17.6	19.1	22.8	25.9

SOURCES: Eurostat and Banco de España.

a This calculation is made under the assumption that, during the first 11 weeks of the quarter, the level of economic activity was similar to that of late 2019 (i.e. a quarter-on-quarter change of 0%), meaning that the decline in the two remaining weeks caused the fall observed in GVA in 2020 Q1. The calculation is only made for the sectors most affected by the health crisis containment measures.

6 Ireland, where GVA in industry rose 15% quarter-on-quarter in Q1, is excluded from the calculation.

Box 3

THE INITIAL ECONOMIC IMPACT OF THE HEALTH CRISIS AND THE LOCKDOWN MEASURES ON THE EURO AREA COUNTRIES (cont'd)

Lastly, the performance of construction during the lockdown was particularly uneven. The decline in activity in the sector compared with its pre-crisis level amounted to 85% in France and somewhat over 50% in Spain. In Germany, by contrast, activity increased during Q1, in a context of favourable weather. The strong fall in construction activity in France might be related to the incentives arising from the temporary employment adjustment programme in force there.[7]

To conclude, although the health crisis is a shock with a common source, its short-term effects have differed in each of the euro area members. These asymmetries reflect not only the differing intensity with which the pandemic has struck each territory, but also the particularities of the lockdown measures, the differences in productive structure, the export orientation of the different economies and their share in global value chains against the backdrop of a global crisis.

7 Between 1 March and 1 June, the "partial unemployment" programme covered 84% of the net wages and all the social security contributions of the employees included under it. The construction sector used this programme intensively, with 57% of its wage-earners availing themselves of it in March, behind only accommodation and food service activities (72%).

Box 4

EXIT FROM LOCKDOWN AND THE LABOUR MARKET: A PROVINCIAL PERSPECTIVE

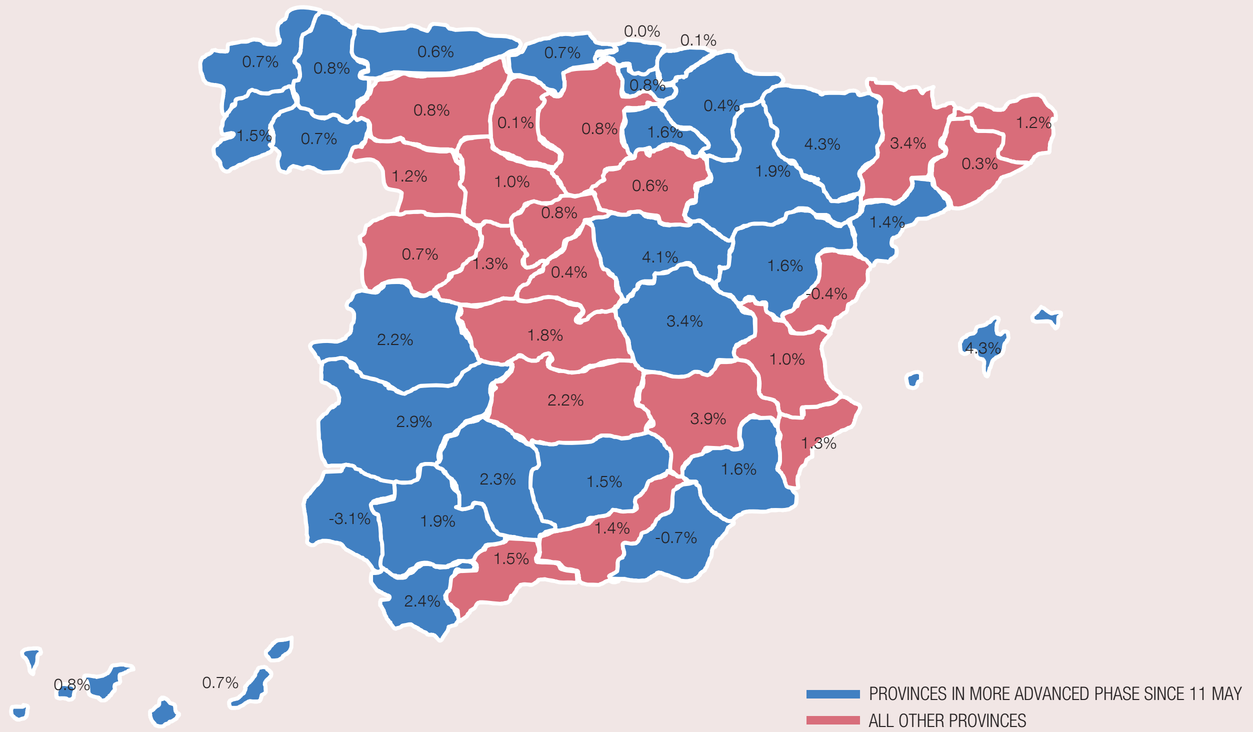
This early-release box was published on 19 June

The labour market situation in Spain improved somewhat in May, both in terms of Social Security registrations and the number of workers on furlough, following the sharp deterioration observed since the onset of the health crisis in mid-March. Total Social Security registrations rose by 1% in May, after falling by 4.6% in cumulative terms between end-February and end-April. Similarly, the number of employees on furlough dropped by 11.5% (almost 400,000 workers) in May.[1] In this box, the differences between these figures by province is used to analyse the impact that the different pace of the easing of lockdown had on employment in May.

In terms of total Social Security registrations, employment patterns reflected a relatively high degree of heterogeneity across provinces in May (see Chart 1). Growth in registrations was generally higher in the provinces that moved to Phase 1 on 11 May. Specifically, the number of Social Security contributors rose by 1.3% on average in the provinces that entered Phase 1 on that date, compared with 0.8% in those that did not. Likewise, the decline in the number of workers on furlough was higher in the provinces that were first to move to Phase 1 (-14.2%), compared with all the other provinces (-9.4%) (see Chart 2). Overall, "actual registrations", defined as total Social Security registrations minus workers on furlough, rose by 4.7% in May in the first subset of provinces and by 3.2% in the remainder.[2]

However, these differences could reflect factors other than the impact of the different pace of the exit strategy, such as differences in the sectoral structure of provinces' economies, which could give rise to seasonal differences in the month. For this reason, the following analysis seeks

Chart 1
MONTHLY CHANGE IN TOTAL SOCIAL SECURITY REGISTRATIONS IN MAY 2020 BY PHASE OF EXIT FROM LOCKDOWN BY PROVINCE



SOURCES: Ministerio de Inclusión, Seguridad Social y Migraciones and Banco de España.

1 In principle, the decline in the number of workers on furlough may be expected to mean that they have returned to work. However, given the lack of information in this respect, it is possible that some of these workers may have become unemployed.

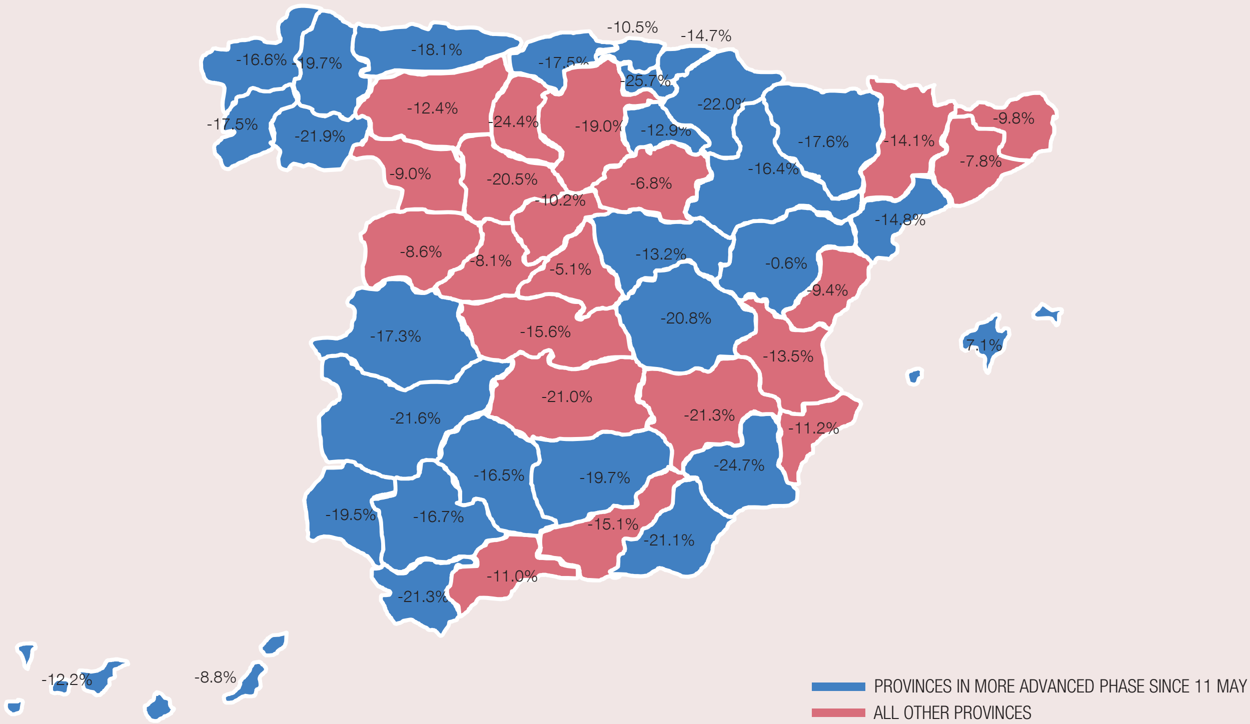
2 Workers on furlough who become unemployed would no longer be recorded as registered with Social Security and, therefore, nor would they be included in "actual" registrations.

to strip out the impact that these other factors may have on the differences in employment patterns by province in May. The analysis is made for total Social Security registrations, that is, workers on furlough and actual registrations as defined above. The findings are presented in Table 1. The variable of interest is the lockdown exit phase, which takes the value of 1 for those provinces that entered Phase 1 on 11 May and the value of 0 in all other cases. The control variables include the temporary employment ratio, the fall in month-end Social Security registrations between February and April (or the incidence of the furlough schemes in April when the dependent variable is the number of workers on furlough) and the sectoral structure of employment in each province.

The findings show that although the rates of growth of total Social Security registrations are higher in the provinces that were first to move to a more advanced phase, this effect is not statistically significant once all the other variables are taken into account. Among the results for the other variables, one key finding is that Social Security registrations tended to perform better in May in those provinces in which the construction sector accounts for a higher share of total employment, reflecting the favourable performance of employment in this sector in the month. Registrations also tended to perform better in those provinces in which the decline in employment was most marked in March and April. By contrast, Social Security registrations performed least well in May in the provinces in which retail trade and hotels and restaurants account for a higher share of employment, as in this initial phase of the exit from lockdown these sectors of activity continued to be subject to significant restrictions.

When the dependent variable analysed is the change in the number of workers on furlough, it is observed that the variable that denotes the move of the particular province to Phase 1 on 11 May has a relatively high and significant effect. In what is considered the most appropriate specification (column 4 in Table 1),[3] an early move to

Chart 2
MONTHLY CHANGE IN NUMBER OF WORKERS ON FURLOUGH IN MAY 2020 BY PHASE OF EXIT FROM LOCKDOWN BY PROVINCE



SOURCES: Ministerio de Inclusión, Seguridad Social y Migraciones and Banco de España.

3 This specification excludes the Balearic Islands from the sample. This is the only province in which the number of workers on furlough was higher in May than in April. This different pattern may probably be explained by the high weight of hotels and restaurants in employment in the province.

Phase 1 of the exit from lockdown is associated with a decline in the number of workers on furlough. This decline is 3 pp higher than that observed in a province that is further behind in the easing of lockdown measures.

This impact on workers on furlough means that when actual registrations (that is, total registrations minus workers on furlough) in May are analysed, an early change of phase is found to have a positive and significant impact (see column 3 of Table 1). Specifically, in the provinces that entered Phase 1 on 11 May, actual registrations rose in that month by 1 pp more than in the other provinces.

The most positive impact of the exit from lockdown on employment is observed in the number of workers on furlough, rather than in Social Security registrations. This is consistent with the purpose for which the furlough schemes (particularly those due to force majeure) were designed: specifically, as a means to maintain workers' income while at the same time reducing firms' costs, for a limited period of time, until the pandemic is under control and workers may resume their employment. By contrast, losses of Social Security registrations are likely to be more persistent.

Restrictions on people's movements and on economic activity were an emergency response to the urgent need to curb the pandemic, and thus the cost in terms of human lives and the pressure on the health system. But clearly these measures have a huge direct cost in terms of output and employment. The findings obtained here provide clear evidence of the positive effect that the start of the exit from lockdown in May had on these two variables. In addition, as the easing of lockdown measures extends into June, further improvements in employment may be expected this month, following the sharp slump at the peak of lockdown.

Table 1
MONTHLY CHANGE IN SOCIAL SECURITY REGISTRATIONS AND NUMBERS OF WORKERS ON FURLOUGH BY PROVINCE IN MAY 2020 AND VARIOUS EXPLANATORY VARIABLES

Dependent variable	Total Social Security registrations		Workers on furlough		Actual Social Security registrations	
Specification	1	2	3	4	5	6
Phase	0.005	0.004	-0.022*	-0.031***	0.007	0.010**
	[0.003]	[0.003]	[0.012]	[0.011]	[0.005]	[0.005]
Fall in Social Security registrations	-0.173**	-0.487***	0.517***	0.240	-0.294***	-0.299***
	[0.084]	[0.102]	[0.186]	[0.191]	[0.070]	[0.067]
Temporary employment ratio	-0.001	-0.001	-0.007***	-0.006***	0.002**	0.001
	[0.001]	[0.000]	[0.002]	[0.002]	[0.001]	[0.001]
Weight of agriculture	0.000	0.004*	-0.002	-0.003	0.006	0.005
	[0.003]	[0.002]	[0.010]	[0.009]	[0.004]	[0.004]
Weight of retail trade and and hotels and restaurants	-0.001	-0.001***	-0.003	-0.001	-0.002*	-0.002*
	[0.000]	[0.000]	[0.002]	[0.002]	[0.001]	[0.001]
Weight of industry	-0.000	-0.000	-0.005**	-0.005**	0.001	0.001
	[0.001]	[0.000]	[0.002]	[0.002]	[0.001]	[0.001]
Weight of construction	0.006***	0.003*	0.009*	-0.001	0.001	0.004*
	[0.001]	[0.001]	[0.005]	[0.005]	[0.002]	[0.002]
Weight of other private services	-0.001	-0.001	-0.001	-0.001	-0.000	-0.000
	[0.001]	[0.000]	[0.002]	[0.002]	[0.001]	[0.001]
Constant	0.030	0.039	0.122	0.135	-0.060	-0.055
	[0.046]	[0.039]	[0.173]	[0.158]	[0.068]	[0.065]
Sample	All	Excl. Balearic Is.	All	Excl. Balearic Is.	All	Excl. Balearic Is.
Observations	50	49	50	49	50	49
R-squared	0.453	0.514	0.784	0.779	0.592	0.634

SOURCES: Ministerio de Inclusión, Seguridad Social y Migraciones and Banco de España.
NOTE: Standard error in square brackets: *** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$.

Box 4

EXIT FROM LOCKDOWN AND THE LABOUR MARKET: A PROVINCIAL PERSPECTIVE (cont'd)

In any event, the results of this analysis should not automatically be interpreted in the sense that a faster exit from lockdown would necessarily have had positive effects on employment. In particular, it is crucial that the pace of exit from lockdown be in step with the achievement of the necessary conditions in healthcare services. This includes not only control of the pandemic at the present time, but also recovery of the capacity needed to cope with potential new outbreaks of the disease, or implementation of the infrastructure required to trace and isolate those who have been in contact with infected persons. Otherwise, a premature exit from lockdown could potentially result in a lower level of recovery of employment in the short term (if, for example, demand were to remain depressed because consumers perceive a high level of health risk), or even in the medium term, if the likelihood of fresh outbreaks of infection were to increase.

Box 5

RECENT DEVELOPMENTS IN SPANISH SMEs' ACCESS TO EXTERNAL FINANCE ACCORDING TO THE ECB'S HALF-YEARLY SURVEY

This early-release box was published on 10 June

On 8 May the ECB published the results of the survey on the access to finance of enterprises (SAFE), which covers the period from October 2019 to March 2020. The survey asks firms, essentially small and medium-sized enterprises (SMEs), about developments in the past six months in their economic and financial position, their external finance needs and the conditions in which they have obtained (or not) such finance. The information was gathered between 2 March and 8 April. As a result, the firms that responded first to the survey would foreseeably have done so with significantly less knowledge of the new macroeconomic setting caused by the COVID-19 pandemic. And that might have partly influenced the results discussed below.

In the case of Spanish SMEs, the data for this latest wave of the survey show a sharp deterioration in their economic situation. Insofar as the last two weeks of the period analysed coincide with the start of the state of alert in Spain, which forced the shutdown of a high number of companies, these dynamics would already be reflecting the initial impact of the COVID-19 pandemic on the economy. Thus, for the first time since 2013, the number of firms reporting an increase in turnover was lower than those indicating the contrary, and the difference between both groups (net percentage) stood at -5%, compared with the positive figure of 15% recorded in the previous survey, and that of -2% for the euro area as a whole (see Chart 1). This, combined with the increase in costs (both labour and others), meant that a higher number of firms reported a fall in profits, with a negative net percentage of -20% being recorded, compared with the figure of -7% posted in the previous wave, and with that of -15% for the euro area as a whole.

On being asked about their main concern, the lack of customers was, once again, that signalled by the largest proportion of Spanish SMEs (23%, 2 pp down on the previous edition; see Chart 2), whereas in the euro area as a whole the problem most frequently mentioned was, for the fifth time running, the shortage of skilled labour (24%). Set against this, access to finance was, among all the factors included in this question, once again that cited by a smaller number of companies: 8%, both in Spain and in the euro area, very similar figures to those posted six months earlier.

Against this background, the proportion of Spanish SMEs that applied for bank loans rose significantly, up 6 pp to 37% (see Chart 3), a higher figure than that recorded in the euro area (29%). Firms' perception of their access to bank financing continued to improve, although it did so once again at a lower rate than in the preceding periods (see Chart 4). This came about in a setting in which the percentage of SMEs considering that the overall economic situation was denting the obtaining of new lending (31%, 5 pp up on the previous period) increased, as did the net proportion of SMEs reporting that the deterioration in their specific situation was an obstacle to access to bank finance (up to 24%, a figure not reached since June 2013). By contrast, 14% of Spanish SMEs continued to perceive an enhanced readiness of banks to grant loans (2 pp up on six months earlier) and 5% indicated a favourable impact associated with their credit history (2 pp down on the previous edition).

The percentage of SMEs whose applications to borrow were rejected held at similar levels to those of the previous survey, around 4%, only 1 pp down on that recorded in the euro area as a whole. Conversely, the broader indicator of difficulties in obtaining bank lending[1] shows a slight worsening, with an increase of 2 pp in the proportion of Spanish firms facing such difficulties, up to 9%, which is 1 pp higher than the related figure for the euro area (see Chart 5).

As regards financing conditions, the net percentage of firms that reported a decline in interest rates stood at 2% (see Chart 6). Moreover, there continued to be a positive net proportion of firms indicating an increase both in loan amounts (10%, an identical figure to the previous wave) and maturities (3%, 1 pp up on six months earlier). By contrast, SMEs once again reported harsher terms governing required guarantees and other loan conditions (other than the amount and maturity).

In sum, the latest SAFE survey shows that, from October 2019 to March 2020, there was a strong downturn in firms' economic situation, both in Spain and in the euro area as a whole. This would likely have been influenced by the pandemic's strong impact in the final weeks of the period considered. However, Spanish SMEs' access to external finance continued to improve, albeit at a more moderate

1 This indicator tracks some of the following situations: rejected loan applications; loan applications for which only a limited amount was granted; loan applications which resulted in an offer that was declined by the enterprises because the borrowing costs were too high; and those cases in which enterprises did not apply for a loan through fear of rejection (discouraged borrowers).

Box 5

RECENT DEVELOPMENTS IN SPANISH SMEs' ACCESS TO EXTERNAL FINANCE ACCORDING TO THE ECB'S HALF-YEARLY SURVEY (cont'd)

Chart 1
TURNOVER AND PROFIT (a)

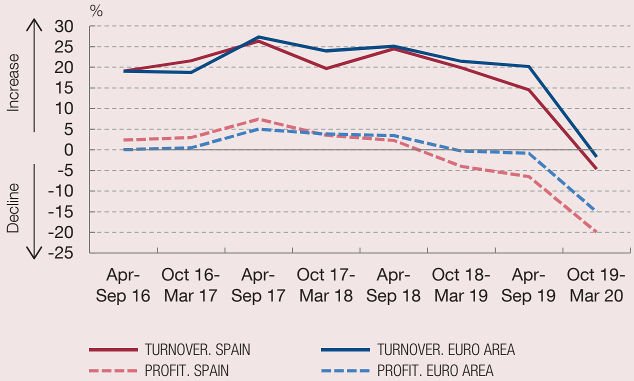


Chart 2
MAIN PROBLEMS AFFECTING ACTIVITY. OCTOBER 2019-MARCH 2020

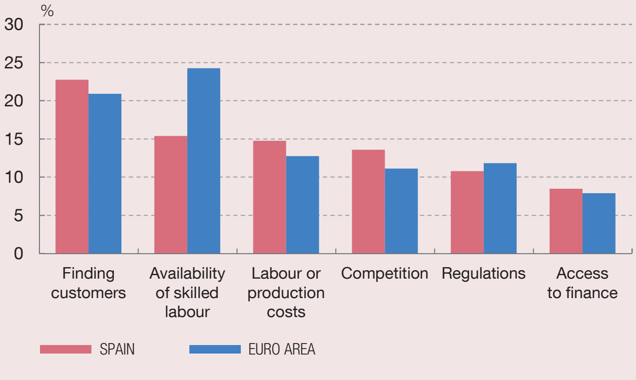


Chart 3
SMEs THAT HAVE APPLIED FOR BANK LOANS

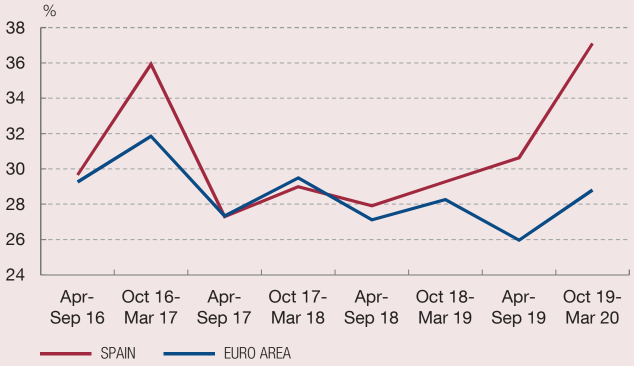


Chart 4
PERCEIVED AVAILABILITY OF BANK LOANS (b)

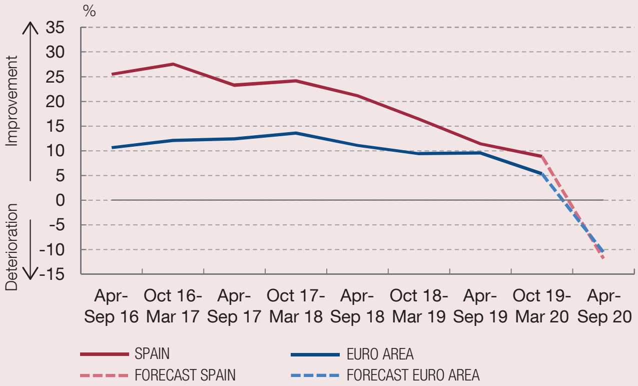


Chart 5
SMEs HAVING DIFFICULTIES OBTAINING BANK LOANS (c)

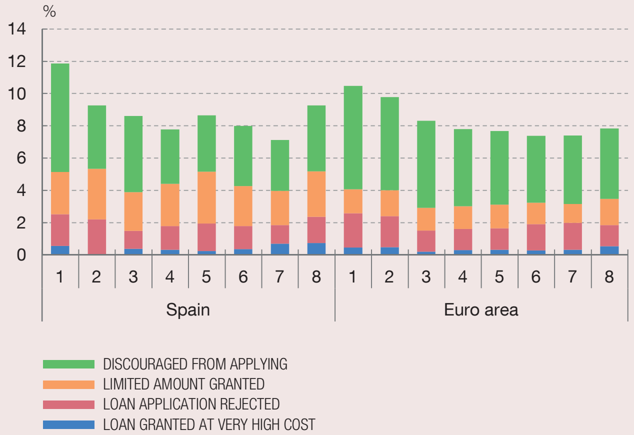
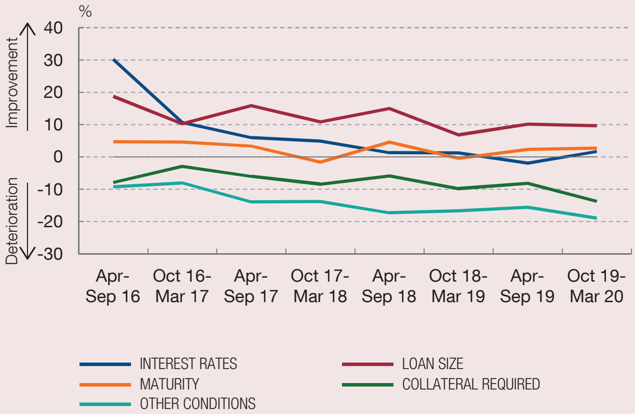


Chart 6
BANK LOAN CONDITIONS. SPAIN (d)



SOURCE: ECB.

a Percentage of firms reporting an increase minus percentage of firms reporting a decline.
b Percentage of firms reporting an improvement minus percentage of firms reporting a worsening.
c This indicator reflects the proportion of firms in one of the following situations: those whose applications for funds were rejected; those which were granted funds but only a limited amount; those which were granted a loan but at a cost they considered very high; and those which did not apply for finance because they expected to be rejected (discouraged from applying). The numbers on the horizontal axis depict the rounds of the survey, with 1 corresponding to the period April-September 2016 and 8 to the period October 2019 to March 2020.
d Percentage of firms reporting an improvement in conditions (lower interest rates, increase in amounts and maturities and lower collateral and other requirements) minus percentage of firms reporting a worsening in these conditions.

rate, and there was a strong rise in applications for bank loans, in a setting in which financing conditions held favourable.

Ahead of the coming months, a high net percentage of Spanish SMEs (12%, very similar to the overall euro area figure of 11%) expect, for the period running from April to September 2020, that there might be a significant deterioration in their access to bank finance, something not seen since the 2012 sovereign debt crisis (although the maximum percentage then recorded, 18%, was higher). This result contrasts with banks' expectations reflected, at similar dates, in the Bank Lending Survey, and which suggest an easing in the lending standards for Q2. In this respect, the firms surveyed in SAFE may possibly not have taken sufficiently into account in their replies the positive impact on their access to finance derived from the ICO guarantees programme, which has entailed the granting of over €30 billion to close to 200,000 Spanish SMEs from end-March to mid-May. Conversely, it might also be the case that, even with this public guarantees programme, SMEs anticipate that their access to lending will be more difficult in the coming months as a result of the worsening of their economic situation.

The economic policy measures adopted to counter the adverse effects of the pandemic and the alleviation of the healthcare situation helped improve conditions on the international financial markets.

Following the sharp deterioration observed from the second half of February, the global financial markets began to improve from mid-March. This recovery, which appears to have benefited from the measures adopted by the economic authorities and from the improvement in the health situation in some geographical areas, was reflected in a widespread climb in stock market indices, lower credit risk premia and diminished volatility of asset prices. However, a high degree of uncertainty remains.

The main stock market indices have recovered substantially since mid-March. Despite the strong growth observed, the indices remain below the levels existing prior to the onset of the health crisis, when they stood at record highs in the United States and Europe. Thus, from the lows reached in mid-March until the cut-off date of this Report, the S&P 500 and the EURO STOXX 50 posted increases of 39% and 27%, respectively (see Chart 2.1). Although the initial declines in stock market indices triggered by the outbreak of the health crisis were more abrupt than those observed during the global financial crisis, the recovery, so far, is at a faster pace.[3]

The recent growth in stock market indices, across sectors, has been stronger in those that are more sensitive to the economic cycle. Thus, sectors such as energy, cars, tourism and construction have experienced the highest growth, owing to the expected rebound in activity following the gradual withdrawal of the lockdown measures. Compared to their pre-health crisis levels, bank share prices continue to accumulate the biggest losses, despite the non-financial origin of the shock. Specifically, at the cut-off date for this Report, the S&P 500 and EURO STOXX bank indices posted falls of 32% and 33%, respectively, compared with the highs recorded in February.

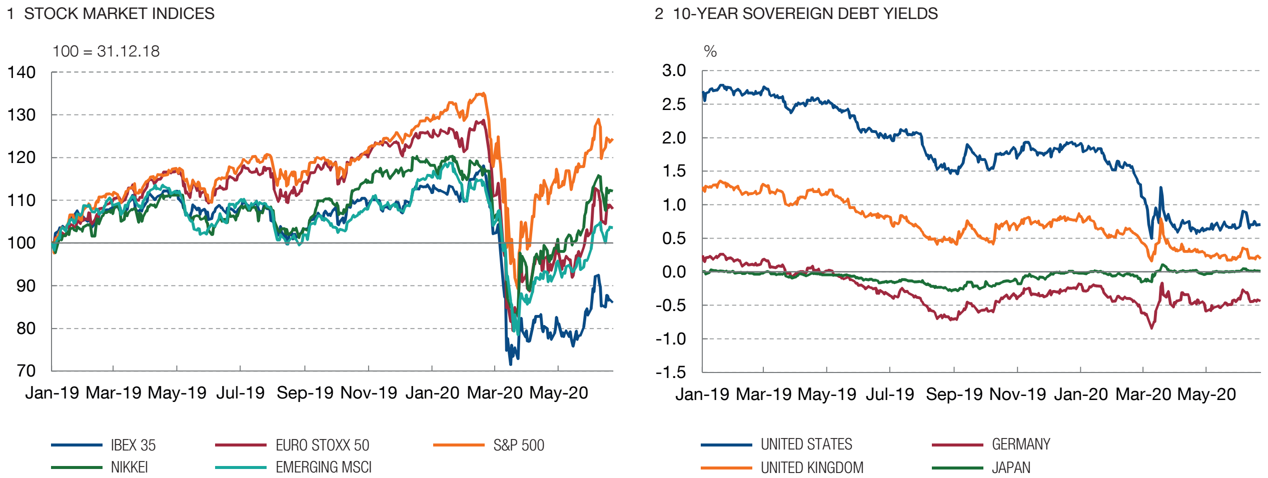
The easing of financial tensions was also reflected in the sovereign debt markets. Specifically, higher-rated long-term debt yields rose and sovereign spreads in the euro area declined. At the cut-off date of this Report, the 10-year sovereign debt yields of the United States and Germany stood at 0.7% and 0.4%, respectively, 20 and 40 bp above the lows posted in early March (see Chart 2.2). The spread on Spanish and Italian 10-year sovereign bonds over the German

3 During the global financial crisis episode, it took the S&P 500 index around four and a half months to recover to the extent observed in the current crisis episode since 23 March, when it posted its annual low.

Chart 2

STOCK MARKETS CLIMB AND HIGHER-RATED SOVEREIGN DEBT YIELDS RISE AGAINST A BACKDROP OF LOWER RISK AVERSION

The economic measures adopted to counter the adverse effects of the pandemic and the improvement in the healthcare situation have helped ease tensions on the financial market. The greater optimism among investors has been reflected in a widespread climb in stock markets, although they have not returned to their pre-COVID-19 levels. The lower risk aversion has also been reflected in the sovereign debt markets, where higher-rated long-term debt yields have risen.



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SOURCE: Refinitiv Datastream.

benchmark stood at 91 and 180 bp, that is, 65 and 101 bp below the highs recorded in April and March, respectively.

The lower risk aversion led to a decline in corporate debt spreads, diminished volatility of financial asset prices and the depreciation of the US dollar. The reduction in corporate debt credit spreads was especially sharp in the high-yield segment. Specifically, from the highs reached in March, these spreads declined by 342 bp in the case of assets issued by US firms and by 248 bp in the case of European issuers. The volatility of asset prices also diminished significantly in this period, especially for shares, which posted record highs on 16 March. In the foreign exchange markets, the lower risk aversion contributed to the depreciation (2%) of the US dollar against the euro over the quarter as a whole.

The greater buoyancy of the international financial markets was also reflected in a higher volume of corporate debt issues. The Federal Reserve and ECB announcements of monetary policy measures, which included expanding the asset purchase programmes,[4] prompted a sizeable increase in the volume of corporate

4 On 18 March, the ECB announced the launch of the Pandemic Emergency Purchase Programme (PEPP) worth €750 billion, the capacity of which was increased by an additional €600 billion on 4 June 2020. The Federal Reserve announced unlimited asset purchases on 23 March, and on 9 April, that such purchases would also include high-yield corporate bonds.

debt issues in the investment-grade segment in the US and the euro area, and in the US high-yield segment. Conversely, in the euro area, activity recovered at a slower pace in the latter segment, whose assets are not eligible under the ECB's purchase programme.

Despite the improved conditions in the financial markets, a high degree of uncertainty remains, as shown by the price volatility indicators. Thus, although the volatility of share prices has decreased significantly since mid-March, at the cut-off date of this Report, the VIX index (which reflects the short-term volatility of the S&P 500 expected by investors), remained clearly above the levels existing prior to the onset of the health crisis.

3.1 External environment of the euro area

Following the severe impact of the health crisis on global activity, the latest indicators show some degree of recovery, mixed by area, in pace with the easing of containment measures, although the pandemic continues to expand worldwide.

The health crisis spread throughout most of the world in the second quarter of the year, resulting in a significant decline in global economic activity. The containment measures extended to most countries during the months of March, April and May, as the virus spread to other geographical areas (see Charts 3.1 and 3.2). The more drastic the measures taken to combat the virus, the greater was the impact on activity (see Chart 3.3). By demand component, the decline is more pronounced in the consumption and tourism indicators, and by productive sector, in passenger transport, leisure activities and other related services.

The economic indicators have recovered slightly since May, conditioned by the easing – mixed by area – of the measures implemented to contain the pandemic, although the disease continues to expand globally. In general, the activity indicators bottomed out between end-March and April, depending on the timeline followed by the pandemic in each area. Since then, activity has rebounded somewhat, from very low levels, as the lockdowns began to be lifted, even though not all countries had the infection under control yet (see Chart 3.2). In China, the first economy hit and the first to show signs of recovery, the data for Q2 (specifically, April and May) point to an improvement in activity, more marked in industrial production indicators than in demand indicators, following the quarter-on-quarter GDP contraction of nearly 10% in January-March (see Box 1). In the rest of economies, the turning point was observed in the May PMIs although, in general, they still lie in contractionary territory following the record-breaking low recorded in April.

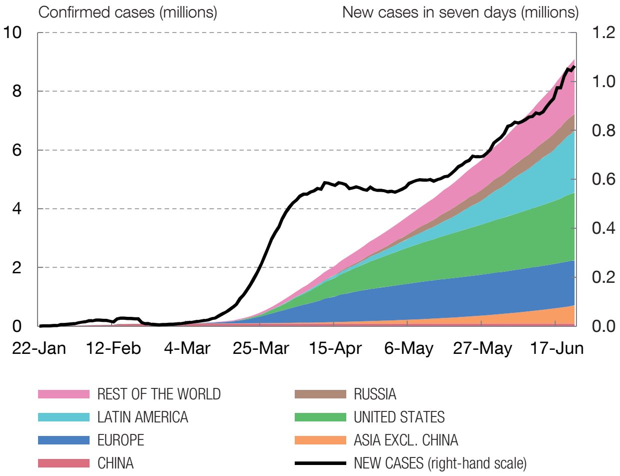
The GDP data published for Q1 reflect the effects of the pandemic, which in most countries only started in March. In the United States, GDP declined, in annualised quarter-on-quarter terms, by 5% in January-March; job destruction was particularly marked, with an increase in the unemployment rate to record highs so far in Q2. The rest of the large advanced economies posted falls in activity comparable to those of the United States. As regards the emerging economies, the spread of the virus and the containment measures implemented have adversely affected activity over the quarter, mainly in Latin America. In addition, the pandemic is still spreading in certain places. This has been compounded by the tightening of financial conditions

Chart 3

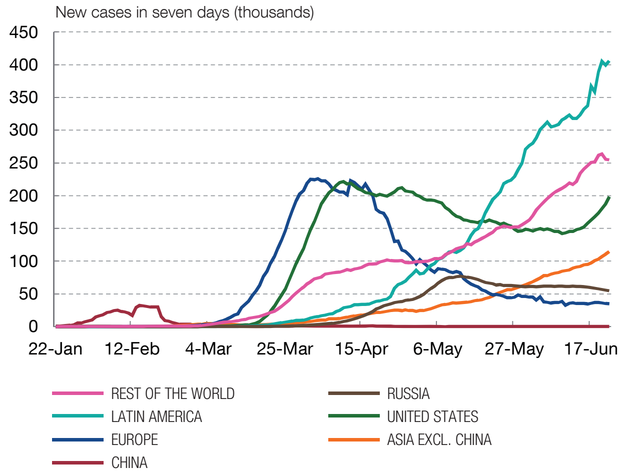
COVID-19 IMPACT ON INTERNATIONAL ECONOMIC ACTIVITY

The international spread of COVID-19 has disrupted global economic activity, but there have been signs of reactivation in the last few weeks. In any event, the magnitude of the negative impact on world activity will depend on the epidemiological evolution of the pandemic, which remains highly uncertain.

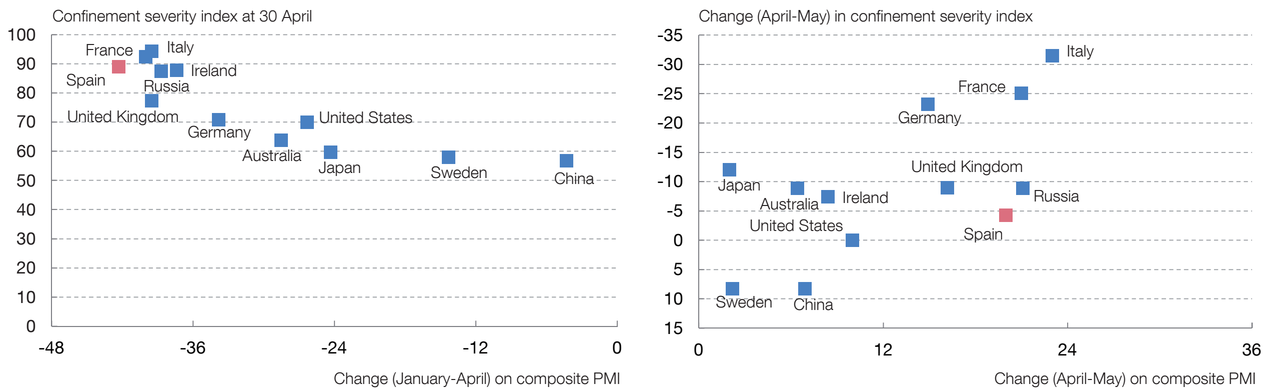
1 TOTAL INFECTIONS AND NEW WEEKLY INFECTIONS



2 PANDEMIC PATH: NEW WEEKLY INFECTIONS



3 CONFINEMENT SEVERITY AND PURCHASING MANAGERS' INDEX (PMI)



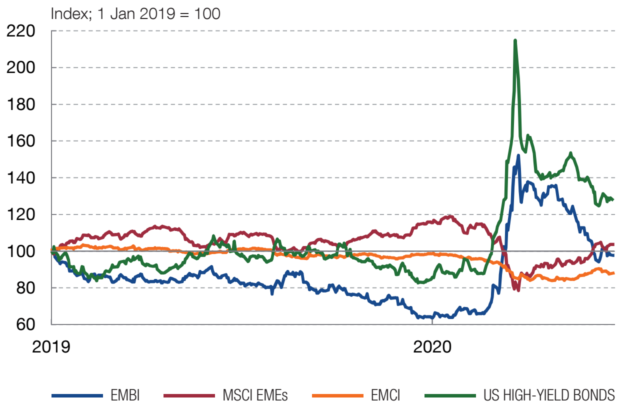
SOURCES: Bloomberg, Consensus Forecast, IHS Markit, Johns Hopkins University - Coronavirus Resource Center, JP Morgan, Oxford COVID-19 Government Response Tracker and Thomson Reuters.

and a slump in portfolio investment flows, although the intensity of these factors has decreased gradually over the course of the quarter, as economic policy measures were adopted globally in support of activity (see Chart 3.4). The growth prospects of commodity exporters have also been affected by the falls in the prices of these products, particularly oil prices.

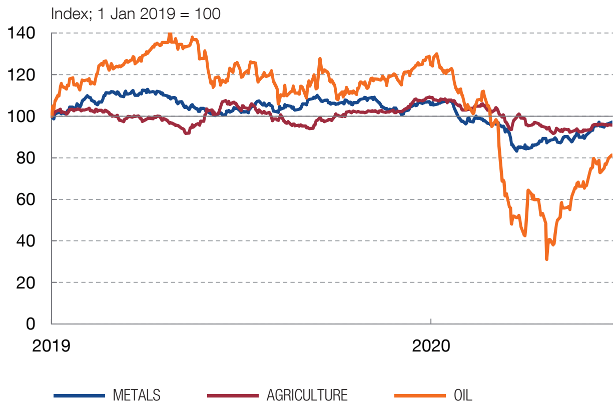
World trade data, which are more lagged, reveal a significant contraction in the January-March period, against a backdrop of high uncertainty. The volume of trade decreased by 2.5% in Q1, with contractions across the board in all areas. The impact of the pandemic on China's trade activities was particularly pronounced,

Chart 3
COVID-19 IMPACT ON INTERNATIONAL ECONOMIC ACTIVITY (cont'd)

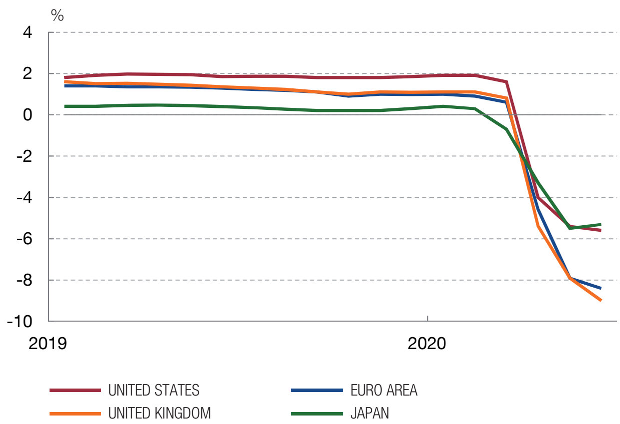
4 FINANCING CONDITIONS OF EMERGING MARKETS



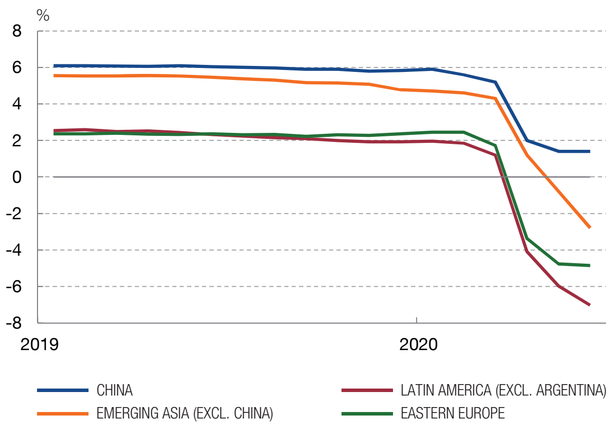
5 COMMODITY PRICES



6 GDP GROWTH FORECASTS FOR 2020: ADVANCED ECONOMIES



7 GDP GROWTH FORECASTS FOR 2020: EMERGING ECONOMIES



SOURCES: Bloomberg, Consensus Forecast, IHS Markit, Johns Hopkins University - Coronavirus Resource Center, JP Morgan, Oxford COVID-19 Government Response Tracker and Thomson Reuters.

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with a fall in export and import flows of 6%. The partial information available for April and May anticipates the continuation of global weakness in Q2. Aside from the uncertainty associated with the health crisis, there is a risk of renewed trade tensions between China and the United States arising from certain recent announcements (such as the reinforcement of controls by US authorities on exports of products to a large Chinese technological firm or the legal initiatives which aim to restrict the access of Chinese firms to US stock markets).

Inflation rates have been declining owing to the negative effects of the pandemic on world demand and the associated decrease in commodities prices. Inflation has decreased overall, in part owing to the fall in commodities prices, particularly oil prices (see Chart 3.5). The plummeting of oil prices since

March has mainly been due to the decrease in demand associated with the disruption of activity worldwide, although it seems that other supply factors have also been involved (see Box 2). Core inflation rates remained moderate, possibly reflecting the predominance of disinflationary elements associated with the slump in demand, although certain supply restrictions have temporarily raised the prices of some products, mainly food.

The economic policy response has been forceful in most countries. The timing of the measures adopted followed the spread of the pandemic across the different regions of the world. Overall, the types of measures adopted in different countries were similar, focusing on providing liquidity to the economic agents and on supporting their income. However, there was some disparity; thus, advanced economies had a more robust reaction and emerging economies had, in general, less fiscal space.[5]

In this setting, economic growth forecasts for 2020 have continued to be revised downwards. According to the analysts' consensus, every region across the globe will go into recession this year (see Charts 3.6 and 3.7). However, it is still projected that the recession will be temporary and that activity will increase in 2021 following a recovery process that will start in the second half of 2020. That said, the consolidation and strength of the recovery will depend, inter alia, on epidemiological developments and, therefore, on the pre-emptive and containment measures that may still be in place or may need to be reimposed, on possible changes in the patterns of behaviour of the economic agents and on the success of the economic policy response.

3.2 The euro area

Economic activity in the euro area suffered an unprecedented fall in the first half of the year as a result of the measures taken to contain the pandemic

Euro area GDP contracted by 3.6% in Q1, reflecting the stringency of the lockdown measures. The fall in output was particularly sharp in Italy, France and Spain, all of which recorded declines of somewhat more than 5%, while in Germany, a country with a lower incidence of the disease and, therefore, a less strict lockdown, GDP fell by 2.2%. By component, GDP was dragged down by the collapse in domestic demand, especially household consumption, while the decline in exports was largely offset by the fall in imports (see Chart 4).

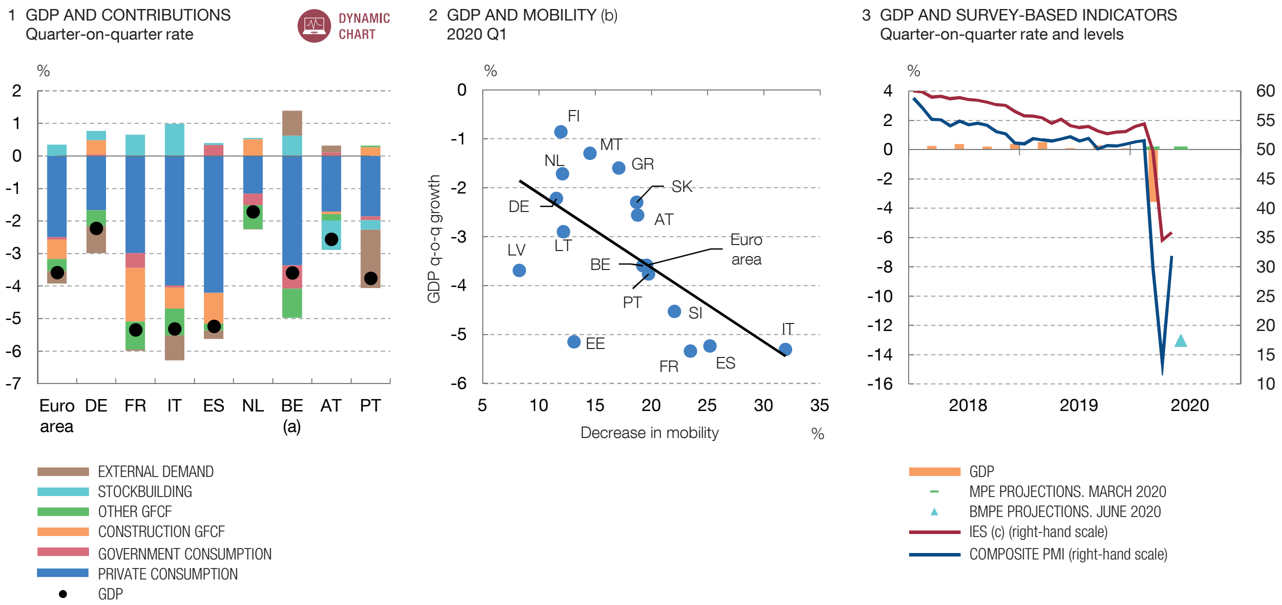
Activity will shrink more sharply in Q2, despite the gradual easing of restrictions. As the virulence of the pandemic has subsided, lockdown measures have been loosened, allowing economic activity to recover gradually. Some

5 See Chapter 3 of the Banco de España's latest *Annual Report* [Banco de España (2020)].

Chart 4

LOCKDOWN MEASURES TRIGGER A SHARP CONTRACTION IN EURO AREA ACTIVITY

Euro area GDP contracted by 3.6% in 2020 Q1, with sharp declines in Italy, France and Spain. The stringency of the lockdown measures led to a collapse in private consumption. The latest data available point to an even sharper fall in 2020 Q2.



SOURCES: Eurostat, European Commission, Markit Economics, ECB and Google Community Mobility Reports.

a Belgium does not report disaggregated GFCF data.
b Google mobility index. Average mobility to grocery, pharmacy and retail outlets, recreation facilities and the workplace. The daily data refer to the median between 3 January and 4 February.
c The IES is normalised and rescaled to present the same average and standard deviation as the PMI.

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indicators, such as PMIs and the European Commission's economic sentiment index, picked up in May after collapsing in April, although they remain at historic lows. All in all, a substantially larger decline in GDP is expected for Q2, which could be as much as 13% in the euro area as a whole.

The lockdown measures are affecting the various productive sectors unevenly. Certain industries, such as retail trade, recreation and accommodation and food services have been directly affected by the compulsory shutdowns. Manufacturing production, hit by the fall in demand and supply chain interruptions (see Box 3 of this Report for further details of the asymmetric effect by sector and country), also contracted sharply, especially in Italy and Germany. Employment, meanwhile, fell by 0.2% in Q1, relative to the previous quarter, and the rate of unemployment rose to 7.3% in April. However, these data do not reveal the full extent of the labour market adjustment, since workers on furlough schemes, who account for around 17% of total employment in Germany and Spain and 23% in Italy, are not considered unemployed. Also, the number of hours worked fell especially sharply in Q1 (by 3% quarter-on-quarter), and further adjustment is expected in Q2.

Activity, according to the Eurosystem's June macroeconomic projections,[6] will decline significantly in 2020 due to the contraction in the first half of the year. These projections were prepared against a background of particularly high uncertainty, given the difficulty of anticipating the course of the pandemic, government containment measures and the ultimate effectiveness of the sizeable economic policy packages adopted. The baseline scenario for the Eurosystem's projections assumes that the pandemic will be partially contained as from the end of Q2. It is also assumed that the monetary, fiscal and labour policies adopted will help shore up household and business incomes, reduce the impact of the crisis in terms of job losses and business insolvencies and successfully contain negative feedback loops between the real and financial sides of the economy. Specifically, under this scenario, GDP is projected to fall by 8.7% in 2020. The economy is expected to recover from the second half of this year, with growth of 5.2% in 2021 and 3.3% in 2022, although GDP is not expected to reach its pre-crisis level until the end of the latter year. However, the probability of further outbreaks of the pandemic and the possibility of financial disruption associated with borrower solvency and of hysteresis effects mean that the balance of risks to economic growth is tilted to the downside. Under a more unfavourable scenario, the fall in GDP in the euro area would reach 12.6% in 2020.

Downward inflationary pressures in a setting of falling oil prices and a sharp drop in demand

In May, headline inflation in the euro area fell to 0.1%, while core inflation held at 0.9%.[7] The slowdown in prices was mainly due to cheaper energy, which more than offset the rise in food prices, especially unprocessed food prices (see Chart 5). The persistence of weak demand (despite the lifting of restrictions on agents' mobility and business activity) and the notable fall in oil prices augur an environment of low inflationary pressures, which may be partly offset by upward pressures as a result of possible occasional supply disruptions.

Against this background, the Eurosystem's forecasting exercise points to inflation of 0.3% in 2020, rising to 0.8% in 2021 and to 1.3% in 2022. These figures are 0.7 pp, 0.6 pp and 0.3 pp less than the forecasts published by the ECB in March (see Table 2). Conversely, core inflation is expected to remain relatively stable over the next few years, reaching 0.8% in 2020 and 0.9% in 2022, against a background of ample spare capacity over the projection horizon. Also, indicators of long-term inflation expectations show very moderate values, of around 1% in the

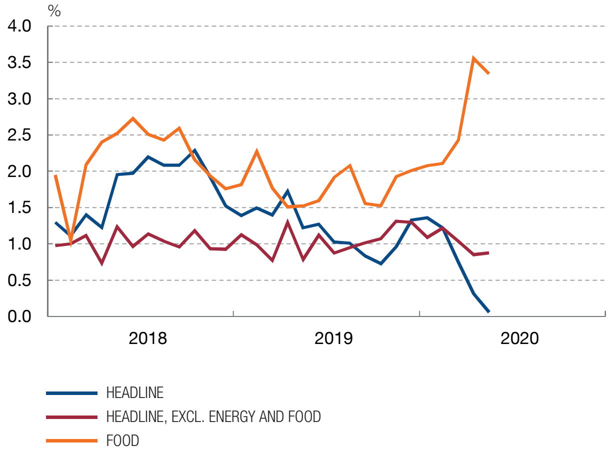
6 See the Eurosystem staff macroeconomic projections for the euro area. June 2020.

7 According to the statistical authorities, the compilation of price data has been affected by the COVID-19 crisis in all euro area countries. Eurostat and the Member States' statistical institutes have agreed a set of procedures to estimate those prices for which they were unable to collect data owing to the mobility restrictions or the shutdown of establishments. All the information on these procedures is available in the inflation section of the Eurostat website (https://ec.europa.eu/eurostat/web/hicp/methodology).

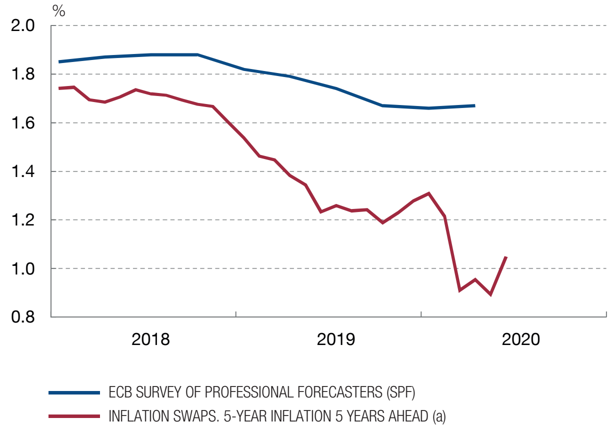
Chart 5
INFLATION IN THE EURO AREA IS CLOSE TO ZERO

Inflation fell to 0.1% in May, a steepening of the downward path of previous months. Excluding energy and food, it stood at 0.9%. The outlook points to low inflationary pressures, against a backdrop of falling energy prices and weak demand. Long-term inflation expectations remain low.

1 INFLATION
Harmonised index of consumer prices (HICP)



2 LONG-TERM INFLATION EXPECTATIONS



SOURCES: Bloomberg, Eurostat and ECB.

a Monthly average of daily data.

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Table 2
EURO AREA GDP AND HICP GROWTH FORECASTS (a)

	2020		2021		2022	
	GDP	HICP	GDP	HICP	GDP	HICP
European Central Bank (June 2020)	-8.7 (-9.5)	0.3 (-0.7)	5.2 (3.8)	0.8 (-0.6)	3.3 (1.8)	1.3 (-0.3)
European Commission (May 2020) (b)	-7.7 (-8.9)	0.2 (-1.1)	6.3 (5.1)	1.1 (-0.3)		
OECD (June 2020)						
Single-hit scenario	-9.1 (-9.9)	0.4 (...)	6.5 (5.3)	0.5 (...)		
Double-hit scenario	-11.5 (-12.3)	0.4 (...)	3.5 (2.3)	0.2 (...)		
International Monetary Fund (April 2020) (b)	-7.5 (-8.8)	0.2 (...)	4.7 (3.3)	1.0 (...)		
Consensus Forecast (June 2020)	-8.4 (-0.5)	0.3 (0)	6.1 (-0.1)	1.0 (-0.1)		

SOURCES: ECB, European Commission, Consensus Forecast, IMF and OECD.

a The figures in brackets are the change with respect to the previous forecast: March 2020 for the ECB, February for the European Commission, March for the OECD, January for the IMF and May for Consensus.
b The European Commission and IMF data are not working-day adjusted. For 2020 the estimated impact is 0.2 pp.

case of five-year expected inflation five years ahead (see Chart 5.2), the risk of deflation having increased.

To date, there has been no evidence of significant tightening of bank lending conditions for households and non-financial firms, by contrast to the case of

banks' capital market funding conditions. The cost of debt securities issuance, which surged from late February, especially in the high-yield segment, has tended to fall since mid-March, coinciding with the announcement of the Pandemic Emergency Purchase Programme (PEPP), although it currently remains somewhat above its level before the outbreak of the health crisis. In contrast, the average interest rate on new bank loans has remained at low levels, even falling in certain segments.

The results of the Bank Lending Survey (BLS) show that the impact of the pandemic on credit standards in 2020 Q1 was contained. Specifically, there was a certain tightening of credit standards in all segments of lending, although compared to that observed in the global financial and the European sovereign debt crises it was minor. This may be explained by various factors, such as the nature of the crisis (the origin of which, on this occasion, was not financial but health-related), the promptness and scale of the economic policy measures adopted (including those taken by the ECB) and the healthier starting position of the euro area banks, given the capital and liquidity buffers they had built up previously. For Q2, banks anticipated a contraction in the supply of credit to households and an increase in lending to businesses. In the latter case this was due to the support measures introduced by governments (basically, State guarantees for bank loans). Conversely, according to the latest ECB survey on the access to finance of enterprises in the euro area (SAFE), European SMEs expected their access to bank finance to deteriorate between April and September 2020.[8.]

The funding received by the private sector in recent months has been notably marked by the economic shutdown associated with the health crisis. Thus, firms have resorted to bank financing to meet their short-term liquidity needs, driving up the year-on-year growth rate of bank lending to this sector, which stood at 6.6% in April (the latest figure available), up 3.6 pp from February. In turn, corporate funding raised on the fixed income markets rose again at a good pace in April (by 6.8%, up 0.8 pp from February), after slowing in March. By contrast, lending to households contracted, owing to the COVID-19 lockdown measures, the decline in confidence and the deterioration in the labour market. As a result, the year-on-year rate of growth of lending to households fell to 3% in April. The slowdown was concentrated in the consumer lending segment (which grew by 1.3% in April, compared with 6.2% in February). The slowdown in the rate of growth of lending for house purchase was much more moderate (0.4 pp in the same period). Turning to monetary aggregates, M3 expanded at a year-on-year rate of 8.3% in April, 2.8 pp more than in February, reflecting the strong credit creation as a result of the economy's acute liquidity needs, essentially in the non-financial corporations sector. Likewise, the narrower

8 A possible explanation for this is that SMEs are not taking into account the potential beneficial effect of guarantee programmes, or they perceive these programmes to be insufficient to allow them to obtain the funding they currently require.

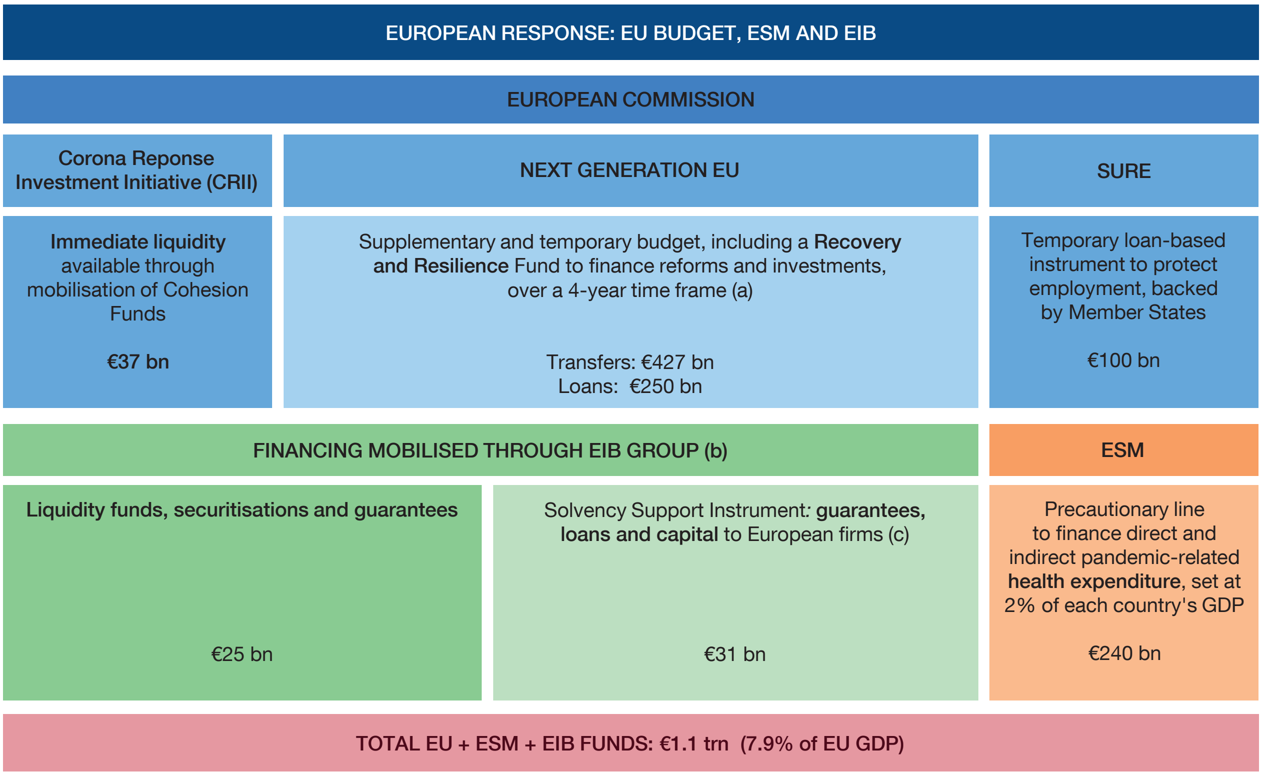
M1 aggregate, which comprises the most liquid forms of money, increased by 11.9% in April, suggesting that the high economic uncertainty is driving up precautionary holdings of liquid assets.

The euro area's economic authorities have responded with expansionary policies to counter the adverse effects of the pandemic

At its last two monetary policy meetings, in April and June, the ECB Governing Council introduced new stimulus measures. In a setting in which the ECB has held its policy rates unchanged, the more expansionary monetary policy stance stems from its refinancing operations with banks and its asset purchase programmes. As regards the former, in April the ECB announced an easing of the terms of its TLTRO-IIIs and a new programme of pandemic emergency longer-term refinancing operations (PELTROs). This is a series of seven operations that will be conducted starting in May 2020 and will mature between July and September 2021, with an interest rate 25 bp below the average rate applied in the Eurosystem's main refinancing operations. In the case of asset purchases, the ECB's Governing Council decided in June to expand the PEPP by €600 billion, to a total of €1.35 trillion, and to extend the horizon for net purchases to at least the end of June 2021. It also announced that it would reinvest the maturing principal payments from securities purchased under the PEPP until at least the end of 2022. In the wake of this decision, a further decline was observed in Spanish and Italian sovereign debt risk premia. In turn, market expectations of the future path of policy rates have barely changed and, therefore, rates are expected to remain at their current levels for the rest of the year.

As the COVID-19 crisis and the lockdown measures continued, the euro area countries expanded their fiscal policy measures considerably. In Italy, a new package of measures was announced in May, amounting to 3.3% of GDP, taking the total budgetary impact of the measures announced since March, on European Commission estimates, to 4.8% of GDP. The new package includes a set of liquidity support measures for SMEs, through direct transfers, energy rebates and subsidies for fixed costs, as well as measures designed to help large and medium-sized firms recapitalise. The public guarantee programme, which supplements the one announced previously, was also reinforced, raising the total available for guaranteeing bank funding for firms to €450 billion (27% of GDP). In Germany, in early June, the Government announced a new fiscal stimulus plan, amounting to 3.8% of GDP, which included a temporary reduction in VAT and the creation of an investment programme in green and digital technologies. This plan is in addition to the measures taken to date, with a budgetary impact, estimated by the European Commission, of 4.7% of GDP. In France, the budgetary cost of the measures approved in March to reinforce the temporary unemployment system was revised up to 1% of GDP (0.7 pp more than the previous estimate), and the resources earmarked to cover the operating

Figure 1
THE SUPRANATIONAL RESPONSE TO THE COVID-19 CRISIS



SOURCE: Banco de España, based on EU sources.

a In sky-blue, measures proposed by the Commission as part of *Next Generation EU,* pending approval.
b The EIB includes two programmes aimed at mobilising up to €240 billion.
c The Solvency Support Instrument is part of the proposals put forward under *Next Generation EU.*

costs of the self-employed and of microenterprises were increased, with a total estimated budgetary cost of 1.9% of GDP.[9]

Owing to the severe impact of the crisis on certain sectors, in recent months several countries have adopted targeted measures for the industries most affected. In Italy, measures were approved to support the tourism industry, exempting hotels from some municipal taxes and distributing “holiday vouchers” to low-income households which may be used at tourist facilities in Italy during the second half of the year. For their part, both France and Germany have taken advantage of the state aid flexibility granted at the European level[10] to introduce

9 For more information, see L. Cuadro-Sáez, F. López-Vicente, S. Párraga and F. Viani (2020), *Medidas de política fiscal en respuesta a la crisis sanitaria en las principales economías del área del euro, EEUU y el Reino Unido,* Occasional Papers, Banco de España, forthcoming.

10 The Temporary Framework approved by the European Commission in March and successively extended provides for a relaxation of the restrictions on state aid, to allow national authorities to grant tax credits and subsidies to firms affected by the pandemic.

support programmes for the aerospace and air transport industries, through credit lines and recapitalisation.

At the European supranational level, several EU instruments have been mobilised to support the measures adopted by the national governments. Since mid-March the European Commission has been presenting proposals, which have been subsequently specified and approved (see Figure 1). The measures proposed include a European instrument for temporary support to mitigate unemployment risks in an emergency (SURE), to provide financial assistance of up to €100 billion, in the form of loans to Member States to cover expenses relating to furlough schemes, conditional on jobs being maintained.

The proposal best placed to boost the European economy is the Recovery Plan for Europe. This initiative, proposed by the European Commission at the end of May and still pending approval, would be based on an additional budget of €750 billion for the European Union within the Multiannual Financial Framework (MFF) for 2021-2027. It would be financed via long-term debt, repayable as from 2028 through new EU-wide taxes, such as digital or environmental taxes. The funds would be assigned to projects in the Member States that foment growth and fulfilment of the EU's common objectives,[11] through a combination of transfers, loans and guarantees.

In addition to the measures announced by the European Commission, funding has also been mobilised by the European Investment Bank (EIB) and the European Stability Mechanism (ESM). As an immediate response to the crisis, the EIB established a new €25 billion pan-European guarantee fund, which could provide backing for funding for businesses of up to €200 billion, in addition to a support plan that aims to mobilise further funding of up to €40 billion to ease liquidity difficulties for SMEs. For their part, the euro area governments established a special ESM credit line (Pandemic Crisis Support) based on the precautionary tools already in place. This has been operational since 15 May and may provide total financing of up to €240 billion. As an exceptional measure, the Member States agreed that the sole eligibility requirement for this credit, which has a ceiling of 2% of GDP for each Member State, will be the commitment to use the funding received to cover healthcare costs directly and indirectly related to the COVID-19 crisis.

11 See Ó. Arce, I. Kataryniuk, P. Marín and J. J. Pérez (2020), *Thoughts on the design of a European Recovery Fund.* Occasional Paper No 2014, Banco de España.

Financing conditions remain comfortable, although the cost of issuing debt securities for non-financial corporations is above pre-health crisis levels.

Since mid-March, the prices of assets issued by resident sectors have recovered a portion of the declines recorded following the expansion of the pandemic. However, in the case of the stock market indices, growth in Spain has been somewhat more moderate than that observed in the rest of the euro area. Central banks' determined action, governmental support measures, the headway made in finding a vaccine and the signs of economic recovery have boosted stock prices in the most recent period. The IBEX35 has risen by 20% from the lows of March, compared with the EURO STOXX 50's gain of 32%. These mixed developments are due to both the greater weight of the banking sector – whose stock valuation has, comparatively, been harder hit by the effects of the pandemic – in the Spanish index and the poorer performance of the equity prices of Spanish companies in some sectors particularly affected by the shock (tourism and transport). In the government bond market, the yield spread between the Spanish and German ten-year bond increased initially to 157 bp (around 90 bp more than prior to the pandemic). However, the expansion of the ECB's asset purchase programmes and the announcement of the European Commission's proposal to create an EU recovery fund have helped to reduce that spread to around 90 bp. Lastly, the 12M EURIBOR has risen by 11 bp since the onset of the health crisis, to -0.18%, as a result of strains in the interbank market. However, these have eased partially in recent weeks.

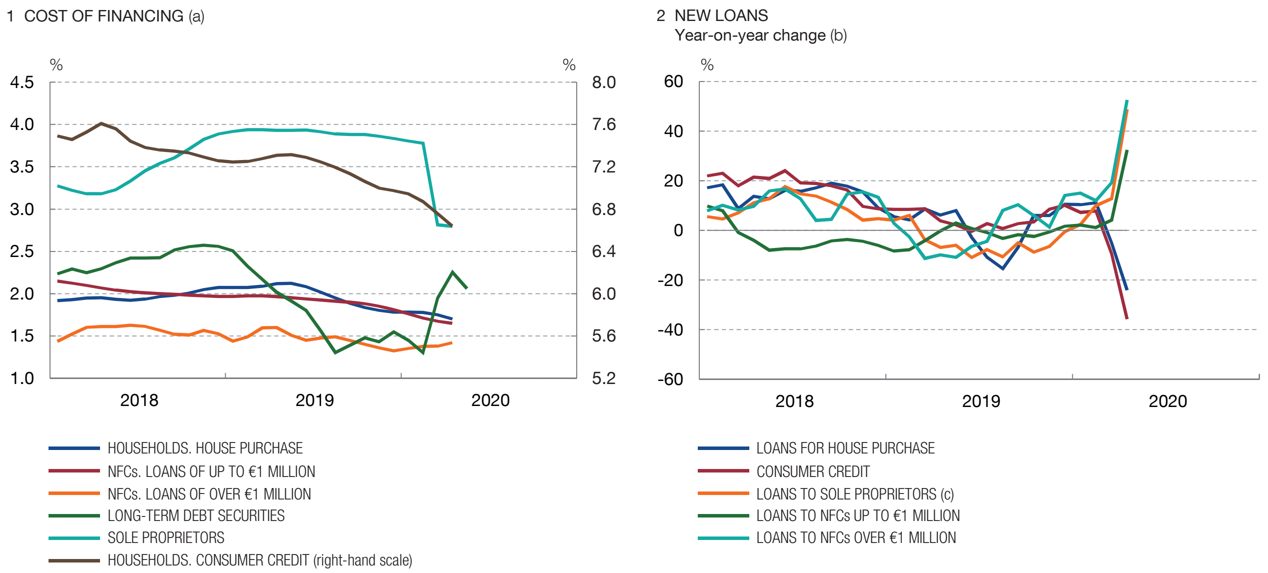
The COVID-19 crisis has not resulted in an increase in interest rates on bank lending to households or non-financial corporations, although the cost of debt securities issuances by the latter sector has increased. The State guarantee scheme made available to the self-employed and firms and the recourse to Eurosystem refinancing operations by financial institutions in very comfortable conditions have prevented the average interest rates applied to new bank loans from rising. Indeed, the data to April (the latest available figures) show that the cost of bank financing has decreased in recent months in most segments, standing in practically all cases at an all-time low (see Chart 6). This decline has been particularly steep for lending to sole proprietors. Conversely, financial market turmoil swiftly spilled over into the average rate on issuances of corporate debt. Although the improvement in the markets over the last three months resulted in a decrease in corporate risk premia, the average cost of long-term borrowing for firms is 75 bp above February levels.

At the end of Q1, financial institutions did not expect to tighten credit standards during Q2. According to the latest Bank Lending Survey (BLS), conducted between

Chart 6

THE COST OF BANK LOANS HAS DECREASED IN RECENT MONTHS, WHILE NEW LOANS TO BUSINESSES HAVE SURGED

The cost of bank loans has recorded additional declines in most segments thanks to the measures adopted by the ECB and the ICO's State guarantee schemes. Conversely, the cost of corporate debt issuances has increased. Lending to individuals has plummeted, while lending to businesses has grown vigorously owing to the increased financing needs of the self-employed and firms.



SOURCES: Thomson Reuters and Banco de España.

a Bank lending rates are the NDER (narrowly defined effective rate), i.e. excluding the related charges and fees, and are adjusted seasonally and for the irregular component, in other words, they are trend-cycle interest rates.
b Three-month cumulative flow.
c Includes renegotiations of previous loans.

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19 March and 3 April, financial institutions anticipated a significant easing of the credit standards for loans to enterprises because of the implementation of the ICO's State guarantee scheme, while those for loans to households were expected to remain stable. By contrast, in the responses to the most recent round of the ECB's survey on the access to finance of enterprises (SAFE), conducted almost contemporaneously, Spanish SMEs signalled that they expected a deterioration in access to bank loans for the period from April to September 2020 (see Box 5). This discrepancy between the two sources could be because not all firms were aware of the details of the State guarantee programmes for bank loans when they submitted their responses. Alternatively, some enterprises could potentially have considered the programmes insufficient to cover their financing needs caused by the sharp downturn in their net income.

Economic activity in Spain fell sharply in 2020 Q1, affected by the lockdown measures adopted to curb the pandemic's expansion

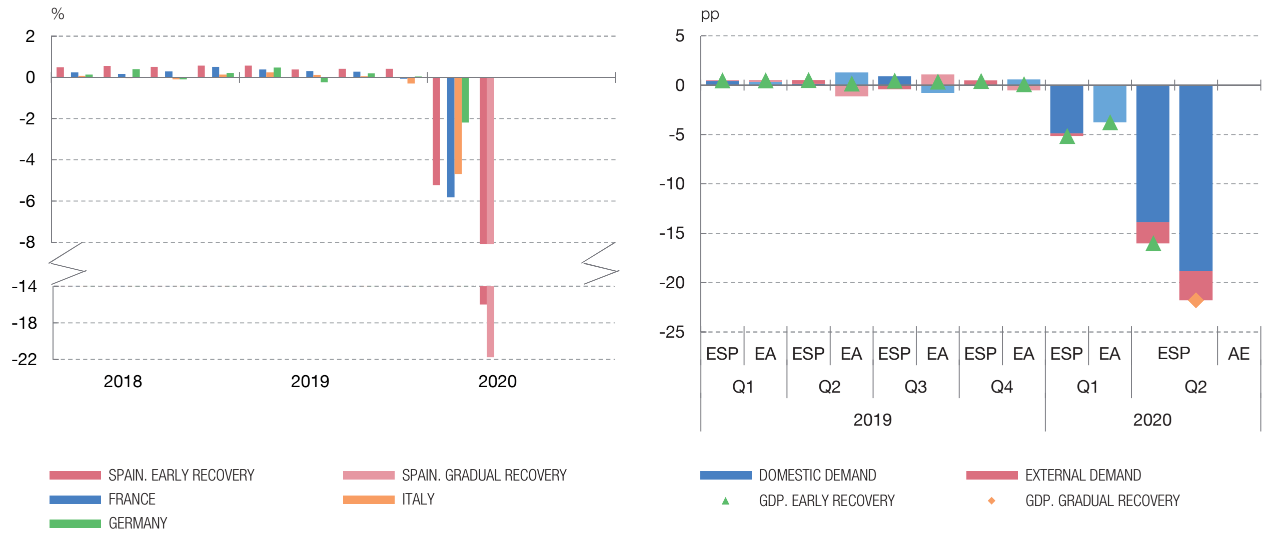
In 2020 Q1 the Spanish economy was dented significantly by the health crisis. The declaration of the state of alert halfway through March gave rise to the largest

Chart 7
ECONOMIC ACTIVITY WILL RECORD THE LARGEST DECLINE OF THE TIME SERIES IN Q2

The Spanish economy and the main euro area economies suffered significant downturns in 2020 Q1 amid the adoption by all countries of lockdown measures of varying severity to curb the expansion of the pandemic. Consequently, activity in 2020 Q2 will be severely hampered and will suffer the largest quarter-on-quarter decline of the time series.

1 GDP GROWTH
Quarter-on-quarter rates (a)

2 CONTRIBUTIONS TO REAL GDP QUARTERLY GROWTH (a)



SOURCES: INE, ECB and Banco de España.

a Banco de España projections for the Spanish economy for 2020 Q2.

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contraction in GDP, to date, in the time series (5.2% quarter-on-quarter, compared with the growth of 0.4% between October and December 2019). This decline, which brought to an end the phase of uninterrupted growth that started at end-2013, is notably steeper than the 2.6% downturn recorded at the worst point of the previous crisis between January and March 2009. The drop in GDP in 2020 Q1 reflected the sharp contraction in private domestic demand (see Chart 7). Conversely, there was an upturn in government consumption, amid an increase in healthcare expenditure to withstand the pandemic. In turn, the contribution of net external demand was slightly negative, -0.2 pp, with marked drops, of a similar scale, in imports and exports.

With the exception of non-market services, activity contracted across all productive sectors in 2020 Q1. The severity of the downturn varied according to sector, based mainly on the impact of the lockdown measures on each sector. Market-related services activity contracted 7.6%, with especially sharp decreases, of up to 11% in some cases, in the retail trade, entertainment, restaurants and accommodation and food service activities sectors. The repercussions of the restrictions on movement and social distancing for these activities were particularly pronounced because of their characteristics. Construction also shrank noticeably by around 8%. The decline in manufacturing activity, around 3%, was less steep. Activity in some sectors, in particular the automotive sector, was affected initially by disruptions to the global supply chains triggered by the pandemic and, subsequently, by the collapse in demand. In turn, the decline in agriculture, which was not directly harmed by the lockdown measures, of around 1% was quite less pronounced.

An unprecedented downturn in economic activity is expected in Q2, affected by the longer duration of the pandemic-containment measures

Economic activity has been particularly adversely affected in Q2 by the restrictions on economic activity and movement of people. The nature of the lockdown measures adopted in Spain has closely resembled that of those adopted in many other economies. However, the severity and duration of the measures have varied significantly across countries, depending on, among other factors, the extent of the pandemic when they were implemented. In this regard, Spain is one of the countries in which the restrictions' effects were the most severe and protracted during the quarter, according to indicators such as road traffic or mobile telephone data, which measure the number of trips to retail or recreation sites and workplaces (see Chart 8). The reduction in the population's movements was particularly marked in the last fortnight of March and the first fortnight of April. Specifically, the decrease was exacerbated between 30 March and 9 April by the reinforced lockdown measures, in the form of the suspension of all non-essential economic activity. For example, during that period motorway traffic decreased year-on-year by approximately 75%.

Since early May, the gradual and staggered easing, by phases and regions, of the lockdown measures has prompted a partial improvement in the mobility indicators. However, they are still clearly below their historical averages. This is the case of motorway traffic, which at mid-June was still recording year-on-year declines in excess of 50%. Mobile telephone indicators exhibit similar behaviour, with a somewhat more pronounced return to normal in journeys to workplaces than in those to retail and recreation sites (although in this latter case movements have tended to pick up speed more recently).

The downturn in GDP will have worsened notably in Q2. In this quarter, the period affected by the lockdown measures is longer than in Q1. Furthermore, most of the days when non-essential activity was suspended, where there was a larger reduction in production compared with its usual level, were in Q2. Against this backdrop, the contraction in GDP will range, in quarter-on-quarter terms, from 16% in an early recovery scenario to 21.8% in a gradual recovery scenario.[12] The latest

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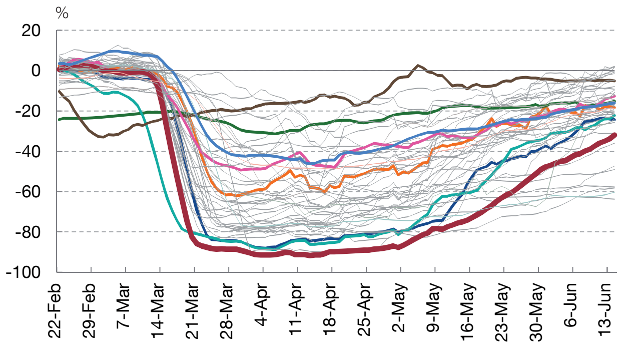
12 For a description of the calibration of these rates, see Banco de España (2020), *Macroeconomic projections for the Spanish economy (2020-2022): the Banco de España's contribution to the Eurosystem's June 2020 joint forecasting exercise.*

Chart 8

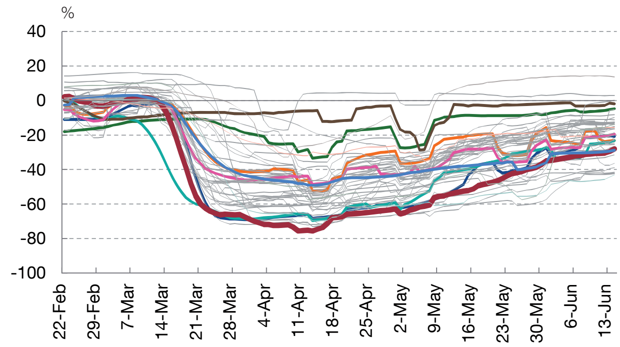
THE SHARP DECLINE IN ACTIVITY HAS MODERATED AS THE QUARTER PROGRESSED

The sharpest decline in activity and expenditure triggered by the pandemic-containment measures took place in April. From May, the various indicators point to these falls moderating partially and gradually.

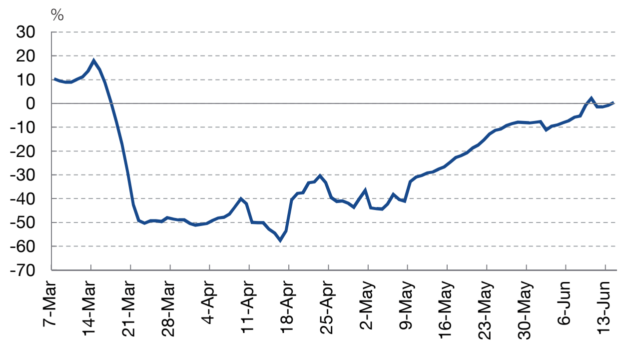
1 LOCAL MOBILITY INDICATORS. RETAIL AND RECREATION SITES



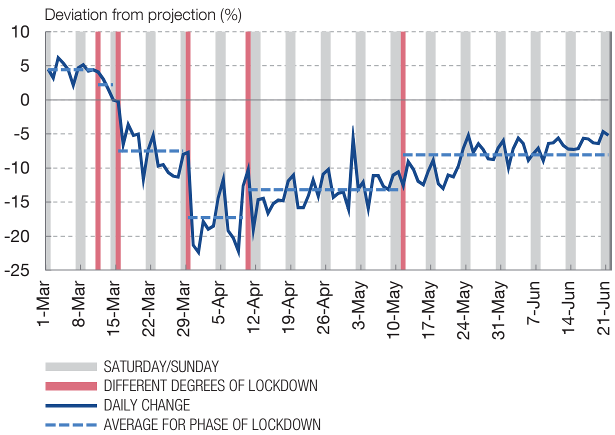
2 LOCAL MOBILITY INDICATORS. WORKPLACES



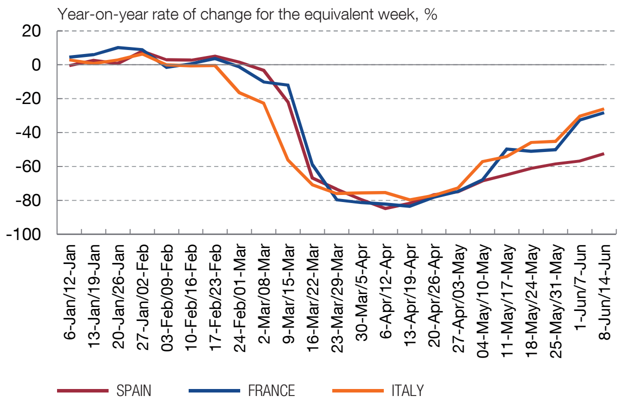
3 HOUSEHOLD EXPENDITURE WITH CREDIT CARDS (a)



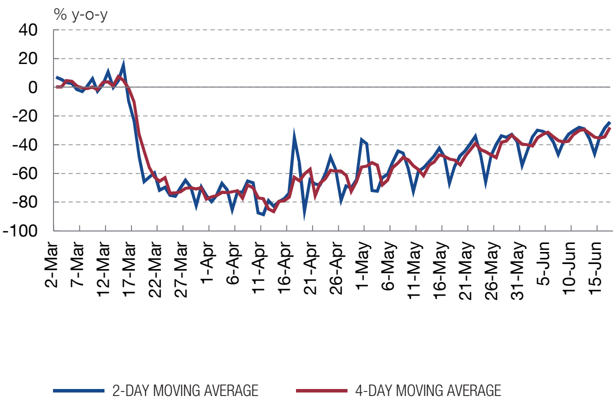
4 ESTIMATION OF THE IMPACT OF THE DIFFERENT LOCKDOWN MEASURES ON ELECTRICITY CONSUMPTION (b)



5 MOTORWAY TRAFFIC



6 SALE OF PETROL AND DIESEL



SOURCES: Google, Sistema de Tarjetas y Medios de Pago, Grupo Atlantia, Dirección de Estudios de Repsol and Banco de España.

a Rate of change of the 7-day moving average compared with equivalent period of previous year. Available aggregated market data provided by Sistema de Tarjetas y Medios de Pago.

b The estimation period runs from 1 January 2019 to 21 June 2020. The regression's dependent variable is the logarithm of hourly electricity consumption over indicators for the year, month, day of the week and time of day, distinguishing between three time slots (super-off-peak from 1 a.m. to 7 a.m., off-peak from 7 a.m. to 1 p.m. and peak from 1 p.m. to 1 a.m.). Maximum temperature, maximum temperature squared and dummy variables for national and regional holidays, weighted by electricity consumption per region, are also included.

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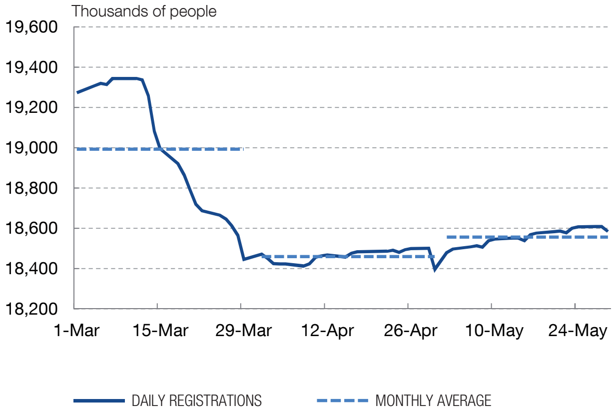
Chart 9

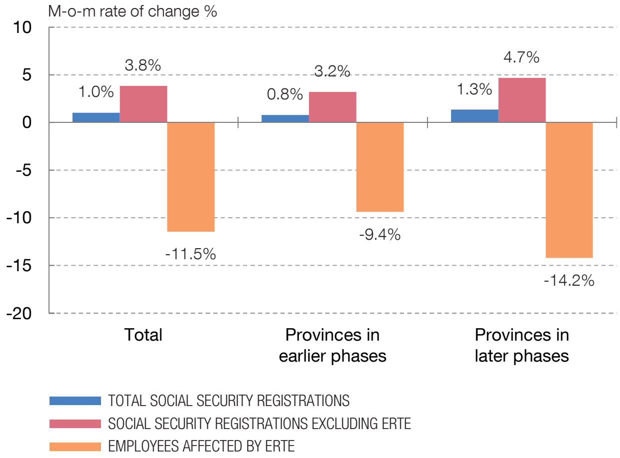
EMPLOYMENT BEGINS A MODERATE RECOVERY TOWARDS THE END OF THE QUARTER

Following heavy declines in social security registrations as of mid-March, a gradual recovery began in May, with an increase of nearly 190,000 as compared with end-April. This upturn was stronger in provinces in later phases of the lockdown easing plan, where there was also a sharper drop in the number of employees under short-time work arrangements (ERTE).

1 DAILY SOCIAL SECURITY REGISTRATIONS SINCE MARCH



2 SOCIAL SECURITY REGISTRATIONS AND SHORT-TIME WORK ARRANGEMENTS (ERTE) IN MAY



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SOURCES: Ministerio de Inclusión, Seguridad Social y Migraciones.

information on the indicators, published following preparation of these scenarios, is consistent with the assumptions used to calibrate this range.

The most severe deterioration of activity and spending prompted by the pandemic and the containment measures took place in April. Developments in electricity demand, new car registrations and credit card spending all point in this direction, along with the above-mentioned mobility indicators. Electricity consumption contracted by more than 15% year-on-year in April (see Chart 9). The decline was particularly marked during the shutdown of non-essential economic activity, when the electricity consumption of businesses fell by up to 40%. Meanwhile, there were virtually zero new private car registrations since dealerships were closed. Lastly, weekly credit card spending declined as much as 60% in early April, coinciding with the most restrictive phase of the confinement measures.

Since early May, indicators have pointed to a partial and gradual easing of the year-on-year decline in activity. This trend has come alongside implementation of the lockdown easing plan. Activity and expenditure remain clearly down on pre-health crisis levels. Indeed, in mid-June electricity consumption was still 9 pp lower than at the same time a year earlier, while private vehicle registrations fell in May by close to 60% year-on-year. In step with these developments, the decline in weekly credit card spending has gradually eased, even reaching marginally positive rates in the second week of June.

Employment has been hit hard by the pandemic, although social security registrations recorded a modest increase in May, particularly in construction, in the wake of heavy declines as of mid-March.

Following the steep cumulative fall that began midway through March, employment may have stabilised somewhat in May. This would be a direct consequence of the gradual easing of lockdown. Consequently, the month-end data for social security registrations depict a more favourable performance than the monthly average figures. Specifically, the increase in average social security registrations in May stood at around 98,000, slightly less than half the figure observed in the same period of 2019, while the year-on-year rate deteriorated 6 tenths to -4.6%. Conversely, a comparison of the social security registration data for the last business days of April and May reveals that the year-on-year decline eased by 3 tenths to -3.8%. This reflects a gradually improving scenario over the course of the month, in step with the relaxing of lockdown (see Chart 9). This more favourable tone was most apparent among the provinces that were the first to move into phase 1 of the lockdown easing plan (see Box 4). By activity, the recovery was particularly evident in construction, which, in the month-end series, posted a month-on-month increase of 4.8% in May, thereby restoring just over 40% of the employment lost between mid-March and end-April. The remaining sectors secured more moderate employment gains in May, with growth of 0.5% in industry and 0.7% in services.

The use of short-time work arrangements (ERTE) as a means of temporarily laying off workers declined in May. At month-end, nearly 3 million employees (21.3% of wage-earners) were under short-time work arrangements, 11.5% fewer than on the last business day of April. This decline was the result of developments in short-time work arrangements due to force majeure (which were down by -14.9%, nearly 460,000 employees). Part of that dip may be explained by these being converted to short-time work arrangements due to other reasons (which rose by more than 70,000). In geographical terms, the decline in the number of employees under short-time work arrangements was greater in those provinces in more advanced phases of the lockdown easing plan. By activity, short-time work arrangements fell more sharply in certain services sectors, such as other service activities (-14.6 pp), accommodation and food service activities (-7.1 pp), commerce (-6.2 pp) and construction (-6.3 pp). However, 77% of employees in accommodation and food service activities remained under short-time working arrangements at end-May.

Measured in terms of hours worked, employment may have declined by approximately 20%. This reduction, which would naturally be somewhat larger in the gradual recovery scenario than under the early recovery scenario, would be very similar in scale to that projected for GDP and may offer the best measure of the decline in the actual use of the labour factor in 2020 Q2.

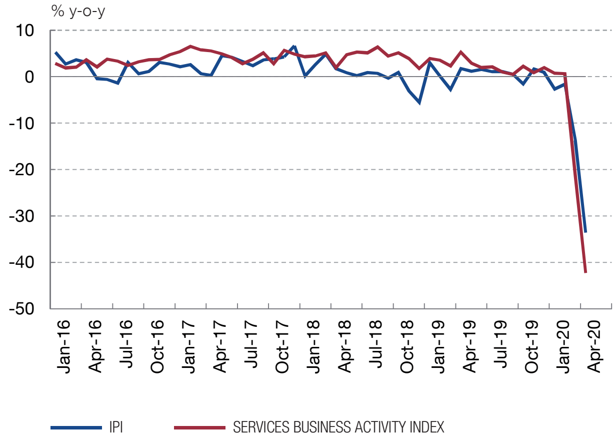
The unemployment rate will rise significantly in 2020 Q2. On average, registered unemployment grew 23.2% in April and May. This increase suggests that the

Chart 10

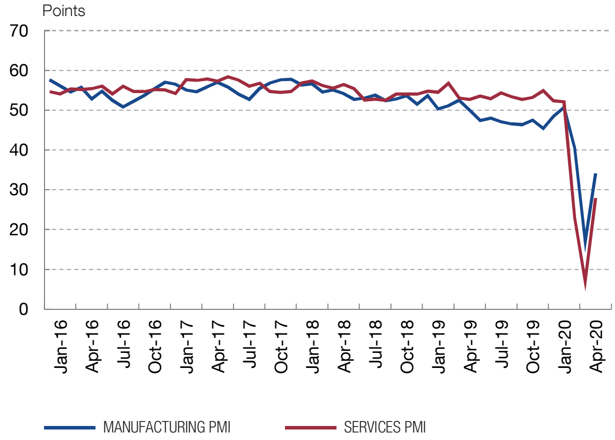
THE SERVICES SECTOR HAS BEEN MORE AFFECTED THAN MANUFACTURING IN 2020 Q2

The services sector, the hardest hit by social distancing measures, has been affected more than industry, as confirmed by both qualitative indicators, such as PMIs, and quantitative indicators, including the industrial production index and the services business activity index.

1 SERVICES BUSINESS ACTIVITY INDEX AND INDUSTRIAL PRODUCTION INDEX



2 PURCHASING MANAGERS' INDICES



SOURCES: INE, Markit Economics and Banco de España.

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unemployment rate, which in 2020 Q1 stood at 14.4% of the labour force (according to the Spanish Labour Force Survey), could draw close to 20% in Q2. It should be noted that, in accordance with European statistical criteria, under certain conditions workers subject to short-time work arrangements are not considered unemployed, since they remain associated with their employers.

The services sector, the hardest hit by social distancing measures, has been more affected than other sectors as a result of the COVID-19 crisis.

As a consequence of the confinement measures, economic activity developments have been very heterogeneous across the sectors in 2020 Q2. In particular, many services sector activities (such as retail, entertainment, accommodation and food services) generally involve considerable interaction at close quarters, meaning they have been particularly affected by the social distancing measures. In fact, the available qualitative indicators reveal that services activity was hit harder than manufacturing in April, when the lockdown measures were at their most stringent, and likewise posted a stronger recovery in May, when the lockdown easing plan began, although it remains well below pre-crisis levels. Specifically, the services PMI (see Chart 10) stood at 7.1 points in April, considerably down on the previous all-time low of 28.2 in November 2008, and recorded a marked uptick in May to 27.9. Meanwhile, the manufacturing PMI likewise posted a new historical low of 17.1 in April (compared with 26.4 in November 2008) and rallied in May to 34.1.

The impact of the health crisis has been more severe on the Spanish economy than the euro area as a whole. The positive growth differential between Spain and the euro area was inverted in 2020 Q2, with respective quarter-on-quarter GDP declines of -5.2% and -3.6%. Likewise, activity could fall more sharply in Spain than the euro area in Q2, as suggested, for example, by the distinct mobility indicator trends. A variety of factors have converged to generate this difference in performance. First, Spain introduced comparatively more stringent containment measures. Second, the measures had a more marked impact on activity in Spain due to certain structural characteristics, such as the high relative weight of accommodation and food services – owing to the scale of tourism-related activities in the country – and the labour market's higher temporary employment ratio. Lastly, as in other countries that had less fiscal headroom prior to the crisis, the budgetary policy response has been somewhat less robust than in economies that had greater scope for action.

The various components of domestic demand and exports will decline sharply in 2020 Q2

All demand components are set to plummet. In domestic demand, as was the case in Q1, the decline in GDP will have a bearing on the different components of private spending, with heavy falls in household consumption and, in particular, the various components of gross fixed capital formation. In addition, the negligible level of tourism activity will foreseeably lead to a more negative contribution from the external sector than in the January-March period.

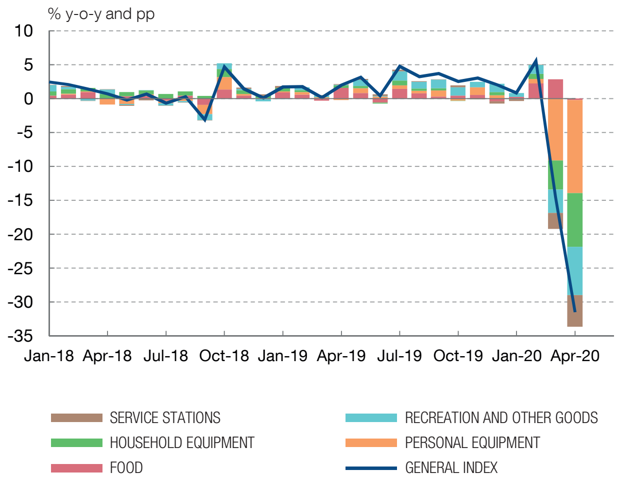
Private consumption was weighed down in Q2 by the confinement measures and heightened uncertainty. This demand component is set to drop more sharply in Q2 than Q1, when it shrank 7.3% in quarter-on-quarter terms, while the fall-off in durable goods reached 16%. In Q2, purchases of durable and semi-durable goods will have plunged once again. In particular, in April and May new private car registrations were down 98% and 63% year-on-year, respectively. Additionally, in April the components of the retail trade index that measure spending on clothing and footwear and household appliances shrank by around 80% and 60% year-on-year, respectively (see Chart 11). Spending on services will also decline heavily due to the shutdown of the hospitality sector. Thus, in April the component of the services business activity index (IASS) representing this sector fell by nearly 95% on a year-on-year basis. Meanwhile, the figures published by tax authorities show that domestic sales of consumer goods and services by large firms were down by more than 30% year-on-year in the same month (comfortably doubling the March decline). Lastly, consumer confidence in that month plummeted to its lowest level in the time series, before recording a muted recovery in May.

In line with this trend in consumption, consumer credit is expected to show a significant slowdown. The confinement of the population and the increase in

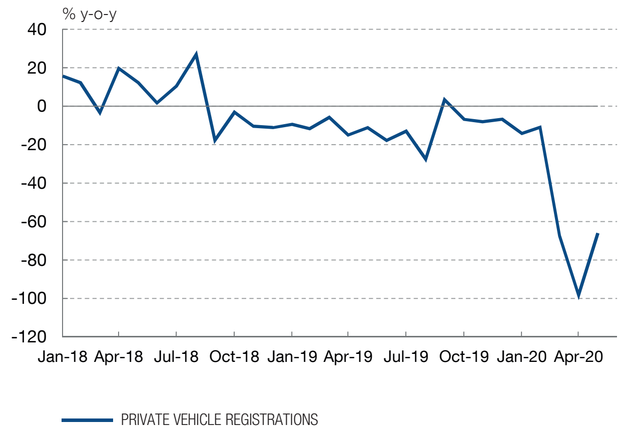
Chart 11
THE COVID-19 CRISIS HAS HAD A CONSIDERABLE IMPACT ON HOUSEHOLD SPENDING

Household spending decisions have been severely affected by the confinement measures introduced to contain the pandemic. The available indicators point to a significant contraction of spending on consumer goods in Q2, particularly on personal and household goods. The health crisis has also prompted a sharp deterioration of confidence indicators, which stand at all-time lows.

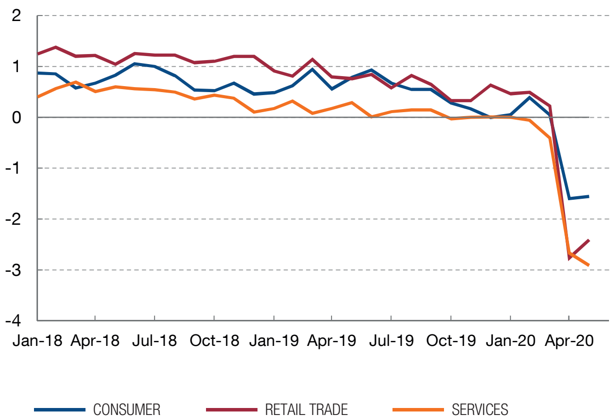
1 RETAIL TRADE INDEX
Y-o-y growth and contributions



2 PRIVATE VEHICLE REGISTRATIONS



3 CONFIDENCE INDICATORS
Standarised data (a)



4 INDICATOR OF UNCERTAINTY REGARDING ECONOMIC POLICIES

SOURCES: INE, ANFAC, European Commission and Banco de España.

a Series computed by subtracting the average and dividing by the standard deviation.

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uncertainty are estimated to have contributed to a sharp decline in demand for lending to individuals (as foreshadowed in the April Bank Lending Survey for 2020 Q2). This, combined with a possibly more restrictive supply of credit, led to a slump in new loans across all segments of lending to individuals in April, especially in consumer credit (see Chart 6). These developments in lending passed through to the outstanding amount, and bank debt in the form of consumer credit went from expanding in February to contracting by 1% year-on-year in April. Indeed, the decline in consumer credit would have been greater in the absence of the moratoria on bank debts (in particular, non-mortgage loans) for individuals.[13]

The household saving ratio appears to have risen sharply in 2020 Q2. The fall-off in consumption, which was highly influenced by the lockdown measures, is expected to be considerably steeper than the decline in income, which appears to have been cushioned by the fiscal support measures. In any event, part of the sector's ability to repay debt is expected to have suffered from a decrease in income.

The different gross fixed capital formation components are expected to have declined sharply in Q2. Residential investment saw a steep fall in Q1, which likely became more intense in April. However, the easing of lockdown appears to be driving an increase in construction activity and in transactions. The decline in business investment in Q1 was relatively mild, which could be explained by the irreversibility of decisions of this type in the very near term. Nevertheless, the magnitude of the decrease in Q2 could be high, judging by the information available. The various qualitative indicators (PMI for manufacturing activity, industrial confidence index, investment goods production expectations in the monthly business survey) fell to their lowest levels in the related time series in April and showed only a small recovery in May. The quantitative indicators, which had already declined sharply in March, showed unprecedented falls in April (see Chart 13). During that month, industrial production of capital goods (excluding vehicles), sales of this type of goods by large firms, and commercial vehicle registrations fell 50%, 38% and 88%, respectively, year-on-year. In the last of these indicators, the year-on-year drop eased to 54% in May.

As regards lending for investment decisions, there was a marked fall in flows of new loans for house purchase in April. The decline, which was slightly lesser than that of consumer loans, passed through to the balance of household debt for house purchase, which has decreased at a somewhat brisker rate in recent months compared with before the outbreak of the health crisis (see Chart 12). In any event, the decrease has been moderated by the legislative moratorium on mortgage debts for economically vulnerable individuals that has been included in the measures to respond to the pandemic.[14] Further, a framework agreement between banks and borrowers has been reached to establish a banking sector moratorium[15] that extends

13 See Royal Decree-Law 11/2020 of 31 March 2020 and Royal Decree-Law 19/2020 of 26 May 2020. At 31 May (latest data available), the moratoria established by the former of these royal decree-laws had led to the deferral of 1.3% of the balance of non-mortgage loans. For its part, the banking sector moratorium provided for by the second of these royal decree-laws has also led to the deferral of 1.8% of individuals' loan repayments (mortgage and non-mortgage alike).

14 See Royal Decree-Law 8/2020 of 17 March 2020 on urgent extraordinary measures to address the economic and social impact of COVID-19.

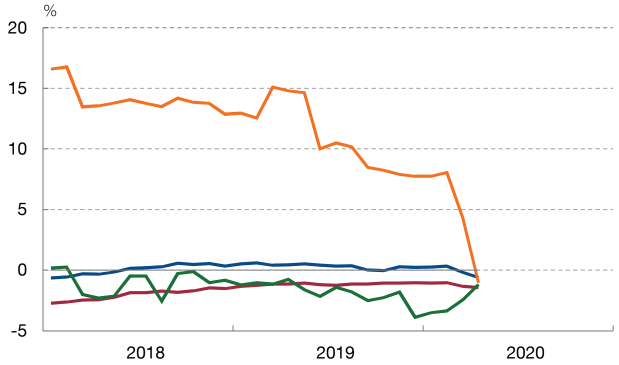
15 See Royal Decree-Law 19/2020 of 26 May 2020 adopting supplementary measures on agricultural, scientific, economic, employment and social security and taxation matters to alleviate the effects of COVID-19.

Chart 12

THE BALANCE OF HOUSEHOLD DEBT CONTRACTED WHILE LENDING TO NON-FINANCIAL CORPORATIONS GREW SHARPLY

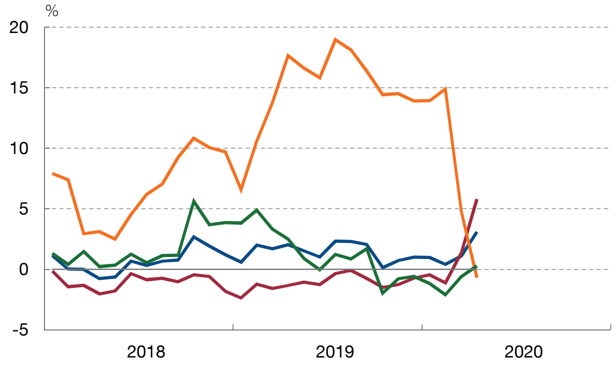
The hibernation of the economy led to a decline in lending to households, which would have been sharper in the absence of the moratoria on the repayment of individuals' bank debts. By contrast, bank lending to non-financial corporations grew robustly due to the high liquidity needs of businesses, which has been supported by favourable lending conditions. Lending to businesses through debt securities has slumped although companies continued to issue them through their subsidiaries abroad.

1 LENDING TO HOUSEHOLDS
Year-on-year change



TOTAL LENDING
LENDING FOR HOUSE PURCHASE
CONSUMER CREDIT (a)
LENDING TO SOLE PROPRIETORS

2 LENDING TO NON-FINANCIAL CORPORATIONS
Year-on-year change



TOTAL LENDING
LENDING OF RESIDENT CREDIT INSTITUTIONS AND SLIs
DEBT SECURITIES (b)
LENDING FROM ABROAD

SOURCE: Banco de España.

a Securitised lending is not included.
b Includes issues by resident subsidiaries of non-financial corporations.

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the range of beneficiaries and allows deferrals to be extended when the legislative moratorium comes to an end. Together, the two moratoria (legislative and banking sector) entail the suspension of 5% of individuals' bank debt. In the absence of these moratoria, loan repayments would have been higher and, therefore, the outstanding amount would have contracted more.

For its part, new lending to business has soared in response to high demand to cover the increase in liquidity needs. New loans for business have grown at a very fast pace in recent months, especially in the self-employed and larger firm segments (see Chart 6). The supply of credit to business was boosted by the public guarantee scheme made available through the ICO to the self-employed and firms,[16] enabling these agents to obtain financing at a lower cost and with a longer maturity.[17] The performance of new loans led to robust growth in the balance of lending to business by resident banks in April (5.8% year-on-year) and an easing of the decline in the

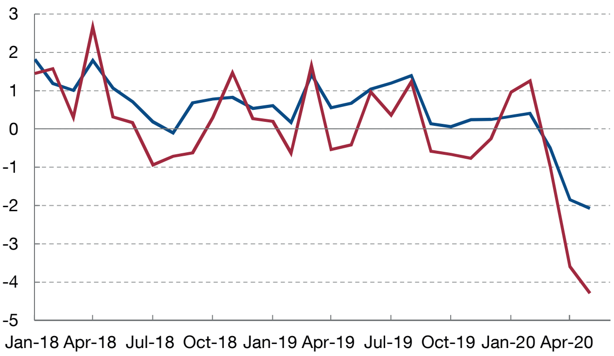
16 See Royal Decree-Law 8/2020 of 17 March 2020 on urgent extraordinary measures to address the economic and social impact of COVID-19.

17 These State guarantees cover up to 80% of loans to the self-employed and SMEs and up to 70% of loans to all other firms, for a maximum of €100 billion. In early June, 80% of the maximum amount of guarantees had already been made available; this represents lending to more than half a million self-employed persons and firms, for an average value of around €125,000 per transaction (close to €90,000 in the case of the self-employed and SMEs).

Chart 13
BUSINESS INVESTMENT WILL PROBABLY BE THE DEMAND COMPONENT WITH THE LARGEST DROP IN Q2

Investment in capital goods and intangibles is expected to suffer an unprecedented slump in 2020 Q2, as suggested by the historic falls observed in the short-term activity and confidence indicators related to this demand component.

1 MONTHLY BUSINESS SURVEY. CAPITAL GOODS
Standarised data (a)



2 INDICATORS RELATED TO BUSINESS INVESTMENT
Year-on-year rates

SOURCES: Ministerio de Industria, Comercio y Turismo, INE, DGT, Agencia Tributaria and Banco de España.

a Series computed by subtracting the average and dividing by the standard deviation.
b Excluding vehicles.

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balance of lending to the self-employed. Lending through debt securities issued on the primary market fell sharply in March and April, against the backdrop of financial market turmoil which led to an increase in credit risk premia.

The provisional data for Q1 evidence a slight worsening in the financial position of the corporate sector. Thus, the ratio of corporate debt to GDP rose to around 75%, reversing the downward trend of the last decade. Nevertheless, the drop in borrowing costs is expected to have enabled the debt burden ratio to remain flat. At the aggregate level, firms' deposits increased substantially in April. It therefore seems likely that a part of the funds raised has been earmarked for setting up liquidity buffers for the coming months ahead of the foreseeable rise in their financing needs.

Exports and imports of goods and services have posted steep falls, especially in the case of tourism flows, which came to a halt as a result of the restrictions on movement and the border closures ordered to tackle the COVID-19 health emergency.

Flows of external trade in goods and services are expected to contract very severely in Q2. There is a high level of uncertainty as to the final effect on the net external balance. However, it seems likely that the outcome will be a worsening in its contribution to GDP growth, since the drop is estimated to have been more pronounced in exports than in imports, owing to the virtual disappearance of non-resident tourism, which has been hit hard by the pandemic. In Q1, trade in goods was already very damaged by the lockdown measures in Spain and its trading partners, leading to exports and imports falling -8.4% quarter-on-quarter. These effects appear to have been significantly exacerbated in Q2, as shown by the year-on-year declines of -37.8% and -30.8% in exports and imports, respectively, in April (Customs data). Foreign trade is expected to have seen a gradual, albeit partial, recovery in May as the lockdown measures in different countries were gradually lifted, as foreshadowed by the qualitative indicators of export orders (see Chart 14).

As regards foreign trade in services, international transport and tourism have been among the sectors hardest hit by the measures adopted to contain the pandemic. The restrictions on movement, social distancing measures and the closures of airports and borders have severely affected international trade in services. According to the World Tourism Organization, tourism flows at the global level were estimated to have fallen 55% and 97% in March and April, respectively, due to travel restrictions. These measures have remained in place during Q2 (the borders of three-quarters of countries remained closed to international tourism in mid-May). Spain, the second country in the world in terms of the number of tourist arrivals and the volume of expenditure by non-resident tourists, saw a decline of 19.2% year-on-year in tourism exports in Q1. Inflows of foreign tourists fell 64.3% in March and 100% in April owing to the closures of borders and accommodation. Spain remained virtually shut to international tourism in May, although from the middle of the month the country began to allow the entry of travellers for reasons of force majeure, subject to a 14-day quarantine. The country's reopening has gathered pace in June. German tourists began to arrive in the Balearic Islands from 15 June, and borders with Schengen area countries were opened on 21 June, except for the border with Portugal, which will reopen on 1 July. Borders with other countries will reopen in phases.

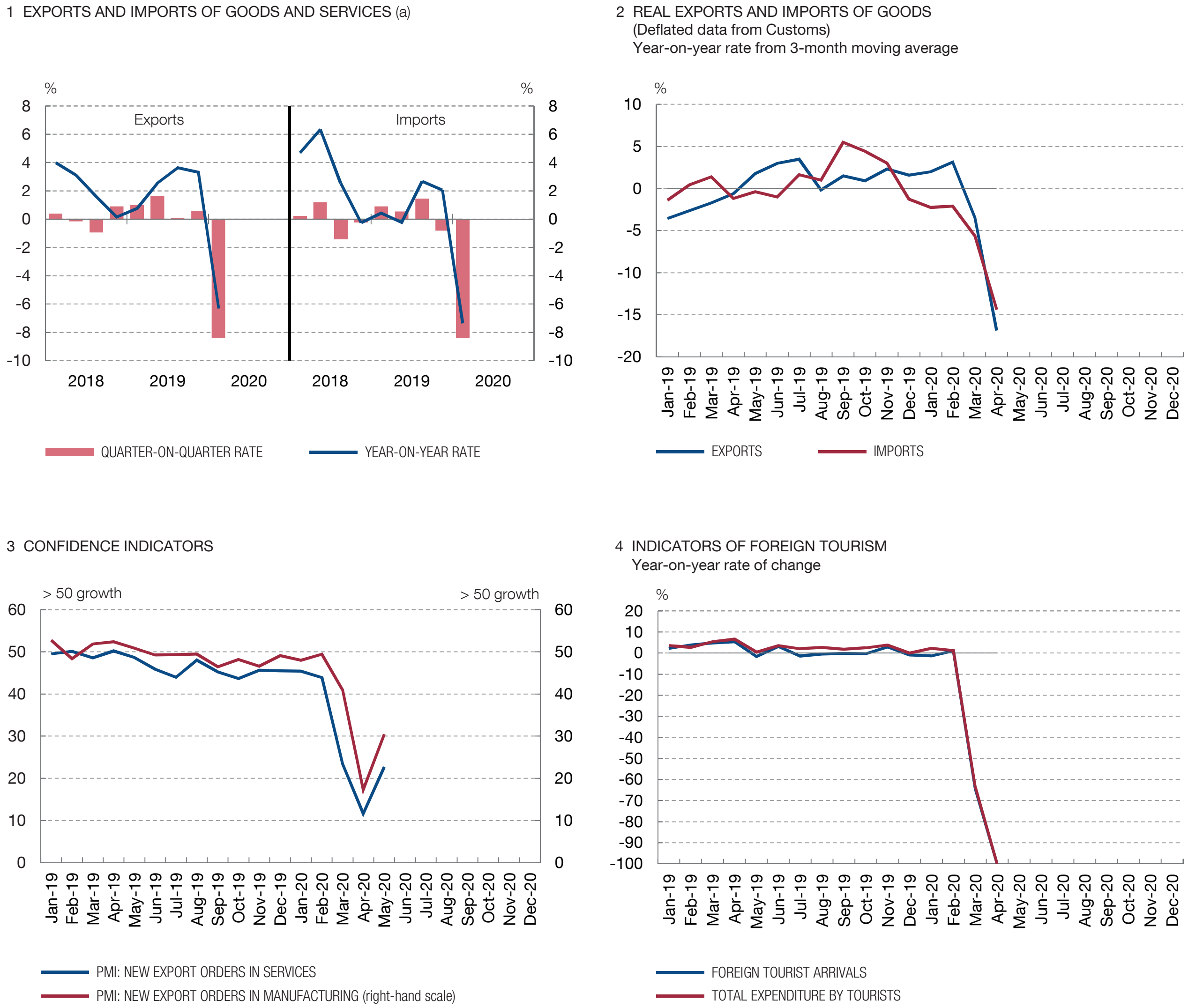
Recent developments in public finances have already begun to show, albeit moderately as yet, the effects of the pandemic and the measures adopted in the context of this crisis

The Council of the European Union activated the general escape clause of the Stability and Growth Programme (SGP) which allows Member States to implement expansionary fiscal policies on a scale which is commensurate to the effects of the health crisis. The activation of the clause, which is applicable under conditions of severe economic slowdown in the countries, as a whole, was approved on 23 March. This allows Member States to temporarily depart from usual budget requirements with the aim of addressing the economic consequences of the pandemic and attempting in this way to avoid a protracted negative impact on

Chart 14

EXTERNAL TRADE FLOWS FELL SHARPLY IN THE SECOND QUARTER

The measures adopted in Spain and globally to contain the COVID-19 pandemic hit foreign trade hard, especially international tourism flows which virtually came to a halt as from the declaration of the state of alert. New export orders suggest that the trade flows bottomed out in April and that a slight recovery began in May, in line with the lifting of the lockdown measures.



SOURCES: INE, Departamento de Aduanas, Ministerio de Asuntos Económicos y Transformación Digital, and Markit.

a QNA data at constant prices. Seasonally adjusted series.

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activity, which among other possible consequences, may hinder the sustainability of public finances in the medium term. In this context, at the end of April the Spanish Government presented the Stability Programme Update for this year that, on this occasion and given the exceptional circumstances under which it was drawn up, only includes a general government deficit target for 2020 of 10.3% of GDP, 7.5 pp higher than in 2019. The assessment by the European Commission of this update ruled that the anti-crisis measures adopted in Spain are in line with the Commission's recommendations on a coordinated response to the coronavirus. At the same time, this assessment recalled the breach of the SGP requirements in 2019 and the need for a refocusing of Spain's public finances, once the crisis is over, towards achieving a healthier fiscal position.

The budget measures adopted in recent months have adapted to the crisis as it has unfolded. The initial measures adopted by the Government in mid-March took action on four fronts: support for the health system, employment protection, the provision of liquidity to viable businesses and support for vulnerable households as a result of the crisis. The measures have been revised as the epidemiological and economic situation has evolved and their scope and duration have been extended. Furthermore, in early June, the Government approved the minimum living income, which will come into force on 1 July at a budgetary cost of 0.17% of GDP in 2020. The Government has also announced the creation of a special non-repayable fund, through which the State will pay regional governments €16 billion, €9 billion of which will be earmarked for healthcare expenditure.

The impact of the crisis and of the measures approved is already visible in the latest budget outturn figures published, although as yet on an evidently smaller scale than that expected in the annual figures. The general government deficit, excluding local government, stood in 2020 Q1 at 0.8% of GDP, 0.5 pp up on the same period a year earlier. This deterioration which picks up the effect of the early weeks of lockdown in the second half of March, took the form of increasing expenditure, which rose 6% year-on-year, and of slowing revenue, whose growth declined from 3.7% in 2019, as a whole, to 1.5% in 2020 Q1 (see Chart 15). The worsening of public finances will be notably accentuated in 2020 Q2, with the result that, on the Banco de España's recent projections, the government deficit, which stood at 2.8% of GDP in 2019, in 2020 could reach 9.5% and 11.2%, respectively, in the early and gradual recovery scenarios.[18]

The performance of consumer prices has been highly influenced by plummeting oil prices and the uneven behaviour of non-energy components relating to changes in consumption patterns during lockdown.

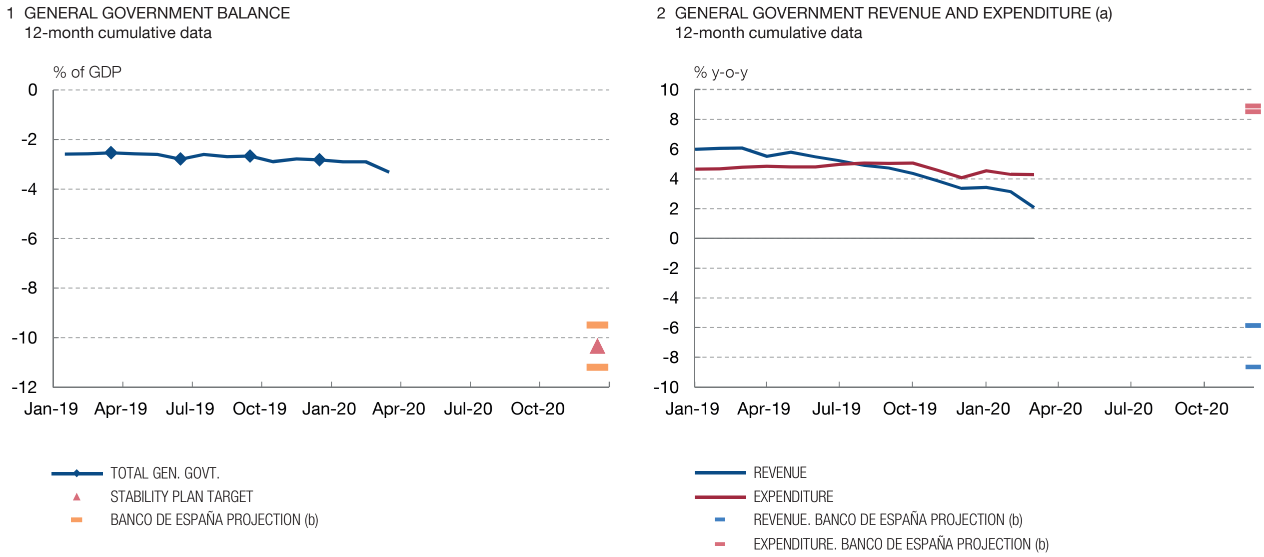
Inflation, measured by the Harmonised Index of Consumer Prices (HICP), declined sharply in recent months to -0.9% in May (see Chart 16). These developments have been dominated by the decline in the price of oil and other commodities. The price of a barrel of oil dropped from approximately $60 in February to $20 at end-April (before rising subsequently). In this setting, the energy component of consumer prices has slowed strongly in these months to -18% year-on-year in May. Among the non-energy components, year-on-year growth in food prices rose

18 See *Macroeconomic projections for the Spanish economy (2020-2022): the Banco de España's contribution to the Eurosystem's June 2020 joint forecasting exercise.*

Chart 15

SHARP DETERIORATION PROJECTED IN PUBLIC FINANCES

The impact of the health crisis, of the measures adopted to contain it and of the fiscal policy measures implemented to counter its effects are visible in the March budget outturn data. The balance will deteriorate much more sharply over the year as a whole.



SOURCE: IGAE.

a The IGAE only provides quarterly information on general government as a whole. The monthly data are estimated on the basis of the aggregate information excluding local government.

b Scenarios of the June 2020 *Macroeconomic projections for the Spanish economy* (2020-2022).

significantly between February and May, especially in the case of unprocessed food, influenced by increased demand and higher production and distribution costs.

By contrast, the growth rate of core inflation eased recently. The growth rate of core inflation eased between February and May by 0.4 pp to 0.9%, its lowest rate of the last two years. The prices of services and non-energy industrial goods slowed in recent months. The core inflation differential with euro area countries was zero in May.

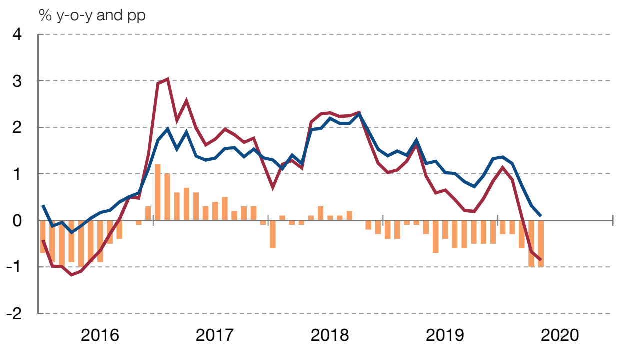
The lockdown measures prompted changes in consumption patterns which affected prices slightly. The National Statistics Institute (INE by its Spanish abbreviation) compiled two special aggregates called "COVID-19 goods" and "COVID-19 services" which include goods and services that continued to be consumed during the confinement period and which posted month-on-month changes of 1.1% and -1.5%, respectively, in April.[19] In May, however, the month-on-month rate of both aggregates was zero. In the next few months, the downward

19 The "COVID-19 goods" aggregate includes food, beverages, tobacco, cleaning and non-durable household goods, pharmaceutical products, pet food and personal care products. The "COVID-19 services" aggregate includes housing and garage rentals, water supply, sewerage, refuse collection, maintenance charges in multi-occupied buildings, electricity, gas, diesel for heating, telephone services, music and television streaming, insurance, charges by banks and funeral services.

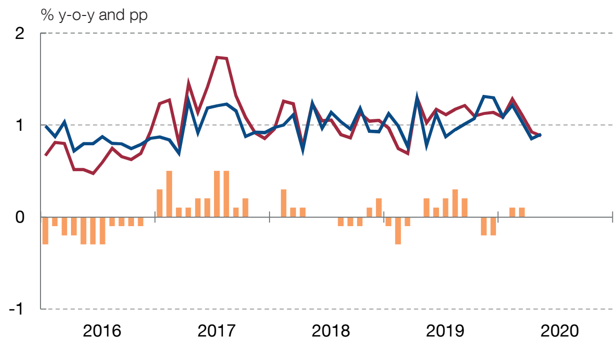
Chart 16
DECLINE IN INFLATION AND MODERATION OF WAGE COSTS

Inflation declined more sharply in Spain than in the euro area, against a backdrop of plummeting oil prices, while the rise in food prices between February and May and the easing of core inflation were similar in both areas. In Spain wages moderated slightly, although wage increases do not show the change in the labour market situation since there are still very few newly signed agreements.

1 OVERALL INDEX

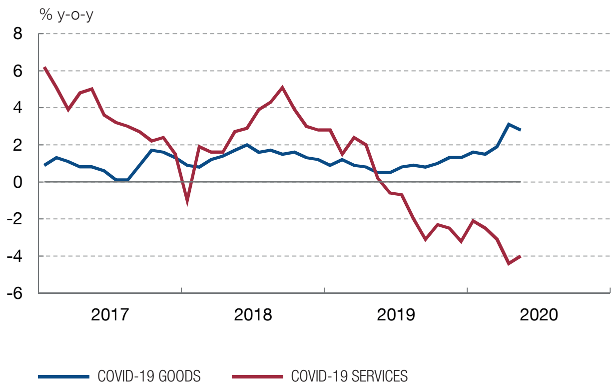


2 OVERALL INDEX EXCLUDING ENERGY AND FOOD



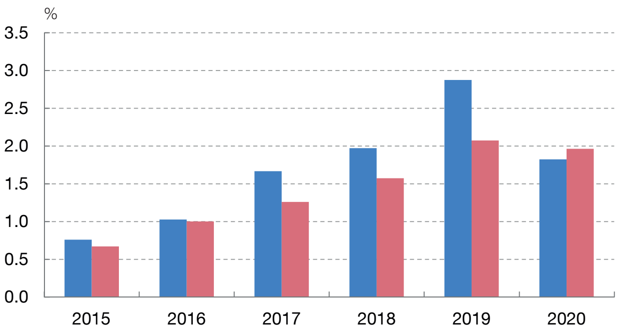
DIFFERENTIAL SPAIN EURO AREA

3 SPECIAL COVID-19 GROUPS (a)

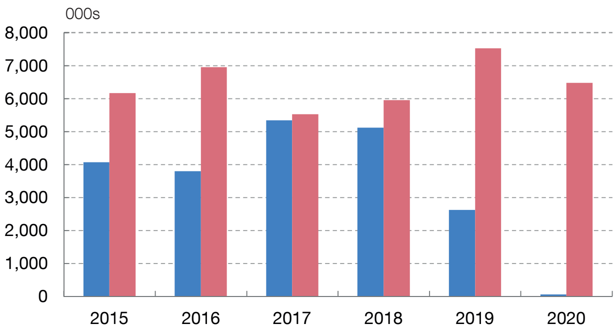


4 SPOT AND FUTURES MARKET OIL PRICES

5 AGREED WAGE INCREASES (b)



6 WORKERS AFFECTED (b)



NEWLY SIGNED AGREEMENTS REVISED AGREEMENTS

SOURCES: INE, Eurostat, Reuters, Ministerio de Trabajo, Migraciones y Seguridad Social, and Banco de España.

a Special groups of goods and services calculated by the INE which most households continued to consume during lockdown.
b Based on information to May 2020.

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pressures stemming from weak demand are expected to prevail over the higher costs associated with supply difficulties during the confinement.

The labour costs of businesses edged downwards in Q1 as a result of the temporary layoffs or short-time working arrangements. Information provided by the quarterly labour costs survey for this period shows that the year-on-year rate of growth of labour costs moderated to 0.8% (1.5 pp lower than at end-2019). The explanation behind this slowdown is that, although workers affected by temporary layoffs or short-time working arrangements are still registered for social security purposes with their company, the latter does not have to pay all (or most) of their salaries, which are replaced by unemployment benefit, nor their social security contributions (in the case of businesses with fewer than 50 employees and only 25% in the case of businesses with 50 employees or more). Consequently, the lower growth affected both the wage cost component (with a year-on-year increase of 0.7%, 1.1 pp down on end-2019) and the non-wage cost component owing to the smaller rise in the social security contributions component (1.3% compared with 4% in 2019 Q4). Hourly labour costs, by contrast, climbed to 4.8% as a result of the reduction of 3.8% in hours actually worked which, once again, is explained by workers affected by temporary layoffs or short-time working arrangements. The large scale of this decline is worth noting even though the confinement measures only affected the second fortnight in March. By branch of activity, total labour costs moderated somewhat more steeply in services (by 1.7 pp to 0.9%), falling by -7.2% in the hospitality sector and by -0.5% in the wholesale and retail trade.

Other wage indicators have remained highly stable since the onset of the crisis. Wage rates under collective bargaining agreements, on data to May, rose by an average of 2%, slightly lower than the 2.3% agreed for the previous year, affecting what is now a very large number of workers (6.5 million). This increase reflects the agreements entered into in previous years, since there are very few newly signed agreements and they do not show the impact of the change in the labour market situation. On Quarterly National Accounts data, compensation per employee increased by 1.5% in the market economy in Q1, unchanged from end-2019.

22.6.2020.