QUARTERLY REPORT ON THE SPANISH ECONOMY

1 OVERVIEW

Pandemic-related developments have continued to influence the global economy significantly throughout the autumn. In many geographical areas, the lifting of most of the containment measures in Q2 led to a rebound in activity in the summer months whose intensity was, in many cases, somewhat greater than forecast. Conversely, in the final stretch of the year, fresh outbreaks of the virus have led to the reintroduction of restrictions on people's mobility and on the normal pursuit of certain economic activities. Consequently, there has been an adverse impact on the GDP of the main regions.

Moreover, the outlook for the global economy in the near future continues to hinge on how the pandemic unfolds and on the news concerning the development of various vaccines to combat COVID-19. In the short run, activity will remain contingent on certain continuing restrictions in the sectors in which social contact plays a more relevant role, and on people's voluntary observance of social distancing, being able to contain fresh outbreaks.

The adaptation of agents' conduct to the circumstances created by the pandemic is expected to be limiting the effects of the pandemic-containment measures on activity. This adaptation process is becoming visible, for example, through the growing resort to working from home or online trade. The tailoring of households' and firms' behaviour to the reality of the pandemic has meant that, given a specific degree of restrictions on mobility and social contact, the impact on activity has been appreciably lower than during the first wave of the pandemic. However, the difficulty of measuring these effects further complicates estimating the coincident course of economic activity and its short-term path.

There were several positive news items in November on the development of different vaccines to combat COVID-19. The news helped allay the previously existing uncertainty over how long it would take for the vaccines to be available. The baseline scenarios on which many institutions (including the Banco de España) have so far based their economic projections envisage that, towards mid-2021, an effective vaccine would become available. Accordingly, it is expected that recent developments will even shorten these timeframes. Yet, at the same time, uncertainty remains high over the time needed to immunise the whole population, given the difficulties that the production and distribution of the number of doses needed entail.

The news on the progress made with the vaccines markedly affected financial market developments. The news on the vaccines led to an increase in investors'

Table 1
MAIN SPANISH MACROECONOMIC AGGREGATES (a)

		2019		2020					
	2019	Q3	Q4	Q1	Q2	Q3	Q4		
National Accounts							Mild	Baseline	Severe
Quarter-on-quarter rate of change, unless otherwise indicated									
Gross domestic product (GDP)	2.0	0.4	0.4	-5.2	-17.8	16.7	0.6	-0.8	-3.0
Contribution of national demand (b)	1.4	0.7	0.0	-4.5	-15.6	14.5	1.4	-0.1	-2.0
Contribution of net external demand (b)	0.6	-0.4	0.4	-0.7	-2.2	2.2	-0.8	-0.7	-1.0
Year-on-year rate of change									
Employment: hours worked	1.5	0.7	1.4	-4.2	-24.9	-6.2	-6.4	-7.2	-10.4
Price indicators									
Harmonised index of consumer prices (HICP)	0.8	0.4	0.5	0.7	-0.6	-0.6	-0.8	-0.8	-0.8
Harmonised index of consumer prices excluding energy and food	1.1	1.2	1.1	1.2	0.9	0.1	-0.1	-0.1	-0.1

SOURCES: INE and Banco de España.

a Information available to 25 November 2020. The shaded figures are Banco de España projections under mild, baseline and severe scenarios.
b Contribution to the quarter-on-quarter rate of change of GDP, in percentage points.

appetite for risk. And almost concurrently, the outcome of the US presidential elections was also a contributing factor. Developments included most notably: marked increases in stock market values, especially in Europe and certain emerging markets; a narrowing of sovereign and corporate debt spreads; a recovery in commodities prices; and, on the foreign exchange markets, the appreciation of certain emerging market currencies and the depreciation of the yen, which usually acts as a safe-haven currency.

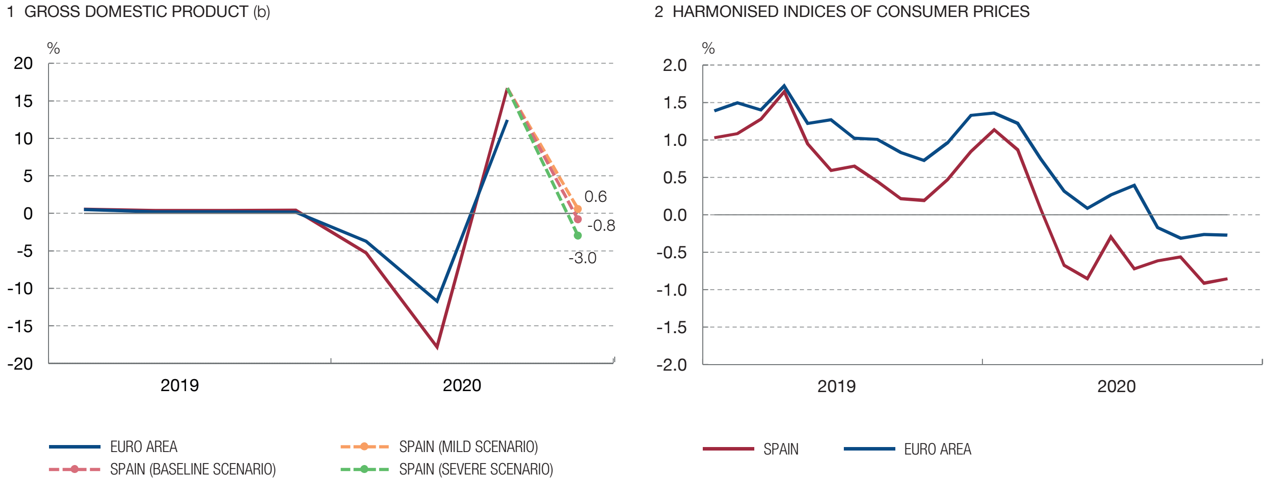
To date, the impact of the health crisis on activity has been very uneven across the geographical areas. Spain has been among the economies most affected since the onset of the pandemic. Thus, while Spain's GDP in Q3 was 9.1% down on its pre-crisis level, that gap was 4.5 pp in the euro area as a whole. Outside Europe, US GDP was 3.5% down on its end-2019 level, while that of China was somewhat more than 3 pp up. The evidence available suggests that, in Q4, the euro area economy will once again have performed worse than its US or Chinese counterparts.

How long it takes to immunise the population will be a crucial determinant of the scale of the pandemic's potential effects beyond the short term. Resolutely implemented economic policies, providing income and liquidity to private agents, have contributed crucially to limiting the harm to the productive system. But they will not manage to prevent all such harm. Moreover, the pandemic is accelerating some structural transformation processes that were already in train previously, such as digitalisation. These will call for a reallocation of resources in economies, the scale of which is still uncertain.

Chart 1

THE RECOVERY LOST MOMENTUM AT THE END OF THE YEAR (a)

Following the sharp pick-up in Q3, the growth rate of activity moderated considerably in the final stretch of the year as a consequence of fresh outbreaks of the pandemic and the measures taken to combat them, and a fall in GDP in Q4 cannot be ruled out. Also, the health crisis is having a significant impact on consumer prices, which have slowed notably since the summer.



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 in the case of the consumer price indices.
b The Q4 data are Banco de España projections.

DOWNLOAD

In the euro area, the resurgence of the pandemic and the lockdown measures adopted in response are expected to have led to a decline in GDP in Q4 relative to Q3. Activity is estimated to have continued to be uneven across the different sectors: the sustaining of manufacturing activity contrasts with the weakness of services, where the restrictions on mobility and personal interaction have a greater effect. From the standpoint of the demand components, a continuing high degree of uncertainty and the worsening outlook for household and corporate income are affecting private expenditure.

The latest Eurosystem projections continue to point to a prolonged impact of the pandemic on euro area activity and prices. According to the baseline scenario of these projections, euro area GDP is not expected to resume its pre-crisis level until mid-2022. Moreover, the persistent nature of the shock will mean that inflation will not draw closer to its price stability objective at the end of the projection horizon, in 2023, when HICP growth is expected to average 1.3%.

Given this outlook, the ECB Governing Council approved a new package of monetary policy measures at its meeting on 9-10 December. Notably, it extended the pandemic emergency purchase programme (PEPP) of public and private assets, both in terms of its net maximum volume (an increase of €500 billion) and its duration (extended to March 2022). Since its introduction on 18 March, the PEPP has proven greatly effective in, first, bringing about a very high degree of monetary accommodation; and, further, in maintaining a level of homogeneity in financial conditions for all agents (households, firms and general government) in the different euro area countries. To achieve this second objective, the crucial characteristic of the programme is its flexibility in the making of asset purchases in terms of their distribution over time and by type of issuer (whether private or public). Under this latter aspect, the programme also has regard to the possibility that the distribution by country may temporarily deviate from each Member State's ECB capital key. Furthermore, the Governing Council decided to programme new targeted long-term refinancing operations (TLTROs), offering more favourable conditions. These operations are proving very useful in preventing the crisis from impairing the supply of bank loans to the real economy.

In Spain, economic activity rebounded sharply in Q3. The 16.7% increase in GDP over the previous quarter, however, did not prevent the resulting level still being (as earlier stated) 9.1% down on the related figure for 2019 Q4, before the pandemic broke. By sector of activity, the gap compared with the pre-crisis level has largely narrowed in manufacturing industry and energy, whereas it remains, on the contrary, very wide in services and, hereunder, in the distributive trade, transport and hospitality in particular (where it was still almost 23% in Q3).

The tightening of the pandemic lockdown measures in Q4 has adversely affected economic activity. At the end of the summer the recovery could be seen to have lost momentum as a result of the rise in numbers infected and of the restrictions adopted to mitigate them. The information for Q4 points to a further slowdown in output in the economy. This will, in any event, be moderate, in step with the targeted nature of the containment measures applied, whose impact is more severe on the services sectors, where personal contact is much more prevalent. A reflection of this has been the more unfavourable trend of the PMI services index compared with the related manufacturing index. The moderation in activity is also patent in some high-frequency indicators and, to a lesser degree, in actual Social Security registrations. The results of the Banco España's survey of a sample of non-financial corporations are along the same lines; almost half the corporations state that they are observing a reduction in their turnover in the current quarter.[1]

Under a baseline scenario which, however, is subject to high uncertainty, GDP could post a quarter-on-quarter decline of 0.8% in Q4 as a whole.[2] This rate would correspond to a year-on-year decline of 9.8%. The uncertainty partly reflects

1 See Box 3 ("Spanish business survey on activity and the impact of COVID-19"), in Macroeconomic projections for the Spanish economy (2020-2023): the Banco de España's contribution to the Eurosystem's December 2020 joint forecasting exercise.

2 See Macroeconomic projections for the Spanish economy (2020-2023): the Banco de España's contribution to the Eurosystem's December 2020 joint forecasting exercise.

the incompleteness of the information available, and partly the difficulties of calibrating the probably diminishing impact of the lockdown measures on activity, as a result of their more selective nature and of agents' adaptation of their behaviour. The taking into consideration of these factors has led to the setting of a range for the quarter-on-quarter rate of change of GDP in Q4 of between -3% and 0.6%. In any event, the performance of the Spanish economy in the recent period has been less favourable than that of other core euro area economies. The rebound in numbers infected that Spain had seen since August did not come about until October in these economies. And as a result the adoption of the related lockdown measures was also delayed.

In a setting in which the pandemic and the lockdown measures would pose an increasingly lesser obstacle to activity, it is estimated that GDP growth will rise in 2021, underpinned by European funds under the *Next Generation EU (NGEU)* programme. A crucial factor behind this outlook for the recovery of activity are expectations that the health situation will improve. Under the baseline scenario, the immunisation of the population over the course of the year is assumed, which allows a gradual lifting of the containment measures. That would entail a reduction in uncertainty and, therefore, more expansionary private spending. In addition, the recovery will also be based on the support of monetary and fiscal policy and, in particular, on the undertaking of spending projects under the NGEU initiative, which would contribute 1.3 pp to the 2021 GDP growth rate. Under the baseline scenario, this rate would be 6.8%.

The high uncertainty over the course of the virus continues to advise, as has been the case since the pandemic broke, formulating alternative scenarios. Against the background of the Eurosystem joint forecasting exercise, two additional scenarios (one mild, one severe) have been formulated together with the baseline. The two scenarios in question differ from the baseline in terms of the assumptions made about the scale of the fresh outbreaks of the disease; the intensity and duration of the lockdown measures introduced; precisely how long immunisation of the population will take; the size of the changes in the behaviour of households and firms in response to the pandemic; and the persistence of the harm to the productive system once the health crisis has been overcome. The GDP growth paths under the severe and mild scenarios stem, respectively, from the lower and upper extremes of the aforementioned range of quarter-on-quarter rates considered for 2020 Q4. Under the mild scenario, the rebound in activity in 2021 would be 8.6%, falling to 4.3% under the severe scenario.

The risks to GDP growth under the baseline scenario are tilted moderately to the downside. In particular, epidemiological developments might be more adverse, which would entail harsher containment measures. Moreover, a greater persistence of the current crisis might prompt a worsening in the financial position of those agents in a position of greater financial vulnerability, thereby amplifying the adverse economic effects of the pandemic.

Uncertainty over the specific materialisation of the use of the NGEU funds remains high. The three scenarios of the latest Banco de España projections contain specific assumptions, common to each of them, as to the size of the funds mobilised, their timing and their composition.[3] Specifically, the projections have opted to include, in 2021, 100% of the current expenditure and 70% of the investment expenditure associated with the NGEU according to the draft State Budget, involving around €21 billion. However, the uncertainty surrounding these assumptions and, therefore, the macroeconomic impact of the expenditure is, at present, high.

Consumer price developments have reflected the effects of the pandemic. On one hand, the strong decline in global demand led in March to a very significant fall in oil prices and, therefore, of the HICP energy component. On the other, core inflation has slowed strongly since July. This has been because of the prevalent disinflationary effects of the reduction in demand, especially in the case of services, on the cost pressures arising from supply-side difficulties. Inflation will rise after 2021 Q1, once the base effects on the year-on-year rate of decline in oil prices at the start of the pandemic dissipate. Conversely, the rise in core inflation from its low current levels will be much more gradual. Under the baseline scenario of the latest Banco de España projections, overall inflation is expected to average 1.3% in 2023. The high persistence over time of such modest price growth rates evokes the risk of a feedback loop in these dynamics, insofar as agents incorporate them into their expectations formation processes.

3 For a description of these assumptions, see Box 2 ("The impact of the NGEU initiative on the scenarios for the Spanish economy") in Macroeconomic projections for the Spanish economy (2020-2023): the Banco de España's contribution to the Eurosystem's December 2020 joint forecasting exercise. The box also contains simulations of alternative assumptions about the use of the funds.

Box 1

CAPITAL FLOWS TO THE EMERGING ECONOMIES DURING THE PANDEMIC

Luis Molina

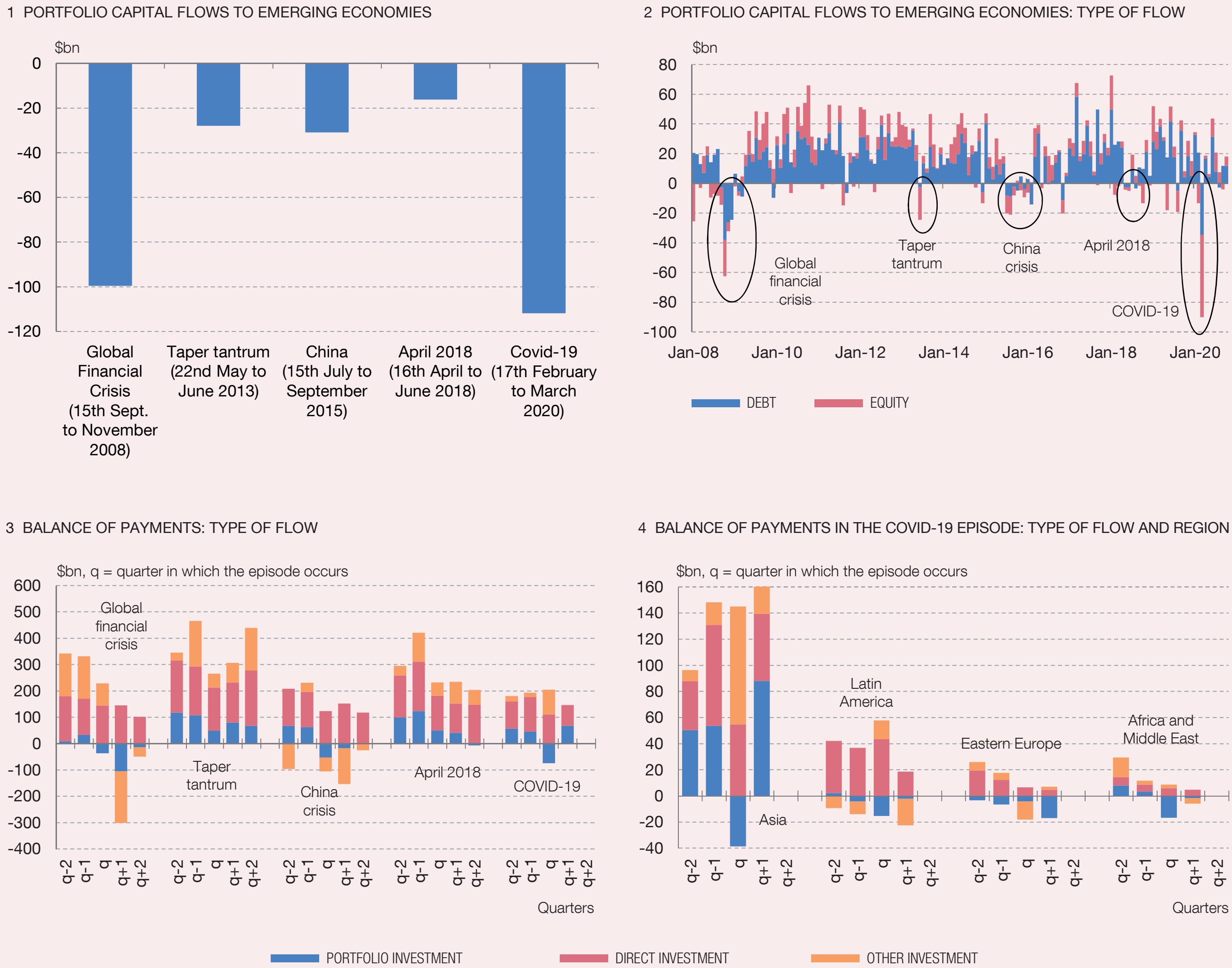
This early-release box was published on 26 November

This box analyses the behaviour of net capital flows to the emerging economies since the COVID-19 pandemic broke. A comparison is made with other episodes of capital flows that have occurred in recent years.

As Chart 1.1 shows, the spread of the health crisis beyond Chinese borders in mid-February prompted very significant portfolio capital outflows from the emerging economies. By end-March, and using information from the Institute for International Finance (IIF), these outflows had exceeded $100 billion in cumulative terms. The scale of these outflows was similar to that recorded between mid-September and November 2008, after the global financial crisis broke. But it was far greater than that of other more recent episodes, such as the hike in US long-term interest rates (known as the “taper tantrum”) in 2013, the turbulence on the Chinese stock market in 2015 and the financial tensions that particularly affected the emerging economies in 2018 Q2.

In March, the month with the biggest portfolio capital outflows, the volume was very sizeable both in outflows from the stock market (around $55 billion) and in debt outflows (around $35 billion) (see Chart 1.2). Moreover,

Chart 1
CAPITAL FLOWS TO EMERGING ECONOMIES DURING EPISODES OF GLOBAL TURBULENCE



SOURCE: Thomson Reuters and national statistics.

these outflows were across the board in the emerging economies, unlike in previous episodes when they tended to be focused on certain specific areas, with their epicentre in Asia in 2008, 2013 (along with Brazil) and 2015, and in Latin America (Argentina in particular), Eastern Europe and Turkey in 2018.

The various economic policy measures adopted shortly after the outbreak of the pandemic, in the advanced and emerging economies alike,[1] contributed to easing global financial conditions and to stabilising capital flows. In any event, not until September was there a reversal, in the emerging economies as a whole, of the capital outflows recorded between February and March (see Chart 1.2), and, in some regions (in emerging Asia and Latin America in particular), this recovery has not yet concluded.

This analysis of capital flows to the emerging economies, conducted drawing on the information provided by the IIF, can be complemented using balance of payments (BoP) data. Admittedly, BoP figures are published with a lesser frequency and a greater delay than those of the IIF; but they enable not only changes in portfolio flows but also those in direct investment and other investment flows to be evaluated.[2] According to this source, in 2020 Q1 the above-mentioned high portfolio outflows – which were particularly acute in Asia – were accompanied by a reduction in foreign direct investment (FDI) inflows (with the exception of Latin America) (see Charts 1.3 and 1.4). These flows were partly replaced by higher inflows comprising other investment (particularly in Asia and Latin America), essentially bank loans, occasionally at short terms, which was not the case in the other capital outflows episodes considered. In 2020 Q2, the strong recovery in portfolio inflows in Asia more than offset the weakness of these capital movements in the other emerging regions, while the buoyancy of other investment inflows observed in the previous quarter diminished.

When assessing the various factors bearing on the behaviour of these capital flows, the literature has traditionally distinguished between "push" or global factors and "pull" or idiosyncratic factors.[3] Among the former, consideration is usually given to global risk aversion, monetary conditions in the main advanced economies (especially in the United States), the dollar exchange rate and commodities prices. Among the latter, the assessment is usually made on the macroeconomic, financial and institutional fundamentals and vulnerabilities of each emerging economy.[4]

In the current episode, the strong rise in risk aversion (see Chart 2.1), the gloomier economic outlook that led to a fall in commodities prices (see Chart 2.2) and the appreciation of the dollar owing to the search for safe-haven assets (see Chart 2.3) were, as occurred in 2008, the main drivers of the capital outflows observed in the emerging economies. Conversely, US monetary policy – which was the main driver of capital outflows during the aforementioned taper tantrum and in April 2018 (as a strong dollar appreciation ensued) – is not estimated to have contributed to the capital outflows from the emerging economies since the onset of the pandemic (see Chart 2.4).

As regards the influence of local factors, Charts 2.5 and 2.6 show that, in general, those countries with a bigger external imbalance and poorer macroeconomic fundamentals have most seen their capital flows worsen recently. These idiosyncratic factors will have played a relatively similar role to that witnessed in other previous episodes when it comes to mitigating or amplifying the financial turbulence generated by the aforementioned global factors. In any event, it will be vital in the coming quarters to monitor the ongoing increase in macrofinancial vulnerabilities in some of these economies as a result of the prolongation of the health crisis, as these vulnerabilities might prompt a further deterioration in capital flows.

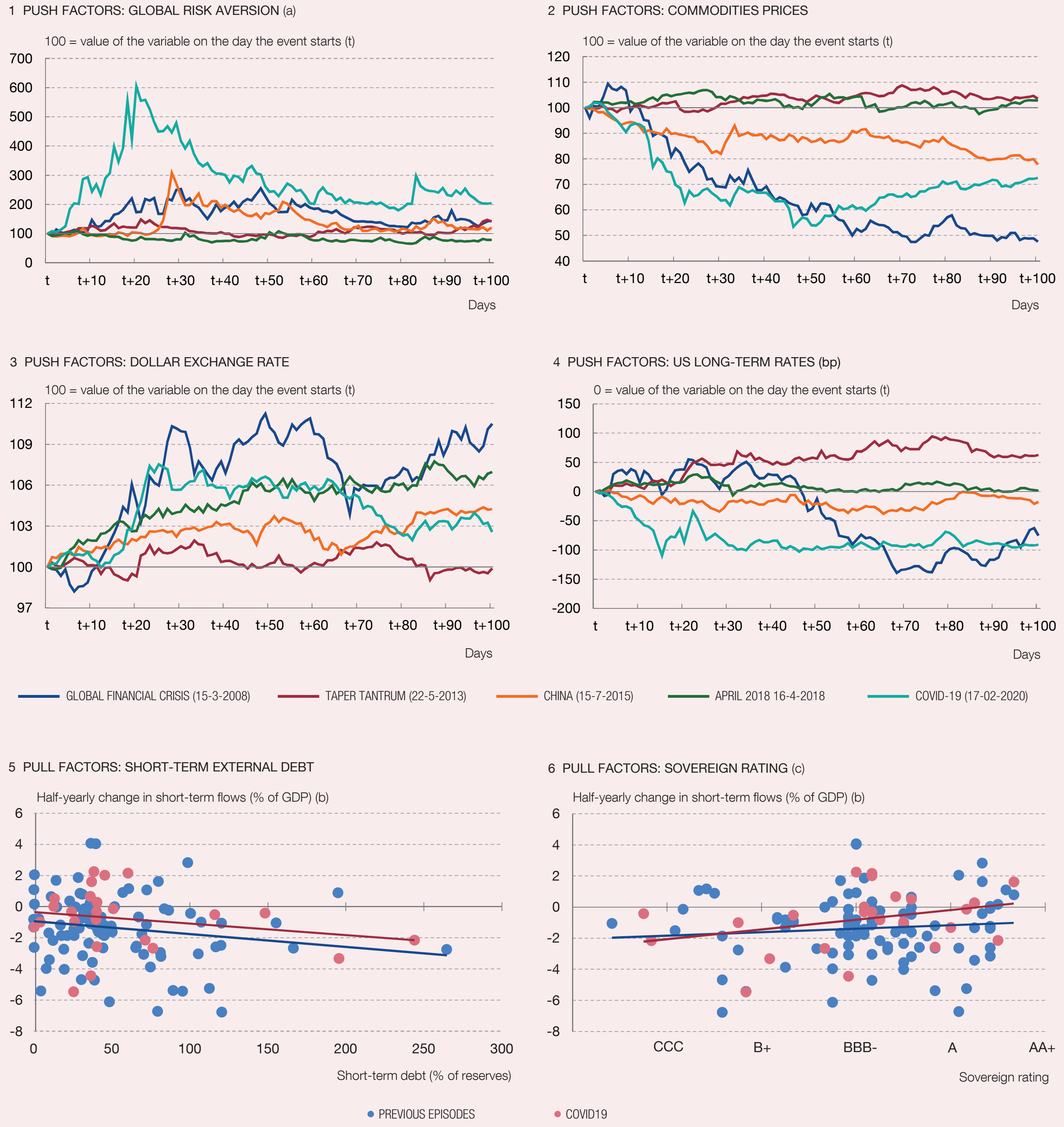
1 See Box 1 of the Report on the Latin American economy. Second half of 2020, Banco de España.

2 The portfolio flows reflected in the IIF and balance of payments statistics are not immediately comparable; among other reasons, because the information provided by the IIF covers fewer countries than that in the balance of payments statistics.

3 See Koepke, Robin (2015), *What Drives Capital Flows to Emerging Markets? A Survey of the Empirical Literature,* Institute of International Finance, University of Wurzburg, and Carney, Mark (2019), *Pull, Push, Pipes: Sustainable Capital Flows for a New World Order,* speech at the Institute of International Finance Spring Membership Meeting, Tokyo.

4 For an empirical estimation of the determinants of flows to emerging economies, see Molina and Viani (2019), *Capital flows to emerging economies: recent developments and drivers,* *Economic Bulletin* 2/2019, Banco de España.

Chart 2
PUSH AND PULL FACTORS BEHIND CAPITAL FLOWS TO EMERGING ECONOMIES



SOURCES: Thomson Reuters, Standard and Poor's, Fitch, Moody's and national statistics.

a Measured by VIX.
b Sum of half-yearly changes in portfolio inflows and other flows.
c Average of Standard and Poor's, Moody's and Fitch ratings.

Box 2

FISCAL POLICY RESPONSE TO THE CRISIS IN THE EURO AREA AND THE UNITED STATES

Luis Guirola, Iván Kataryniuk and Carlos Moreno

This early-release box was published on 3 December

This box compares the fiscal impulse announced in the euro area and in the United States since the onset of the COVID-19 pandemic. The stimulus has two components. First, national authorities have adopted discretionary fiscal policy measures, the breadth of which is unprecedented in recent decades. Second, automatic budget stabilisers, such as unemployment benefits, have operated in both areas. Assessing the contribution of the fiscal policy response to the health crisis requires taking into account the role played by both these components.

The discretionary fiscal policy measures adopted in both areas have been focused on providing income support to households and firms. In the case of households, the funding of short-time work schemes was extended in many euro area countries, while in the United States the duration and generosity of federal unemployment insurance were increased. In addition, moratoria on interest payments and rentals were introduced in both areas. In the case of firms, far-reaching public guarantee programmes have been approved to encourage new lending to the business sector.[1] In general, the measures announced are temporary and their direct impact is concentrated mainly in 2020 and 2021 H1. In Europe, national responses have been complemented with supranational policies,[2] including the NextGenerationEU (NGEU) programme[3] whose funds, once approved, will become available between 2021 and 2026.

Some of the measures described have an immediate budgetary cost, such as those affecting the labour market, while others entail only a contingent liability for general government until such time as they are enforced, such as the guarantees. But both types of measures have a positive impact on the economic situation in the short term. The final budgetary impact of this broad raft of measures will ultimately depend on their level of implementation. It is important to note that insofar as some of the measures approved build on existing programmes, estimates of the fiscal effort they entail should consider only the additional expenditure incurred by the new measures, after subtracting the inertial component of the programmes already in place.

Bearing in mind all the above, Chart 1 presents an estimate of the fiscal impulse associated with the discretionary measures that have direct budgetary impact, both for the euro area and the United States. In 2020 this impulse is estimated to amount to 6.3 percentage points (pp) of GDP in the euro area and to 8.4 pp in the United States, when the metric used is the change in the cyclically-adjusted primary balance estimated by the IMF in October 2020.[4] However, given the temporary nature of the vast majority of the measures, and the impact that the IMF assumes the NGEU will have in Europe, the overall fiscal policy stance over a longer horizon would be slightly expansionary in the euro area. Chart 2 sets out the amounts approved under the public guarantee programmes established in both regions. These amounts, which have not necessarily been used in full, are significantly higher in the euro area.[5]

With regard to the role played by the automatic stabilisers, the academic literature has documented that these stabilisers are larger in the European economies, although it is difficult to quantify the differential income stream being generated as a result in the current crisis. There are several reasons why the US government budget has less automatic stabilisation capacity than those of the euro area countries.[6] These include a smaller public sector (see Chart 3), a less progressive tax system and a less generous unemployment insurance system.[7] The United States also has greater institutional constraints at the

1 See L. Cuadro-Sáez, F. López-Vicente, S. Párraga and F. Viani (2020, "Fiscal policy measures in response to the health crisis in the main euro area economies, the United States and the United Kingdom", *Occasional Paper* No 2019, Banco de España.

2 See M. Delgado, I. Kataryniuk, F. López-Vicente and J. J. Pérez (2020). "Supranational debt and financing needs in the European Union", *Occasional Paper* No 2021, Banco de España.

3 See Banco de España (2020), Box 5, "Next Generation EU: Main characteristics and impact of its announcement on financial conditions", *Economic Bulletin* 3/2020.

4 See Fiscal Monitor, October 2020.

5 No comparable data is available for the euro area and the United States on the extent to which these programmes have been used.

6 See P. Burriel, P. Chronis, M. Freier, S. Hauptmeier, L. Reiss and D. Stegarescu (2020). "A fiscal capacity for the euro area: lessons from existing fiscal-federal systems", *Occasional Paper* No 2009, Banco de España.

7 See S. Albrizio, J. C. Berganza and I. Kataryniuk (2017). "Federal unemployment insurance in the United States", Analytical Articles, *Economic Bulletin* 2/2017, Banco de España.

sub-national government level – given the nominal budget balance rules and individual state's debt limits – compared with European rules which, broadly speaking, permit a medium-term approach since they do not factor in the impact of the economic cycle.

By way of illustration, Chart 4 sets out estimates based on microsimulations drawing on individual data.[8] On this evidence, the automatic stabilisers in the euro area would be able to absorb a larger portion of a negative shock on gross household income than those in the United States (absorbing 38.5% compared with 32.2%), owing to the different levels of progressivity of the tax system in the two areas. In the event of an income shock affecting only a single sub-set of households and resulting in their unemployment, the automatic stabilisers would absorb 48.5% of the shock on household disposable income in the euro area and 33.4% in the United States, reflecting

Chart 1
CHANGE IN CYCLICALLY-ADJUSTED PRIMARY BALANCE (% OF GDP)

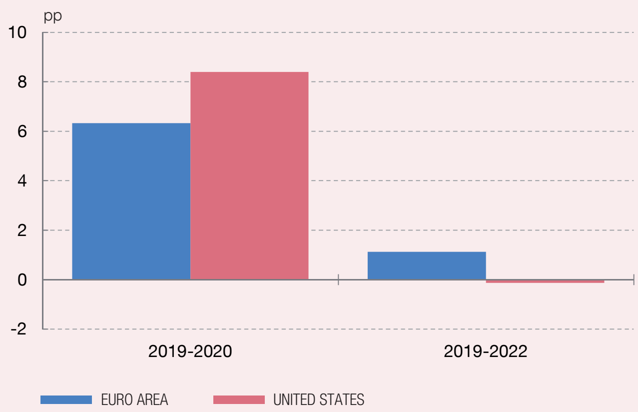


Chart 2
DISCRETIONARY FISCAL POLICY MEASURES WITH NO IMMEDIATE BUDGETARY IMPACT: GUARANTEES

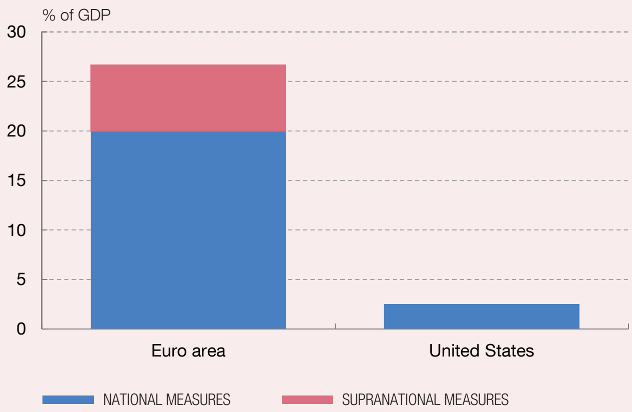


Chart 3
SIZE OF GENERAL GOVERNMENT IN THE EURO AREA AND THE UNITED STATES (a)

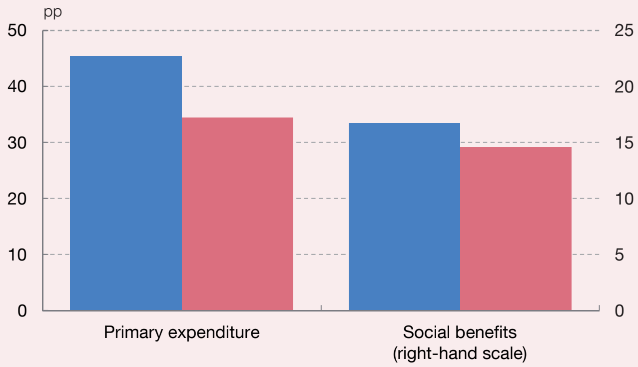


Chart 4
AUTOMATIC STABILISERS: STABILISATION OF DISPOSABLE INCOME IN FACE OF DIFFERENT SHOCKS (DOLLS ET AL., 2012)

EURO AREA UNITED STATES

SOURCES: IMF, OECD, AMECO and Dolls et al. (2012).

a 2019 data.

8 See M. Dolls, C. Fuest and A. Peichl (2012). "Automatic stabilizers and economic crisis: US vs. Europe." *Journal of Public Economics,* 96(3-4), 279-294.

the differences in the power of unemployment insurance in the two areas.

In short, the euro area and US authorities have responded to the crisis by swiftly adopting highly ambitious fiscal policy measures. Comparing the response in the two areas is complex, since at least three elements must be considered. First, the discretionary measures adopted with a direct budgetary cost. Second, the measures generating contingent liabilities for general government. Lastly, the estimated income stream stemming from the operation of the automatic stabilisers. Although the first factor appears to have had the most impact, in the United States, in 2020, consideration of the other two components provides a more balanced assessment of the relative efforts of the euro area and the United States.

Box 3

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

Álvaro Menéndez Pujadas

This early-release box was published on 15 December

On 24 November, the ECB published the results of the Survey on the Access to Finance of Enterprises (SAFE) in the euro area, which covers the period from April to September 2020. The survey asks firms, essentially SMEs, about developments over the preceding six months in their economic and financial situation, their external finance needs and the terms and conditions on which such financing had, or had not, been obtained.

The data from this survey round show a marked deterioration in the economic situation of Spanish SMEs as a result of the severe impact associated with the COVID-19 pandemic. The number of SMEs reporting higher turnover between April and September was, for the second consecutive round, lower than the number reporting turnover declines, and the difference between the two groups (net percentage) increased significantly, to -55%, compared with the previous survey round, corresponding to the period from October 2019 to March 2020 (-5%). This is the lowest net percentage value recorded in this survey since the first half of 2009 (-59%) and is also lower, in absolute terms, than that recorded for the euro area (-46%) (see Chart 1). These adverse turnover developments led a high number of SMEs to report a decline in profits (a net percentage of -55%, compared to -20% in the previous survey round and -47% for the euro area). This occurred despite the net percentage of SMEs reporting higher costs decreasing substantially.

Difficulty in finding customers was considered the key concern by the highest percentage of Spanish (24%) and euro area (22%) SMEs (see Chart 2). These percentages barely increased in comparison to six months earlier, despite the sharp rise in SMEs reporting a decline in turnover. Set against this, among the factors included in this question, access to finance continued to be the concern raised by the lowest number of Spanish SMEs (9%) and by the second lowest number of euro area SMEs (10%). These percentages were slightly higher than those recorded six months earlier.

Against this background, the proportion of Spanish SMEs that applied for bank loans rose significantly, up 11 percentage points (pp) to 48% (see Chart 3), a higher figure than that recorded in the euro area (38%). In addition, SMEs' perception of their access to bank financing continued to improve, doing so at a higher rate than six months earlier (see Chart 4). This result contrasts with what SMEs reported in the previous round, when most expected access to finance to deteriorate between April and September. This could be because when responding to that survey, they lacked sufficient information to adequately assess the public support measures and, in particular, the positive impact of the public guarantee facilities.

Access to finance improved despite the sharp rise in the percentage of SMEs that perceived the general economic

Chart 1
TURNOVER AND PROFIT (a)

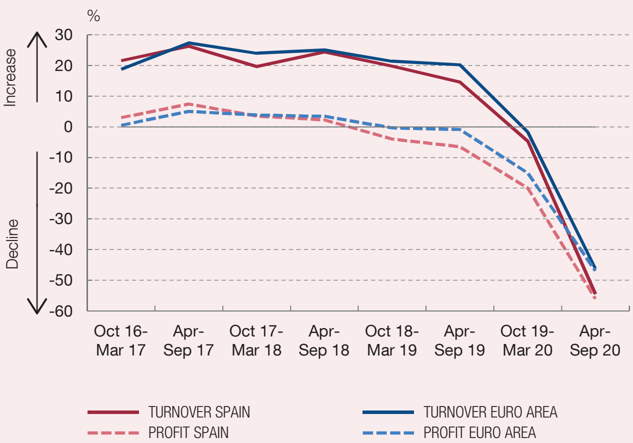
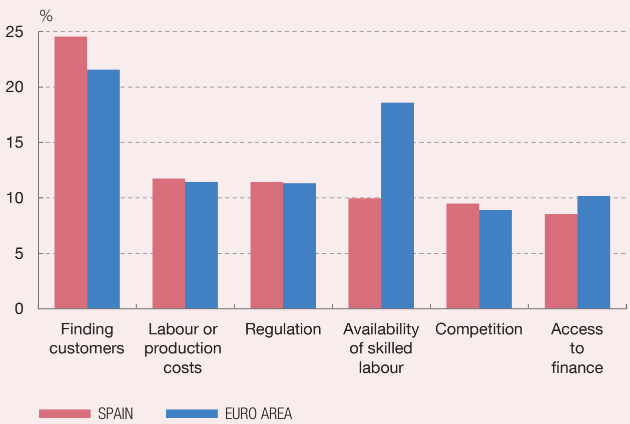


Chart 2
MAIN PROBLEMS AFFECTING BUSINESS. APRIL-SEPTEMBER 2020



SOURCE: ECB.

a Percentage of firms reporting an increase minus percentage reporting a decline.

outlook as an impediment to access to new loans (47%, up 16 pp from the previous period) and the deterioration in their firm-specific outlook as an obstacle to accessing bank financing (49%, the second highest value, behind that recorded in June 2009). By contrast, 16% of Spanish SMEs continued to perceive an improvement in the willingness of banks to lend (up 2 pp from six months earlier and practically twice that recorded in the euro area) and 8% reported a favourable impact associated with access to public financial support, including guarantees. This is the highest value recorded for this factor since this survey began in 2009.

3% of SMEs had their loan applications rejected, down 1 pp from the previous survey round and 2 pp lower than

Chart 3
SMEs THAT HAVE APPLIED FOR BANK LOANS

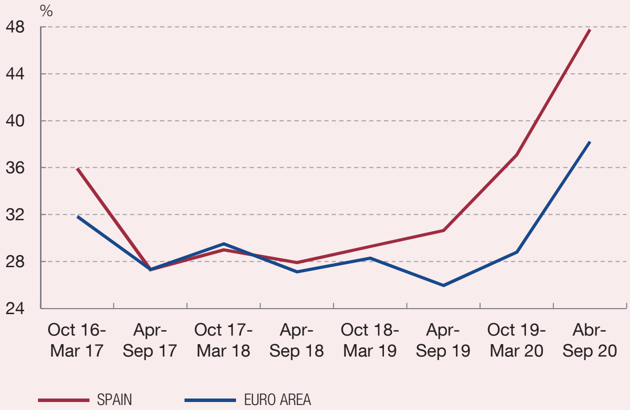


Chart 4
PERCEIVED AVAILABILITY OF BANK LOANS (a)

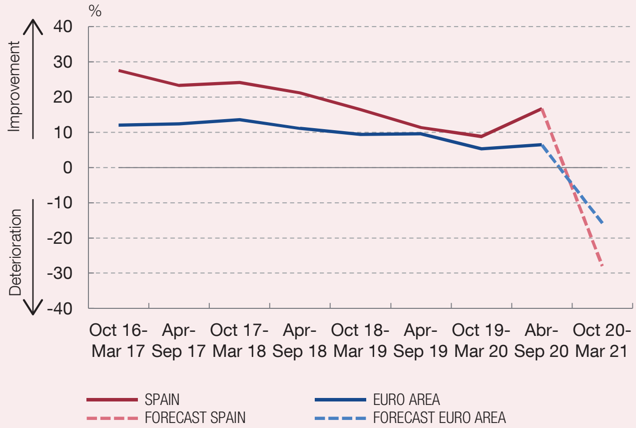


Chart 5
SMEs HAVING DIFFICULTIES OBTAINING BANK LOANS (b)

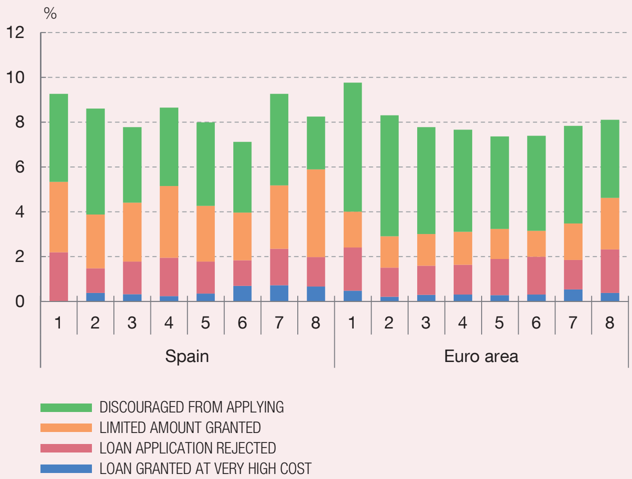
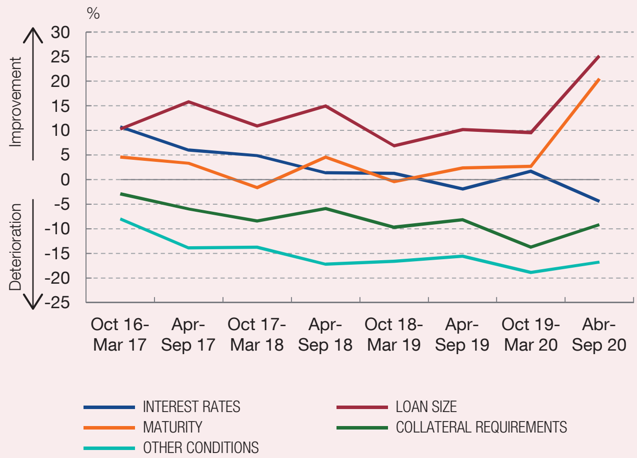


Chart 6
BANK LOAN CONDITIONS. SPAIN (c)



SOURCE: ECB.

a Percentage of firms reporting an improvement minus percentage of firms reporting a worsening.
b 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 for fear of rejection (discouraged from applying). The numbers on the horizontal axis depict the rounds of the survey, with 1 corresponding to the period October 2016-March 2017 and 8 to the period April-September 2020.
c 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.

that recorded in the euro area. In a similar vein, the overall financing obstacles indicator[1] improved slightly, with the proportion of Spanish SMEs encountering this type of obstacle declining by 1 pp to 8%, a figure similar to that of the euro area (see Chart 5).

With regard to financing conditions, a net percentage of 4% of SMEs reported an increase in interest rates (see Chart 6). In addition, SMEs perceived once again, in net terms, a tightening of collateral requirements and of other loan terms and conditions (other than size and maturity). However, the net proportion of firms that reported an increase in both loan size (25%) and maturity (20%) remained clearly positive. In both cases, these percentages were far higher than in the previous survey round (10% and 3%, respectively). This appears to be linked to the favourable conditions of the loans granted under the public guarantee scheme.[2]

In summary, the latest round of the SAFE shows that, between April and September 2020, Spanish SMEs' economic outlook deteriorated considerably, doing so somewhat more acutely than in the euro area as a whole, owing to the severe impact of the COVID-19 pandemic. However, in a setting in which bank loan applications grew, Spanish SMEs' access to external finance continued to improve and financing conditions remained favourable. These developments would be explained largely by the positive impact associated with the public guarantee facilities.

Looking ahead, a high net percentage of Spanish SMEs (28%, above the 16% of euro area SMEs) expected their access to bank financing to deteriorate significantly between October 2020 and March 2021. This result, however, could be influenced, at least partially, by the firms surveyed being unable to factor into their responses the possible positive impact on access to finance of Royal Decree-Law 34/2020 of 17 November 2020 (approved after this survey was conducted). This Royal Decree-Law extends to June 2021 the deadline for applying for loans backed by a public guarantee, with longer maturities and payment holidays than those of the first guarantee facility.

1 This indicator reflects one 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 SME because the borrowing costs were too high; and those cases where SMEs did not apply for a loan for fear of rejection.

2 For further details, see Box 1 "The role of the public guarantee programme in the recent buoyancy in lending to the self-employed and non-financial corporations", included in the Banco de España Analytical Article "Recent developments in financing and bank lending to the non-financial private sector", published in September 2020.

Box 4

INTERNATIONAL TRADE IN MEDICAL PRODUCTS DURING THE COVID-19 PANDEMIC

Coral García, César Martín and Francesca Viani

This early-release box was published on 14 December

As a consequence of the COVID-19 pandemic, global demand for medical products has increased very significantly in recent months, affecting international trade flows.[1] Thus, between January and July 2020, world trade in medical products increased by 7.5% compared with the same period in 2019. This increase was particularly marked in the case of personal protective products (36%) and medicines (6%) (see Chart 1.1). This is in a context where a large number of countries have introduced trade policy measures, often of a temporary nature, to limit exports of such goods or to liberalise their import (see Chart 1.2).[2]

The impact of these developments on the trade balance of the world's main economies has been highly uneven. Thus, for instance, between February and July, the cumulative 12-month balance associated with international trade in medical products in China changed from a $0.8 billion deficit to a $36 billion surplus — which would explain 64% of the increase in China's trade surplus in goods recorded in that period. Conversely, it deteriorated by 20% in the United States — thereby increasing the country's trade deficit growth rate for goods between February and July by 2.2 pp — and by 10.5% in the European Union (EU) — which would have reduced the EU's trade balance growth rate during this period by 6 pp.

In the case of Spain, imports of medical products also increased more than exports of these types of goods in the first nine months of the year (23.5% year-on-year and 10.5% in nominal terms), raising the economy's deficit under this heading by 55% to €6.9 billion, which accounts for approximately 62% of the Spanish trade deficit, much more than it did in 2019 (19%) (see Chart 1.3). These developments are in sharp contrast to those observed in Spain during the same period regarding foreign trade in other goods, which saw marked declines in imports and exports and an improved trade balance (see Chart 1.4).

The rest of the box presents some of the main features of the international market for medical products, which help to understand the disparity in trade developments across countries described above. First, this market is significantly concentrated: a small number of countries account for the bulk of global exports. In particular, the five leading suppliers account for more than 50% of all world exports in each category of medical products (see Chart 2.1). This means that concentration is higher than for manufacturing as a whole, even above that observed for the car industry, renowned for its high level of concentration.

Notwithstanding the above, a second characteristic of the market for medical products is that the main suppliers of these products vary significantly from one category to another. Thus, for instance, in 2019, Switzerland, Germany and Belgium were the largest exporters of medicines worldwide, while the United States led in exports of medical supplies and instruments, and China ranked first in personal protective products (see Chart 2.2).

Lastly, it should be noted that, even within one category of medical products, no country is entirely self-sufficient, as there is a high degree of intra-industry trade. In fact, the countries that are the largest exporters of a certain type of product are also often among the largest importers of that very same product (see Charts 2.2 and 2.3). An index of intra-industry trade comparing the volume of exports and imports made by different countries for a subset of medical products relating to the COVID-19 pandemic points to a similar effect.[3] This index peaks at 1 when a country's exports are equal to its imports of goods in this category. As can be seen in Chart 2.4, even the largest exporters of medical products — such as the United States, China and Germany — need to import large quantities of the same types of goods.

As for Spain, its interdependence index for international trade in the medical products most related to the COVID-19 pandemic is relatively high, albeit lower than that of other major euro area economies, such as France or Italy. In this respect, it is worth noting that, although the bulk of Spanish exports of medical products in 2019 was in the medicine category, imports of these same products were even higher (see Chart 2.5). Moreover, in line with the international evidence mentioned above, Spanish imports of medical products are concentrated in a relatively small number of supplier countries, with the United States and Germany playing a particularly important role in the

1 For the purposes of this box, the classification of medical products developed by the World Trade Organization (WTO) has been used. See WTO (2020), "Trade in medical goods in the context of tackling COVID-19", WTO Information Note.

2 See Espitia, A., Rocha, N. and M. Ruta (2020). *A pandemic trade deal. Trade and policy cooperation on medical goods,* World Bank.

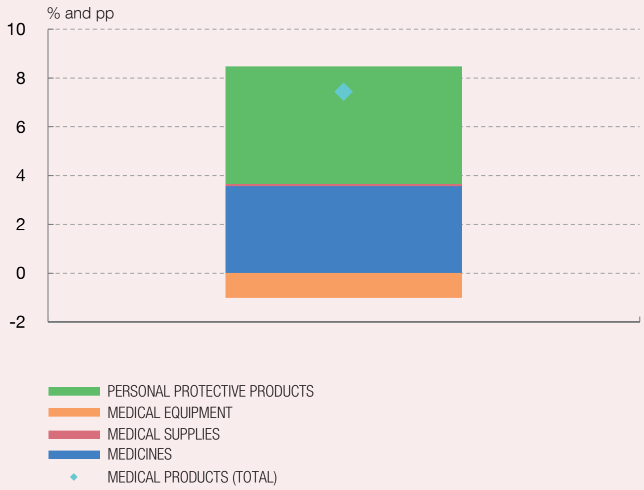
3 For more details on this exercise, see OECD (2020), "Trade interdependencies in Covid-19 goods", OECD Policy Responses to Coronavirus.

provision of medicines and medical supplies, and Germany, France and China in purchases of personal protective products (see Chart 2.6).

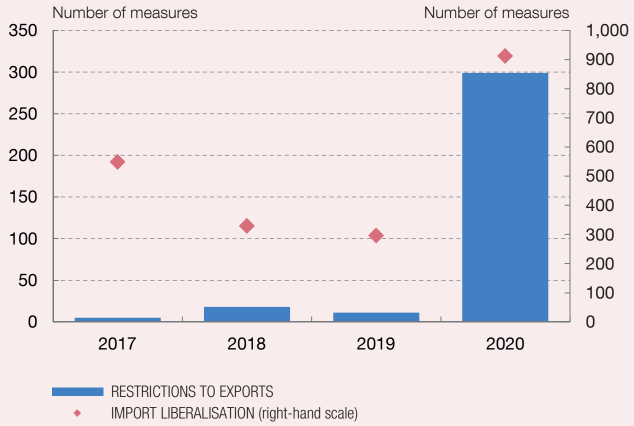
In short, the rise in demand of medical products in recent months as a consequence of the COVID-19 pandemic has resulted in a very significant increase in international trade flows for these types of products. As this is a particularly concentrated industry, these flows have had an uneven impact on trade balances across countries. In the case of Spain, the international trade deficit in medical products recorded in recent years would have increased notably in 2020 to date, although it appears to have a relatively minor weight in terms of the economy's aggregate output.

Chart 1
RECENT DEVELOPMENTS IN INTERNATIONAL TRADE IN MEDICAL PRODUCTS

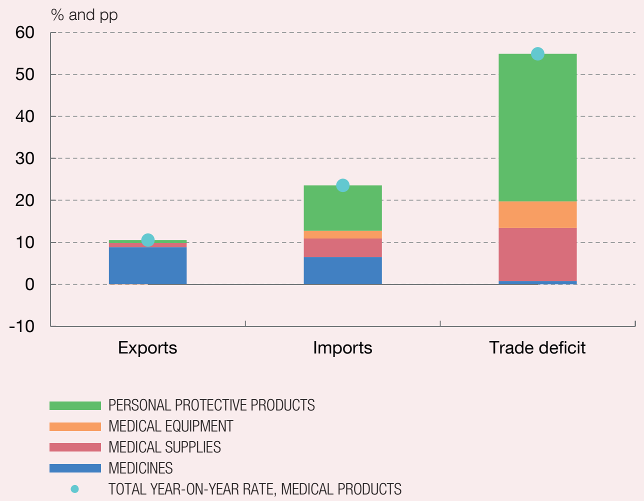
1 YEAR-ON-YEAR CHANGE IN TRADE FLOWS IN MEDICAL PRODUCTS (JANUARY-JULY) (a)



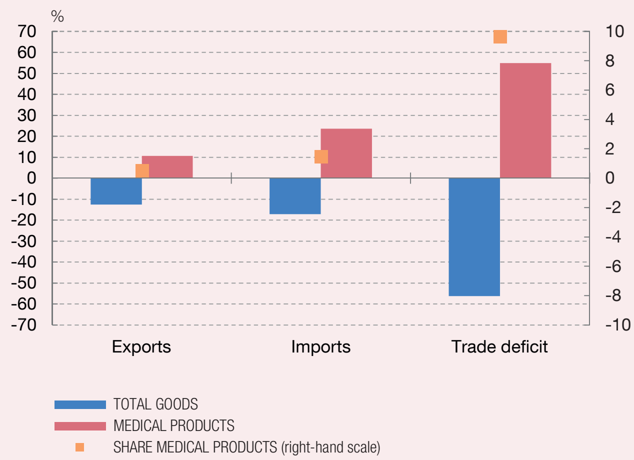
2 TRADE POLICY MEASURES AFFECTING TRADE IN MEDICAL PRODUCTS (b)



3 CHANGES IN FOREIGN TRADE IN MEDICAL PRODUCTS. SPAIN
Y-o-y rates of change in the period January-September 2020 and share by product



4 CHANGES IN SPAIN'S FOREIGN TRADE: MEDICAL PRODUCTS AND TOTAL ASSETS
Y-o-y rates of change in the period January-September 2020



SOURCES: UN Comtrade, Eurostat, Global Trade Alert, WTO, Departamento de Aduanas and OECD.

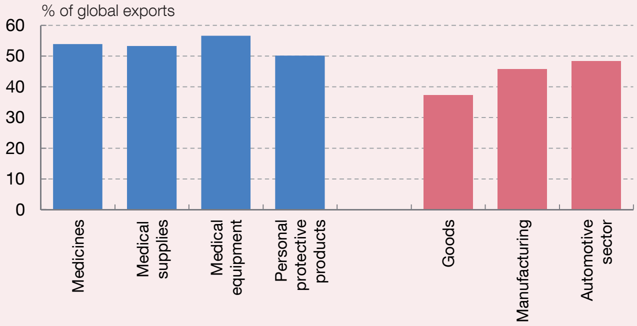
a The data refer to a group of countries for which this information is available in the UN Comtrade and Eurostat statistics. These countries account for around 70% of world trade. China's trade flows are calculated based on the bilateral flows reported by its trading partners.
b Number of measures adopted between January and November 2020 according to the HS4 code of the WTO medical products classification.

Box 4

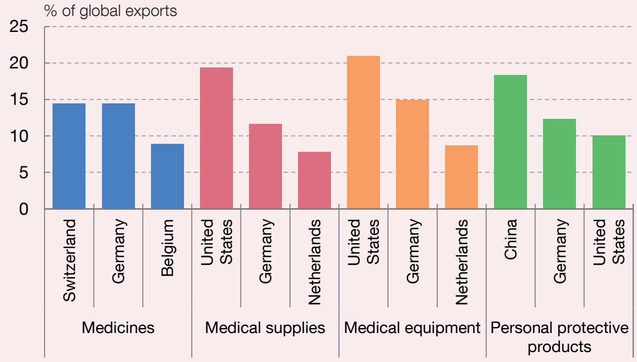
INTERNATIONAL TRADE IN MEDICAL PRODUCTS DURING THE COVID-19 PANDEMIC (cont'd)

Chart 2
STRUCTURE OF INTERNATIONAL TRADE IN MEDICAL PRODUCTS

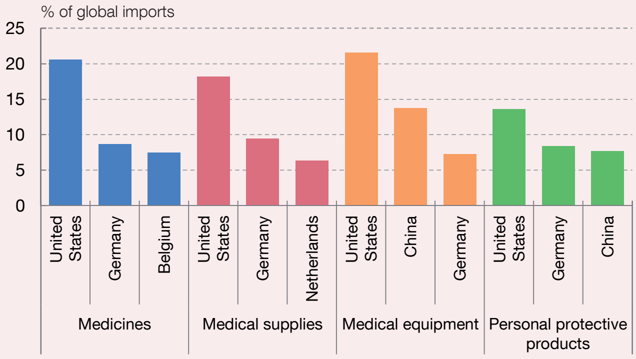
1 CONCENTRATION OF EXPORTS (a)
Exports from the five largest exporters



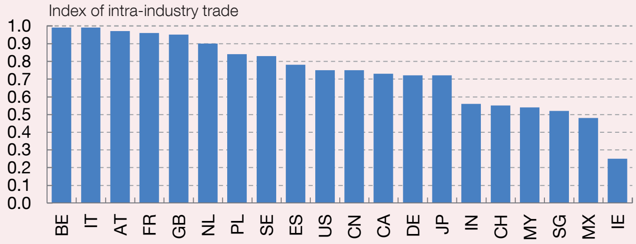
2 LARGEST EXPORTERS OF MEDICAL PRODUCTS (b)



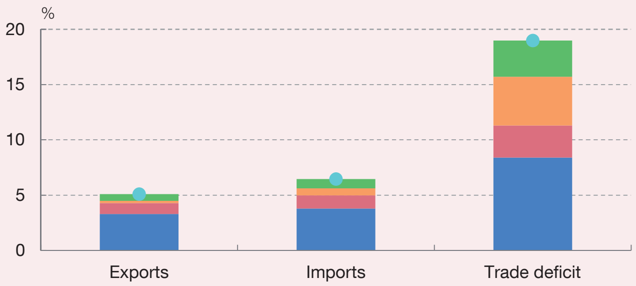
3 LARGEST IMPORTERS OF MEDICAL PRODUCTS (c)



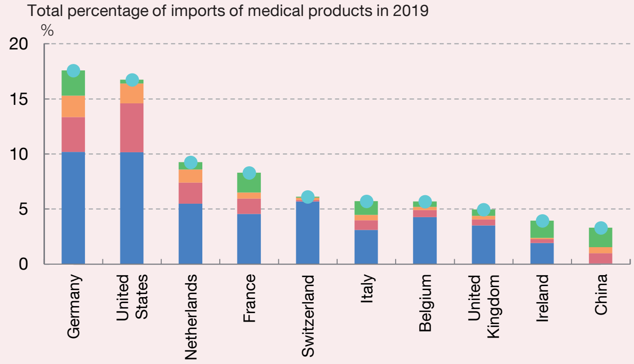
4 INTERDEPENDENCIES IN TRADE IN MEDICAL PRODUCTS RELATED TO COVID-19 (d)



5 EXTERNAL TRADE IN MEDICAL PRODUCTS. SPAIN
Percentages of external trade in goods in 2019



6 SPANISH IMPORTS OF MEDICAL PRODUCTS: MAIN SUPPLIERS AND CATEGORIES
Total percentage of imports of medical products in 2019



PERSONAL PROTECTIVE PRODUCTS   MEDICAL EQUIPMENT   MEDICAL SUPPLIES   MEDICINES   TOTAL MEDICAL PRODUCTS

SOURCES: UN Comtrade, Eurostat, Global Trade Alert, WTO, Departamento de Aduanas and OECD.

a 2019 data. Manufacturing and automotive sector: 2018 data. WTO classication of medical products, by HS6 code.
b 2019 data. WTO classification of medical products, by HS6 code.
c 2019 data. WTO classification of medical products, by HS6 code.
d 2018 data. WTO classification of COVID-19-related medical products, by HS6 code.

From an economic policy standpoint, the fact that there is a high degree of interdependence worldwide in exports and imports of medical products makes it advisable to adopt coordinated trade policies which steer clear of non-cooperative strategies that limit or hinder trade in these types of products.

Box 5

RECENT INFLATION DYNAMICS AND OUTLOOK FOR SPAIN

Isabel Sánchez

This early-release box was published on 17 December

As has occurred with many other macroeconomic variables (for instance, with GDP, the general government budget balance and employment), the performance and even the measurement of inflation in Spain and globally have been significantly affected in recent months by the COVID-19 pandemic and by the measures deployed to contain it.

In spring, shortly after the spread of the virus at global level, numerous governments decided to halt all non-essential activities in order to limit the spread of the pandemic. From a purely statistical standpoint, this decision significantly disrupted the preparation of consumer price indices by national statistical offices, since the restrictions imposed made it impossible to acquire (and, therefore, compile prices for) a broad range of consumer goods and services (notably, cultural and accommodation services, flights and package holidays). Following Eurostat recommendations, the Spanish National Statistics Institute responded by imputing to these products a month-on-month price change similar to that for the same month of the previous year, so that the year-on-year rate for these prices remained virtually unchanged.

Beyond the biases which might derive from this imputation, the pandemic also appears to have influenced consumer price index signals coming from another channel, which is related to the profound transformation of households' consumption patterns. These changes are not included in the customary inflation indicators, where weights are only updated once a year (at the start of the year). The absence of a real time update of the weights of the different categories of goods and services seems to have led, according to some studies, to inflation being underestimated.[1] Specifically, in the period March-May 2020 the difference between the inflation rate calculated with a reweighted index based on the effective weights at each point in time and that obtained with the customary index is estimated to range from 0.09 pp to 0.36 pp, according to the methodology used, in the case of Spain. For example, it should be taken into account that certain products whose consumption was not affected by the lockdown, such as food, were precisely those which posted sharper price increases in those months.

Aside from the statistical issues, the declining path shown by inflation in recent months in Spain clearly evidences that, in net terms, the combined impact of different supply and demand-side factors caused by the pandemic has been widely disinflationary (see Chart 1). In this connection, although the outbreak of the health crisis raised the possibility that considerable disruptions could arise in the supply chains, exerting substantial upward pressure on inflation, they were not sufficiently strong or persistent to be reflected, in general, in a significant pick-up in prices.

An analysis of the various indicators of inflationary pressure used by the Banco de España allows a more detailed assessment of some of the channels that have shaped recent developments in inflation in Spain.[2] Chart 2 shows the values for several of these indicators in February 2020 (just prior to the pandemic), their latest figures (represented by the red circles and blue boxes, respectively) and their historical levels. In particular, a very sharp drop in inflationary pressure can be seen on account of the greater degree of slack in the economy. At the same time, other domestic and external factors seem to be exerting less pressure on prices. For instance, in line with the lack of significant disruptions to global value chains, no signs of inflationary pressures on import prices were observed. Furthermore, inflationary pressures exerted by inflation expectations also appear to have moderated in recent months, especially in the case of firms and consumers.

On account of their relevance to aggregate price dynamics, highlighting three specific items is useful. The first is energy. The sharp contraction in global economic activity triggered by the pandemic has caused a steep drop in global demand for oil and oil products, which in April drove crude oil prices down to lows not seen in the last 30 years. As the recent recovery in oil prices is still far from complete, this has been one of the main factors behind the marked deceleration in the HICP's energy component in recent months.

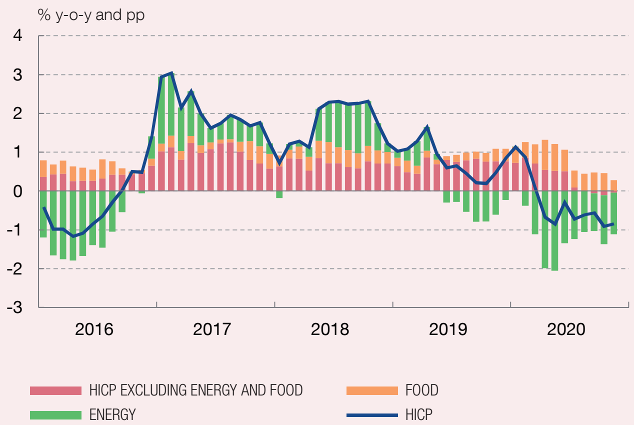
1 See, for example, Reinsdorf (2020), *COVID-19 and the CPI: Is inflation underestimated?,* IMF Working Paper, WP/20/224; Cavallo (2020), *Inflation with Covid consumption baskets,* NBER Working Paper 27352, and European Central Bank (2020), "Consumption patterns and inflation measurement issues during the COVID-19 pandemic", Box 3, *Economic Bulletin,* 2020/11.

2 For more details on these indicators, see L.J. Álvarez and I. Sánchez (2018), "Composite indicators of inflationary pressures", Analytical Articles, *Economic Bulletin,* 4/2018, Banco de España.

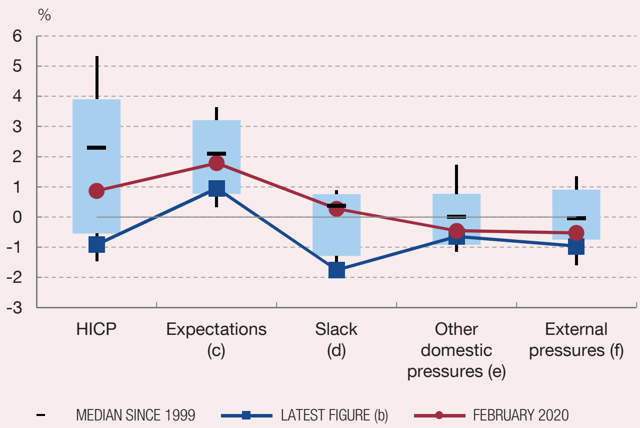
Second, and at the other extreme, as mentioned above, the recent food price dynamics are noteworthy. During the state of alert, most fresh food and some processed food prices accelerated in Spain. These price increases were associated in part with higher household demand and also some supply-side factors related to harvesting and transporting perishable foods. In any event, these developments were relatively temporary and, in recent months, the year-on-year growth rate of food prices has moderated, recording growth similar to that observed pre-pandemic.

Third, tourism-related services prices. The most significant event in terms of recent inflation developments was the steep drop in core inflation recorded since July. Services prices were the main contributing factor to this decline. Among them, the biggest driving force was undoubtedly the sharp deceleration in tourism-related services prices, which have

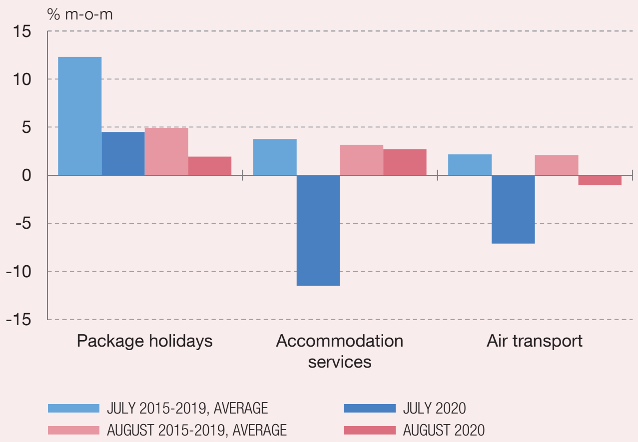
1 HICP: DEVELOPMENTS AND CONTRIBUTIONS



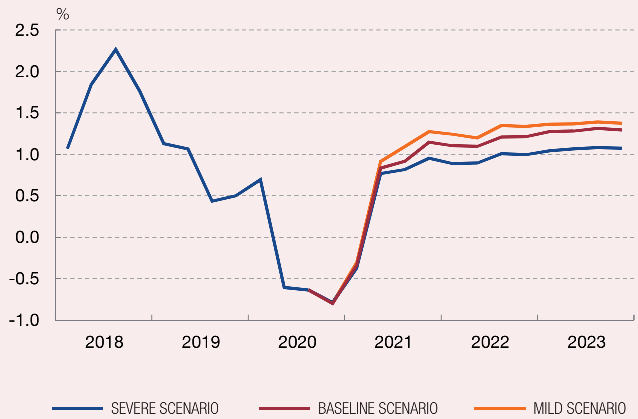
2 INDICATORS OF INFLATIONARY PRESSURE (a)



3 TOURISM HICP



4 HEADLINE HICP. BANCO DE ESPAÑA DECEMBER 2020 PROJECTIONS



SOURCES: INE, Eurostat and Banco de España.

a See Álvarez and Sánchez (2018) for a description of the composite indicators of inflationary pressure.
b Monthly: October 2020; quarterly: 2020 Q3; daily: 2 December 2020.
c Inflation expectations of professional forecasters, firms, consumers and obtained from inflation swaps.
d Includes output gap, capacity utilisation, unemployment rate, quarter-on-quarter change in the unemployment rate, recession gap and quarter-on-quarter change in GDP and in private consumption.
e Includes labour costs, business mark-ups and domestic producer prices.
f Imported goods prices: final products, intermediate goods and commodities.

recorded an unprecedented collapse since the onset of the pandemic.[3] In particular, package holiday prices rose in July (high season) by almost two-thirds less than usual compared with June (4.5% versus 12.3% on average between 2015 and 2019) (see Chart 3).[4] Likewise, accommodation services prices recorded a month-on-month decline for the first time in a July, falling by 11.5%, compared with an average increase of 4% over the last four years.

Looking ahead to the coming quarters, to the extent that the severe adverse impact that the COVID-19 pandemic and the associated containment measures have had on aggregate economic activity is expected to be relatively persistent, inflation rates are likely to hold at very low levels and only recover very gradually as the negative contribution of the energy component dissipates and core inflation recovers some momentum in line with activity (see Chart 4). That said, certain downside risks to these forecasts cannot be ruled out. These include, among others, a slower-than-forecast economic recovery in Spain and globally, inflation expectations possibly deanchoring and the crisis having more persistent effects on some services, such as those related to tourism, hospitality and entertainment.

3 The year-on-year rate of the services component decreased by 1.3 pp between June and July, with the deceleration in the tourism-related items contributing 0.9 pp to that decline.

4 Although these rates could have been distorted by the change represented by having data available in July, after imputing the prices in the preceding months, the steep year-on-year declines in the tourism-related items highlight the severe impact of the pandemic and the containment measures on these sectors.

Box 6

THE EMPLOYMENT STATUS OF TERTIARY EDUCATION GRADUATES IN SPAIN: A EURO AREA COMPARISON

Brindusa Anghel, Sergio Puente and Ana Regil

This early-release box was published on 24 November

The economic literature has often stressed that tertiary education lies behind cross-country differences — in terms of economic growth and the level and pace of productivity gains — and differences among individuals — as regards wages or the availability of job opportunities.[1] However, the ensuing benefits for various tertiary education qualification holders differ.[2] Furthermore, it may be that supply and demand for each specific qualification become decoupled. Indeed, in the case of Spain, some recent analyses have highlighted a notable mismatch between the most popular qualifications among students and those most sought-after by employers.[3] The unemployment rate of Spanish tertiary education graduates aged 30-34 in 2018 approximately doubled that of their European peers. This poses the question of the extent to which this difference is because of the different specialisation of Spanish tertiary education graduates in terms of the qualifications they choose.

Charts 1 and 2 show the distribution of tertiary education students by field of specialisation for Spain and the euro area in 2006 and 2018. These two years are useful for analysing possible shifts in the latest period.

Both in Spain and the euro area, social sciences and law comprise the most common group of qualifications among individuals aged 30-34 with a tertiary education, accounting for around one-third of the total. This group is followed by the engineering and health-related fields. Despite these similar patterns, there are some differences between Spain and the euro area. Specifically, the share of tertiary education students studying education, information and communication technologies (ICTs), services and health-related fields is higher in Spain. Conversely, the share of degrees related to social sciences and law, engineering and the arts is lower in Spain. Moreover, these differences were far smaller in 2006, meaning that this difference in the specialisation of Spanish tertiary students emerged after the 2008 global financial crisis. Since then, in Spain tertiary education graduates from the education, ICTs, services and health fields have increased at the expense of the social sciences and law, arts and humanities, and engineering and construction fields.

The distribution by field of specialisation also reveals important gender gaps. Men account for a large majority of engineering and ICTs tertiary graduates (see Charts 7 and 8). At the other end of the scale are health and education, where women represent more than two-thirds of total tertiary education graduates. These differences are very similar to those observed in the euro area in 2006 and 2018.

Consequently, the high unemployment rate of Spanish tertiary education graduates compared to the related euro area rate does not, ostensibly, seem to be due to the different field of specialisation. Indeed, the unemployment rate of Spanish tertiary graduates in 2018 was much higher for all qualifications, except for arts, humanities and languages (see Charts 3 and 4).

To more accurately determine the explanatory power of the different specialisation of individuals with a tertiary education in Spain, it is worth performing a simple hypothetical or counterfactual exercise. This involves calculating an employment rate for all individuals with a tertiary education in Spain drawing on the unemployment rates for each individual qualification and their observed distribution in the euro area (see Table 1). Comparing this dummy unemployment rate with the observed rate measures the extent to which the different tertiary education specialisation could be behind the differences observed relative to the unemployment rate in the euro

1 For the importance of tertiary education to economic growth, see, for example, J. Vandenbussche, P. Aghion, and C. Meghir (2006), "Growth, distance to frontier and composition of human capital", Journal of Economic Growth, 11(2), 97-127; P. Aghion and P.W. Howitt (2008), *"The economics of growth",* MIT Press; and E.A. Hanushek (2016), "Will more higher education improve economic growth?". *Oxford Review of Economic Policy,* 32(4). From an individual standpoint, having a tertiary education qualification is also usually associated with better labour market outcomes. A summary of some of this literature can be found in P. Oreopoulos and U. Petronijevic (2013), "Making College Worth it: a Review of Research on the Returns to Higher Education", *NBER Working Paper* No. 19053.

2 By way of example, according to the Spanish Labour Force Survey (EPA by its Spanish initials), the average monthly wage received in 2018 by workers with tertiary education qualifications related to personal services, such as security or hospitality, was €2,063/month, compared with €2,934 in the case of engineering.

3 Drawing on employability indicators by area of study (Table 17 of the U-Ranking 2020 project, F. Pérez and J. Aldás (2020), "U Ranking 2020: Synthetic Indicators of Spanish Universities" Fundación BBVA- IVIE 8th edition) there is practically no correlation (3%) between the distribution of the qualifications of tertiary education students who completed their studies in the 2013-2014 academic year and the rate of social security registrations in each field of education in 2018. Specifically, 30% of tertiary education students had chosen a degree that, on completion, had a lower rate of social security registrations than the average rate of 71% across the different fields of education.

area.[4] The result is that the unemployment rate of young Spanish tertiary education graduates would have been very similar, in 2006 and 2018, had the distribution by specialisation been the same as that observed for the euro area as a whole.

The gap between male and female tertiary education graduates' unemployment rates in Spain was 1.9 pp in 2006, 0.6 pp higher than in the euro area. In 2018, the gender gap in unemployment rates had fallen to 1.6 pp, 0.1 pp lower than in the euro area. The role of

Chart 1
TERTIARY-EDUCATED POPULATION AGED 30-34, BY QUALIFICATION, SPAIN AND EURO AREA. 2006

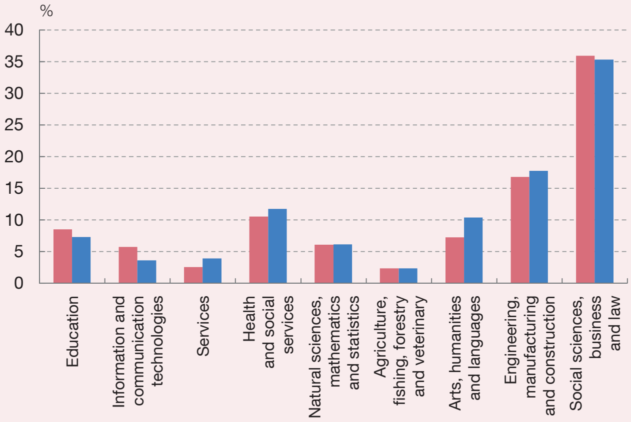


Chart 2
TERTIARY-EDUCATED POPULATION AGED 30-34, BY QUALIFICATION, SPAIN AND EURO AREA. 2018

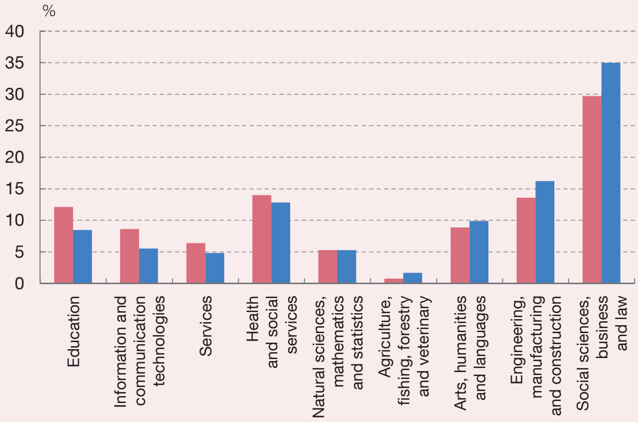


Chart 3
UNEMPLOYMENT RATE AMONG TERTIARY-EDUCATED POPULATION AGED 30-34, BY QUALIFICATION. 2006

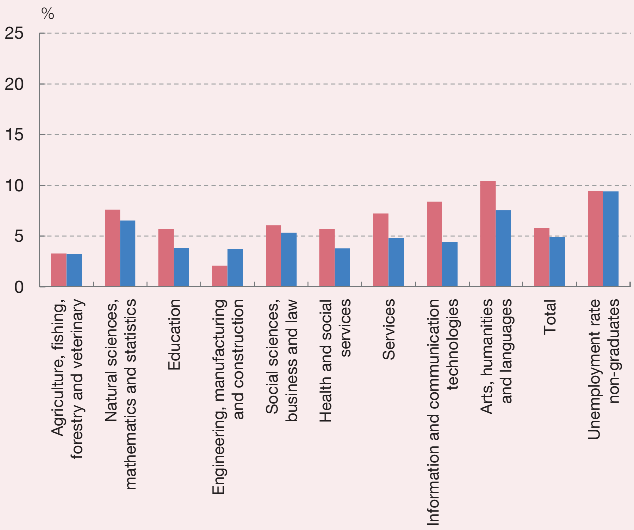
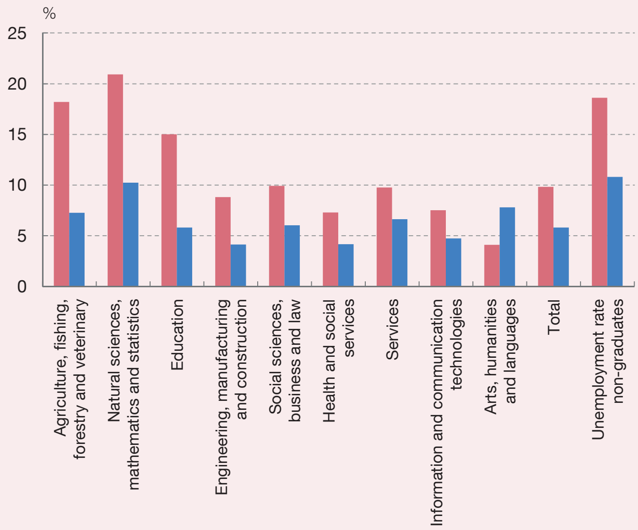


Chart 4
UNEMPLOYMENT RATE AMONG TERTIARY-EDUCATED POPULATION AGED 30-34, BY QUALIFICATION. 2018



SPAIN EURO AREA

SOURCE: Eurostat (Labour Force Survey).

4 The analysis disregards considerations such as the possible coverage of imbalances between domestic supply of tertiary education graduates and the related demand in each of the fields of specialisation via differing flows of immigrants with a tertiary education. In any event, there does not seem to be a clear correlation, by field, between foreign tertiary education graduates as a percentage of total graduates from that field and the differences in that qualification's weight within total qualifications compared with the euro area.

specialisation is also different between the two years. Thus, in 2018, in the hypothetical case that distribution by qualification in Spain had been identical to that in the euro area, the male unemployment rate would have been higher and the female unemployment rate lower, closing the gender gap. Conversely, in 2006 the gender gap between the unemployment rates in Spain was slightly higher when calculated with the euro area qualification distribution.

One measure of the quality of the tertiary education system is the proportion of graduates working in high-

Chart 5
TERTIARY-EDUCATED EMPLOYED POPULATION AGED 30-34 IN HIGH-SKILLED JOBS, BY QUALIFICATION. 2006

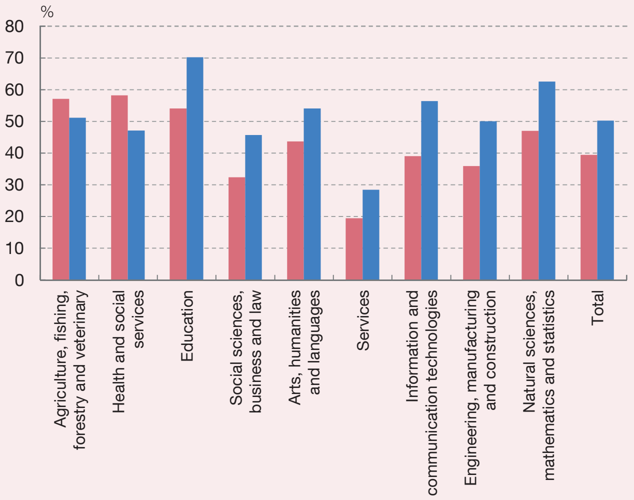


Chart 6
TERTIARY-EDUCATED EMPLOYED POPULATION AGED 30-34 IN HIGH-SKILLED JOBS, BY QUALIFICATION. 2018

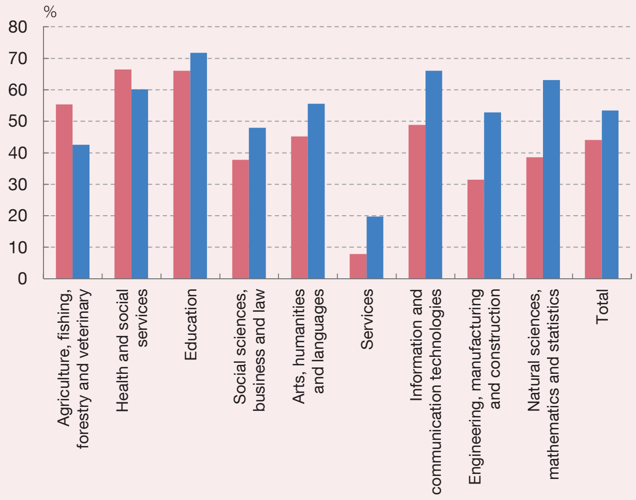


Chart 7
DIFFERENCE BETWEEN TERTIARY-EDUCATED MEN AND WOMEN AGED 30-34, BY QUALIFICATION. 2006

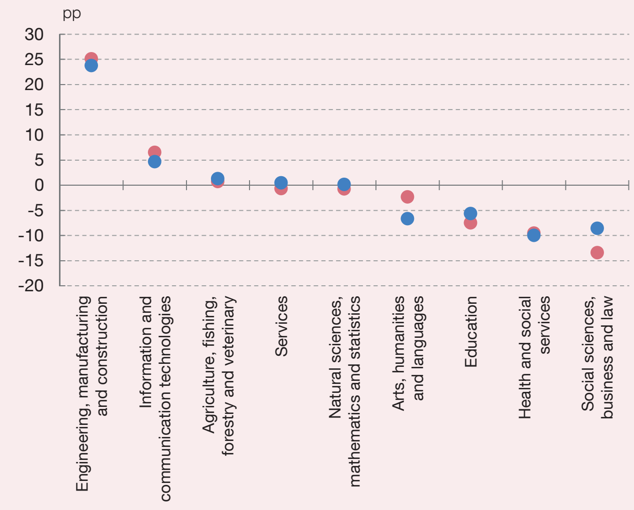
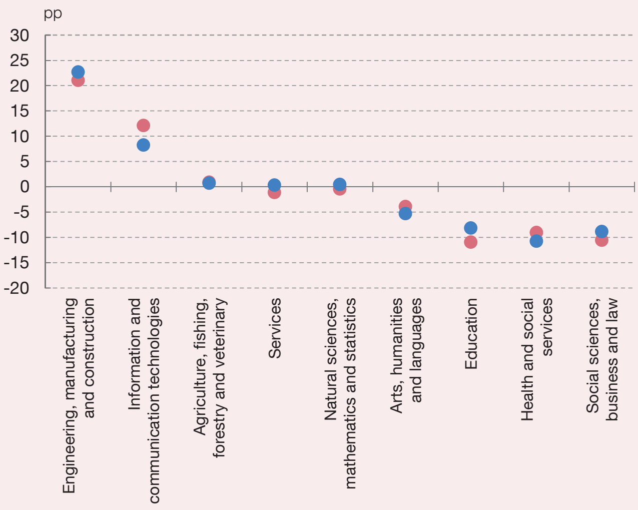


Chart 8
DIFFERENCE BETWEEN TERTIARY-EDUCATED MEN AND WOMEN AGED 30-34, BY QUALIFICATION. 2018



SOURCE: Eurostat (Labour Force Survey).

skilled jobs.[5] The share of young Spanish tertiary education graduates working in high-skilled jobs is lower than in the euro area (see Charts 5 and 6). However, in this case, the differences are much smaller than in the unemployment rate. Furthermore, they are uneven across fields of specialisation. Thus, in Spain in 2018 there was a higher proportion of skilled workers in agriculture and health, with the difference attributable to men in the case of the former and to women in the latter, while in the rest of the fields the shares were lower than those of the euro area. In 2006 the situation was similar, with somewhat lower shares of skilled workers from all degrees. The

Table 1
UNEMPLOYMENT RATES FOR TERTIARY-EDUCATED POPULATION AGED 30-34. SPAIN AND THE EURO AREA

	2006			2018		
	Spain (%)	Unemployment rates in Spain, distribution by euro area qualification (a) (%)	Euro area (%)	Spain (%)	Unemployment rates in Spain, distribution by euro area qualification (a) (%)	Euro area (%)
All	5.7	5.8	4.9	9.8	9.8	5.8
Men	4.8	4.6	4.2	8.9	9.7	4.9
Women	6.7	6.7	5.5	10.5	9.8	6.6

SOURCE: Eurostat (Labour Force Survey).

a The unemployment rates in Spain are weighted by labour force qualification in the euro area.

Table 2
PROPORTION OF TERTIARY-EDUCATED EMPLOYED POPULATION AGED 30-34, IN HIGH-SKILLED JOBS (a). SPAIN AND EURO AREA

	2006			2018		
	Spain (%)	% of employed persons in high-skilled jobs in Spain, distribution by euro area qualification (b) (%)	Euro area (%)	Spain (%)	% of employed persons in high-skilled jobs in Spain, distribution by euro area qualification (b) (%)	Euro area (%)
All	39.4	39.8	50.2	44.0	42.8	53.4
Men	39.0	39.2	51.8	40.4	40.2	54.3
Women	39.7	40.9	48.6	46.8	45.4	52.6

SOURCE: Eurostat (Labour Force Survey).

a High-skilled jobs are occupations 1 and 2 of the International Standard Classification of Occupations (ISCO): 1 -Managers; 2 -Middle management and professionals.
b The proportion of employed persons in high-skilled jobs in Spain is weighted by qualification of employed persons in the euro area.

5 In this analysis, high-skilled jobs are associated with Major Groups 1 and 2 of the International Standard Classification of Occupations: 1 - Managers; 2 - Professionals.

relative improvement between 2006 and 2018 is fundamentally due to women, without the different specialisation playing an important role in the gap with Europe, as is shown in Table 2, which constructs a dummy rate of tertiary education graduates in high-skilled jobs, calculated in a similar fashion to the dummy unemployment rate. Were the distribution across degrees to match the European one, the share of skilled workers among young tertiary education graduates would be very similar (slightly higher in 2006 and slightly lower in 2018).

The evidence set out suggests that the greater incidence of unemployment among Spanish tertiary education graduates is not due to a qualification choice skewed more towards those with fewer employment opportunities than in the euro area as a whole. Conversely, the on-average less skilled jobs performed by young Spanish tertiary education graduates suggests that their higher level of unemployment compared with their euro area peers may be due to, among other factors, poorer-quality tertiary education. Likewise, we cannot rule out the presence of structural characteristics of the economy constraining the labour market's ability to appropriately absorb the flows of new tertiary education graduates.

The course of the second wave of the pandemic at the global level, the deployment of new containment measures in the vast majority of countries and, more recently, the news on the development of effective treatments against COVID-19 have influenced the performance of international financial markets in Q4

Q4 has been marked by several events that have influenced developments in international financial markets. Early in the quarter the absence of major changes in the economic policies adopted to mitigate the impact of the pandemic and in the macroeconomic outlook prompted some stability in the global financial markets. However, from the last week of October, the adoption of new lockdown measures in Europe to curb the effect of the second wave of the pandemic, together with the uncertainty in the United States about the approval of a fiscal stimulus package and the outcome of the presidential elections, has prompted investors to flock to safe haven assets, leading, consequently, to falls in the prices of risk-bearing assets. These dynamics reversed abruptly following the announcement on 9 November that one of the vaccines that was being developed in recent months against COVID-19 showed very promising results. The announcement triggered sharp rises in the stock market indices and increases in high-quality sovereign bond yields.

The stock market indices that have recovered more robustly in the quarter as a whole are the ones that had experienced the sharpest falls in the previous months as a result of the pandemic (see Chart 2.1). The S&P 500 index exceeded its record highs during the quarter, accumulating at the cut-off date for this Report a gain of 9.1% with respect to the levels at end-September. In Europe, the EURO STOXX 50, which had dropped in October to levels similar to those seen at end-May owing to the worsening of the health situation, rebounded subsequently, resulting in a cumulative gain from end-September of 10.3%. In Spain, the IBEX 35 was up 21.8% in the same period, well above the two foregoing indices and the Japanese Nikkei 225 index (15.4%). Aside from the aforementioned reasons, the Nikkei 225 was also driven by the signing of the Regional Comprehensive Economic Partnership (RCEP), a free trade agreement between Asia’s main economies (for more details on this agreement see Section 3 of this Report). That said, unlike the US stock market index, most of the European selective stock market indices continue to stand below the pre-pandemic levels.

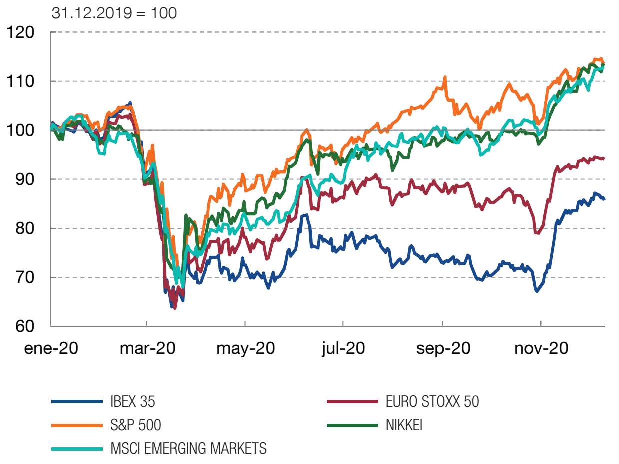
Sectoral stock market indices have performed unevenly, in line with the asymmetrical impact of the pandemic on the different segments of economic activity (see Chart 2.2). Following the promising news on the effectiveness of the

Chart 2

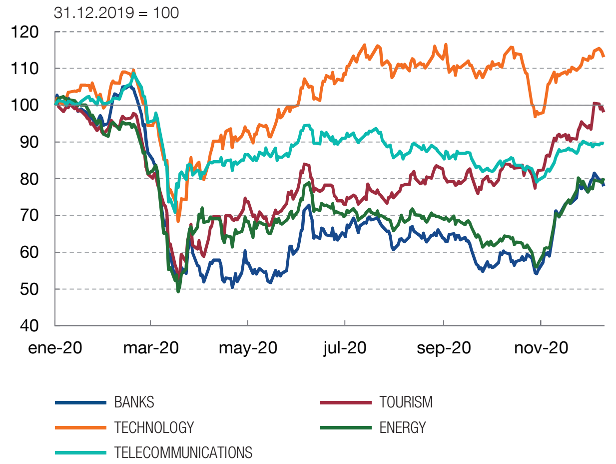
THE QUARTER SAW A SHARP IMPROVEMENT IN MARKET SENTIMENT FOLLOWING THE DISCOVERY OF AN EFFECTIVE VACCINE AGAINST COVID-19

After the falls at the end of October associated with the worsening of the pandemic, the announcement of the discovery of an effective vaccine against COVID-19 led to an improvement in market sentiment, with sharp rises in stock market indices, rises in high-quality sovereign yields and reductions in sovereign risk premia in the euro area. The heterogeneous behaviour of stock market indices is explained by the uneven impact of the pandemic on diffferent countries and segments of economic activity.

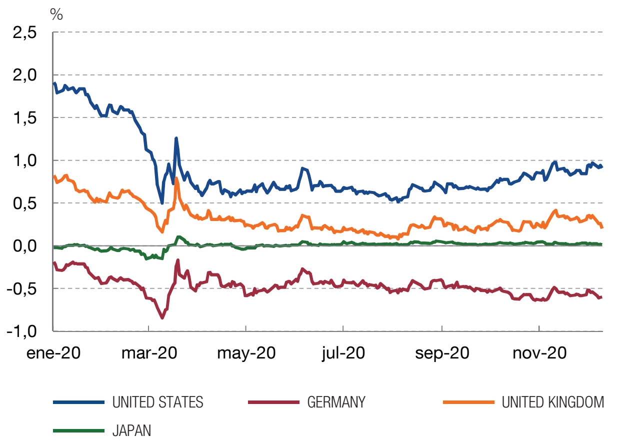
1 STOCK MARKET INDICES



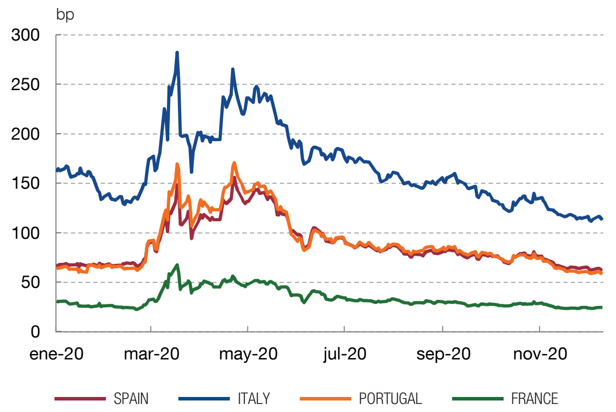
2 SECTORAL STOCK MARKET INDICES. EUROSTOXX



3 10-YEAR SOVEREIGN BOND YIELDS



4 EURO AREA 10-YEAR SOVEREIGN SPREADS



SOURCE: Refinitiv Datastream.

vaccines currently being developed, the sectors whose stock valuations had performed better during the pandemic posted lower growth than those whose stock valuations had been hit harder. Thus, since end-September the EURO STOXX bank index had posted a cumulative gain of 38.2% at the cut-off date for this Report, and the energy and tourism sector indices recorded gains of 27.3% and 23.7%, respectively. This contrasts with the more moderate increase accumulated by the technological sector index in the same period (2.9%). In the US stock market, the energy sector index headed the recovery, followed by the car industry index, with cumulative gains of 36.2% and

35.9%, respectively. Conversely, the telecommunications and technology sector indices posted much more moderate gains (5.5% and 8.9%, respectively).

The lower risk aversion in the second half of the quarter was also reflected in the sovereign and corporate debt markets. At the cut-off date for this Report, the US 10-year sovereign bond yield posted an increase of 23 bp compared with the levels at end-September (see Chart 2.3). By contrast, the German benchmark bond yield, which had increased more moderately following the announcements relating to the COVID-19 vaccines in recent weeks, has dropped by 8 bp in Q4 to date. Sovereign risk premia in the euro area increased slightly following the announcement of new lockdowns, but they returned to the declining path of recent months in early November, conditioned by the Eurosystem's asset purchase programme and the agreement on the EU's recovery fund (see Chart 2.4). At the cut-off date for this Report, the spreads on Italian, Portuguese and Spanish 10-year sovereign bonds over the German benchmark were below or very similar to those observed at the beginning of the year, with cumulative falls in Q4 to date of 26 bp, 21 bp and 15 bp, respectively. The credit spreads of euro area non-financial corporations have narrowed, particularly in the case of those domiciled in periphery countries, although the levels are still slightly higher than those observed prior to the health crisis.

The US dollar has continued to depreciate in recent months against the rest of the main currencies of the developed countries. The difference in the monetary policy stance of the United States compared with that of the euro area and other emerging economies, whose most recent dynamics are analysed in Section 3, may be an explanation for this.

3.1 External environment of the euro area

Global economic activity embarked on a recovery path in Q3, although this has proved incomplete, uneven by country and sector, and fragile, highly influenced by the course taken by the pandemic. Indicators for Q4 point to a widespread loss of momentum, as a consequence of the fresh outbreaks of the disease and the containment measures adopted

After falling sharply in 2020 H1, global economic activity picked up strongly in Q3, as a result of the easing of the lockdown measures introduced during the first wave of the pandemic and economic policy support. In the United States, GDP rose by 7.4% quarter-on-quarter and the labour market situation improved significantly, with the unemployment rate down from the highs verging on 15% in April to 7.9% at end-September (and to 6.7% at the cut-off date for this report). In the United Kingdom, GDP growth was even higher, at 15.5% in quarter-on-quarter terms (after falling by 19.8% in Q2), while in Japan GDP rose by 5.3% quarter-on-quarter after three consecutive quarters of decline. Nevertheless, in none of these cases did GDP return to its pre-pandemic levels. But this was not so in China, where the recovery continued in Q3, albeit at a more moderate pace, as GDP climbed by 2.7% quarter-on-quarter and activity rose above the levels recorded before the onset of the health crisis (see Charts 3.1 and 3.2). In the emerging market economies, such as those of Latin America, the easing of the lockdown measures and expansionary policies also prompted very significant growth in activity in Q3. The case of Turkey stands out, where GDP rose by 15.6% quarter-on-quarter, recovering its pre-pandemic levels.

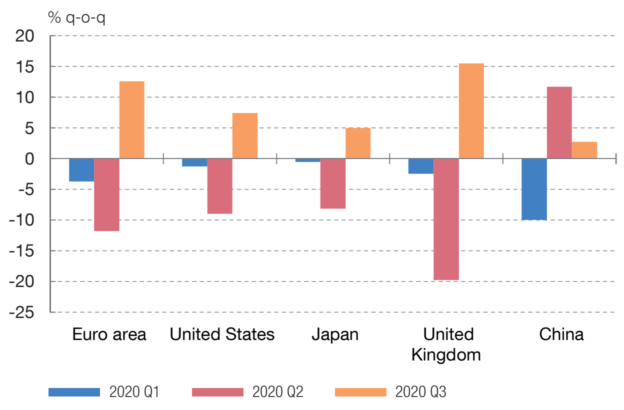
World trade also showed signs of a partial recovery in Q3. The volume of global trade in goods rose by 12.5% in quarter-on-quarter terms in Q3, after falling by 12.2% in Q2. The euro area and the United States are among the regions that contributed most to this recovery in global trade in the quarter. As regards trade policy, in mid-November fifteen Asia-Pacific nations, including China, Japan and South Korea, signed a new multilateral agreement – the RCEP – to form a trading bloc that accounts for 30% of world GDP and world population. This agreement, which entails tariff cuts in the bloc and greater harmonisation of product origin rules among the signatory countries, will foreseeably strengthen the role of the Asian production chains worldwide and also China's leadership in the region.

The last quarter of the year has seen a fresh outbreak in the pandemic and a deterioration in economic activity, most markedly in the advanced economies. In light of the increase in the number of cases, especially in Europe and the United

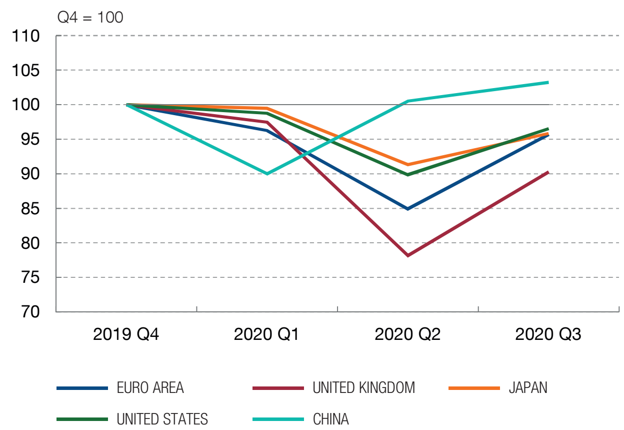
Chart 3
THE IMPACT OF THE COVID-19 PANDEMIC ON INTERNATIONAL ECONOMIC ACTIVITY

The Q3 GDP data show strong activity growth after the very sharp fall observed in 2020 H1. The spread of the second wave of COVID-19 has required fresh restrictions on mobility and activity in certain sectors, leading to a setback in the recovery of economic activity in Q4. As a result, the growth forecasts for 2020 have improved, but those for 2021 have been revised down.

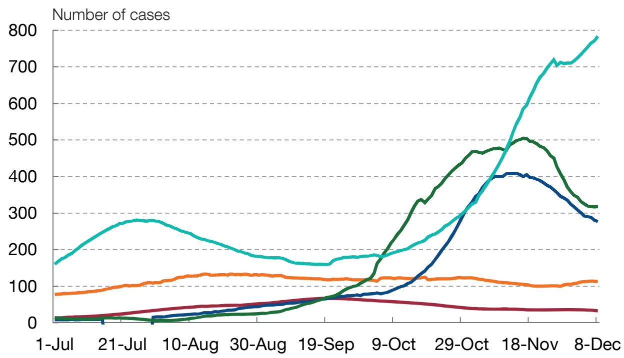
1 QUARTER-ON-QUARTER GDP GROWTH



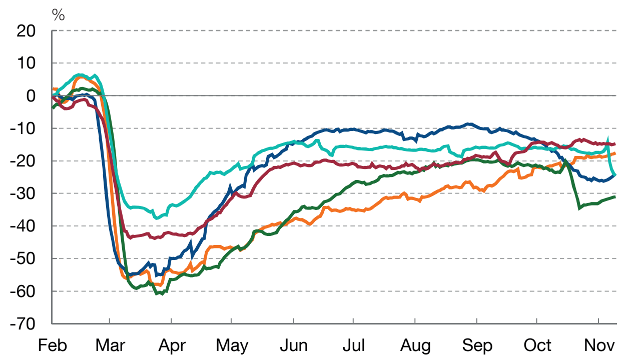
2 LEVEL OF GDP IN THE MAIN WORLD ECONOMIES



3 NEW CASES PER 100,000 INHABITANTS. 14-DAY TOTAL

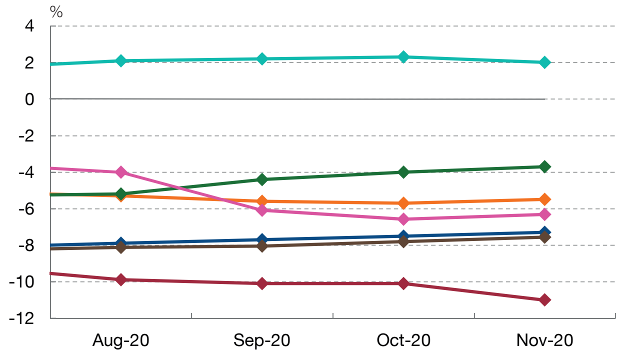


4 MOBILITY INDICATORS (a)

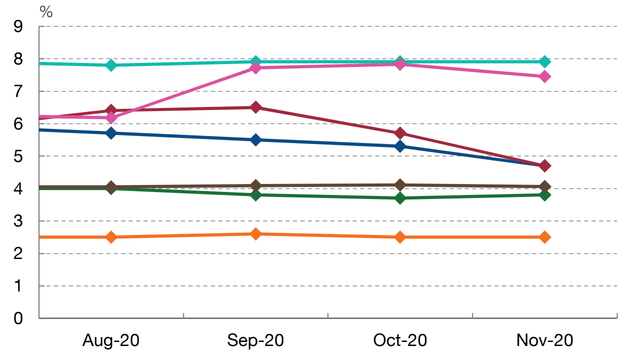


ASIA, EXCL. CHINA
LATIN AMERICA
EURO AREA
UNITED KINGDOM
UNITED STATES

5 GDP GROWTH FORECASTS FOR 2020



6 GDP GROWTH FORECASTS FOR 2021



EURO AREA
UK
JAPAN
US
CHINA
LATAM-6 (b)
EMERGING ASIA, EXCL. CHINA

SOURCES: Bloomberg, Consensus Forecasts, IHS Markit, Johns Hopkins University - Coronavirus Resource Center, Google, JP Morgan and Thomson Reuters.

a 7-day moving average of mobility to retail, leisure and food outlets and workplaces.
b Argentina, Brazil, Chile, Colombia, Mexico and Peru.

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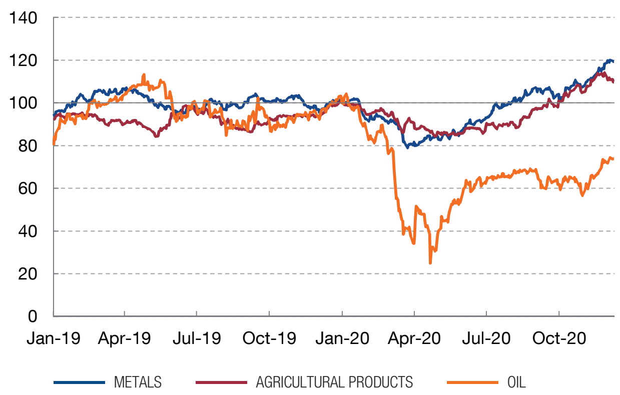
Chart 3
IMPACT OF THE COVID-19 PANDEMIC ON INTERNATIONAL ECONOMIC ACTIVITY (cont'd)

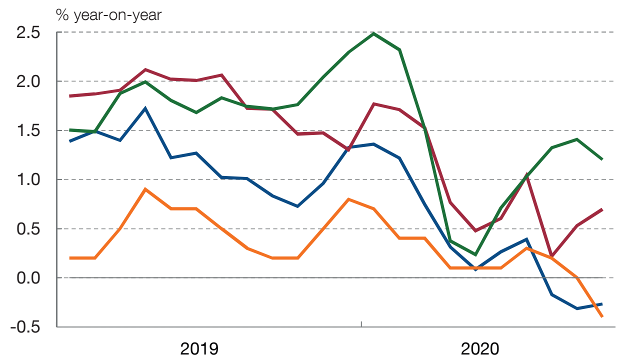
In November, the emerging market economies' financial indicators recovered significantly, after falling sharply in September. Inflation remains very low despite the increase in commodity prices. Likewise, core inflation also remains at historically low levels.

7 FINANCIAL CONDITIONS IN EMERGING MARKET ECONOMIES

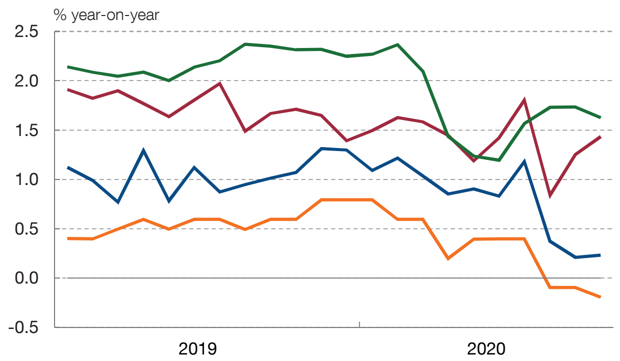
8 COMMODITY PRICE DEVELOPMENTS



9 INFLATION IN DEVELOPED ECONOMIES



10 CORE INFLATION IN DEVELOPED ECONOMIES



EURO AREA UNITED KINGDOM JAPAN UNITED STATES

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SOURCES: Bloomberg, Consensus Forecasts, IHS Markit and Thomson Reuters.

States, the great majority of countries have introduced new lockdown measures (see Charts 3.3 and 3.4). Despite being less restrictive than in the first wave, these measures have affected economic activity, and indicators for Q4 reflect a setback in the recovery, especially in the services sector which has borne the brunt of the restrictions.

The economic outlook is marked by great uncertainty, associated primarily with the course of the pandemic and the availability of vaccines in the coming months. Consensus Forecasts for November reflect upward revisions to expected growth for 2020, as a consequence of a stronger than expected recovery in Q3, but downward revisions to growth for 2021 in some regions, owing to the effects of the spread of the pandemic (see Charts 3.5 and 3.6). There are some downside risks to these forecasts, related to a possible adverse course of the pandemic. In the case of Europe, the outcome of the Brexit negotiations is an added element of uncertainty. Some recent developments offer more optimistic signals for the global economy overall, such as the election outcome in the United States or the positive news on the availability of vaccines for COVID-19.

Recent developments in emerging market financial markets, as in global markets, have been driven by progress in the development of COVID-19 vaccines (see section 2 of this report). After falling sharply in September, the emerging market economies' financial indicators recovered substantially in November: stock markets climbed, sovereign spreads narrowed and exchange rates appreciated (see Chart 3.7). In addition, after the important capital flight episode observed in the early months of the pandemic (see Box 1), capital flows to emerging market economies have gradually recovered. Indeed, some high-frequency data point to high portfolio capital inflows since early November, especially in Asia and Latin America.

Disinflationary pressure associated with the effects of the pandemic remains, despite the increase in commodity prices (see Charts 3.8 to 3.10). Headline inflation rates are low; in some cases, as in the euro area and Japan, they are below zero. In the United States, inflation has moderated again recently, curbing the upward pattern observed since June. And this despite the increase in commodity prices, stemming both from supply and demand factors, the latter essentially related to the possible availability of vaccines for COVID-19. Rising metals prices are also connected with higher demand from China, while part of the recent climb in oil prices is on account of the lower than expected production increase agreed by OPEC and its members. In this case downside risks remain, owing both to supply factors (for instance, renewed production in Libya and doubts regarding compliance with the OPEC agreement) and demand factors (as a result of the effects of the second wave of the pandemic). Core inflation rates, which exclude energy and food, also remain very low, despite being somewhat higher than headline inflation rates.

Regarding monetary policy, the measures taken by central banks again seek to mitigate the effects of the pandemic. At its November meeting, the Federal Reserve reiterated its commitment to hold the federal funds rate at its current level until inflation averages slightly over the 2% target for some time, in line with its strategy review approved in September. The Bank of England, at its November meeting, extended its asset purchase programme by £150 billion, taking the total to £895 billion. Also in November, the Bank of Japan introduced a new deposit facility paying 0.1% interest for regional banks that make cost cuts or enter into mergers to boost their profitability. The new facility is to remain in place until March 2023. Among the emerging market economies, the rate cut cycle seems to have reached its limit in some cases, so that the expansionary monetary policy stance is maintained through non-standard measures. Conversely, the Turkish central bank raised its policy rate by 475 bp to 15% in November, in an endeavour to return to a more orthodox monetary policy.

In the fiscal policy sphere, governments are studying renewing stimulus programmes. Most notable in this respect is the possibility of a new fiscal package in the United States, following Biden's victory in the presidential elections, although without a Democrat majority in the Senate it could be difficult to obtain approval for his election promises. On the expenditure side, the new administration intends to scale up government consumption and social benefits and embark on an ambitious infrastructure programme focused on environmentally sustainable projects, clean energy and the housing market. This increased expenditure would be financed in part by higher taxes on large corporations and high-income households. Overall, these measures would boost the discretionary fiscal impulse in the United States which, to date, has been somewhat higher than in the euro area. However, a more balanced assessment must take into account the greater deployment of public guarantee programmes and the larger capacity of automatic stabilisers in the euro area (see Box 2). In the United Kingdom the fiscal package for employment support measures has been extended to March, and in Japan the government has proposed a new fiscal stimulus package, to be approved by parliament.

3.2 The euro area

After robust growth in euro area activity in Q3, the measures implemented to prevent the pandemic from expanding are adversely affecting activity in the final stretch of the year. Inflation has fallen in recent months to historically low levels, although some factors that have depressed prices are temporary and will reverse in 2021

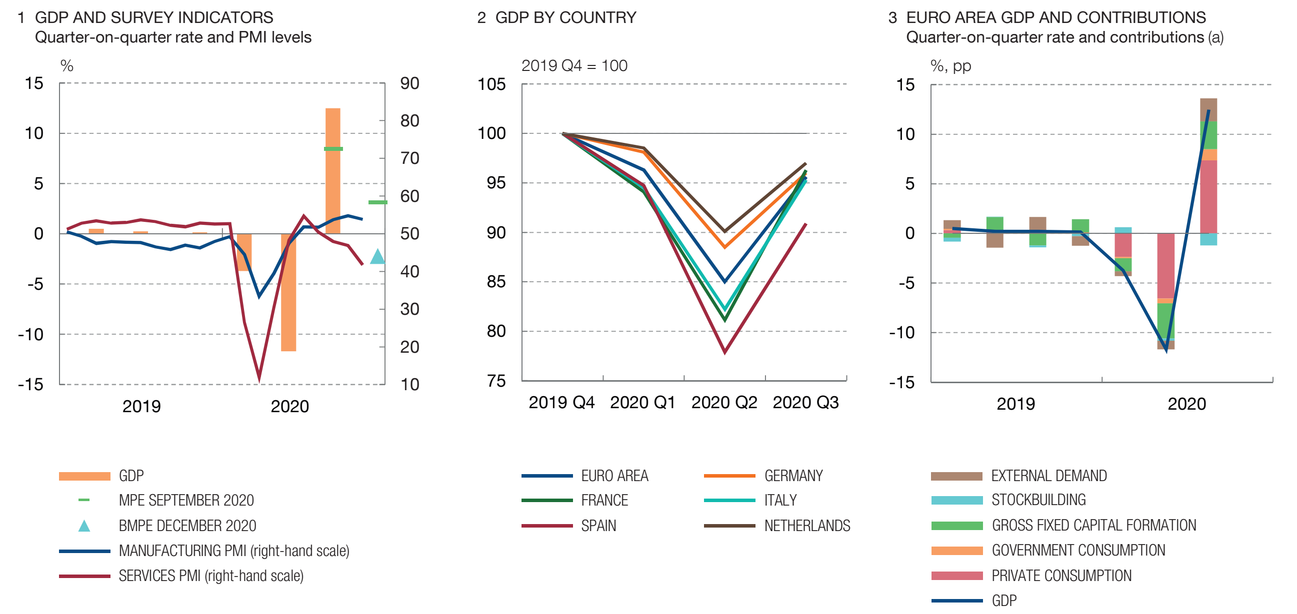
Euro area GDP rebounded by 12.5% in Q3, a stronger increase than expected by the main international organisations and 4.1 pp more than forecast in the September 2020 ECB staff projection exercise. The positive surprise was widespread across countries, albeit uneven in scale. Strong consumption, investment and a robust external sector, compared with the historic falls recorded in Q2 (which triggered an 11.7% decline in GDP), were the main factors behind this recovery, driven by the significant improvement in the health situation in Europe over the summer that enabled a gradual easing of the lockdown measures (see Chart 4).

Nonetheless, since the end of the summer, growth in the number of infections quickened in several European countries, requiring the implementation of fresh restrictions. Overall, these have been more selective than those deployed during the spring. This increase in infections has been uneven across countries, in terms of both its severity and its timing. The deterioration in the health situation

Chart 4

AFTER POSTING STRONG GROWTH IN Q3, GDP IS EXPECTED TO CONTRACT IN Q4

The positive GDP growth surprise in Q3 will be countered in part by the weak levels of activity in Q4 recorded by the latest indicators. Compared with pre-pandemic GDP levels, the pick-up in activity in Spain is more moderate than in the main euro area economies.



SOURCES: Eurostat, Markit Economics and ECB.

a Excluding Ireland, owing to the major fluctuations shown by some of its GDP components as a result of the effect of multinationals.

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affected Spain first, then France and Belgium, and finally spread gradually to the rest of the region. As this worsening of the pandemic has been accompanied by fresh restrictions, growth in 2020 Q4 will likely be considerably affected. Indeed, some available indicators, such as the PMI and the European Commission's economic sentiment indicator, already point to activity falling off in Q4. According to the latest Eurosystem macroeconomic projections, activity in the euro area could contract by around 2.2% quarter-on-quarter.

The fresh containment measures and the uncertainty surrounding the course of the pandemic will weigh down household spending, after its significant recovery in Q3. Indeed, consumers' intention to make major purchases over the next 12 months fell in November for the second consecutive month. In tandem, the European Commission's indicator of savings intentions in the next 12 months has followed an upward path since August.

The pick-up in activity in Q3 was broad-based in both manufacturing and services, resulting in a recovery in employment. The strong growth observed in Q3 spread to all major sectors of the economy. However, the latest indicators, such as the PMI, show a marked deterioration in services, as is to be expected following the introduction of fresh restrictions. Employment recovered by 1% in Q3 compared with Q2. This essentially resulted in a lower percentage of individuals subject to temporary lay-off schemes. However, the latest data in some countries, such as Spain and France, show a slight increase in that percentage.

The Eurosystem's December macroeconomic projections[4] show a smaller contraction in activity in 2020 than forecast in September, owing mainly to the strong recovery in Q3. However, the growth forecast for 2021 has been revised down. The baseline scenario of the December projection exercise rests on a relatively contained expansion of the pandemic in the coming months and the first vaccines being available in the first half of 2021. However, the entire population is not expected to be vaccinated until early 2022. In this connection, it is assumed that the containment measures will remain in force in the near term and be eased gradually in the medium term. This will enable activity to recover progressively in the coming years. A 7.3% decline in GDP in 2020 is projected under this scenario, a 0.7 pp smaller contraction than projected in September. This revision is based on the upward surprise in Q3, which would be countered in part by the expected contraction in Q4. In 2021, activity would rise again (3.9%), albeit at a slower pace than expected in September (down 1.1 pp). In the following years, growth would quicken in 2022, to 4.2%, to moderate again in 2023 (2.1%). These forecasts assume under the baseline scenario that use of the Next Generation EU (NGEU) funds will amount to around 0.5% of euro area GDP in each year in 2021-2023, meaning that this instrument will play an important role in the region's recovery process. In any event, the forecasts are subject to a high degree of uncertainty, since a larger-than-assumed expansion of the pandemic or a slower-than-assumed mass vaccination campaign could have adverse effects on activity in the near term. Furthermore, there is a risk that this health crisis might scar long-term growth. The extent of the scarring is currently hard to determine and linked, among other factors, to hysteresis effects, difficulties in building up human capital and business solvency issues.

Inflation stands at very low levels by historical standards as a result of some temporary factors, but also weak demand and the appreciation of the euro

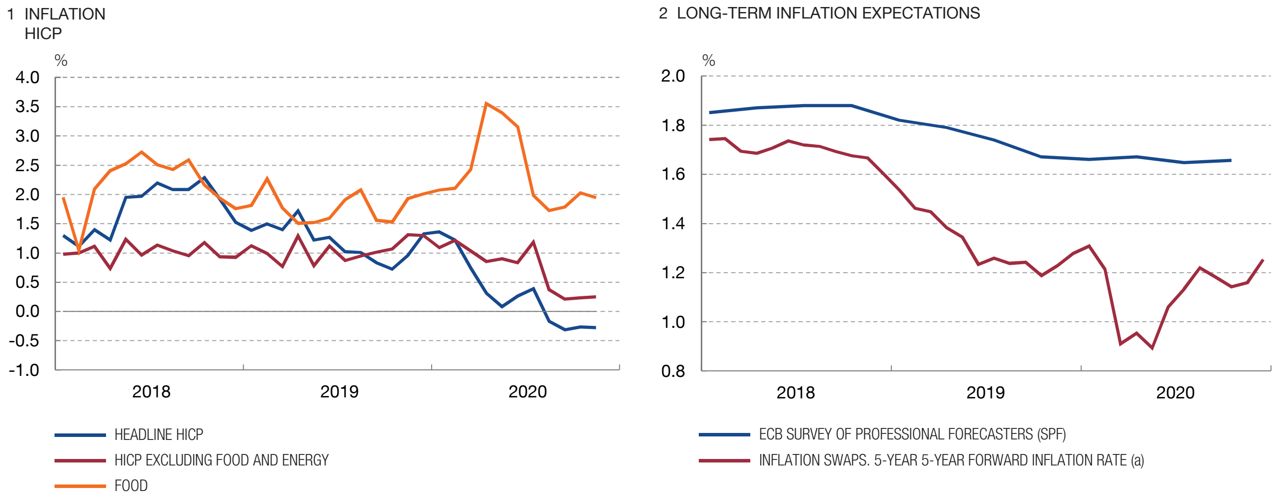
In November, headline inflation in the euro area held steady at -0.3%, while core inflation has stood at around 0.2%, an all-time low in the series, since September (see Chart 5.1). Weak inflation is the result of services prices slowing since the onset of the pandemic and the lower prices of energy and non-energy industrial goods. In addition, the ongoing euro appreciation – 6.7 pp in nominal effective terms between early 2020 and this report going to press – and the temporary VAT rate cut in Germany were the main factors behind core inflation standing at an all-time low. Most international organisations point to very subdued inflation in 2020,

4 See Eurosystem staff macroeconomic projections for the euro area, December 2020.

Chart 5

EURO AREA INFLATION IN NEGATIVE TERRITORY

In November, inflation stood at -0.3%, preserving the decline recorded at the end of Q3. Excluding energy and food, inflation stood at 0.2%. Expectations are for low inflationary pressure, against a backdrop of falling energy prices and weak demand. Long-term inflation expectations have remained stable in recent months.



SOURCES: Bloomberg, Eurostat and ECB.

a Monthly average of daily data.

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picking up next year when several of the aforementioned factors reverse. Nevertheless, inflationary pressures will likely be limited over the coming years, as inferred from the low level of long-term inflation expectations (see Chart 5.2).

Against this background, the latest Eurosystem projection exercise expects average inflation of 0.2% in 2020, which would gradually increase over the coming years to 1.4% in 2023 (see Table 2). Compared with the September projections, these figures have been revised down for 2020 and 2022. Core inflation has also been revised down, by 0.1 pp, over the entire projection horizon, but remains on an upward path throughout (0.7% in 2020, 0.8% in 2021, 1.0% in 2022 and 1.2% in 2023). The risks to these forecasts are predominantly to the downside and are mainly linked to the possibility of a weaker-than-projected recovery in demand. In addition, the risk of inflation expectations deanchoring has increased recently after several months of negative inflation rates. The upside inflation risks mainly appear to be external in origin: higher global demand and some production relocation processes affecting global value chains.

At its most recent monetary policy meeting in December, the ECB Governing Council decided to extend the stimulus measures by recalibrating its monetary policy instruments, with a view to maintaining favourable financing conditions for the duration of the pandemic crisis. The ECB left its key policy rates unchanged and adjusted its asset purchase programmes and longer-term refinancing operations.

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

	2020		2021		2022		2023	
	GDP	HICP	GDP	HICP	GDP	HICP	GDP	HICP
ECB (December 2020)	-7.3 (0.7)	0.2 (-0.1)	3.9 (-1.2)	1.0 (0.0)	4.2 (1.0)	1.1 (-0.2)	2.1 (...)	1.4 (...)
European Commission (November 2020) (b)	-7.8 (-0.9)	0.3 (0.0)	4.2 (-1.9)	1.1 (0.0)	3.0 (…)	1.3 (...)		
OECD (December 2020)	-7.5 (0.4)	0.3 (...)	3.6 (-1.5)	0.7 (...)	3.3 (…)	1.0 (...)		
IMF (October 2020) (b)	-8.3 (1.9)	0.4 (…)	5.2 (-0.8)	0.9 (…)	3.1 (…)	1.2 (…)	2.2 (…)	1.4 (…)
Consensus Forecast (December 2020)	-7.3 (0.0)	0.3 (0.0)	4.7 (-0.0)	0.9 (0.0)				

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

a In brackets, change with respect to the previous forecast, which was September 2020 for the ECB, July for the European Commission, September for the OECD, June for the IMF and November for Consensus Forecast.
b The European Commission and IMF data are presented without adjusting for business days. The estimated effect for 2020 is 0.2 pp on GDP growth.

Accordingly, the Governing Council agreed to increase the envelope of the pandemic emergency purchase programme (PEPP) by €500 billion to a total of €1,850 billion. It also lengthened the time horizon for net purchases under the PEPP to at least the end of March 2022 (reiterating the message that net purchases will be conducted until it judges that the COVID-19 crisis phase is over) and extended the reinvestment of principal payments from maturing securities until at least the end of 2023. As regards the longer-term refinancing operations, three additional auctions of the third series of targeted longer-term refinancing operations (TLTRO III) were announced, to be conducted between June and December 2021, and the borrowing conditions for banks that achieve a new lending performance target were recalibrated. Specifically, the period over which the more favourable interest rate will apply was extended by 12 months to June 2022, provided that the counterparties maintain their stock of eligible loans during a new evaluation period, ending in December 2021, while the total amount that counterparties will be entitled to borrow in TLTRO III operations was raised from 50% to 55% of their eligible loans. Also announced were four additional pandemic emergency longer-term refinancing operations (PELTROs) in 2021, allotted on a quarterly basis, each with a tenor of one year, at an interest rate 25 bp below the main refinancing operations (MRO) rate. Lastly, the Governing Council decided to extend the duration of the collateral easing measures adopted in April 2020 until June 2022, in the interest of shoring up banks' capacity to make full use of the refinancing operations against the backdrop of the pandemic crisis. The ECB's decisions were in keeping with analysts' expectations. Accordingly, the market movements that followed their announcement were muted. Moreover, the market does not expect the key policy rates to change over the coming quarters.

Financing conditions for the private sector remain comfortable, although there have been indications of a certain tightening in some segments. Although the cost of bank lending remains at historically low levels across all segments, in lending to firms the spreads against interbank rates have risen slightly. Should the financial institutions' expectations contained in September's Bank Lending Survey bear out, in 2020 Q4 credit standards for lending to firms and, to a lesser degree, to households for house purchase will have tightened, while credit standards in the consumer credit and other lending segment will have eased slightly. In the Survey on the Access to Finance of Enterprises (SAFE), SMEs also predicted a worsening in the conditions of access to financing over the coming months, following the improvement observed between April and September.[5] By contrast, the spread between the average cost of long-term financing on corporate debt markets and the interest swap rate has continued to shrink in recent months. Thus, at the end of November the spread stood close to, albeit still slightly above, the pre-health crisis level. This has been persistently supported by the ECB's PEPP introduced in mid-March and subsequently expanded in early June.

The latest data on funding raised by the private sector show lending to firms losing momentum and that to households picking up slightly. The growth in the outstanding amount of bank loans extended to non-financial corporations has slowed, expanding in annualised quarter-on-quarter terms by 1.6% in October, down 5.2 pp on three months earlier, while the growth rate in funding raised on debt securities markets eased by 22.3 pp to 4.3% (see Chart 6.1). The annualised quarter-on-quarter growth rate in lending to households rose to 4.3% in October (up 1 pp on July) as a result of loans for house purchase recording more vigorous growth of 6.1%, and in spite of the slowdown in consumer credit and other lending, which grew 2.5% and 1%, respectively (see Chart 6.2).

The year-on-year growth in private sector holdings of liquid assets has barely changed in recent months, following the acceleration observed after the outbreak of the pandemic. The broad monetary aggregate M3 grew at a year-on-year rate of 10.5% in October (0.4 pp more than in July), while the narrow monetary aggregate M1, covering the most liquid forms of money, grew by 13.8% year-on-year (0.3 pp more than in July).

In the realm of fiscal policy, European countries have submitted their draft budgetary plans for 2021. Prominent among the measures foreseen in the plans are investment programmes backed by funds from the European Recovery and Resilience Facility (RRF), part of the NGEU programme. For example, France announced an investment programme of €100 billion (4% of GDP), which will be partially financed by the RRF. Italy also announced that the RRF grants would be fully absorbed by a public investment programme, along with partial recourse to the loans. Further, in the final stretch of the year, euro area countries have extended and

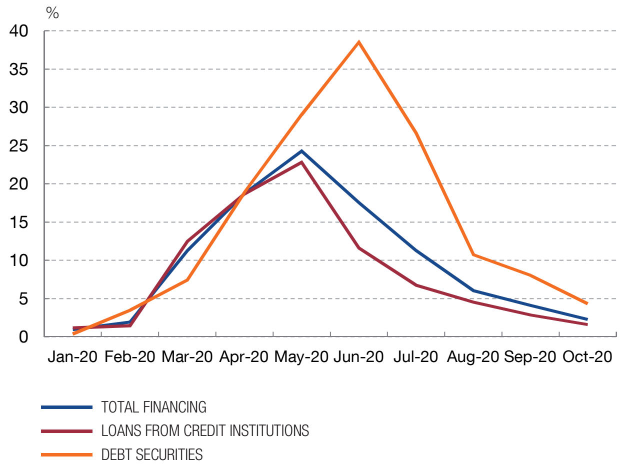
5 See Box 3 of this report, "Recent developments in Spanish SMEs' access to external finance according to the ECB's six-monthly survey".

Chart 6

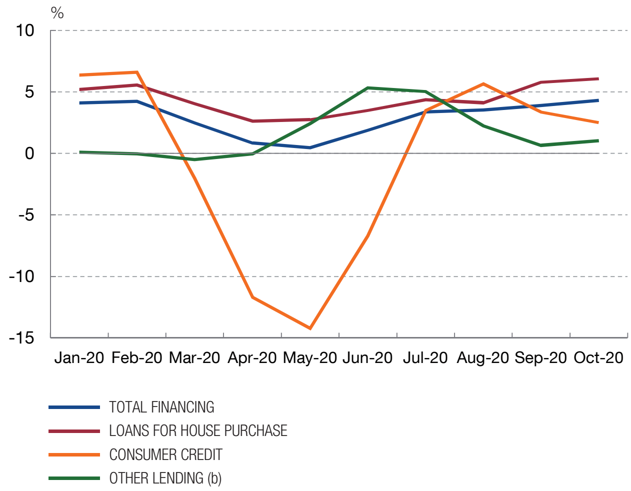
BUSINESS LENDING HAS LOST MOMENTUM; HOUSEHOLD LENDING HAS PICKED UP SLIGHTLY

The pace of growth of business lending – both via bank loans and on the debt securities markets – has continued to slow in recent months. By contrast, the quarterly rate of growth of lending to households has risen slightly since July, as a result of the uneven performance of its components. Thus, while the rate of growth of loans for house purchase has continued to increase, the rate of growth of consumer credit and other lending has slowed.

1 FINANCING OF NON-FINANCIAL CORPORATIONS
Annualised quarter-on-quarter change (a)



2 HOUSEHOLD FINANCiNG
Annualised quarter-on-quarter change (a)



SOURCE: ECB.

a Seasonally-adjusted data.
b Includes loans granted to the self-employed.

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supplemented the measures approved in previous quarters to support firms and households. In particular, Italy announced tax reductions, the extension of the ban on dismissals and furlough programmes, and the suspension of certain taxes on the self-employed.

On November 18, the European Commission presented its 2021 Euro area recommendation. In the near term, considerable importance is attached to maintaining support to households and firms. To that end, the general escape clause, which allows the fiscal rules to be waived under exceptional circumstances, has been extended to 2021. Over a longer horizon, the Commission recommends an orderly withdrawal of the stimulus measures when the circumstances so allow, with a view to maintaining a robust medium-term fiscal position. The recommendations also emphasise the need to implement structural reforms that foster inclusive and sustainable growth, to adapt tax systems to the digitalisation of the economy, to improve the efficiency of public administration and to preserve macrofinancial stability.

Lastly, as regards the deepening the euro area, on 30 November the Eurogroup agreed to reform the European Stability Mechanism (ESM). Under the agreement, the ESM will act as the common backstop for the Single Resolution Fund as of 2022 (two years earlier than scheduled). Further, the ESM has been given a stronger role in the preparation and monitoring of financial assistance programmes, while its lending toolkit has been reformed, now including a credit line that is available to countries that satisfy certain eligibility criteria before requesting assistance. The Member States have agreed to sign the ESM Treaty in January 2021 and launch its ratification by the national parliaments, with a view to its entry into force in 2022.

Bank financing conditions for the non-financial private sector tighten, while market financing improves thanks to the support of monetary policy and the announcements on COVID-19 vaccine progress

Conditions on Spanish financial markets improved over the final quarter of the year to a greater extent than on average in the euro area following the positive news regarding progress in developing COVID-19 vaccines. Between the end of September and the cut-off date of this Report the IBEX-35 climbed 21.8%, while the EURO STOXX 50 rose 10.3%. The more favourable performance of the Spanish stock market is essentially explained by the greater weight in the index of sectors that have benefited most from the announcements relating to the development of effective COVID-19 vaccines, such as tourism and banking, which advanced in Q4 by 64.6% and 60.5%, respectively. That said, these sectoral indices still show accumulated losses of 30.7% and 27.1%, respectively, in comparison with their pre-health crisis levels. Against a background of greater appetite for risk on the markets, the yield spread between Spanish and German 10-year government bonds has narrowed during Q4 by some 15 bp, to 63 bp, which is below its pre-pandemic level. Meanwhile, 12-month EURIBOR has fallen in Q4 to -0.50%, an all-time low.

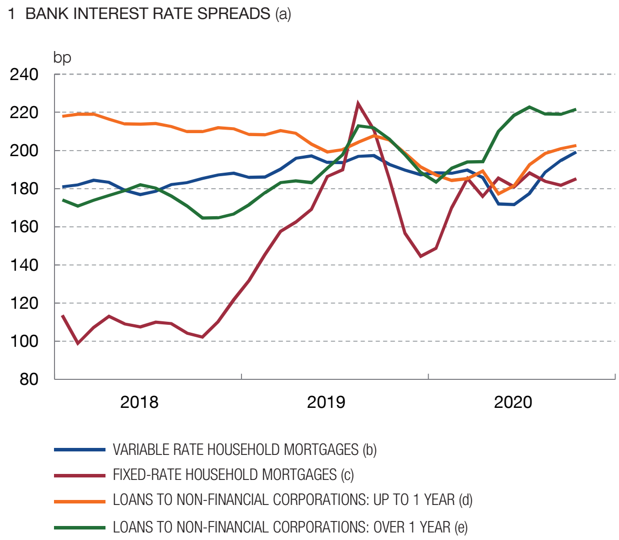
The cost of financing for the private sector has remained at low levels, although financial institutions do not appear to have passed the recent decreases in money market interest rates through to their new lending. The spread between the cost of bank lending and money market interest rates has widened in recent months, as the falls in the latter have, so far, not been passed through to the former, particularly in the case of non-financial corporations (see Chart 7.1). In contrast to the stability of bank lending rates, the average cost of corporate debt financing has continued to decline in recent months, although in November (the latest data available) it was still 15 bp above its level before the health crisis. The spread of this cost over the swap rate with the same maturity has also fallen in recent months, although it remains some 30 bp above its pre-pandemic level.

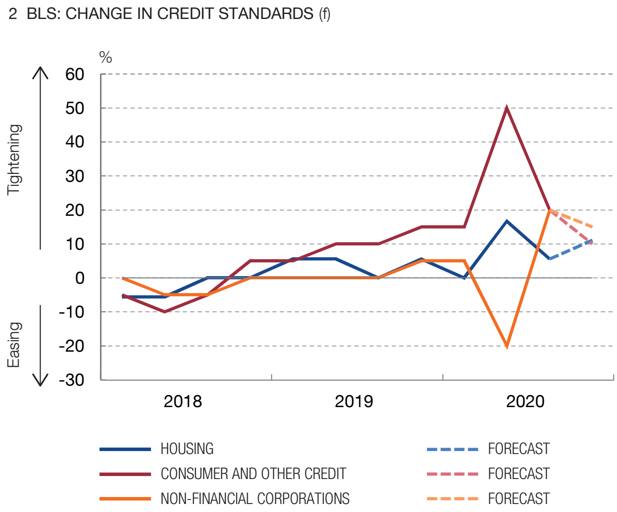
According to the Bank Lending Survey (BLS), credit standards have tightened across the board in Q3, as a consequence of the increase in perceived risks, a trend that may continue in the last few months of the year. In the corporate financing segment, this tightening has occurred after the easing between April and June, prompted by the measures taken to boost the flow of lending to the corporate sector, which had high liquidity needs. However, the contraction of supply in the household lending segments represents a continuation of the trend in the previous quarter (see Chart 7.2). For the final quarter of the year, the BLS anticipates that

Chart 7

BANK LENDING SPREADS HAVE INCREASED IN RECENT MONTHS AND CREDIT STANDARDS HAVE TIGHTENED

The spreads between the interest rates on new bank loans and market interest rates have widened in recent months, especially in the non-financial corporations sector. According to the latest Bank Lending Survey (BLS), credit standards tightened in Q3 in all segments, a trend that may continue in Q4.





SOURCES: Thomson Reuters and Banco de España.

a Bank lending rates are NDERs (narrowly defined effective rates), i.e. they do not include related charges and fees, and they are adjusted for the seasonal and irregular components.
b Spread over the 12-month EURIBOR of the previous month.
c Spread over the 20-year interest rate swap of the same month.
d Spread over the 3-month EURIBOR of the previous month.
e Spread over the 3-year interest rate swap of the same month.
f Indicator = percentage of institutions that have tightened their standards considerably × 1 + percentage of institutions that have tightened their standards somewhat × 1/2 – percentage of institutions that have eased their credit standards somewhat × 1/2 – percentage of institutions that have eased their credit standards considerably × 1.

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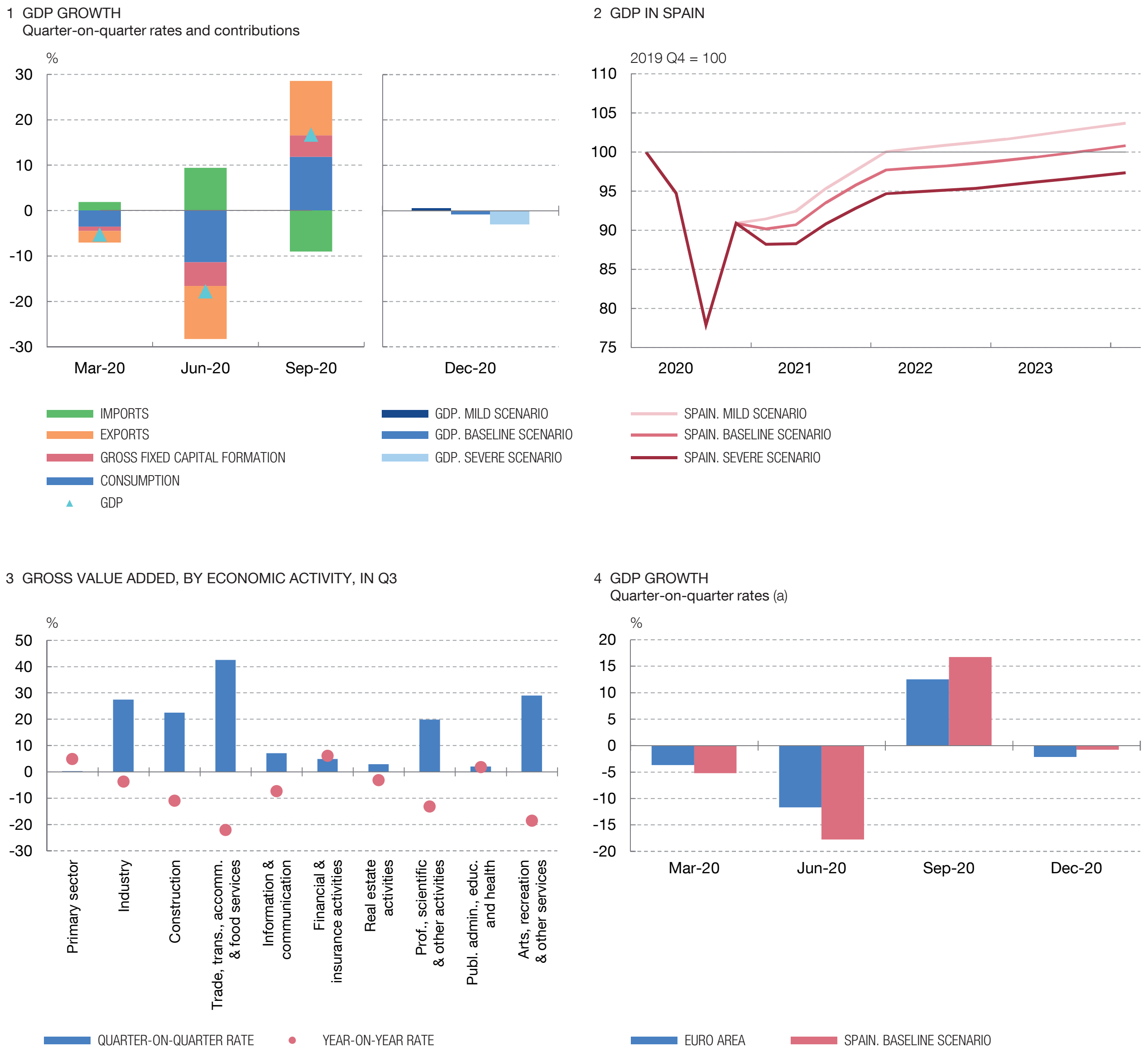
credit standards will continue to tighten, both in the household and in the corporate financing segments. According to the latest ECB survey on the access to finance of enterprises (SAFE) in the euro area, the sharp decline in business activity from the start of the pandemic did not affect the access to finance of Spanish SMEs between April and September 2020, which even improved slightly with respect to the previous period. However, in this survey, companies anticipated a significant tightening of access to bank financing in the coming months (see Box 3).

Economic activity in Spain rebounded significantly in Q3, driven by the easing of the pandemic containment measures, although it failed to reach its pre-health crisis levels and the recovery slowed as cases increased again in the summer

In Q3 Spanish GDP increased sharply, although it still remains well below its pre-pandemic levels. The gradual easing of the restrictions on mobility and the

Chart 8
ECONOMIC ACTIVITY RECOVERED PARTIALLY IN Q3

The recovery of activity in Q3 was mainly based on domestic demand (especially consumption) and to a lesser extent on the external sector. This recovery was broadly based across the different sectors, although there were notable differences as regards the gap between current and pre-pandemic activity levels.



SOURCES: INE, ECB and Banco de España.

a Banco de España projections for the Spanish economy and ECB projections for the euro area.

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activity of certain sectors which took place towards the end of Q2 boosted GDP growth in Q3, following the sharp falls recorded in the first half of the year, to a seasonally adjusted quarter on quarter rate of 16.7% (see Chart 8.1). However, this output growth, which was practically the same as the forecast under scenario 1 of the Banco de España's projections exercise published in September,[6] was not enough for the level of activity to recover fully, so that GDP in Q3 was still 9.1% below its end-2019 level (see Chart 8.2).

The sharp increase in output in Q3 was essentially based on domestic demand. The strong positive contribution of domestic demand to GDP growth in this period (15.3 pp), in contrast to its sizeable negative contribution in the previous quarter, is largely explained by the behaviour of private spending, the components of which — in particular household consumption and investment in capital goods — grew very markedly. Government consumption, meanwhile, accelerated again, against a background of rising spending on health and education in response to the needs arising from the pandemic. As regards the external sector, the contribution of external demand to growth was also positive (2.2 pp), as imports grew more slowly than exports, the latter being driven by inbound tourism, which, despite remaining at very low levels, rebounded sharply in Q3.

The recovery in Q3 was broadly based across the different sectors, although there was considerable sectoral heterogeneity as regards the gap between current and pre-pandemic activity levels. Between June and September, the growth in wholesale and retail trade, transport and accommodation and food services (42.5%) and in arts and recreation services (29%) stood out (see Chart 8.3). However, despite this very strong recovery, the activity of these sectors was still well below the levels recorded at the end of 2019 (22.5% and 19%, respectively). By contrast, other sectors (such as the primary sector, financial and insurance activities and public administration, education and health), had higher levels of activity in Q3 than before the pandemic (4.9%, 6.2% and 1.4%, respectively).

The growth differential between Spain and the euro area was positive for the first time since the start of the crisis, but insufficient to close the gap that opened up in the first half of the year. The recovery in GDP in Q3 was significantly stronger in Spain than in the euro area as a whole (16.7%, as against 12.5%), after a contraction that was also much more pronounced in the Spanish economy in the two preceding quarters (see Chart 8.4).[7]

The increase in the number of cases over the summer dampened the recovery. From the end of July, the rapid deterioration in the epidemiological situation in Spain led to the introduction of fresh restrictions by domestic and international authorities, which bore down on the strength of the recovery. In particular, restrictions imposed on travellers from Spain by some of the main countries that provide tourists for Spain

6 See Box 1 ("Macroeconomic scenarios for the Spanish economy (2020-2022)") of the "Quarterly Report on the Spanish Economy", *Economic Bulletin,* 3/2020, Banco de España.

7 For a more detailed analysis of the factors that explain the negative growth differential between Spain and the euro area in Q2, see "Quarterly report on the Spanish economy", *Economic Bulletin,* 3/2020, Banco de España.

held back activity in the tourism industry significantly in the latter part of Q3, a trend that has continued in the final three months of the year.[8]

The worsening of the health crisis in Q4 has been an additional drag on the dynamism of activity, which may even entail a decline in GDP

The tightening of the pandemic containment measures in Q4 has intensified the slowdown in activity that began in Q3. The new restrictions have generally been more targeted than those deployed in the spring, but they have again had a negative impact on activity and have, once more, had a larger negative impact on those services sectors that require a high degree of social interaction. This slowdown in activity has been reflected in the monthly indicators normally used to monitor economic developments, in the higher frequency indicators that have been closely monitored during the health crisis and also in the Spanish business survey conducted by the Banco de España to assess the recent performance of activity and the impact of the pandemic. As regards this latter source, almost half of the businesses surveyed reported a fall in turnover in Q4, which was especially pronounced in the case of the services most affected by the containment measures, such as accommodation and food services, leisure and entertainment activities and wholesale and retail trade.[9]

Purchasing Managers' Indices (PMI) have declined since August. At the outset, this weakness stemmed essentially from services, although the most recent data also show signs of an incipient slowdown in manufacturing, which has been affected by the negative impact of fresh outbreaks of the pandemic on domestic demand and on the main export markets (see Chart 9.1). The latest available data on the Industrial Production Index (IPI) and on the Services Sector Activity Index (IASS, by its Spanish abbreviation), for October and September, respectively, also show a partial recovery which is stronger in industry than in services (see Chart 9.2).

The developments in agents' confidence and in a broad range of high frequency indicators are also consistent with a pattern of slowing activity in the last part of the year. According to the European Commission's economic sentiment indicator, the recovery in agents' confidence came to a halt in August and, so far in Q4, it is estimated to have fallen once more from already relatively low levels, especially as regards services and consumers. Recent developments in various indicators of mobility (for example, on the location of mobile phones, air and road traffic, and fuel

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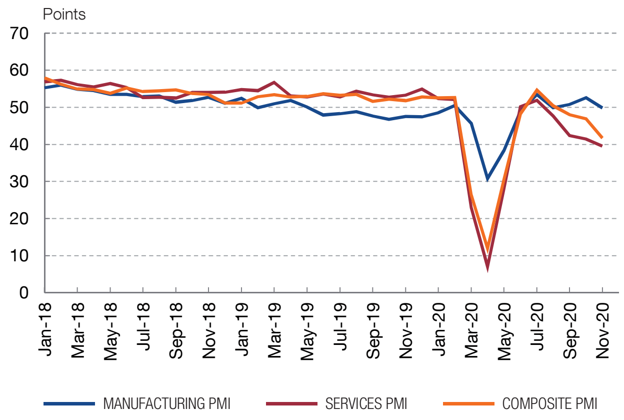
8 See Box 8 ("Recent developments in inbound tourism in Spain"), of the "Quarterly Report on the Spanish Economy", *Economic Bulletin,* 3/2020, Banco de España.

9 See Box 3 ("Spanish business survey on activity and the impact of COVID-19") of *Macroeconomic projections for the Spanish economy (2020-2023): the Banco de España's contribution to the Eurosystem's December 2020 joint forecasting exercise,* Banco de España.

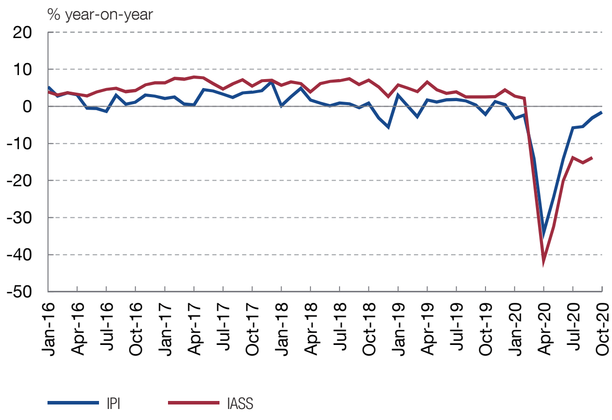
Chart 9
SERVICES WILL CONTINUE TO BE HARDER HIT BY THE EFFECTS OF THE PANDEMIC THAN MANUFACTURING

The services sector, relatively harder hit by the social distancing measures, initially experienced a greater negative impact from the pandemic than manufacturing and its partial recovery in Q3 was weaker. Based on the most recent qualitative and quantitative indicators, the sectoral unevenness will continue and could even become more accentuated in Q4.

1 PURCHASING MANAGERS' INDICES



2 SERVICES SECTOR ACTIVITY INDEX AND INDUSTRIAL PRODUCTION INDEX



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SOURCES: INE, Markit Economics and Banco de España.

sales), of electricity consumption and of bank card spending indicate that the recovery decelerated as Q3 unfolded and, in certain cases, it could have even reversed in the last stretch of the year (see Chart 10).

Against a highly uncertain backdrop, the Banco de España's latest projections indicate that GDP could contract in Q4 compared with the previous quarter.[10] The considerable uncertainty about the evolution of the pandemic, both in December and over the coming quarters, and about the extent to which agents are adapting to this health crisis made it advisable for the Banco de España to include three alternative scenarios *(mild, baseline* and *severe)* in its latest projection exercise. In line with recent changes in the above-mentioned activity indicators, these scenarios suggest a notable slowdown in the pace of GDP growth in Q4, ranging from growth of 0.6% in the mild scenario to a contraction of 0.8% and 3% in the baseline and severe scenarios, respectively. In year-on-year terms, this would be equivalent to a loss of activity of 8.6% in the mild scenario, of 9.8% in the baseline scenario and of 11.8% in the severe scenario. By component, the slowdown in GDP would reflect external demand's negative contribution to growth whereas, in the realm of domestic demand, private spending items would post moderately negative rates.

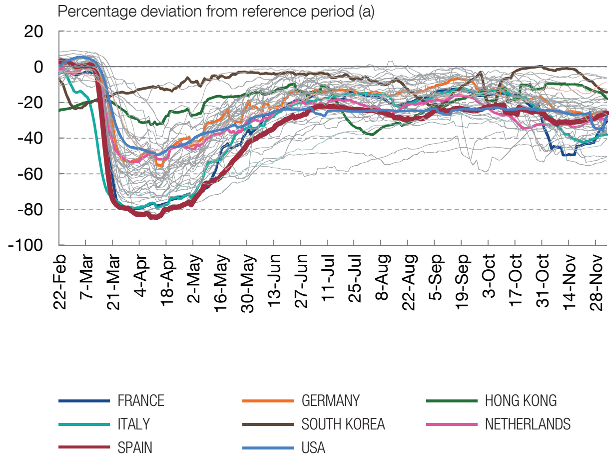
10 See the *Macroeconomic projections for the Spanish economy (2020-2023): the Banco de España's contribution to the Eurosystem's December 2020 joint forecasting exercise.*

Chart 10

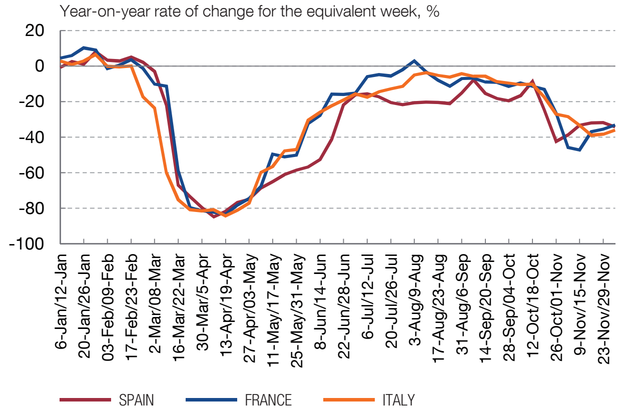
THE WORSENING OF THE HEALTH CRISIS WHICH BEGAN IN THE SUMMER MONTHS AND CONTINUED INTO THE FINAL STRETCH OF THE YEAR HAS HAD A NEGATIVE IMPACT ON THE MOMENTUM OF ACTIVITY

The introduction of new containment measures to curb outbreaks in the second wave of the pandemic prompted the recovery path of activity to slow down as the third quarter unfolded. This slowdown is estimated to have intensified in the final stretch of the year as indicated by a broad range of indicators of mobility, electricity consumption and bank card spending.

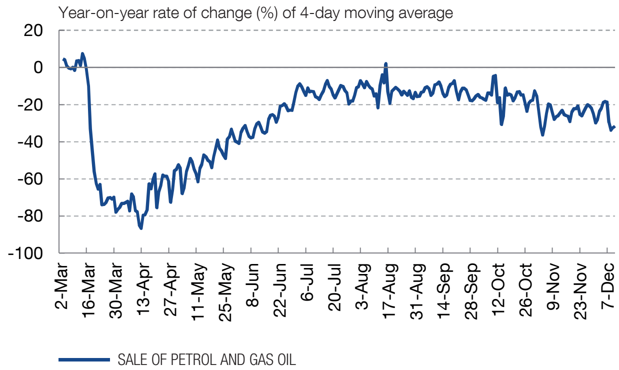
1 LOCAL MOBILITY INDICATORS. RETAIL AND RECREATION OUTLETS, TRANSIT STATIONS AND WORKPLACES



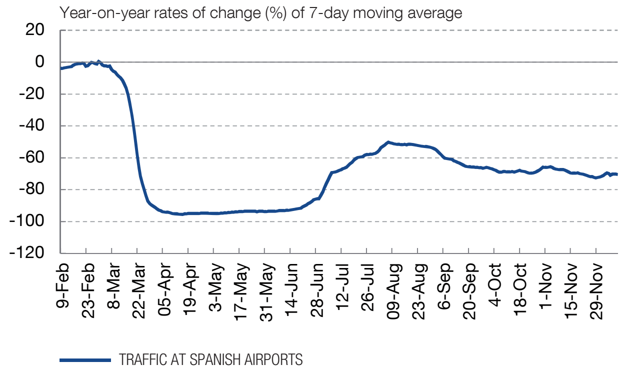
2 MOTORWAY TRAFFIC



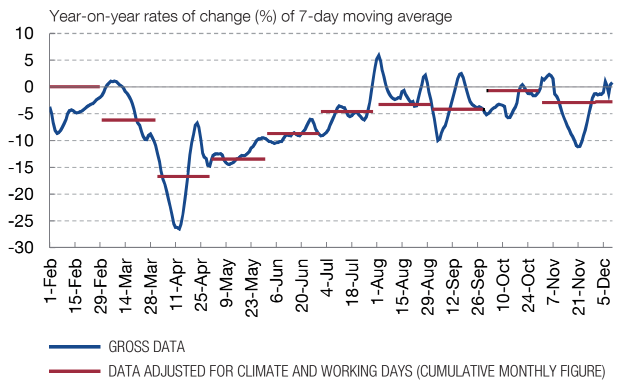
3 SALE OF PETROL AND GAS OIL



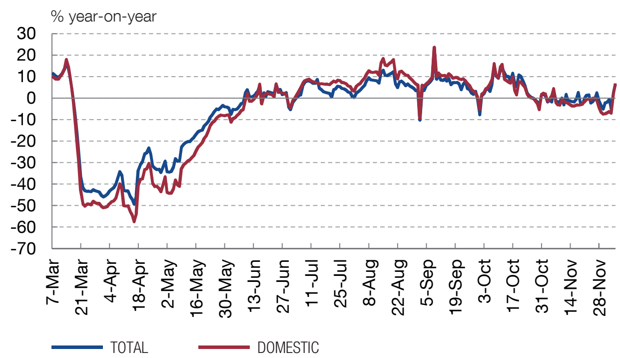
4 TRAFFIC AT SPANISH AIRPORTS



5 DEMAND FOR ELECTRICITY



6 SPENDING WITH CARDS



SOURCES: Google, Atlantia Group, Repsol Research Division, European Organisation for the Safety of Air Navigation, Red Eléctrica de España, Sistema de Tarjetas y Medios de Pago, and Banco de España.

a Percentage deviation from mobility observed in a pre-pandemic reference period (3 January to 6 February 2020). 7-day moving averages are depicted.

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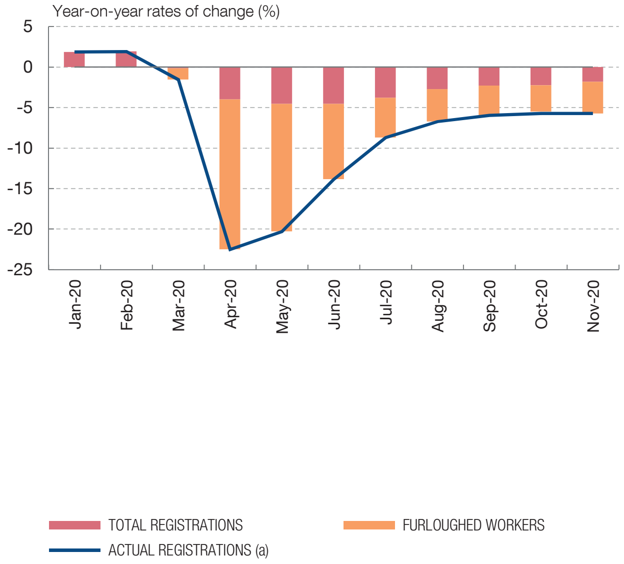
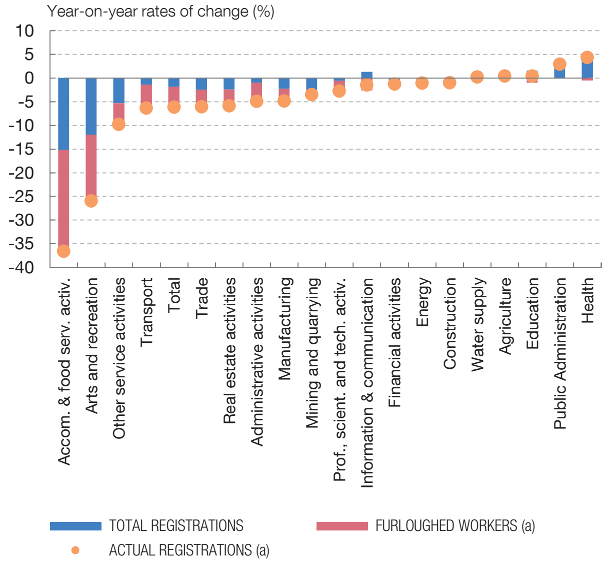
Chart 11
RECENT DEVELOPMENTS IN EMPLOYMENT

In November, the year-on-year rate of change in total social security registrations improved to -1.8 %, but it was offset by rising numbers of furloughed workers, leaving the year-on-year rate of decline in actual social security registrations at -5.8 %, the same as in October. In November there was an increase in the workers on furlough in the sectors most exposed to the new restrictions, which caused the sectoral heterogeneity in employment to rise.

1 YEAR-ON-YEAR RATE OF CHANGE IN TOTAL AND ACTUAL REGISTRATIONS (AVERAGE MONTHLY DATA)



2 YEAR-ON-YEAR RATE OF CHANGE IN ACTUAL REGISTRATIONS BY SECTOR, IN NOVEMBER (AVERAGE MONTHLY DATA)



SOURCE: Ministerio de Inclusión, Seguridad Social y Migraciones.

a Actual registrations are calculated as total registrations minus the number of workers on furlough.

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The recovery in unemployment has stalled in Q4, albeit unevenly by productive sector

Total social security registrations have improved slightly in recent months, with their year-on-year rate of decline progressing from 2.3% at the end of Q3 to 1.8% in November (see Chart 11.1). This improvement was observed, especially, in agriculture – with a year-on-year rise of 0.9% in November, 1 pp higher than that in September – and in non-market services sectors. The latter showed year-on-year growth in social security registrations of 3.6% in November (compared with 2.8% in September), partly reflecting the effect of new hires in the healthcare services to address the pandemic (4.9%), although social security registrations in general government also rose in the first two months of the quarter (3%). Likewise, employment performed positively in market services and the year-on-year rate of total social security registrations to November increased by 0.3 pp to -4.1%. By contrast, the year-on-year decline in social security registrations in industry and construction in November was very similar to that at the end of Q3.

This improvement in total social security registrations was offset by the increase in furloughed workers. The average number of furloughed workers in November reached 759,309, approximately 80,000 more than in October. This increase was observed in furlough schemes associated with the new restrictions (which affected almost 200,000 workers at end-November) and sectors afforded special protection following the latest extension of the schemes until end-January (affecting almost 225,000 workers). Conversely, workers furloughed for other reasons have dropped sharply since end-September. By activity, furloughed workers continue to be highly concentrated in market services (89%) and, especially, in the hospitality sector (44.8%) (see Chart 11.2). The different restrictions on economic activity have also been noted in the increase in the self-employed who receive the special temporary suspension of activity benefit. Thus, compared with nearly 150,000 self-employed workers who were receiving this benefit during Q3, this group has increased to almost 350,000 at end-November, which represents more than 11% of the total self-employed workers registered for social security purposes.

Overall, actual social security registrations showed a year-on-year decline of 5.8% in November, an improvement of 0.2 pp on the rate observed in September. Nevertheless, sectoral heterogeneity is very high: year-on-year declines of more than 35% and 25% were recorded in the hospitality sector and in the arts and recreation services, respectively, more moderate falls were observed in manufacturing (-4.8%) and in construction (-1%), and non-market services even posted a year-on-year rise. Actual social security registrations in market services as a whole declined by 10.7% in November compared with the same month in 2019. If the number of self-employed workers receiving the temporary suspension of activity benefit is taken into account, the decline in actual social security registrations would stand at 7.5% in year-on-year terms, a similar decrease to that in August.

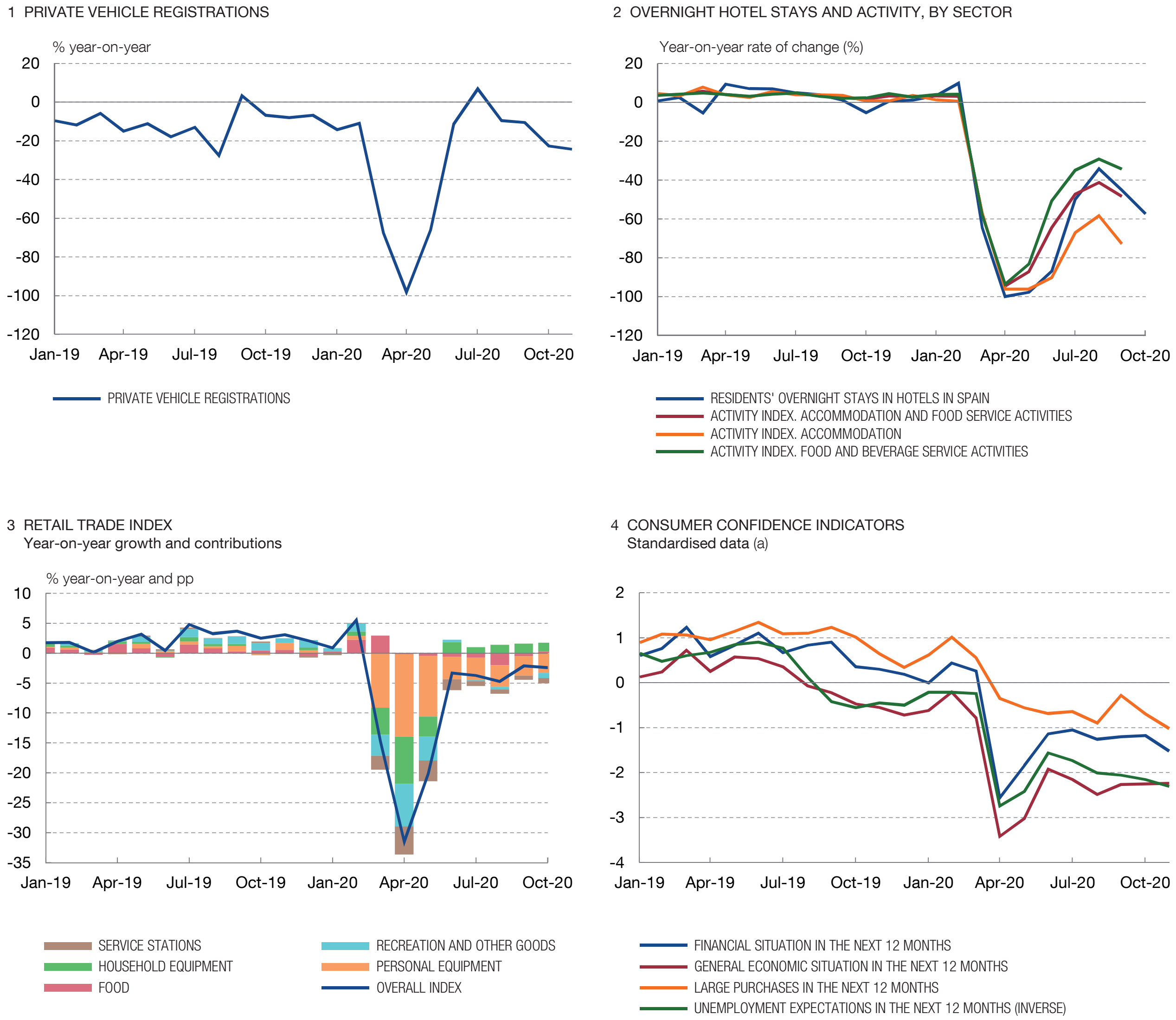
These movements would be consistent with a slight decrease in employment, measured in terms of hours worked, during Q4. In the baseline scenario of the Banco de España's latest projections exercise, in line with economic activity, the number of hours worked is projected to drop off in Q4 following its strong rebound in Q3. Nevertheless, this decline would not be as pronounced as that recorded during the spring months. This weakness in developments in employment, together with a mild recovery in the labour force participation rate (following that already observed in Q3), is expected to push the unemployment rate up from 16.3% in Q3 to around 17%.

The deceleration of GDP in Q4 would reflect the negative contribution of external demand and of national private expenditure components

After rebounding robustly in Q3, household consumption is estimated to have fallen off in the final stretch of the year, weighed down by the worsening of the pandemic and the stricter containment measures applied. A wide range of

Chart 12
HOUSEHOLD CONSUMPTION IS ESTIMATED TO HAVE FALLEN IN THE FINAL STRETCH OF THE YEAR

The trend towards a recovery in household spending is estimated to have halted in the 2020 Q4, against a backdrop of a worsening of the pandemic, harsher containment measures and a deterioration of confidence levels. Household spending will decline more sharply in the purchase of services than in that of goods.



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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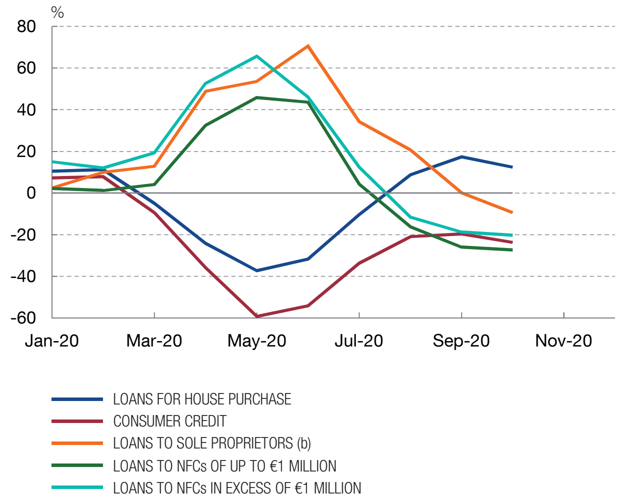
indicators, such as private vehicle registrations, are pointing in this direction. The year-on-year rate of decline in private vehicle registrations quickened between September and November, with the result that in the first 11 months of the year they have plummeted by close to 30% in year-on-year terms (see Chart 12.1). Turning to spending on services, the slide in residents' overnight stays in hotels in Spain stepped up in October, for the second consecutive month, in line with the stricter mobility restrictions in force in this period (see Chart 12.2). Similarly, in light of the

Chart 13

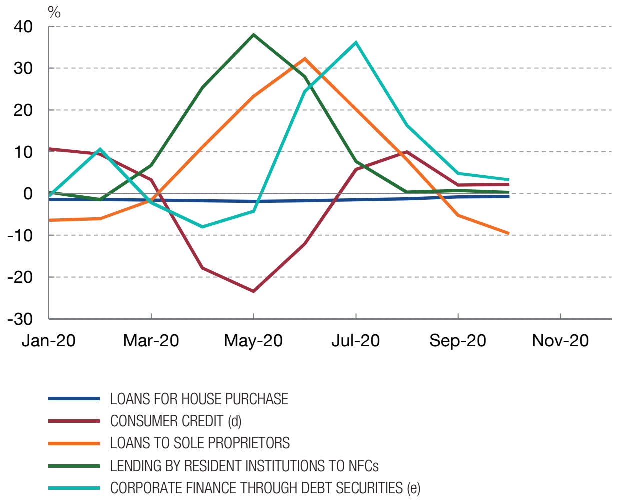
RECOVERY IN NEW LOANS TO HOUSEHOLDS AND DECLINE IN LENDING TO PRODUCTIVE ACTIVITIES

The economic recovery from the summer prompted a rise in new loans to households, particularly in those for house purchase derived, in part, from the taking of purchase decisions that were delayed during lockdown. In the case of productive activities, new lending has contracted, following the high volume of new loans raised by firms and sole proprietors during the spring to cover their liquidity needs.

1 NEW LOANS
Year-on-year change (a)



2 LENDING TO HOUSEHOLDS AND NON-FINANCIAL CORPORATIONS
Annualised quarter-on-quarter change (c)



SOURCE: Banco de España.

a Three-month cumulative flow.
b Includes renegotiations of previous loans.
c Seasonally adjusted rates.
d Excludes securitised lending.
e Includes issues by resident subsidiaries of non-financial corporations.

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information on household card payments, spending on leisure and restaurants is estimated to have fallen in October and more sharply so in November.[11] In any event, these indicators underline that the pandemic and the containment measures are having a very uneven impact on the various items of expenditure, which is more marked in the purchase of services than in that of goods. Noteworthy in this area is the continued strength of spending on household appliances which, according to the retail trade index, exceeds pre-health crisis levels (see Chart 12.3).

The fall in consumption appears to have driven up the household saving rate. In a context marked by notable uncertainty, the deterioration of consumer confidence in recent months (see Chart 12.4) appears to have prompted an increase in households' precautionary saving rate. This seems to have resulted in a greater build-up of liquid assets (cash and deposits), which rose by 6% between February and October. All this in a situation in which, despite further timid growth in lending to households in recent months (see Chart 13), the financial position of households has

11 See BBVA Research (2020), "Spain: Impact of COVID-19 on consumption in real-time and high-frequency in nov-20" and Caixabank Research (2020), "Pandemia y lluvia, binomio desafortunado en la semana del Black Friday".

worsened owing to the pandemic. Moreover, potential removal of the income protection measures and debt moratoria in the medium term could jeopardise the debt repayment capacity of some, more vulnerable, households.

After rebounding by more than 15% in Q3, residential investment is expected to fall in the closing months of the year. Residential investment saw strong growth in Q3, in line with the robust recovery observed in activity. Nevertheless, residential building permits between January and September were still 24% below those of the same period a year earlier. Similarly, the recovery in house purchases since the middle of the year, which has been more marked in the new-build segment, does not appear, for the time being, to have offset the fall recorded in these transactions in Q2 (see Chart 14.1). This recovery appears to have been fostered by a greater buoyancy in new lending for house purchase which, in quarter-on-quarter terms, has moderated the rate of contraction in the balance of outstanding loans for house purchase (see Chart 13).[12] Nevertheless, the recent trend in the few available indicators of residential investment in Q4, such as confidence in the residential construction sector (to November) and the apparent consumption of cement (to October), suggests that it will dip again in the last stretch of the year (see Chart 14.2).

Average house prices continued to slow down in Q3, posting year-on-year growth of 1.7%. This deceleration was attributable to the price of existing housing, as that of new builds accelerated owing to the supply shortages in this segment (see Chart 14.3). Other alternative price indicators, such as notaries' statistics and appraisals, show a very sharp slowdown from May onwards, with declines from July and September, respectively. This information may foreshadow a decrease in average house prices in the final stretch of the year, for the first time since the outbreak of the pandemic; the notaries' statistics indicate that such fall would be concentrated in existing housing transactions, and the appraisal information to November suggests that it would be steeper on the islands and the Mediterranean coast (see Chart 14.4).

Business investment appears to have fallen in the closing months of the year, affected by the high level of uncertainty. Numerous investment decisions are possibly being delayed owing to the high level of uncertainty regarding future sales, the significant decline in the degree of capacity utilisation and the decrease in funds available for such outlays. This seems to be confirmed by the latest trend in the short-term indicators related to business investment. Indeed, in October and November there was a slowdown in the recovery (and even some fall-off compared with Q3 levels) in the activity PMIs, the services and industry confidence indices and

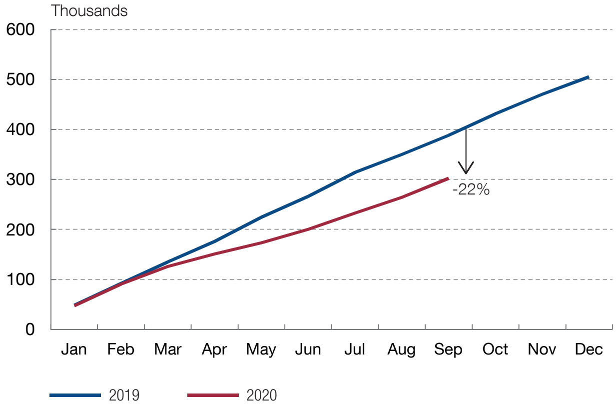
12 The behaviour of outstanding amounts is also influenced by the moratoria on mortgage and non-mortgage loans, which accounted for between 4.8% and 8.4% of outstanding debt at end-November. Consequently, in the absence of such measures, the volume of repayments in recent months would have been higher, reducing the buoyancy of the outstanding amount.

Chart 14

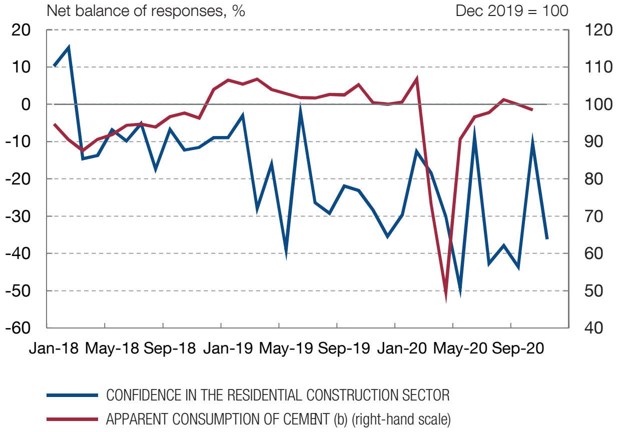
RESIDENTIAL INVESTMENT IS EXPECTED TO CONTRACT IN THE FINAL STRETCH OF THE YEAR, WHILE SOME INDICATORS POINT TO A DECLINE IN PRICES

Despite the recovery recorded in Q3, activity in the residential sector over the course of 2020 remains below the level of a year ago, as reflected by purchases and building permits. The coincident indicators suggest a fall-off in residential investment in Q4, while prices may decrease in the final stretch of the year, chiefly in the existing housing segment.

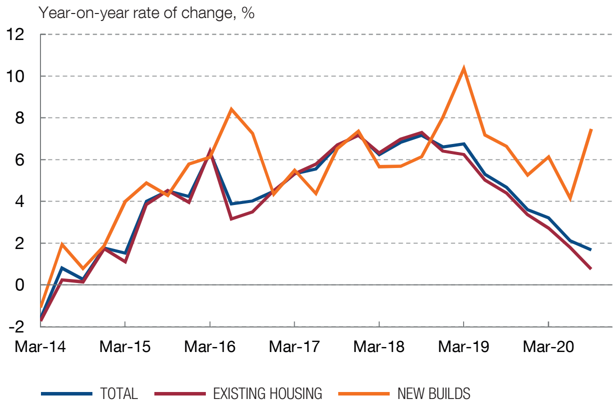
1 CUMULATIVE HOUSE PURCHASES IN THE YEAR (a)



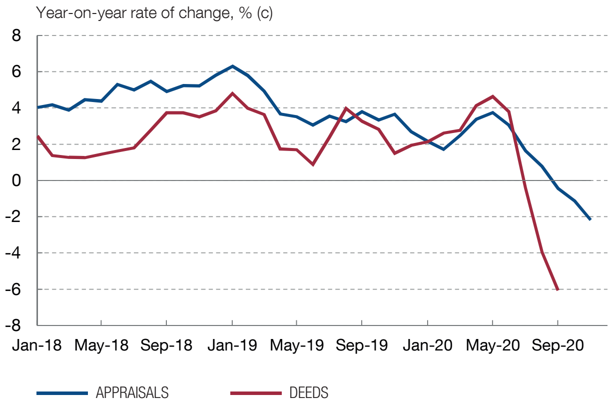
2 COINCIDENT INDICATORS OF RESIDENTIAL INVESTMENT



3 INE HOUSE PRICE INDEX



4 HOUSE PRICE INDICATORS



SOURCES: Banco de España, Centro de Información Estadística del Notariado, INE, Ministerio de Asuntos Económicos y Transformación Digital, Ministerio de Transportes, Movilidad y Agenda Urbana and Tinsa.

a The percentage reported in the chart shows the fall in cumulative purchases over the course of 2020 (to September) compared with the similar period in 2019.
b Seasonally adjusted series.
c Rates of change calculated on three-month moving average.

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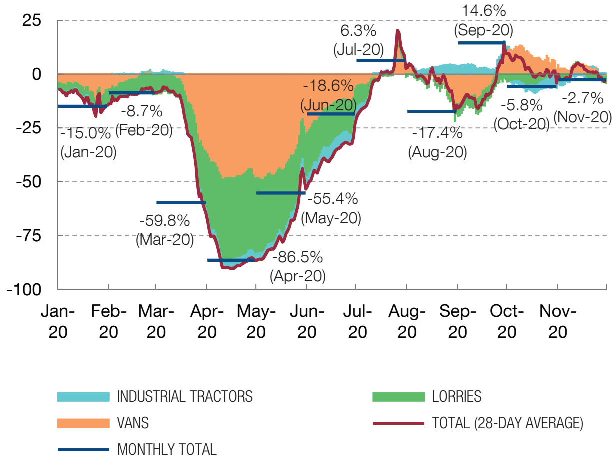
the business confidence indicator associated with investment goods production in the Ministry of Industry, Trade and Tourism's monthly business survey. Moreover, after a positive Q3, commercial vehicle registrations have posted negative year-on-year rates in recent months (see Chart 15.1). Nevertheless, this aggregate is expected to embark on a gradual recovery in the medium term, as suggested by the findings of the Autumn 2020 industrial investment survey of the Ministry of Industry, Trade and Tourism (see Chart 15.2).

Chart 15

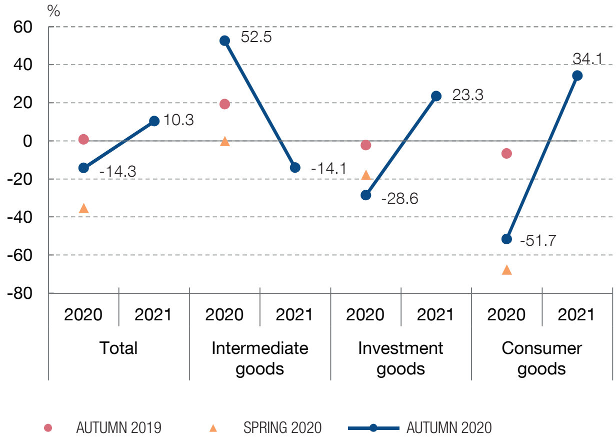
BUSINESS INVESTMENT WILL DECREASE IN Q4

Investment in capital goods and intangibles is expected to have declined between October and December, as suggested by the recent trend in the confidence and activity indicators related to this demand component, such as commercial vehicle registrations, which have fallen over recent months in year-on-year terms. Business investment is expected to recover gradually in the medium term, as indicated by the latest industrial investment survey.

1 COMMERCIAL VEHICLE REGISTRATIONS
(% y-o-y and contributions, 28-day moving average and monthly total)



2 INDUSTRIAL INVESTMENT SURVEY
Forecast of investment in industry (% y-o-y in current prices)



SOURCES: Ministerio del Interior (Dirección General de Tráfico) and Ministerio de Industria, Comercio y Turismo.

As regards the financing of investment decisions, the volume of new loans raised by non-financial corporations and the self-employed has contracted significantly in recent months, following the high growth observed at the outset of the pandemic (see Chart 13.1). Having grown year-on-year by 60% in May, new loans to non-financial corporations and to sole proprietors contracted at rates exceeding 20% in October. Between March and October, the flow of new lending to productive activities amounted to €248 billion, of which nearly 43% was financed through the first public guarantee scheme managed by the Official Credit Institute (ICO, by its Spanish abbreviation), with 76% of such financing guaranteed.[13] In addition to covering the most pressing liquidity needs, this scheme has improved firms' liabilities structures as the financing conditions are more favourable than usual market conditions. The recent improvement in conditions and the extension of the deadline for applying for the first guarantee scheme,[14] together with the launch of a second scheme amounting to €40 billion[15] (earmarked not only for new investments,

13 At end-September, 14.2% of the outstanding amount of loans to non-financial corporations related to loans arranged through the ICO guarantee scheme.

14 See Royal Decree-Law 34/2020 of 17 November 2020 on urgent measures to support business solvency and the energy sector and on tax matters. On data to 30 November, just over €15 billion in guarantees were still available under the first scheme.

15 See Royal Decree-Law 25/2020 of 3 July 2020 on urgent measures to support economic recovery and employment.

but also for working capital financing), will foreseeably help stimulate lending over the coming months.

In line with these developments, the outstanding amount of loans by resident financial institutions to non-financial corporations has slowed down sharply in recent months (see Chart 13.2). Corporate finance in the capital markets has also lost momentum. Drawing on provisional data, the corporate sector's aggregate financial position appears to have continued to worsen in Q3. Specifically, the debt-to-GDP ratio is expected to have risen to 82%, which would have slightly increased the sector's debt burden ratio. Moreover, different micro-simulation exercises conducted by the Banco de España show that the health crisis will cause the percentage of firms under high financial pressure – understood as those whose earnings are insufficient to cover debt interest – to increase significantly to around 40% in 2020, as well as an, albeit more moderate, deterioration in the corporate sector's solvency.[16]

Exports and imports of goods and services have been hit hard by the negative impact of the worsening of the health crisis both in Spain and in its main external markets

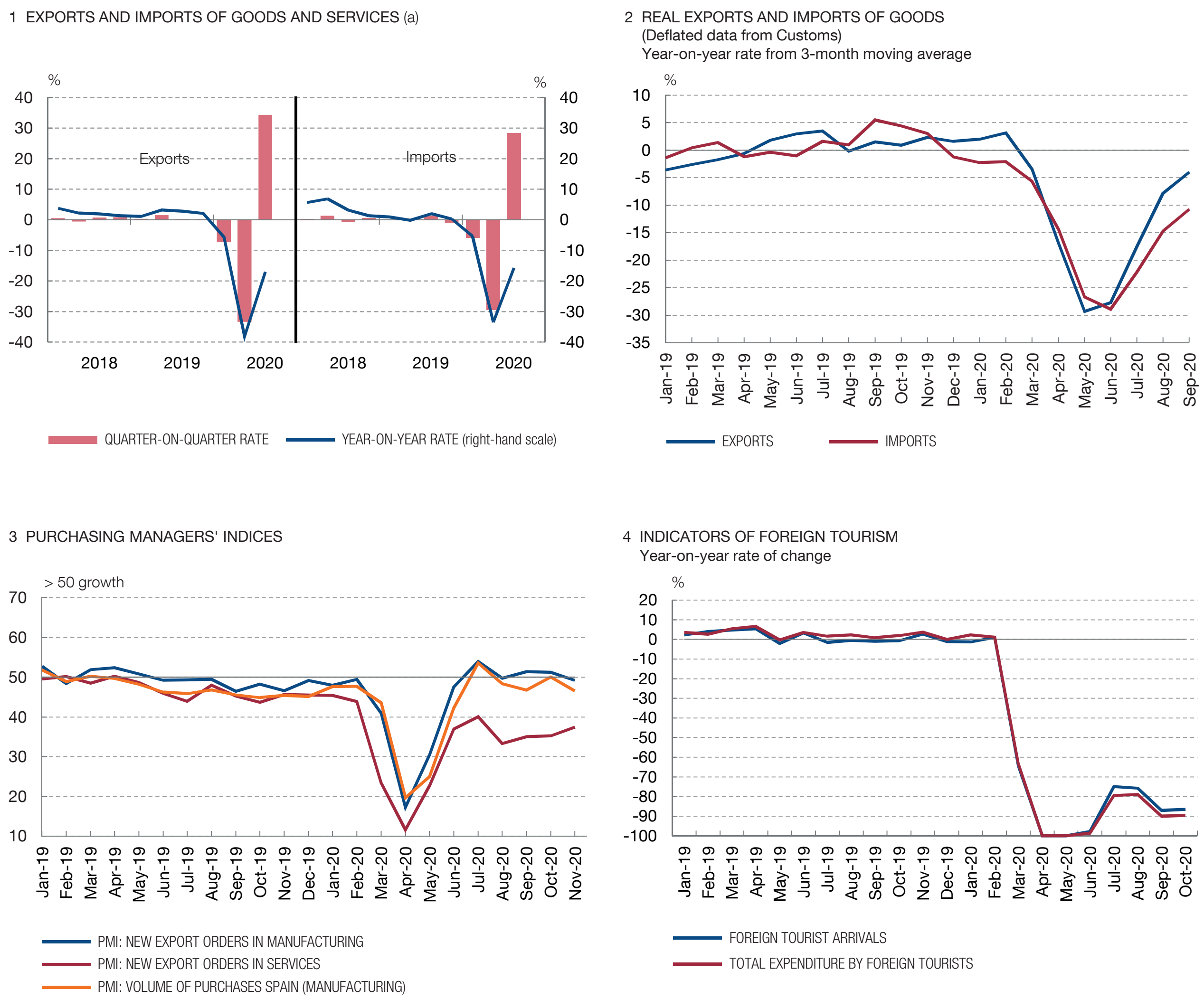
A new downturn is anticipated in foreign trade in the final stretch of the year, which is expected to extend to exports and imports. In Q3 there was a partial recovery in exports and imports, leading to a positive contribution of 2.2 pp from net external demand to GDP growth (see Charts 16.1 and 16.2). However, the latest information available would suggest that the contribution of net exports to GDP growth has returned to negative territory in Q4, with exports – held back in particular by the fall in non-resident tourism – weakening by more than imports. For example, in the international trade in goods, new export orders according to Spain's manufacturing PMI worsened in November, contracting slightly, as compared with the moderate expansion recorded in the preceding months (see Chart 16.3). Moreover, the input purchases component of the manufacturing PMI, which to some extent foreshadows the trend in imports, is also expected to perform unfavourably. In turn, the trend in new export orders according to the services PMI would be consistent with a more pronounced worsening in services exports in Q4 than in goods exports. All this in a context of some easing of the pace of recovery in global trade which, on the information available to September, remains below the levels of the same period a year earlier.

Tourism exports suffered the adverse effects of the deterioration of the epidemiological situation both in Spain and in its main European source

16 See "The impact of the COVID-19 crisis on the financial position of non-financial corporations in 2020: CBSO-based evidence", Analytical Article, *Economic Bulletin,* 4/2020, Banco de España.

Chart 16
A NEW DOWNTURN IS ANTICIPATED IN FOREIGN TRADE

Following the strong upsurge recorded in the third quarter, transactions with the rest of the world appear to have weakened in the last quarter of 2020, as restrictions on mobility were reintroduced in Spain and in Europe to curb the second wave of the pandemic. Manufacturing-sector survey indicators signal relatively contained declines in trade in goods towards the end of the year, while available indicators for foreign tourism show very severe contractions.



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

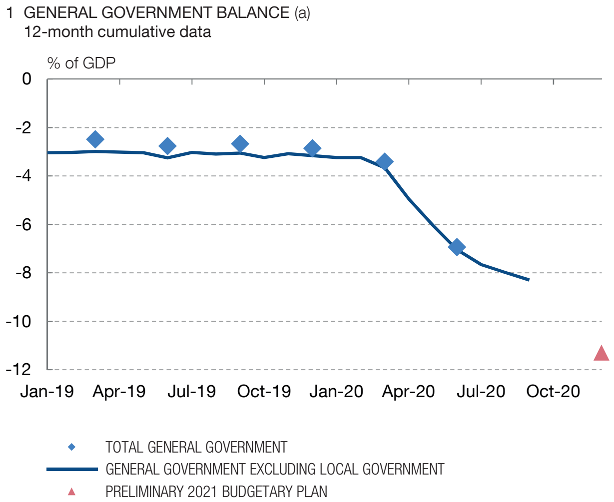
a QNA data at constant prices. Seasonally adjusted series.

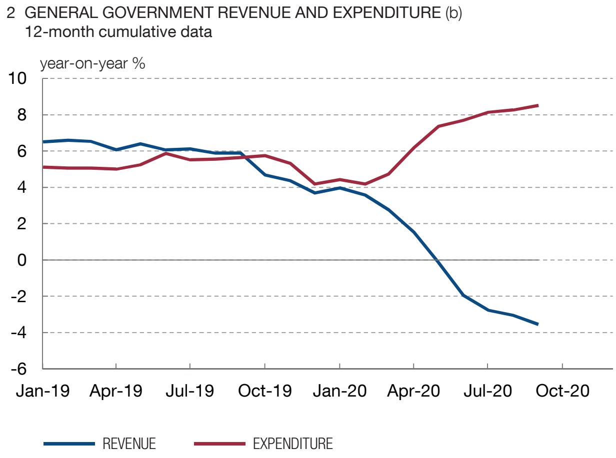
markets. The resurgence of the pandemic led to the extension of the restrictions on international mobility adopted in several European countries, particularly in the United Kingdom and in Germany. This has dispelled expectations of establishing safe travel corridors to those Spanish regions faring better from an epidemiological standpoint, such as the Canary Islands. Thus, in October (the latest available figures), foreign tourist arrivals and expenditure remained on the extremely sluggish course of the previous month, with falls of almost 90% year-on-year in

Chart 17

THE PACE OF DETERIORATION OF PUBLIC FINANCES HAS MODERATED SLIGHTLY IN RECENT MONTHS

The health crisis, the measures adopted to contain it and the fiscal policy measures implemented to counter its effects had a strong impact on public revenue and expenditure in the first half of the year, which has gradually eased in recent months. This would point to a somewhat more positive end-2020 budget balance than was anticipated by the 2021 Budgetary Plan.





SOURCES: IGAE, 2021 Budgetary Plan (October 2020).

a The IGAE only provides quarterly information on general government as a whole. It publishes the data on the total, excluding local government, on a monthly basis.

b Relating to the aggregate for general government, excluding local government and transfers witthin general government.

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both variables (see Chart 16.4). In the first ten months of 2020, inflows of international tourists and foreign tourist expenditure declined by 76.1% and 77.3%, respectively.

The most recent data on the general government budget outturn show a less adverse performance than in the first half of the year and point to a somewhat better year end than was expected a few months ago. Looking ahead to next year, the draft State budget, currently before the Senate, includes a considerable increase in government investment financed through European funds

Public finances, which were affected very severely by the pandemic in the first half of the year, have continued to deteriorate in recent months, albeit at a more moderate pace, which would point to a somewhat better year-end performance than was expected in September. The 12-month cumulative general government deficit, excluding local government, stood at 8.3% of GDP in September, 5.1 pp higher than in December 2019 (see Chart 17.1). The most recent data show a less pronounced contraction in revenue – from a year-on-year decline of 12% in the first half of the year to a fall of 2% in Q3[17] – and more moderate growth of expenditure, which declined from 13% year-on-year in the first half of the year to 8% in Q3, mainly on account of reduced spending on social benefits for furloughed employees and self-employed individuals whose activity has been suspended temporarily (see Chart 17.2).

In recent months, the Government has approved new measures affecting public finances. These include, most notably, the extension of employment protection schemes to January 2021, the entry into force of two new taxes (on financial transactions and on certain digital services) and the reduction in the VAT on disposable surgical masks from 21% to 4%.

The 2021 State budget is close to being approved. After its passage through the Lower House of the Spanish Parliament, the draft budget is being debated in the Senate at the date of this report going to press. Its final approval is expected in the last few days of the year. The draft budget includes, among other measures, a rise in pensions and public-sector wages along the lines of the Government's inflation forecasts (0.9%) and different tax hikes.[18] Overall, the expansionary fiscal policy stance would be maintained, underpinned mainly by an intensive use of the European funds made available to countries under the NGEU programme. The impact of these funds on economic activity in Spain is thoroughly analysed in the Banco de España's latest projections.[19]

In recent months, the behaviour of consumer prices has continued to be influenced by decelerating energy prices and core inflation, in a context of weak demand

Inflation, as measured by the HICP, has declined at a slightly steeper rate in recent months to stand at -0.8% in November (see Chart 18.1). These developments reflect the slowdown in prices and, to a lesser extent, in core inflation (see Charts 18.2 and 18.3). The energy component slowed to a year-on-year rate of -9.5% in November, in line with the behaviour of electricity and oil prices (see Chart 18.4). Among the non-energy components, food prices grew relatively steadily between July and October – at higher rates for fresh food than for processed food – but eased in November.

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17 The decline is somewhat larger (around 6%), if the information for October is included, which is when corporate income tax on profit earned between April and September is collected. This information is only available for the central government.

18 A higher rate of personal income tax and of wealth tax for higher earners, a limit on double taxation exemptions for large corporations, a higher tax rate on insurance premiums and increased VAT on some sugary drinks, among others.

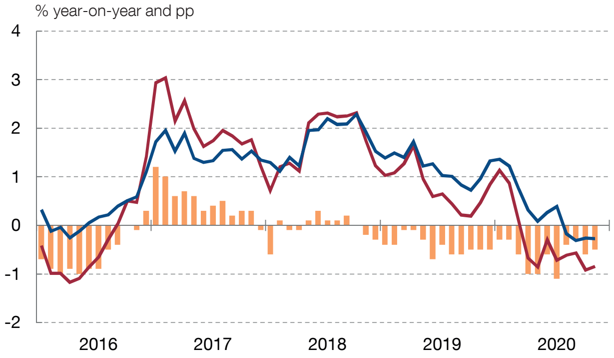
19 See Box 2 ("The impact of the NGEU initiative on the scenarios for the Spanish economy") of the *Macroeconomic projections for the Spanish economy (2020-2023): the Banco de España's contribution to the December 2020 joint forecasting exercise.*

Chart 18

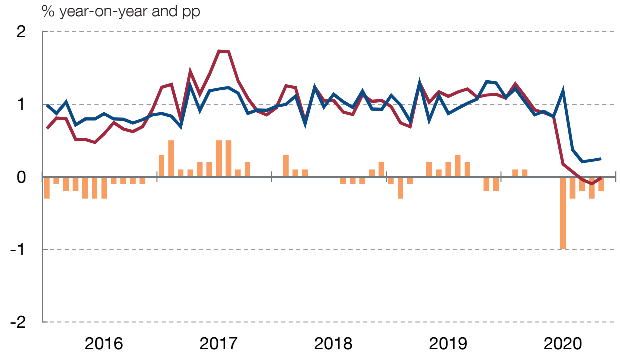
DECLINE IN INFLATION AND MODERATION IN WAGE INCREASES

The rate of decline of headline inflation has stepped up slightly in recent months, in a setting in which oil prices have fallen moderately and core inflation has hovered around 0%. Wage rates remain relatively steady, against a backdrop of scant progress in collective bargaining negotiations this year.

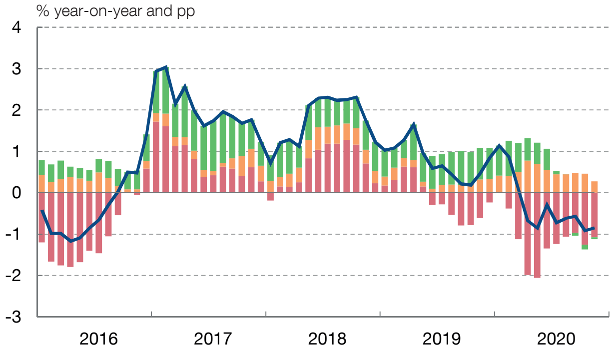
1 HEADLINE HICP



2 HICP EXCLUDING ENERGY AND FOOD

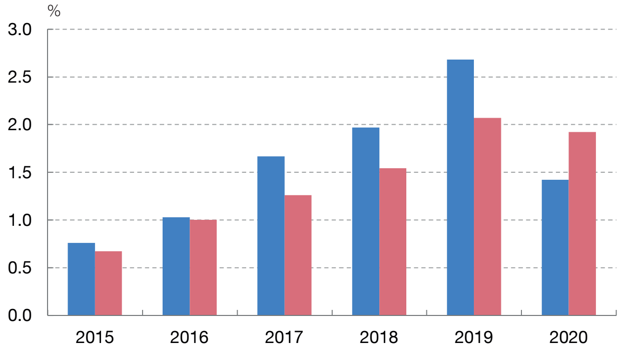


3 HICP: CHANGE AND CONTRIBUTIONS

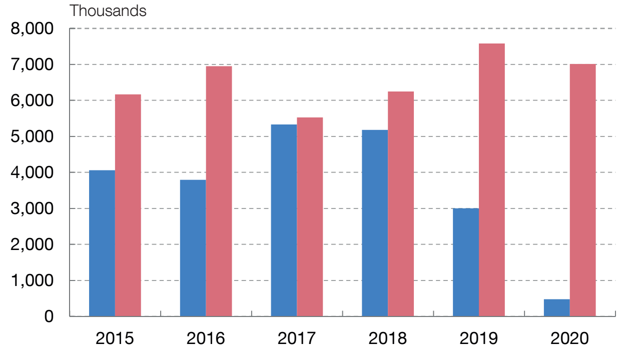


4 SPOT OIL PRICES AND FUTURES MARKET

5 AGREED WAGE INCREASES (a)



6 WORKERS COVERED BY COLLECTIVE BARGAINING (a)



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

a On data up to November 2020. The revised wage agreements are agreements signed in previous years; the newly signed agreements are those signed in 2020.

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Core inflation slowed slightly between August and November to a year-on-year rate of 0%. This deceleration was extensive to the various components of core inflation. First, services prices, which recorded a steady year-on-year growth rate during the summer months, decelerated subsequently to a rate of -0.1% in November. Tourism-related items continued to post sharp year-on-year declines. Second, the pace of growth of non-energy industrial goods prices also eased year-on-year to 0.1% in November, as a result of the less dynamic behaviour of vehicles, among other items. The core inflation differential with euro area countries was -0.2 pp in November.[20]

In the coming months, the inflation rate is expected to remain negative, although it will gradually move closer to zero. This would be driven by an increasingly less negative contribution from energy prices. In this regard, futures markets are pointing to a slightly upward trend in oil prices in the coming months. Moreover, core inflation is expected to remain at very moderate values (close to zero) in the coming months. This appears to be the result of the projected stability in the prices of both non-energy industrial goods and services, which would see little recovery in items related to tourism, leisure, and accommodation and food service activities until an effective medical solution becomes available. For further details on recent developments in inflation and the outlook for the coming months, see Box 5.

On the cost side, collective bargaining agreements have continued to show high stability in negotiated wage settlements, with scant progress in negotiations this year. Thus, wage rates under collective bargaining agreements, on data to November, rose by an average of 1.9%, compared with 2.3% agreed for the previous year, affecting what is now a very large number of workers (almost 7.5 million) (see Charts 18.5 and 18.6). However, these increases essentially reflect the commitments of agreements entered into in previous years, since there are very few newly signed agreements and they do not include the impact of the change in the labour market situation brought about by the pandemic. QNA data on compensation per employee showed a slight decline (0.9%) in the market economy in Q3, following the fall of 12.6% recorded in Q2, associated with the mitigating impact of furlough schemes on the labour costs paid by companies.

Cut-off date: 10.12.2020.
Publication date: 18.12.2020.

20 At the cut-off date for this report, the only inflation data available for the euro area as a whole were provisional preliminary estimates for November.