

## ANNUAL REPORT 2021

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## Chapter 1

An incomplete recovery amid uncertainty: from the pandemic to the rise in inflation and the outbreak of war

## Chapter 2

Challenges and policies for sustainable and balanced growth of the Spanish economy

## Chapter 3

Rising global inflation

## Chapter 4

The Spanish economy and the climate challenge

## CONTENTS

1. Introduction
2. The firming of the economic recovery and the rise in inflation at the global and euro area levels
3. Positive and negative aspects of the recovery in Spain
4. Economic policies amid uncertainty

## OVERVIEW

- The global recovery in activity continues, although it is incomplete, uneven and faces considerable obstacles ...
- ... which are especially evident in the Spanish economy
- The short-term outlook, affected by the war in Ukraine, is highly uncertain ...
- ... and, among other matters, depends on the economic policy response, which has mitigated the impact of the pandemic but must adapt to a changing environment
- The Spanish economy needs a targeted fiscal policy and an incomes agreement

## THE RECOVERY IN ACTIVITY CONTINUES, ALTHOUGH IT IS INCOMPLETE, UNEVEN AND FACES CONSIDERABLE OBSTACLES

Progress in the vaccination campaign meant that, over the course of 2021, the pandemic containment measures could, with some ups and downs, gradually be eased. This spurred a relative resurgence in demand and the economic recovery (which was also driven by very accommodative economic policies)

While the pandemic has gradually become less prominent as a significant factor in economic developments, economic activity has been increasingly weighed down by the rise in commodity prices (and in inflation in general), supply bottlenecks and, more recently, the war in Ukraine

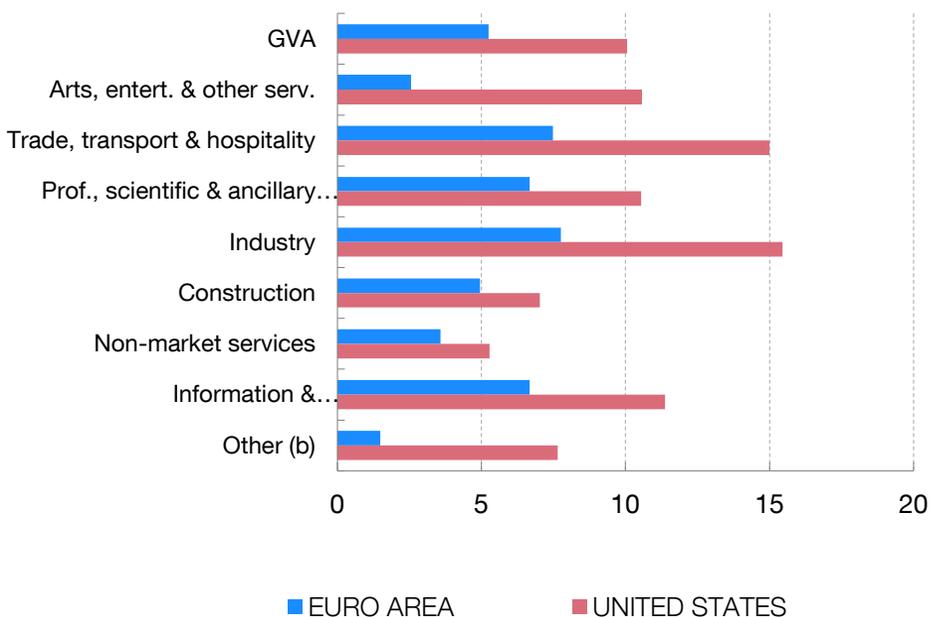
In general, in recent months, amid high uncertainty the growth outlook has been revised significantly downwards and the inflation outlook upwards, especially in the short term

The dynamics to be monitored in the coming months notably include changes in global financing conditions, particularly in the emerging markets, against a background in which a large majority of central banks are making headway in the normalisation of their monetary policy

# THE RECOVERY, WHICH IS PROVING PARTICULARLY UNEVEN ACROSS COUNTRIES AND SECTORS, WILL FORESEEABLY SLOW DOWN AS A RESULT OF THE WAR

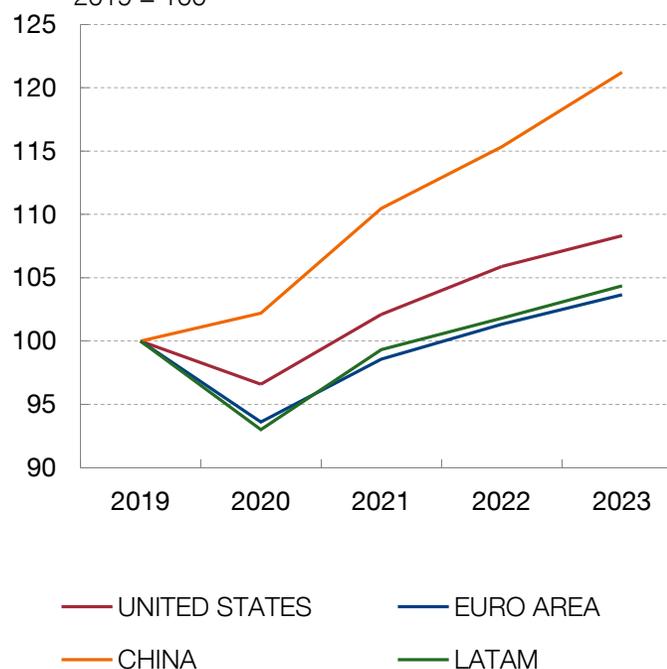
### GVA GROWTH BY SECTOR

%, growth in 2021



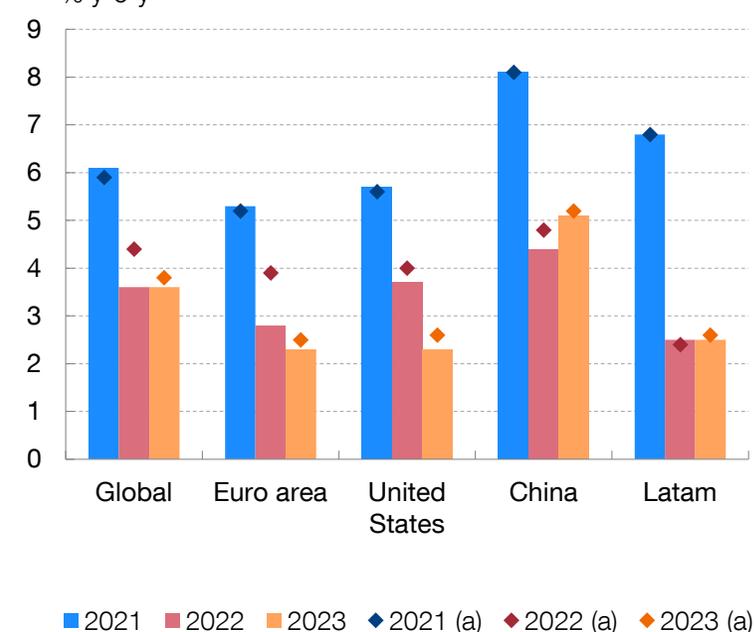
### GDP LEVEL BY REGION: APRIL 2022 PROJECTIONS

2019 = 100



### GDP GROWTH PROJECTED BY THE IMF IN THE APRIL 2022 WEO

% y-o-y



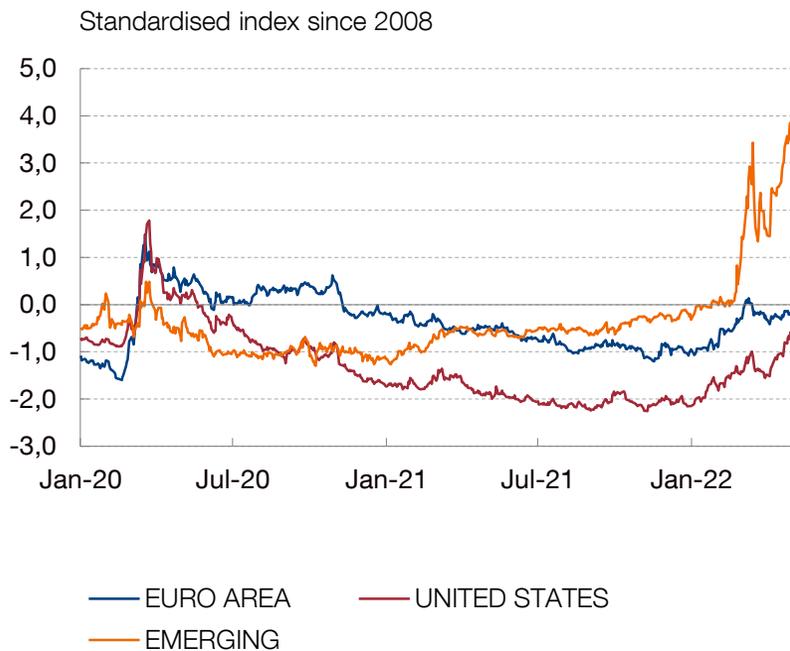
SOURCES: Eurostat, national statistics and IMF (*World Economic Outlook*, April 2022).

a. *World Economic Outlook* projections, October 2021.

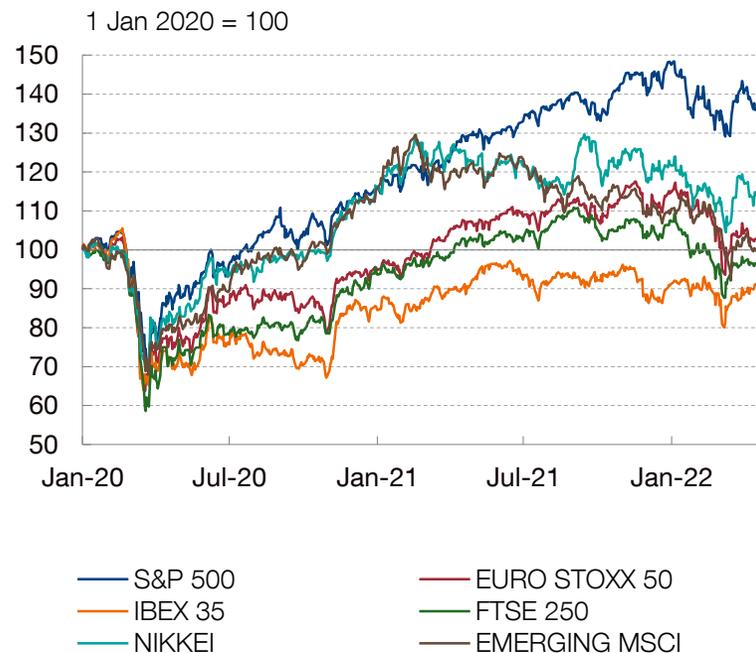
b. "Other" includes the primary sector and other market services (financial activities, insurance and real estate activities).

# GLOBAL FINANCIAL CONDITIONS HAVE TIGHTENED RECENTLY AND WILL BE HIGHLY INFLUENCED BY THE MAIN CENTRAL BANKS' FUTURE DECISIONS

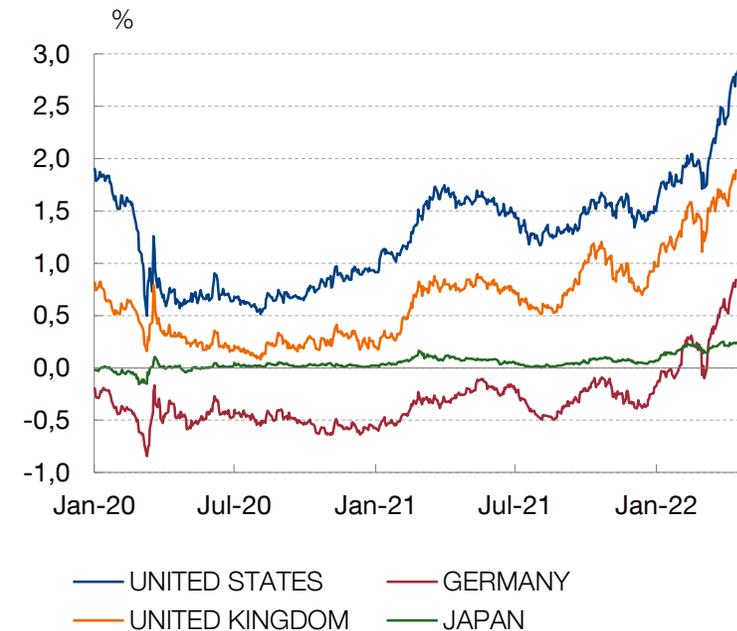
## GOLDMAN SACHS FINANCIAL CONDITIONS INDICES



## STOCK MARKET INDICES



## TEN-YEAR SOVEREIGN YIELDS



SOURCES: Refinitiv Datastream and Bloomberg Data License.

## THE RECOVERY REMAINS INCOMPLETE AND HIGHLY UNEVEN IN SPAIN

The Spanish economy's GDP grew by 5.1% in 2021 overall. Output continued to grow in 2022 Q1, albeit at a quarter-on-quarter rate of 0.3%, considerably slower than in 2021 Q4 (2.2%)

That said, in 2022 Q1 economic activity in Spain stood 3.4 pp below the pre-pandemic level, while, in the euro area as a whole, GDP stood 0.4 pp above its pre-crisis level

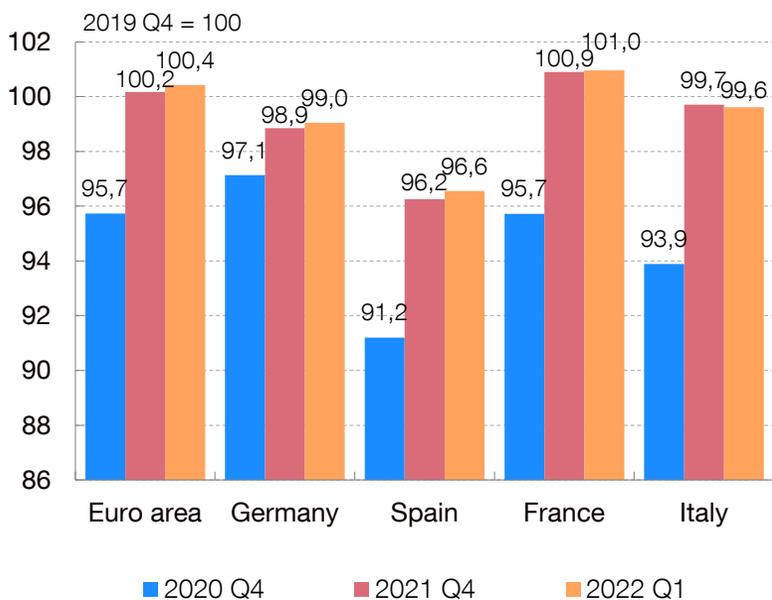
Employment has recovered more vigorously than GDP, albeit also with high cross-sectoral heterogeneity (further adrift from the pre-pandemic levels in sectors like hospitality and leisure that were hit hardest by the restrictions on mobility)

In 2021 government receipts surged and the budget deficit decreased, yet the latter remains at very high levels and the general government debt-to-GDP ratio has barely diminished

# SINCE THE ONSET OF THE PANDEMIC, THE POORER PERFORMANCE OF THE SPANISH ECONOMY AS COMPARED WITH THE EURO AREA CAN BE ASSOCIATED WITH VARIOUS FACTORS ...

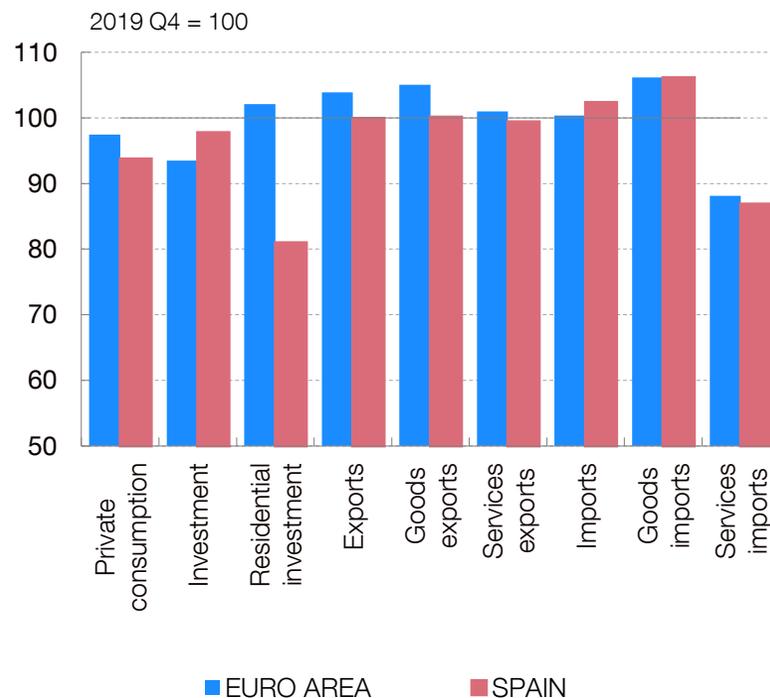
- On the demand side, Spain's straggling recovery is attributable to services exports, private consumption and residential investment
- On the supply side, the gap with the euro area is indicative of the Spanish economy's specialisation in the sectors most affected by the pandemic (in particular, in those related to tourism), although these sectors have also performed worse in Spain than in the euro area

RETURN OF GDP TO PRE-PANDEMIC LEVELS

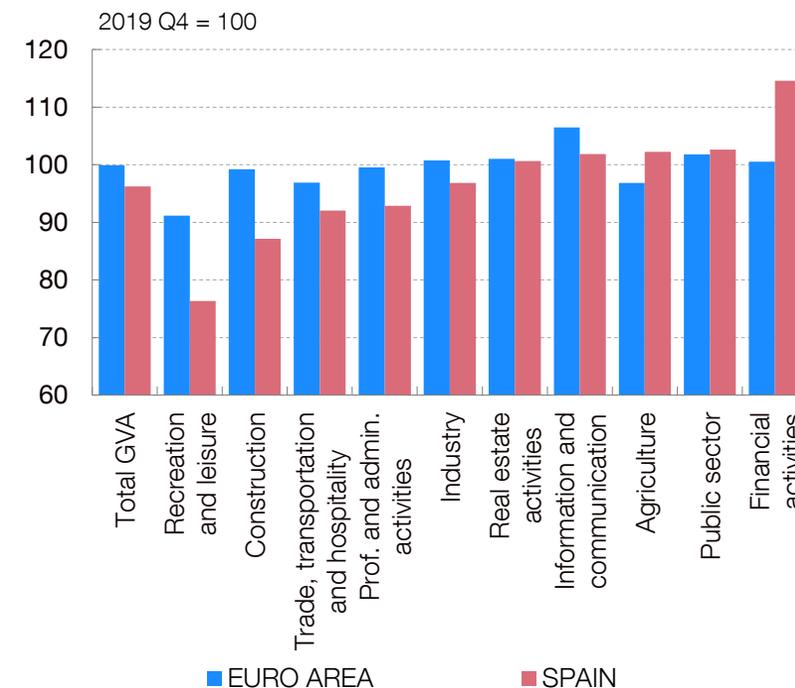


SOURCES: INE and Eurostat.

RETURN OF GDP TO PRE-PANEMIC LEVELS, BY DEMAND COMPONENT (2021 Q4)



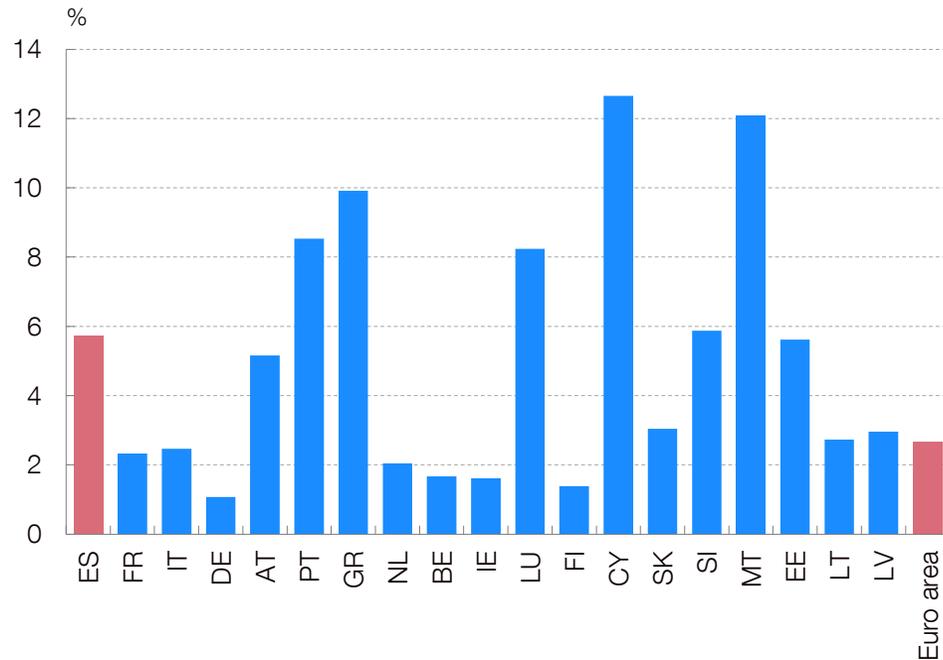
RETURN OF REAL GVA TO PRE-PANDEMIC LEVELS (2021 Q4)



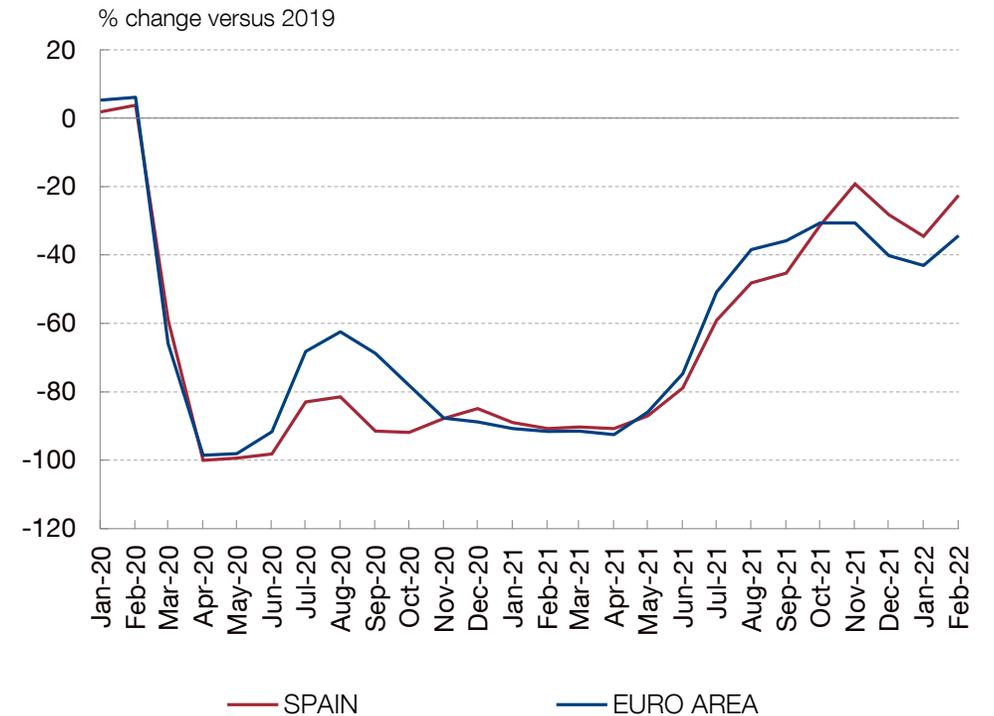
## ... INCLUDING MOST NOTABLY THE HIGH SHARE OF TOURISM IN OUR ECONOMY ...

- Although it should be noted that tourism services exports recovered strongly in 2021 H2, a trend that has continued at the start of 2022

RELATIVE SHARE OF TOURISM EXPORTS IN GDP (2019)



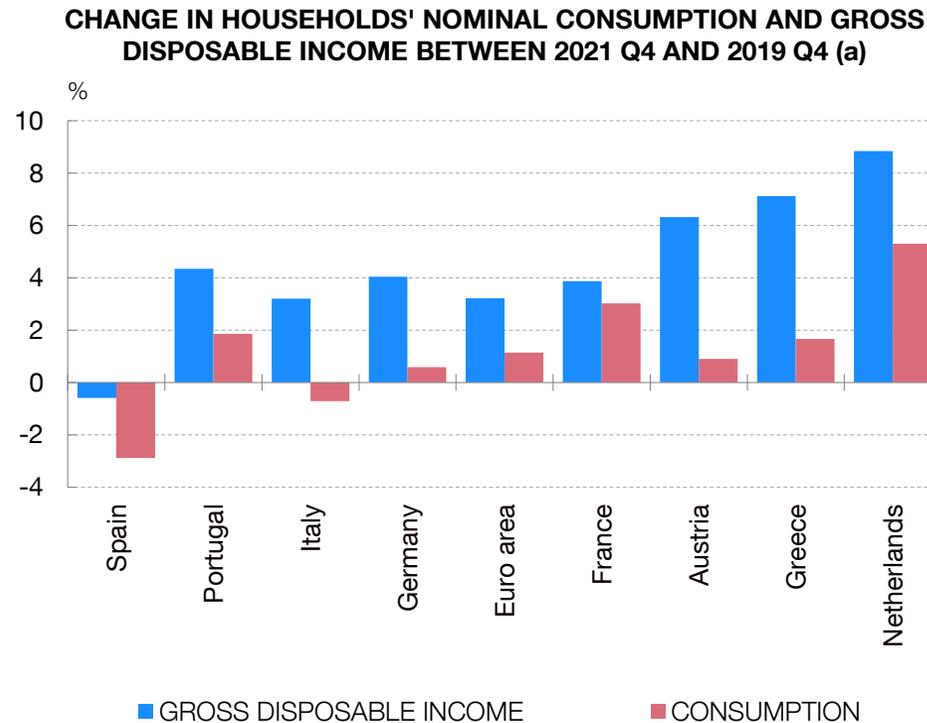
FOREIGN OVERNIGHT STAYS AT TOURIST ACCOMMODATION



SOURCES: INE and Eurostat.

## ... AND THE POORER PERFORMANCE OF PRIVATE CONSUMPTION ...

- Among other factors, this appears to be related to less favourable developments in household disposable income in Spain
- These developments, in turn, seem to be related, among other factors, to the poorer performance of employment in Spain (at end-2021, employment, in terms of hours worked, was 3.6% below its pre-pandemic level in Spain, while in the euro area the gap was 1.8%)



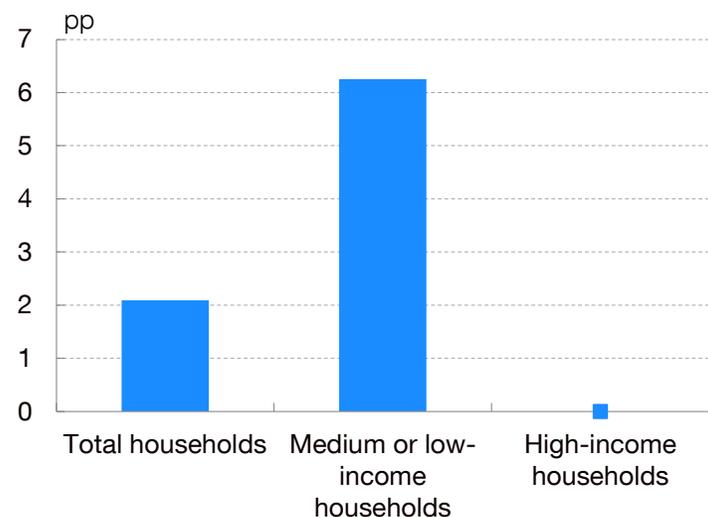
SOURCES: INE and Eurostat.

a. The latest data on gross disposable income refer to 2021 Q3 in the case of France, Greece and the Netherlands.

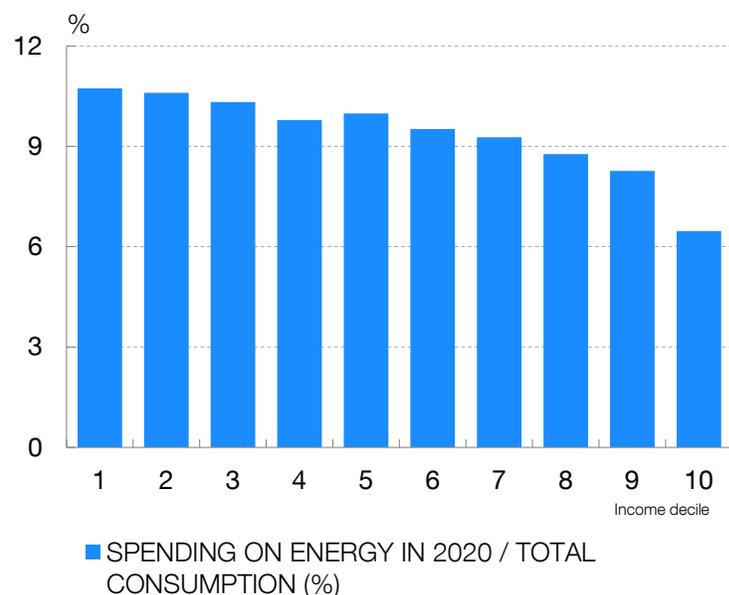
# ... AS HOUSEHOLDS HAVE BARELY USED THE SAVINGS BUILT UP SINCE THE ONSET OF THE PANDEMIC AND THEIR SAVING RATIO REMAINS VERY HIGH

- Higher-income households, which saved the most in the first year of the pandemic, do not appear to have tapped those savings in 2021. Conversely, lower-income households, whose surplus saving in 2020 was somewhat more modest, did use a portion of those funds. This could be because the rise in energy prices affects this group of households more
- In any event, in 2021 the saving ratio remained well above its pre-pandemic levels

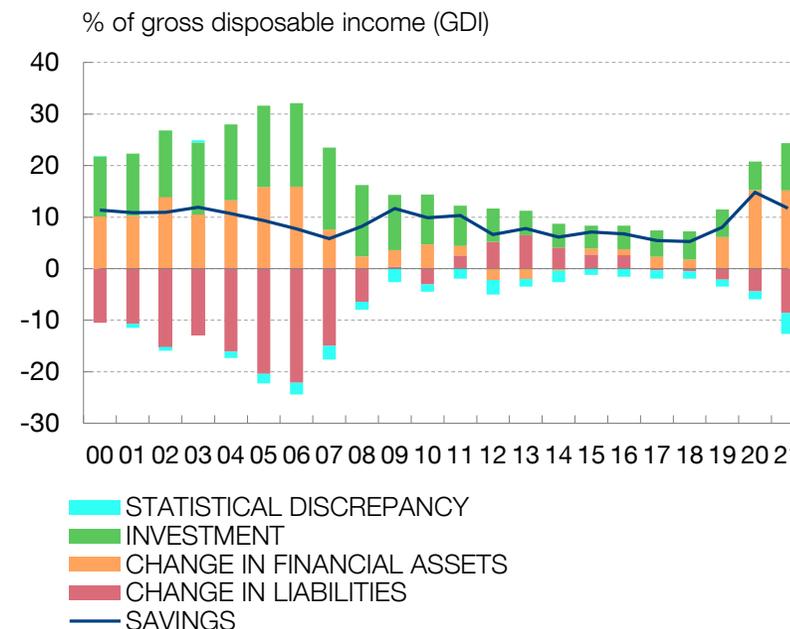
**MARGINAL IMPACT OF HAVING A STOCK OF SAVINGS ON THE PROBABILITY OF REPORTING A SPENDING INCREASE IN 2021 (a)**



**AVERAGE SPENDING ON ENERGY, BY INCOME DECILE**



**USE OF HOUSEHOLDS' GROSS SAVINGS (b)**



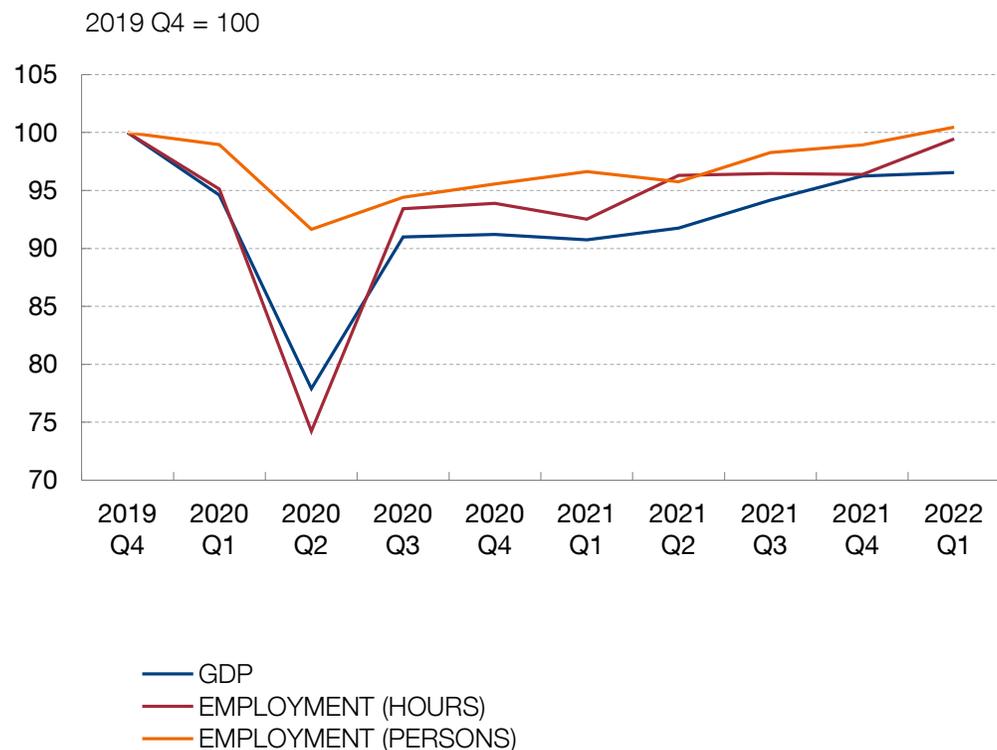
SOURCES: INE, ECB (Consumer Expectations Survey) and Banco de España.

a. Results drawn from the ordered probit estimation. It captures the difference in the probability of reporting an increase in spending between households that had saved and those that had not, for total households and each income group.

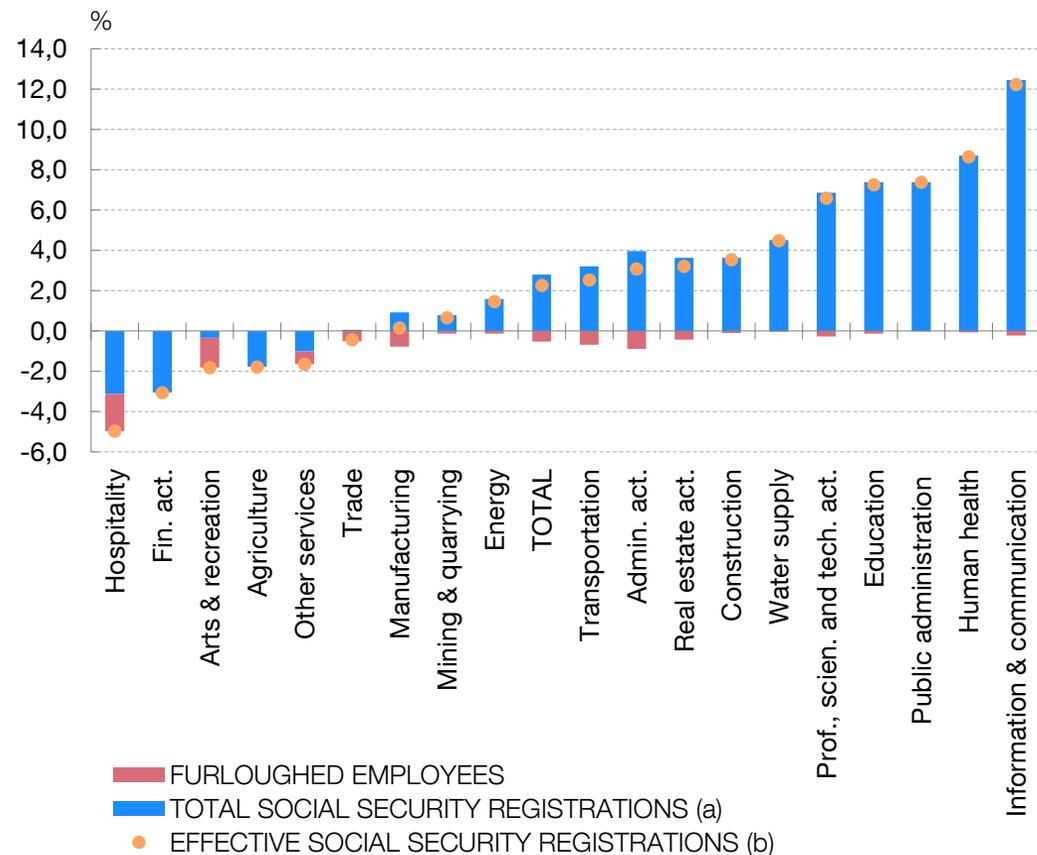
b. Savings include capital transfers. Investment is gross capital formation plus acquisitions less disposals of non-produced, non-financial assets.

# EMPLOYMENT HAS SHOWN GREATER MOMENTUM THAN GDP, ALBEIT WITH HIGH CROSS-SECTORAL HETEROGENEITY

## GDP AND EMPLOYMENT



## TOTAL SOCIAL SECURITY REGISTRATIONS, FURLOUGHED EMPLOYEES AND EFFECTIVE SOCIAL SECURITY REGISTRATIONS, BY SECTOR. CHANGE IN MARCH 2022 VERSUS FEBRUARY 2020



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

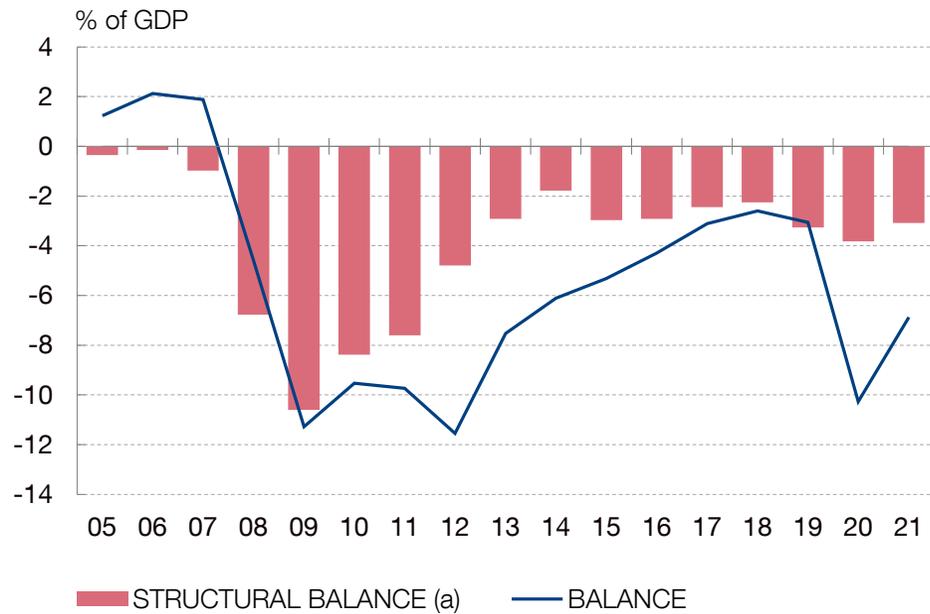
a. Seasonally adjusted series.

b. Effective social security registrations are defined as total registrations less furloughed employees

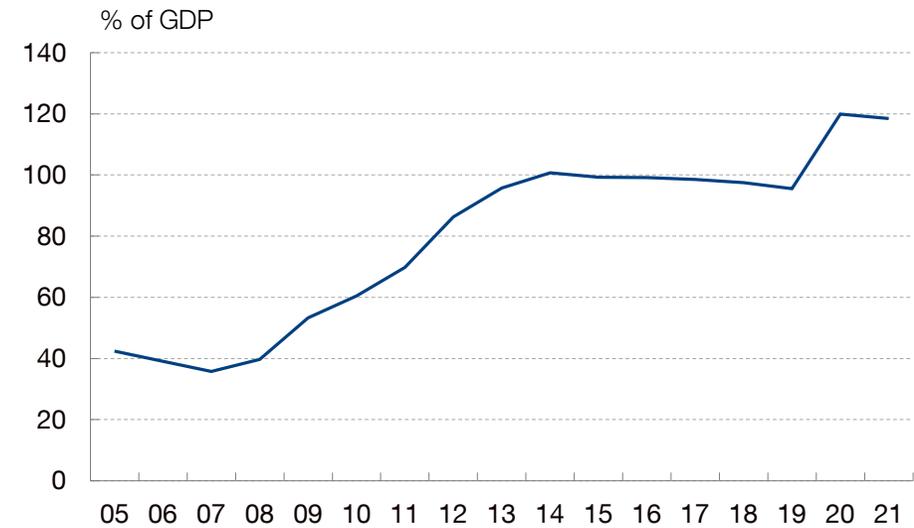
# THE IMBALANCE OF PUBLIC FINANCES REMAINS AT VERY HIGH LEVELS

- On the receipts side, the revenue raised in 2021 grew by 13%, much higher than the macroeconomic variables proxying the tax bases suggested
- On the expenditure side, although pandemic-induced spending (e.g. that associated with furlough schemes) fell steeply in 2021, total expenditure grew by 5% (partly due to the minimum income scheme, the compensation to pensioners for inflation and NGEU)

### GENERAL GOVERNMENT TOTAL AND STRUCTURAL BALANCE



### PUBLIC DEBT



SOURCES: Banco de España, IGAE and Ministerio de Hacienda.  
a Banco de España estimate.

## THE SHORT-TERM OUTLOOK FOR THE SPANISH ECONOMY, AFFECTED BY THE WAR IN UKRAINE, IS SUBJECT TO EXTRAORDINARY UNCERTAINTY

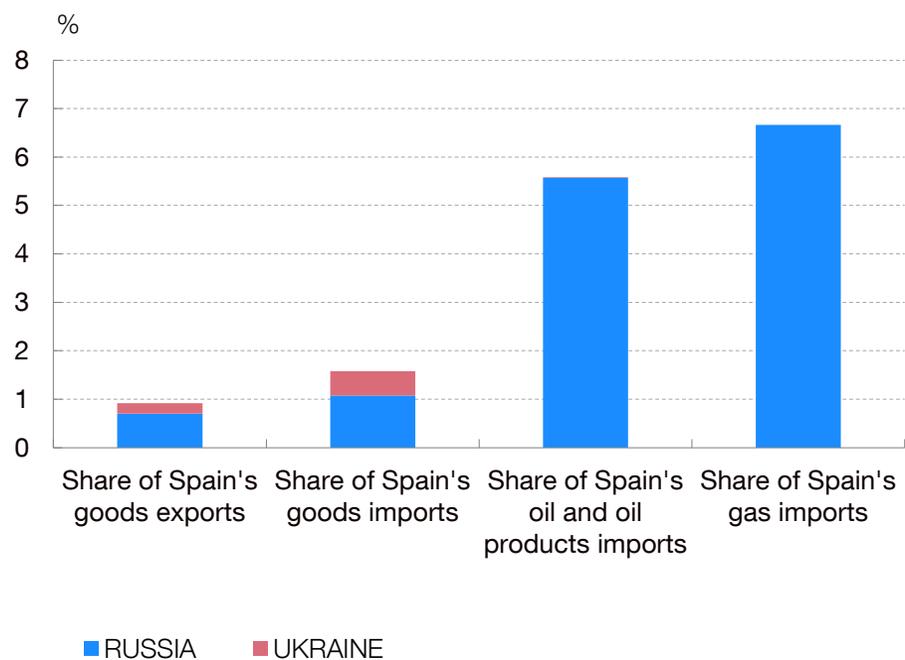
The direct effects of the war on Spain (through foreign trade with Russia and Ukraine) are modest, but the indirect effects will foreseeably be significant

The channels through which this impact will materialise include an additional increase in the price of commodities, a deterioration in households' and firms' confidence, a downturn in world trade (in part because the disruptions in global value chains have been compounded) and a bringing-forward of monetary tightening

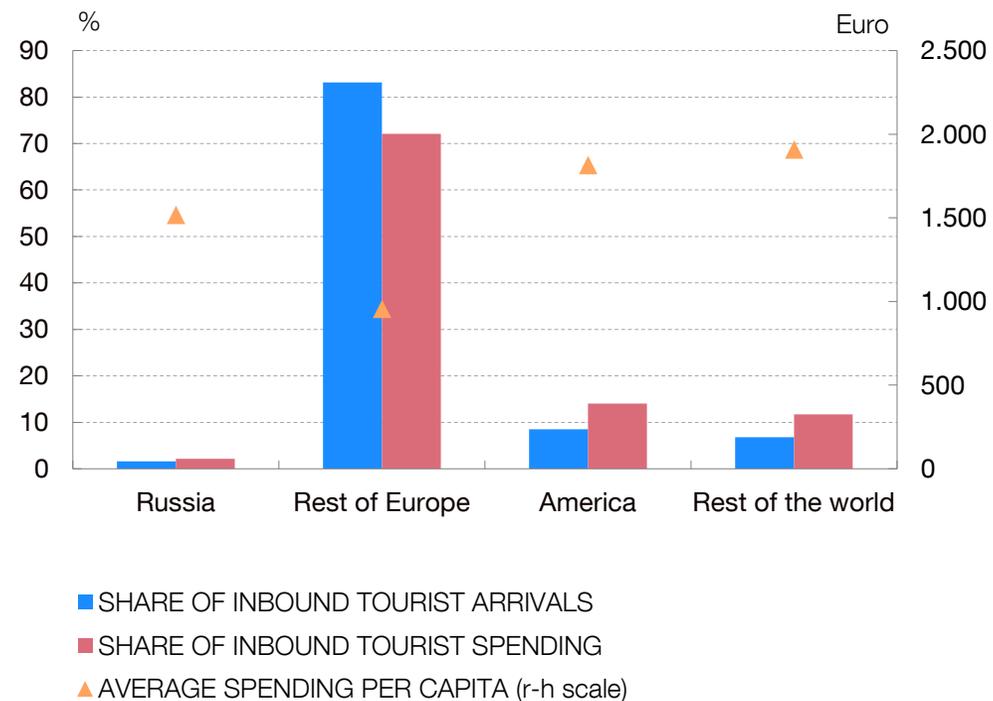
In the Banco de España's latest projections, published in April, GDP growth was revised downwards and inflation upwards, especially in 2022

Information that has become available since these projections were published, which includes lower-than-expected GDP growth in Q1, points, in the absence of any further shocks, to a fresh downward revision to the expected GDP growth rate for this year

## FOREIGN TRADE IN GOODS EXPOSURE TO RUSSIA AND UKRAINE



## THE RUSSIAN SOURCE MARKET'S SHARE OF SPAIN'S INBOUND TOURISM 2019



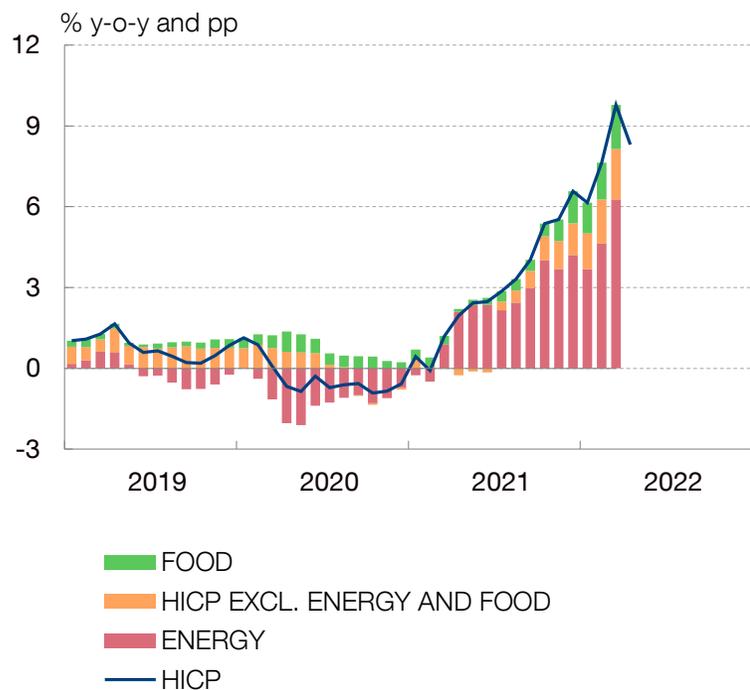
SOURCES: Departamento de Aduanas e Impuestos Especiales, INE, European Commission and Banco de España

# ... BUT THE INDIRECT EFFECTS OF THE WAR ON OUR ECONOMY WILL FORESEEABLY BE SIGNIFICANT

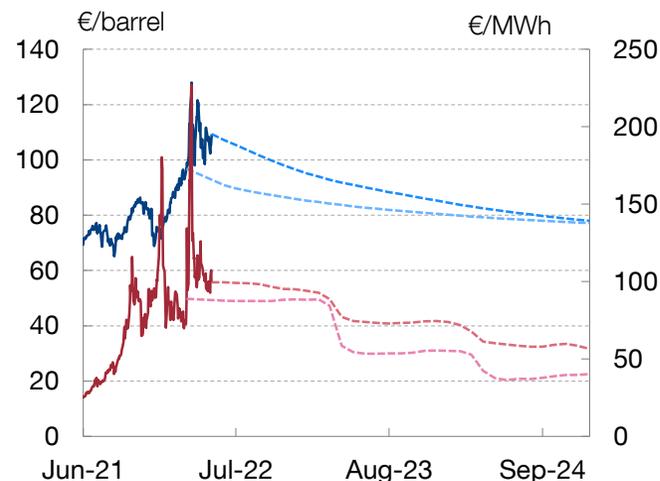
- For instance, the upturn in prices (particularly in commodity prices), which had already impacted Spanish GDP growth very negatively in 2021, will be more acute and persistent than anticipated before the outbreak of the war ...

## COMMODITY PRICES

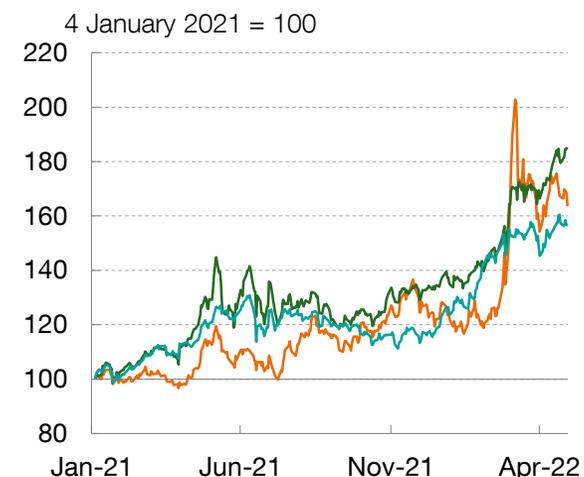
SPAIN: HICP CHANGE AND CONTRIBUTIONS



OIL AND NATURAL GAS



AGRICULTURAL GOODS

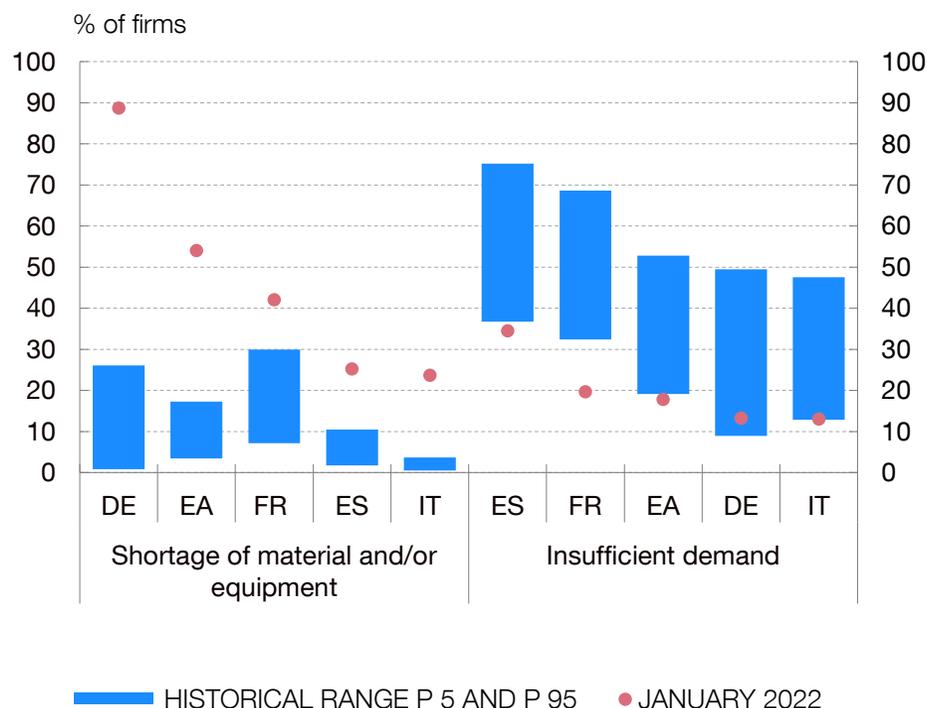


SOURCES: INE, Bloomberg and Refinitiv.

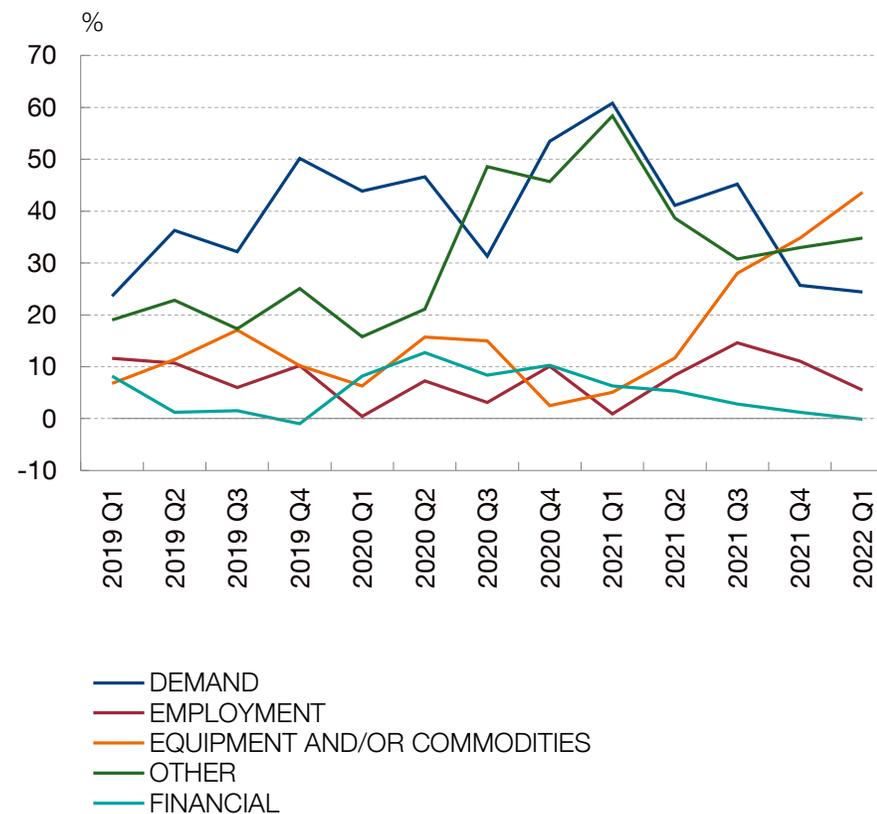
# ... BUT THE INDIRECT EFFECTS OF THE WAR ON OUR ECONOMY WILL FORESEEABLY BE SIGNIFICANT

- ... the same is true of the global production and supply chain bottlenecks, which hindered Spanish economic activity considerably in 2021 and may persist for longer than was expected some months ago

**FACTORS LIMITING MANUFACTURING PRODUCTION**



**SPAIN: LIMITING FACTORS IN THE INVESTMENT GOODS INDUSTRY**

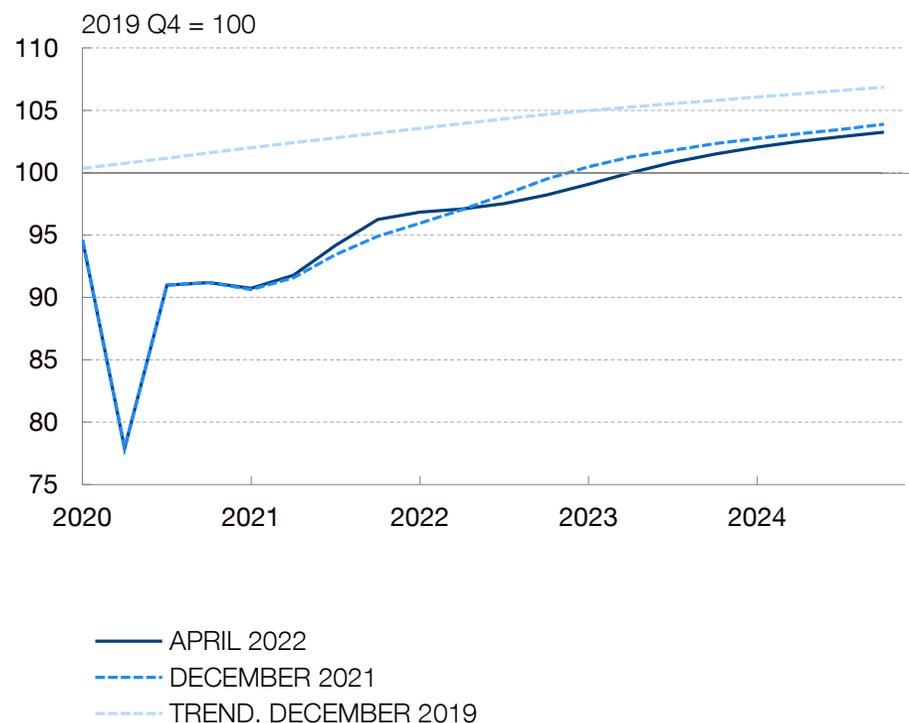


SOURCE: European Commission.

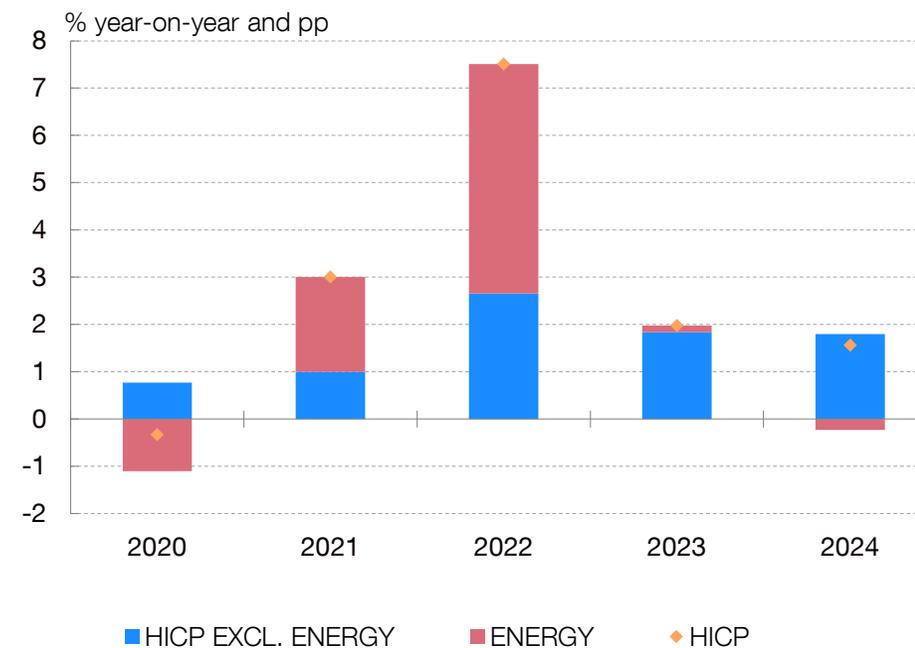
# AGAINST THIS BACKDROP, THE BANCO DE ESPAÑA'S LATEST MACROECONOMIC PROJECTIONS, PUBLISHED IN APRIL, ENVISAGE LOWER GROWTH AND HIGHER INFLATION

- All in an extraordinarily uncertain setting

### REAL GDP



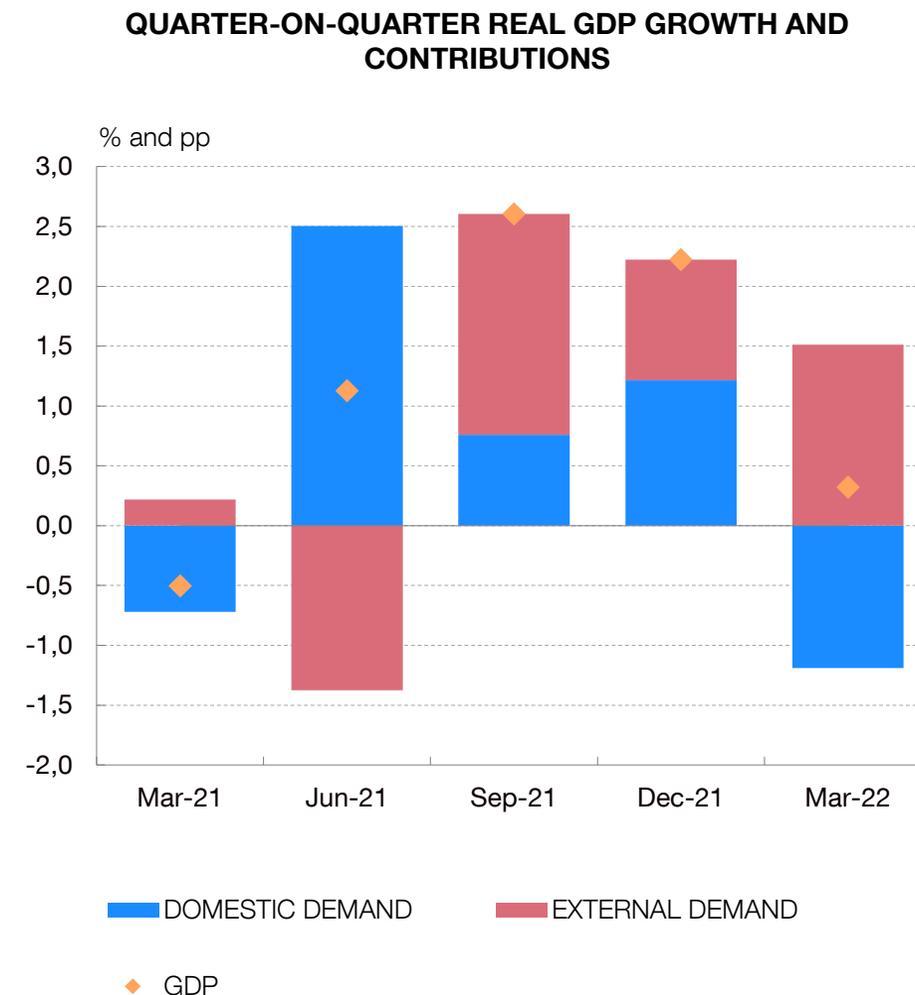
### HICP: GROWTH AND CONTRIBUTIONS (a)



SOURCES: INE and Banco de España.

## THE INFORMATION THAT BECAME AVAILABLE AFTER THE PUBLICATION OF THESE PROJECTIONS WOULD INDICATE A FRESH DOWNWARDS REVISION TO THE GDP GROWTH RATE IN 2022

- In particular, in 2022 Q1 GDP grew at a quarter-on-quarter rate of 0.3%, considerably less than estimated by the Banco de España (0.9%)
- On the price side, the new data point to sharper increases in the non-energy component than envisaged in the April projections and more moderate growth in the energy component
- Moreover, in the coming months the Iberian mechanism to cap the price of gas and lower that of electricity which was recently approved in Spain and Portugal, in accordance with the European Commission, will foreseeably exert downward pressure on energy prices in Spain



SOURCE: INE.

## **ECONOMIC POLICIES, WHICH MUST ADAPT TO THE CURRENT SITUATION, WILL CONTINUE TO PLAY A KEY ROLE IN ACTIVITY DEVELOPMENTS IN THE SHORT TERM**

Since the onset of the pandemic, economic policies have provided very considerable support to activity both in Spain and globally. In Spain, the furlough schemes and the ICO guarantee facilities have played a notable role

Even before the outbreak of the war in Ukraine, the economic recovery that was under way and the surge in inflation had already raised the prospect of a degree of normalisation in some of these expansionary measures, particularly in the monetary and fiscal policy realm

The war has generated new requirements in the fiscal arena and, through higher inflationary pressures, has propelled the process of monetary policy normalisation at the world's foremost central banks

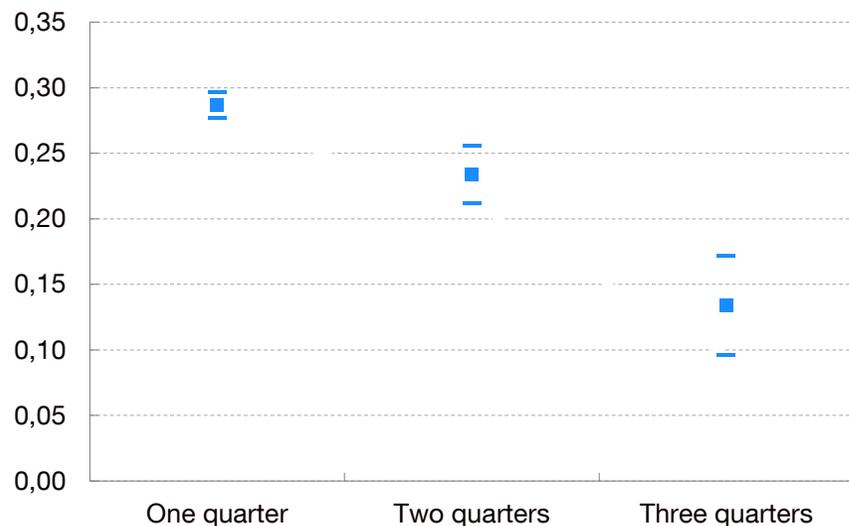
In Spain, fiscal policy must help mitigate the adverse economic effects of the war, which are once again highly uneven across sectors, firms and households. However, given the relatively limited fiscal space, they must also target the most vulnerable groups and be temporary

Beyond the fiscal policy response, an incomes agreement between social partners in our country would help avoid a spiral of price and cost increases, which would only exacerbate the harmful effects of the current inflationary episode and the war in Ukraine

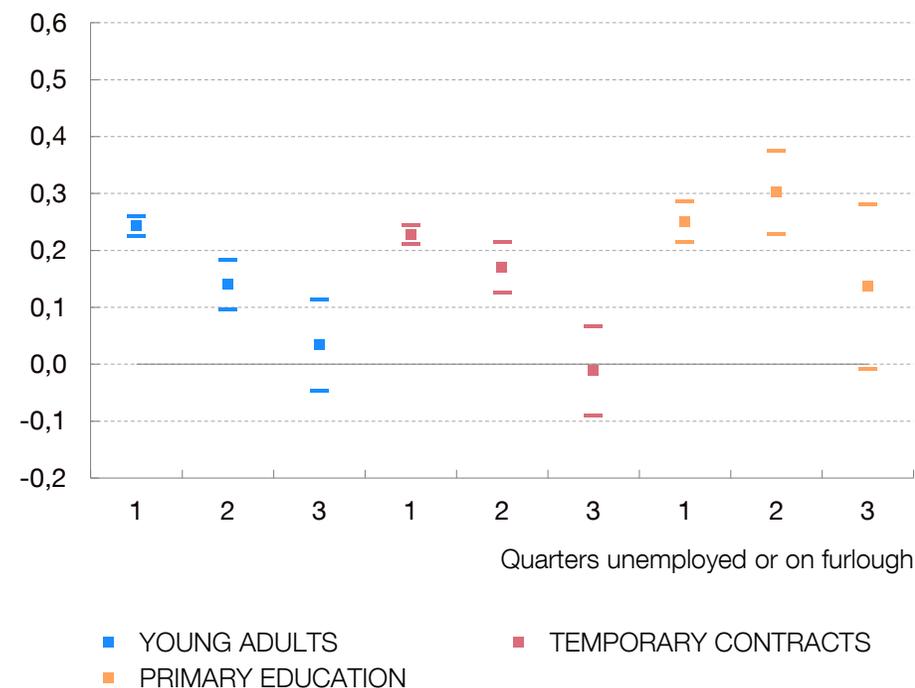
# THE FURLOUGH SCHEMES HAVE BEEN EFFECTIVE IN PROMOTING THE RETURN TO WORK, ALTHOUGH THEY APPEAR TO BECOME LESS EFFECTIVE THE LONGER THE FURLOUGH

- A Banco de España study shows that the probability of returning to work is higher for a furloughed employee than an unemployed person
- However, this difference decreases the longer the duration of the furlough, particularly for younger workers, workers with temporary contracts and lower-skilled workers

**IMPACT ON THE PROBABILITY OF RETURNING TO WORK (FURLOUGH vs UNEMPLOYMENT)**



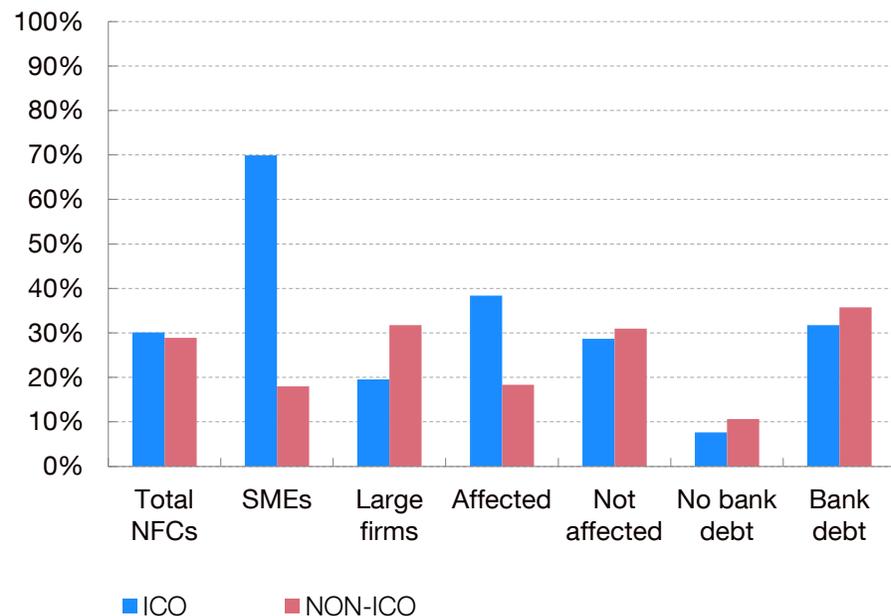
**IMPACT ON THE PROBABILITY OF RETURNING TO WORK, BY INDIVIDUAL CHARACTERISTIC (FURLOUGH vs UNEMPLOYMENT)**



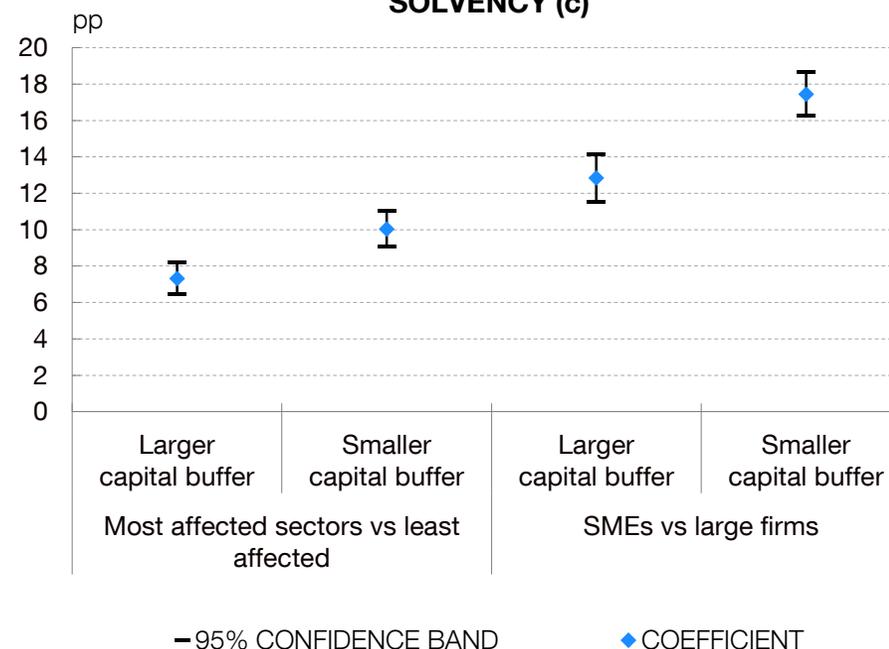
SOURCES: Microdata on EPA flows (INE) and Banco de España.

# THE PUBLIC GUARANTEE FACILITIES ALLOWED MUCH OF FIRMS' LIQUIDITY NEEDS TO BE COVERED AND UNDERPINNED THE SUPPLY OF CREDIT, PARTICULARLY FOR BANKS WITH LESS CAPITAL

**COVERAGE OF FIRMS' LIQUIDITY NEEDS IN 2020 (a) (b)**



**PROPORTION OF NEW LENDING TRANSACTIONS WITH PUBLIC GUARANTEES, BY BORROWER CHARACTERISTIC AND BANK SOLVENCY (c)**



SOURCE: Banco de España.

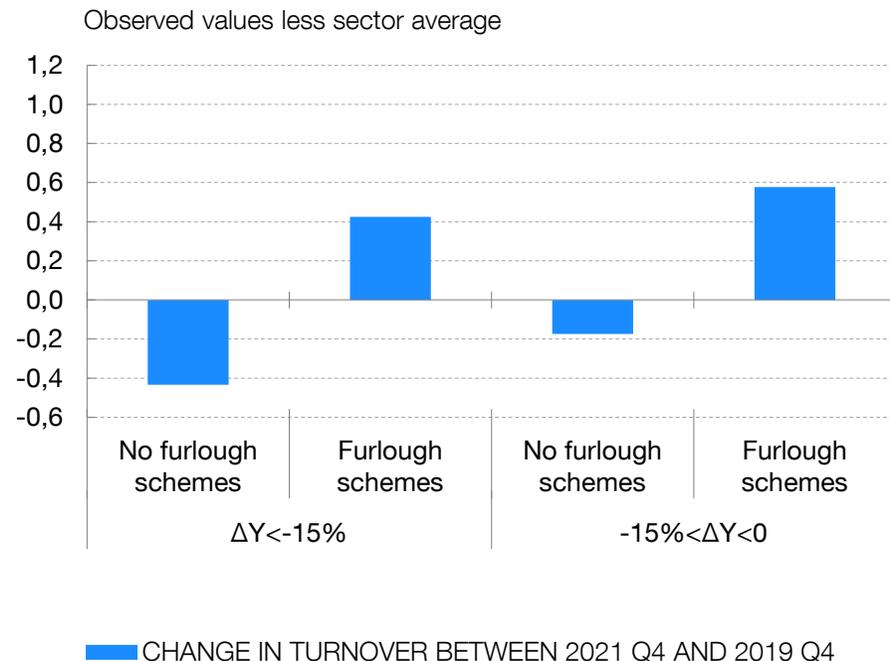
a. Includes new credit transactions drawn. Size is defined in line with the European Commission Recommendation. The sectors most affected by the health crisis are transportation, accommodation and food service activities, recreation and motor vehicles. The firms are classified as having bank debt or not based on whether they had bank loans on their balance sheet in December 2019.

b. Only credit transactions maturing after 2020 are considered, as those maturing within the year would have to be refinanced. Firms' liquidity needs are defined as the sum of debt maturities and the liquidity deficit generated both by the operating activity and by investment in fixed assets.

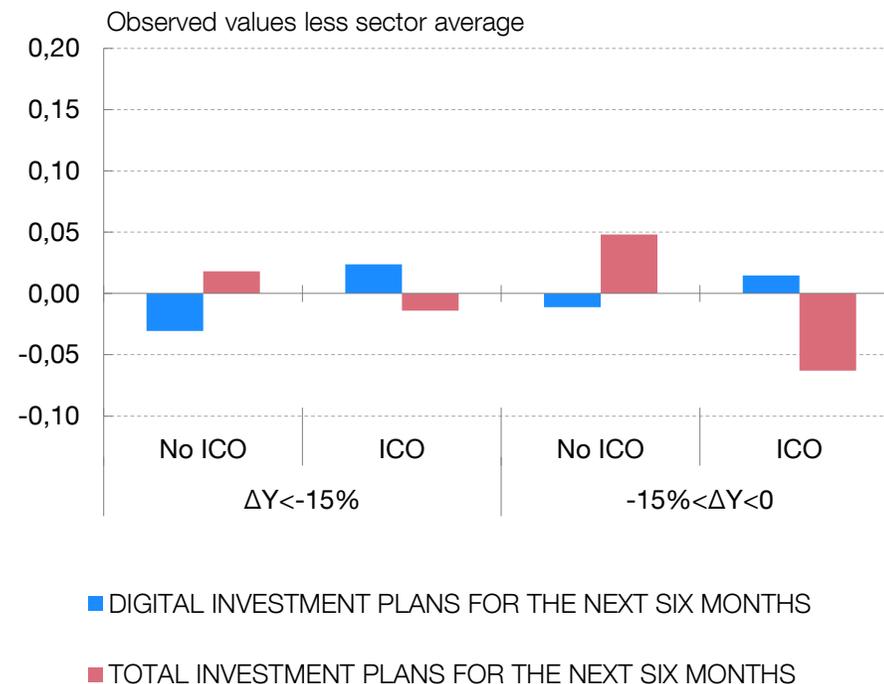
c. The diamonds are the coefficients estimated in a regression analysis in which: (i) the dependent variable is the amount of the new State-backed loans as a percentage of total credit obtained by a firm from a particular bank in a given month, and (ii) the explanatory variables of interest are firm characteristics that proxy their restrictions in terms of access to financing and their interaction with a dichotomous variable that takes the value of 1 for banks with smaller capital buffers (those whose capital buffers are below the average for Spanish banks as a whole) and zero otherwise (banks with larger capital buffers). The firm characteristics of interest are: (i) a dichotomous variable that is equal to 1 if the firm operates in one of the sectors most affected by the pandemic (see Note a), and (ii) an indicator of whether the firm is an SME (see Note a). The estimate is for a period between March and December 2020 and also uses firm-level controls and bank-time and province-time fixed effects. The vertical lines denote the 95% confidence bands.

# THE BANCO DE ESPAÑA BUSINESS ACTIVITY SURVEY (EBAE) CONFIRMS THAT THE FURLOUGH SCHEMES AND ICO GUARANTEE FACILITIES CONTRIBUTED FAVOURABLY TO THE RECOVERY

## TURNOVER IN 2021 (a) (b)



## DIGITAL INVESTMENT AND CHANGE IN INVESTMENT PLANS (a) (c) (d)



SOURCE: EBAE.

a.  $\Delta Y$  denotes the change in the firm's turnover between 2019 Q4 and 2020 Q4.

b. The variable "Furlough schemes" denotes those firms that in 2020 Q4 reported that such schemes were proving "important" or "very important", whereas "No furlough schemes" denotes those that reported that these schemes were proving "unimportant" or "of little importance".

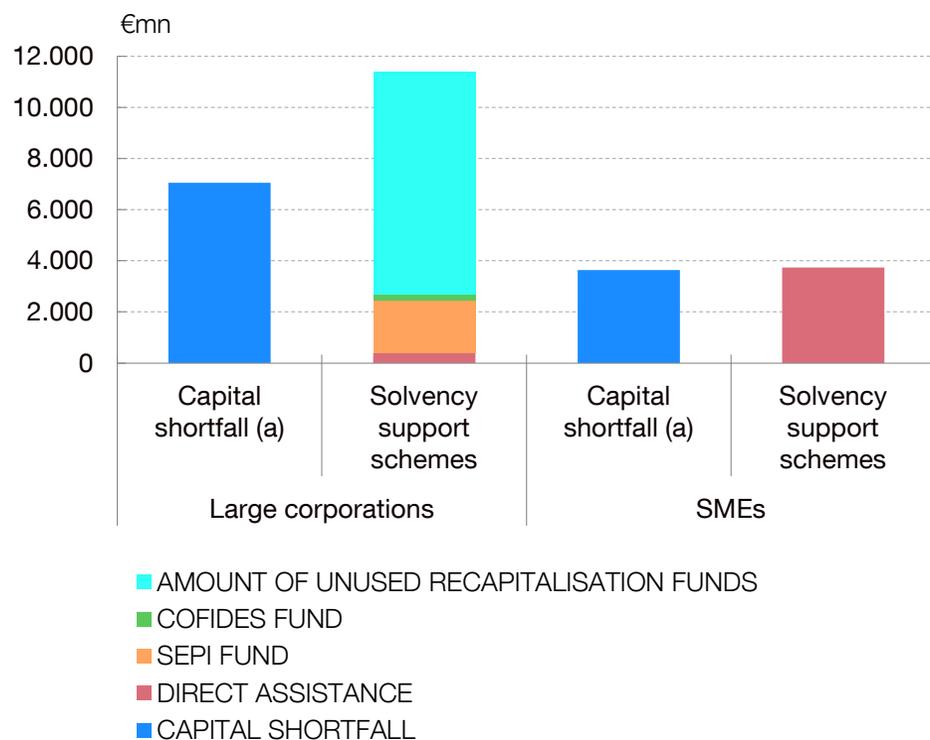
c. The variable "ICO" denotes those firms that in 2020 Q4 reported that the ICO facilities were proving "important" or "very important", whereas "No ICO" denotes those that reported that the ICO facilities were proving "unimportant" or "of little importance".

d. A positive (negative) value denotes an increase in the probability of increasing (decreasing) digital or total investment in the next six months. Investment in new technologies and digitalisation is deemed digital investment. Total investment plans are calculated on the basis of the question on the likelihood of reducing pre-planned investments at the firm.

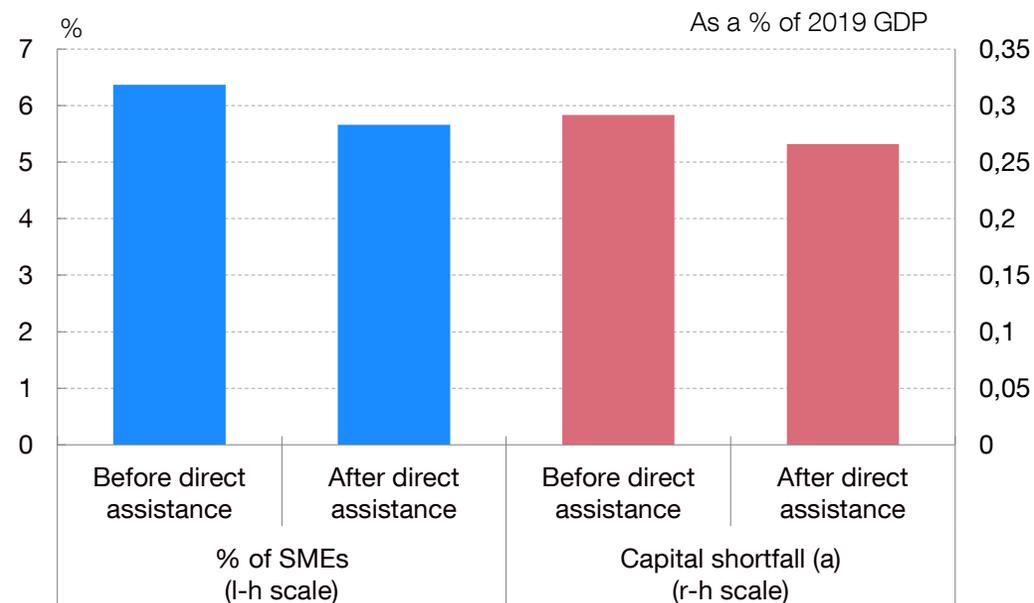
# MEANWHILE, THE DIRECT ASSISTANCE SCHEME APPEARS TO HAVE ONLY PARTIALLY MITIGATED THE DETERIORATION IN SPANISH SMEs' SOLVENCY

- According to Banco de España estimates, despite the funds under the scheme sufficing to cover all SMEs' capital shortfalls, the percentage of such firms with a capital shortfall following the crisis barely declined after the assistance scheme

**CAPITAL SHORTFALL IN 2020 AND AMOUNT UNDER THE CORPORATE SOLVENCY SUPPORT SCHEMES**



**SMEs WITH A CAPITAL SHORTFALL IN 2020**



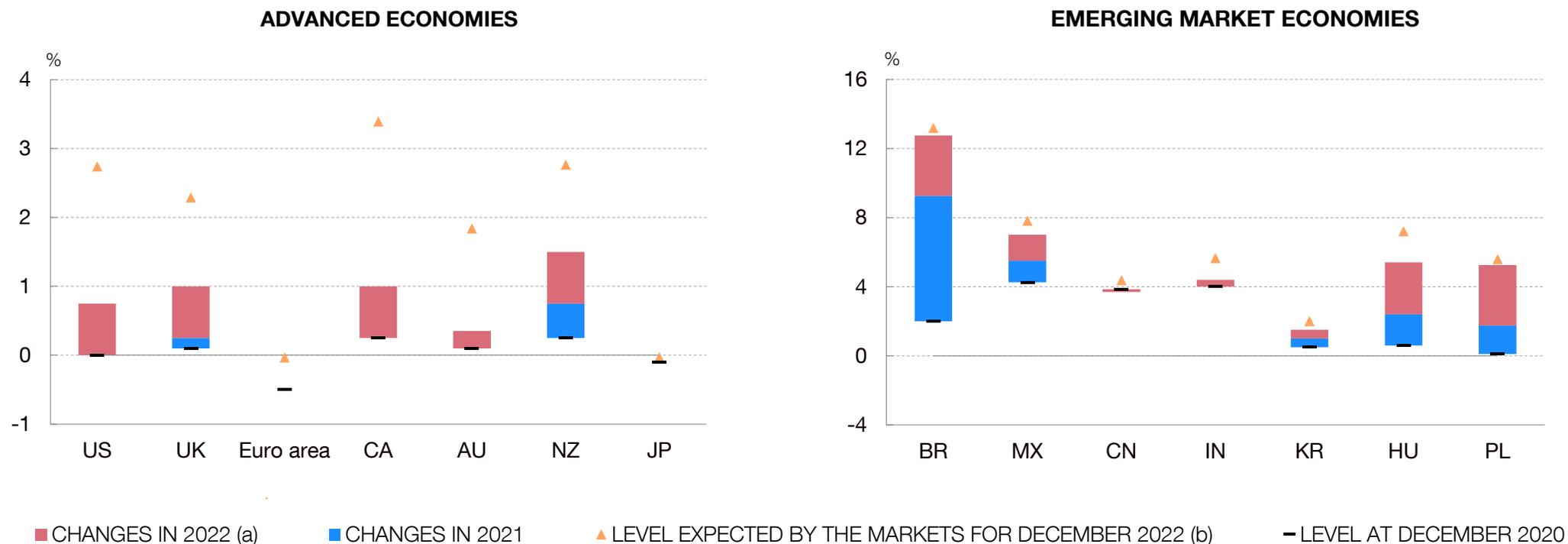
SOURCE: Banco de España.

a. Firms are deemed to have a capital shortfall when their capital ratio (equity/total assets) was positive in 2019 but fell in 2020 to stand below 15%. The amount of the capital shortfall is the volume required by firms with a shortfall to return to their 2019 capital ratio, with a 15% limit.

# MONETARY POLICY IS MOVING TOWARDS NORMALISATION IN THE ADVANCED ECONOMIES WHILE THE CYCLE OF TIGHTENING CONTINUES IN THE EMERGING MARKET ECONOMIES

- The headway in this process, which is in response to strengthening inflationary pressures, could give rise to tensions in capital markets and to a tightening of bank lending conditions (although this has not yet been evident to any significant extent) and an increase in agents' debt burden

## POLICY INTEREST RATES



SOURCES: National central banks.

a. Includes changes to policy rates adopted before 13 May 2022.

b. Based on futures for the interbank overnight rate, interest rate swaps and the OIS rate for the euro area, in April 2022.

# SINCE LATE 2021 THE ECB HAS ADOPTED SEVERAL MEASURES CONSISTENT WITH A GRADUAL NORMALISATION OF ITS MONETARY POLICY STANCE

## Some recent decisions

- In December 2021 it was announced that **net asset purchases under the PEPP** would end in March 2022
- In April it was announced that **net asset purchases under the APP** would conclude in Q3

## Key aspects of the ECB's response

In the current extraordinarily uncertain setting, and provided that euro area medium-term inflation expectations remain anchored around its 2% target, the ECB has emphasised that its monetary policy response will depend on the performance of economic indicators, in addition to being gradual and maintaining all the optionality and flexibility provided by its various instruments

It will take whatever action is needed to fulfil its mandate to pursue price stability and to contribute to safeguarding financial stability

Within the Governing Council's mandate, under stressed conditions, flexibility will remain an element of monetary policy whenever threats to monetary policy transmission jeopardise the attainment of price stability

The first interest rate increase will take place some time after the end of the net purchases under the APP

## What are these effects?

- **Indirect effects:** whereby rising energy costs are ultimately passed through to the prices of other goods and services due to firms attempting to maintain their profit margins
- **Second-round effects:** whereby a rise in inflation leads to sharper wage increases (which, in turn, are passed through to product prices) due to employees attempting to avoid a loss of purchasing power

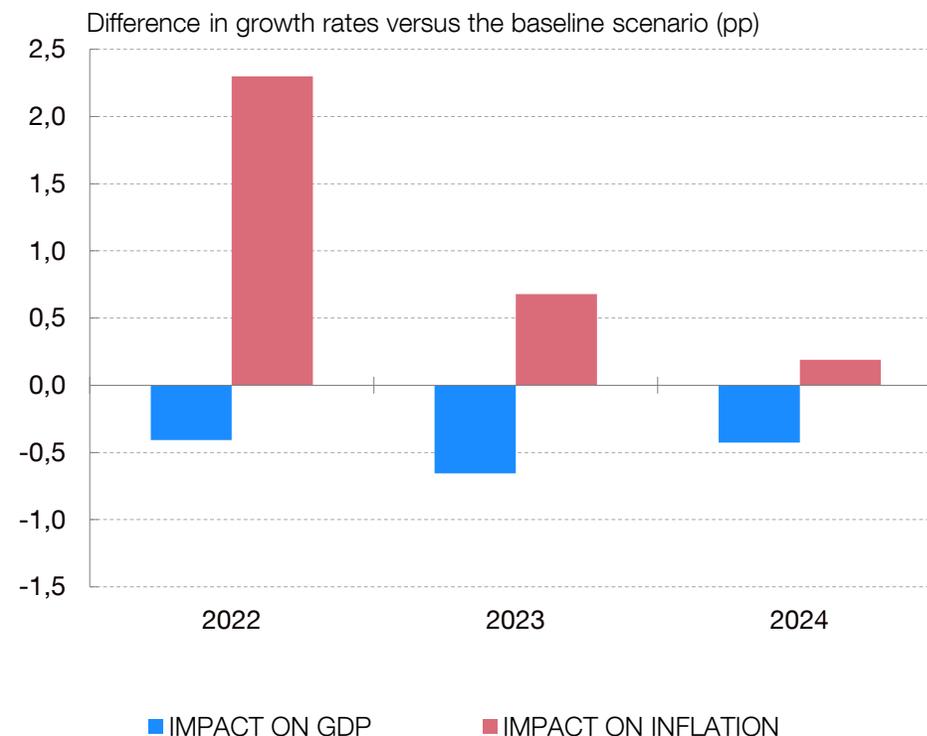
## Have such effects already materialised in Spain?

- **For the time being, they have not materialised to a substantial extent**
  - Various sources, for instance the Banco de España's Central Balance Sheet Data Office and the Banco de España Business Activity Survey (EBAE), indicate that since early 2021 firms have only very partially passed rising costs through to the final prices of their products. This would have **narrowed profit margins somewhat**
  - The information on collective bargaining in Spain shows that wage settlements are clearly below the observed inflation rates, which means a **loss of purchasing power for employees**

## Why is the materialisation of these effects a risk?

- The longer the current inflationary episode persists, the likelier it is that significant indirect and second-round effects will materialise
- In the event of feedback between wage and price growth, the current inflationary episode will last longer and its economic cost, in the form of **steeper declines in international competitiveness, activity and employment levels, and national income**, will be greater

## ECONOMIC IMPACT OF MARGINS AND WAGES RESPONDING TO HIGHER ENERGY PRICES (a)



SOURCE: Banco de España (Quarterly report on the Spanish economy, *Economic Bulletin* 1/2022).

a. Business owners and employees seeking an increase in their prices and wages to nullify the initial impact of the energy shock on their incomes is envisaged.

The incomes agreement as a means of mitigating this risk

- Via this agreement, firms and employees would agree to share the inevitable loss of income that the higher prices of commodity imports entail for the domestic economy

What should the characteristics of this agreement be?

## MINDFUL OF THE UNEVEN IMPACT

The uneven impact of the current shocks across workers, firms and sectors should be addressed. In other words, adopting excessively uniform measures, which would be too rigid for some segments of agents, should be avoided

## WAGES

It should avoid formulas that automatically index wages to past inflation or indexation clauses

## MULTI-YEAR

It should include multi-year commitments relating to both wage increases – where the nominal benchmarks for wage bargaining should be based on the projected trend in underlying inflation – and to job protection

## PROFIT MARGINS

These wage guidelines should be accompanied by explicit profit margin moderation commitments