REPORT

1 Global economic activity has slowed somewhat in recent months

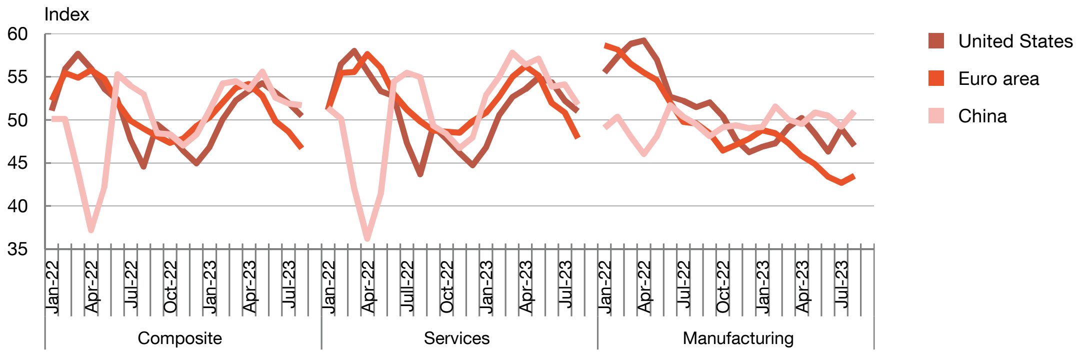
— In 2023 Q2, global growth moderated with respect to that observed in the previous quarter. However, this aggregate performance was marked by highly uneven economic growth across geographical areas. Thus, while GDP growth was higher than expected in some of the main world economies, such as the United States, the United Kingdom and Japan, it surprised on the downside in the euro area and in China.

— According to the available indicators, global economic activity has decelerated further in Q3, as the weakness of the manufacturing sector appears to have spread to services (see Chart 1.a), against a backdrop of tightening financing conditions.

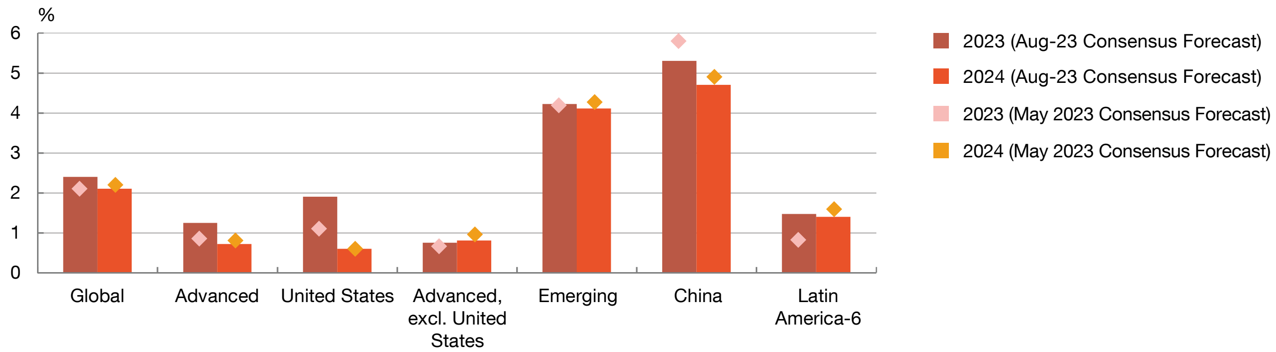
— Overall, these developments have prompted slight revisions to global growth forecasts for 2023 and 2024 (see Chart 1.b). However, the 2023 growth forecast for the United States has been revised significantly upwards (partly on account of its strong labour market), and the forecast for China (owing, among other factors, to the sluggishness of investment and its real estate sector) and the euro area has been revised downwards for this and the coming year.

Chart 1

1.a Purchasing Managers' Indices



1.b Growth forecasts (a)



SOURCES: S&P Global, Consensus Forecasts and Refinitiv.

a "Advanced economies" include United States, the euro area, Japan, United Kingdom, Norway, Sweden, Switzerland and Canada. "Emerging market economies" include Argentina, Brazil, Chile, Colombia, Mexico, Peru, Czech Republic, Hungary, Poland, Romania, Russia, Türkiye, China, India, Indonesia, Malaysia, Philippines and Thailand, and "Latin America-6", Argentina, Brazil, Chile, Colombia, Mexico and Peru.

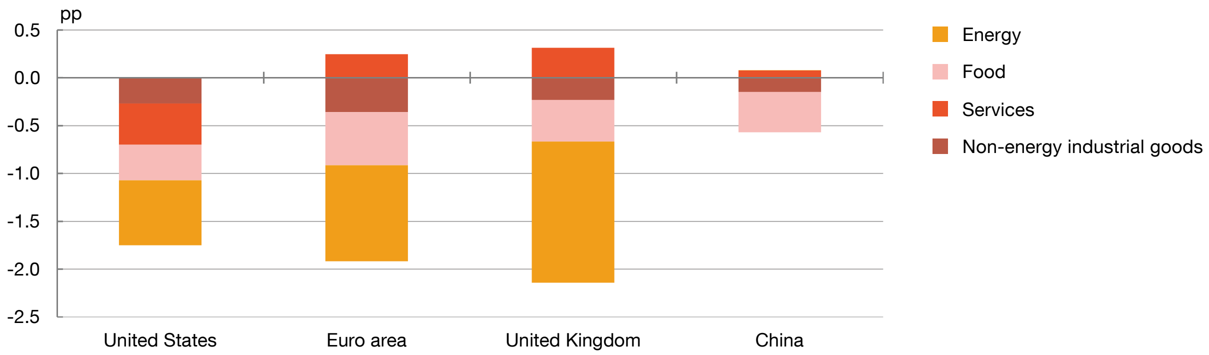
2 Global headline inflation has continued to ease, despite a stronger-than-expected rise in oil prices and still-high underlying inflation

— In recent months, headline inflation rates have continued to decline globally, mainly owing to the lower contribution from food and energy (see Chart 2.a). Nevertheless, recent developments in oil and natural gas prices have surprised on the upside following the materialisation of different adverse supply shocks (see Chart 2.b).

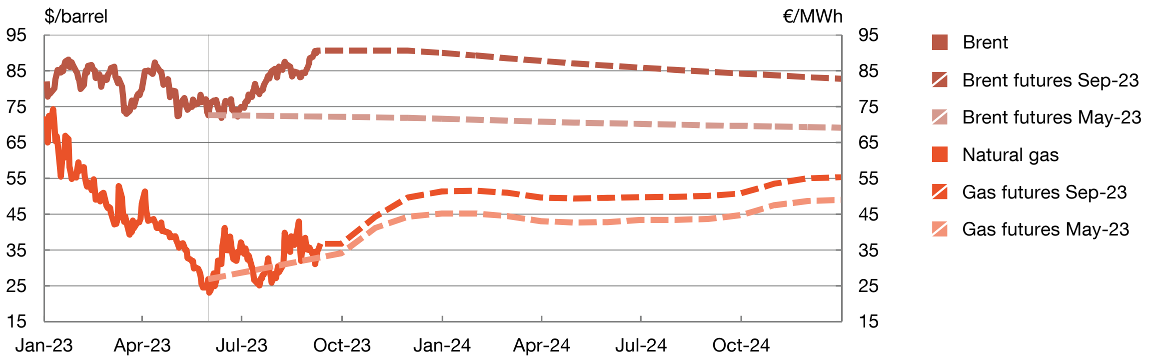
— Moreover, the moderation in underlying inflation is not as marked or widespread as that of headline inflation. Among the components of underlying inflation, services inflation remains persistent and has actually increased in some countries since April (see Chart 2.a). These adverse developments can be attributed to a combination of factors, such as the strength of demand for services in H1, the rise in wages (which account for a relatively high share of the cost structure of services), and the performance of profit margins in that sector.

Chart 2

2.a Breakdown of inflation. Contributions to year-on-year rate. Difference between April and July 2023



2.b Gas and oil prices and futures



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SOURCES: Refinitiv, IMF and national statistics.

3 The pace of global monetary policy tightening has continued to slow in recent months and some central banks have already reduced their interest rates

— Most central banks in emerging market economies have paused their monetary tightening cycles and, in some countries, such as Brazil, Chile, Poland and China, they have even started to cut policy rates, given the moderation in inflation and the slowdown in activity in these economies (see Chart 3.a).

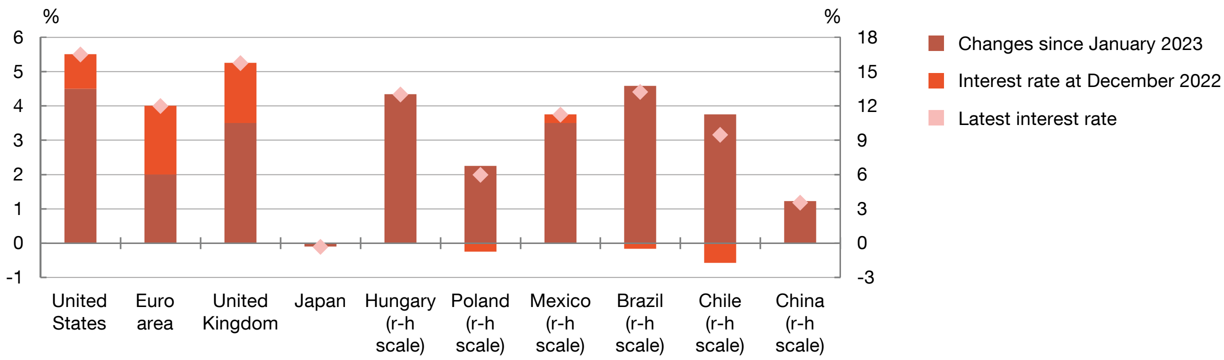
— Among the advanced economies, at their last monetary policy meetings, the US Federal Reserve (on 26 July), the Bank of England (on 2 August) and, more recently, the European Central Bank (ECB) (on 14 September), decided to raise their policy rates by 25 basis points (bp), albeit signalling that they may be entering the final stages of their interest rate hiking cycles.

— In any event, given the persistence of considerable underlying inflationary pressures and the messages conveyed by the world's main central banks, international financial markets have started, in recent months, to assume that interest rates will remain relatively high for longer than expected a few months ago.

— Against this backdrop, recent developments in international financial markets have been marked by an increase in long-term interest rates (for instance, the US and German 10-year benchmark yields have risen by 48 bp (to 4.3%) and 20 bp (to 2.6%) since end-June, respectively[1]), and by the uneven performance of the main global stock market indices, with slight gains in the United States and falls in most European stock markets.

Chart 3

3.a Policy interest rates



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SOURCES: National central banks and Refinitiv.

1 The rise in US sovereign bond yields also partly reflects the announced increase in Treasury issuance and the credit rating downgrade by Fitch in August.

4 In the euro area, economic activity proved weaker than expected

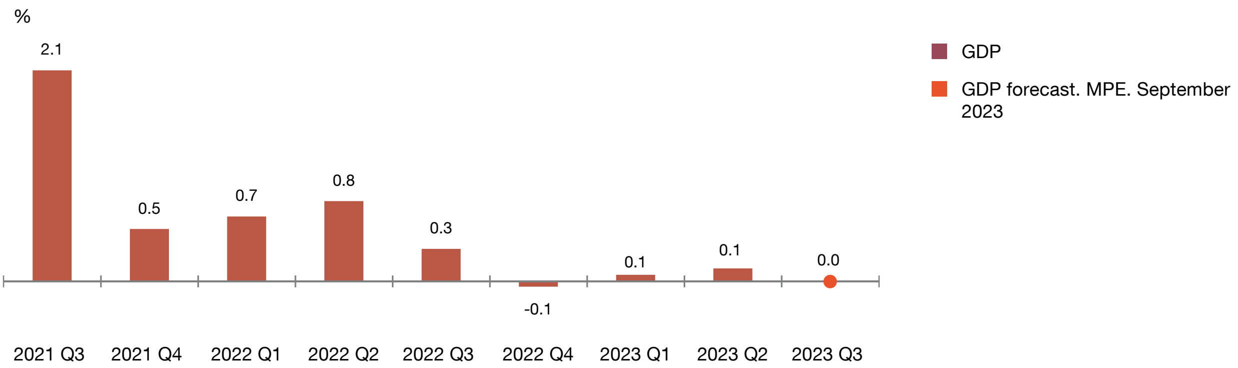
— In line with the sluggishness observed in the early months of the year, euro area GDP grew by only 0.1% in Q2, a lower-than-expected growth rate.

— The latest short-term economic indicators suggest that these signs of relative weakness worsened in the summer months, especially in sectors and demand components (for example, manufacturing and investment) that are more sensitive to tighter financing conditions.

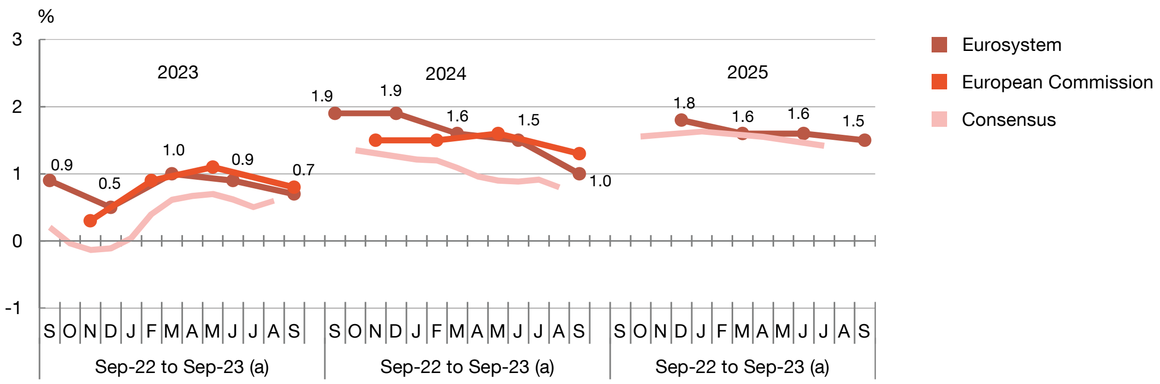
— In this setting, the September ECB staff macroeconomic projection exercise points to euro area GDP growth of around 0% in Q3 (see Chart 4.a). In annual average terms, GDP growth has been revised down over the entire projection horizon in the ECB's baseline scenario. In particular, average growth rates are expected to reach 0.7% in 2023, 1% in 2024 and 1.5% in 2025 (0.2 pp, 0.5 pp and 0.1 pp, respectively, below the June forecasts (see Chart 4.b)).

Chart 4

4.a Euro area. GDP (quarter-on-quarter rate)



4.b Euro area. GDP growth forecasts



SOURCES: European Commission, Consensus Economics, Eurosystem and Eurostat.

a The letters refer to the months when the respective forecasts were published.

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5 Headline inflation in the euro area held stable in July and August, in part due to the increase in the energy component and persistently high rates of underlying inflation

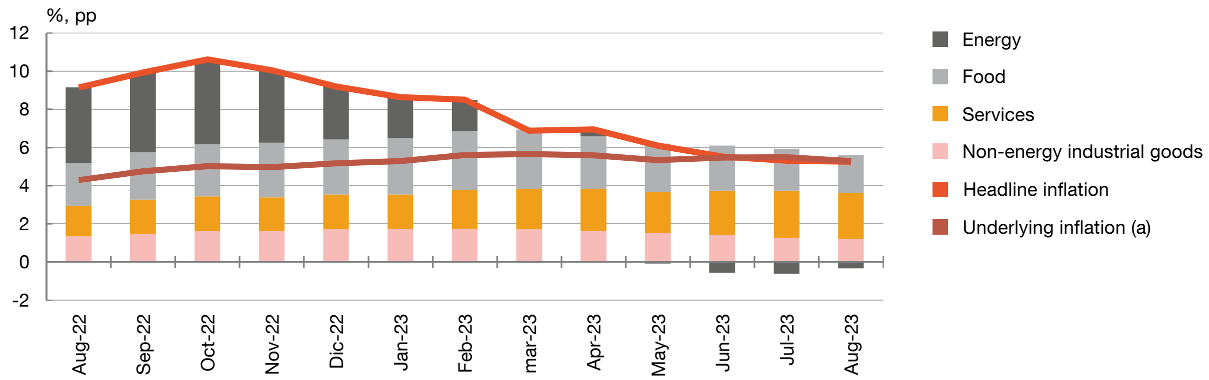
— According to the HICP flash estimate, euro area inflation stood at 5.3% year-on-year in August, higher than expected mainly due to an increase in the energy component. The contribution of food to inflation has continued to decline in recent months, but still remains at high levels (see Chart 5.a).

— Underlying inflation stood at 5.3% in August. This represented a reduction of 0.2 pp on the June figure, attributable to the easing contribution of non-energy industrial goods. Conversely, the contribution of services to the current inflationary pressures held at very high levels.

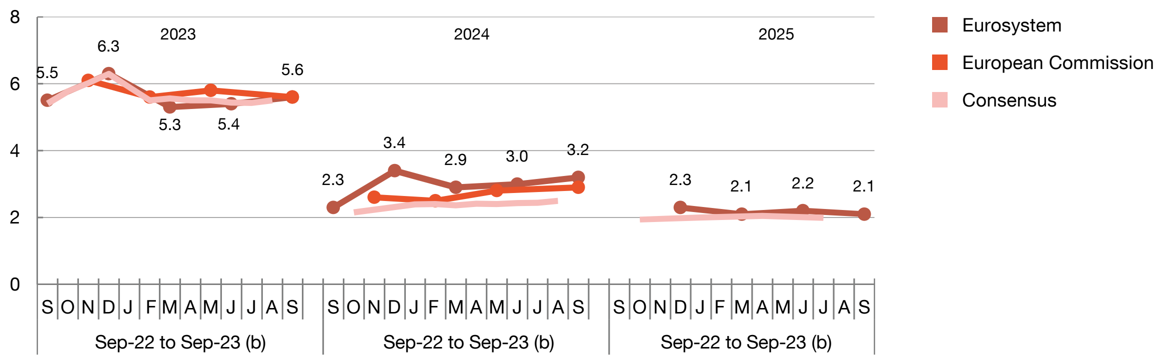
— In the light of these dynamics, and following changes to the assumptions about future developments in energy prices (revised up slightly) and exchange rates (envisaging a slightly more appreciated euro), the September ECB staff macroeconomic projection exercise revises up the headline inflation rates for 2023 and 2024 by 0.2 pp (to 5.6% and 3.2%, respectively) and revises down that for 2025 by 0.1 pp (to 2.1%) (see Chart 5.b).

Chart 5

5.a Euro area inflation and contribution of the components



5.b Euro area. Inflation forecasts



SOURCES: European Commission, Consensus Economics, Eurosystem and Eurostat.

a HICP excluding energy and food.
b The letters refer to the months when the respective forecasts were published.

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6 In September, the ECB raised its key interest rates for the tenth consecutive time to reinforce the progress of inflation towards the target rate of 2% over the medium term

— Inflation continues to decline, but is still expected to remain too high for too long.

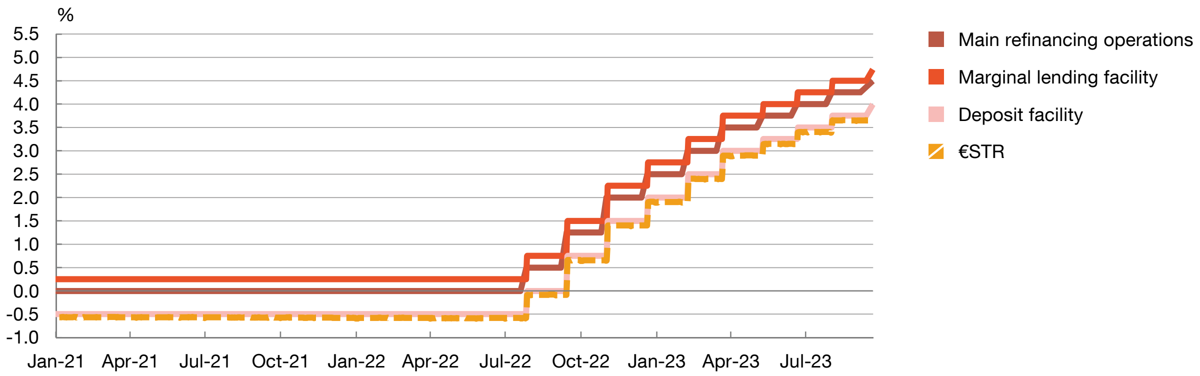
— In consequence, at its September meeting the ECB Governing Council decided to again raise its interest rates by 25 bp, taking the deposit facility rate to 4%, representing a cumulative increase of 450 bp since July 2022 (see Chart 6.a).

— With this decision, and based on its current assessment, the Governing Council considers that the key ECB interest rates have reached levels that, maintained for a sufficiently long duration, will make a substantial contribution to the timely return of inflation to the target.

— The Governing Council's future decisions will ensure that the key ECB interest rates will be set at sufficiently restrictive levels for as long as necessary. It will continue to follow a data-dependent approach to determining the appropriate level and duration of restriction. In particular, its interest rate decisions will continue to be based on its assessment of the inflation outlook in light of the incoming economic and financial data, the dynamics of underlying inflation, and the strength of monetary policy transmission.

Chart 6

6.a Key ECB interest rates and €STR



SOURCES: Banco de España and Refinitiv Datastream. Latest data: 14 September 2023.
NOTE: The latest increase in key ECB interest rates, announced on 14 September, is effective from 20 September.

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7 In Spain, GDP growth increased slightly less than expected in 2023 Q2, owing mainly to the notable drop in exports

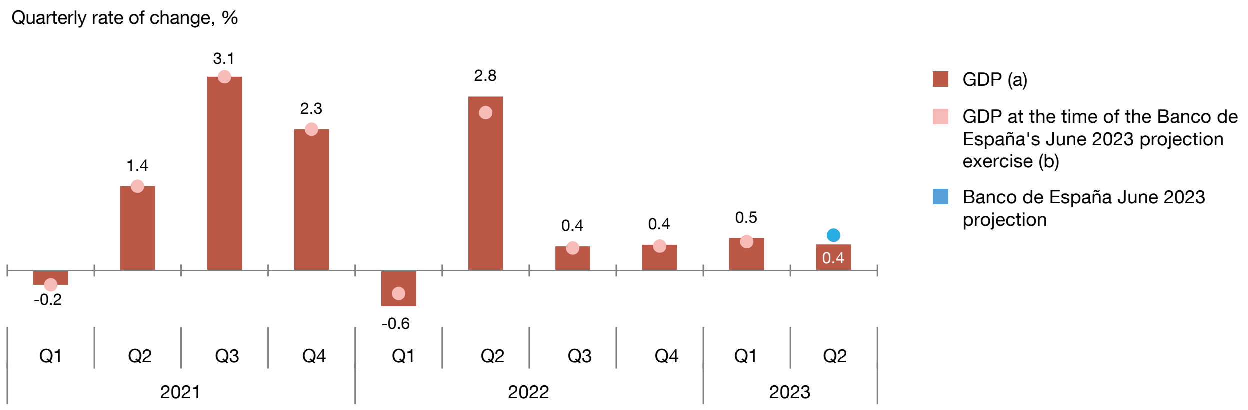
— As per the Quarterly National Accounts (QNA) flash estimate published by the National Statistics Institute (INE) in late July,[2] Spanish GDP grew 0.4% quarter-on-quarter in 2023 Q2, slightly less than envisaged in the Banco de España projection exercise published in June and than recorded in 2023 Q1 (see Chart 7.a).

— According to the INE flash estimate, GDP growth in 2023 Q2 was underpinned by an appreciable increase in domestic consumption and investment, against the background of a significant drop in exports and net external demand making a negative contribution to growth.

— From the supply perspective, the growth between April and June was mainly spearheaded by the services sectors – in particular arts, recreation and other services; information and communication, and non-market services. Conversely, activity levels declined in the primary sector and, to a lesser extent, in industry, energy and real estate services.

Chart 7

7.a Spanish GDP



SOURCES: Banco de España and INE.

a Latest series published by the INE (28 July 2023).
b Latest GDP series available (28 April 2023) at the time of the Banco de España's June 2023 projection exercise. Subsequently, on 23 June, the INE published its second QNA estimate for 2023 Q1, which, relative to the series published on 28 April with the Q1 flash estimate, slightly revised up the quarterly GDP performance for that quarter and the preceding three quarters, and revised down that for 2022 Q1.

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2 This flash estimate also included revised growth rates for previous quarters, having an overall positive carry-over effect on the average GDP growth rate for 2023. For more details, see the Projections in this report.

8 The latest short-term economic indicators suggest that economic growth in Spain may have decelerated slightly in 2023 Q3

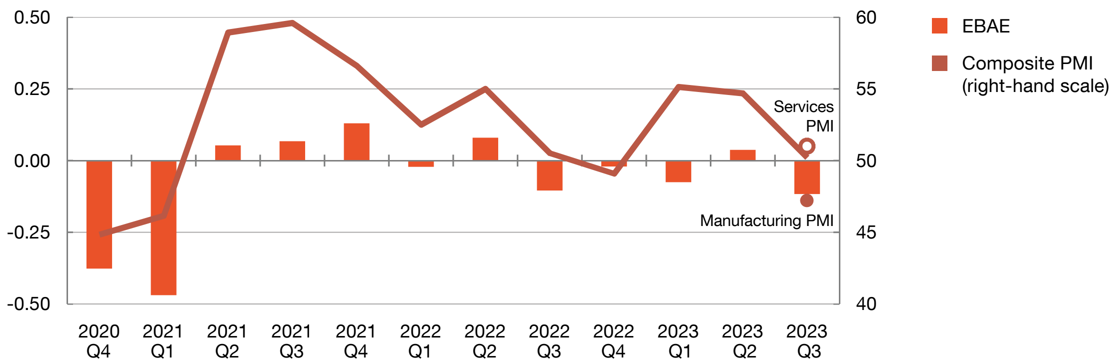
— Against a background of economic slowdown both globally and in the euro area, an overall analysis of the latest available indicators suggests that Spanish GDP could grow by around 0.3% in the period July-September.[3]

— The indicators consistent with a slight slowdown in activity in Q3 notably include the employment and confidence indicators. In particular, both the services and manufacturing PMIs have been in steady decline in recent months, with the latter standing in clear contractionary territory (see Chart 8.a).

— The results of the Banco de España Business Activity Survey (EBAE), which point to a drop in Spanish business turnover in Q3 as a whole, are also consistent with an easing pace of GDP growth in the current quarter.[4]

Chart 8

8.a EBAE turnover and composite PMI (a) (b)



SOURCES: EBAE (Banco de España) and S&P Global.

a The qualitative responses from the EBAE are converted into a numerical scale as follows: significant decrease = –2; slight decrease = –1; stability = 0; slight increase = 1; significant increase = 2.
b The composite PMI figure for 2023 Q3 is the average in July and August.

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3 For more details, see the Projections in this report.
4 For more details, see Fernández Cerezo and Izquierdo (2023).

9 Job creation appears to have slowed in Q3, after a highly buoyant start to the year

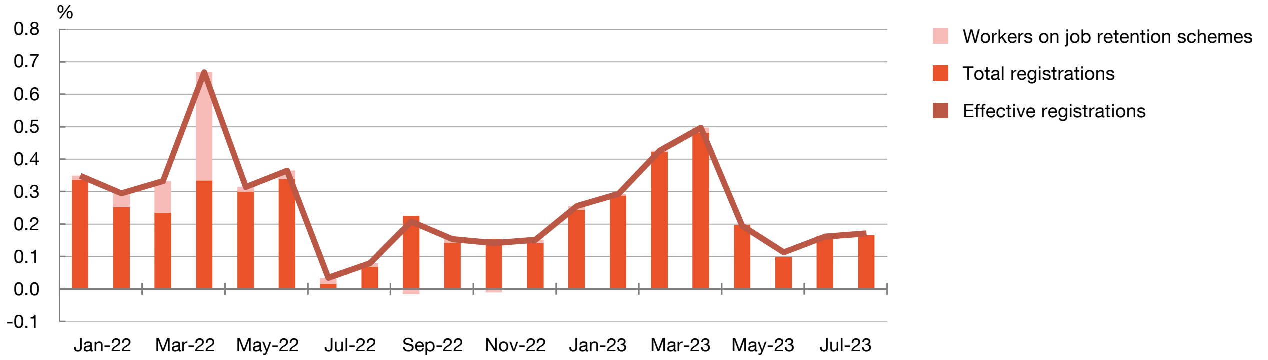
— Social security registrations grew, on a seasonally adjusted basis, by 0.2% in July and August, in line with the growth rates of 0.2% and 0.1% observed in May and June, respectively (see Chart 9.a).

— However, these developments in social security registrations would be consistent with a slowdown in job creation in Q3, after a strong performance in the first four months of the year that enabled the unemployment rate to fall to 11.6% in Q2, its lowest level since 2008 Q3.

— The moderation in employment growth during Q3 has been widespread across sectors of activity. That said, there were notable slowdowns in social security registrations in the construction and market services sectors, although their year-on-year growth rates remain higher than in the industrial sector.

Chart 9

9.a Total social security registrations, workers on job retention schemes and effective social security registrations (a)



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

a Seasonally adjusted monthly rate.

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10 Financing conditions for the Spanish private sector have continued to tighten

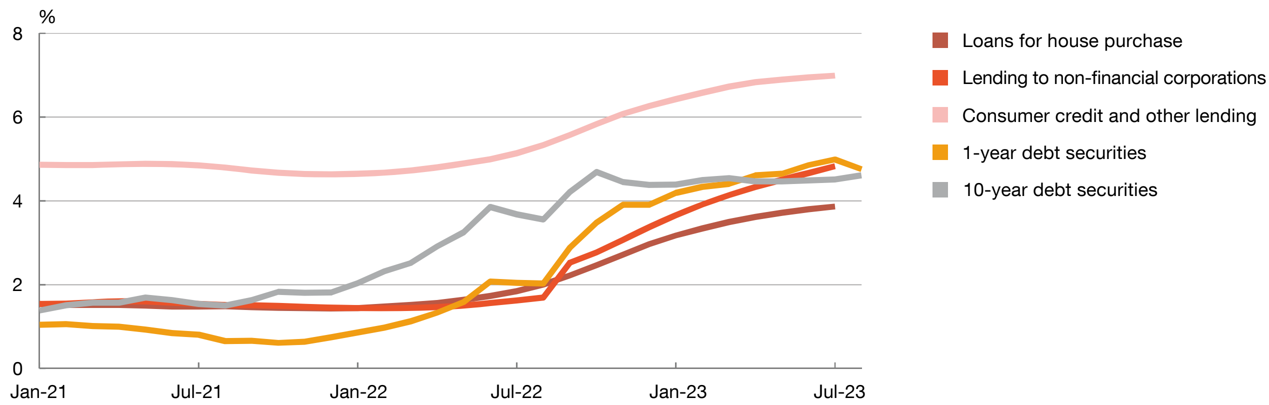
— The cost of new financing to households and firms has continued to increase in recent months, except in the case of short-term corporate debt issues, whose cost fell in August (see Chart 10.a).

— Meanwhile, according to the Bank Lending Survey, both the demand for and supply of credit continued to decline across the board in Q2. Although this reduction was less marked than in the previous quarter, the latest round of this survey suggests a further contraction in credit supply and demand in Q3.

— In this setting, the figures for new financing flows show that, in July, new bank loans to firms lost momentum, while new loans for house purchase continued on the downward path that began in mid-2022. Conversely, both new consumer credit and corporate financing raised through debt securities issuance picked up in July.

Chart 10

10.a Cost of new financing to households and firms (a)



SOURCE: Banco de España.

a Bank interest rates are narrowly defined effective rates (NDERs) and are adjusted seasonally and for the irregular component.

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11 Private consumption has risen in the summer months, on the back of recreation and tourism-related activities, albeit at a slower pace than in Q2

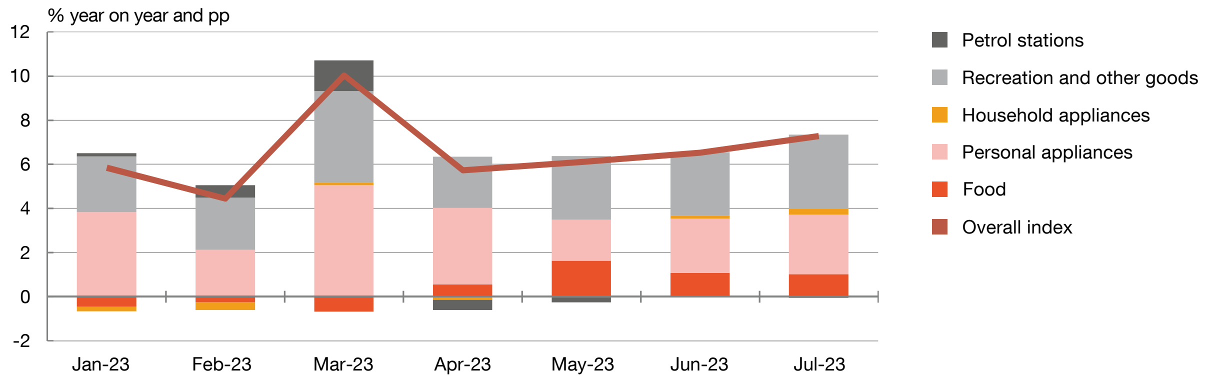
— According to the latest information, household consumption has risen in Q3, driven mainly by recreation and tourism. Thus, retail trade data for July show that the "Recreation and other goods" component is behind almost half of the increase in the overall index during that month (see Chart 11.a).

— On the information provided by the European Commission's economic sentiment indicator, consumer confidence also contributed to the consumption growth in Q3.

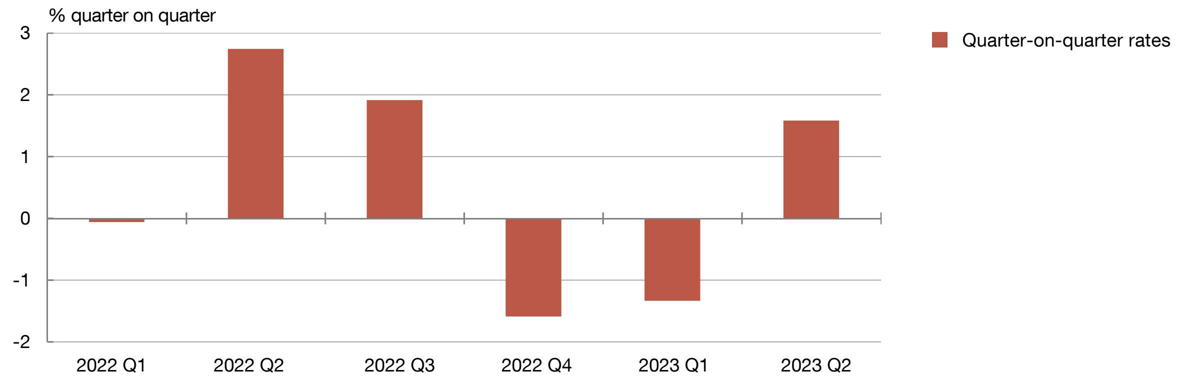
— However, the pace of private consumption growth between July and September (and in the coming quarters) will foreseeably be lower than that recorded between April and June (1.6% according to the flash estimate published by the INE) (see Chart 11.b). This is because growth in this demand component is still appreciably influenced by the tightening of financing conditions and by households' accumulated loss of purchasing power in the last few quarters.

Chart 11

11.a Retail trade: growth and contribution of components



11.b Recent developments in private consumption



SOURCES: INE and Banco de España.

12 Investment appears to have slackened in Q3, after the sharp rise in the previous quarter

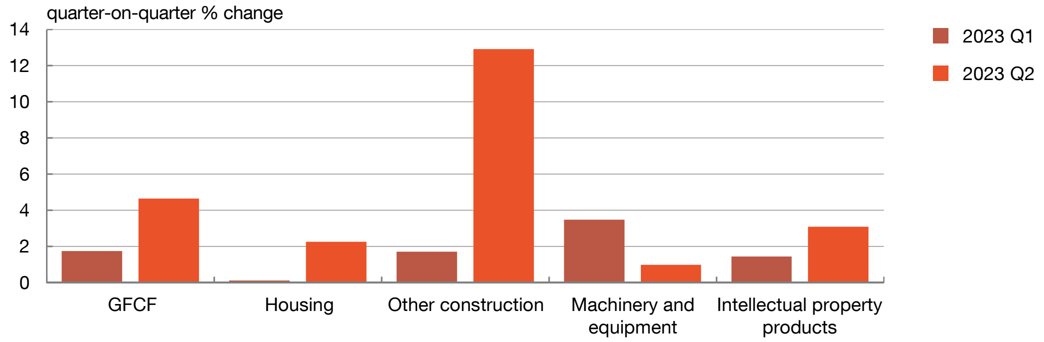
— In Q2, gross fixed capital formation (GFCF) showed considerable vigour and grew by 4.6%, according to the flash QNA estimates published by the INE at end-July. Of note among the investment components was the growth in other construction and intangible capital. Investment in capital goods also increased, albeit somewhat less than expected (see Chart 12.a).

— Looking ahead to the current and coming quarters, the recovery in investment is likely to continue, albeit at a slower pace than in the second quarter. Thus, although business investment growth could be boosted by both the roll-out of the projects under the NGEU programme and the availability of firms' own funds (following the recovery in their gross operating surplus), it would be weighed down to some extent by the tightening of financing conditions in recent quarters and by the recent slowdown in economic activity.

— In the light of these factors and of the most recent developments in the residential construction sector (for example, in the housing construction execution indicator, which has remained on a downward path for the past few months), residential investment is expected to follow a relatively modest growth path. House prices grew 3.6% year-on-year in Q2, in line with the 3.5% seen in the previous quarter, which entailed a 1.4% quarter-on-quarter increase in the seasonally adjusted series.

Chart 12

12.a Recent developments in investment and its components



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SOURCE: INE.

13 Buoyant tourism receipts over the summer months have probably helped to raise net external demand's contribution to growth in 2023 Q3

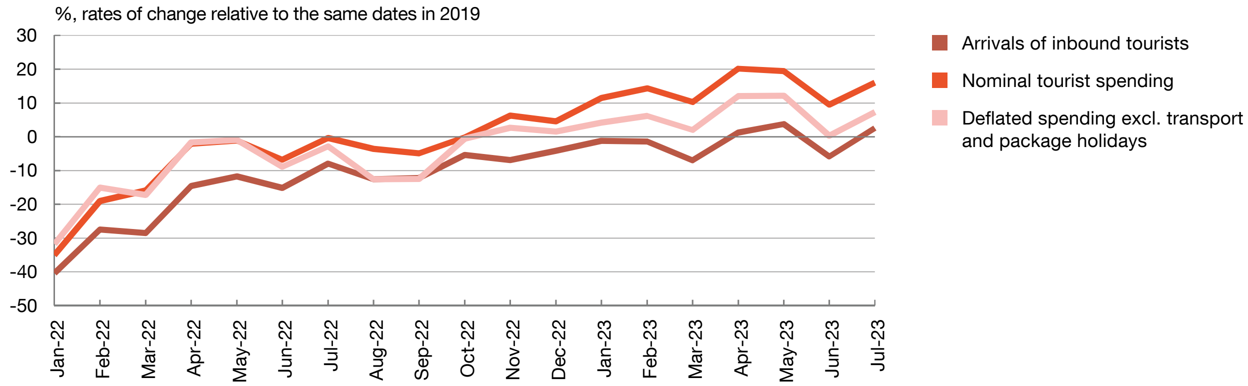
— Net external demand made a large negative contribution (-1.4 pp) to GDP growth in 2023 Q2 against a background of a sharp fall in goods exports (-5.9% quarter on quarter) and an increase in services imports (up by 12.3%).

— However, the contribution of net external demand to GDP growth is likely to have grown in 2023 Q3, especially in the light of robust inbound tourism over the summer. In July, tourist arrivals were 2.6% higher than in the same month in 2019, while spending by non-resident tourists broke July 2019 levels, by 16% in nominal terms and 7.3% in real terms (see Chart 13.a). This increase in spending appears to have been partly driven by the arrival of visitors with higher purchasing power.[5]

— By contrast, in a context of slowing economic activity around the world (especially visible in the manufacturing sector) and in line with the slowdown in activity shown by the PMI indicators, trade in goods with the rest of the world has shown relatively weak momentum so far in 2023 Q3.

Chart 13

13.a Indicators of inbound tourism. Rates of change relative to pre-pandemic levels



SOURCES: INE and Banco de España.

5 For more details, see García, Gómez Loscos and Martín Machuca (2023).

14 In spite of increasing spending, the public deficit has continued to fall in recent months thanks to strong revenue growth

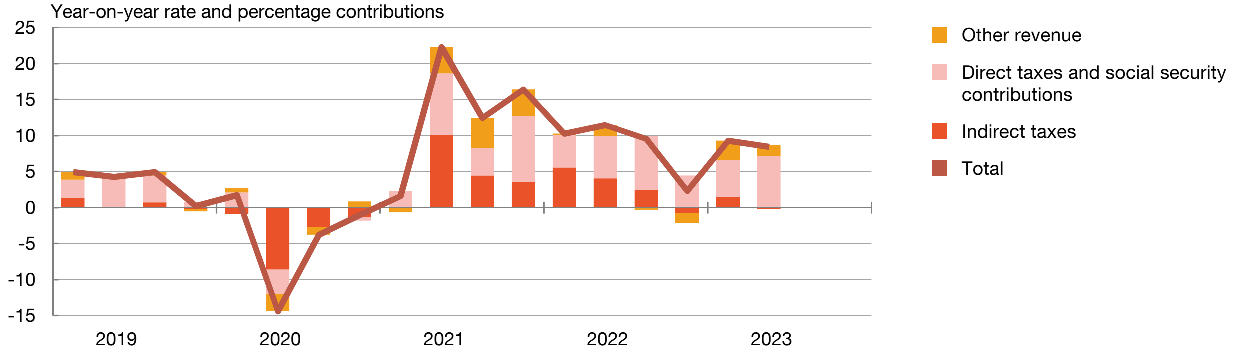
— After the slowdown seen in the last few months of 2022, public revenues stepped up significantly in 2023 H1 (see Chart 14.a). This was mainly owing to the nominal rise in income, which boosted direct tax revenues and social security contributions.[6] Conversely, indirect tax revenues have been sluggish so far in 2023 and have grown slower than would be expected based on their drivers.

— Meanwhile, spending growth in 2023 H1 was higher than in 2022 as a whole, owing to the sharp rise in social benefits caused by the pension revaluation and, to a lesser extent, to growing government consumption (see Chart 14.b).

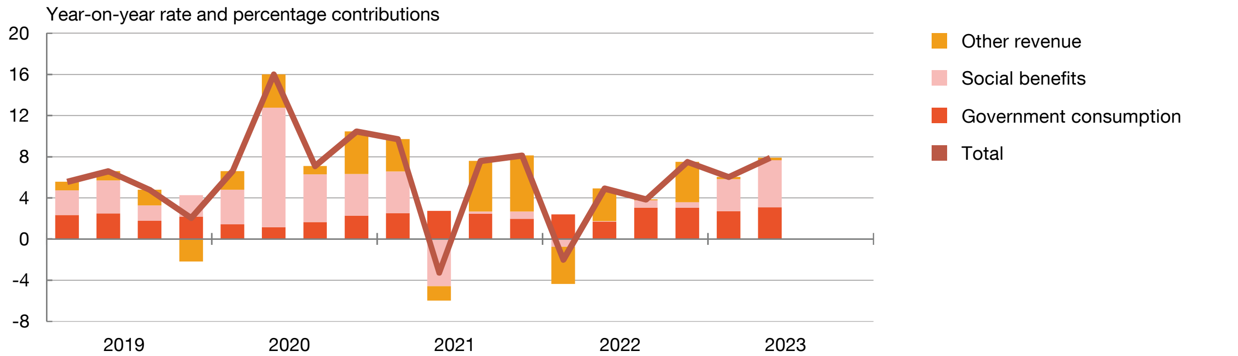
— As a result, the 12-month cumulative general government balance stood at -4.4% of GDP in June, 0.4 pp better than at end-2022.

Chart 14

14.a Change in government revenue (a)



14.b Change in government spending (a)



SOURCES: Banco de España and IGAE.

a Data from 2023 Q2 are overall general government figures, not including local government, and excluding transfers between general government units.

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6 This change was also affected by the measures approved by the Government, which would appear to have had a positive net impact of 0.7 pp on the growth rate of revenues (resulting from a positive impact of 1.5 pp linked to tax and social security contribution rises and a negative impact of 0.8 pp linked to tax cuts implemented in response to the energy crisis).

15 Headline inflation picked up somewhat in July and August, influenced by rising oil prices and various base effects

— The moderating path of headline inflation that began in August 2022 brought down the annual growth rate of the HICP to 1.6% in June. Headline inflation has picked up again since then, to 2.1% in July and 2.4% in August (see Chart 15.a).

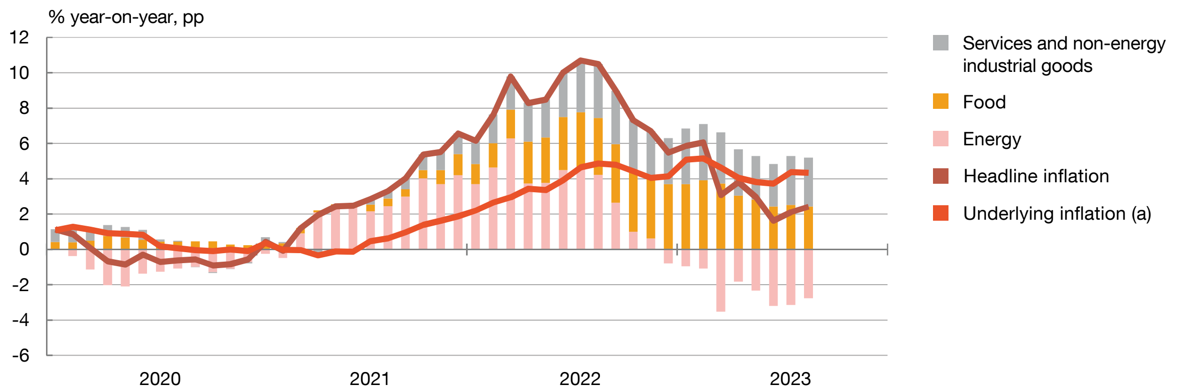
— This uptick is mainly an effect of the moderation of the pace of decline of energy prices, which are the consequence of both the recent (higher-than-expected) rise in crude oil prices on international markets and the base effects linked to the declines in oil derivatives prices in 2022 Q3.

— Turning to food, although some products (such as olive oil and some fruits and vegetables) have come under additional inflationary pressure in recent months owing to adverse weather conditions, food price inflation in general has continued to ease recently. This slowdown is relatively widespread and by August had affected 70% (in terms of their weight in the consumption basket) of the HICP's food components.

— Underlying inflation picked up in July, contributing to the rise in headline inflation, before moderating somewhat in August because of price rises in the components relating to recreation, hospitality and tourism (consistent with the vigorous performance of these segments over the summer) and also the lesser impact of the summer sales on prices (owing to the annual revision of the weightings, which cut the weight of clothing and footwear in the consumer basket in early 2023).

Chart 15

15.a Inflation in Spain: change and contribution of components



SOURCES: Eurostat and Banco de España.

a Headline inflation, excluding energy and food.

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16 Wage settlements continued to rise somewhat in the summer months against a backdrop of a significant pick-up in non-wage costs

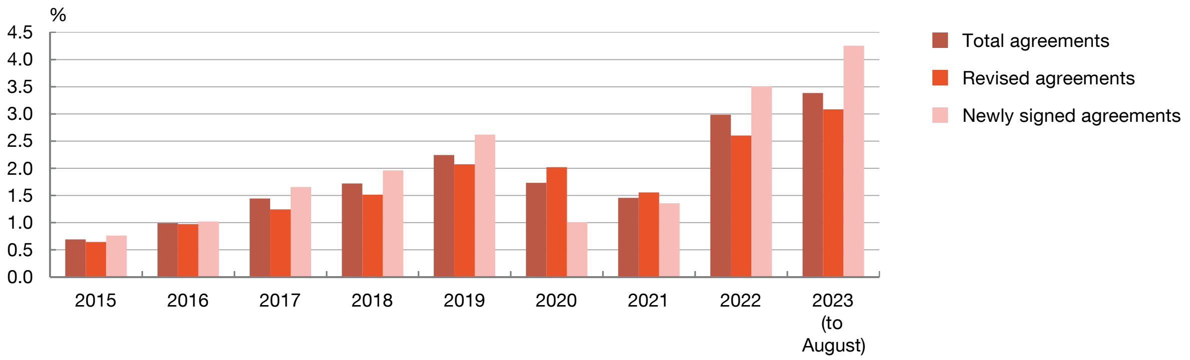
— Based on data to August, wage settlements agreed for 2023 stand at 3.4%, with the previous year's figure standing at 2.9% (see Chart 16.a). However, new collective agreements signed in 2023, which already affect nearly 2.5 million workers, show an increase (4.3%).

— In any case, compensation per employee in the market economy has risen faster than negotiated wage increases in collective agreements, rising 6.3% in Q1 and 4.6% in Q2. According to the quarterly labour costs survey, these rises are the result of changes in both non-wage costs and ordinary wage costs.

— Non-wage costs rose by 7.4% in 2023 H1, mainly owing to higher social security contributions.[7] In the same period, ordinary wage costs grew by 5.6%, faster than negotiated wage settlements in collective agreements. Among other things, this may reflect wage increases as a result of job changes. The difference between the rise in ordinary wage costs and negotiated wage settlements tends to be greater in sectors with higher employment buoyancy and/or more severe labour shortages – as in the information and communication sector, for example.

Chart 16

16.a Wage settlement



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SOURCE: Ministerio de Trabajo y Economía Social.

7 In particular, owing to the rise in both the maximum and minimum social security contribution bases (by 8.6% in the first case and by 8% in the second case, following the minimum wage hike, as well as the 0.6 pp increase in the social security contribution rate as a result of the entry into force of the intergenerational equity mechanism.

17 Profit margins appear to have moderated somewhat in 2023 H1, albeit unevenly across sectors

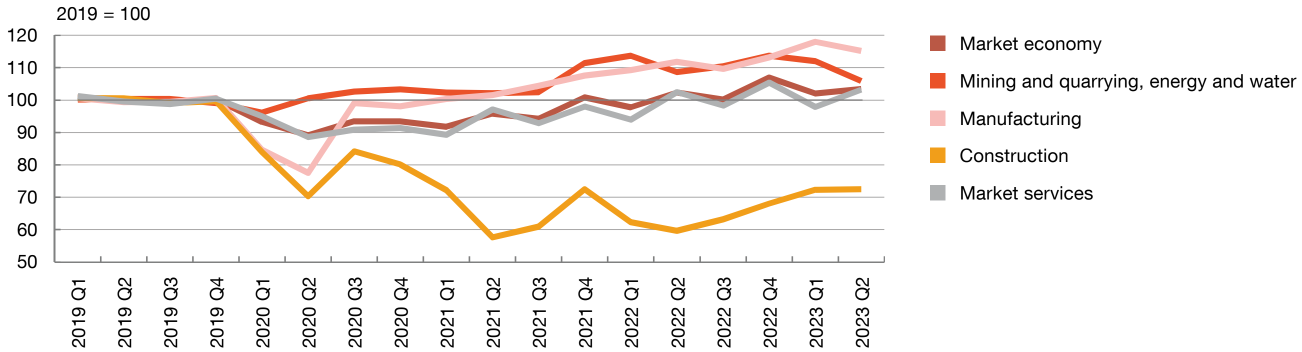
— According to the provisional National Accounts data for 2023 Q2, the ratio of gross operating surplus (GOS) to gross value added (GVA) in the market economy appears to have moderated slightly in the first half of the year, following the upturn seen in late 2022 (see Chart 17.a). In any event, this overall trend masks a significant degree of heterogeneity across sectors, owing, at least partially, to differences in the strength of demand from sector to sector.

— In aggregate terms, this is consistent with the behaviour of the ratio of gross operating profit (GOP) to GVA observed in the sample of firms in the Banco de España's Central Balance Sheet Data Office Quarterly Survey (CBQ).

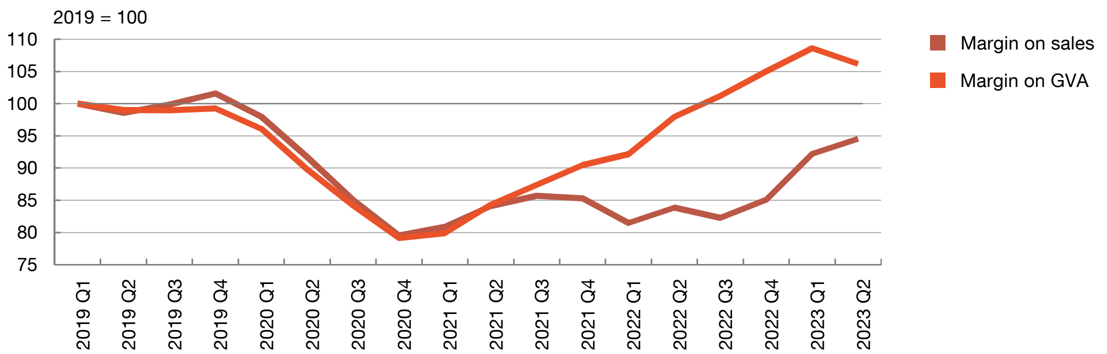
— Meanwhile, in the CBQ, profit margins (proxied as the ratio of GOP to turnover) continued to rally, albeit still falling short of pre-pandemic levels (see Chart 17.b).

Chart 17

17.a Changes in profit margins (GOS/GVA) according to National Accounts data. Breakdown by sector



17.b Changes in profit margins according to CBQ data (a)



SOURCES: Banco de España and INE.

a Margin on sales is defined as the ratio of GOP to net turnover. Margin on GVA is defined as the ratio of GOP to GVA. Four-quarter cumulative data.

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18 The Banco de España's latest macroeconomic projections revise GDP growth for 2024 downwards and headline inflation for 2023 and 2024 upwards

— The last section of this report describes the key features of the Banco de España's latest macroeconomic projections for the Spanish economy over the horizon 2023-2025.

— Under the assumptions of the exercise, Spanish GDP is projected to grow by 2.3%, 1.8%, and 2.0% in 2023, 2024 and 2025, respectively. The current projections hold the growth rate forecast for 2023 unchanged from the projections published in June, as a result of factors that exert opposing pressures on growth and data that offset each other.[8] However, the growth rates for 2024 and 2025 are revised downwards by 0.4 pp and 0.1 pp, respectively, mainly due to the projections' new underlying assumptions, which entail a rise in energy prices, a worsening external environment and a further tightening of financing conditions.

— Meanwhile, compared with the June projections, the average headline inflation rate is revised upwards by 0.4 pp for 2023 (to 3.6%) and by 0.7 pp for 2024 (to 4.3%). For 2023, this revision primarily owes to the rise in oil prices during the summer. In 2024, it owes mainly to the higher cost of energy according to the futures markets, but also, to a lesser extent, to the effects on inflation entailed by the renewal until end-2023 of the lower VAT on food and of the public transport subsidy.

— The risks to these projections are tilted to the downside with regard to activity and balanced with respect to inflation.

Figure 1

	2023	2024	2025
GDP	2.3% =	1.8% ↓ 0.4 pp	2.0% ↓ 0.1 pp
Inflation	3.6% ↑ 0.4 pp	4.3% ↑ 0.7 pp	1.8% =

SOURCE: Banco de España.

8 On the one hand, the latest QNA data up to 2023 Q2 published by the National Statistics Institute (INE) in late-June entail a slight positive carry-over effect on GDP growth this year. On the other, on the latest short-term economic information, the downward revision to the growth forecast for H2 has a slightly negative carry-over effect.