QUARTERLY REPORT ON THE SPANISH ECONOMY

1 OVERVIEW

The global economic recovery has continued over recent months. However, the improvement in global activity and trade has lost some steam in the final stretch of the year. Contributing to this have been freshly emerging COVID-19 outbreaks in some regions and the intensification of two phenomena which have become increasingly manifest as the year has unfolded and are largely a consequence of the opening up of economies after the pandemic: the tensions in global supply chains; and the rise in the prices of a broad set of goods used in production processes and which, in some cases, are also part of the consumer basket.

Global productive capacity has encountered difficulties meeting the rise in demand following the phase of greater pandemic-imposed restrictions. The pick-up in demand has given rise to shortages of specific commodities and intermediate goods used in productive processes. A further outcome is the inadequacy of existing international shipping capacity to smoothly cater for the recovery in trade flows. In many cases, this has seen a lengthening of the time needed to meet goods orders.

Moreover, these supply and demand imbalances have given rise to notable inflationary pressures globally. Price increases have been particularly significant in the case of many commodities, particularly certain energy ones. As a result of the rise in prices, households in countries that are importers of these products have seen their purchasing power fall and costs in certain productive processes have climbed notably, thereby tempering the intensity of the recovery.

Output is performing unevenly across geographical areas. A measure of the widely differing degree of recovery in the various economies is given by the gap between the current and pre-crisis level of output. In the United States, this gap already has a positive sign: GDP in 2021 Q3 was 1.4 pp up on the related level in 2019 Q4. But in the euro area, GDP is still slightly below its pre-crisis level. The emerging economies have, on the whole, recouped their pre-pandemic levels. The cumulative growth since late 2019 is considerably lower than it would have been had pre-crisis trend growth held unchanged. Largely, this is because the economic effects of the virus currently remain relatively high in this group of countries (and greater, in any event, than in the advanced economies, owing to lower vaccination roll-out). More recently, moreover, the speed of the recovery is being curbed in some economies by the tightening in monetary policy induced by the increase in inflation.

In many countries' labour markets, signs of some structural changes appear to be emerging. The recovery is prompting the emergence of signs of labour

Table 1
MAIN SPANISH MACROECONOMIC AGGREGATES (a)

		2020				2021			
	2021	Q1	Q2	Q3	Q4	Q1	Q2	Q2	Q4
National Accounts									
Quarter-on-quarter rate of change, unless otherwise indicated									
Gross domestic product	4.5	-5.4	-17.7	16.8	0.2	-0.6	1.1	2.0	1.6
Contribution of domestic demand (b)	4.1	-4.3	-15.2	15.4	-0.1	-0.6	2.1	0.2	1.2
Contribution of net external demand (b)	0.3	-1.1	-2.4	1.4	0.3	0.0	-1.0	1.8	0.3
Year-on-year rate of change									
Employment: hours worked	7.4	-4.6	-25.3	-6.3	-6.1	-2.7	29.5	3.3	4.1
Price indicators									
Harmonised index of consumer prices (HICP)	3.0	0.7	-0.6	-0.6	-0.8	0.5	2.3	3.4	5.6
Harmonised index of consumer prices excluding energy and food	0.5	1.2	0.9	0.1	-0.1	0.1	-0.2	0.7	1.5

SOURCES: INE and Banco de España.

a Information available to 1 December 2021. The shaded figures are Banco de España projections in the baseline scenario.
b Contribution to the quarter-on-quarter rate of change of GDP, in percentage points.

shortages in some productive activities. This might partly reflect changes in the relative demand for different skill sets, determined, for example, by the increased weight of goods, to the detriment of services, in consumer baskets, or by the greater weight of online as opposed to face-to-face sales. Moreover, labour availability is being influenced by the reductions in the labour force experienced in some countries during the pandemic. That is the case, in particular, of the United States, where this trend has subsequently been reversed only partially.

Consumer price inflation rates have risen notably. The main determinant here is the increase in energy prices. Moreover, the negative base effects stemming from the notable slowdown in energy prices and in the prices of other goods and services at the onset of the pandemic are also playing a significant role. Core inflation rates have also risen somewhat, but much more modestly so.

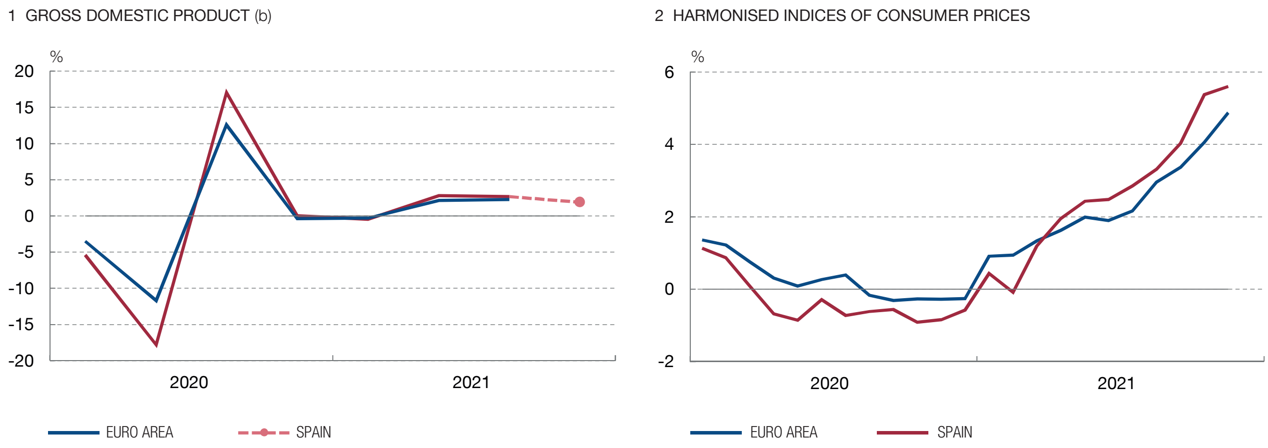
In the euro area, too, supply bottlenecks and the rise in consumer basket prices are adversely affecting economic activity in the final stretch of the year. The latest Eurosystem projections are for GDP to regain greater momentum as from mid-2022, as these obstacles to growth progressively fade.[1] Over the coming year, euro area output is expected to grow by 4.2%, before slowing to 2.9% and 1.6% in 2023 and 2024, respectively. As regards consumer prices, inflationary pressures are proving more acute and persistent than was expected some months back. However, the current projections adhere to the conclusion that the rise in inflation is highly likely to be transitory, meaning that the average growth rate of the HICP would, in the

1 https://www.ecb.europa.eu/pub/projections/html/index.en.html.

Chart 1

THE RECOVERY CONTINUED IN Q4, ALTHOUGH THE PACE OF GDP HAS EASED OWING TO THE PERSISTENCE OF BOTTLENECKS AND HIGHER INFLATION (a)

The pick-up in activity has continued in the autumn, with employment performing favourably. However, the disruption to global production chains and the rise in inflation have tempered the pace of growth. In particular, the increase in the HICP has stepped up, driven by the energy component, although core inflation has also risen.



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 index.

b The Q3 data are Banco de España projections.

medium term, descend from its current high (4.9% in November, on provisional data) to more moderate levels. Specifically, the estimate for average inflation in 2024 is 1.8%.

In Spain, headway in the vaccination roll-out has enabled the course of the epidemic to trend favourably for most of the autumn. This led to the virtual disappearance of the pandemic restrictions, with an almost full re-opening of services activities. Yet more recently there has been a fresh rise in the incidence of the virus, requiring the incipient reintroduction of some containment measures.

On the latest Banco de España projections,[2] the recovery in the Spanish economy will continue over the next three years. In the final stretch of 2021, the buoyancy of economic activity is expected to ease owing to the squeeze on household and business income induced by higher costs and prices and by the persistence of bottlenecks in some productive processes. It is estimated that the influence of these factors will moderate over the course of the coming year. Thus, as these obstacles are gradually lifted, improved private agent confidence and labour market conditions, the extension of the period of favourable financial conditions and the roll-out of the projects linked to the *Next Generation EU* (NGEU) programme will

2 See Box 1.

boost spending. In 2021, output is, on the latest estimates, expected to grow by 4.5%. In 2022, GDP will accelerate to 5.4%, enabling the pre-crisis level to be resumed towards the start of 2023.

After remaining high in the opening months of 2022, inflation is expected to slow sharply thereafter. Pointing along these lines are the futures markets, which foretell a marked slowdown in energy product prices in the opening months of 2022. The ultimate materialisation of this trajectory, along with the stripping out of the existing positive base effects, would lead to a notable decline in HICP growth rates. In the medium term, consumer price developments will be overshadowed by the core component (i.e. the aggregate excluding energy goods and food). This indicator will post relatively modest growth, once the effects of the bottlenecks wane and a degree of labour market slack takes hold.

The baseline scenario for economic activity in these projections is subject to some downside risks. Firstly, uncertainties include the possibility of a further worsening of the epidemiological situation, of which there are some signs in late 2021. The consequences of the recent emergence of the omicron strain are, at present, enormously uncertain. At the same time, the slow pace of vaccination roll-out in some areas of the world may be conducive to new variants of the virus arising, with characteristics entailing more adverse consequences for public health worldwide.

Also, the persistence of inflationary pressures might be greater than assumed under the baseline scenario. Some possible factors that may ultimately lead to a higher and/or more persistent path of inflation than that considered under this scenario include a prolongation of the period of global supply disruptions and of high energy and other inputs prices, and a greater degree of pass-through of the cost increases to final prices and wage costs. Were there to be material deviations by medium-term inflation expectations above the monetary policy objective, financial conditions might ultimately be affected, with potentially adverse effects on the vulnerability of the most indebted agents and on the availability and cost of new financing flows.

There are, however, some factors that might prompt upward growth bias. The pace of the recovery might quicken were households and firms to decide to earmark a higher-than-anticipated portion of the saving built up during the pandemic to consumer and investment spending. This would also be the case if tourist flows were to converge more quickly than expected under the baseline scenario towards their pre-crisis levels.

A final factor of uncertainty concerns the rate of absorption of the NGEU resources, and the economic impact of the projects and reforms undertaken. The investment projects to be developed under this programme may play a very

Figure 1

RECENT GLOBAL ECONOMIC DEVELOPMENTS, OUTLOOK AND MAIN SOURCES OF UNCERTAINTY

	MAIN RECENT DEVELOPMENTS	SHORT-TERM OUTLOOK	SOURCES OF UNCERTAINTY
ACTIVITY	The global economic recovery slowed down in Q3, held back by persistent global supply chain bottlenecks and inflationary pressures	The pace of growth in global activity may remain steady in 2021 Q4, with the growth outlook in the advanced and emerging economies converging somewhat towards levels slightly lower than anticipated a few months ago	— The course of the pandemic and vaccination programmes — Persistence of the current global value chain bottlenecks — Duration of the current bout of energy price rises and the surge in inflation, and possible indirect and second-round effects — Possible increase in volatility on international financial markets in the event of changes to the economic, public health and monetary policy outlook in the main world economies — Social and geopolitical tension in certain regions
PRICES	Inflation rates have continued to rise globally, driven by the surge in energy prices and persistent supply-side problems	Given that most of the determinants of the recent rise in inflation are predominantly temporary in nature, price increases are expected to ease off over the course of 2022	
OTHER	The central banks of the advanced economies have begun to adjust their monetary policy stance, while many emerging economies have seen substantial hikes in official interest rates	International financial markets are highly influenced by the course of the pandemic and by investors' shifting expectations of monetary policy changes in the main economies	

SOURCE: Banco de España.

important role in transforming the Spanish economy. Yet to maximise their impact on growth and employment will require an appropriate selection of projects and effective application, which must moreover be accompanied by the design and implementation of a wide range of structural reforms.