

# THE ECONOMIC SETTING FOLLOWING THE INVASION OF UKRAINE AND THE ECONOMIC POLICY RESPONSE

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INSTITUCIÓN FUTURO – 20<sup>TH</sup> ANNIVERSARY

Pamplona

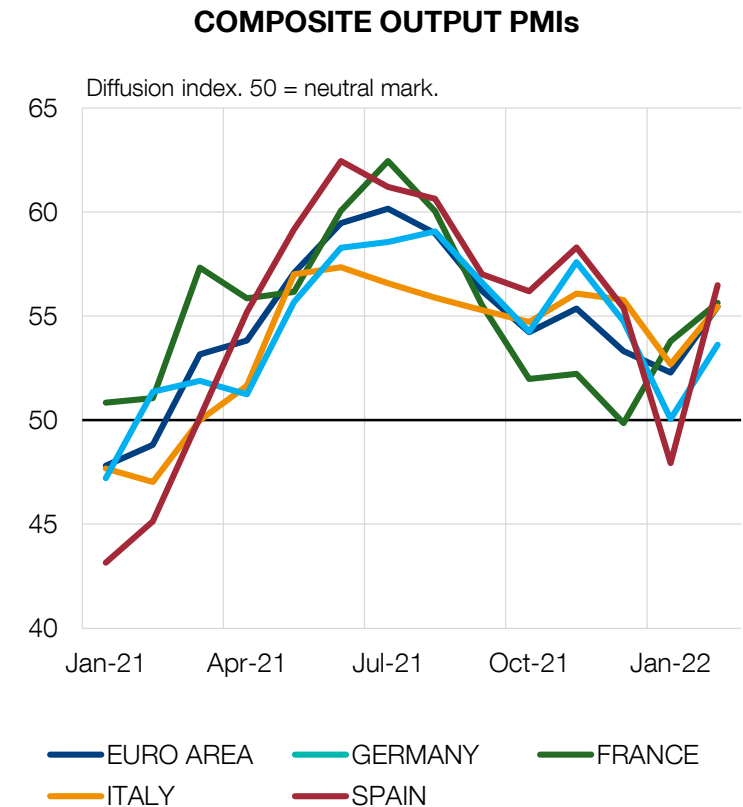
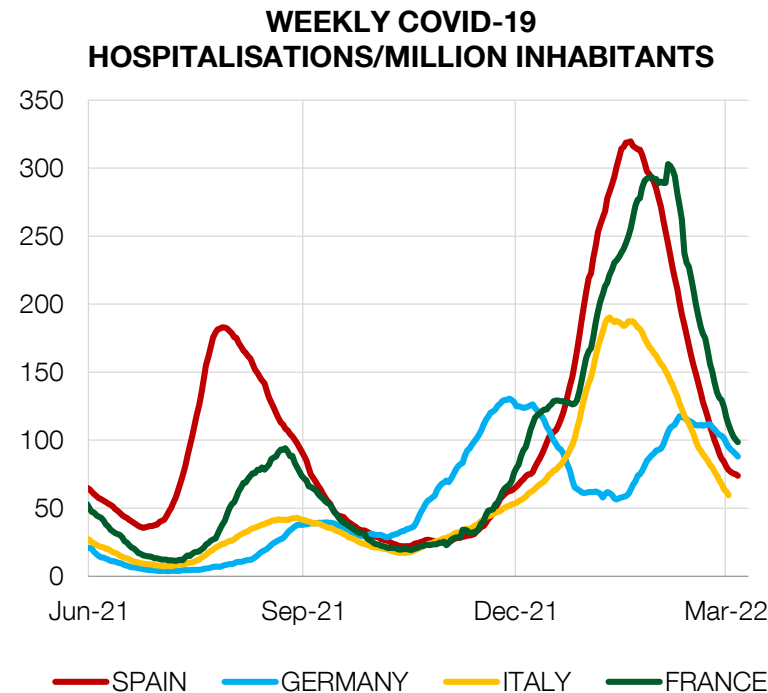
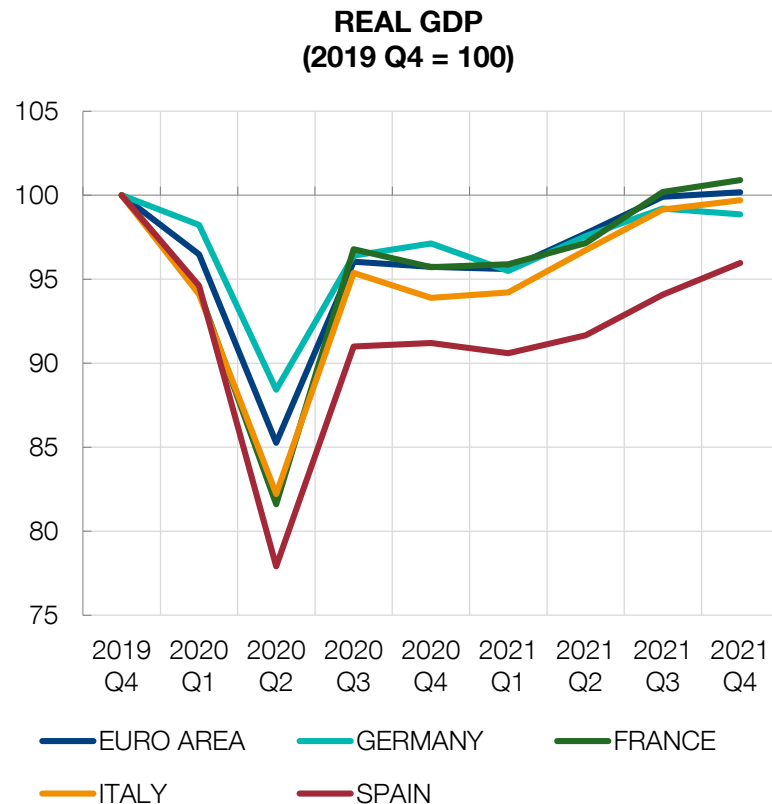
29 March 2022



# BEFORE THE WAR, THE EUROPEAN AND GLOBAL ECONOMIES WERE GRADUALLY RECOVERING, ALBEIT UNEVENLY ACROSS COUNTRIES AND ECONOMIC SECTORS...

**Before the start of the invasion,** analyst consensus forecasts broadly coincided in expecting a **first quarter in which economic activity would decelerate somewhat** as a consequence of the negative, but limited, impact of the Omicron variant.

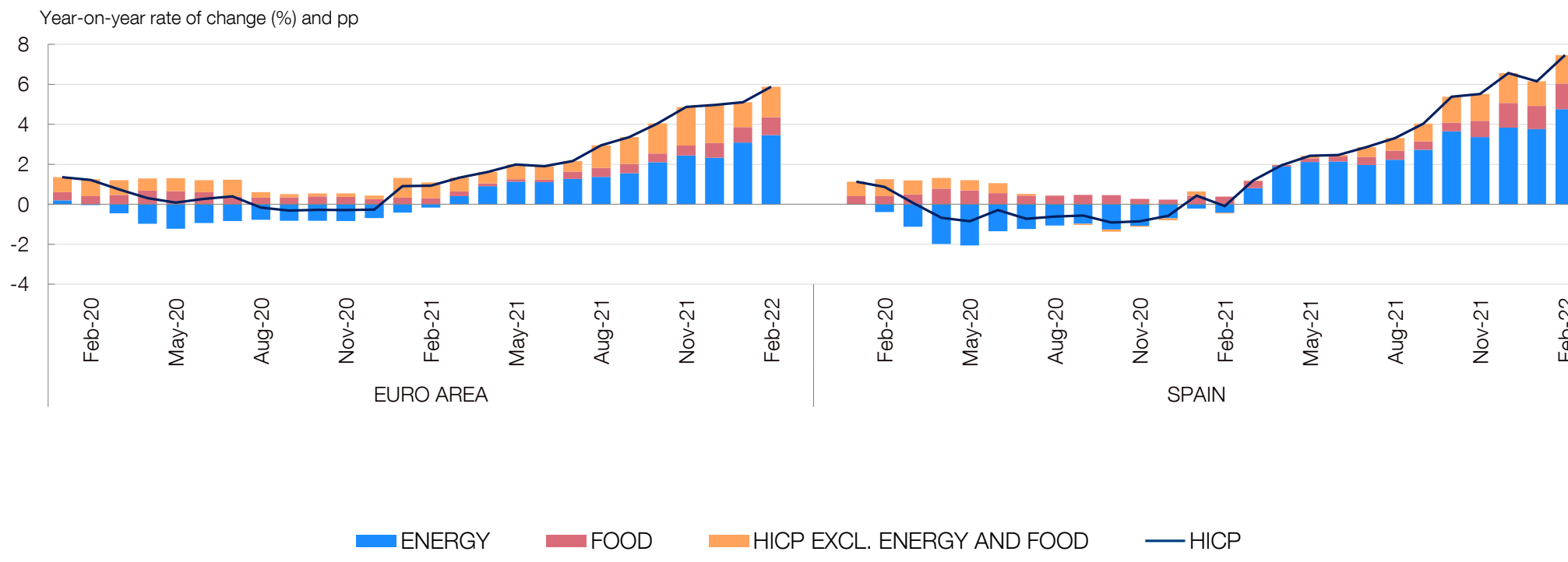
**For the rest of the year, assuming an improvement in the pandemic, further progress in the recovery was expected,** underpinned by a decline in uncertainty, the gradual disappearance of bottlenecks, the maintenance of favourable financing conditions and, in Europe, the gradual implementation of NGEU.



Sources: Eurostat, IHS Markit and Our World in Data. Latest data: 2021 Q4 (GDP), February 2022 (PMIs), 3-6 March (hospitalisations).

The rise in inflation has surprised on the upside due to both its strength and its persistence, including in the early months of 2022.

## HICP AND CONTRIBUTIONS



Sources: Banco de España, Eurostat and INE. Latest observation: February 2022.

## Commodities

- Russia and, to a lesser extent, Ukraine are among the **main producers of certain energy and non-energy commodities**.
- **Europe is highly dependent** on imports of some of these products: Russia accounted for some 20% of total euro area oil imports and some 35% of total euro area gas imports in 2020. In 2019, only 6% of Spain's energy imports (4.5% of total energy consumption) came from Russia, but this figure is much higher for countries such as Germany (17%) and Italy (22%).
- A hypothetical reduction in, or cut to, supply from Russia could have a significant impact on the European economy.
- **Indeed, oil, natural gas and other non-energy commodity prices have already risen sharply.**

## Finance

- **Direct financial exposure** to Russia and Ukraine is generally **very limited** among European firms and banks (especially, once again, among Spanish ones).
- Initially, **financial market volatility increased and financing conditions tightened.**

## Trade

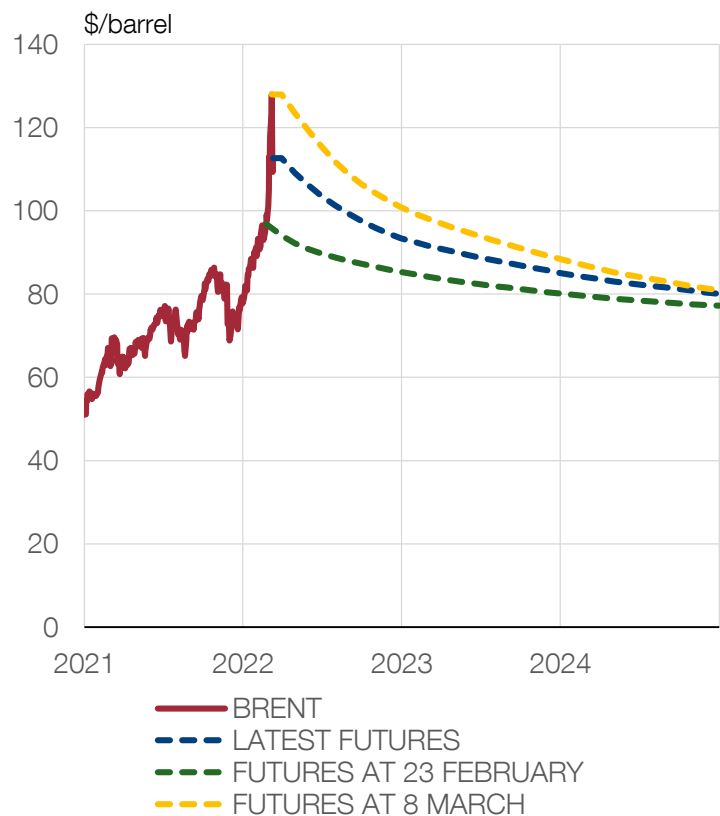
- **European countries' direct trade exposure to Russia is relatively low and smaller in Spain. Yet the indirect effects may also be considerable**, particularly amid sanctions.
- In 2019 euro area exports of goods to Russia and Ukraine accounted for 1.6% and 0.3%, respectively, of its total goods exports. Spain's exports of goods to Russia and Ukraine accounted for 0.7% and 0.2%, respectively, of its total, whereas the relative dependence on imports from Russia stood at 1.1% in 2019 (0.5% in the case of Ukraine, although this figure was higher for certain primary products).

## Confidence/ uncertainty

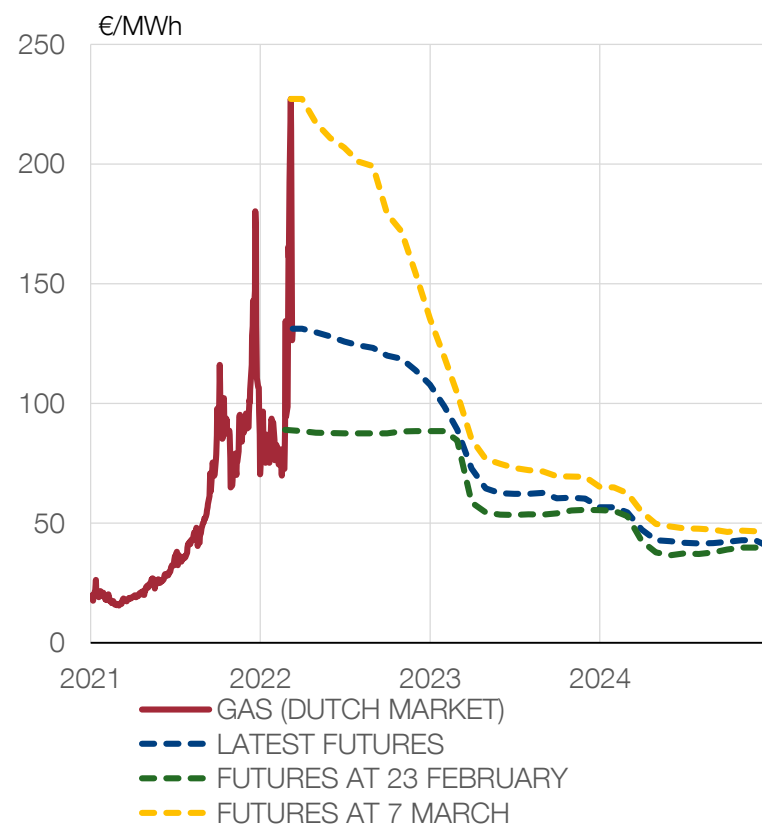
- **Households and firms will have difficulty foreseeing future economic developments**, particularly regarding their own incomes. This will affect their consumption and investment decisions.
- Several simulation exercises carried out internally at the Banco de España suggest that, in some particularly acute scenarios as to the severity and duration of the conflict, GDP losses through this channel could be significant.

# ENERGY AND NON-ENERGY COMMODITY PRICES HAVE RISEN SIGNIFICANTLY AS A RESULT OF THE INVASION OF UKRAINE

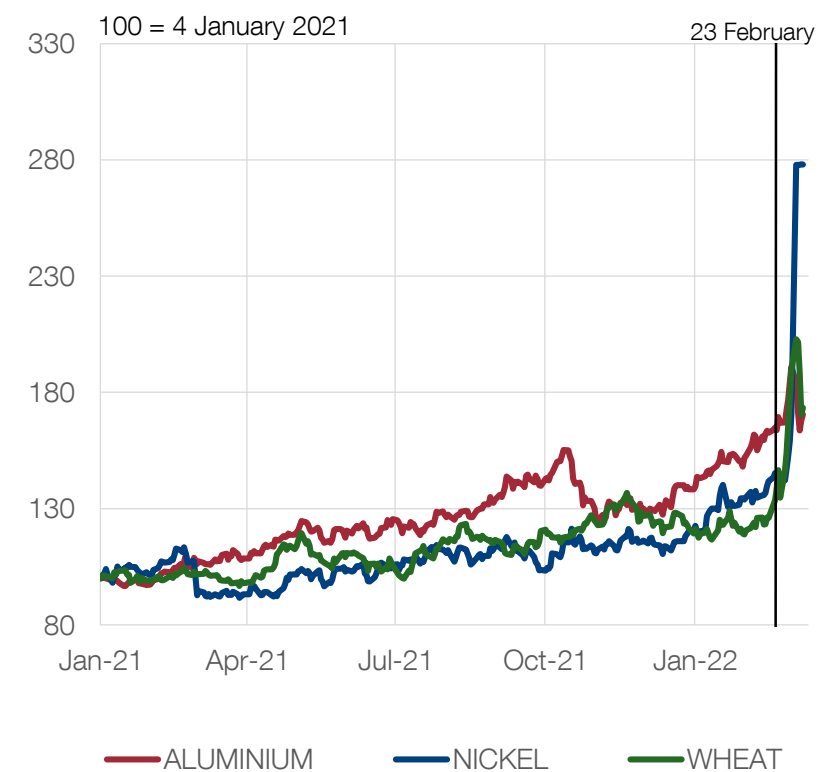
### OIL PRICE AND FUTURES



### GAS PRICE AND FUTURES



### SOME COMMODITY PRICES



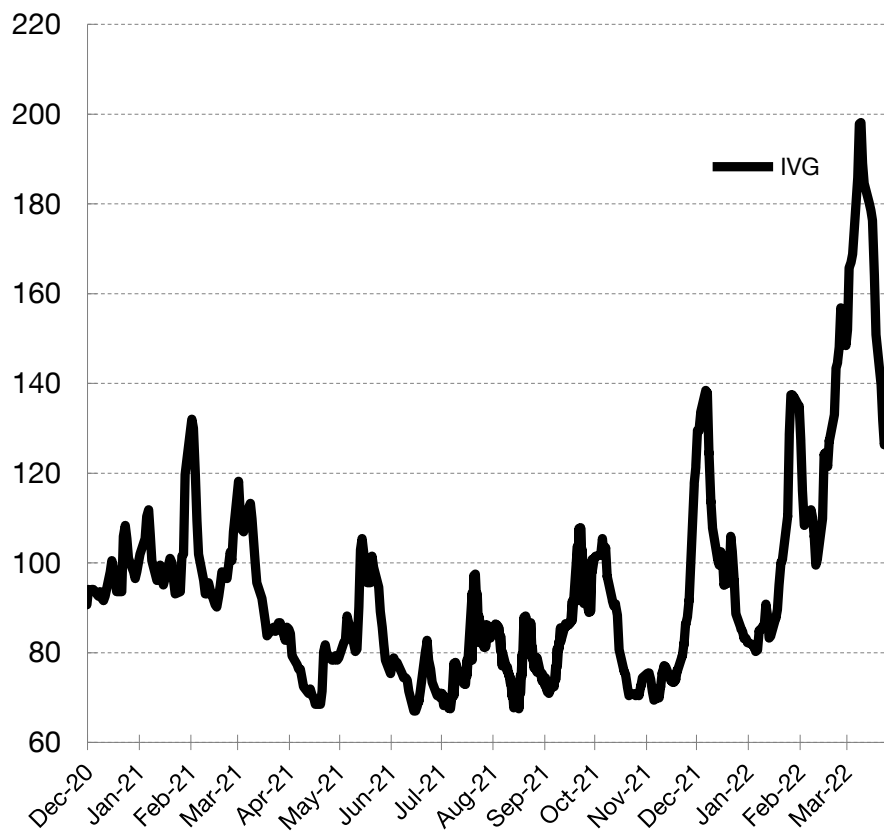
Source: Refinitiv. Latest update: 11 March 2022.

## RUSSIA'S SHARE OF THE NATIONAL IMPORTS OF OIL AND NATURAL GAS FROM OUTSIDE THE EU. 2021 H1.

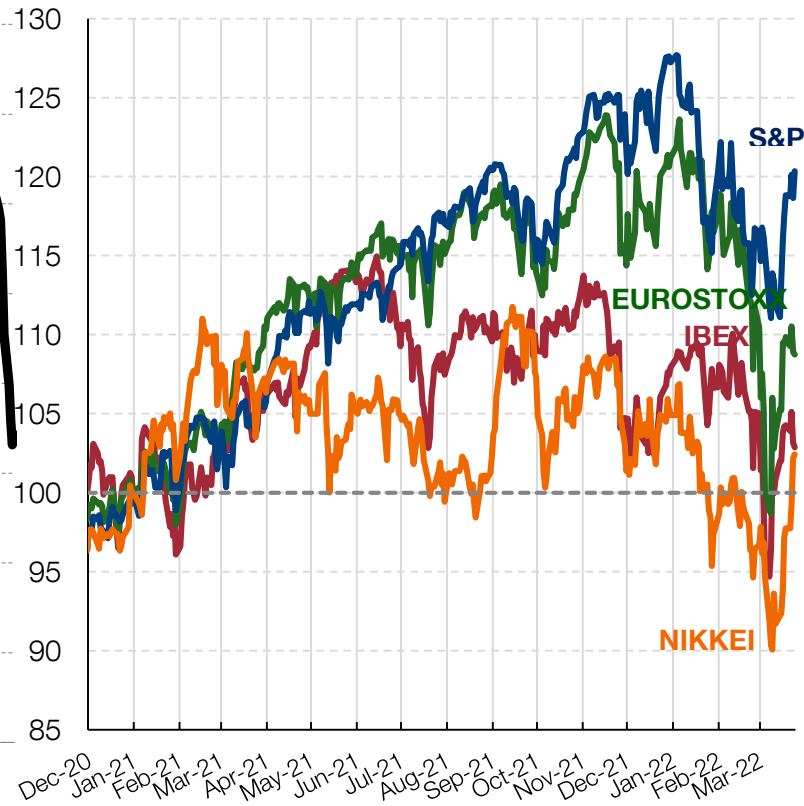
	Oil		Natural gas	
	Percentage (%) of final energy consumption	Russia's share (%) of the national imports from outside the EU	Percentage (%) of final energy consumption	Russia's share (%) of the national imports from outside the EU
Euro area	36.1		23.7	
Spain	45.0	0-25	19.1	0-25
Germany	34.9	25-50	26.8	50-75
France	37.1	0-25	20.6	25-50
Italy	31.3	0-25	30.9	25-50
Finland	23.7	75-100	3.0	75-100

# FINANCE CHANNEL: AFTER THE WAR'S STRONG INITIAL NEGATIVE IMPACT ON THE MARKETS, THE SITUATION HAS RETURNED TO NORMAL, SOMEWHAT LESS IN EUROPE

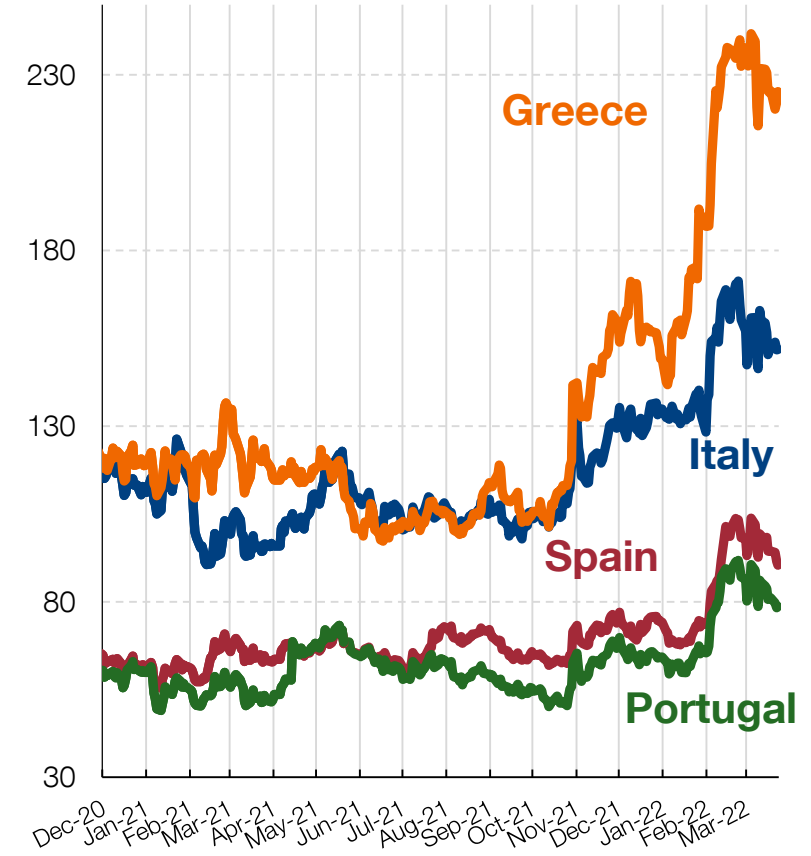
GLOBAL UNCERTAINTY (31/12/2020 = 100)



STOCK MARKETS (31/12/2020 = 100)



10-YEAR SOVEREIGN YIELD SPREADS AGAINST GERMANY (bp)



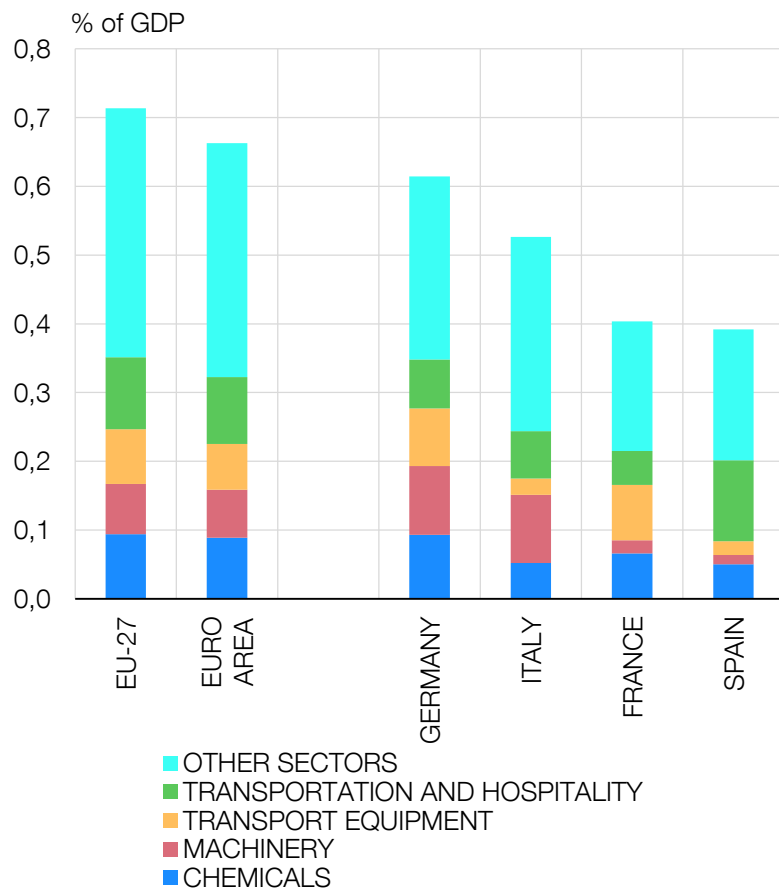
Source: Bloomberg



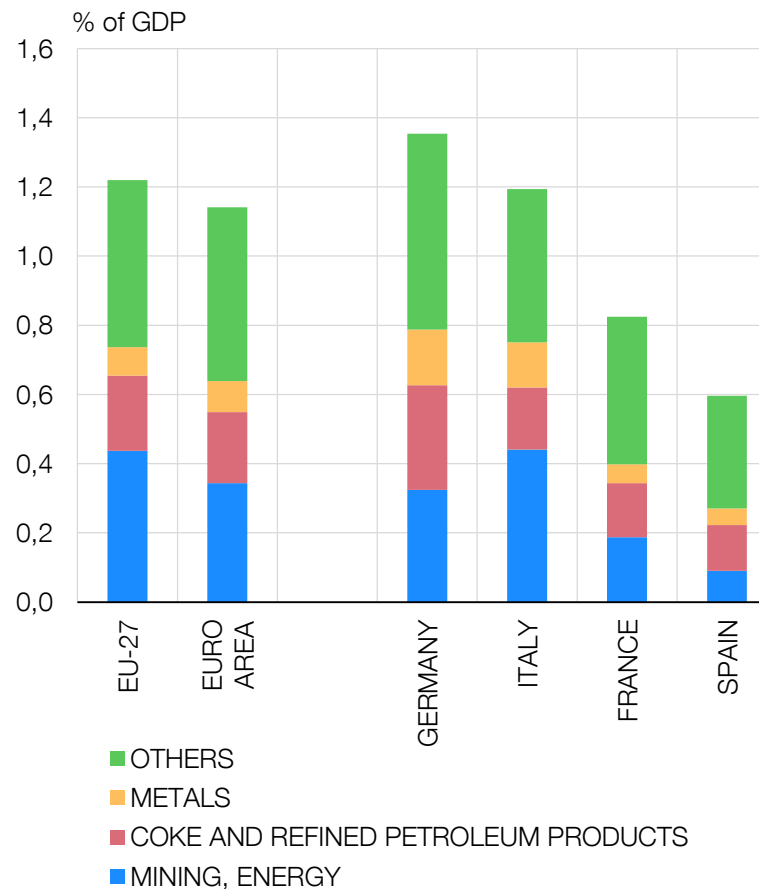
# TRADE CHANNEL: THE EU'S DIRECT TRADE EXPOSURE TO RUSSIA AND UKRAINE IS LOW, BUT THE INDIRECT EFFECTS MAY BE CONSIDERABLE. BOTTLENECKS HAVE INCREASED RECENTLY

## EXPORTS TO RUSSIA

(Value added generated on exports to Russia, by exporting industry, 2018)

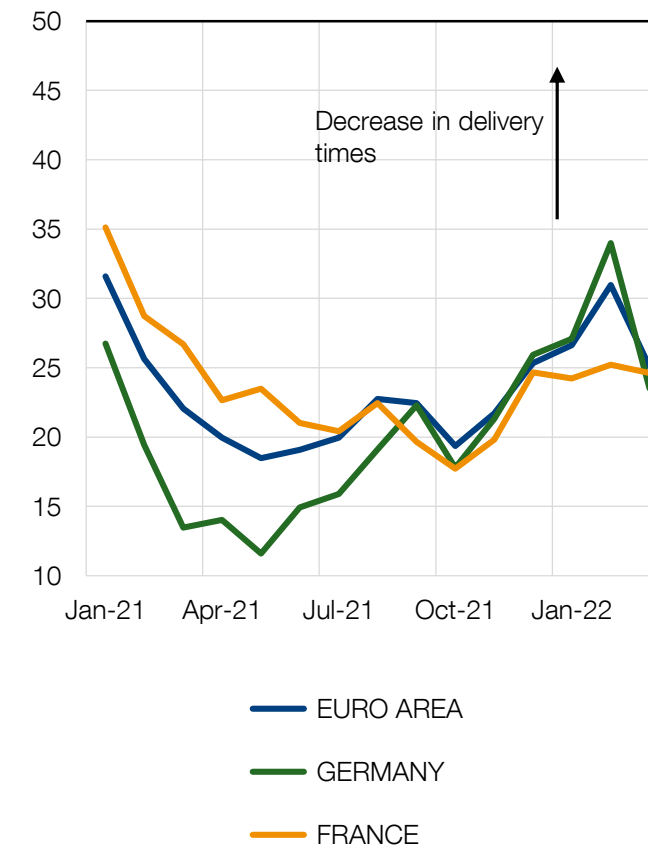


## VALUE ADDED GENERATED IN RUSSIA ON EUROPEAN IMPORTS, 2018



## DELIVERY TIMES, MANUFACTURING

Diffusion index  
50 = neutral mark



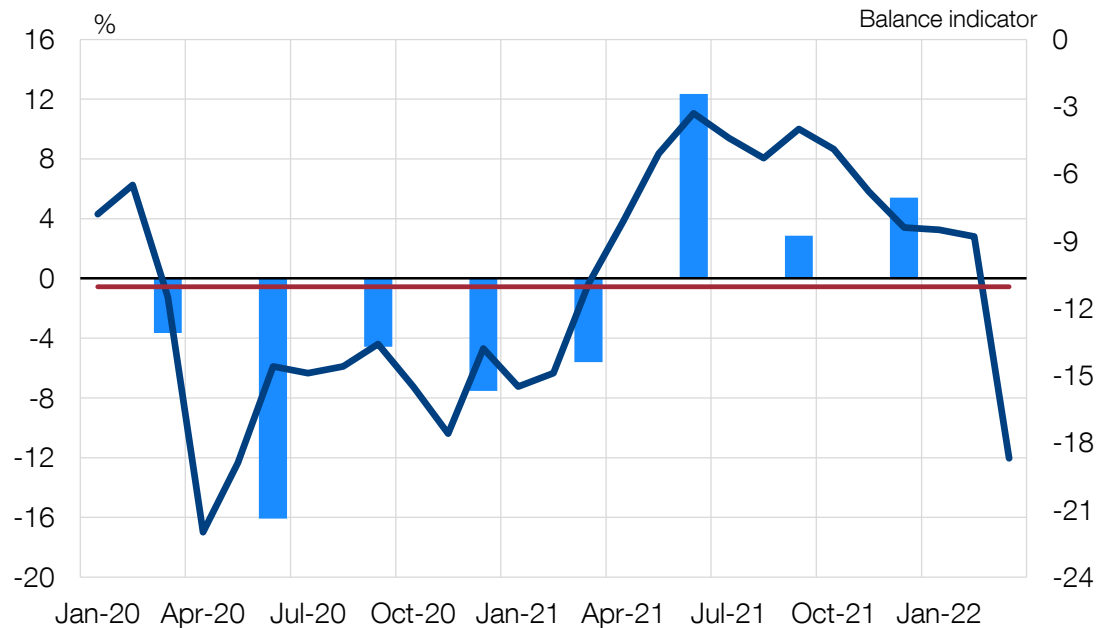
Sources: Eurostat, OECD TiVA and IHS Markit.



# THE WAR IN UKRAINE COULD HAVE GREATER ECONOMIC REPERCUSSIONS THROUGH THE CONFIDENCE CHANNEL FOR THE EURO AREA...

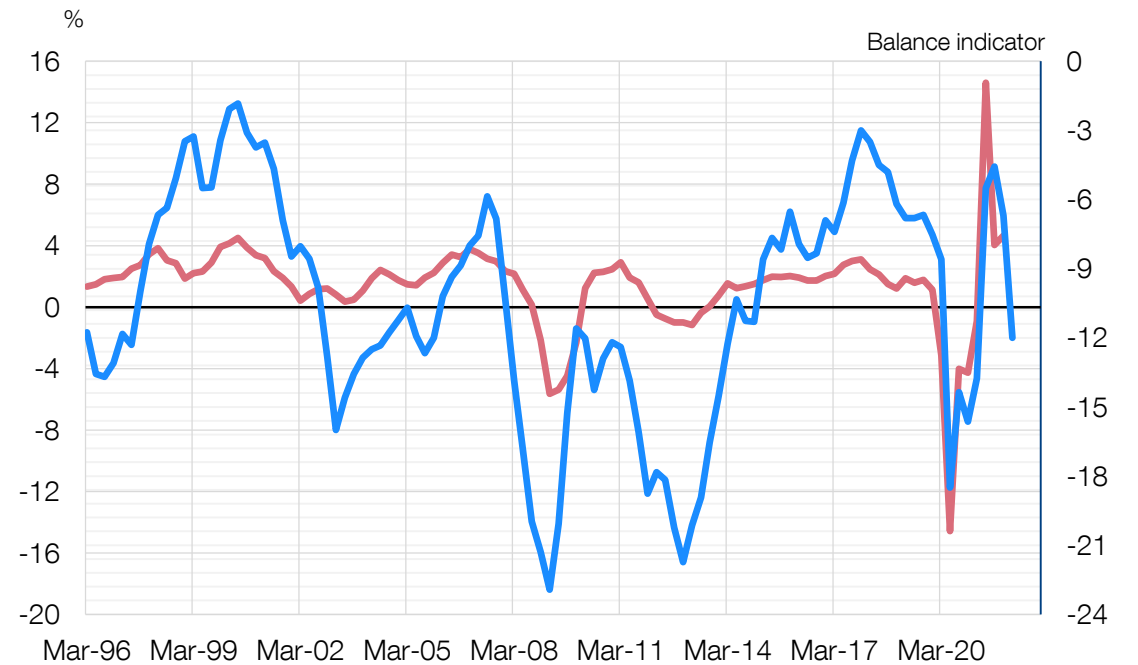
**Consumer confidence has already deteriorated sharply in the euro area, according to the European Commission's indicators.**

**EURO AREA. CONSUMER CONFIDENCE AND PRIVATE CONSUMPTION**



- PRIVATE CONSUMPTION (Year-on-year growth)
- CONFIDENCE INDICATOR (r-h scale)
- LONG-TERM MEAN 2000 - 2020 (r-h scale)

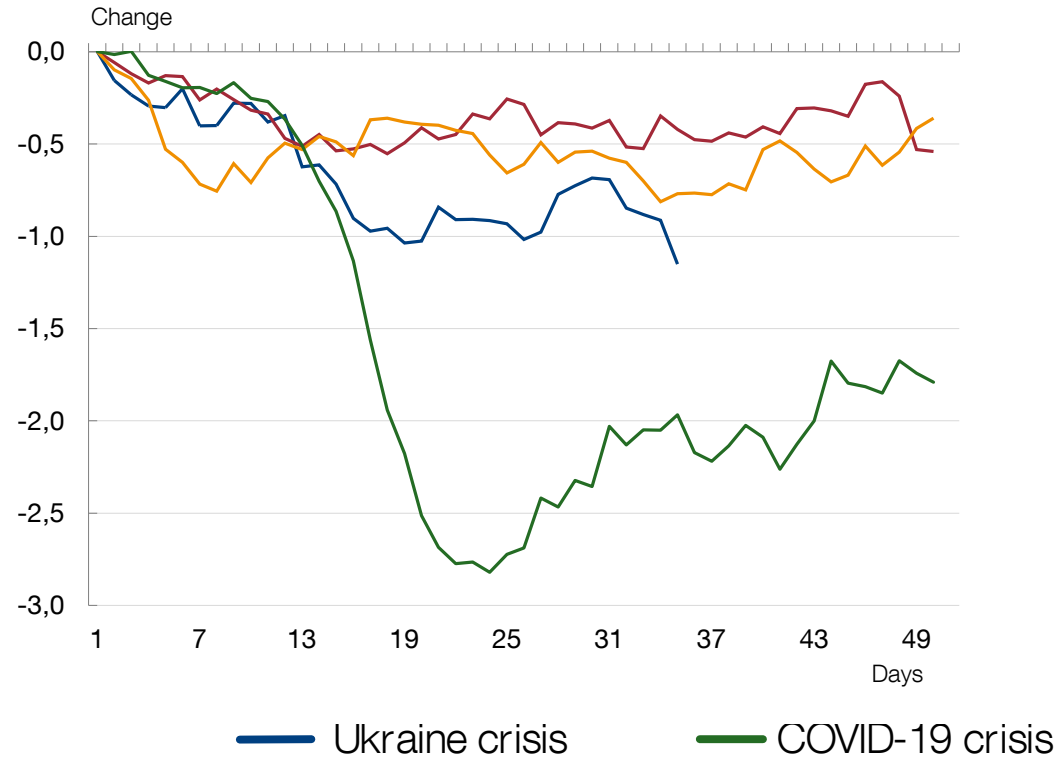
**EURO AREA. CONSUMER CONFIDENCE AND GDP**



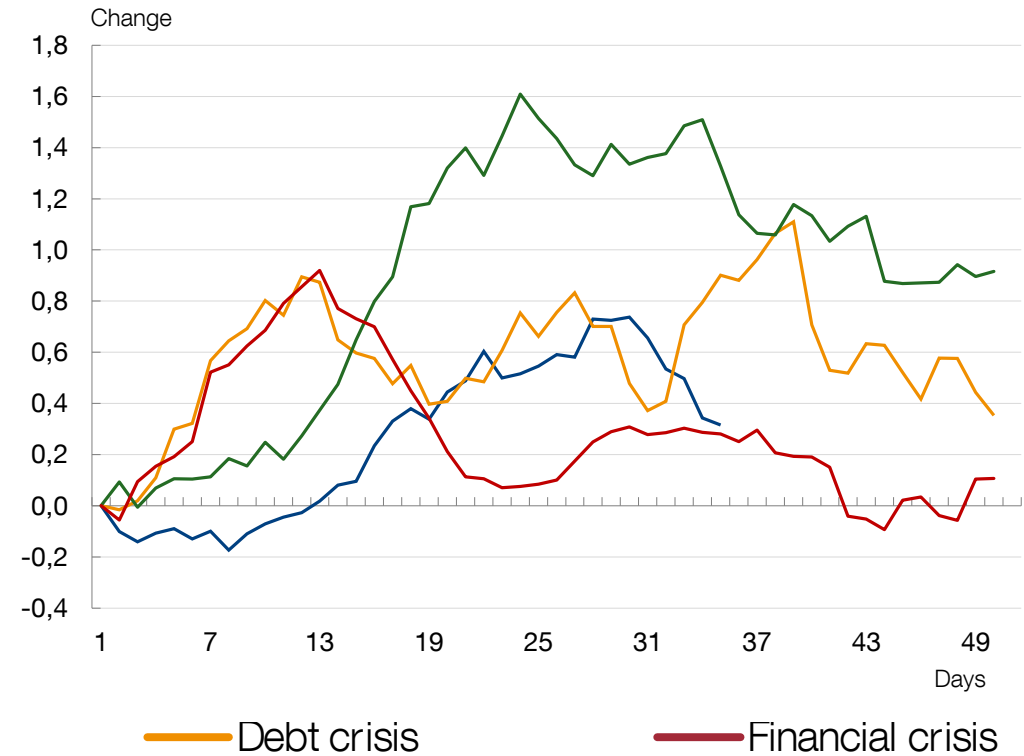
- GDP (YEAR-ON-YEAR CHANGE)
- CONSUMER CONFIDENCE (R-H SCALE)

Source: European Commission. Latest data: March 2022 (flash estimate).

**ECONOMIC SENTIMENT IN SPAIN (DENSI)**



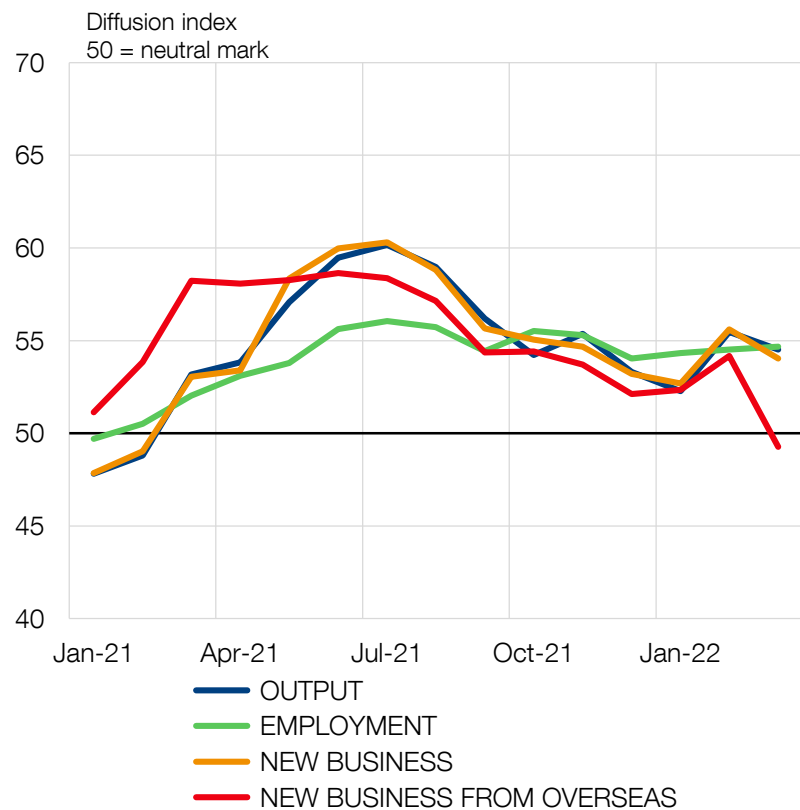
**ECONOMIC POLICY UNCERTAINTY IN SPAIN (EPU INDEX)**



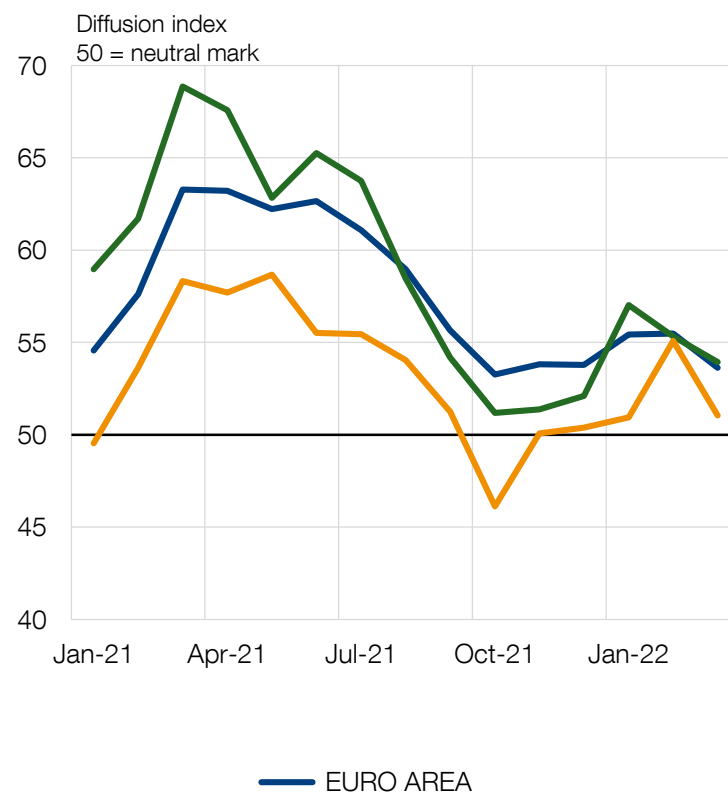
Sources: Banco de España, GPR, EPU, Refinitiv and Factiva.

The DENSI and the EPU index are constructed drawing on the “economic sentiment” and the “economic policy uncertainty” contained in the articles published in Spain’s main newspapers. The DENSI takes into account the difference between the number of articles containing keywords related to potential upturns in economic activity in the short term and the number of those containing keywords related to potential downturns in economic activity in the short term, while the EPU index is based on the number of articles on economic policy uncertainty.

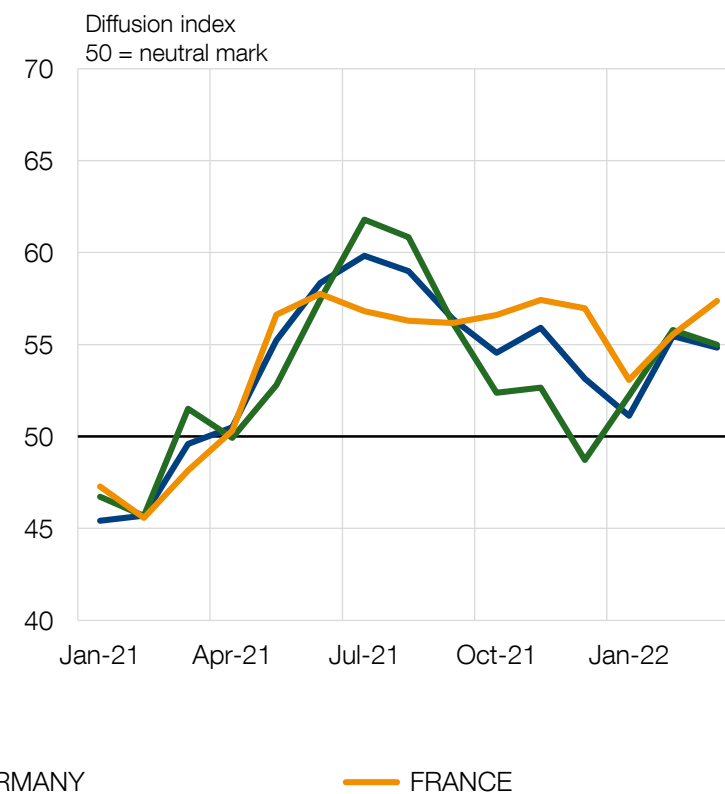
## EURO AREA COMPOSITE PMI



## MANUFACTURING PMI



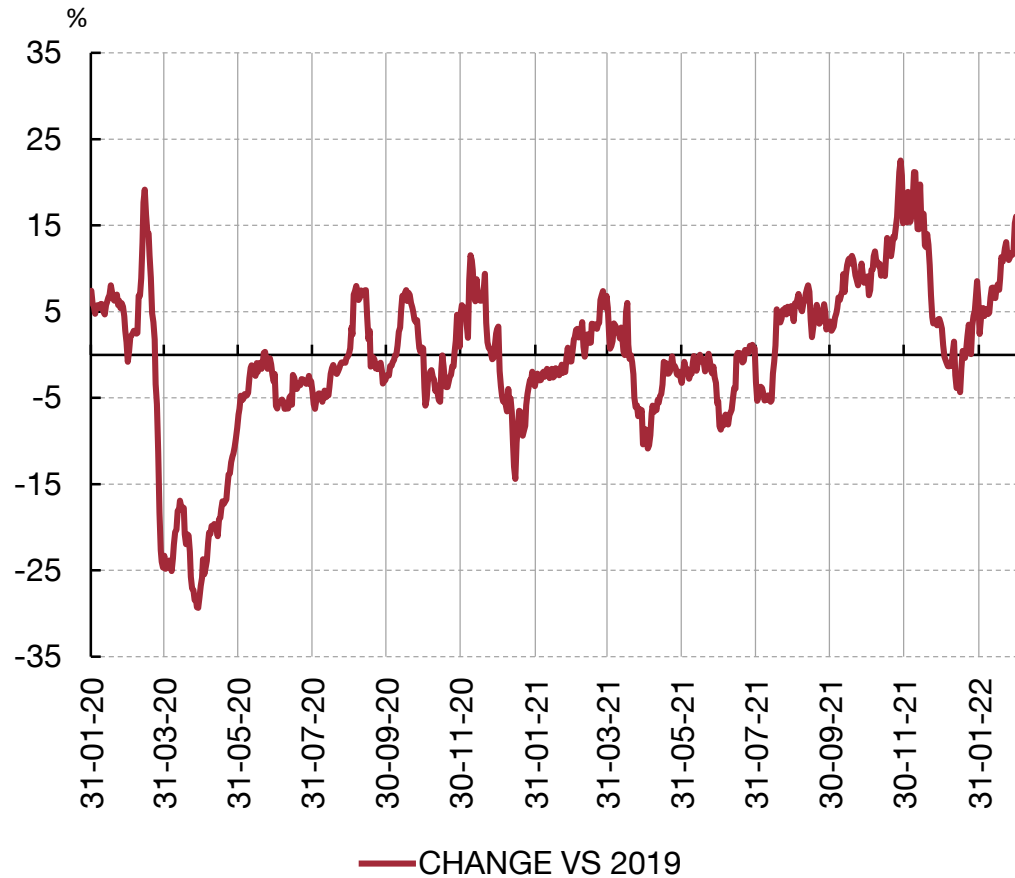
## SERVICES PMI



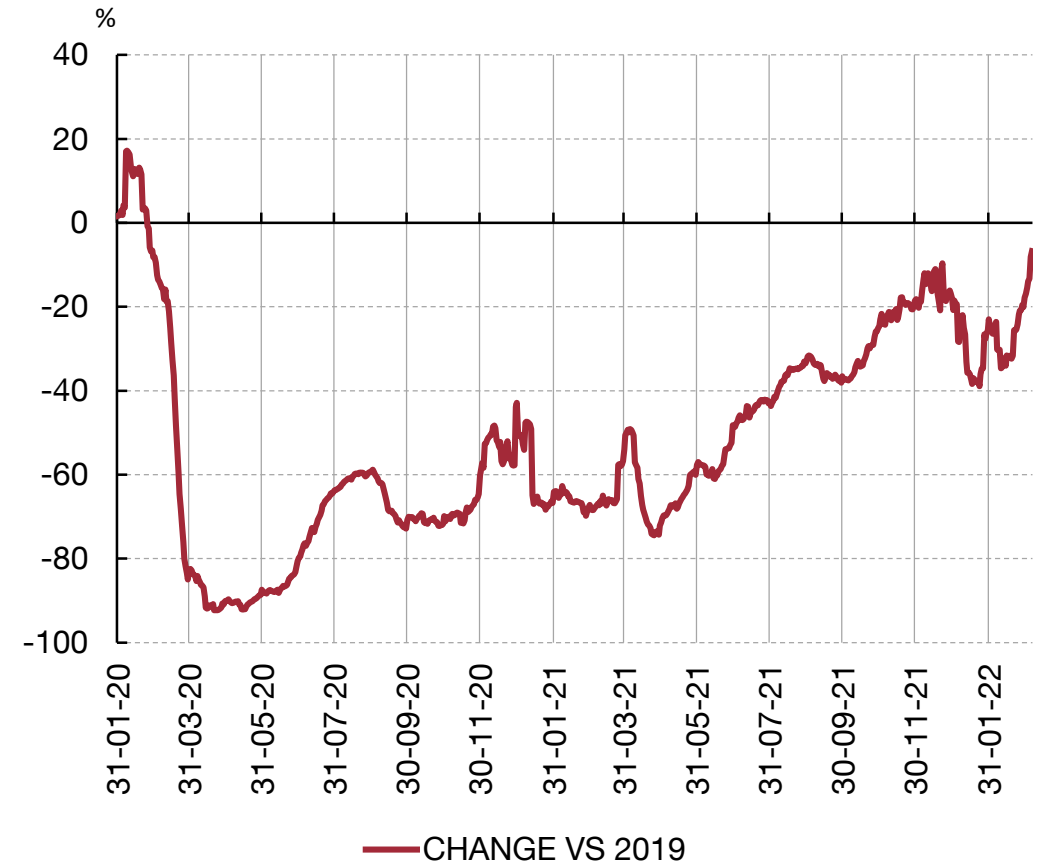
Source: IHS Markit. Latest observation: March flash PMIs.

# IN SPAIN, LARGE ENTERPRISES' RETAIL SALES ARE STILL SHOWING NO SIGNS OF SLOWING DOWN, PERHAPS AFFECTED BY STOCKPILING

**RETAIL SALES BY FIRMS USING THE IMMEDIATE SUPPLY OF VAT INFORMATION SYSTEM (14-day moving average)**



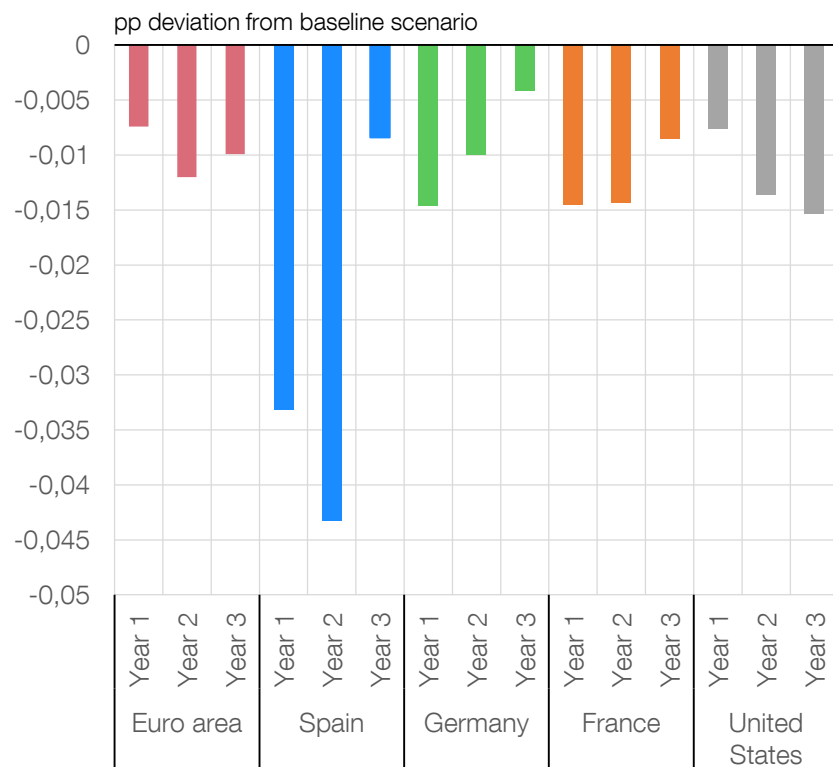
**TURNOVER OF HOSPITALITY FIRMS USING THE IMMEDIATE SUPPLY OF VAT INFORMATION SYSTEM (14-day moving average)**



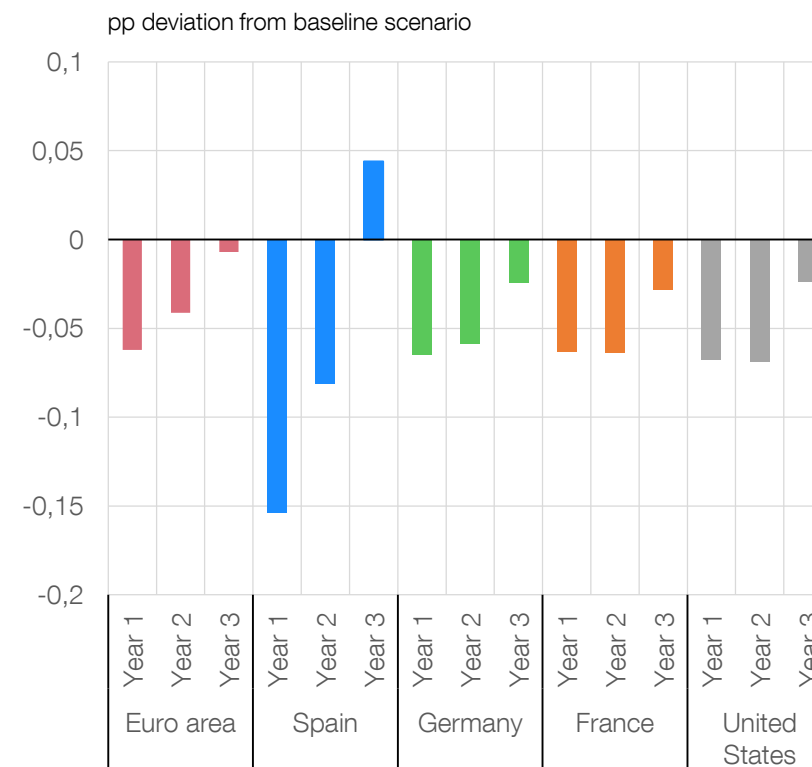
Source: Agencia Estatal de Administración Tributaria, drawing on the returns filed with its Immediate Supply of VAT Information System by firms engaging mainly in retail trade and hospitality. CPI-deflated data. Latest figure available: 8 March 2022.

# IN ANY EVENT, THE ENERGY SHOCK WILL FORESEEABLY HAVE A NOTICEABLE IMPACT ON ACTIVITY, WHICH WILL DEPEND ON THE SHOCK'S INTENSITY AND DURATION

### IMPACT ON GDP OF A 10% INCREASE IN GAS PRICES FOR ONE YEAR



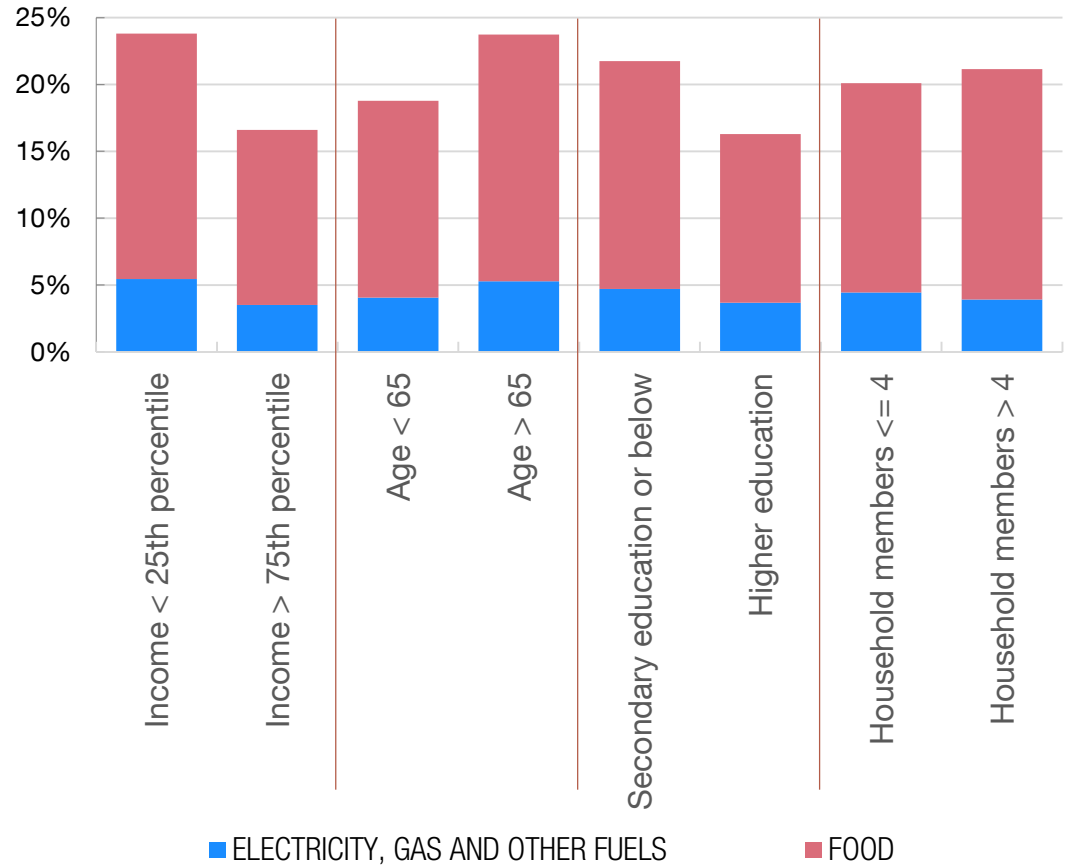
### IMPACT ON GDP OF A 10% INCREASE IN OIL PRICES FOR ONE YEAR



Source: Banco de España.

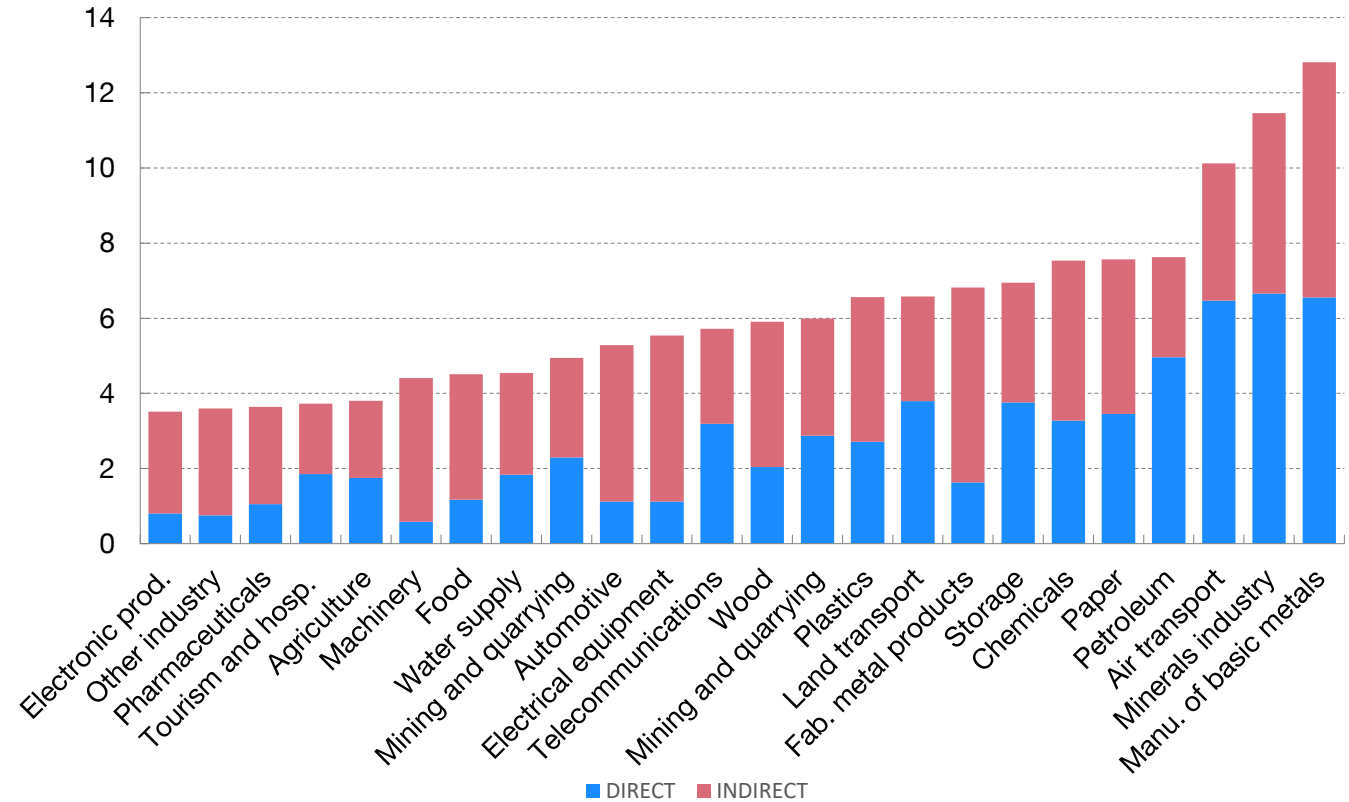
# THE IMPACT WILL BE HIGHLY HETEROGENEOUS ACROSS HOUSEHOLDS AND SECTORS

PROPORTION OF SPENDING ON FOOD AND ELECTRICITY, GAS AND OTHER FUELS



Source: Banco de España.

GAS AND ELECTRICITY CONSUMPTION (% OF OUTPUT)

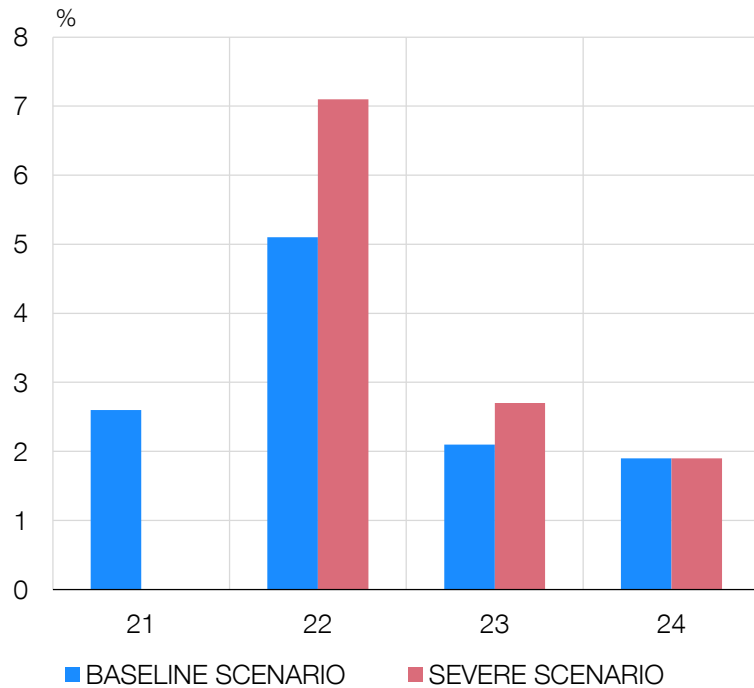


Source: OECD. Inter-Country Input-Output (ICIO).

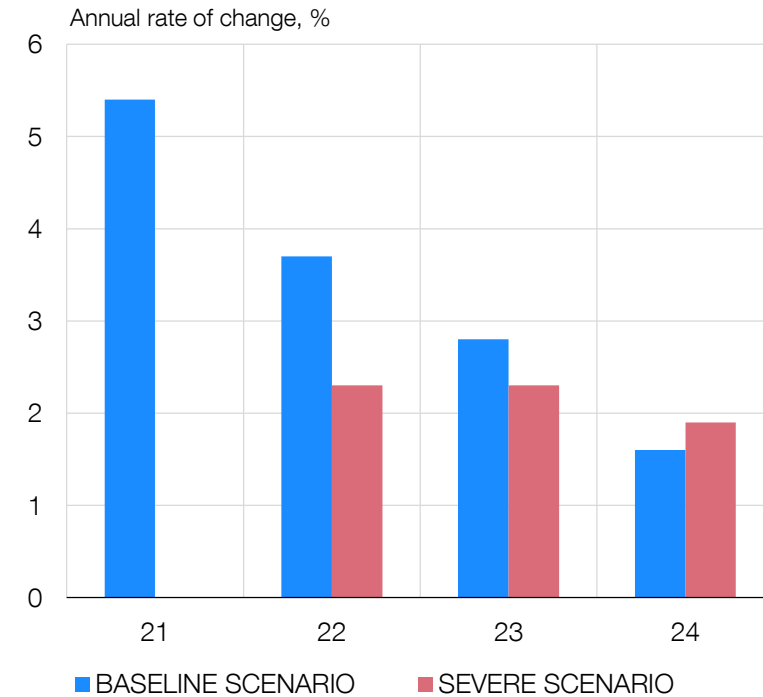
# OVERALL, THE WAR REPRESENTS A NEW AND FORESEEABLY HIGHLY SIGNIFICANT SHOCK, WITH ADVERSE CONSEQUENCES IN TERMS OF A WEAKER ECONOMIC PERFORMANCE AND GREATER INFLATIONARY PRESSURES

As regards the scale of the impact, the estimates are subject to extraordinary uncertainty. The ECB has drawn up three scenarios, and euro area **GDP growth** for 2022 has been **revised downwards**, compared with the December projections, **by between 0.5 pp (to 3.7%) and 1.9 pp (to 2.3%)**, and **the average inflation rate for 2022 has been revised upwards**, again compared with the December projections, **by between 1.9 pp (to 5.1%) and 3.9 pp (to 7.1%)**.

HEADLINE INFLATION IN EURO AREA



REAL GDP IN EURO AREA



Source: ECB (March 2022 projections).



## Boosting strategic autonomy and alleviating the impact of the crisis

- In the short term, action should focus on **providing support to the most vulnerable firms and cohorts** (temporarily easing the State aid framework for the business sector, establishing certain temporary limits on retail electricity prices, and increasing storage).
- Over the medium term, **Europe's strategic autonomy in both energy and defence needs to be boosted**. In energy, by further diversifying suppliers and reducing reliance on fossil fuels more swiftly.

## Mutualising the cost

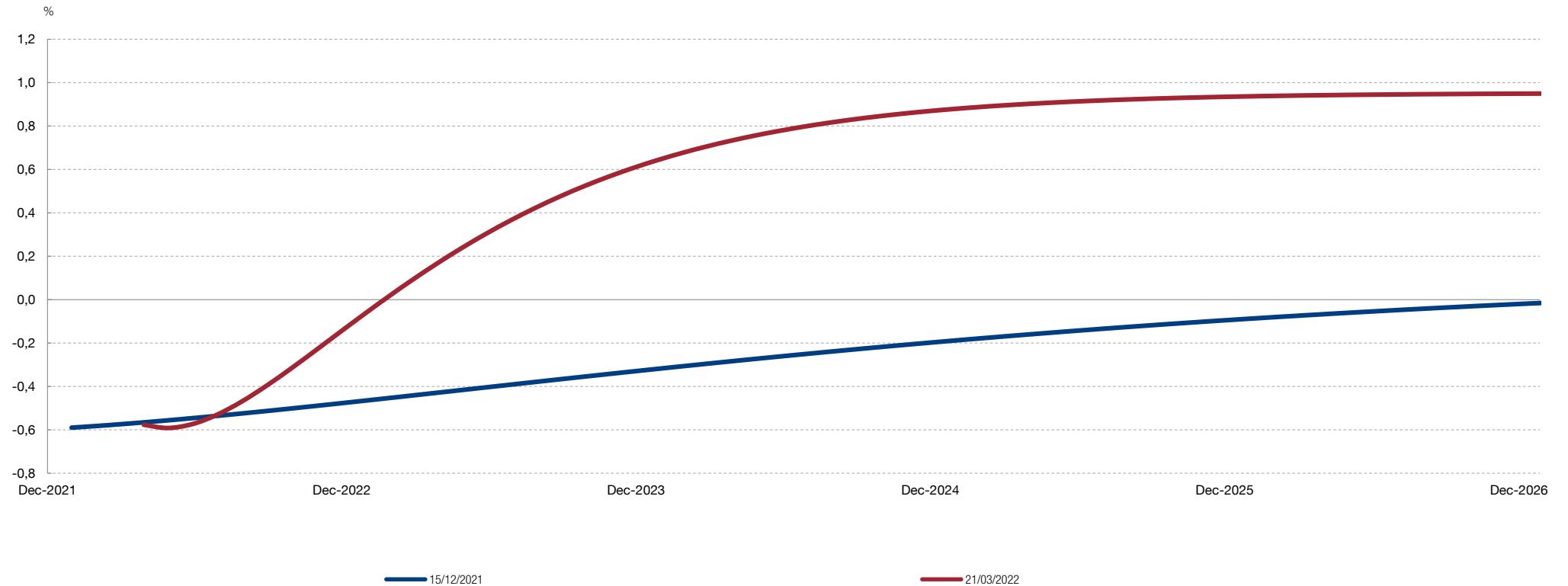
- Like the pandemic, the armed conflict represents a highly adverse, exogenous shock common to all European economies, but potentially one that will have asymmetric effects across countries, sectors and firms, given that the levels of exposure to and dependence on the Russian and Ukrainian economies vary widely, and the starting positions also differ across countries.
- **Joint European action, through the pooling of budgetary resources, is once again the most effective means** of funding the public expenditure arising as a result of the invasion.
- **It should prevent the war from being a source of financial fragmentation in Europe.**

## Accelerating European integration

- Creation of a **permanent central fiscal capacity** in the euro area.
- Creation of a **European safe asset** (one step forward in this regard is the pan-European bond issuances to finance NGEU) and **deeper capital market integration** in the euro area.
- **Completion of the banking union:** establishing a European deposit insurance scheme and a common framework for resolving systemic crises.

- The decisions **weigh the different risks** to the price stability target in the current context:
  - On one hand, the new shock **drives up the inflation dynamic in the near term and increases the probability of second-round effects** and, therefore, of these inflationary pressures extending into the medium term.
  - **On the other**, the war will have an **adverse impact on growth**, which could be very significant, particularly in the short term and in a setting in which the euro area economy remains well short of its potential level. This **could reduce inflationary pressures in the medium term**, which is the relevant time horizon for monetary policy.
  - Under all of the scenarios analysed, **inflation is expected to gradually decline and stabilise at levels close to our 2% target in 2024**.
  - Various indicators of **long-term inflation expectations drawn from financial markets and surveys are also anchored at around 2%**, once adjusted for risk premia.
- There is less of a need to reinforce the accommodative stance through net asset purchases: **the monthly purchases under the APP have been reduced for Q2** and the calibration for Q3 will depend on developments in the economic outlook.
- The **data-dependent** nature of the decisions has been underlined and the **flexibility and optionality** in the use of instruments has increased:
  - **The measures needed to ensure price stability and financial stability will be adopted.**
  - If in the coming months new data support the expectation that the medium-term inflation outlook will not weaken, net asset purchases under the APP will end in Q3. However, should the medium-term inflation outlook change, the net asset purchase plan will be revised (in terms of both its amount and its duration).
  - **The possible time interval between the end of net purchases and the point at which interest rates start to be raised has been widened.**
  - Interest rate adjustments will be **gradual**.
  - **Need to prevent fragmentation** with a flexible reinvestment of debt repayments under the PEPP or, if applicable, with alternative instruments.

## EURO AREA: INSTANTANEOUS FORWARD €STR OIS CURVE



Sources: Refinitiv Datastream and Banco de España.

## National fiscal policy

- **Granular responses targeting** the most vulnerable households, firms and sectors.
- The measures need to be **temporary and selective**, given the notable increase in budgetary imbalances during the pandemic and the current high inflation, avoiding an across-the-board fiscal impulse.
- It should be accompanied by the timely design and, once the recovery takes hold, the implementation of a **medium-term consolidation programme** that enables the high public debt to be gradually reduced.
- Implementation of a **comprehensive and ambitious set of reforms** to address our structural problems and raise potential output, which would also help reduce our public debt.
- **Acceleration of the NGEU projects and reforms.**
- As part of the incomes agreement, **the widespread use of automatic indexation clauses in the expenditure items** that might further fuel the current inflationary process **must be avoided**.

## Incomes agreement between employees and employers

- The **loss of income** in the economy on account of rising energy costs, compounded by the invasion of Ukraine, **should be shared between employees** (fall in their purchasing power) **and firms** (reduction in their profit margins), to prevent an inflationary spiral.
- **Avoidance of measures that are broad or excessively rigid**, given the heterogeneity among sectors, firms and workers, to prevent the adjustment from being borne by the most vulnerable.
- **Non-usage of formulae that automatically link wages** to past inflation or indexation clauses, which, if applied, would increase second-round effects (inflation-wage growth spiral).
- **Multi-year commitments to wage increases** (e.g. to underlying inflation), complemented, where appropriate, by **job protection** commitments that provide certainty to agents in their consumption and investment decisions.
- **Profit-margin moderation commitments**, to ensure the competitiveness of Spanish firms and that economic growth is affected as little as possible.

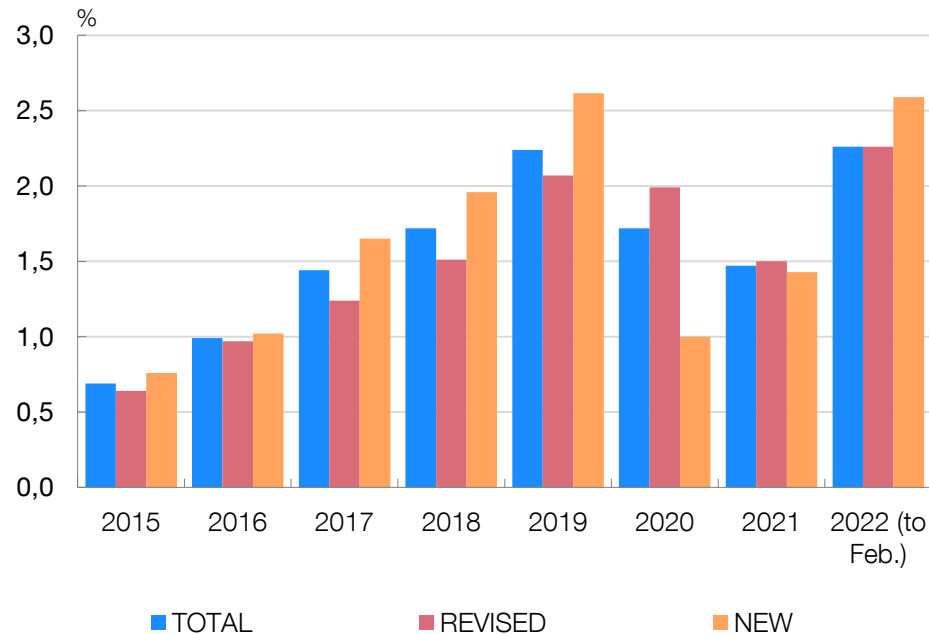
# IT APPEARS THAT COSTS ARE ALREADY BEING SHARED BETWEEN EMPLOYEES AND EMPLOYERS

As regards employees, in February the wage increase agreed for 2022 rose to 2.3% (from 1.5% for 2021), a percentage clearly below the inflation rates observed in recent months and those expected for 2022.

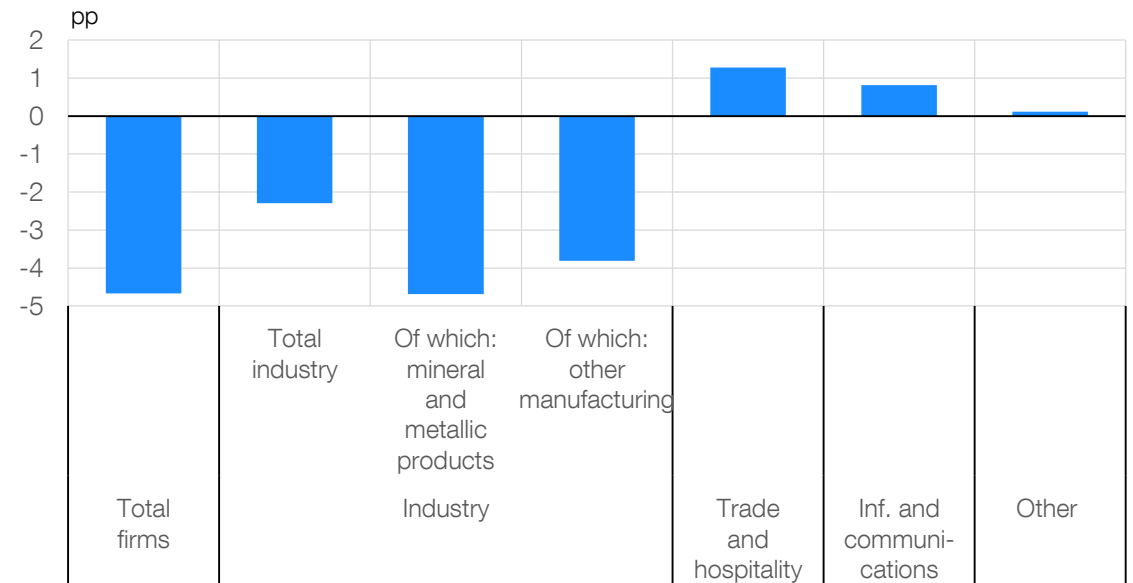
## Firms have not been fully passing the increase in their costs through to the prices of their products:

- According to the [Banco de España Business Activity Survey \(EBAE\)](#), in 2021 Q4 three-quarters of Spanish firms experienced a rise in their costs, while only 30% increased the prices of their products.
- According to the [Central Balance Sheet Data Office Quarterly Survey](#), higher energy costs have dampened the recovery in earnings in the most energy-intensive sectors.

WAGE INCREASE AGREED



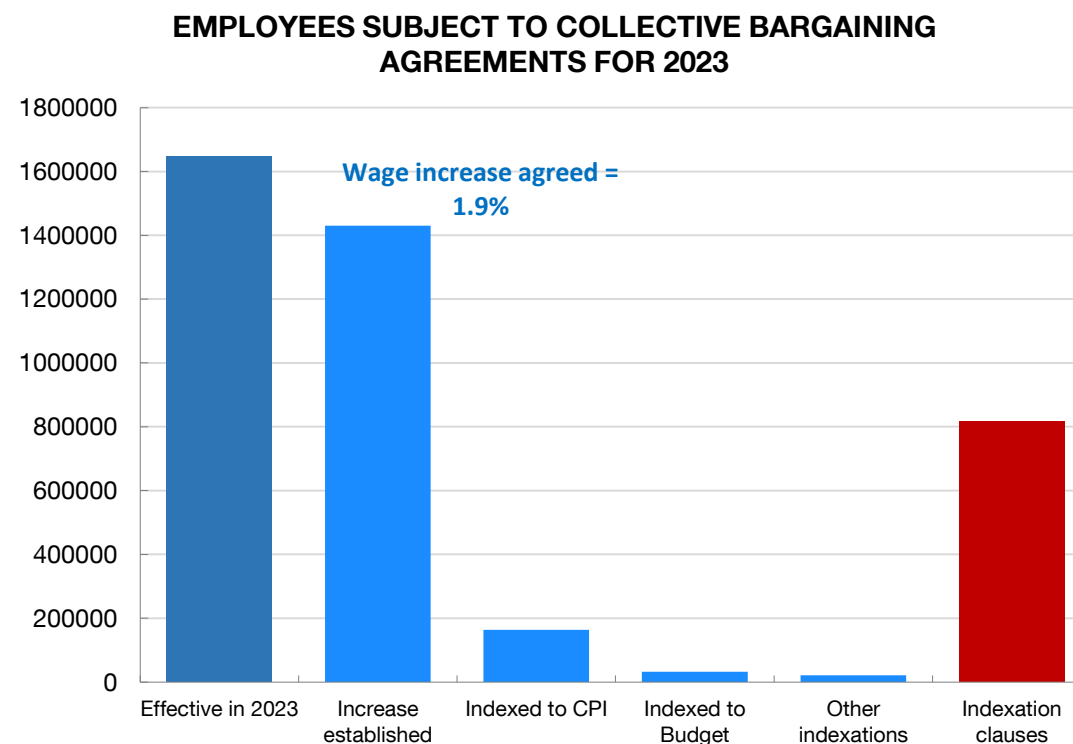
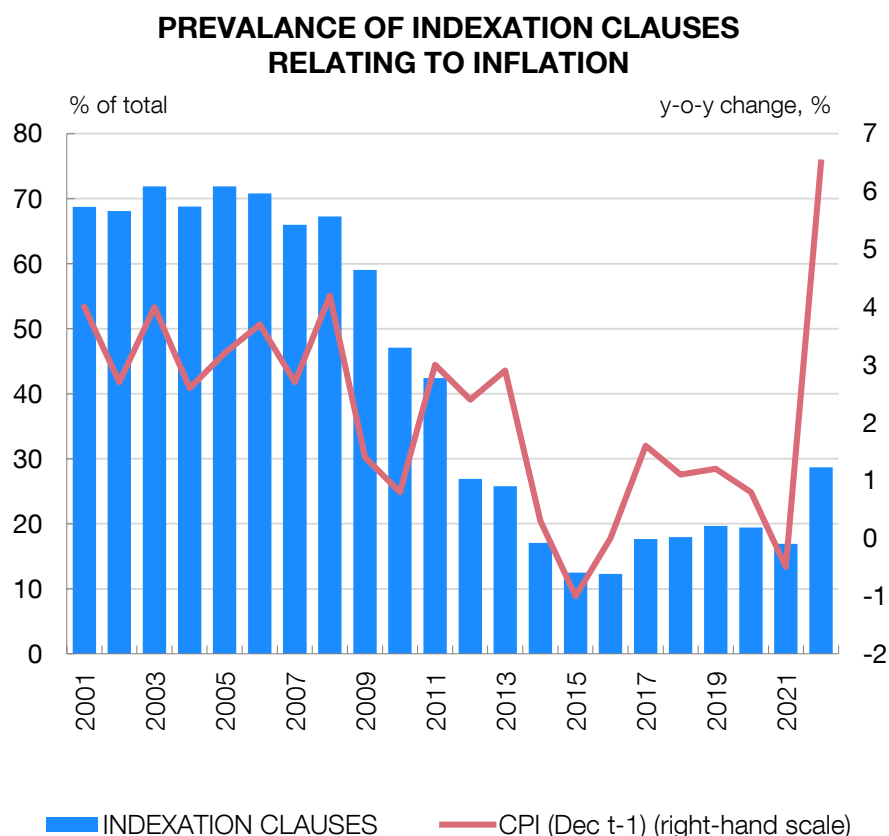
BUSINESS MARK-UP IN 2021 Q4  
Difference with respect to 2020 Q4



Sources: Banco de España and Ministerio de Trabajo y Economía Social. In the right-hand chart, mark-up is defined as the ratio between GVA and output.

In the agreements recorded to February 2022, there has been an increase in the percentage of employees with indexation clauses (28.7%, compared with 16.9% in 2021).

The wage increase agreed for 2023 is expected to be in line with that agreed for 2022. However, for 10% of the employees concerned, this increase is indexed to inflation developments, and one-half of the employees affected have indexation clauses included in their agreements.



Source: Ministerio de Trabajo y Economía Social. Latest observation: February 2022.

THANK YOU FOR YOUR ATTENTION

