

A BRIEF OVERVIEW OF BANCO DE ESPAÑA ANNUAL REPORT 2021 AND OF MOST RECENT MACROECONOMIC PROJECTIONS FOR THE SPANISH ECONOMY

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CHAPTER 1

AN INCOMPLETE RECOVERY AMID UNCERTAINTY: FROM THE PANDEMIC TO THE RISE IN INFLATION AND THE OUTBREAK OF WAR



THE RECOVERY REMAINS INCOMPLETE AND HIGHLY UNEVEN IN SPAIN

The Spanish economy's GDP grew by 5.1% in 2021. Output continued to grow in 2022 Q1, albeit at a quarter-on-quarter rate of 0.2%, considerably slower than in 2021 Q4 (2.2%)

That said, in 2022 Q1 economic activity in Spain stood 3.6 pp below the pre-pandemic level, while, in the euro area, GDP already stood above its pre-crisis level

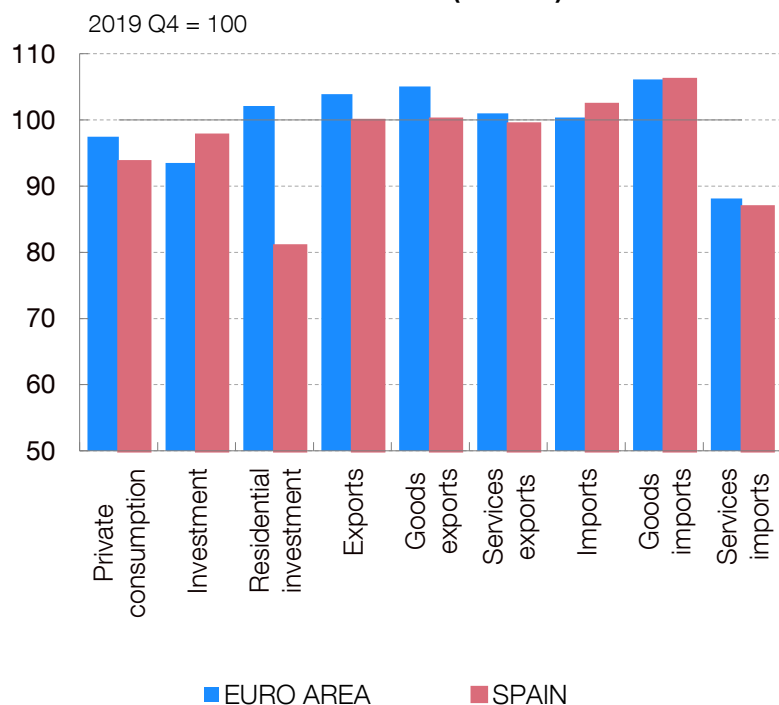
Employment has recovered more vigorously than GDP, albeit also with high cross-sectoral heterogeneity (further adrift from the pre-pandemic levels in sectors like hospitality and leisure that were hit hardest by the restrictions on mobility)

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

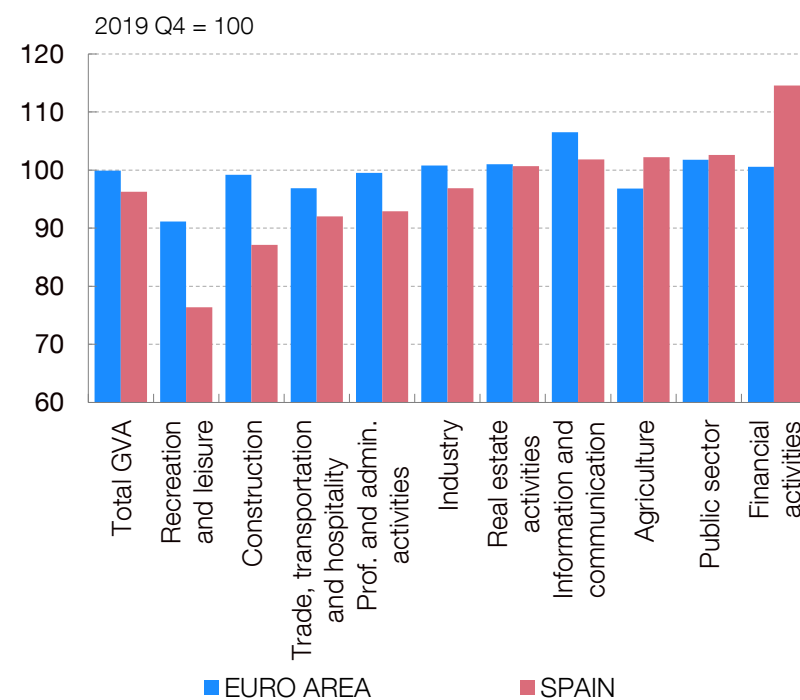
SINCE THE ONSET OF THE PANDEMIC, THE POORER PERFORMANCE OF THE SPANISH ECONOMY AS COMPARED WITH THE EURO AREA CAN BE ASSOCIATED WITH VARIOUS FACTORS

- 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-PANEMIC LEVELS, BY DEMAND COMPONENT (2021 Q4)



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



SOURCES: INE and Eurostat.

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

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 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

CHAPTER 2

CHALLENGES AND POLICIES FOR SUSTAINABLE AND BALANCED GROWTH OF THE SPANISH ECONOMY



A BROAD RANGE OF STRUCTURAL CHALLENGES...

Job creation
and
employment
stability

Sustainability of
public finances

Training and
human capital

Productivity

Digitalisation

NGEU
programme

Climate change

Globalisation
dynamics

Inequality

Firm size

European
institutional
framework

Population
ageing

Cross-sectoral
reallocation

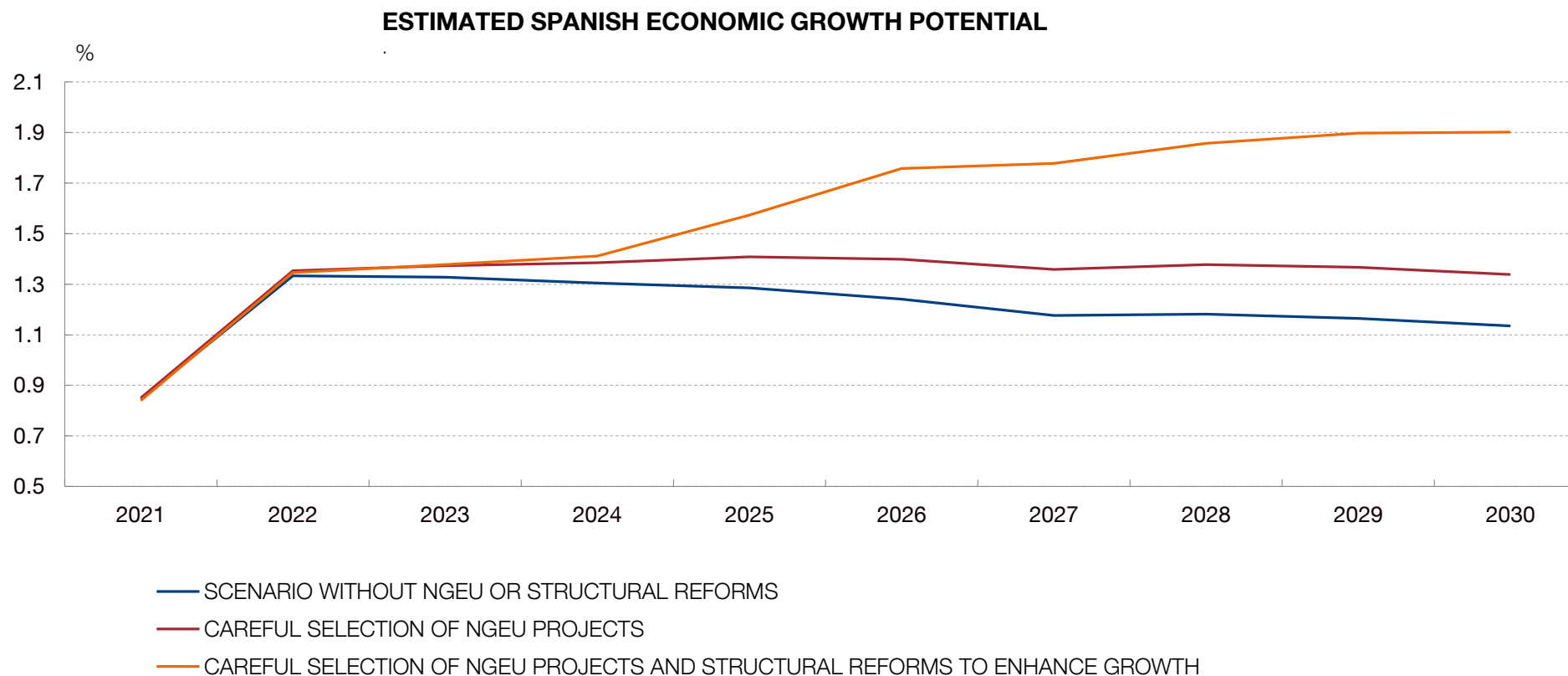
Challenges
facing the
banking sector

Innovation and
technological
capital



THE IMPORTANCE OF A RIGOROUS SELECTION OF THE NGEU PROJECTS AND OF THE IMPLEMENTATION OF AMBITIOUS REFORMS

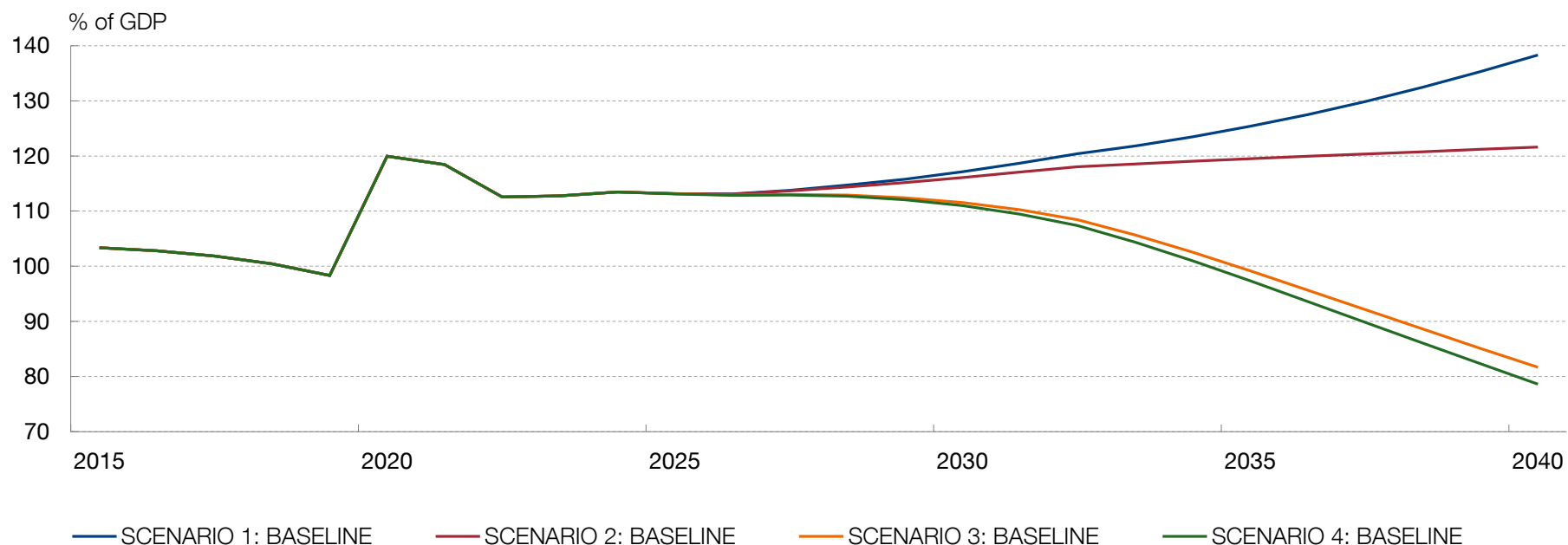
- Different combinations of reforms and investment projects associated with the NGEU programme could have a very different impact on the Spanish economy's medium-term growth capacity



SOURCE: Banco de España.

- To bolster the sustainability of Spanish public finances, a multi-annual fiscal consolidation plan will have to be rigorously implemented, once the pandemic is over and the adverse economic effects of the war in Ukraine have diminished

SIMULATED PUBLIC DEBT PATHS UNDER VARIOUS SCENARIOS (a)



SOURCE: Banco de España, on INE and IGAE data.

a Drawing on “Macroeconomic projections for the Spanish economy (2022-2024)”, Box 1 of the “Quarterly report on the Spanish economy”, *Economic Bulletin* 1/2022, Banco de España.

All the scenarios include a deterioration in the structural primary balance up to 2040 owing to ageing costs (pensions, health care and long-term care). Scenario 1 assumes a fiscal policy that does not correct that deterioration. Scenario 2 envisages a fiscal policy that makes a consolidation effort consistent with maintaining the structural primary balance envisaged in the Banco de España’s latest projections for 2024. Alternatively, scenario 3 assumes a fiscal policy that makes a further adjustment to the structural primary balance of 0.3 pp of potential GDP each year, until structural balance equilibrium is reached. Lastly, scenario 4 modifies scenario 3 with long-term potential GDP growth of 1.9% (instead of 1.3% as assumed in all the other scenarios).

CHAPTER 3

RISING GLOBAL INFLATION



THE IMPACT OF THE RISE IN PRICES ON THE DIFFERENT TYPES OF SPANISH HOUSEHOLDS AND FIRMS IS VERY UNEVEN

The sharp rise in prices in recent quarters has already had an appreciable impact on activity in aggregate terms, as regards both the Spanish economy's growth rate in 2021 and its outlook for 2022-2024

Beyond the impact of this episode on the main macroeconomic variables, the rise in prices seems to have affected households differently depending, among other aspects, on household structure, age, education, income and net financial position

Some of the measures approved in recent months would have an impact on the distributional effects of inflation

The impact of the inflationary episode is also highly uneven across sectors of activity, depending mainly on how intensely energy inputs are used in their production processes

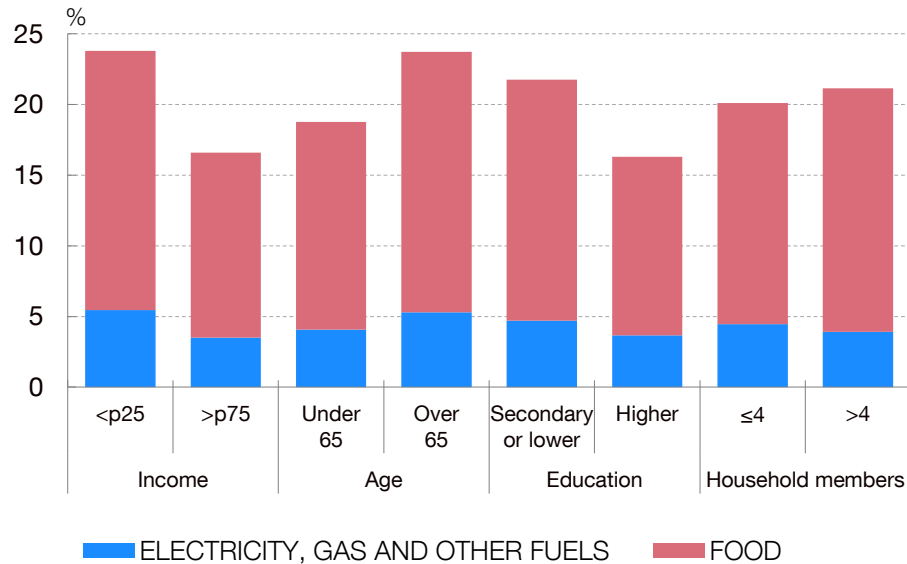
Furthermore, within each sector, smaller firms are relatively more reliant on energy inputs, making them more vulnerable to the current inflationary pressures

THE ASYMMETRIC IMPACT OF RISING INFLATION ON HOUSEHOLDS

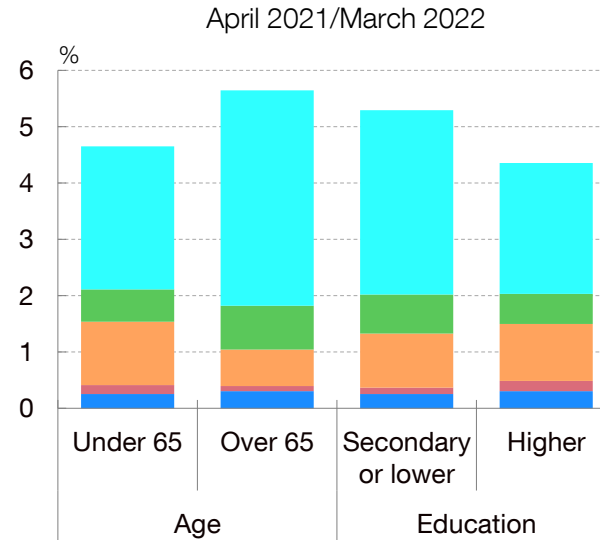
- In recent months, lower-income households, households where the reference person was older than 65 and households with secondary education or less experienced higher inflation than that borne by higher-income households, those where the reference person was younger and those with a higher level of educational attainment
- All of this is a consequence of the differences between these types of households in the share of spending in staple goods, whose prices have shown a greater relative increase recently

HOUSEHOLD-SPECIFIC INFLATION

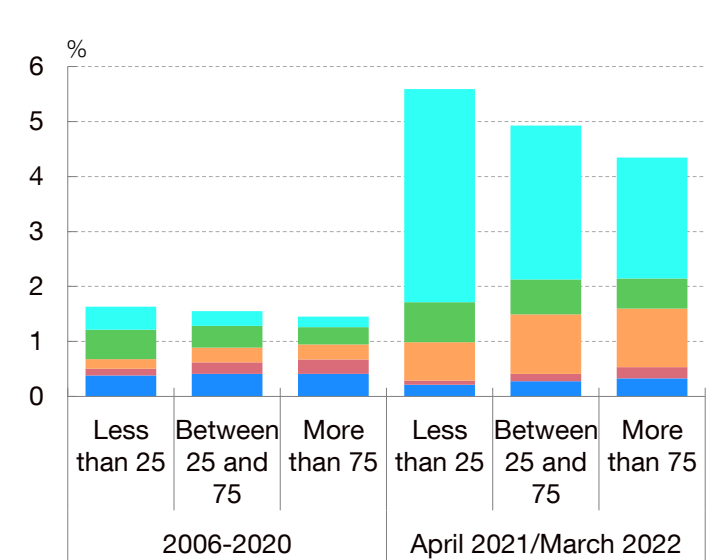
SHARE OF EXPENDITURE ON FOOD AND ELECTRICITY, GAS AND OTHER FUELS (2006-2020)



BY EDUCATIONAL ATTAINMENT LEVEL AND AGE



BY INCOME PERCENTILE



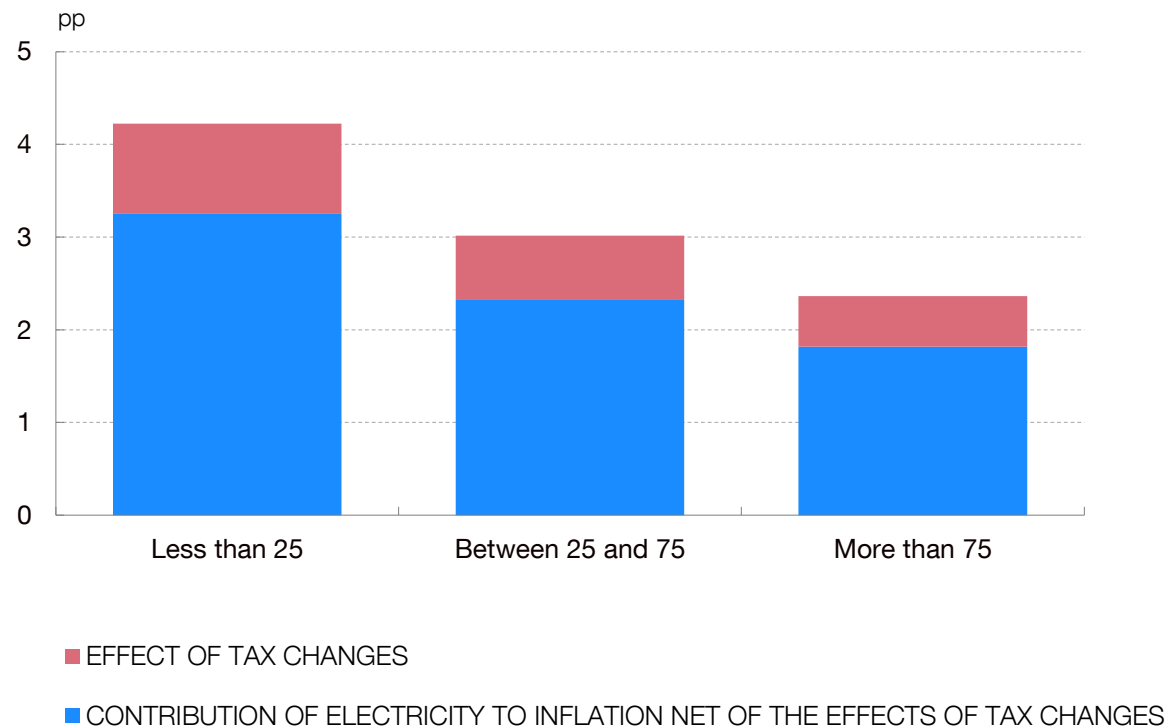
SOURCES: Household Budget Survey, INE and Banco de España.

SOME OF THE MEASURES APPROVED IN RECENT MONTHS WOULD HAVE AN IMPACT ON THESE DISTRIBUTIONAL EFFECTS OF INFLATION

- Banco de España estimates suggest that the indirect tax cuts approved in 2021 reduced average inflation more for lower-income households than for households in the top quartile of the income distribution
- Conversely, according to preliminary estimates of the impact of the recently approved fuel discount (€0.20 per litre of fuel) the reduction of the inflation borne by higher-income households could be greater than that experienced by lower-income households

CONTRIBUTION OF RECENT CHANGES IN ELECTRICITY TAXES TO HOUSEHOLD-SPECIFIC INFLATION BY INCOME PERCENTILE

April 2021/March 2022 (a)



SOURCES: Household Budget Survey, INE and Banco de España.

a. The tax changes considered are the reduction of VAT on electricity from 21% to 10% (Royal Decree-Law 12/2021) and the reduction in the excise duty on electricity from 5.1% to 0.5% (Royal Decree-Law 17/2021).

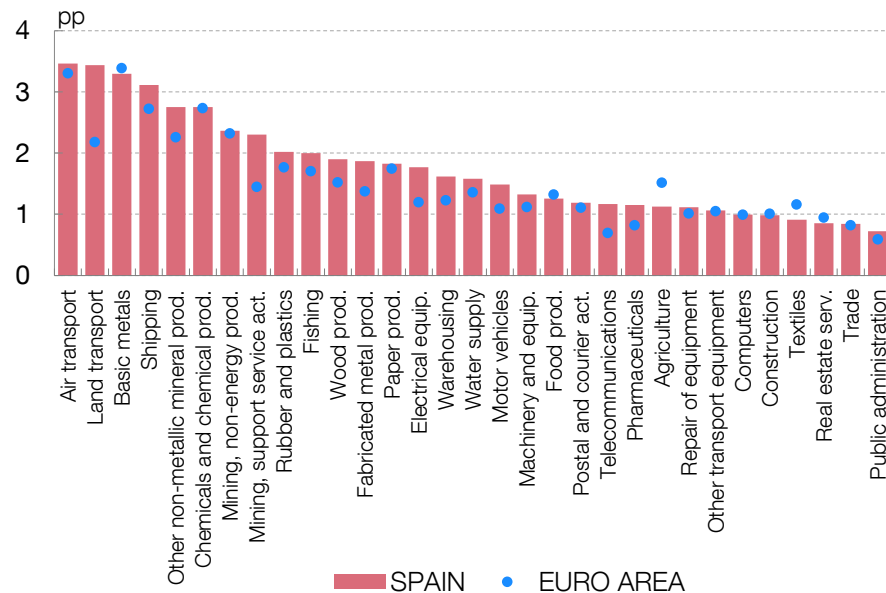
THE ASYMMETRIC IMPACT OF RISING INFLATION ON FIRMS

- The simulations conducted by the Banco de España suggest that the sectors most affected in Spain (through direct and indirect channels) by the increase in energy costs would be air transport, land transport, basic metals and shipping
- This increase in total production costs is expected to lead to a moderate increase in the share of financially vulnerable firms in Spain, albeit with high sectoral heterogeneity

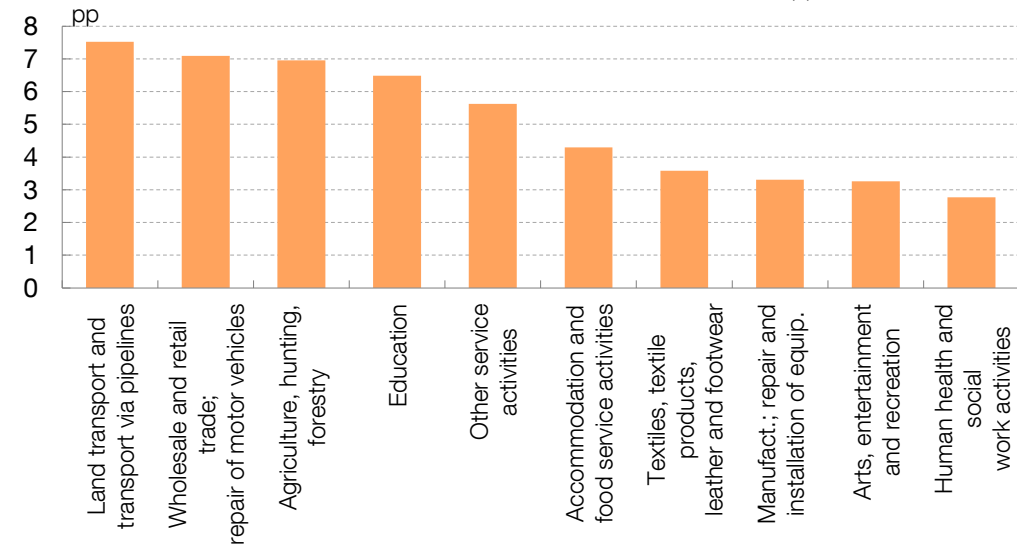
22% INCREASE IN THE PRICE OF ENERGY (a)

Sectors with the highest increase

INCREASE IN SECTORAL COSTS (b)



INCREASE IN THE SHARE IN EMPLOYMENT OF FIRMS WITH NEGATIVE PROFITABILITY IN 2022 (c)



SOURCES: OECD and Banco de España

a. The increase in energy prices observed between the Banco de España projections published on 5 April 2022 and those published on 17 December 2021

b. See Izquierdo, Moral-Benito, Prades and Quintana (2022).

c. Simulation using individual data. Profitability is defined as (ordinary net profit + financial costs) / assets net of non-interest-bearing liabilities.

CHAPTER 4

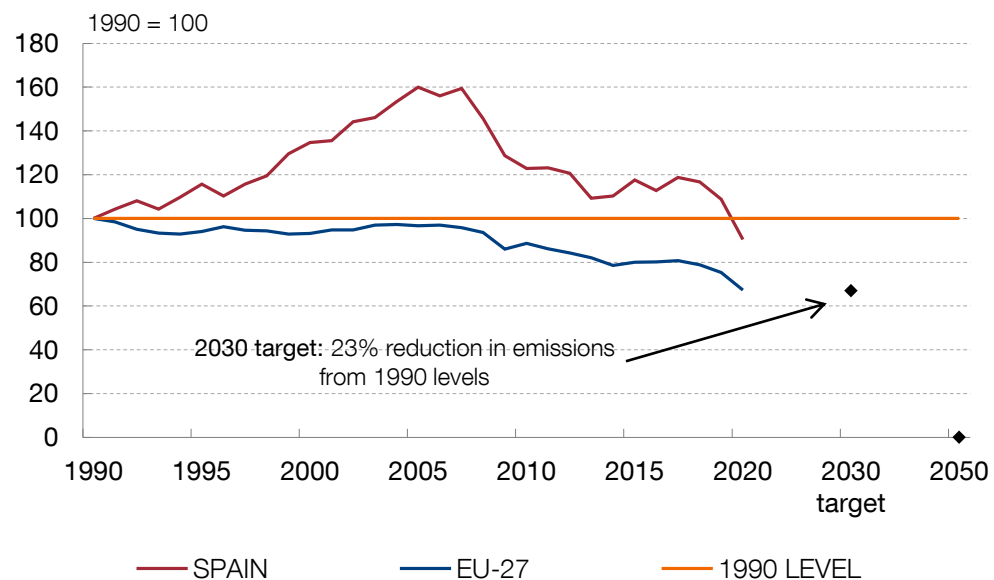
THE SPANISH ECONOMY AND THE CLIMATE CHALLENGE



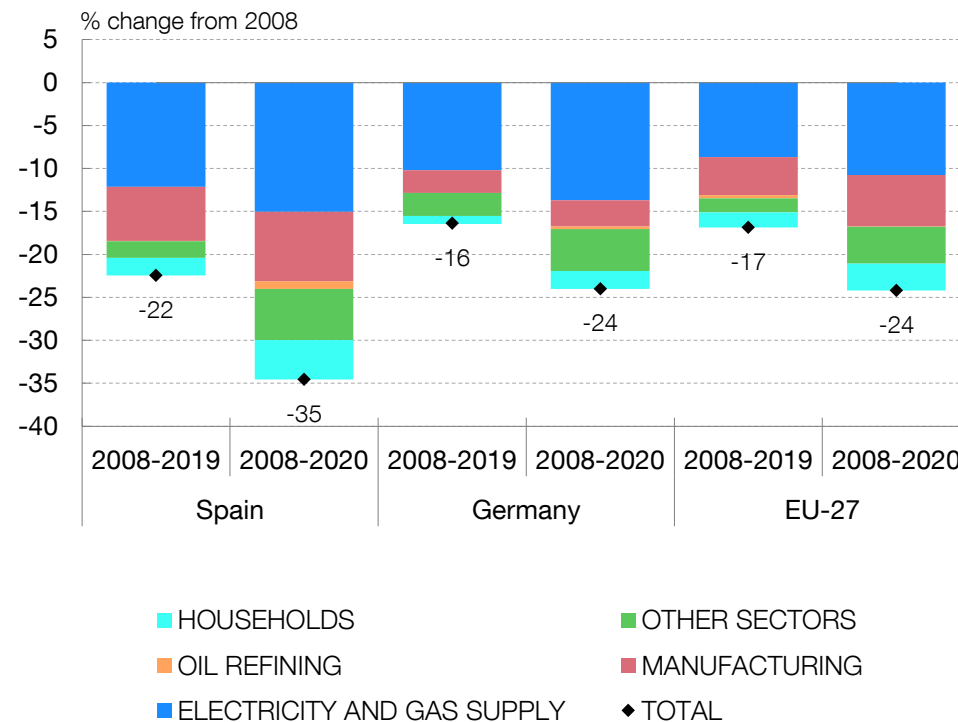
THE TRANSFORMATIONAL CHALLENGE FACING THE SPANISH ECONOMY IS ENORMOUS

- For example, the proportion of electricity generated using renewables should increase from 43% in 2020 to 74% in 2030

CO2 EMISSIONS



SECTOR CONTRIBUTIONS TO THE REDUCTION IN EMISSIONS SINCE 2008

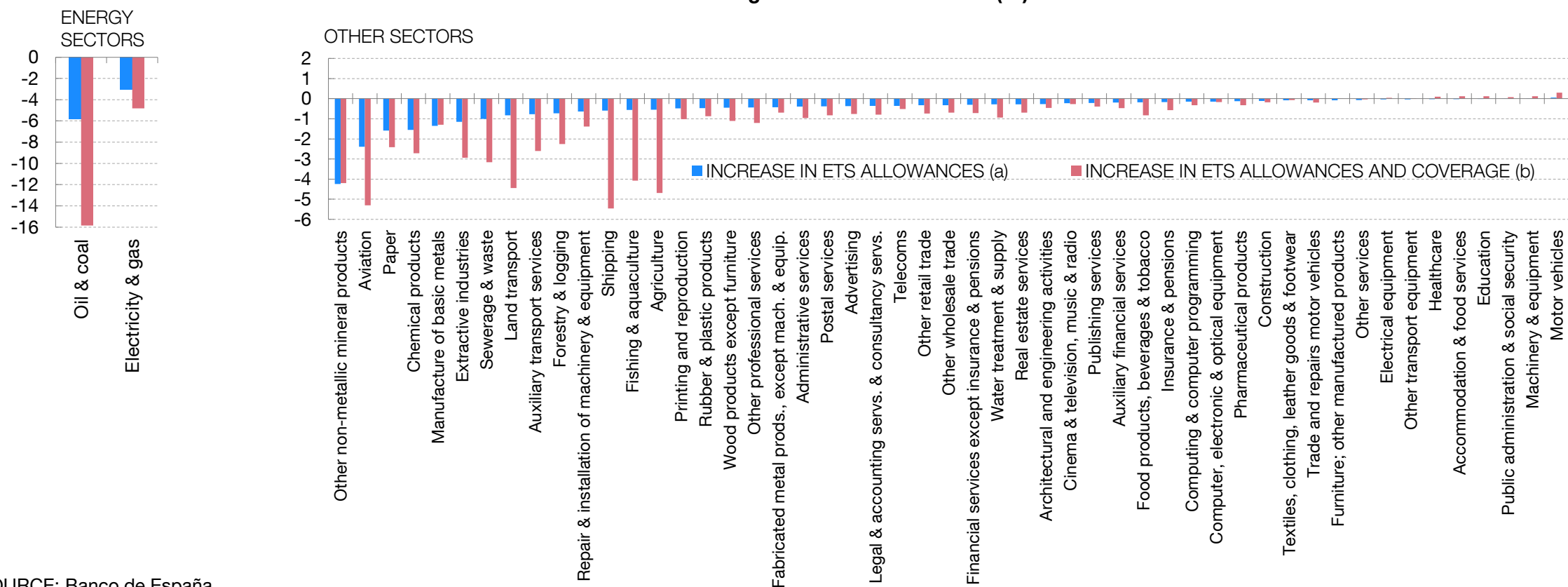


Sources: Our World in Data and Eurostat.

THE BANCO DE ESPAÑA'S CATS MODEL ENABLES THE – HIGHLY UNEVEN – IMPACT OF THE GREEN TRANSITION ON SPAIN'S ECONOMIC SECTORS TO BE ASSESSED

- According to the CATS model, if Spain's sectoral structure and Spanish industries' emission intensity were the same as those of Germany or the EU-27 average, the aggregate economic impact of the simulated transition risks would be virtually unchanged

INCREASE IN PRICE OF CO₂ EMISSIONS FROM €25 TO €100 PER TONNE, AND INCREASE IN PRICE AND COVERAGE
Rate of change of sector value added (%)



SOURCE: Banco de España.

a. Increase in price of CO₂ emissions, from €25 to €100 per tonne.

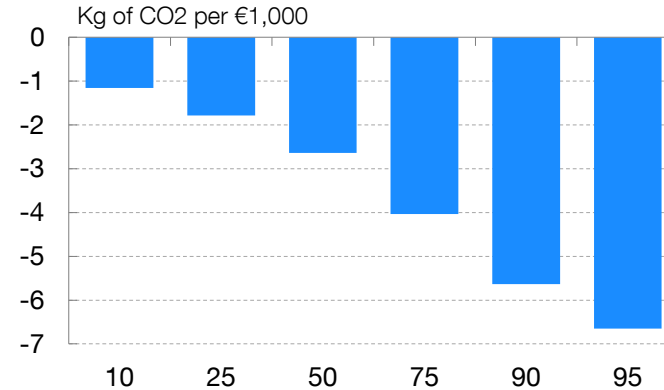
b. Increase in price of CO₂ emissions, from €25 to €100 per tonne, and extension of coverage of EU-ETS to include all the emissions of all the productive sectors.

THE FORESEEABLE FUTURE INCREASE IN THE PRICE OF THE MOST POLLUTING GOODS AND SERVICES WILL HAVE MOST IMPACT ON CERTAIN POPULATION GROUPS ...

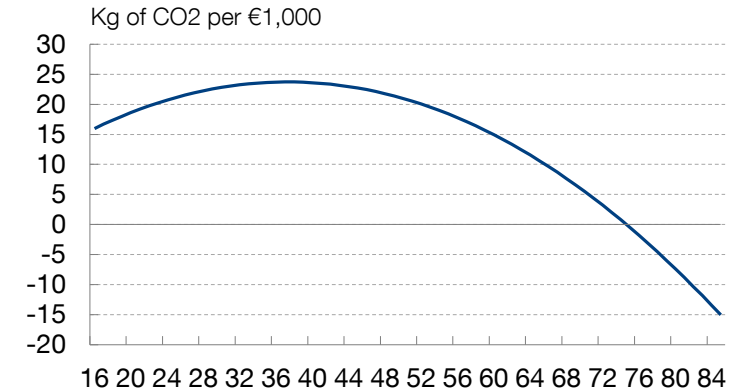
• ... especially, in view of their consumption patterns, on

- lower income households,
- households whose reference person is in the 35 to 45 age group,
- households in rural areas,
- households with a lower educational level,
- and larger households

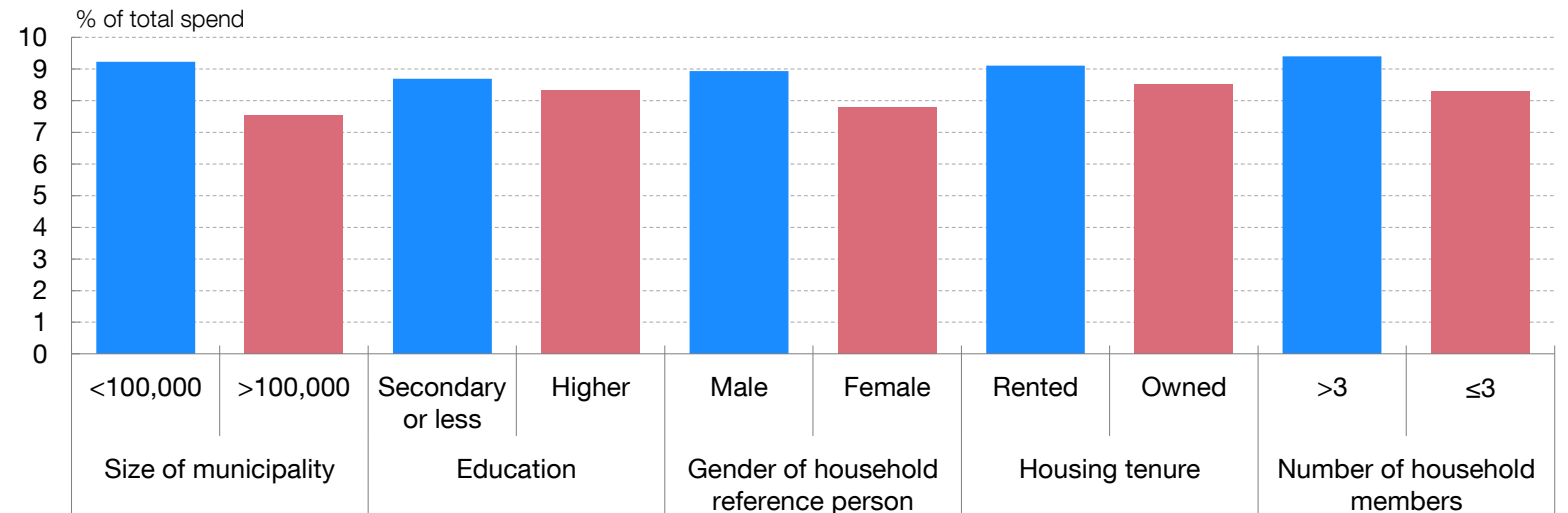
CHANGE IN EMISSION INTENSITY BY INCOME DECILE (a) (b)



CHANGE IN EMISSION INTENSITY BY AGE GROUP (c) (d)



PROPORTION OF EXPENDITURE ON HIGH EMISSION INDUSTRIES BY OTHER SOCIOECONOMIC FACTORS



SOURCES: INE and Banco de España.

a. Household income.

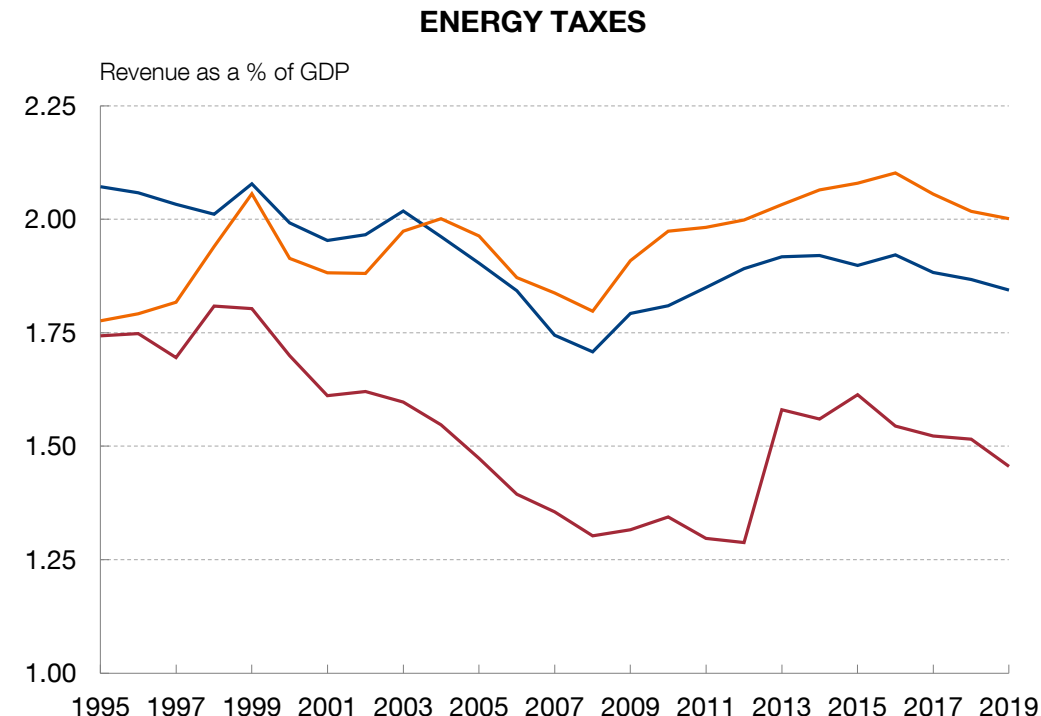
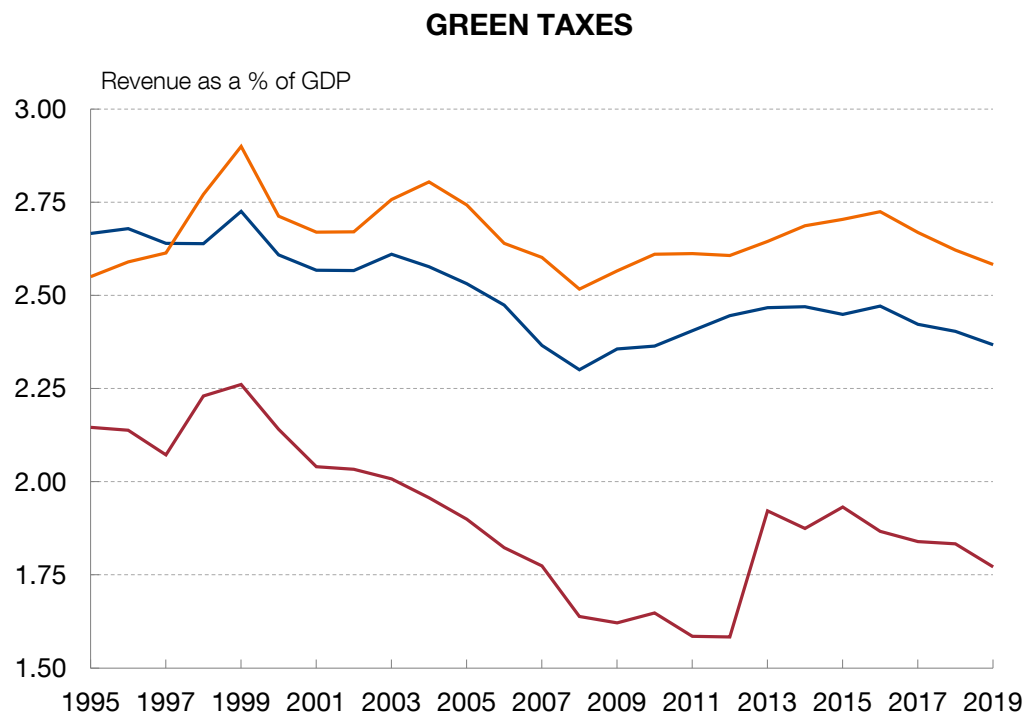
b. Difference in emission intensity compared with non-income households.

c. Age of household reference person.

d. Difference in emission intensity compared with households whose reference person was around 75 years old.

SPAIN CONSISTENTLY FEATURES AMONG THE EU-27 ECONOMIES IN WHICH GREEN TAXATION RAISES THE LEAST REVENUE IN RELATIVE TERMS

- Although hydrocarbon taxes in Spain are lower than elsewhere, the tax rates have not risen in real terms in recent years.



— SPAIN — EU-27 (WEIGHTED) — EU-27 (ARITHMETIC)

SOURCE: Eurostat.

CONTENTS

1. Annual Report 2021

2. Macroeconomic projections for the Spanish economy (2022-2024)



Q1

Sharper slowdown than projected in our last projection exercise (due to Omicron, the road hauliers' strike and the outbreak of war), which significantly affects the projection of average GDP growth in 2022

Q2

Acceleration in the rate of growth of activity, partly as a result of the buoyancy of contact-intensive sectors following the easing of practically all pandemic restrictions. GDP growth in Q2 is estimated at 0.4%

Rest of the projection horizon

No significant changes to the outlook for activity beyond the near term. Relatively robust growth is maintained from the second half of 2022, with GDP growth of 2.8% in 2023 and 2.6% in 2024. Pre-pandemic activity levels are regained in 2023 Q3

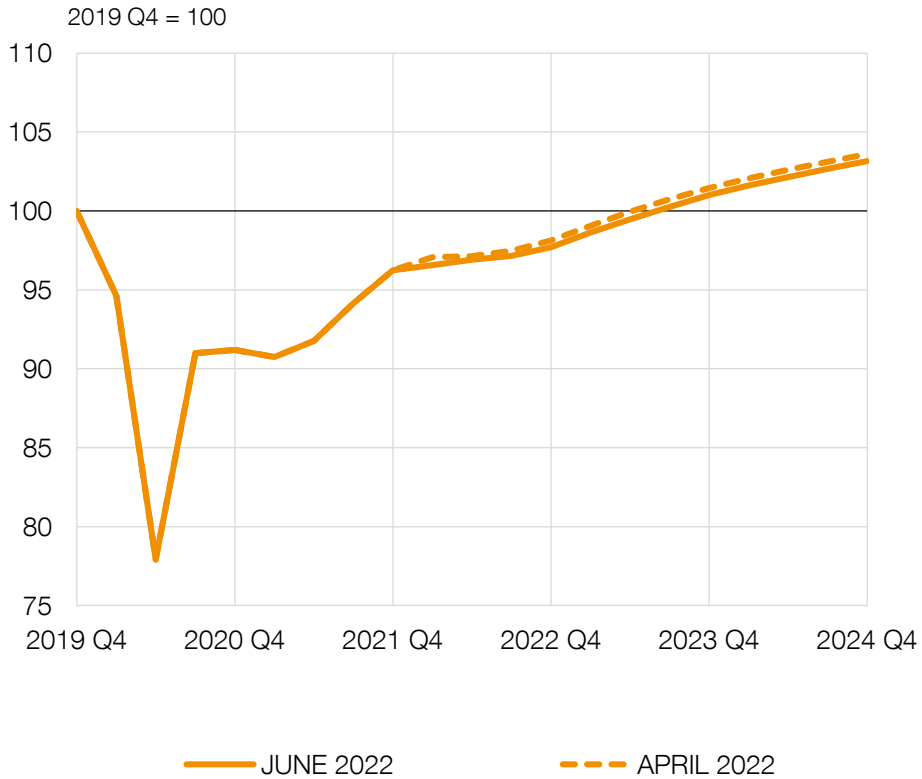
**Main risks
(on balance on the
downside)**

- Duration and intensity of the war in Ukraine (uncertainty, commodity prices, bottlenecks, etc.)
- Impact of worldwide monetary policy normalisation on financial markets and financing conditions
- Use and impact on the Spanish economy of European NGEU funds
- Persistence and impact of the current inflationary episode (macro impact, competitiveness, etc.)
- Course of the pandemic (zero-COVID policy in China, services recovery, etc.)

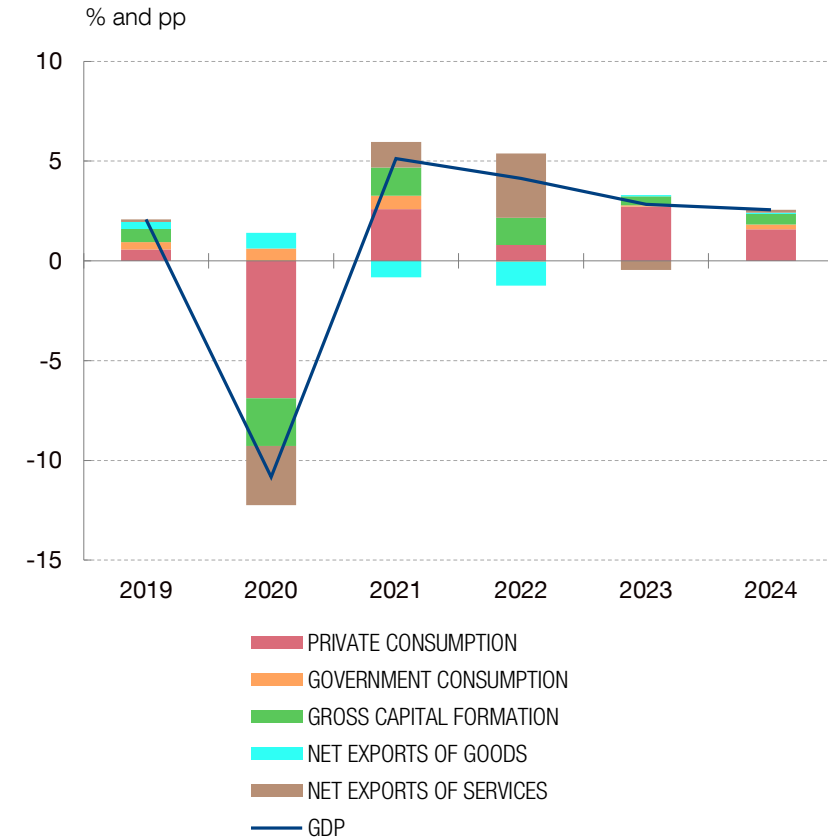
GDP TO RECOVER PRE-PANDEMIC LEVEL IN 2023 Q3

GDP GROWTH DRIVEN BY TOURISM AND INVESTMENT IN 2022, AND BY CONSUMPTION IN 2023-2024

**GROSS DOMESTIC PRODUCT
(chained volume index)**



**GDP GROWTH AND CONTRIBUTIONS OF
MAIN COMPONENTS**



SOURCES: Banco de España and INE.
Latest observation: 2022 Q1 (flash estimates).

Recent developments

Inflation has continued to accelerate in recent months – mainly driven by energy and food, but also by the rise in underlying inflation –, leading to continuous upward revisions of the inflation rates projected by the analysts' consensus, for both the Spanish and global economies

Outlook for the coming quarters

- The entry into force of the Iberian mechanism to cap gas prices and reduce electricity bills will exert downward pressure on the energy component of inflation in the coming months
- However, the inflation paths for food and the underlying component for the period 2022-2024 are revised up significantly
- Although the current inflationary episode is projected to gain in intensity and persistence, the recent high inflation rates are expected to moderate in the coming quarters, in line with commodity prices on futures markets and the gradual reversion of some of the factors that have triggered the price hikes (i.e. bottlenecks)

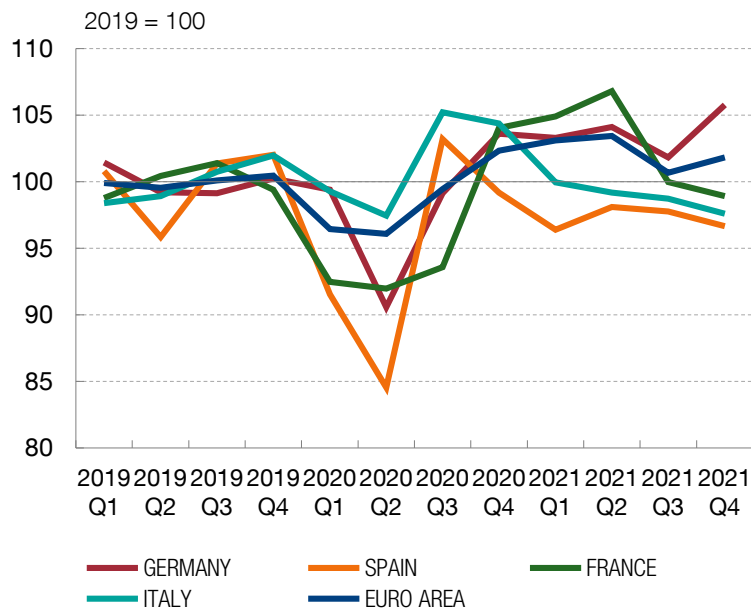
Main risks (overall, upside)

- Duration and intensity of the war in Ukraine (commodity prices, bottlenecks, etc.)
- Materialisation of significant indirect and second-round effects

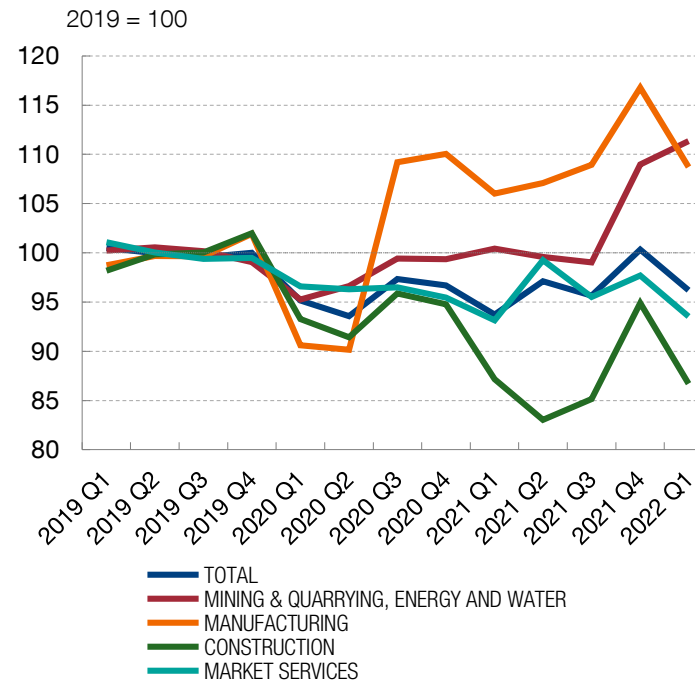
CONSIDERABLE UPSIDE RISKS TO INFLATION: BEHAVIOUR OF MARK-UPS

- At the end of 2021, profit margins in Spain stood below their pre-pandemic levels and were less buoyant than in the euro area as a whole. This overall behaviour is compatible with considerable variation across sectors. There are signs that profit margins were somewhat subdued over recent quarters. The difficulty of proxying an unobservable variable, such as mark-ups, means that it is advisable to interpret these conclusions with caution and, above all, that verifiable metrics of the behaviour of mark-ups in the current context need to be developed

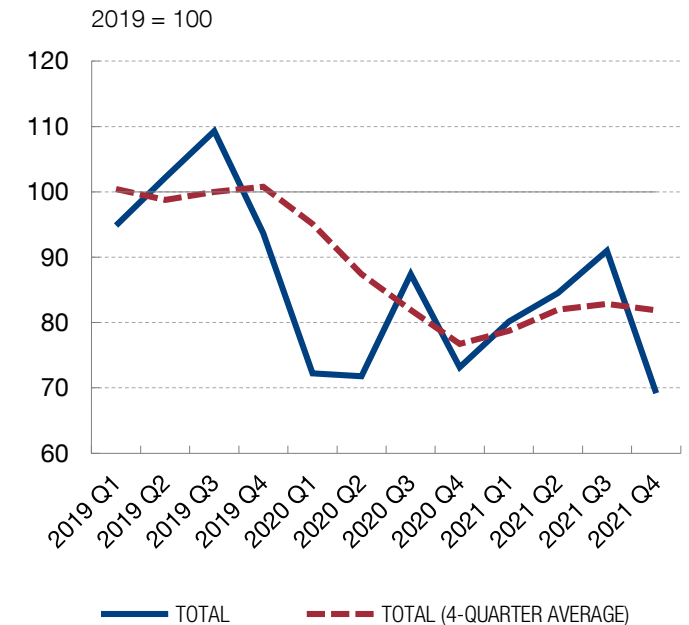
NFC's GOS/GVA RATIO



SPAIN: GOS/GVA RATIO BY SECTOR (a)



OPERATING MARGIN ACCORDING TO THE CBQ (b)



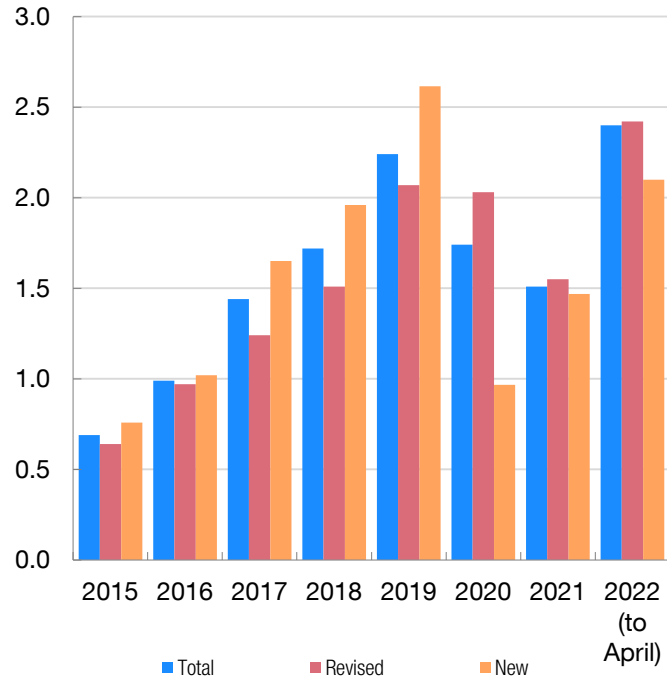
SOURCES: Eurostat, INE and Banco de España.

a) Gross operating surplus (GOS) is calculated as gross value added (GVA) less compensation per employee.

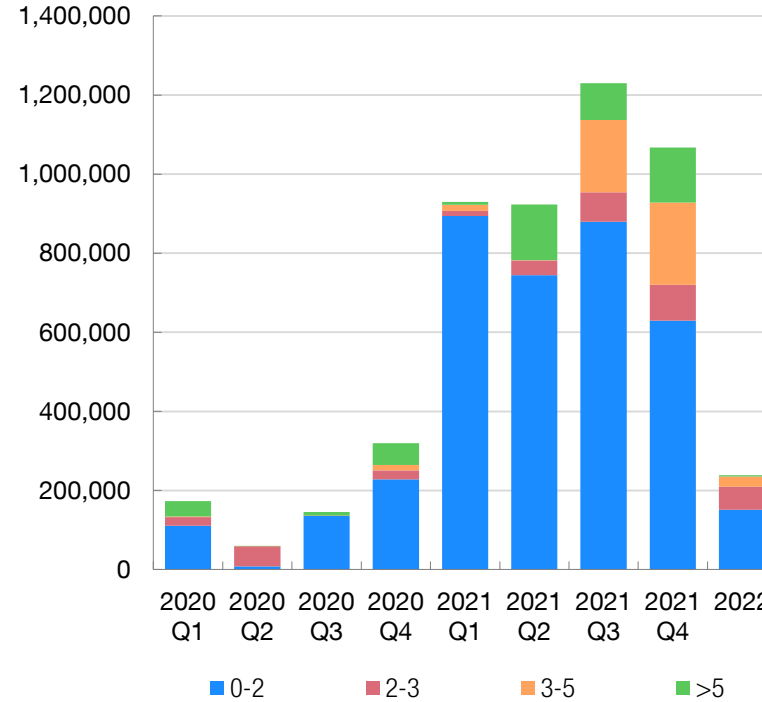
b) Operating margin = gross operating profit / net turnover.

CONSIDERABLE UPSIDE RISKS TO INFLATION: POSSIBLE SECOND-ROUND EFFECTS

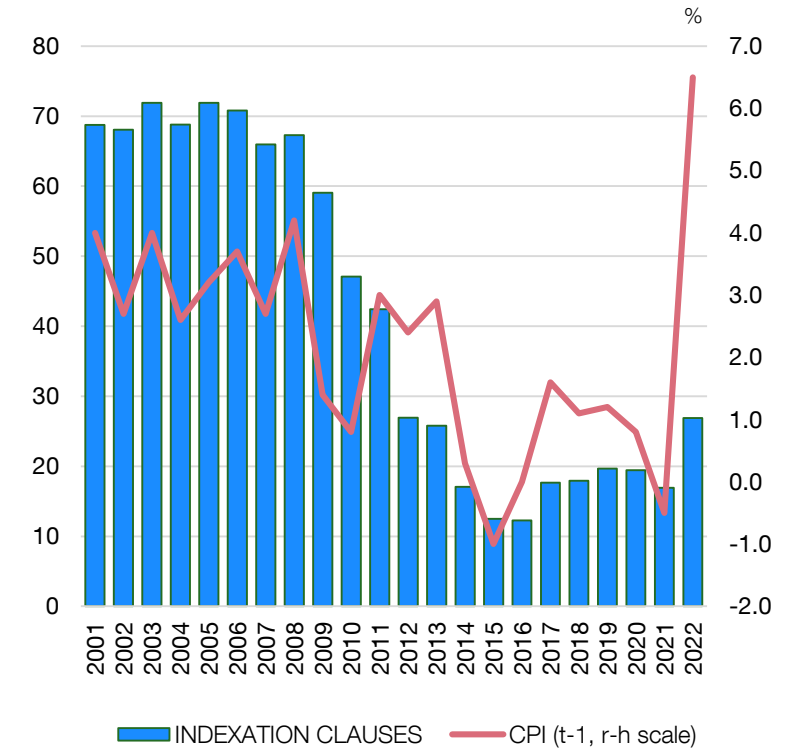
WAGE SETTLEMENTS (%)



WAGE SETTLEMENTS AND WORKERS COVERED IN 2022, BY DATE OF SIGNING OF AGREEMENT



INFLATION INDEXATION CLAUSES



SOURCES: Ministerio de Trabajo y Economía Social and Banco de España

THANK YOU FOR YOUR ATTENTION

