Editorial

Global economic activity has lost momentum over the summer. This is the result of various interacting adverse factors. Worldwide, inflation has risen to rates not seen in several decades, eliciting a firm response from central banks which, in turn, is leading to a tightening of financial conditions. In addition, in most countries, the acceleration in consumer prices is largely driven by the increase in the cost of many commodity imports, which is squeezing the purchasing power of households and non-financial corporations. In turn, numerous commodity price rises have been exacerbated by the war in Ukraine, which has also generated uncertainty regarding the security of Europe's energy supply and the possibility of a significant escalation in global geopolitical tensions.

Global financial conditions have tightened since mid-August. In early summer, the perception that central banks could choose to tighten monetary policy gradually, in view of the slowdown in activity, led to an increase in risk appetite, with rising stock prices and easing interest rates. However, these trends were subsequently reversed when the monetary authorities reaffirmed their commitment to combating inflation. A key development observed in global financial markets is the broad-based appreciation of the US dollar, which could have significant implications for other countries. It could, for instance, further increase high commodity prices (given that commodities are generally traded in US dollars), or add to the financial burden of agents who have borrowed in that currency (as is often the case in many emerging market economies).

Europe is particularly exposed to some of these recent adverse developments. Its vulnerability to the war in Ukraine stems from its geographical proximity to the conflict and, in particular, its reliance on commodity imports from Russia, especially gas, which is used as a primary source of energy by households and firms and also in electricity production. The war has triggered increasing disruptions in the supply of gas, which Europe is addressing through a number of complementary channels, including the geographical diversification of gas imports, using the limited possibilities available in the short run to replace it with other energy sources, and reducing consumption, all of which have resulted in high storage capacity utilisation. Nevertheless, the measures adopted to date cannot fully guarantee that there will be no winter supply interruptions this year, especially in some central European countries. In the least favourable scenarios, this could severely affect economic activity.[1]

The impact of these factors has prompted a downward revision of economic growth projections across all geographical areas. The short-term outlook has worsened as a result of persistently high inflation rates, tighter financial conditions and protracted supply distortions. Beyond the next few quarters, economic growth is crucially dependent on the course of the war in Ukraine. If the uncertainty generated by the conflict were to abate, activity should pick up, in a

1 See J. Quintana (2022), "Economic consequences of a hypothetical suspension of Russia-EU trade", Analytical Articles, *Economic Bulletin* 2/2022, Banco de España.

setting in which there are emerging signs that the global production and transport bottlenecks could be easing and that inflationary pressures could be reaching their peak, as indicated by the fact that most commodity prices (which had soared to very high levels) have declined somewhat.

In the last few months, **Spain too has seen growing signs of loss of economic momentum.** The lifting of most of the pandemic-related restrictions drove activity in Q2 and paved the way for continued recovery in international tourism in the summer months. However, social security registrations, whose strength surprised on the upside in the first half of the year, decelerated in Q3. In addition, higher energy prices have gradually spread to an increasing share of the goods and services that make up the household consumption basket. This has reduced households' purchasing power, which in turn has given rise to weaker household expenditure indicators. Moreover, the high cost of energy commodities and supply insecurities are affecting production at the most electro-intensive industries. Overall, this decline in industrial and household income is also driving down demand for output at all other sectors. In any event, according to the latest edition of the Banco de España Business Activity Survey (EBAE by its Spanish acronym), the deterioration in activity perceived by firms in Q3 is highly uneven across sectors, with those that have benefited most from the lifting of the pandemic-related restrictions, such as hospitality and leisure,[2] recording the best performance.

Various factors will exert downside pressure on the economic growth outlook for the coming quarters. On top of persistent inflation, lower agents' confidence and continued high uncertainty, all of which are heavily influenced by the consequences of the current energy crisis and the war in Ukraine, inbound tourism will likely lose some momentum once the bulk of the pent-up post-pandemic demand has been met. In addition, external demand can be expected to weaken, against a backdrop of simultaneous monetary policy tightening in numerous countries.

Under certain assumptions – which are subject to great uncertainty – economic activity could become more dynamic from spring 2023. Specifically, throughout 2023, energy and food prices will moderate gradually (drawing on futures market trends), the supply bottlenecks and economic consequences of the war in Ukraine will ease (albeit very slowly) and the pass-through of higher costs and prices to final product prices and wage demands will be relatively contained. A larger relative roll-out of investment projects under the NGEU programme would also contribute to this economic recovery in Spain.

Under this scenario, Spanish GDP growth, after rising by 4.5% this year, will decelerate to 1.4% in 2023 and then head up again, in 2024, to 2.9%.[3] Meanwhile, the rate of growth of prices is revised up over the entire projection horizon, meaning that forecast inflation rates are now significantly higher and more persistent than some months ago. Specifically, inflation is expected to average 8.7% in 2022, and to moderate gradually thereafter, to 5.6% in 2023 and 1.9% in 2024. Naturally, this inflation outlook for Spain is also subject to extraordinary uncertainty and will depend, inter alia, on commodity price developments and on the wage and profit margin response to higher consumer prices and production costs.

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2 See M. Izquierdo (2022), "Encuesta a las empresas españolas sobre la evolución de su actividad: tercer trimestre de 2022", Notas Económicas, *Boletín Económico* 3/2022, Banco de España.

3 See Box 1, "Macroeconomic projections for the Spanish economy (2022-2024)", in this report.