

Editorial

The world economy has lost steam in the final stretch of the year, mainly as a result of the adverse impact on activity of the war in Ukraine, high inflation and the monetary policy response to persistently rising prices. That said, in a setting characterised by extraordinary uncertainty and multiple simultaneous adverse shocks, global economic activity seems to have shown considerable resilience in recent months. The factors behind this resilience appear to have included, among others, considerable labour market buoyancy in many of the main world economies and the fiscal measures deployed by the various national authorities in response to the energy crisis and rising inflation.

In recent months, the slowdown in world economic activity has contributed to some easing of the inflationary pressures stemming from commodity price developments. The prices of metal and food commodities have mostly tended to decline during the autumn months. As for energy commodities, the price of oil also fell during this period, while there were very pronounced falls in gas prices on European markets at the beginning of the autumn (when temperatures were relatively high for the time of year). In more recent weeks, however, the increase in demand for gas (and less favourable meteorological conditions) has led to a further rise in gas prices, showing once again how volatile they are.

The easing of energy commodity prices has begun to be passed through to the energy component of consumer prices, although this process has been markedly uneven across countries. The pass-through of the fluctuations in the wholesale prices of energy commodities to the energy component of consumer prices has generally been very uneven across countries. Among other reasons, this has been attributable to differences in the national regulation of energy markets and in the nature and forcefulness of the measures recently deployed by the authorities of each country to mitigate price increases. In this respect, the growth rates of the energy component of consumer prices have moderated appreciably in recent months in countries such as the United States and Spain. By contrast, they have moderated less in many other euro area economies, where the pass-through to retail energy prices of past rises in wholesale energy (and especially gas) prices is still not complete.

Despite the recent slowdown in the energy component of consumer prices, underlying inflation remains at very high levels in the main world economies and signs of a slowdown in this item are still very incipient. Also, the growth rate of food prices has generally continued to climb in recent months. Among the components of underlying inflation, the developments in the prices of non-energy industrial goods and services have recently shown signs of stabilising in many economies, partly as a result of the gradual easing of global production and logistics chain bottlenecks. However, the pass-through of past increases in the prices of energy and other imported inputs to the prices of these products is probably still not complete, so that it will continue to exert some upward pressure on such

prices in the short term. The higher wage demands recently discernible at international level also appear to be contributing to these inflationary pressures, although very unevenly across countries, essentially as a result of differences in labour market tightness and the prevalence of wage indexation mechanisms.

In the light of these developments, the world's main central banks (including the European Central Bank) have in recent meetings (many of which were held in mid-December) reaffirmed that they intend to continue tightening their monetary policy over the coming months. Their aim is to bring inflation rates back down to levels compatible with monetary policy objectives in the medium term and to avoid a de-anchoring of economic agents' medium-term inflation expectations that could damage growth prospects very severely and persistently.

As in recent months, international financial markets proved to be highly sensitive to these monetary policy decisions, in this case reacting with share price falls and bond yield increases. In fact, the prices of the main financial assets have in recent months displayed considerable volatility and have reacted relatively strongly to any development (in activity or price indicators, or in the communication of the central banks themselves) that might entail a change in the rate at which the main central banks are tightening their monetary policy. All this has generally been compatible with international capital markets operating in a relatively orderly fashion, although there have been some disruptive episodes and significant tightening in certain market segments and geographical areas.

In Spain, the buoyancy of economic activity in the final stretch of the year appears to have been similar to that in Q3. In line with global and European developments, the weakness of Spanish economic growth in Q4 appears to be explained essentially by heightened uncertainty, the deterioration in agents' confidence, inflationary pressures and tightening financial conditions. That said, aggregate economic activity in Spain has been buoyed, to some extent, by the continuing favourable labour market developments and the fiscal impulse deployed over the last few months. Moreover, across productive sectors, industrial production has been relatively stable, partly as a consequence of the considerable order backlog that built up when global production and supply chain bottlenecks were at their most severe.

The weakness of consumption is one of the main factors behind the modest GDP growth projected for Q4. In the current quarter, household spending is showing some weakness, with the disappearance of a large part of the stimulus to consumption (especially of tourism, leisure and hospitality-related services) arising from the practically complete removal of the restrictions associated with the pandemic during the first half of the year. Among other factors, this appears to be related to the loss of household purchasing power caused by the surge in prices (relative to that in incomes) and in interest rates (essentially for households paying interest on debt at variable rates). Also, against a background of declining confidence indicators and elevated uncertainty, the stock of savings built up during the pandemic appears to be barely contributing to aggregate household spending.

Since the summer, the rate of change of consumer prices, as measured by the HICP, has fallen substantially. Specifically, inflation fell by 4 percentage points between July and

November, mainly as a consequence of the slowdown in energy prices. Also contributing to the fall in the headline inflation rate has been a slight decline in the core component, although this still remains very high (4%). In this respect, inflationary pressures are still very widespread in the consumer goods and services basket, and the increases in the prices of energy and other imported inputs over the last few quarters do not yet appear to have been fully passed through to the final prices of many products. Against this background, it seems likely that underlying inflation rates will remain above 2% for a prolonged period.

In a highly uncertain macro-financial and geopolitical situation, the macroeconomic projections for Spain presented in Box 1 of this report envisage GDP growth rates of 4.6% in 2022, 1.3% in 2023, 2.7% in 2024, and 2.1% in 2025. According to these projections, economic activity will remain significantly weak in 2023 Q1, as a result of the same factors that have weighed on GDP growth in the second half of 2022. From 2023 Q2, however, economic growth is projected to strengthen progressively as, inter alia, agents' real incomes improve (due to the gradual decline in inflationary pressures), external markets recover and Next Generation EU investment projects are rolled out.

Within the framework of this projections exercise, the headline inflation rate is expected to slow from 8.4% in 2022 to 4.9% in 2023, to 3.6% in 2024 and to 1.8% in 2025. This path will be heavily conditioned by energy price developments over the coming quarters (which will in turn depend on a variety of factors, such as the course of the war in Ukraine, the temperatures experienced in Europe over the next two winters and the buoyancy of the Chinese economy), and also by the duration, design and forcefulness of current and future measures deployed to mitigate rising energy prices. One of the assumptions underlying these projections is that the pass-through of the cost and price increases observed over the past year and a half to wages and the other prices in the economy will remain moderate.