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MONTHLY REPORT • ECONOMIC AND FINANCIAL MARKET OUTLOOK
DECEMBER 2022

INTERNATIONAL ECONOMIES AND MARKETS

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BPI

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December 2022

The *Monthly Report* is a publication developed jointly by CaixaBank Research and BPI Research (UEEF)

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International economy: an improving outlook at the end of the year

As we close in on the end of a year characterised by uncertainty and volatility in economic and financial variables, the feeling is that the world economy is absorbing the effects of supply shocks, increased geopolitical risk, and the rise in interest rates much better than expected at the end of the summer. With the third quarter now confirmed as having closed in positive territory in most of the world's major economies (with the exception of Japan and the United Kingdom), the cooling of activity in recent weeks has been appreciable but less intense than anticipated, with the services sector offsetting both the general weakening of industry and the initial effects of rising interest rates on the more unbalanced housing markets. The downward adjustment of expectations also seems to have slowed, in a trend consistent with a significant cooling of activity but not with a generalised recession affecting employment.

Positive developments in global value chain bottlenecks since the summer (stocks have recovered) and the good performance of energy prices (gas and oil) have granted the first break in a long time to the supply constraints that have been weighing on the international economy for the last two years. Together with a continued positive tone in the labour market and the safety cushion of savings accumulated by households during the pandemic (1.5 trillion in the US alone), this is helping to moderate the downward adjustment in activity in the final weeks of the year. It is also helping to reduce the risk of stagflation, especially if, as it seems, prices begin to retreat from the highs reached in the autumn due to a mismatch between global supply and demand.

This is a favourable backdrop for central banks to take a breather after their December meetings to assess the effects on activity, financial stability and inflation of the largest tightening of financial conditions in decades. The monetary authorities have already used much of the firepower at their disposal, but it is not yet clear whether they have done enough to achieve their objectives, especially given the lags in monetary policy action. This pause could lead to a more surgical approach to the terminal rate, which may fall lower than expected by markets, but a further phase of rate hikes may also be necessary to keep inflation expectations in check if inflationary pressures intensify again. For now, it is also worth noting that, with much of the work done, a normalisation in monetary policy seems to be underway without any major financial crashes (except the UK mini-crisis). This is also the case in emerging markets, despite high levels of global debt.

So the positive news is that the central forecast scenarios drawn after the summer are becoming more likely, in most cases anticipating a slowdown in activity over the winter, but not a recession with job losses linked to energy rationing in Northern Europe. Many of these scenarios predicted that oil and natural gas prices at this time of year would be above their current actual levels, which means there is a margin of safety in the forecasts in case of possible negative surprises. In this regard, while all of winter is still ahead of us and it is too early to claim victory on the energy front, it seems that the risk profile is also changing to focus on the effects of the end of China's Covid-zero policy, and any possible complications in the final stages of the monetary normalisation process. More importantly, after a very complex year, we seem to be closing the period in a better situation than could have been expected only a few months ago, with supply shocks fading. Hopefully this will set the tone for the entire year of 2023.

Chronology

NOVEMBER 2022

2 The Fed raises official interest rates by 75 bps.
15 The world's population reaches 8 billion people.

OCTOBER 2022

5 OPEC agrees to cut crude oil production by 2 million barrels a day compared to August 2022 levels.
23 Xi Jinping receives a third term as general secretary of the Chinese Communist Party.
27 The ECB raises official interest rates by 75 bps.

SEPTEMBER 2022

8 Queen Elizabeth II dies after a 70-year reign.
16 The death of Mahsa Amini sparks a wave of mass protests in Iran.
27 Sabotage on the Nord Stream 1 and 2 gas pipelines.
30 The European Council approves measures to reduce energy demand.

AUGUST 2022

Summer 2022 Heat waves and drought in Europe and other countries around the world.
Summer 2022 Disruptions in the supply of Russian energy to Europe.
31 Mikhail Gorbachev, the last president of the USSR, dies.

JULY 2022

7 Boris Johnson resigns as prime minister of the United Kingdom.
8 Assassination of Shinzō Abe, former Japanese prime minister.
28 Mario Draghi resigns as prime minister of Italy.

JUNE 2022

26 G7 summit in Germany where the war in Ukraine and energy were top of the agenda.
28 NATO summit in Madrid where Russia is identified as the greatest direct threat.
30 Russia makes gains in establishing control of the Donbas.

Agenda

DECEMBER 2022

2 Spain: rating Fitch.
Spain: registration with Social Security and registered unemployment (November).
Portugal: industrial production (October).
13-14 Federal Open Market Committee meeting.
15 Governing Council of the European Central Bank meeting.
15-16 European Council meeting.
16 Spain: quarterly labour cost survey (Q3).
23 Spain: quarterly national accounts (Q3).
Spain: loans, deposits and NPL ratio (October and Q3).
Spain: balance of payments and NIIP (Q3).
Spain: state budget execution (November).
Portugal: home prices (Q3).
Portugal: household savings rate (Q3).
29 Portugal: NPL ratio (Q3).
30 Spain: CPI flash estimate (December).
Spain: household savings rate (Q3).
Portugal: CPI flash estimate (December).

JANUARY 2023

3 Spain: registration with Social Security and registered unemployment (December).
6 Portugal: employment and unemployment (November).
Euro area: economic sentiment index (December).
9 Portugal: turnover in industry (November).
11 Spain: financial accounts (Q3).
21 Spain: loans, deposits and NPL ratio (November).
26 US: GDP (Q4 and 2022).
Spain: labour force survey (Q4).
27 Spain: GDP flash estimate (Q4).
Euro area: economic sentiment index (January).
30 Portugal: business and consumer confidence indicator (January).
Spain: CPI flash estimate (January).
31 Portugal: GDP flash estimate (Q4).
Portugal: CPI flash estimate (January).
Euro area: GDP (Q4).
31-1 Federal Open Market Committee meeting.

Outlook better than expected, on the eve of a New Year

While the main indicators for the Portuguese economy improved slightly over the last month, any reading is hampered by the enormous volatility of some data and trends retain a downward risk. Nevertheless, this helps to allay fears of a sharp fall in activity and even opens the door to the possibility of ending the year without a fall in GDP. There has been good news on several fronts. We have revised our growth forecast for 2022 slightly upwards, by 4 decimal points to 6.7%. Though pressure on economic activity, and especially on consumption and investment, will remain high as long as inflation does not fall in a sustained way. The rapid increase in ECB interest rates will also test resilience in the coming quarters.

At the sectoral level, signs have been mixed, with industry showing some decline (industrial production fell in year-on-year terms in October) and services showing signs of greater resilience, albeit slowing down somewhat. Of particular note are household consumption indicators, which remain on positive ground, with electronic withdrawals and payments and car sales (both with double-digit year-on-year growth) standing out, although retail sales almost stabilised in October. It is also worth mentioning confidence indicators, which improved across the board in November (though remaining at low levels), with the exception of the consumer confidence index, which remains close to the level registered at the beginning of 2020.

Among other positive news are the first signs of a possible decrease in the inflation rate, though still to be confirmed, and persistent robustness in the labour market. With regard to inflation, the overall rate fell by two tenths in November, to 9.9%, though this was mainly due to the decline in energy prices. Indeed, the underlying index, which is made up of factors with more persistent behaviour, maintained a marginal upward trend, rising from 7.1% to 7.2% in November. While we assume prices will remain under pressure in the coming months, there is reason to believe in a reversal of trajectory, which should be more evident by the spring of 2023. If confirmed, this would bring significant relief to families and companies and help sustain domestic demand.

The labour market also remains resilient, with employment rising, unemployment contained and the unemployment rate marginally down year-on-year in October (2 decimal points, to 6.1%). Particularly noteworthy is employment, which in October remained close to the maximum levels of the series and around 2.3% above pre-pandemic values. Similarly, the employment rate (which measures the proportion of employed persons in the total number of people of working age) remains close to all-time highs, slightly below 64%. Still, there are some signs of stabilisation or even of trend reversal, in line with our outlook of a slight increase in the unemployment rate in 2023. For example, registered unemployment rose for the third consecutive month in October (although still falling year-on-year, and below pre-pandemic levels), and job vacancies registered at job centres fell again in October (25.7% year-on-year and 8% monthly).

Yet despite these signs, to which it is important to be alert, there is no doubt that the robustness of the labour market has been a fundamental support during this phase, supporting family consumption, which up to September was sitting at around 3.4% above the pre-pandemic levels. The reading is similar if we look at disposable household income, as this has barely registered any losses since the start of the pandemic, with year-on-year growth of 4.7% at the end of the first half this year, in stark contrast to the evolution of this aggregate during the sovereign debt crisis, when losses of around 7.5% took place between 2010 and 2014. Additionally, we recall that unemployment was over 17% in 2013.

In short, in real terms, there is no doubt that the adjustment of household income has been very significant, with the nominal expansion that has taken place only partially compensating for inflation. However, the manner in which this impact is distributed across the population is very different from previous crises. A decade ago a significant part of the adjustment was concentrated on the population that lost its job. This time, in contrast, the resilience of the labour market is allowing the impact of the crisis to be transmitted more evenly across the population. In line with this, income inequality metrics have improved since 2015 (the earliest year in the INE series), with the gap between the bottom and top income decile (net of personal income tax) improving by almost 1 point by 2020, to 5.6.

In short, despite current uncertainties and the difficulties faced by many families and companies, the economic indicators at the end of the year offer some hope, as do the more structural trends.

Paula Carvalho

Average for the last month in the period, unless otherwise specified

Financial markets

	Average 2000-2007	Average 2008-2019	2020	2021	2022	2023	2024
INTEREST RATES							
Dollar							
Fed funds (upper limit)	3.43	0.81	0.25	0.25	4.50	4.75	3.50
3-month Libor	3.62	1.01	0.23	0.21	4.75	4.75	3.50
12-month Libor	3.86	1.48	0.34	0.52	4.90	4.50	3.50
2-year government bonds	3.70	1.04	0.13	0.62	4.20	4.00	3.00
10-year government bonds	4.70	2.57	0.93	1.45	3.80	3.50	3.00
Euro							
ECB depo	2.05	0.20	–0.50	–0.50	2.00	2.50	2.00
ECB refi	3.05	0.75	0.00	0.00	2.50	3.00	2.50
€STR	–	–0.54	–0.56	–0.58	1.92	2.47	2.17
1-month Euribor	3.18	0.50	–0.56	–0.60	2.03	2.53	2.23
3-month Euribor	3.24	0.65	–0.54	–0.58	2.14	2.59	2.29
6-month Euribor	3.29	0.78	–0.52	–0.55	2.35	2.66	2.40
12-month Euribor	3.40	0.96	–0.50	–0.50	2.56	2.73	2.51
Germany							
2-year government bonds	3.41	0.35	–0.73	–0.69	1.75	2.25	2.25
10-year government bonds	4.31	1.54	–0.57	–0.31	2.00	2.70	2.70
Spain							
3-year government bonds	3.62	1.69	–0.57	–0.45	2.23	2.77	2.80
5-year government bonds	3.91	2.19	–0.41	–0.25	2.47	3.04	3.05
10-year government bonds	4.42	3.17	0.05	0.42	3.30	3.80	3.70
Risk premium	11	164	62	73	130	110	100
Portugal							
3-year government bonds	3.68	3.33	–0.61	–0.64	2.41	3.02	3.08
5-year government bonds	3.96	3.94	–0.45	–0.35	2.70	3.28	3.30
10-year government bonds	4.49	4.68	0.02	0.34	3.35	3.85	3.75
Risk premium	19	314	60	65	135	115	105
EXCHANGE RATES							
EUR/USD (dollars per euro)	1.13	1.26	1.22	1.13	1.00	1.05	1.10
EUR/GBP (pounds per euro)	0.66	0.84	0.90	0.85	0.87	0.86	0.85
OIL PRICE							
Brent ($/barrel)	42.3	80.1	50.2	74.8	95.0	94.0	83.0
Brent (euros/barrel)	36.4	62.5	41.3	66.2	95.0	89.5	75.5

Forecasts

Change in the average for the year versus the prior year average (%), unless otherwise indicated

International economy

	Average 2000-2007	Average 2008-2019	2020	2021	2022	2023	2024
GDP GROWTH							
Global	4.5	3.3	–3.0	6.0	3.1	2.7	3.4
Developed countries	*2.6*	*1.4*	*–4.4*	*5.2*	*2.6*	*1.0*	*1.7*
United States	2.7	1.7	–2.8	5.9	1.6	1.1	1.7
Euro area	2.2	0.8	–6.3	5.3	3.2	0.2	1.6
Germany	1.6	1.2	–4.1	2.6	1.8	–0.2	1.2
France	2.2	1.0	–7.9	6.8	2.5	0.6	1.5
Italy	1.5	–0.3	–9.1	6.7	3.7	–0.2	1.0
Portugal	1.5	0.5	–8.3	5.5	6.3	0.5	2.3
Spain	3.7	0.6	–11.3	5.5	4.5	1.0	1.9
Japan	1.4	0.4	–4.6	1.7	1.5	1.7	1.2
United Kingdom	2.6	1.3	–11.0	7.5	4.4	–1.4	–0.4
Emerging and developing countries	*6.5*	*4.9*	*–1.9*	*6.6*	*3.5*	*3.9*	*4.5*
China	10.6	8.0	2.2	8.1	3.0	5.2	5.0
India	7.2	6.8	–6.7	9.0	7.3	6.0	6.7
Brazil	3.6	1.6	–3.9	4.6	1.8	0.9	1.8
Mexico	2.4	1.9	–8.1	4.8	1.9	1.4	2.5
Russia	7.2	1.3	–2.7	4.8	–8.1	–3.2	3.0
Turkey	5.5	4.5	1.9	11.4	3.1	3.0	3.2
Poland	4.2	3.6	–2.1	6.0	4.1	1.0	4.8
INFLATION							
Global	4.1	3.7	3.2	4.7	8.6	6.0	4.1
Developed countries	*2.1*	*1.6*	*0.7*	*3.1*	*7.2*	*4.0*	*2.0*
United States	2.8	1.8	1.2	4.7	8.0	3.4	2.0
Euro area	2.2	1.4	0.3	2.6	8.1	5.1	2.1
Germany	1.7	1.4	0.4	3.2	8.2	5.2	2.2
France	1.9	1.3	0.5	2.1	5.9	4.1	2.0
Italy	2.4	1.4	–0.1	1.9	7.7	4.8	2.0
Portugal	3.1	1.1	0.0	1.3	7.9	5.7	2.2
Spain	3.2	1.3	–0.3	3.1	8.5	4.6	2.3
Japan	–0.3	0.4	0.0	–0.2	2.2	1.9	1.0
United Kingdom	1.6	2.3	0.9	2.6	8.9	5.5	2.3
Emerging countries	*6.7*	*5.6*	*5.1*	*5.9*	*9.7*	*7.4*	*5.6*
China	1.7	2.6	2.5	0.9	1.9	1.8	1.6
India	4.5	7.3	6.6	5.1	6.7	5.3	5.0
Brazil	7.3	5.7	3.2	8.3	10.5	5.1	4.0
Mexico	5.2	4.2	3.4	5.7	7.2	4.7	3.8
Russia	14.2	7.9	3.4	6.7	14.7	7.5	6.8
Turkey	22.6	9.6	12.3	19.6	69.3	36.4	29.0
Poland	3.5	1.9	3.7	5.2	11.9	7.0	3.7

Forecasts

Change in the average for the year versus the prior year average (%), unless otherwise indicated

Portuguese economy

	Average 2000-2007	Average 2008-2019	2020	2021	2022	2023	2024
Macroeconomic aggregates							
Household consumption	1.7	0.5	–6.9	4.7	5.0	0.5	2.0
Government consumption	2.3	–0.3	0.4	4.6	2.0	–0.2	–0.2
Gross fixed capital formation	–0.4	–0.7	–2.2	8.7	1.7	3.8	8.4
Capital goods	3.2	2.6	–5.4	13.9	–	–	–
Construction	–1.5	–2.6	1.0	5.5	–	–	–
Domestic demand (vs. GDP Δ)	1.3	0.1	–5.3	5.8	4.0	0.9	2.9
Exports of goods and services	5.3	4.0	–18.8	13.5	16.5	4.3	6.6
Imports of goods and services	3.6	2.7	–11.8	13.3	10.1	5.0	7.8
Gross domestic product	**1.5**	**0.5**	**–8.3**	**5.5**	**6.3**	**0.5**	**2.3**
Other variables							
Employment	0.4	–0.5	–1.9	2.7	1.6	–0.3	0.5
Unemployment rate (% of labour force)	6.1	11.4	7.0	6.6	5.9	6.4	6.1
Consumer price index	3.1	1.1	0.0	1.3	7.9	5.7	2.2
Current account balance (% GDP)	–9.2	–2.9	–1.2	–1.1	–2.7	–2.3	–1.7
External funding capacity/needs (% GDP)	–7.7	–1.6	0.1	0.7	2.1	2.1	2.3
Fiscal balance (% GDP)	–4.6	–5.1	–5.8	–2.9	–1.5	–1.3	–0.7

Forecasts

Spanish economy

	Average 2000-2007	Average 2008-2019	2020	2021	2022	2023	2024
Macroeconomic aggregates							
Household consumption	3.6	0.0	–12.4	6.0	1.9	0.7	2.3
Government consumption	5.0	1.1	3.5	2.9	–1.8	0.7	0.7
Gross fixed capital formation	5.6	–1.4	–9.7	0.9	5.2	1.7	2.1
Capital goods	4.9	0.1	–13.3	6.3	6.2	0.5	3.1
Construction	5.7	–2.9	–10.2	–3.7	4.3	2.5	1.5
Domestic demand (vs. GDP Δ)	4.9	–0.3	–4.5	4.9	1.6	0.9	1.9
Exports of goods and services	4.7	2.9	–19.9	14.4	17.9	2.3	1.9
Imports of goods and services	7.0	0.2	–14.9	13.9	9.3	2.4	1.9
Gross domestic product	**3.7**	**0.6**	**–11.3**	**5.5**	**4.5**	**1.0**	**1.9**
Other variables							
Employment	3.2	–0.4	–6.8	6.6	3.7	0.6	1.3
Unemployment rate (% of labour force)	10.5	19.5	15.5	14.8	12.8	13.1	12.8
Consumer price index	3.2	1.3	–0.3	3.1	8.5	4.6	2.3
Unit labour costs	3.0	0.6	7.7	0.3	0.7	3.1	2.0
Current account balance (% GDP)	–5.9	–0.3	0.6	1.0	0.5	0.5	1.1
External funding capacity/needs (% GDP)	–5.2	0.1	1.1	1.9	1.5	1.5	2.0
Fiscal balance (% GDP)[1]	0.3	–6.5	–10.3	–6.9	–4.5	–4.3	–3.6

Note: *1. Excludes losses for assistance provided to financial institutions.*

Forecasts

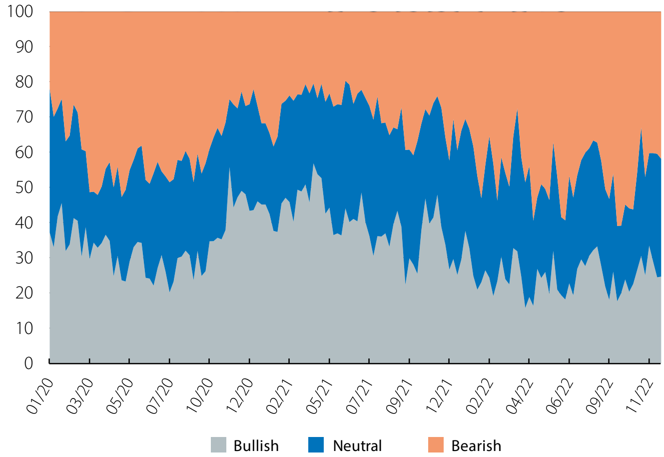
Autumn rally in the financial markets

Investor optimism consolidates in November. As was the case in late October, the performance of risk assets was driven by a positive tone among investors during much of November. Some of the main factors behind this optimism included signs of moderation in the inflationary tensions, the somewhat less pronounced slowdown in economic activity and the tentative stabilisation of the energy markets, as well as the confirmation that the trajectory of fiscal policy in some countries (such as Italy and the United Kingdom) looks set to remain in line with monetary policy objectives. Even in China, which is facing a difficult health situation, the authorities gave slight glimpses of a possible relaxation of its zero-COVID policy. In this context, the major central banks appeared to be in favour of reducing the pace of monetary tightening. In the financial markets, expectations of a possible pivot in monetary policy triggered a rally in international stock markets and in fixed-income assets, as well as a depreciation of the dollar. This optimism helped to reduce the cumulative losses in the year, albeit in a highly uncertain and volatile environment.

The Fed could adopt a less aggressive stance. The minutes of the FOMC's November meeting reflected a somewhat more relaxed tone regarding the future path of monetary policy. The Fed members supported further rate hikes at the upcoming meetings, but were open to a reduction in the pace of the increases after having already introduced four consecutive 75-bp rises. This «pivot» to a less aggressive stance was corroborated by Jerome Powell himself, who stated that there could be a change in the pace of monetary tightening as soon as the December meeting. However, Powell also warned that, despite the slight yield in inflation, it remains very high and the labour market is showing little sign of slowing down, which justifies further interest rate hikes (alluding to the possibility of keeping rates somewhat higher and for a little longer). Nevertheless, the financial markets are assuming that the Fed will slow the process of rate hikes in December (with a 50-bp increase up to the 4.25%-4.50% range), and that by the end of 2023 it will once again stand at around 4.50%, almost 0.5 pps lower than that forecast in October. This shift in expectations contributed to the reduction in US sovereign debt yields from the highest levels of the year. In November, the yield on the 10-year bond dropped by more than 40 bps, to around 3.6%, while in the case of the 2-year bond it fell by around 20 bps, to around 4.3%.

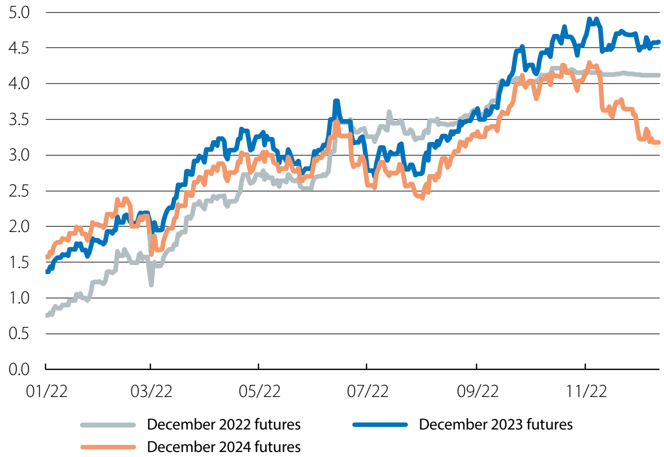
The ECB also hints at further rate hikes, but at a slower pace. In the euro area, the minutes of the monetary authority's meeting showed its members' support for the 75-bp interest rate hike implemented in October. With regard to the forthcoming meetings, however, it was clear that opinions were divided over how to manage the tightening of financial

US: market sentiment
(%)



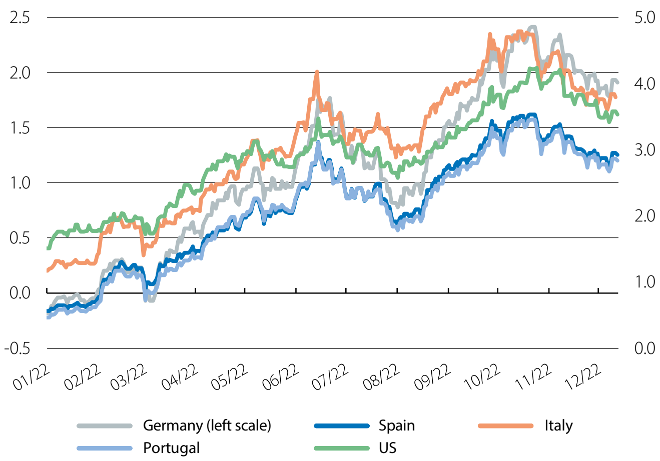
Note: *Percentage of respondents to the American Association of Individual Investors survey regarding their sentiment: optimistic (bullish), neutral or pessimistic (bearish).*
Source: *BPI Research, based on data from Bloomberg.*

Federal Reserve reference interest rate futures
(%)



Source: *BPI Research, based on data from Bloomberg.*

Yields on 10-year sovereign debt
(%) (%)



Notes: *US, Spain, Italy and Portugal, right-hand scale. Data as of 9 December.*
Source: *BPI Research, based on data from Bloomberg.*

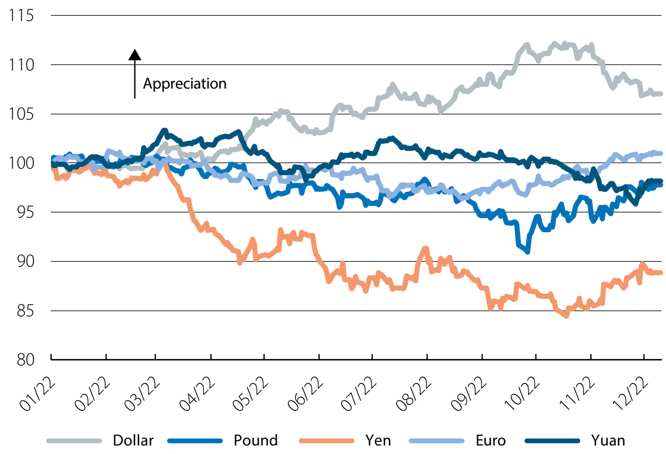
conditions in a scenario marked by inflation that remains very high and the emergence of downside risks to economic activity. Nevertheless, just as in the US, the markets anticipate a moderation in the cycle of rate hikes in the upcoming meetings, with a 50-bp increase expected at the December meeting (bringing the depo rate to 1.00% and the refi rate to 2.50%). This movement led to a widespread decline in euro area sovereign debt yields in the long sections of the curve, albeit to a lesser extent than in the case of US debt.

The dollar offers a respite. The spread of risk-on sentiment, driven by the optimism in the financial markets mentioned earlier, eased the buying pressure on the dollar which it had been experiencing since Q2 with the beginning of the Fed's rate hikes and the outbreak of war in Ukraine. This favoured the appreciation of the euro, which consolidated its exchange rate above parity against the dollar. The pound sterling also appreciated significantly against the dollar, by more than 5% in November, reflecting a good reception among investors regarding the fiscal measures announced by the new prime minister Rishi Sunak.

Oil and gas prices drop. Uncertainty surrounding future crude oil demand in a context of slower economic growth led to the oil price falling by 10% in November. This trend was reversed in early December as a result of the emergence of signs of a possible relaxation of the health policy in China, the start of the EU embargo on Russian crude oil (see the Focus «Europe and the mission to decouple from Russian oil: an achievable goal in the short-term» in the MR10/2022) and the imposition of a price cap on Russian oil by the G7. Specifically, the EU and the G7 agreed not to buy Russian oil transported by sea above 60 dollars a barrel. This measure came into force on 5 December, although an extension is given until 19 January for vessels that were loaded before that date. The European gas price, meanwhile, fell once again in November on average, favoured by the high levels of inventories amassed by the EU and a relatively warm autumn. However, in late November and early December, gas prices began to climb as temperatures fell in Europe.

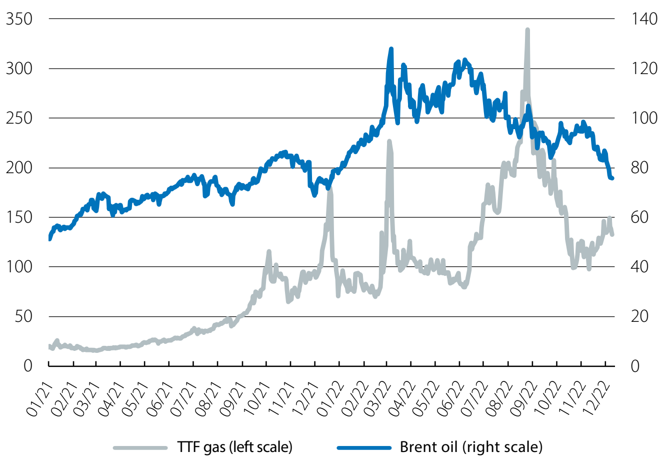
The improvement in investor sentiment supports a stock market rally. For the second consecutive month, the major stock market indices performed well and recovered some of the losses accumulated during the year. In addition to the factors mentioned above, this improvement was also favoured by the end of the Q3 business earnings campaign, which resulted in a higher balance of profits than that expected by the consensus of analysts. The gains also extended to the emerging country indices, with the MSCI Emerging Markets index closing November up around 15%. Part of this rally was due to the gains registered in China's stock markets, which benefited from government measures aimed at supporting the real estate sector, as well as expectations of a less stringent approach to COVID that would favour the Asian giant's economic recovery.

Currencies: effective exchange rates
Index (100 = January 2022)



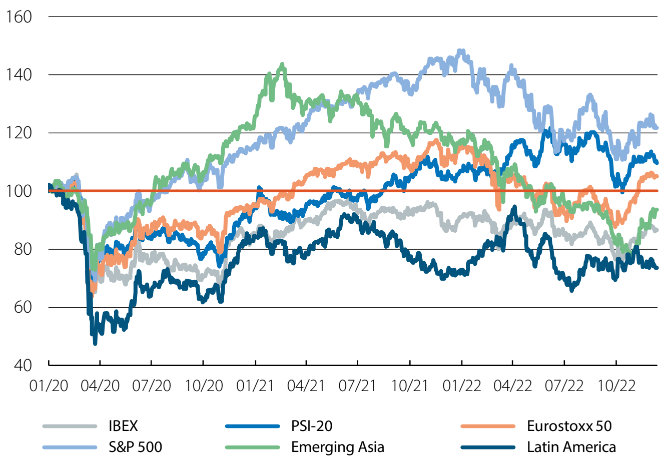
Note: *Data as of 9 December.*
Source: *BPI Research, based on data from Bloomberg.*

Natural gas and oil prices
(Euros per MWh) *(Dollars per barrel)*



Note: *Data as of 9 December.*
Source: *BPI Research, based on data from Bloomberg.*

Main international stock markets
Index (100 = January 2020)



Note: *Data as of 9 December.*
Source: *BPI Research, based on data from Bloomberg.*

The impact of higher agricultural commodity prices on emerging and low-income countries

After several years of stability, international food prices peaked in the spring of 2022 following the outbreak of the war in Ukraine. The rally began in Q4 2020 and intensified in 2021 with the increase in energy prices, disruptions to global supply chains following the pandemic and extreme weather events that reduced harvests. Subsequently, between March and May of this year following the invasion of Ukraine, prices rose to record highs due to the disruption in the flows of agricultural commodities from two of the world's leading exporters.[1] Today, almost 10 months after the start of the war, a large part of the trade flows through the Black Sea have been restored,[2] while fears about interruptions in basic food supplies have also subsided. As a result, prices of agricultural goods, particularly cereals, have fallen since that peak reached in the spring (wheat by more than 40% and corn by around 20%), despite still remaining around 30% above the average for the last five years.

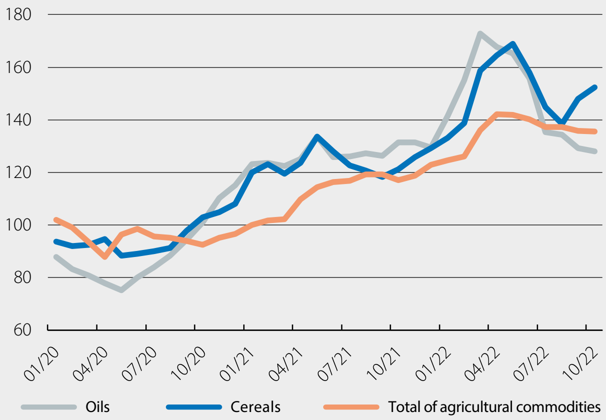
However, the relative improvement in international prices of agricultural goods has barely been reflected in global consumer prices. The main reason for this is the depreciation of many countries' currencies against the dollar. In particular, this depreciation intensified with the Fed's first interest rate hike, and it has led to higher commodity prices in local currencies relative to their US-dollar price.[3] As an example, while the price of corn went from 650 to 789 dollars per bushel between February and May, the price in Turkish lira rose from 9,014 to 12,592 over the same period. This aspect also helps to explain why the upward pressure exerted by domestic food prices on countries' inflation rates has persisted.

The surge in agricultural prices does not affect all countries alike

Rising food prices, coupled with rising energy prices, have eroded consumers' purchasing power over the past 12 months around the world. But the impact has not been the same in all countries. According to the IMF,[4] food products account for a larger portion of consumer spending in low-income countries than they do in high-income countries. Whereas in the former the average expenditure on food reaches as high as 44% of disposable income,[5] in emerging economies this percentage is around 28% and in developed economies it drops to 16%. This uneven distribution has been reflected in the significant increase in inflation rates in lower-income countries and in some emerging countries, reaching double digits in most cases. In addition, the support from governments to limit the negative impact of price increases on real incomes has also been uneven. The fiscal effort of emerging and lower-income countries during the pandemic has significantly reduced the scope

Agricultural commodities: prices

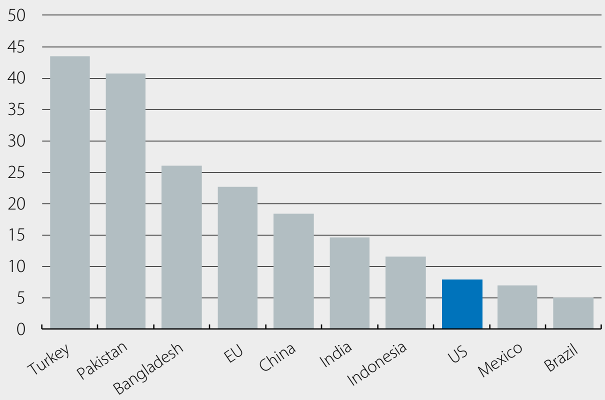
Index (100 = January 2010)



***Source:** BPI Research, based on data from the FAO and Bloomberg.*

Wheat: price change in local currency

(%)



***Note:** Percentage change in prices between February and September 2022.*
***Source:** BPI Research, based on data from the World Bank.*

1. According to data from the Food and Agriculture Organization of the United Nations (FAO), Russia and Ukraine account for a quarter of the world's wheat exports, one fifth of barley and corn exports and over half of sunflower oil exports, and they supply around one-eighth of all the calories traded in the world.
2. The Black Sea Grain Initiative signed between the United Nations, Russia and Ukraine in July 2022 has allowed Ukraine to export over 11 million tons of agricultural goods by sea to date since August.
3. Since the 1980s, most commodities are traded in international markets in US dollars.
4. See IMF (2022). «Fiscal Policy for mitigating the social impact of high energy and food prices» (June).
5. Low-income countries are found all around the world, although sub-Saharan Africa is where the largest number of these countries are concentrated.

for action of their fiscal policies. So far this year, 44% of these economies have implemented price measures, compared to 84% in the case of advanced economies.

The surge in food prices in the group of less-favoured countries not only has an impact on inflation, but also extends to other areas of the economy and highlights their vulnerability to the volatility of international food prices. At the macroeconomic level, the price rally leads to a decline in the rate of growth.[6,7] In addition, as observed in the food crisis of 2008-2009, rising food costs tend to coincide with episodes of currency weakness, and this accentuates the tightening of domestic financial conditions and exacerbates the trade deficit in these countries (75% of emerging and low-income countries are net importers of agricultural commodities). At the microeconomic level, rising food prices reduce households' purchasing power, lead to greater social inequality (in terms of access to food), and exacerbate poverty.

Food security: a key issue

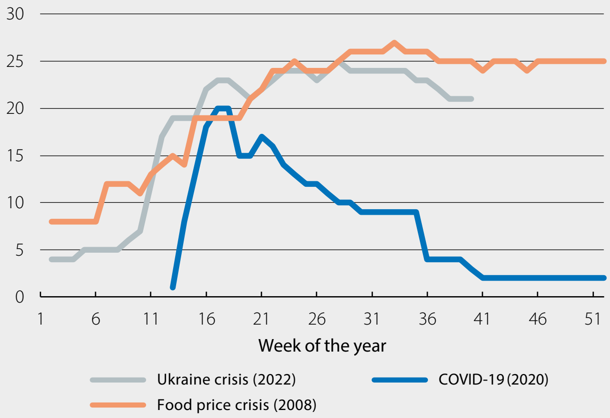
The World Bank estimates that international prices of agricultural commodities will fall by an average of 5% in 2023, as a result of the gradual return of export flows from Ukraine and the moderation of demand in the context of a slowdown in the global economy, before later stabilising in 2024. However, despite this dynamic, prices of the main cereals (wheat, corn and rice) are expected to remain above their historical average, in view of the fall in global grain production between 2022 and 2023, which could reach 2.3% (57 million metric tons) according to the US Department of Agriculture.

Nevertheless, in the face of high geopolitical and economic uncertainty, there are risks that could lead to further price rallies. In addition to the war in Ukraine, which could lead to a fall in Ukraine's agricultural production of up to 45% between 2022 and 2023, these risks also include: the persistence of inflationary pressures worldwide, the appreciation of the dollar, continued high energy costs – not only crude oil and natural gas, but also fertilizers –, the diversification towards crops for biofuel generation, the restrictive trade policies of some exporting countries in an attempt to control domestic prices, and increasingly extreme weather events such as La Niña.

Moreover, rising food prices – accentuated by the war – have contributed to an increased risk of food crises in many emerging and low-income countries (especially in sub-Saharan Africa, the main importers of Russian and Ukrainian grain), as well as accelerating the process of food insecurity[8] in certain parts of the world (led by sub-Saharan Africa, Eastern Europe, Central Asia, and Latin America). In addition to posing a serious humanitarian problem,[9] this aspect could slow these countries' economic growth in the medium term.

Trade: countries prohibiting exports of agricultural goods

Number of countries



Source: *BPI Research, based on data from IFPRI.*

6. See World Bank. «Commodity Markets Outlook. Food Price Shocks: Channels and Implications» (worldbank.org).
7. The exception to this trend is observed in net commodity exporting countries. For example, Brazil is one of the five largest net exporters in the world. Exports of agricultural goods account for 37% of its total exports and grew at a rate of 9.4% per year over the last two decades.
8. According to the FAO, food insecurity occurs when people do not have regular and permanent access to food of sufficient quantity and quality to survive.
9. Estimates by the Food Security Information Network suggest that over 200 million people around the world were in a situation of food insecurity as of September 2022.

The big data dependence of the markets and monetary policy

In 2022, the central banks have implemented aggressive interest rate hikes in a pattern not seen since the 1980s. More stealthily, another monetary policy tool has had an equally virulent impact on the financial markets: communication. We only have to go back to 10 November 2022. At that session, the 10-year US sovereign interest rate collapsed by 30 bps, marking its biggest daily decline since 2009 and the second sharpest in the last 35 years. The cause, a seemingly harmless surprise: the US inflation figure for October, at a high 7.9% year-on-year, was 2 percentage points lower than expected by the analyst consensus. Those 2 percentage points, however small, reverberated through the international financial markets.[1] After all, given the uncertainty in the current economic environment and the reorientation in central banks' communication tools, investors are hungry for information that can help them get a sense of what monetary policy might do next.

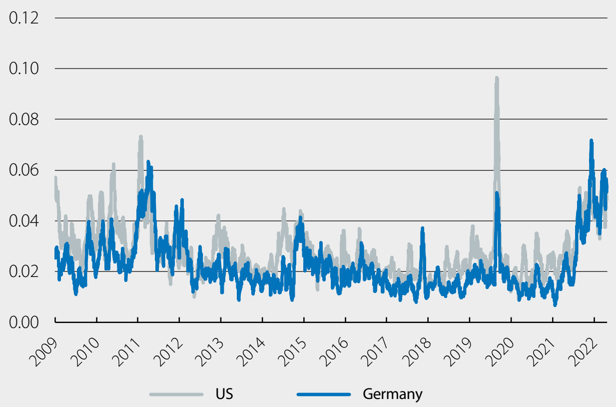
Monetary policy communication: a tool being reoriented

This communicative reorientation has gone through three phases. At the end of 2021, the central banks were still giving fairly explicit messages about what path interest rates would take, and they did so in both the short and the long term. At the beginning of 2022, under pressure due to the persistence and intensity of the inflation rally, they became explicit about their intention to aggressively raise interest rates at their upcoming meetings. Finally, in recent months, the explicitness has once again waned: the latest messages continue to point towards further rate hikes, but highlight the uncertainty of the environment and advocate a more flexible approach to decision-making.

As an example, in late 2021, the US Fed stated that it was appropriate to maintain a dovish monetary policy until the labour market reached full employment and inflation was slightly above 2%, exceeding this level for quite some time. In Europe, the ECB adopted a similar strategy: it would keep rates at historical lows until 2% inflation was projected on a sustained basis (which, according to market rate expectations, would still take 1 to 2 years to occur). In 2022, they quickly changed course, but the message on rates remained relatively explicit: the Fed raised rates in March and declared that it would continue to do so over the coming months, while the ECB began to signal the same message between June and July. Thus, they will have ended 2022 with cumulative increases of more than 400 and 200 bps, respectively. At this point, both institutions are still indicating that further rate hikes lie ahead, but that automatic pilot has been disengaged and decisions will be taken «meeting by meeting» and be «data-dependent».

1. There was a high degree of contagion to the interest rates of other countries. For example, in Germany the 10-year sovereign rate fell by more than 15 bps, while Spain's rate dropped by 20 bps and Italy's collapsed by almost 30 bps.

Daily fluctuation of the 10-year interest rate
30-day moving average (pps)



Note: *Average of the daily fluctuation in absolute value in 30-day windows.*
Source: *BPI Research, based on data from Bloomberg.*

Germany: sensitivity of sovereign rates to domestic inflation surprises *
(p. b.)

Note: ** The sensitivity corresponds to the coefficient ß estimated in 30-month windows using the regression $\Delta i_t = a + ß(\pi_t - \pi^e_t) + \varepsilon_t$, where Δi_t is the daily fluctuation of the interest rate, π_t is the observed inflation figure, and π^e_t is the inflation expected by the Bloomberg consensus.*
Source: *BPI Research, own calculations based on data from Bloomberg.*

All this results in less predictability – an approach that is necessary for monetary policy to respond quickly and appropriately to developments in the economic environment, but which accentuates uncertainty and helps to explain the heightened volatility in market interest rates (see first chart).[2,3]

Market sensitivity

The Fed and ECB are putting the evolution of the data at the forefront of their upcoming decisions, especially developments in inflation – hence the market's hypersensitivity on 10 November. But this sensitivity is

2. Relative measures of volatility (i.e. taking into account the starting level of interest rates) have also settled in 2022 at above pre-pandemic levels (e.g. the coefficient for the fluctuation of the US rate is 90% higher than the average for the period 2017-2019).
3. A complementary explanation for the higher volatility in interest rates is the lower liquidity in various bond markets, such as in the Treasuries market. See Michael Fleming and Claire Nelson, «How Liquid Has the Treasury Market Been in 2022?», Federal Reserve Bank of New York Liberty Street Economics, 15 November 2022.

not a one-day anecdote: it has steadily increased throughout 2022.

As we see in the second and third charts, the interest rates on 2- and 10-year debt in recent months have become more reactive to inflation surprises in both Germany and, above all, the US.[4] Also, as the fourth chart shows, the sensitivity of German interest rates to surprises in the US inflation data has also been increasing, showing what appears to be a stronger correlation between the US treasury and the German *bund*.[5] One consequence of this volatility in rates is that caution must be exercised when trying to infer market expectations on the basis of prices in the financial markets: beyond monetary policy expectations, these interest rates are likely to incorporate risk premia due to the uncertainty regarding the current environment.

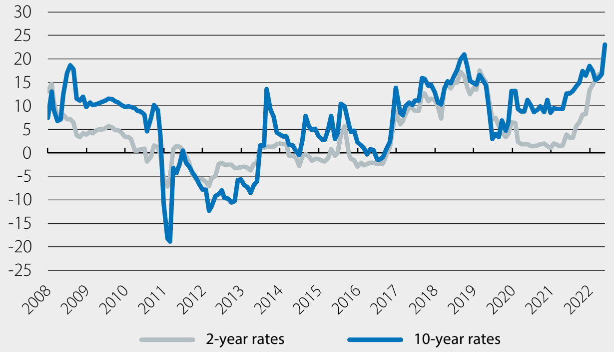
Similarly, in the last chart we can also see how the sensitivity of other types of assets in 2022 has been very different to the average observed in other periods. Particularly pronounced is the change in the sensitivity of the US stock market to inflation surprises: not only has it increased (in absolute terms), but it has also changed sign. One possible explanation for this shift is that, whereas inflation above the consensus expectation in the period 2016-2021 could signal a more dynamic economy, and thus a better outlook for corporate earnings, a similar surprise today implies the expectation of a more restrictive monetary policy, with the associated negative impact on growth and stock-market performance.[6] On the other hand, the negative sensitivity of the exchange rate is consistent with the fact that higher-than-expected inflation causes the dollar to appreciate due to the expectation of rate hikes in the US.

Finally, it is important to note that surprises in the inflation statistics impact short-term inflation expectations (identified in this case by inflation swaps for the next two years), while they do not appear to have any significant impact on medium- and long-term expectations (identified by the 5-year, 5-year inflation swap). This shows that, despite an exceptional economic and financial environment and high inflation, the central banks are managing to uphold their credibility and keep inflation expectations close to the 2% target.

4. In these exercises, the estimated sensitivity corresponds to the coefficient β of the regression $\Delta i_t = a + \beta(\pi_t - \pi_t^e) + \varepsilon_t$, where Δi_t indicates the change in the interest rate on the sovereign bond (US and German 2- and 10-year bonds) on the day the inflation data is published, π_t is the observed inflation (the flash indicator in the case of Germany) and π_t^e is the inflation expected by the Bloomberg consensus. We estimate the regression using data from the 30 months prior to *t* and we show the value of the parameter β over time.
5. One possible interpretation of this stronger correlation is that the markets read the US signals as clues about the future of Europe.
6. As for sovereign risk premia, in 2016-2021 they tended to narrow in response to higher-than-expected inflation, while in 2022 no significant response is apparent.

US: sensitivity of sovereign rates to domestic inflation surprises *

(bps)



Note: ** The sensitivity corresponds to the coefficient ß estimated in 30-month windows using the regression $\Delta i_t = a + \beta(\pi_t - \pi_t^e) + \varepsilon_t$, where Δi_t is the daily fluctuation of the interest rate, π_t is the observed inflation figure, and π_t^e is the inflation expected by the Bloomberg consensus.*
Source: *BPI Research, own calculations based on data from Bloomberg.*

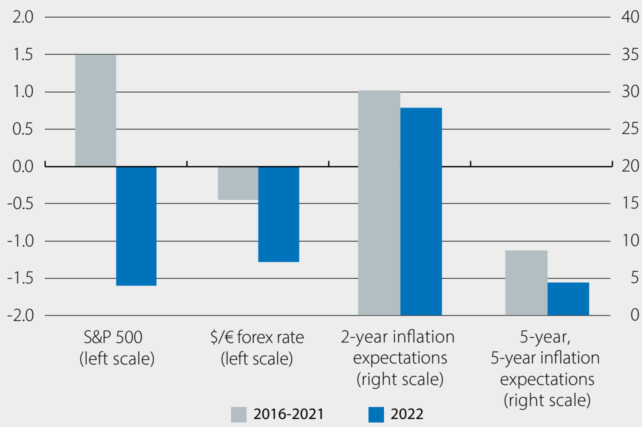
Germany: sensitivity of sovereign rates to inflation surprises in the US *

(p. b.)

Note: ** The sensitivity corresponds to the coefficient ß estimated in 30-month windows using the regression $\Delta i_t = a + \beta(\pi_t - \pi_t^e) + \varepsilon_t$, where Δi_t is the daily fluctuation of the interest rate, π_t is the observed inflation figure, and π_t^e is the inflation expected by the Bloomberg consensus.*
Source: *BPI Research, own calculations based on data from Bloomberg.*

US: sensitivity of financial variables to domestic inflation surprises *

(p. p.) *(p. b.)*



Note: ** The sensitivity corresponds to the ß estimated in 30-month windows using the regression $\Delta y_t = a + \beta(\pi_t - \pi_t^e) + \varepsilon_t$, where Δy_t is the daily fluctuation of the financial variable in question, π_t is the observed inflation figure, and π_t^e is the inflation expected by the Bloomberg consensus.*
Source: *BPI Research, own calculations based on data from Bloomberg.*

Interest rates (%)

	30-November	31-October	Monthly change (bp)	Year-to-date (bp)	Year-on-year change (bp)
Euro area					
ECB Refi	2.00	2.00	0	200.0	200.0
3-month Euribor	1.97	1.70	27	254.5	254.5
1-year Euribor	2.83	2.63	20	333.1	333.5
1-year government bonds (Germany)	2.18	2.08	10	281.8	295.5
2-year government bonds (Germany)	2.13	1.94	19	274.9	284.1
10-year government bonds (Germany)	1.93	2.14	–21	210.7	227.3
10-year government bonds (Spain)	2.95	3.23	–28	238.1	251.9
10-year government bonds (Portugal)	2.88	3.15	–27	241.2	252.2
US					
Fed funds (upper limit)	4.00	3.25	75	375.0	375.0
3-month Libor	4.76	4.46	30	455.1	458.6
12-month Libor	5.55	5.45	11	497.0	509.5
1-year government bonds	4.69	4.60	8	431.0	445.0
2-year government bonds	4.31	4.48	–17	357.8	375.9
10-year government bonds	3.61	4.05	–44	209.5	220.2

Spreads corporate bonds (bps)

	30-November	31-October	Monthly change (bp)	Year-to-date (bp)	Year-on-year change (bp)
Itraxx Corporate	92	114	–22	43.6	35.2
Itraxx Financials Senior	103	123	–20	48.0	37.4
Itraxx Subordinated Financials	185	220	–36	76.5	60.0

Exchange rates

	30-November	31-October	Monthly change (%)	Year-to-date (%)	Year-on-year change (%)
EUR/USD (dollars per euro)	1.041	0.988	5.3	–8.5	–8.1
EUR/JPY (yen per euro)	143.680	146.970	–2.2	9.8	12.5
EUR/GBP (pounds per euro)	0.863	0.862	0.1	2.6	1.2
USD/JPY (yen per dollar)	138.070	148.710	–7.2	20.0	22.4

Commodities

	30-November	31-October	Monthly change (%)	Year-to-date (%)	Year-on-year change (%)
CRB Commodity Index	564.3	549.6	2.7	–2.4	–0.1
Brent ($/barrel)	85.4	94.8	–9.9	9.8	24.0
Gold ($/ounce)	1,768.5	1,633.6	8.3	–3.3	–0.7

Equity

	30-November	31-October	Monthly change (%)	Year-to-date (%)	Year-on-year change (%)
S&P 500 (USA)	4,080.1	3,872.0	5.4	–14.4	–9.6
Eurostoxx 50 (euro area)	3,964.7	3,617.5	9.6	–7.8	–5.1
Ibex 35 (Spain)	8,363.2	7,956.5	5.1	–4.0	–1.1
PSI 20 (Portugal)	5,862.7	5,718.3	2.5	5.3	7.1
Nikkei 225 (Japan)	27,969.0	27,587.5	1.4	–2.9	0.1
MSCI Emerging	972.3	848.2	14.6	–21.1	–20.7

Stagflation or permacrisis?

Geopolitical shock: a higher-risk environment on the horizon. In recent months, we have seen both supply- and demand-side shocks multiply, resulting in an economic scenario with higher inflation and lower growth than we were anticipating a few quarters ago. The legacy of the pandemic – bottlenecks, pent-up demand and a recovering labour market – has been compounded by the outbreak of the war in Ukraine, the resulting energy shock and restrictive monetary policies, with the fastest cycle of interest rate hikes in decades in economies such as the US and the euro area. In this environment, the word stagflation re-entered our lexicon. However, what perhaps better defines the current environment is the high degree of uncertainty and an international context in which geopolitical tensions have returned to centre stage. So far this year, the geopolitical risk (GPR) index has reached 160 points. Since 1985, on an annual average, only between 2001 and 2003 had the index exceeded 150 points. So it is no surprise that the British Collins dictionary has named «permacrisis» (an extended period of instability and insecurity) as the word of the year.

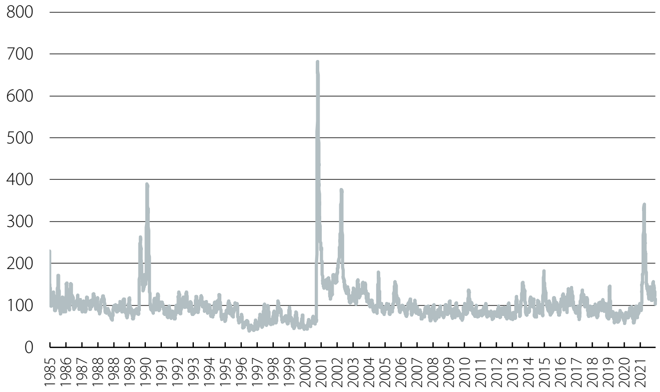
Energy shock: persistently high gas prices. One of the main factors shaping the current scenario is the energy crisis. In November, the average spot price of gas per the main European benchmark (TTF) fell to €118/MWh (–15% compared to October). This moderation was supported by the high levels of reserves across the EU, which were at around 92% of capacity at the end of November (compared to an average level at the same time of year of 82% over the last five years), as a result of the high substitution of imports and reduced consumption. However, this decline occurred in a month with relatively warm temperatures and, in any case, prices are still 44% higher than a year ago and six times higher than the historical average (around €20/MWh). In addition, futures contracts continue to point to prices above €100/MWh in the next two years, suggesting that the high energy prices will continue to constrain business and household activity.

Inflationary shock: is the peak finally behind us? As a result of the moderation in energy prices, headline inflation in the euro area stood at 10.0% in November (versus 10.6% in October), the first decline since mid-2021. Core inflation (excluding energy and food) remained stable at 5.0%. In the US, inflation continued to moderate in October (the latest available data), with the headline index falling to 7.7% (versus 8.2% in September) and the core index down to 6.3% (6.6% in September). This cooling of inflation may support a moderation in the pace of the interest rate hikes by the Fed and the ECB. It is still too early to declare that inflation has peaked, and there will likely be volatility in the data, but we can expect to see a gradual moderation during the course of 2023. In particular, the base effects themselves, the greater stability of energy prices, the easing of the bottlenecks, the cooling of economic activity and the limited second-round effects should, on the whole, allow for a correction of the imbalances between supply and demand and, thus, support a gradual reduction in inflation next year.

Supply shock: the downside risks have moderated. In the euro area, the composite PMI figure (47.8 in November versus 47.3 in

Global: geopolitical risk (GPR) index

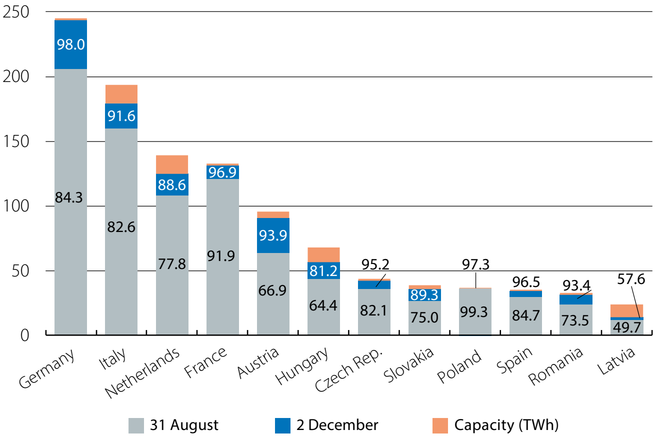
Level (100 = average for the period 1985-2019)



Note: *The chart shows the 30-day moving average. The geopolitical risk index is built using newspaper articles by searching for keywords related to geopolitical risks. A higher index value indicates increased geopolitical risk.*
Source: *BPI Research, based on data from D. Caldara and M. Iacoviello (2022). «Measuring Geopolitical Risk», American Economic Review, April, 112 (4), pages 1194-1225 (data downloaded from https://www.matteoiacoviello.com/gpr.htm on 12 December 2022).*

Europe: gas reserves

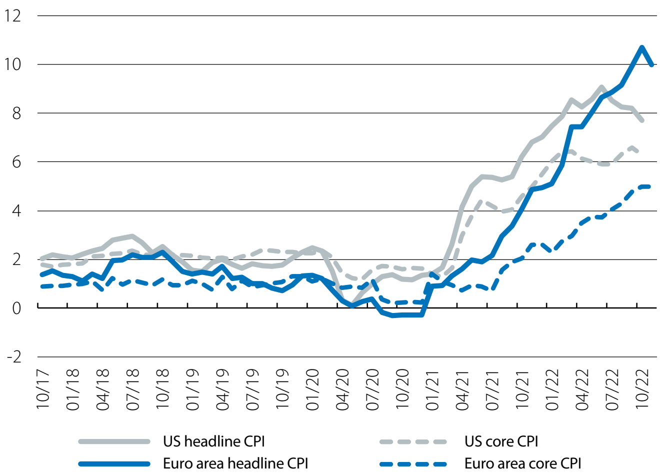
Storage level (TWh and % of total capacity)



Note: *The chart shows the sum of the percentages corresponding to the storage levels at each date, relative to each country's total capacity.*
Source: *BPI Research, a partir de datos de Gas Infrastructure Europe.*

US and euro area: CPI

Year-on-year change (%)



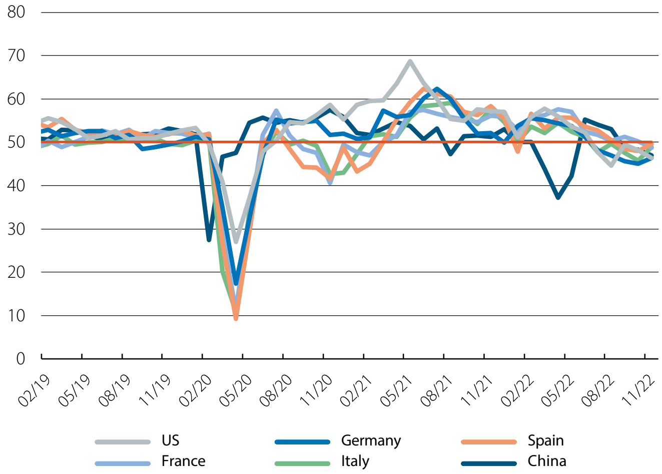
Source: *BPI Research, based on data from the Bureau of Labor Statistics and Eurostat.*

October) was better than expected, albeit consistent with a slight contraction in GDP in Q4. The improvement was concentrated in the manufacturing PMI (which climbed from 46.4 to 47.1 in November), which could reflect the normalisation of supply chains. On the other hand, the services PMI remained unchanged, and also in contractionary territory (48.6 points). The publication of the Ifo Business Climate Index for Germany in November underscores this same message. Despite a slight increase in November (from 84.5 to 86.3 points), the data are consistent with a decline in economic activity. On the other hand, in the US, the data also showed signs of a cooling in activity. In particular, the manufacturing ISM in November was below 50 points for the first time since May 2020, while in the labour market the pace of job creation slowed to 263,000 jobs, a relatively high figure but lower than in October.

Food shock: emerging economies in a vulnerable situation. As the World Bank recently pointed out, food price inflation has exceeded headline inflation in 90% of the 156 countries with available data. Developing and emerging economies are particularly vulnerable, with around 90% of them experiencing food inflation in excess of 5%. Despite the recent price moderation, the risks remain high. The deterioration in the geopolitical environment, and the war in Ukraine in particular, is the number one concern. However, the global environment of higher inflation and higher interest rates is also a major source of risk, as it exerts upward pressures on food costs due to the higher commodity prices, wages, and capital costs. The World Bank also notes that the percentage of the world's population in a situation of food insecurity will continue to rise, exacerbating all the adverse effects which such a situation generates in the long term.

Succession of shocks in China: the health restrictions will continue to hold back the economy. Economic activity in China continues to show signs of weakness in Q4. As the country struggles to contain the largest new outbreak of COVID-19 cases since the beginning of the pandemic, and while the authorities are debating the zero-COVID policy, economic activity is showing clear signs of slowdown. China's official composite PMI suffered its fifth consecutive fall in November, dropping to 47.1 points (versus 49.0 in October). In addition, the latest surge in cases is the one that poses the greatest risks since the first wave due to its geographical extension: over 100 cities have reported cases in recent days (compared to around 50 in April). The low level of vaccine coverage, coupled with the lack of capacity in the health system, make it difficult to imagine a steady reopening of the Chinese economy over the coming months (see the Focus «China's symptoms: more than COVID» in this same report). Although signs have emerged of a concerted effort to introduce flexibility into the country's health policy, there is still a long way to go. The low immunity of the population poses a major obstacle for the sustained reopening of the economy, and relatively severe restrictions are most likely to be required to contain the pressure on the health system in the short term. Moreover, the experience of the reopening process in other Asian countries shows that mobility rates take over six months to return to normal.

Global: composite PMI
Level



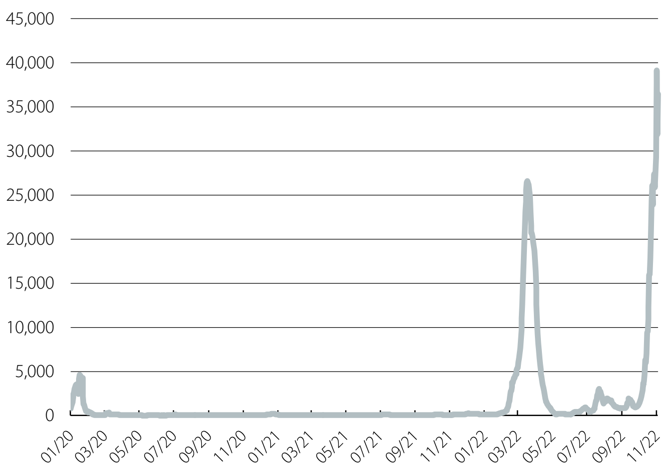
Source: *BPI Research, based on data from PMI Markit, via Refinitiv.*

Global: food price inflation
Year-on-year change (%)

Country	Nominal food inflation	Country	Real food inflation
Zimbabwe	321%	Zimbabwe	52%
Lebanon	208%	Lebanon	46%
Venezuela	158%	Iran	32%
Turkey	99%	Sri Lanka	20%
Argentina	87%	Rwanda	17%
Sri Lanka	86%	Hungary	15%
Iran	84%	Colombia	15%
Rwanda	41%	Uganda	15%
Suriname	40%	Turkey	13%
Laos	39%	North Macedonia	13%

Notes: *The table shows the top 10 countries with the highest food price inflation (real and nominal). Real food price inflation is calculated as food inflation minus headline inflation.*
Source: *BPI Research, based on data from the World Bank's latest food security update (November 2022).*

China: new confirmed cases of COVID-19
Daily cases (7-day average)



Source: *BPI Research, based on data from Johns Hopkins University, via Our World in Data.*

China's symptoms: more than COVID

China is facing a particularly challenging economic environment. The combination of a housing crisis and slowing global demand – two major drivers of China's growth in recent decades – has been joined by a third force, which over the last two years has been shown to have significant potential to distort the economy: the zero-COVID policy. The authorities' response to new outbreaks of the pandemic continues to involve recurrent lockdowns in some of China's biggest cities, as well as shop closures and inciting greater caution among Chinese consumers, which increases the volatility of the economic environment. As a result of these three forces, China's economy is expected to grow by around 3% this year, the lowest rate in almost half a century (with the exception of 2020, when the Asian giant grew by 2.2%). In the medium term, economic growth also looks set to experience a slowdown. The 20th National Congress of the Communist Party of China (CPC) has shed some light on the «black box» of Chinese politics and the top priorities for the next five years.

Symptom 1: zero-COVID or growth problems?

The indefinite extension of China's zero-COVID policy can be understood as the result of three main factors: the more limited capacity of the country's health system to cope with a possible wave of infections after the reopening of the economy, the low rate of effective vaccination, and the political narrative, which throughout this period has repeatedly underlined the success of China's strategy in avoiding the high levels of mortality observed in other countries.[1] Thus, in the short term, the variable that could lead to a sustained softening of the zero-COVID policy is progress in the vaccination rate, also taking into account the reinforcement of the official discourse in support of the current health policies.

As of the first half of November, 57% of the population in China had received three doses, compared with a two-dose coverage of 73% of the population in the EU and 69% in the US.[2] Moreover, among the elderly population (over 80 years of age), this figure is estimated to be 40%, well below the threshold that allowed the sustained reopening of the economy in other Asian countries (all with vaccination rates exceeding 90% among the elderly population when restrictions were lifted). Finally, the speed of the vaccine roll-out has shown signs of stagnating in recent months (with a daily vaccination rate of 0.01% of the total population, compared to an average of around 0.5% in the winter of 2021). In short, beyond periodic adjustments to the zero-COVID policy, this factor can be expected to continue to pose a significant constraint on the Chinese economy throughout 2023, whether because of the need for new «forced» lockdowns in the event of a lifting of the restrictions (to avoid excessive pressure on the healthcare system) or

Comparison of economic indicators

	China		Japan	South Korea	US	Eurozona	BRICS	ASEAN
	2000-2009	2015-2019	2015-2019	2015-2019	2015-2019	2015-2019	2015-2019	2015-2019
GDP per capita (PPP, international dollars)	5,163	14,554	41,468	40,896	60,489	45,311	11,565	11,775
GDP growth (annual average, %)	10.4	6.7	0.9	2.8	2.4	1.7	5.8	5.6
Gini Index	42.0	38.6	32.9	31.4	41.3	33.3	38.0	38.6
Patent applications (per 1,000 inhabitants)	0.1	0.9	2.0	3.2	0.9	0.3	0.4	0.0
Total consumption (% of GDP)	55.8	55.0	74.5	63.9	81.8	76.1	64.6	71.0
Final public consumption (% of GDP)	15.3	16.4	19.6	15.8	14.1	20.4	14.3	11.7
Tax revenues (% of GDP)	16.9	17.7	30.6	24.8	25.9	40.2	10.5	14.2
Current health expenditure (% of GDP)	4.2	5.1	10.7	7.3	16.7	10.3	4.7	3.8
Private health expenditure (% of current expenditure)	66.9	42.5	16.0	41.8	49.2	25.2	55.0	53.6
Direct private health expenditure (% of current expenditure)	56.2	35.6	12.9	32.4	11.5	16.2	44.3	41.3
Hospital beds (per 1,000 people)	1.9	4.0	13.1	12.1	2.8	5.5	2.5	1.1
Doctors (per 1,000 people)	1.2	1.9	2.4	2.3	2.6	5.6	1.5	0.6

Notes: *For the BRICS countries (Brazil, Russia, India, China and South Africa), the ASEAN countries (Brunei, Cambodia, the Philippines, Indonesia, Laos, Malaysia, Myanmar, Singapore, Thailand and Vietnam) and the euro area (Germany, Spain, France and Italy), we use weighted averages based on each country's population. For all countries, we use the average for the period 2015-2019 or the latest available data up to 2019 at the time the exercise was performed. The Gini Index is a measure of inequality and can take values between 0 and 100. Higher figures denote higher levels of inequality, and vice versa. Total consumption is the sum of final household consumption (private consumption) and final public consumption.*
Source: *BPI Research, based on data from the World Bank and the OECD (Global Revenue Statistics Database).*

1. The official COVID-19 mortality figures in China show a cumulative mortality rate of 0.4 people per 100,000 inhabitants, one of the lowest in the world (e.g. 37.6 in Japan, 257.8 in the EU, 316.3 in the US and 31.6 for Asia as a whole). Comparing estimates of excess mortality over the period, China would still be in a «leadership» position, albeit somewhat less far ahead: between 3 and 190 excess deaths per 100,000 inhabitants in China, versus 81-99 in Japan, 330-340 in the EU, 370-410 in the US and 160-380 on the Asian continent. See *The Economist* (2022), «The pandemic's true death toll» (consultation date: 31 October 2022).
2. The technology used in the vaccines administered in China is considered to be less effective. Therefore, it is estimated that three doses of these vaccines are required in order to achieve the degree of protection equivalent to two doses of the mRNA vaccines predominantly used in the EU and the US.

due to a continuation of the strategy to try and eliminate the virus.

China's current health policy must be framed in a broader context. Although China has been the driver of global growth over the last two decades, it is still a middle-income country, with a GDP per capita of around one-third of the euro area average (in purchasing power parity terms) and a quarter of the level of the US (see table). In this context, although health expenditure has been increasing in recent years, it is still substantially below that of more developed countries, and the basic healthcare infrastructure (measured in terms of hospital beds or doctors per patient) is also more limited, albeit with better rates than other emerging countries such as the rest of the BRICS or ASEAN blocs.

Specifically, the US leads the way in current health expenditure, although almost 50% of this is private expenditure and the high figures also reflect the high costs at which the health system operates in this country (private expenditure encompasses direct household expenditure on health products or services, expenditure by private insurance companies and by the social sector). In euro area countries or Japan, health expenditure is around 10% of GDP, and private expenditure accounts for less than 25% of the total. In China, in contrast, not only is the total health expenditure lower, but 40% of it is private, with a significant fraction being direct household expenditure (35% of the total health expenditure). Together, these figures suggest a healthcare system still in a development phase, with a significant fraction of the population having limited access to healthcare.

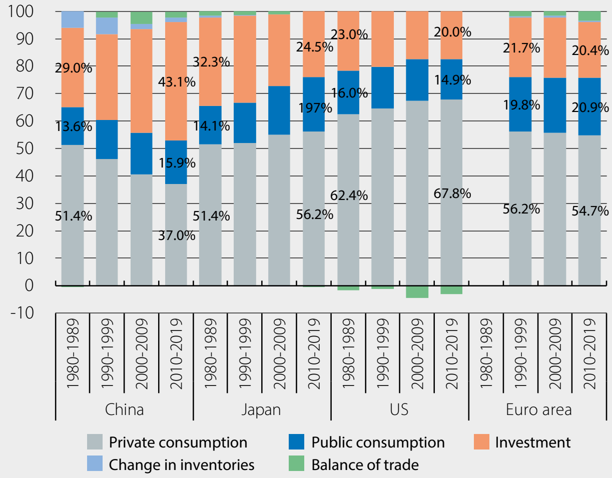
Symptom 2: low private consumption or lack of a social safety net?

The low level of public healthcare expenditure is also related to the limited scope of China's welfare state. The relative weight of the state in the economy, measured by tax revenues as a percentage of GDP, is less than 20% (compared to over 30% for the OECD as a whole). This leaves a large portion of the population without a social safety net of healthcare, social benefits, unemployment benefits or pensions.[3] This factor is also key for explaining the country's persistently high savings rate, which is around 45%.

Similarly, China has one of the lowest levels of consumption in the world (55% of GDP, less than 40% of which is private consumption)[4] and a high level of investment (see chart). While these factors have been

GDP by component

Relative weight (%)



Note: The breakdown of GDP by component uses an expenditure-based (or demand-based) approach, whereby the calculation of a country's GDP is the result of the sum of the components of private consumption, public consumption, investment, the balance of trade and the change in inventories.

Source: BPI Research, based on data from the OECD.

behind the economy's rapid growth in recent decades, today, with the momentum associated with the process of capital accumulation and convergence with advanced economies having run out of steam, they are restricting the buoyancy of economic activity.[5]

China's current symptoms thus go beyond its zero-COVID policy and are the result of deeper imbalances in its economic development model. Experience shows that there is no «vaccine» for escaping the famous middle-income trap.[6] At the recent Congress of the CPC, President Xi renewed his pledge to pursue a vision of «shared prosperity» and to transform China into a «medium-developed country» over the next 15 years. However, the growing focus on issues of security and self-sufficiency entails further risks for the country's long-term potential growth, in addition to the demographic challenge and the risk of global economic fragmentation. The long-term health of the Chinese economy will depend on the quality of the treatment it receives, its success in rebalancing the growth model, and its ability to embark on a transition to higher value-added activities.

3. In addition, the citizen registration system establishes a clear division of rights between rural and urban populations. The granting of *hukou* status determines a citizen's access to a wide range of benefits and social services in urban areas, such as healthcare, public education, the pension system, and eligibility for bank loans.
4. In emerging countries, on average, total consumption represents 65% of GDP. In advanced economies, it represents 75% or more of GDP. Generally speaking, private consumption accounts for between 50 to 60% of GDP.
5. In turn, the limited international mobility of capital in the country and a less developed financial system have led to a low average return on investment and have contributed to the current housing bubble (due to the housing market being used as a savings tool).
6. The middle-income trap refers to a situation in which a country in the process of economic convergence can no longer compete internationally in the production of more labour-intensive goods, but it also cannot compete in higher value-added activities because it is still far from the technological frontier and has relatively low productivity levels.

Changes in the US Congress: a castling until the presidential elections?

In the midterm elections on November 8th, a red wave was anticipated, with the Republican Party hoping to control the House of Representatives and the Senate and thus gain full control of Congress. High inflation, the somewhat gloomy economic outlook for 2023, and Joe Biden's low approval ratings (at 37% compared to 55% in early 2021) filled the Republican Party with optimism. Yet the final outcome of the vote produced a somewhat different scenario to what members of the «Grand Old Party» (GOP) had expected.

In the House of Representatives, where 100% of the seats were put to the vote, the Republicans gained control of the House, albeit by a narrower margin than anticipated in the polls. But in the Senate, where 35 out of the 100 seats were up for election, the Democrats managed to take the Pennsylvania vote from the Republicans and thereby secure a majority in the upper house with 51 of the 100 seats (assuming that the two independent members elected in Vermont and Maine continue to caucus with the Democratic vote plus the tie-breaking vote of the president of the Senate, Kamala Harris).

The Biden administration may have difficulty passing new laws and fiscal plans

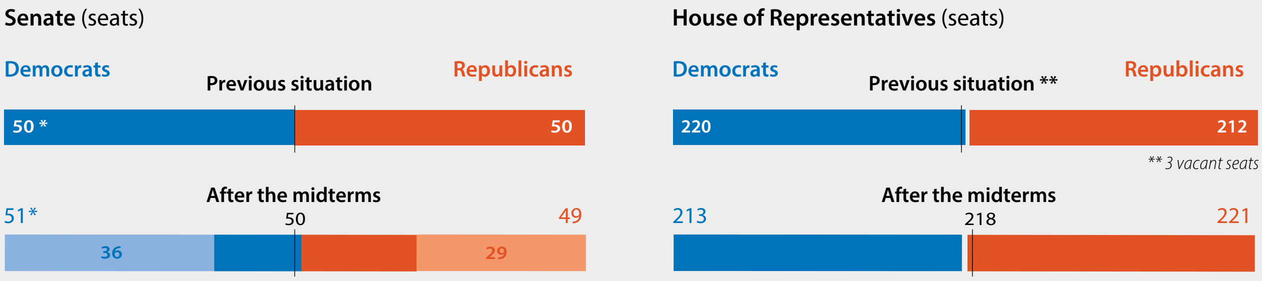
With a divided Congress, and in a highly polarised political environment, it seems unlikely that Joe Biden's government will be able to push through proposals that drift far from the centre of the political spectrum. Not only that, it could also have difficulties in pushing through basic measures such as raising the debt ceiling – the limit above which the country's Treasury cannot issue new debt to finance the federal government, which could potentially be binding in Q3 2023. If this figure is reached without Congress raising the ceiling or suspending the requirement to comply with it, then the administration will have no choice but to call a government shutdown. It would not be the first time, and the experience of the last shutdown between December 2018 and January 2019 suggests that it would have a clear negative impact on economic growth, as well as generating financial reverberations that would be most undesirable at such a delicate time in the financial markets.[1] However, previous experiences also show that a will among both parties to avoid such consequences ends up steering the situation to be unblocked when an increase in the debt ceiling is agreed upon in exchange for concessions in other areas. Also, should the US economy fall into recession, which is not our central scenario, one would expect the two parties to reach some sort of agreement, however minimal, in order to mitigate the adverse impact on households, while also saving face for the presidential elections in November 2024.

Other aspects in which this division of the chambers could have an impact include the presidential appointment of public officials and the supervision of the president's executive branch. In relation to the first aspect, Democratic control of the Senate will most likely facilitate the process of the presidential appointments that must be made over the next few years, which are particularly important in the judicial sphere. On the other hand, Republican control of the House of Representatives, while not allowing the GOP to introduce new laws, could be used to further scrutinise the Biden administration. While this supervision is not expected to paralyse what has already been approved in the houses, it could slow some procedures down, although the impact of this would likely be more cosmetic than substantive.

Despite the absence of major plans looking ahead, Biden's term in office will still have been active in a context of high inflation and public debt

In the nearly two years he has been in the White House, President Joe Biden has been active in implementing

US: result of the midterm elections



** Includes the independents who caucus with the Democrats*

***Source:** BPI Research, based on data from the Associated Press.*

1. According to estimates by the Congressional Budget Office, GDP in Q4 2018 and Q1 2019 was 0.1% and 0.2% lower than it would have been in the absence of the government shutdown.

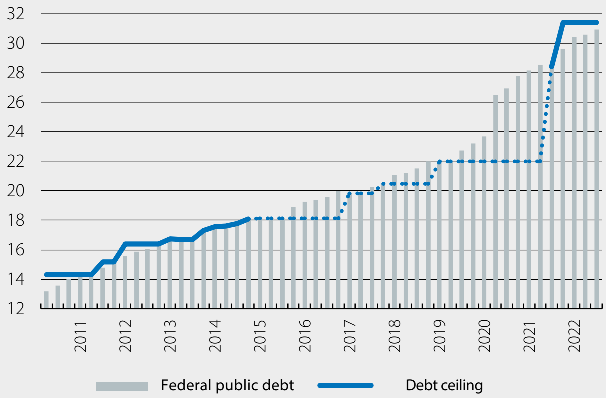
fiscal and stimulus plans, even though Democratic control of both houses was no guarantee of a smooth path to passing them. Therefore, a divided congress represents more of a gradual change than a disruptive one relative to the previous situation. Some of the most significant plans he has introduced include the American Rescue Plan, approved in Q1 2021, which allocated 1.9 trillion dollars (the majority disbursed in 2021) to help cushion the impact that the pandemic was still having on many households. Most of the measures included in this package were direct expenditure, such as stimulus checks for vulnerable households or increased unemployment support. However, the implementation of this programme was a source of much criticism due to its potentially inflationary impact.[2]

Another major programme presented by Joe Biden, and approved in November 2021, was the Infrastructure Investment and Jobs Act, with a budget of 1.2 trillion dollars to be spent over the next five years on projects for improving classic infrastructure (such as roads, bridges and the railway network), public transport and internet access, with environmental considerations incorporated into most of the investments. However, of this 1.2 trillion total, only just under half represents new expenditure, as the rest will be financed through other existing infrastructure programmes. After one year of the programme, according to data from the White House, 185 billion dollars have already been disbursed.

Finally, the Biden administration wanted to present a highly ambitious plan to tackle climate change. Under the name Build Back Better, this package did not gain the necessary support in Congress. Nevertheless, half a year later in August 2022, and renamed the Inflation Reduction Act, it did. In addition to the name, a key difference between the two plans is the fact that the original one involved an increase in the budget deficit in order to finance the investments, whilst the second one incorporates fiscal savings and tax-collection measures (such as imposing a minimum corporation tax rate of 15%). Thus, the investments in energy security and support measures to curb climate change (such as tax credits to finance investment in clean energy) are less than the fiscal savings and the increase in revenues envisaged under this plan. In total, the Biden administration expects to invest 433 billion dollars over the next 10 years and raise some 739 billion, which represents a saving of over 300 billion dollars in the budget deficit over the next decade. However, the outstanding disbursements under all these plans could be subject to changes in the framework of a divided Congress[3] and given the pending negotiations on matters such as the debt ceiling.

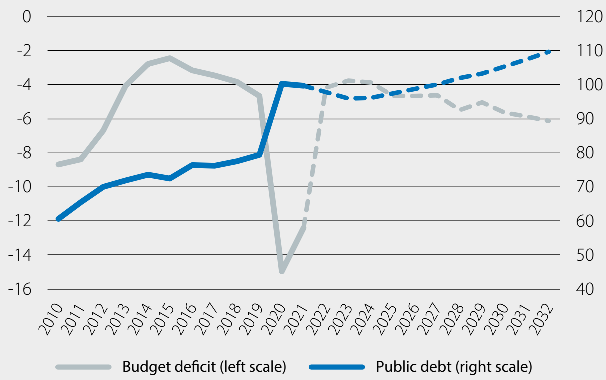
After all, reducing the budget deficit will not only help to ease the inflationary pressures, but it will also help to achieve more sustainable public finances. As can be seen in the last chart, the US has a structural budget deficit which causes its debt-to-GDP ratio to increase year after year. Thus, according to estimates by the Congressional Budget Office, this ratio will most likely continue to rise over the next decade, and in an environment of higher interest rates, the cost for American citizens will be higher.

US: public debt and the debt ceiling
(USD trillions)



Note: *The dashed line shows periods when the debt ceiling was suspended.*
Source: *BPI Research, based on data from the US Treasury.*

US: public debt and budget deficit
(% of GDP)



Note: *The dashed line shows the latest forecasts by the Congressional Budget Office.*
Source: *BPI Research, a partir de datos del Congressional Budget Office.*

2. At the time, prior to the outbreak of the war in Ukraine, headline and core inflation stood at 1.7% and 1.3%, respectively, but GDP had just reached the pre-pandemic level. Although the high inflation observed since then can be attributed to multiple factors (such as the global energy shock,the bottlenecks exacerbated by China's zero-COVID policy, or a highly dovish monetary policy throughout 2021), direct fiscal aid measures certainly played a role.

3. These support measures have raised some suspicions in Europe, as leaders in the region consider it could constitute subsidies for US industry, damaging European exports.

The EU: raider of the lost fiscal rules

30 years ago, the countries that founded the EU committed themselves to restricting and coordinating their fiscal policies with a common set of rules, best known for the debt and deficit limits of 60% and 3% of GDP. The aim was to avoid negative externalities between the public accounts of individual states and the consequent risks of financial instability.[1] These reasons are still valid today, but the rules have become outdated following a global financial crisis, a sovereign debt crisis in Europe, and a pandemic.[2] In fact, despite having been adjusted over the years,[3] the rules finally had to be formally suspended in March 2020.

The reform proposed by the European Commission

In this context, last November the European Commission presented a proposal to reform the fiscal rules with a view to their re-implementation in 2024. The proposal does not change the debt and deficit targets of 60% and 3% (they are laid down in the EU treaties and changing them is rather infeasible); instead, it establishes them as medium-term targets and focuses on reforming the system to steer us towards them. In particular, the Commission proposes placing at the heart of the system a series of «structural fiscal plans», which would be drawn up at the national level and would revolve around three major axes: (i) investment priorities, (ii) structural reforms, and (iii) a fiscal path. Taken together, these three pillars would serve as the basis for assessing each state's debt and ensuring its sustainability.

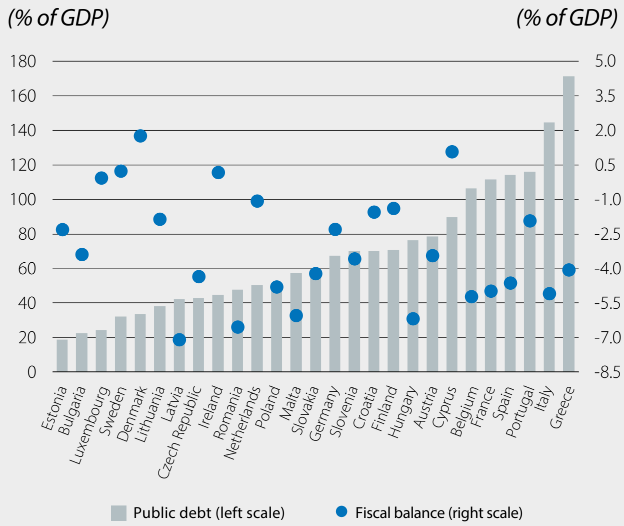
In more detail, each national government would draw up its «structural fiscal plan» based on a four-year time horizon. The Commission would evaluate the plan and discuss it with the country in question, before approval is finally sought from the European Council. The fiscal path that would guide the evolution of the public accounts would be defined on the basis of a net primary expenditure rule,[4] adjusting to the specific situation of each state and its debt sustainability analysis. Once in place, the plans would be monitored and evaluated, both by the Commission and by the independent fiscal authority of each country. Moreover, given this personalised approach, it would be necessary to establish a common framework with a clear set of rules and transparent criteria to guide the evaluation of each country's public accounts.

Finally, the European Commission proposes to maintain the system of «excessive deficit procedures» (EDPs) for breaches of the 3% deficit target, as well as to extend the range of sanctions in the event of non-compliance (reducing the pecuniary damage in order to make their implementation more credible, but accentuating the reputational damage). In the event of extraordinary economic events, the plan also envisages the activation of escape clauses to freeze the rules (at both the European and the country level).

Factors to consider and next steps

Firstly, the Commission is moving away from the uniformity of the current rules in favour of a more personalised approach to the sustainability of each

EU-27: state of the public accounts in 2022



Source: BPI Research, based on data from the European Commission (European Economic Forecast, autumn 2022).

1. The formation of the EU increased the degree of «substitutability» among the sovereign bonds of the different countries. The benefits (costs) of a good (bad) fiscal policy at the national level would thus have an impact on the rest of the countries. For example, a lavish country would face lower interest rates than it would suffer if it were outside the EU, but it would cause higher interest rates in the rest of the countries.
2. Among other shortcomings, the rules: (i) have failed to prevent the deterioration of public accounts which they sought to avoid, (ii) induce an overly procyclical fiscal policy which penalises investment, and (iii) are overly complex and based on variables that cannot be observed (e.g. the output gap or the structural balance). See the Focus «A step towards a reform of the fiscal rules in Europe?» in the MR03/2020 and «European fiscal rules: an end to the 60% limit?» in the MR03/2021.
3. See the Dossier «The EU in 2022: fiscal rules reform back on the table» in the MR12/2021. For example, a set of medium-term budgetary objectives (MTOs) were introduced, which the 2005 reform of the Stability and Growth Pact called for to be maintained throughout the business cycle in order to provide margin for manoeuvre in times of recession. Another example is the «1/20 rule» relating to debt reduction, which was introduced as part of the so-called «six-pack» of 2011, requiring countries to cut their excess debt above 60% of GDP by one twentieth each year. For a country with a debt ratio of 160% today, this would require primary surpluses of over 3% for the next 20 years.
4. That is, spending net of discretionary income, and excluding interest payments and disbursements related to cyclical fluctuations in unemployment, such that the rule would not interfere with the functioning of automatic stabilisers.

European Commission proposal to reform the EU's fiscal rules

Starting point	The current rules (deficit of 3%, debt of 60%, debt correction rate of 1/20) are suspended until the end of 2023.
Medium-term targets	Deficit < 3% of GDP. Debt < 60% of GDP.
How to achieve the targets	National structural fiscal plans based on: • Investment plans. • Structural reforms. • Fiscal path.
Structural fiscal plans	• Fiscal path based on a net primary expenditure rule. • 4-year time horizon to place debt on a declining path and to bring the deficit < 3% (+3 additional years conditional on reforms). • Bilateral negotiation with the European Commission and subsequent approval by the European Council. • Monitoring by the national independent authorities for fiscal responsibility and the European Commission.

Source: *BPI Research, based on the European Commission's communication of 09/11/2022.*

country's debt. This is a vision that is much better suited to the current environment and in particular to the disparity that exists between the public accounts across the EU (see chart).

Moreover, the Commission presents a broader view of debt sustainability, explicitly stating that it also depends on investment and reforms (i.e. on an economy's ability to grow and its resilience). In this regard, the new rules would help create space for fiscal policy. In other words, the sustainability of the public accounts is a constraint which fiscal policy must adhere to, but it is not its primary objective. Fiscal policy must help to stabilise the business cycle,[5] and it can also help to foster stronger, more resilient and more inclusive long-term economic growth.[6]

Thirdly, the proposal simplifies the current fiscal framework (e.g. the use of indicators based on unobservable variables, such as structural deficits, would no longer be mandatory). However, it does so in a limited way and, given that many details are yet to be defined, it remains to be seen whether the final version will really involve less complexity and uncertainty.

On the downside, the time horizons appear somewhat generous: the plans would allow up to four years for the fiscal path to bring the deficit below 3% and for debt to be placed on a sustainably downward trajectory. Moreover, this timeframe could be extended by another three years depending on the country's reform and investment programme. Thus, the plan would likely extend beyond the mandate of the current government, which means that adhering to it would require a high degree of national commitment, as well as commitment, coordination, and legitimacy among all the actors involved (governments, independent fiscal authorities, the European Commission and the Council).

In any case, it is worth acknowledging the Commission's ambition: at a time when there is no consensus among the major European capitals on how to reform the fiscal rules, it has proposed a reform which goes far beyond marginal adjustments. Beginning in December, Member States must employ the same level of ambition in their negotiations, and when the fiscal rules are reinstated in 2024, they should incorporate a redesign that reflects the lessons of the past 30 years and which fits Europe's current reality.

5. Especially in a monetary union, given that there is only one central bank and it cannot cope with idiosyncratic shocks between different countries.
6. e.g. by facilitating the energy and digital transitions.

European household energy bills in the bleak midwinter

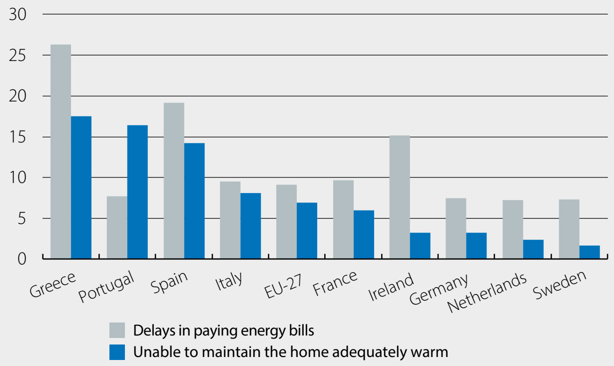
The energy crisis has led to an increase in energy prices which is not affecting all households alike, since their resources and initial situation are not the same in all cases. In this article, we analyse the level of energy poverty among European households and how the portion of household budgets spent on energy bills has increased in 2022.

A household is considered to be in a situation of energy poverty when it cannot meet all of its energy needs.[1] This situation is not only price-dependent, but is the result of a combination of three factors: low income, high expenditure on energy services (relative to income), and low energy efficiency in homes. Thus, measuring the energy poverty of households is no easy task, as we need to analyse multiple elements and there is no single measure that summarises the situation. Two indicators from surveys of household living conditions which do a reasonable job of summarising the problem are households' inability to keep their home adequately warm and delays in paying their energy bills.[2] In the EU, 6.9% of households were unable to keep their homes at an adequate temperature in 2021 and 6.4% were late in paying their energy bills. However, there are significant differences in these two measures from country to country, and there is generally a higher percentage of households in difficulty in southern Europe (see first chart).

Another way to analyse energy poverty is by looking at expenditure on energy bills, as this can reveal difficulties in meeting household energy needs.[3] In the EU-27, 13.4% of households had a level of energy expenditure that was below half the national median (in 2015, the latest year with comparable available information), which may be an indication of what is often referred to as «hidden energy poverty». On the other hand, if we measure energy expenditure as a proportion of household income, we see that 15.1% of households had an energy expenditure to income ratio of over twice the national median, a level generally considered «disproportionate». In both metrics, the dispersion among European countries is less pronounced, indicating that energy poverty measured on the basis of household spending was more similar between countries.[4] In Spain, the situation in both metrics in 2020 had not changed substantially from the 2015 data: 10.3% of households had a very low level of expenditure (13.0% in 2015) and 16.8% of households had a level that was disproportionate to their income (14.2% in 2015).

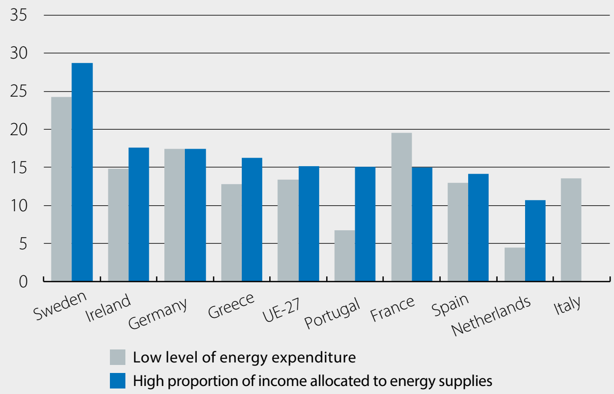
As we can see, energy poverty is a multidimensional phenomenon, so it is not easy to estimate how the current crisis is affecting each element. Measures such as the inability to keep the home adequately warm depend, above all, on the household already being in a precarious situation to begin with. Therefore, according to simulations by the European Commission,[5] the rally in energy prices due to the current crisis is having a

EU: energy poverty based on self-assessment in surveys
(% of households)



Source: *BPI Research, based on data from the Energy Poverty Advisory Hub (EU SILC, 2021).*

EU: energy poverty measured according to expenditure on energy supplies
(% of households)



Notes: *A household is considered to have a low level of energy expenditure if their expenditure is less than half the national median. A household is considered to have a high proportion of its income allocated to energy supplies if this proportion exceeds twice the national median.*
Source: *BPI Research, a partir de datos de Energy Poverty Advisory Hub (EU HBS, 2015).*

1. See European Commission (2020). « Commission Staff Working Document EU Guidance on Energy Poverty». SWD(2020) 960, https://ec.europa.eu/transparency/documents-register/api/files/SWD(2020)960_0/de00000000001888?rendition=false
2. EU Energy Poverty Hub of the European Commission.
3. EU Energy Poverty Hub of the European Commission.
4. Sweden would be an exception, with worse levels of energy poverty when measured on the basis of expenditure, although on the other hand it scored better in the other measures (maintaining the home at an adequate temperature and delays in paying bills).
5. See B. Menyhért (2022). «The effect of rising energy and consumer prices on household finances, poverty and social exclusion in the EU». Publications Office of the European Union. Luxembourg, doi:10.2760/418422, JRC130650.

relatively small impact on this aspect. On the other hand, these higher prices are having a more substantial impact on the measures related to the level of expenditure.[6]

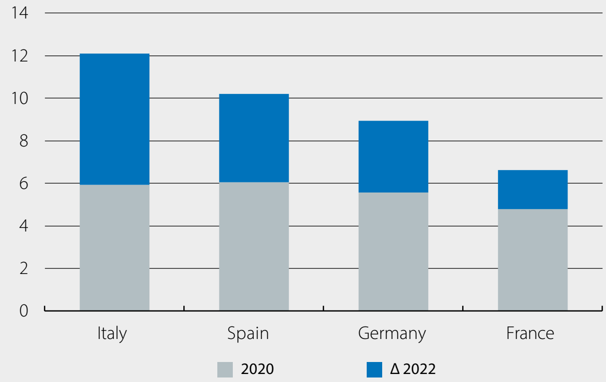
Energy bills are rising, but not equally in every country

We focus our analysis of the impact of rising energy bills on the euro area's four major economies (Germany, France, Italy and Spain).[7]

For context, in 2020 households in France spent 4.8% of their income on energy bills, while in Germany the figure was 5.6% and in Italy and Spain, around 6.0%. From this starting point, energy prices have sky-rocketed (+72% increase since 2021), although the extent of the increase has been somewhat uneven between countries: up to September 2022, in France prices prices have risen by 40%; in Germany, by more than 60%; in Spain, by around 70%, while in Italy prices have almost doubled.[8] This means that, in 2022, households' annual energy bills have increased by an average of around 500 euros in France, some 800 euros in Spain, over 1,000 euros in Germany and around 1,400 euros in Italy. As such, households are having to allocate a significantly larger portion of their income to paying their energy bills. Moreover, the divergence between countries has widened significantly: French households are still the ones allocating the smallest portion to their energy bills, at 6.5% of their income, while in Germany they spend almost 9.0%, in Spain just over 10% and in Italy, more than 12%.[9]

These estimates show how, in all countries, households are having to allocate a greater portion of their income to cope with the increase in their energy bills. Lower-income households will have the greatest difficulties

Expenditure on electricity, gas and other fuels, by country
(% of household income)



Source: *BPI Research, based on data from Eurostat and ISTAT.*

in paying their energy bills, so it is key that support measures are targeted in order to reach all these struggling households. This aid must also be accompanied by incentives for energy saving. In this regard, price signals remain an essential element for reducing demand as much as possible and for encouraging European households to save energy in the bleak midwinter.

6. The expenditure-based energy poverty variables used in the second chart are measures of the relative position of household spending. Therefore, according to calculations by the European Commission, given that the price increase is fairly similarly for everyone, the relative position between them does not change very much.
7. For this simulation, we obtain from the Household Budget Survey (HBS) published by Eurostat the composition of expenditure by income tranches in 2020 for all countries except Italy, where we use the same statistics published by its statistics office (ISTAT). The income indicators are obtained from the Income and Living Conditions (ILC) Survey, also published by Eurostat, in all cases. To estimate household expenditure on energy, we use the component CP045 «Electricity, gas and other fuels» from the HICP. This component already encompasses the general impact of the government measures implemented to reduce energy bills (e.g. VAT cuts), but not the specific aid for more disadvantaged groups.
8. These divergences are due, among other factors, to the composition of each country's energy consumption. For example, Italy has the highest exposure to gas, a commodity which saw its price increase by a factor of 17: around 31% of its direct energy consumption corresponds to gas, and more than 56% of electricity generation is based on gas (22% and 35% on average in Europe, respectively).
9. These estimates measure how much it would cost to achieve the same level of energy consumption as in 2020 (i.e. they do not take into account possible reductions in energy consumption).

Year-on-year (%) change, unless otherwise specified

UNITED STATES

	2020	2021	Q4 2021	Q1 2022	Q2 2022	Q3 2022	09/22	10/22	11/22
Activity									
Real GDP	–3.4	5.9	5.7	3.7	1.8	1.9	–	–	–
Retail sales (excluding cars and petrol)	2.1	17.5	16.2	11.2	7.8	8.5	8.2	8.0	...
Consumer confidence *(value)*	101.0	112.7	112.9	108.1	103.4	102.2	107.8	102.2	100.2
Industrial production	–7.2	4.9	4.5	4.8	4.5	4.2	5.0	3.3	...
Manufacturing activity index (ISM) *(value)*	52.5	60.6	60.1	57.8	54.8	52.2	50.9	50.2	49.0
Housing starts *(thousands)*	1,396	1,605	1,679	1,720	1,647	1,458	1,488	1,425	...
Case-Shiller home price index *(value)*	228	267	284	299	314	310	306	...	...
Unemployment rate *(% lab. force)*	8.1	5.4	4.2	3.8	3.6	3.6	3.5	3.7	3.7
Employment-population ratio *(% pop. > 16 years)*	56.8	58.4	59.2	59.9	60.0	60.1	60.1	60.0	59.9
Trade balance [1] *(% GDP)*	–3.2	–3.6	–3.6	–3.9	–4.0	–3.9	–3.9	...	...
Prices									
Headline inflation	1.2	4.7	6.7	8.0	8.6	8.3	8.2	7.7	...
Core inflation	1.7	3.6	5.0	6.3	6.0	6.3	6.6	6.3	...

JAPAN

	2020	2021	Q4 2021	Q1 2022	Q2 2022	Q3 2022	09/22	10/22	11/22
Activity									
Real GDP	–4.6	1.6	0.5	0.6	1.7	1.8	–	–	–
Consumer confidence *(value)*	31.0	36.3	38.3	34.8	33.1	31.2	30.8	29.9	28.6
Industrial production	–10.6	5.6	1.1	–0.6	–3.6	4.0	9.6	4.5	...
Business activity index (Tankan) *(value)*	–19.8	13.8	18.0	14.0	9.0	8.0	–	–	–
Unemployment rate *(% lab. force)*	2.8	2.8	2.7	2.7	2.6	2.6	2.6	2.6	...
Trade balance [1] *(% GDP)*	0.1	–0.3	–0.3	–1.0	–2.0	–3.1	–3.0	–4.4	...
Prices									
Headline inflation	0.0	–0.2	0.5	0.9	2.4	2.9	3.0	3.8	...
Core inflation	0.2	–0.5	–0.7	–0.9	0.8	1.5	1.8	2.5	...

CHINA

	2020	2021	Q4 2021	Q1 2022	Q2 2022	Q3 2022	09/22	10/22	11/22
Activity									
Real GDP	2.2	8.1	4.0	4.8	0.4	3.9	–	–	–
Retail sales	–2.9	12.4	3.5	1.6	–4.9	3.5	2.5	–0.5	...
Industrial production	3.4	9.3	3.9	6.3	0.6	4.8	6.3	5.0	...
PMI manufacturing *(value)*	49.9	50.5	49.9	49.9	49.1	49.5	50.1	49.2	48.0
Foreign sector									
Trade balance [1,2]	524	681	681	728	823	905	905	905	...
Exports	3.6	30.0	23.1	15.7	12.9	10.0	5.6	–0.6	...
Imports	–0.6	30.0	23.7	10.6	1.4	0.8	0.3	–0.7	...
Prices									
Headline inflation	2.5	0.9	1.8	1.1	2.2	2.7	2.8	2.1	...
Official interest rate [3]	3.9	3.8	3.8	3.7	3.7	3.7	3.7	3.7	3.7
Renminbi per dollar	6.9	6.5	6.4	6.3	6.6	6.9	7.0	7.2	7.2

Notes: *1. Cumulative figure over last 12 months. 2. Billion dollars. 3. End of period.*
Source: *BPI Research, based on data from the Department of Economic Analysis, Bureau of Labor Statistics, Federal Reserve, Standard & Poor's, ISM, National Bureau of Statistics of Japan, Bank of Japan, National Bureau of Statistics of China and Refinitiv.*

EURO AREA

Activity and employment indicators

Values, unless otherwise specified

	2020	2021	Q4 2021	Q1 2022	Q2 2022	Q3 2022	09/22	10/22	11/22
Retail sales *(year-on-year change)*	–0.8	5.5	4.4	6.1	1.1	...	0.0	–2.7	...
Industrial production *(year-on-year change)*	–7.6	9.0	0.3	–0.2	0.4	...	4.9	...	...
Consumer confidence	–14.2	–7.4	–7.6	–13.7	–22.3	–26.9	–28.7	–27.5	–23.9
Economic sentiment	88.3	110.8	116.0	111.1	104.0	96.5	93.7	92.7	93.7
Manufacturing PMI	48.6	60.2	58.2	57.8	54.1	49.3	48.4	46.4	47.1
Services PMI	42.5	53.6	54.5	54.1	55.6	49.9	48.8	48.6	48.5
Labour market									
Employment (people) *(year-on-year change)*	–1.5	1.4	2.4	3.1	2.7	...	–	–	–
Unemployment rate *(% labour force)*	8.0	7.7	7.1	6.8	6.7	...	6.6	6.5	...
Germany *(% labour force)*	3.7	3.6	3.3	3.1	3.0	...	3.0	3.0	...
France *(% labour force)*	8.0	7.9	7.5	7.3	7.6	...	7.1	7.1	...
Italy *(% labour force)*	9.3	9.5	9.0	8.5	8.1	...	7.9	7.8	...
Real GDP *(year-on-year change)*	–6.3	5.5	4.8	5.5	4.3	2.1	–	–	–
Germany *(year-on-year change)*	–4.1	2.8	1.2	3.5	1.7	1.3	–	–	–
France *(year-on-year change)*	–7.9	7.2	5.1	4.8	4.2	1.0	–	–	–
Italy *(year-on-year change)*	–9.1	7.0	6.5	6.4	5.0	2.6	–	–	–

Prices

Year-on-year change (%), unless otherwise specified

	2020	2021	Q4 2021	Q1 2022	Q2 2022	Q3 2022	09/22	10/22	11/22
General	0.3	2.6	4.6	6.1	8.0	9.3	9.9	10.6	10.0
Core	0.7	1.5	2.4	2.7	3.7	4.4	4.8	5.0	5.0

Foreign sector

Cumulative balance over the last 12 months as % of GDP of the last 4 quarters, unless otherwise specified

	2020	2021	Q4 2021	Q1 2022	Q2 2022	Q3 2022	09/22	10/22	11/22
Current balance	1.8	2.6	2.6	1.8	0.7	–0.3	–0.3	...	...
Germany	7.0	7.4	7.4	6.6	5.4	4.3	4.3	...	...
France	–1.8	0.4	0.4	0.1	–0.5	–1.2	–1.2	...	...
Italy	3.9	3.1	3.1	2.1	0.9	–0.5	–0.5	...	...
Nominal effective exchange rate[1] *(value)*	**93.8**	**94.2**	**92.7**	**92.5**	**90.1**	**88.9**	**89.2**	**90.5**	**92.2**

Credit and deposits of non-financial sectors

Year-on-year change (%), unless otherwise specified

	2020	2021	Q4 2021	Q1 2022	Q2 2022	Q3 2022	09/22	10/22	11/22
Private sector financing									
Credit to non-financial firms[2]	6.3	3.5	3.3	4.4	6.1	8.4	8.9	8.9	...
Credit to households[2,3]	3.2	3.8	4.1	4.4	4.6	4.5	4.4	4.2	...
Interest rate on loans to non-financial firms[4] *(%)*	1.2	1.2	1.1	1.2	1.4	1.8	2.3	2.5	...
Interest rate on loans to households for house purchases[5] *(%)*	1.4	1.3	1.3	1.4	1.5	2.1	2.3	2.7	...
Deposits									
On demand deposits	12.9	12.6	10.5	9.1	7.7	6.3	5.5	3.4	...
Other short-term deposits	0.6	–0.8	–1.5	–0.3	0.9	5.3	8.1	9.9	...
Marketable instruments	8.1	11.6	9.9	0.7	2.0	4.3	7.8	3.2	...
Interest rate on deposits up to 1 year from households *(%)*	0.2	0.2	0.2	0.2	0.2	0.4	0.6	0.8	...

Notes: *1. Weighted by flow of foreign trade. Higher figures indicate the currency has appreciated. 2. Data adjusted for sales and securitization. 3. Including NPISH. 4. Loans of more than one million euros with a floating rate and an initial rate fixation period of up to one year. 5. Loans with a floating rate and an initial rate fixation period of up to one year.*

Source: *BPI Research, based on data from the Eurostat, European Central Bank, European Commission, national statistics institutes and Markit.*

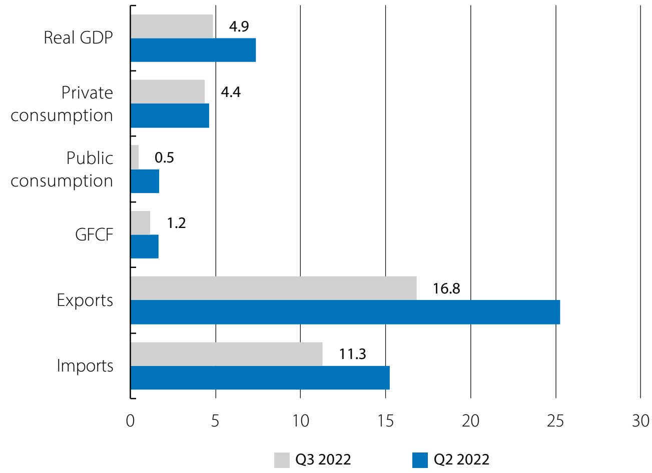
Ending the year with mixed feelings

Levels of economic activity confirm an underlying robustness in Q3, but there are signs of a slowdown. Economic growth of 4.9% in Q3 2022 has been confirmed, with internal and external demand contributing with 2.9 and 2.0 percentage points, respectively. A slowdown in activity is expected in the coming period, especially in the winter months, due mainly to rising energy and financing costs affecting both households and businesses. This deceleration is already evident in synthetic activity indicators, such as the daily activity indicator calculated by the Bank of Portugal, which at little more than halfway through 4Q 2022 points to stagnation when compared to the same period last year. This trend is confirmed by the OECD weekly activity indicator, the consumption and overall activity coincident indicators from the Bank of Portugal, and the November confidence indicators, which suggest that families will continue to adopt a cautious attitude in their consumption decisions (approximately 65% of GDP) and whose components relating to current demand in the various sectors of activity - industry, services, commerce - have been confirmed. Despite this, the economic climate indicator improved by 3 decimal points when compared to October, reflecting better expectations for the evolution of prices and demand from the end of Q1 2023 onwards, in line with our scenario of a return to a more favourable scenario from Q2 2023 onwards.

Inflation dropped in November to 9.9%. Portuguese inflation followed the trend of the eurozone of retreat during November. Indeed, INE's quick estimate of CPI for November shows a slight moderation compared to the October data (10.1%). The negative monthly change in the energy products index (-1.49%) was the main contributor to the decrease in the overall nuumber for November. This was not unrelated to the behaviour of oil prices in the international market as prices fell in November, with the price of Brent crude moderating to 89 euros on average, 6.5% lower than in October. Nevertheless, the price chain dynamics were still trending upwards, and core prices continue to grow. We are comfortable with our forecast for average inflation in 2022 (7.9%), but we think it is still too early to say with conviction that we will have reached the peak of this inflationary cycle.

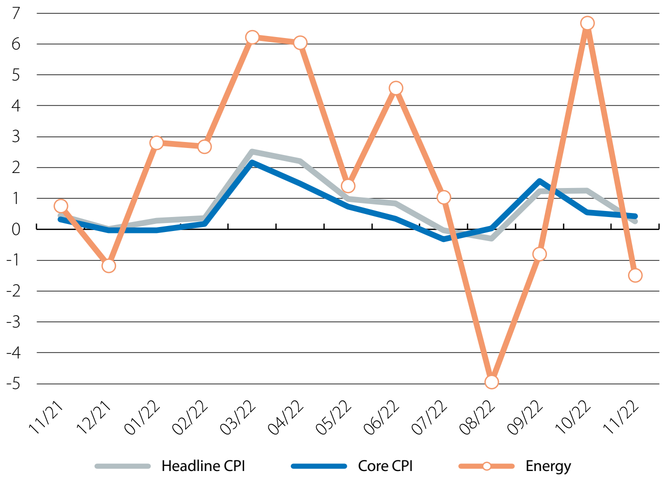
Labour market: are we seeing the first signs of reversal? According to data from the INE for October, the employed population decreased slightly (-0.2%; - 8,000 people), but maintains an increase compared to the same period last year (+0.7%; +36,200), while the unemployment rate stabilised at 6.1% for the second straight month. Other data call for greater caution, however. Unemployment registered at job centres in October rose by 0.7%, the third consecutive increase, but compared to the same period last year, it continues a considerable decline (-17.8%). We highlight the increase in seasonal unemployment in construction (+1.5%), an outcome that differs from that observed in the years prior to the pandemic. In fact, there is normally a seasonal increase in unemployment in this sector in the months of December and January, possibly due to weather conditions. This year,

Portugal: GDP and components of demand
Year-on-year change (%)



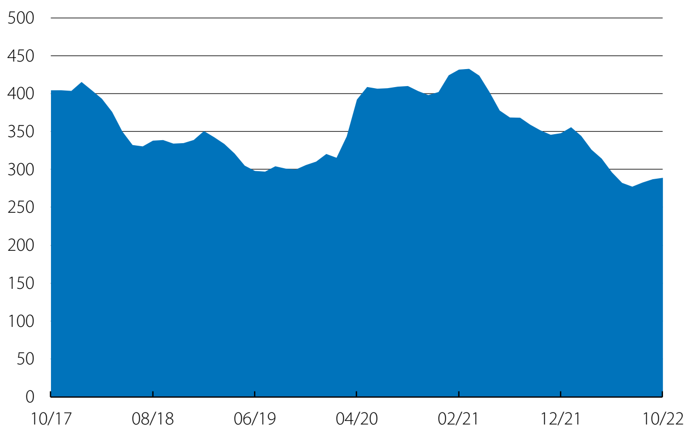
Source: *BPI Research, based on data from the National Statistics Institute of Portugal.*

Portugal: CPI
Monthly change (%)



Source: *BPI Research, based on data from the National Statistics Institute of Portugal.*

Portugal: registered unemployment at job centres *
(Thousands of people)



Note: ** Data not seasonally adjusted.*
Source: *BPI Research, based on data from the Portuguese Institute for Employment and Vocational Training (IEFP).*

however, the increase in unemployment occurred in September and October. Looking at the average of construction unemployment in the month of October in the 4 years prior to the pandemic, we see an average decrease of 2.7%, which stand in contrast to that which happened in 2022. Similar movements were also seen in real estate, administrative and support services (+1%, compared to an average of -0.9% in the 4 years prior to the pandemic). These may be the first effects of the economic slowdown, energy crisis, tightening financial conditions and global uncertainty.

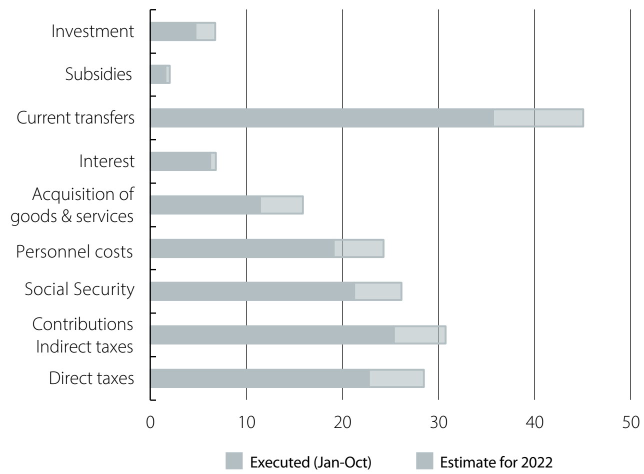
The budget balance remained in surplus until October, at 1.3% of GDP.This figure represents a reduction from the 3.0% registered up to September, justified by the support measures for families and pensioners. It should be recalled that the Government announced a set of measures to support families and businesses in the face of rising inflation and energy costs, some of which had a significant and extraordinary impact in October. It includes, for example, the one-off payment of 125 euros for individuals with a gross monthly income of up to 2,700 euros, and the payment of a half monthly pension to pensioners. Expenditure thus increased by 1.8% year-on-year until October, with current transfers increasing by 2.6% year-on-year. Revenue continued to grow significantly (14.7% year-on-year), with the substantial impact of tax and contributory revenue (15.7%), particularly VAT, which accounted for around 40% of tax revenue collected in the first 10 months.

The current account deficit corrected slightly in the 12 months ending in September. The deficit was €4.336 billion, down €228 million on the previous month, but still well above the deficit observed a year ago. The recovery of tourism activity and the improvement in the surplus in the other services traded (whose exports rose 70%, practically double the advance in imports) were the main factor preventing a sharper worsening of the current account last year. In turn, the balance of goods continues to suffer from the deterioration in the terms of trade, despite the greater increase in quantities exported than imported (see focus External Accounts: better structurally (despite the current situation)).

The risks to financial stability have worsened. The current context (high inflation, expectations of recession and/or significant deceleration and restrictive financial conditions), combined with vulnerabilities in the Portuguese economy (high debt levels, high exposure of credit contracts to variable interest rates and the exposure of the banking system to certain assets) holds risks to financial stability. The Bank of Portugal highlights the risk of a revaluation of risk premiums and a reduction in the price of residential property (although this risk is contained in the face of mitigating factors such as restrictions on the supply of housing, a lower percentage of transactions financed by credit or the implementation of macroprudential measures). In addition, it points to a risk of deterioration in the financial situation of individuals and companies and an increase in the risk of default, despite greater resilience. It also mentions the risk of a less marked reduction in the public debt ratio, in view of the increase in interest charges and the expected slowdown of the economy. With regard to the banking sector, Banco de Portugal also mentions market and credit risks, with a potential increase in impairments, and risks associated with the digital and climate transition.

Portugal: Budget Execution (public accounts)

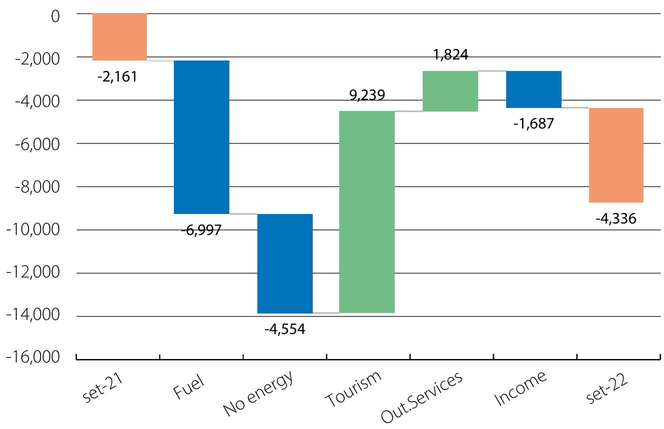
Portugal: Budget Execution (public accounts)



Source: *BPI Research, based on data from DGO and OGE 2023.*

Current account: development of the various scales

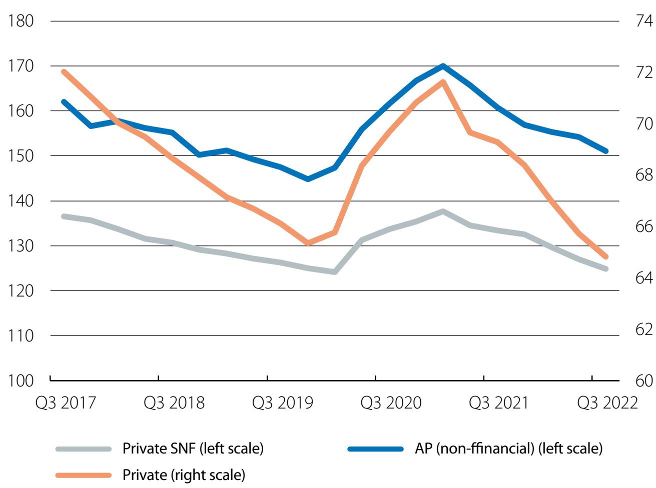
(Millions of euros)



Source: *BPI Research, based on data from the INE.*

Portugal: non-financial sector indebtedness

(% GDP)



Source: *BPI Research, based on Bpstat data.*

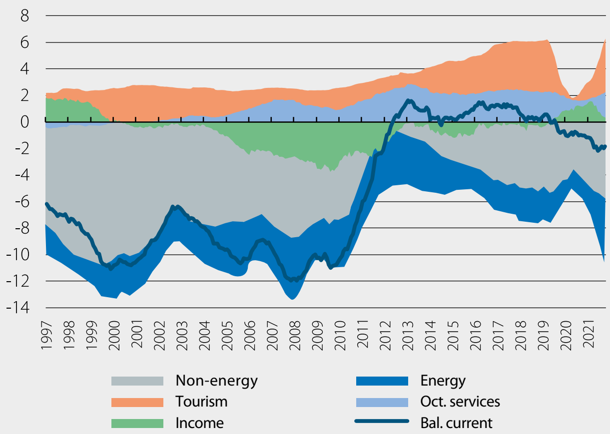
External accounts: better structurally (despite the current situation)

In the last three years, including 2022, the current account has returned to deficit, constituting a warning factor for external indebtedness. In the 12 months ending in September, the current account deficit amounted to €4.336 billion, equivalent to 1.9% of GDP. The overall debt level has not increased[1], however, and we believe that any such movement will be temporary, since the deterioration of the current account mainly reflects contextual factors associated with the pandemic, the impact of the war in Ukraine and the energy crisis, and as yet unresolved imbalances between supply and demand at a time when activity is no longer subject to restrictions. Indeed, a longer term view shows structural improvements in Portugal's external accounts, contributing to a greater resilience of the economy to external shocks and to a positive outlook for the evolution of Portugal's external debt.

This is evident in light of:i) the evolution of balances since the period in which the current account recorded its worst deficits up to now; ii) what the account's evolution would have been assuming trends from the 5 years prior to the pandemic; iii) and finally, the evolution of the weight in GDP of exports and imports of goods and services.

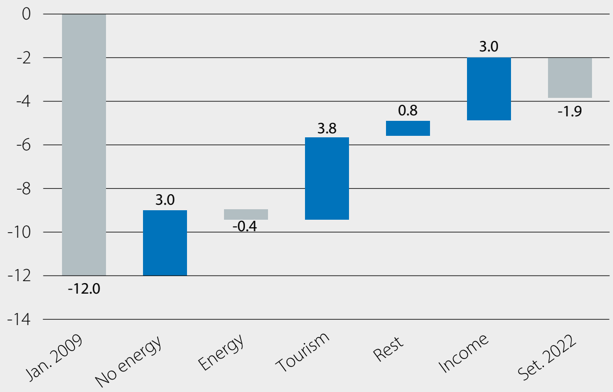
Since the year 2000, the current account has recorded three periods of deficit above 10%. The first between May 2000 and April 2002; the second between February and December 2006; and a third between February 2008 and January 2011. In this last period, in January 2009, a peak of the external imbalance equivalent to 12% of GDP was recorded. In that period, the energy deficit represented 4.4% of GDP, similar to the current 4.9% (reflecting the increased price of energy and the fact that Portugal is a net importer of these goods), but other imbalances were higher. The improvement since then will reflect a readjustment of the country's production structure in favour of the tradable sector (see second figure with plots). These positive readjustments are evident in the balance of non-energy goods, whose deficit remains well below the 9% recorded at the start of 2009 (6% in the year ending September 2022), reflecting the accumulated growth in the period in quantity exported of 28%, above the 10% increase in the quantity imported. Meanwhile, the tourism balance reflects a commitment to use comparative advantages to develop the sector, while there has been an increase in sales of other types of services and an improvement of income

Current account: components
(% of GDP)



Source: *BPI Research, based on data from Banco de Portugal.*

How the components of the current account have evolved since the highest deficit until now
(% of GDP)



Source: *BPI Research, based on data from Banco de Portugal.*

balances, mainly through remittances from emigrants and an increase in secondary income received from the private sector.

Looking at how the various balances would have behaved if they had evolved at the same rate as the five years prior to the pandemic[2] (i.e. excluding the effects associated with anomalous events such as the pandemic and the war), the counterfactual analysis suggests a positive evolution of the current account. In this scenario, the current account balance would be just above zero, benefiting from better performances across virtually all balances. The non-energy goods balance would show a higher deficit, reflecting the strength of

1. In September 2022, gross external debt stood at €405 billion, down €5.5 billion from the end of 2019, and net external debt was €168 billion, down €12 billion from 2019.

2. This period includes the post-Troika years, in which domestic demand recovered remarkably, influencing the behaviour of imports.

domestic demand and the need for increased imports to satisfy it; the energy balance would be less negative, as the impact associated with the extraordinarily high increase in energy prices is eliminated; and the services balance would continue to benefit from the development of the tourism sector and from the increased penetration of services provided by domestic companies in other markets.

Finally, in summary, but very revealing of the improvement in Portugal's external position, we have the increase in the weight of exports of goods and services in GDP. At the end of the first half of this year, these represented 45% of GDP, 25 percentage points higher than some 30 years ago.

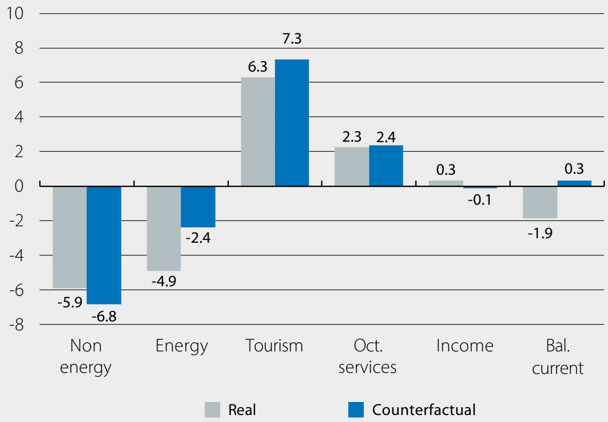
From a short-term perspective, the unfavourable impact caused by factors external to economic activity on the balances of goods and services (those with the greatest influence on the current account) **is visible.**In 2020-21, their behaviour was influenced by the confinements and, in 2022, by the strong increase in prices and deterioration in the terms of trade.[3] The balance of goods, structurally in deficit, has been the main cause of the deterioration in the current deficit throughout 2022. In the 12 months ending September, the balance of goods recorded a deficit of €29.5 billion, equivalent to 10.8% of GDP, the highest level since the first half of 2011 and not far below the 12%-13% seen in 2008-2009.However, cross-checking data from various sources[4] shows that the worsening of the balance of goods reflects the unfavourable terms of trade shock.[5] If in 2022 prices were equal to those of 2019, the balance of goods would have improved by about 13% compared to 2019,[6] putting the deficit in the balance of goods at around 6.5% of GDP, suggesting that the terms of trade effect justifies the deterioration of the deficit by about 4 percentage points. While the information available for the balance of services, structurally in surplus, does not allow the price effect to be isolated, it is clear that the impact of the confinements in reducing its surplus (it went from a surplus of 8.4% of GDP in 2019 to 4.3% in 2020 and 4.8% in 2021) was quickly corrected with the opening of economic activity globally, as the surplus as a percentage of GDP already equalled that recorded in 2019 in the 12 months ending in September.

In short, taking into account these conditioning factors and the prospects of a gradual dilution of imbalances in the energy markets, which are largely responsible for the worsening of the terms of trade, our expectation that the current account balance will tend towards a level closer to balance (forecast current account balance 2024: -1.2%) is justified, reflecting the structural improvements we have highlighted.

Teresa Gil Pinheiro

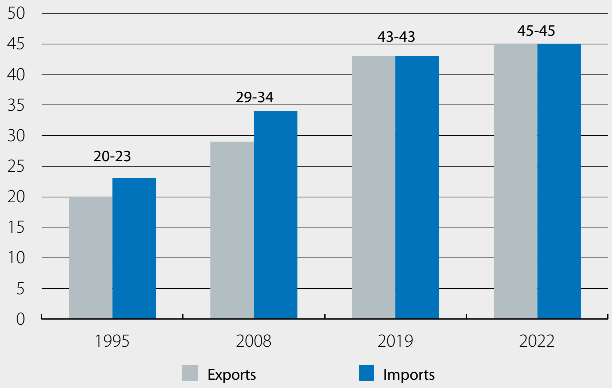
3. In the first half of 2022 (latest data available) terms of trade fell by 4.5% year-on-year.
4. To calculate the unit price of imports and exports, we used the international trade statistics published by INE.
5. The unfavourable trend in the terms of trade reflects an increase in the prices of imported goods that is higher than that of exported goods.
6. Resulting from an increase in the exported quantity of approximately 3%, while the imported quantity is still 1.3% below that of 2019.

Current account: real evolution versus counterfactual evolution
(% of GDP)



Source: *BPI Research, based on data from Banco de Portugal.*

Exports and imports of goods and services at constant prices
(% of GDP)



Source: *BPI Research based on data from INE.*

Summer 2022: balance of tourist activity

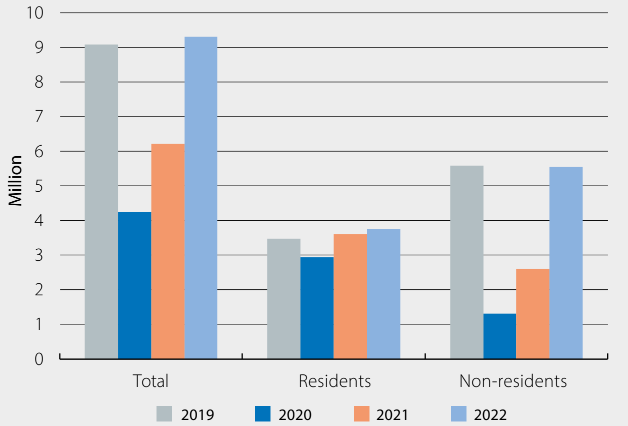
Summer is by nature the peak period for tourism in Portugal. The third quarter of each year is the period in which typically one third of the annual number of guests arrives. In this article we take stock of the summer of 2022, a period in which sanitary restrictions were practically non-existent, and we briefly look ahead to what may lie ahead for the sector.

The first major highlight was the number of guests. In Q3 2022, the number of guests of Q3 2019 was exceeded for the first time (by 2.5%) with a total of 9.3 million guests. Another symbolic fact is that August was the month with the highest number of tourists on record, with 3.3 million guests, slightly surpassing the previous record from August 2019. But the profile of this post-pandemic summer evolution was not uniform. In 2021, resident guests were the engine of recovery and exceeded the 2019 figure by 23%, i.e. they more than compensated for the fall of 545,000 resident guests that occurred in 2020. In turn, non-resident guests in Q3 2021 only recovered 30% of the fall of 4.2 million guests recorded in Q3 2020. In 2022, non-resident guests have finally made the decisive leap forward, recovering 69% of the guests lost in Q3 2020 and enabling a full restoration and surpassing of pre-pandemic levels.

Thus, if domestic tourists prevented more pronounced falls in the sector in 2021, it was the return of foreign tourists in 2022 that allowed a return to true normality. The total number of foreign tourists in 3Q 2022 was only -0.6% compared to the same period of 2019. Europeans, the most important segment of foreign tourists and which accounted for about 70% of guests in Q3 2019, beat this by 2.5%. Of the most important source countries (UK, Spain, Germany and France), only Germany was 3.1% behind the 2019 figure. But the highlight was tourists from the United States of America, with growth of 32%,[1] replacing Germany as the third most important source country in Q3 2022. We believe that this growth in North American tourists is based on several factors. Firstly, on a trend of global recovery in the tourism sector, which also includes long-distance tourism. In general, the pandemic and confinement periods meant that families postponed consumption and now, with the relaxation of restrictions, they have the financial means to make trips formerly postponed. The appreciation of the dollar against the euro, which intensified in Q3 2022, also makes European destinations more competitive. Portugal also benefits from the competitive advantage of being the European country where airline tickets from the USA

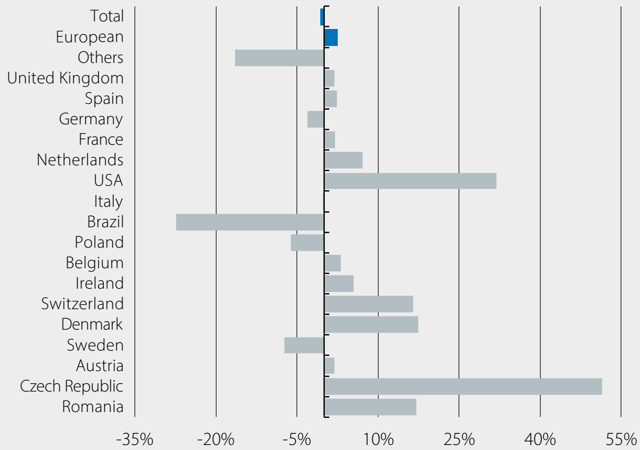
1. Tourists from the Czech Republic increased the most (51.5%), although their weight is not very significant (only 0.7% of foreign tourists).

Portugal: number of tourists
(Sum of 3Q)



Source: *BPI Research, based on data from the INE.*

Number of foreign tourists
(3Q 2022 versus 3Q 2019)



Source: *BPI Research, based on data from the INE.*

are the cheapest. The "Others" slice includes countries such as China and Russia, whose tourist arrivals have been constrained either for health reasons (in the first case) or for geopolitical reasons (in the second).

We have already seen that the number of tourists in Q3 2022 exceeded pre-pandemic levels, but did that translate into revenue? The answer is a positive one. For this analysis, we deflated the INE series of total income from tourist accommodation establishments. In real terms, we note that it was only in Q2 2022 that revenues exceeded those of the same quarter pre-pandemic for the first time, and only by 8%. This is not unrelated to the fact that tourist numbers only exceeded 2019 figures for the first time in April (and subsequently in the July to September period). In 3Q 2022, revenues surpassed 2019 figures by 17%, despite the number of tourists only being

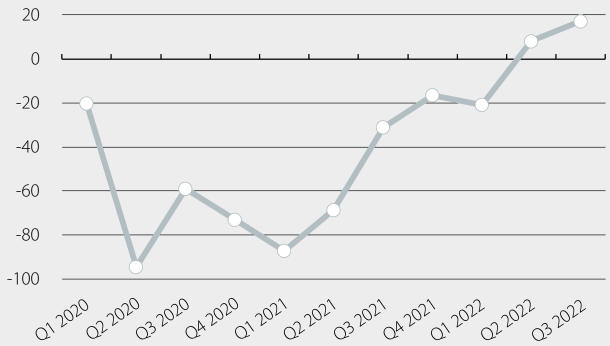
2.5% higher, as we saw earlier. We believe that the explanation for this lies in three aspects. First, the percentage of overnight stays in four and five star hotels was slightly higher. In parallel, RevPAR[2] on average was 20% higher in these months compared to the same months in 2019, exceeding €100 for the first time in August. This suggests a higher profile tourism in hotel units with the capacity to generate more revenue, probably through greater cross selling and service portfolio. Finally, the price effect,
with increases in the value of overnight stays higher than increases in the overall basket of consumer prices.

Looking ahead, the known data seems to be positive. In recent months, airline tickets issued to Portugal have shown very significant growth compared to 2021, suggesting that tourism will be stronger than recent years in coming quarters. As is well known, flight data has a strong correlation with the number of tourists, and, with this in mind, we have compared our forecast for Q4 2022 and Q1 2023 with a forecast applying to those quarters in 2021 with a variation equal to the number of tickets issued (with one-month lag).[3] The forecasts do not differ substantively and the most important data to highlight is the pattern of similarity with the pre-pandemic period, with our forecast differing in pointing to year-end guest numbers slightly below Q4 2019. This data seems to be corroborated by the most recent surveys that signal a greater willingness to travel in 2023 and even increased budget to do so.[4] The strong financial results of airlines in Q3 2022 will also enable capacity very close to 2019 levels. All these forecasts are not immune to contextual risks. On the negative side, income erosion due to inflation, the energy crisis and geopolitical conflicts. On the positive side, the possibility of relief in China's zero Covid policy and also the accumulated surplus savings.

Tiago Belejo Corre

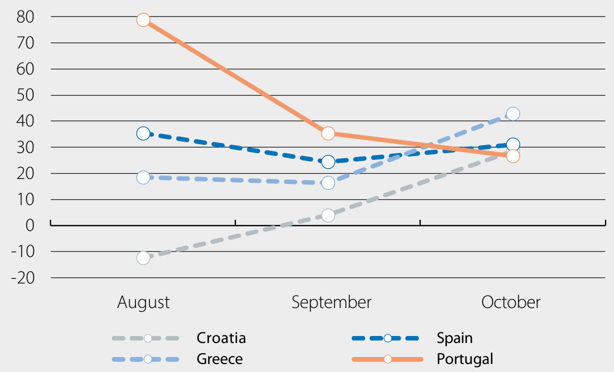
2. Acronym for Revenue per available room.
3. This means that for the guest forecast in October 2022, we took as reference the evolution of tickets issued in September, while for November 2022 we took the airline tickets issued in October as reference. For the months of Q1 2023, we have kept the last known change (October 2022 issues) as a reference.
4. See Expedia Group's "Traveler Insights Report 2022 Q4", where 46% of consumers say travel is more important now than before the pandemic, and 43% say they will increase their travel budget for next year.

Income from tourist accommodation establishments
Change from the same quarter of 2019 (%)



Note: *The amounts of income were deflated, so the variation is presented in real terms.*
Source: *BPI Research, based on data from the INE.*

Airline tickets issued to Portugal and competitors
Yoy vs 2021 (%)



Notes: *Tickets issued in global distribution systems for journeys within the next 365 days, for Portugal and competing markets. Values subject to change due to postponement or cancellation. Tickets booked directly with Low-Cost companies are outside the scope of these data.*
Source: *BPI Research, based on data from Turismo de Portugal and ForwardKeys.*

Tourists: forecast for the coming quarters
(Millions)

Source: *BPI Research, based on data from INE, Turismo de Portugal and ForwardKeys.*

Effort rate: a reference for renegotiation of mortgage loans

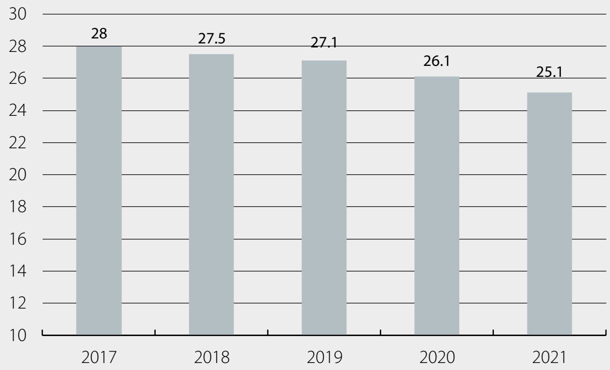
Following the meeting of the Council of Ministers of 3 November, a decree-law was approved establishing measures to monitor and mitigate increased effort rates in loan contracts for the acquisition or construction of permanent home ownership.[1] As communicated by the government, this decree-law aims to regulate the negotiation process between banks and clients whenever a certain effort threshold is reached in loans.[2] The threshold is measured by the effort rate, a ratio between income and financing costs. Specifically, the conditions for the debtor to be covered by this decree-law and to be able to renegotiate his housing credit free of charge are as follows: 1) effort rate equal to or greater than 50%; 2) effort rate equal to or greater than 36% which has worsened by more than five percentage points; 3) effort rate equal to or greater than 36% with an increase of three percentage points in the interest rate at which the mortgage loan was contracted. In this article, we intend to give an idea of the scope and importance of this measure.

When purchased using mortages, the property in which people in Portugal live often represents the largest part of their assets, but also the largest share of their responsibilities and an important proportion of the monthly expenses. In fact, at the end of 2021, the value of the mortgage portfolio in the Portuguese banking system amounted to more than EUR 101 billion under more than 1.4 million contracts. There are thus more than 2 million Portuguese mortgage holders, which shows the importance that the recent rise in interest rates can have for a significant part of the population. The weight of loans to individuals secured by mortgages on the assets of the Portuguese banking system is also very significant, rising to a quarter of the total at the end of 2021 (see the first graph), highlighting the importance of this issue for the banks. What then will be the applicability of this measure in the current portfolio of mortgages?

Estimating the average loan-to-value ratio of the national bank's mortgage portfolio[3], there is no cause for concern. In any case, considering only the average mortgage instalment or adding to it the average personal loan

Weight of loans to individuals secured by real estate in the assets of Portuguese banks

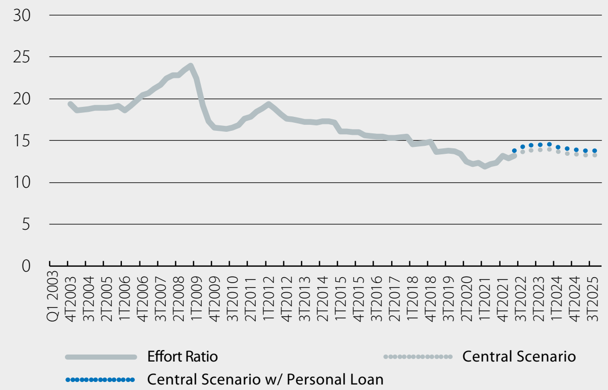
(%)



Source: BPI Research, based on data from Banco de Portugal (Financial Stability Report - June 2022).

Effort rate: Housing Loan portfolio (average loan)

(%)



Source: BPI Research, based on data from the INE.

instalment,[4] the estimated effort rate remains below 20% and far from the levels established by the decree-law.

This way of approaching the issue is limiting insofar as the overall mortgage portfolio also includes older mortgages and where the outstanding principal (and therefore the monthly instalment) is also lower. On the other hand, we estimate that around 40% of the total volume of mortgage loans in the current banking portfolio will have been contracted from 2019. A range of literature on the subject indicates the situation of «negative equity»,[5] that is, when the mortgaged property is worth less than the associated outstanding

1. At the time of writing, the decree has not yet been published, so we rely on information provided at the press conference following the Council of Ministers.
2. In its resolution, the Council of Ministers indicates that not only mortgage loans, but also personal loans should be considered for effort.
3. In August 2022, INE data indicated an average outstanding debt and an average repayment instalment of 60,750 euros and 268 euros, respectively The following assumptions were made: 1) income growth rates equal to those of the «Medium-Term Agreement on Improving Incomes, Wages and Competitiveness»; 2) annual growth rate of average outstanding capital equal to the average of the last 4 years; 3) repayment term of the loan of 30 years; 4) loan spread of 1.2%; 5) evolution of the 12-month Euribor index equal to our projections.
4. We used as a proxy a personal loan in line with the average loan indicated in the 2021 Credit Markets Monitoring Report of Banco de Portugal (amount of 6,800 euros, term of 5 years and rate of 10%).
5. See A. Linn & R. Lyons. «Three triggers? Negative equity, income shocks and institutions as determinants of mortgage default.» Bank of England Staff Working Paper No. 812.

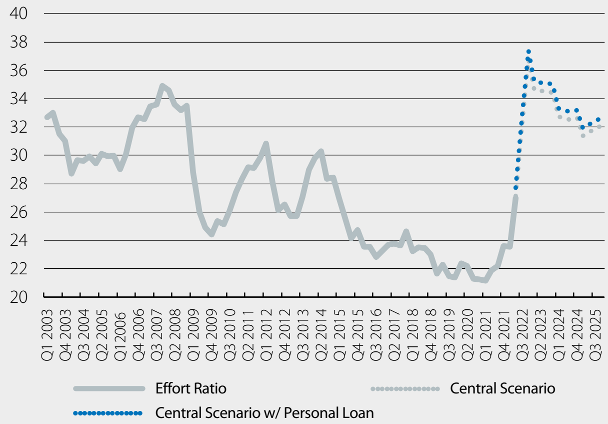
principal, as one of the triggers for default. This is more likely to occur when there is a downturn in the property market at the beginning of the loan, when the outstanding principal is higher. Other authors also point out that the peak probability of default on home purchase loans occurs at approximately 4 years of its life.[6] Thus, we calculated the estimated effort rate for new loans[7] to assess the framework of the legislative measure. As can be seen (third graph), we expect the peak effort rate to occur in Q4 2022 (37%, both for those with mortgages and those with mortgages combined with personal loans), as a result of the high rate of rate hikes by the ECB. Subsequently, due to the joint effect of a price adjustment in the real estate market (which we expect to be small), together with the slowdown in the rise of indexing factors and the recovery of household income, the rate returns to levels below the thresholds defined by the decree-law.

From this analysis we can deduce that there is a possibility that part of the loans contracted (mainly those contracted last year with effort rates of around 30%), may exceed the 36% effort rate level. The 50% threshold is expected to apply to a very small percentage of loans and will be cases that would have been in great difficulty even before the start of the cycle of interest rate rises. Another relevant attenuating factor is our estimate that fixed-rate loans in recent years account for around one third of the total (see last graph). This is important as these loans are immune to the rise in indexing and, as long as there has been no loss of income in the meantime, their approval has already taken into account the financial capacity of the families for a given instalment amount.

By way of conclusion, it should be noted that the effort rate measure is a reference, but it contains some limitations, especially the fact that it ignores the metric of disposable income in absolute terms. For example, a household with a monthly income of 4,000 euros and another with 2,000 euros may both have an effort rate of 36%, but the net disposable income after payment of loan instalments, which is used to meet the remaining expenses, is different, and therefore the real effort is also quite different. On the other hand, if the renegotiation of loans results in grace periods or longer maturities, the overall interest payable by families will be higher and it will also be more difficult for banks to comply with the Bank of Portugal's macro-prudential measure, which

Effort rate: new loans

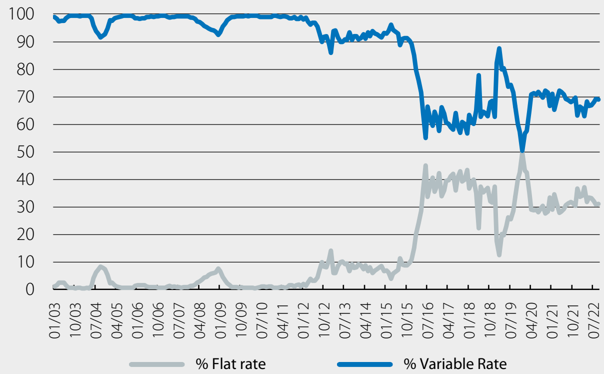
(%)



Source: *BPI Research, based on data from the INE.*

New Mortgage Loans: variable rate vs fixed rate

(%)



Source: *BPI Research, based on data from the Banco de Portugal. Note: Banco de Portugal discloses the new home loan operations with rates in force for a term of less than one year. We are assuming that rates with a term longer than 1 year refer to fixed rates.*

aims for the gradual convergence of loans to an average maturity of 30 years by the end of 2022. Furthermore, some authors argue that policies aimed at promoting and maintaining employment are more likely to contain long-term defaults than policies to temporarily modify mortgages.[8] In summary, the fact that it streamlines the negotiation process between banks and borrowers is a positive aspect of this decree-law. Despite the fact that interest rates are now returning to levels considered normal, the rise in rates was quick, and this measure could facilitate a one-off and immediate response to some families, reducing the increase in default.

Tiago Belejo Correia

6. See Francke, M., & Schilder, F. (2014). «Losses on Dutch residential mortgage insurance». Journal of European Real Estate Research 7.3, 307-326.
7. We start with the following assumptions: 1) income growth rates equal to those of the «Medium-Term Agreement on Improving Incomes, Wages and Competitiveness»; 2) housing price/m2 growth rates equal to our HPI forecasts; 3) average property size is equal to the known metric of the Spanish market (93.75 m^2); 4) loan amortization period is 30 years; 4) 80% LTV; 5) loan spread of 1.2%; 6) evolution of the12-month Euribor index equal to our projections.

8. See Gerardi, Kristopher; Herkenhoff, Kyle F.; Ohanian, Lee E.; Willen, Paul S. (2013). «Unemployment, negative equity, and strategic default». Atlanta Fed Working Paper No. 2013-4.

Activity and employment indicators

Year-on-year change (%), unless otherwise specified

	2020	2021	Q4 2021	Q1 2022	Q2 2022	Q3 2022	09/22	10/22	11/22
Coincident economic activity index	–5.3	3.5	6.5	7.3	7.0	6.0	5.7	5.4	...
Industry									
Industrial production index	–6.9	4.5	–1.5	–2.1	2.0	2.1	0.9	...	...
Confidence indicator in industry *(value)*	–15.3	–5.3	–1.4	–0.1	–2.3	–4.7	–5.4	–6.3	–6.6
Construction									
Building permits - new housing (number of homes)	0.7	13.5	–6.9	45.6	–22.9	6.0	10.8	...	...
House sales	–11.2	20.5	17.2	25.8	4.5	...	–	–	–
House prices *(euro / m^2 - valuation)*	8.3	8.6	11.0	11.5	14.2	15.8	15.6	13.5	...
Services									
Foreign tourists *(cumulative over 12 months)*	–76.2	51.5	51.5	259.9	298.1	244.4	244.4	199.7	...
Confidence indicator in services *(value)*	–19.0	0.1	12.0	13.0	21.1	17.9	14.4	11.1	7.6
Consumption									
Retail sales	–3.0	4.9	7.3	12.7	3.1	3.3	2.5	1.1	...
Coincident indicator for private consumption	–6.2	4.9	7.6	7.1	5.7	3.5	2.9	2.4	...
Consumer confidence index *(value)*	–22.4	–17.2	–13.5	–19.3	–30.5	–31.8	–32.7	–35.2	–37.7
Labour market									
Employment	–1.9	2.8	3.1	4.7	1.9	1.1	1.1	0.8	...
Unemployment rate (*% labour force*)	7.0	6.6	6.3	5.9	5.7	5.8	6.1	6.1	...
GDP	**–8.3**	**5.5**	**6.6**	**12.0**	**7.4**	**4.9**	**–**	**–**	**–**

Prices

Year-on-year change (%), unless otherwise specified

	2020	2021	Q4 2021	Q1 2022	Q2 2022	Q3 2022	09/22	10/22	11/22
General	0.0	1.3	2.4	4.3	8.0	9.1	9.3	10.1	9.9
Core	0.0	0.8	1.5	3.1	5.5	6.5	6.9	7.1	7.2

Foreign sector

Cumulative balance over the last 12 months in billions of euros, unless otherwise specified

	2020	2021	Q4 2021	Q1 2022	Q2 2022	Q3 2022	09/22	10/22	11/22
Trade of goods									
Exports *(year-on-year change, cumulative over 12 months)*	–10.3	18.3	18.3	21.2	18.9	22.8	22.8	...	...
Imports *(year-on-year change, cumulative over 12 months)*	–14.8	22.0	22.0	33.3	31.5	35.0	35.0	...	...
Current balance	**–2.1**	**–2.5**	**–2.5**	**–4.3**	**–4.7**	**–4.3**	**–4.3**	**...**	**...**
Goods and services	–3.9	–5.7	–5.7	–6.9	–6.4	–5.1	–5.1	...	...
Primary and secondary income	1.8	3.2	3.2	2.7	1.7	0.8	0.8	...	...
Net lending (+) / borrowing (–) capacity	**–0.1**	**1.2**	**1.2**	**–0.8**	**–1.3**	**–2.1**	**–2.1**	**...**	**...**

Credit and deposits in non-financial sectors

Year-on-year change (%), unless otherwise specified

	2020	2021	Q4 2021	Q1 2022	Q2 2022	Q3 2022	09/22	10/22	11/22
Deposits [1]									
Household and company deposits	10.0	9.3	9.3	8.9	8.2	7.8	7.8	8.0	...
Sight and savings	18.8	16.3	16.3	15.3	12.9	11.2	11.2	10.8	...
Term and notice	1.2	1.2	1.2	1.1	2.3	3.3	3.3	4.4	...
General government deposits	–21.0	–4.1	–4.1	9.8	8.5	–0.1	–0.1	4.8	...
TOTAL	**8.9**	**9.0**	**9.0**	**8.9**	**8.2**	**7.5**	**7.5**	**7.9**	**...**
Outstanding balance of credit [1]									
Private sector	4.6	2.9	2.9	2.8	2.7	2.0	2.0	1.8	...
Non-financial firms	10.5	2.2	2.2	1.2	1.0	–0.1	–0.1	–0.4	...
Households - housing	2.1	3.3	3.3	3.0	3.8	3.3	3.3	3.1	...
Households - other purposes	–1.1	3.1	3.1	6.4	3.3	3.2	3.2	3.0	...
General government	–4.2	3.8	3.8	5.3	–1.3	–1.5	–1.5	0.6	...
TOTAL	**4.2**	**2.9**	**2.9**	**2.8**	**2.5**	**1.9**	**1.9**	**1.7**	**...**
NPL ratio *(%)* [2]	**4.9**	**3.7**	**3.7**	**3.6**	**3.4**	**...**	**–**	**–**	**–**

Notes: *1. Residents in Portugal. The credit variables exclude securitisations. 2. Period-end figure.*
Source: *BPI Research, based on data from the National Statistics Institute of Portugal, Bank of Portugal and Refinitiv.*

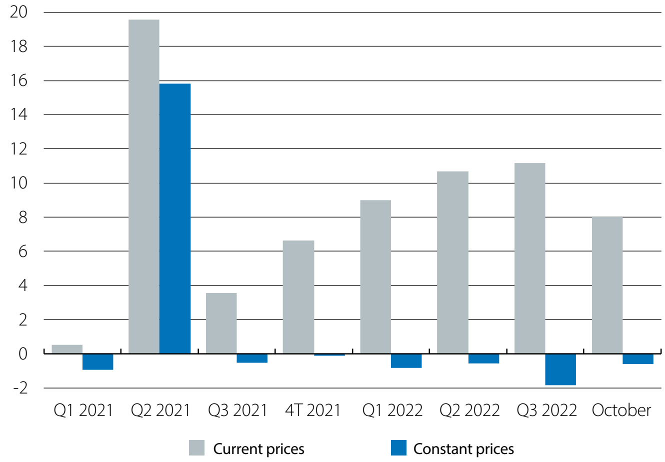
The Spanish economy performs better than expected in the closing stages of the year

The Spanish economy continues to slow, but is holding up better than expected in the adverse context, introducing upward biases into our GDP forecast for Q4 2022 (–0.3% quarter-on-quarter vs. +0.2% in Q3). The indicators for the last quarter of the year provide mixed signals. On the one hand, there is a cooling in domestic spending, dented by the deterioration in real income, and a worsening of the Purchasing Managers' Index (PMI) in the industrial sector. On the other hand, the labour market is holding up better than expected, with job creation slightly dampened but still positive, while the tourism sector remains buoyant and is very close to recovering pre-pandemic levels, with the weakness of one of our biggest source markets – Germany – being offset by the strength of others. Another good piece of news is the containment of inflation. Thanks to the correction in electricity and gas prices, it has now registered four consecutive months of declines, placing it at 6.8% in November, the lowest rate since January.

The weakening of economic activity is less pronounced than expected. The cooling of activity is especially evident in industry, which is more susceptible to the supply shocks that have been affecting the economy, whereas services are holding up very well. In particular, the manufacturing sector's PMI, hampered by the heightened uncertainty as well as the increased energy, transport and commodity costs, remains in contractionary territory (45.7 points in November) due to a drop in production and a shrinking order book. However, the services PMI climbed back above 50 points in November, reaching 51.2 points, the highest level since July, thanks to stronger than expected demand. Household spending, meanwhile, remains very weak but is declining at a slower rate than before, and retail purchases – excluding service stations and in real terms – registered the smallest decline in five months in October (–0.6% year-on-year vs. –1.8% in Q3 2022).

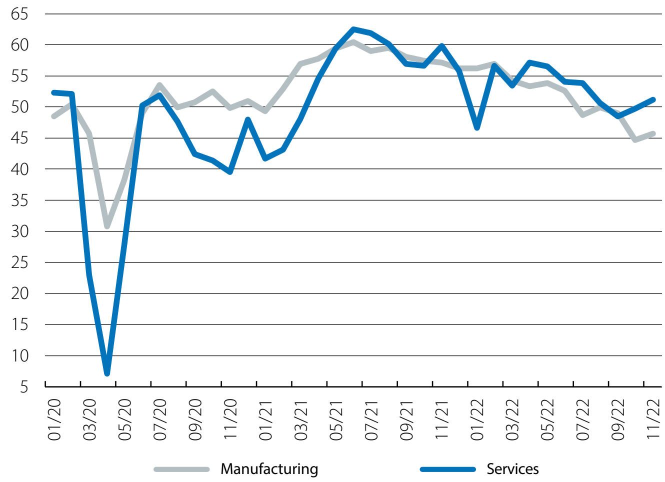
The labour market remains resilient. The pattern in employment in recent months remains positive, despite the current adverse economic scenario. Social Security affiliation numbers fell very slightly in November, by just 155 workers, which represents a significant improvement compared to the usual trend in that month (an average decline of 23,200 people in the period 2014-2019). In seasonally adjusted terms, this was the biggest monthly increase in the last year (77,695), meaning that the seasonally-adjusted number of registered workers not on furlough has grown by 0.5% in Q4 so far, compared to 0.7% in Q3, marking a slower decline than we had anticipated. As for registered unemployment, the figures are once again better than expected, with a fall of 33,512 people; this is the biggest decrease in a month of November in the last decade, except for in 2021 when it was affected by the recovery of employment after the pandemic.

Spain: retail trade
Year-on-year change (%)



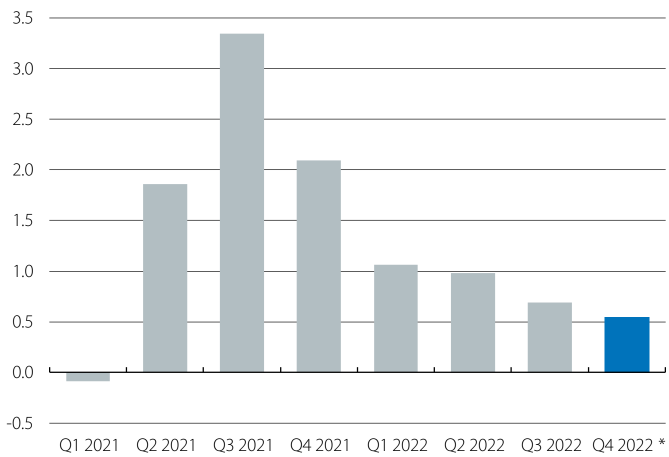
Note: Data excluding service stations, corrected for seasonal and calendar effects.
Source: BPI Research, based on data from the National Statistics Institute .

Spain: PMI
Level



Source: BPI Research, based on data from IHS Markit.

Spain: registered workers affiliated with Social Security
Quarter-on-quarter change (%)



*Notes: Seasonally adjusted series of registered workers not on furlough. * Data for October-November.*
Source: BPI Research, based on data from the Ministry of work, migration and social security (MITRAMISS).

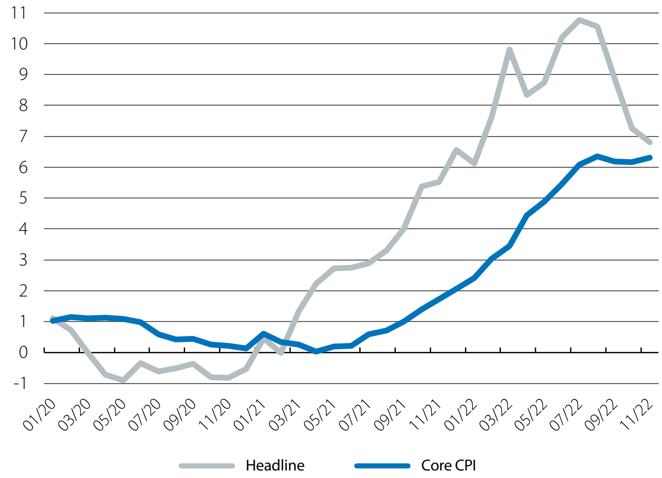
Inflation continues to fall, driven by the drop in energy prices. According to the leading indicator, headline inflation moderated to 6.8% in November (7.3% in October). This was mainly due to the fall in electricity prices as the decline observed in late October continued throughout November, thanks to benchmark gas prices remaining contained, lower levels of electricity generation at gas-fired power plants and a higher number of consumers paying the surcharge to offset the gas price cap. The fall in fuel prices has also played a role in this moderation, albeit to a lesser extent, as the price of a barrel of Brent oil registered a 6.5% monthly reduction in November, bringing it to 89 euros. However, in the other components of the CPI, the increases in production costs are still being transmitted to final prices. Therefore, core inflation, which excludes energy and unprocessed foods, rose slightly in November to 6.3%.

The recovery in tourism revenues is offsetting the sharp deterioration in the foreign energy deficit. Up until last September, the current account balance had a surplus of 1,376 million euros, 77.9% less than a year earlier (6,224 million). This deterioration is mainly explained by the widening of the deficit in the balance of goods, which increased to 53,437 million euros, four times higher than in the same period last year (–13,267 million). On the one hand, the energy deficit continues to rise and reached an all-time peak in the period January-September (–39,480 million vs. –18,007 million in 2021), as a result of the sharp rise in import prices (up 70.5% year-on-year). However, the balance of non-energy goods has also deteriorated, registering a deficit of 13,957 million (compared to a surplus of 4,740 million in 2021), as a result of greater import growth (27.4% vs. 19.8% in the case of exports), which was also driven by a sharp price rally (18.3%).

On the upside, and thanks to the excellent summer season, the tourism sector registered a cumulative surplus of 39,356 million euros for the first nine months of the year. The data for October remain encouraging: the number of foreign tourist arrivals is gaining momentum, approaching 7.2 million, and they spent almost 8.3 billion euros. This narrows the gap versus the levels of the same month in 2019 to 5.4% and 0.3%, respectively (–11.6% and –3.9% in September). Overnight stays in hotels by foreign tourists also improved, with the figure as of October lying 6.3% below that of October 2019 (–8.2% in the previous month).

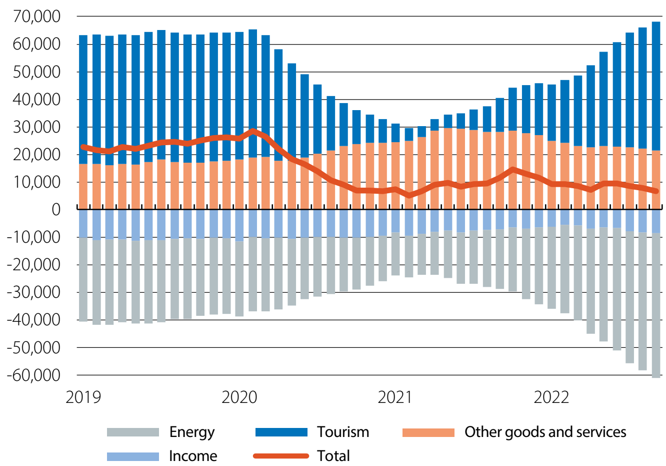
There are growing signs of cooling in the housing market. In Q3 2022, home values based on appraisals stagnated in quarter-on-quarter terms, having registered meagre growth in the previous quarter (0.4%); in year-on-year terms, there has been a sharp slowdown over the course of 2022 to 4.7% in Q3, 2 points less than in Q1. Housing demand is also beginning to run out of steam: the number of sales rose by 6.9% year-on-year in September, compared to rates in excess of 30% in the first few months of the year; however, in cumulative terms for the last 12 months, a total of 644,000 sales have been completed, marking the highest figure since 2008.

Spain: CPI
Year-on-year change (%)



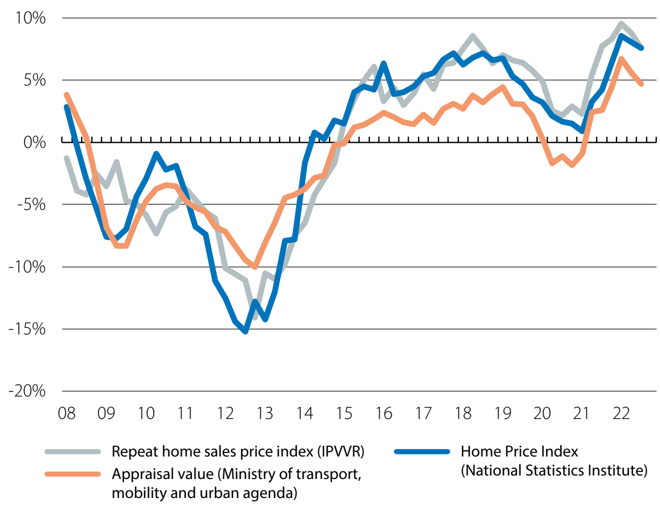
Source: *BPI Research, based on data from the National Statistics Institute.*

Spain: current account balance
(EUR millions)



Note: *12-month cumulative figures.*
Source: *BPI Research, based on data from the Bank of Spain and the Department of Customs.*

Spain: home prices
Year-on-year change (%)



Source: *BPI Research, based on data from the Association of Property Registrars, the National Statistics Institute and the Ministry of transport, mobility and urban agenda.*

Evolution of household financial assets in nominal and real terms in Spain

Increase in savings in nominal terms since the pandemic

In this article, we analyse the purchasing power of the stock of Spanish households' financial assets[1] in a context of high inflation.

In 2020 and 2021 there was a significant increase in savings among Spanish households. In particular, the COVID-19 restrictions and lockdowns made it difficult for households to spend their money on in-person activities (such as tourism and leisure), while at the same time the support from economic policies softened the decline in gross disposable income – it fell by just 2.0% year-on-year in 2020, and by 2021 it was already back above the pre-pandemic level.

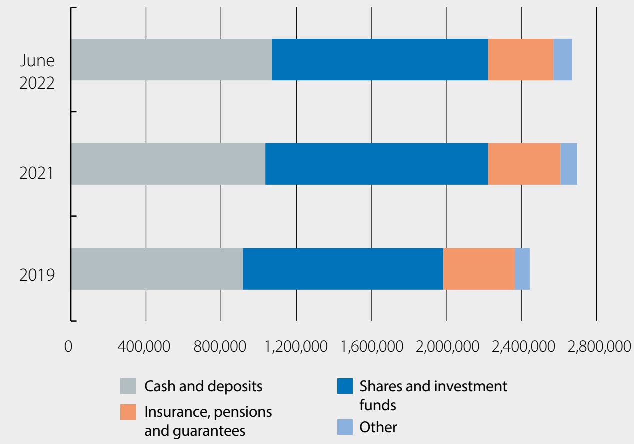
In this context, the stock of households' financial assets[2] increased by over 224 billion euros between the end of 2019 and Q2 2022. This is a vast increase; to put it in context, between the end of 2015 and the end of 2019 the stock of assets rose by 119.9 billion, far short of the increase of the last two and a half years.

This growth corresponds to an acquisition of assets of 229 billion euros and a revaluation effect of –8 billion. The savings accumulated by households during the pandemic have played a significant role in this increase in financial assets:[3] in view of the restrictions on leisure and social activities, households opted to acquire more financial assets. Specifically, in each year between 2015 and 2019, Spanish households acquired financial assets worth an average of 2.6% of their gross disposable income. This figure rose to 14.9% in 2020 and 9.1% in 2021, and in the first two quarters of 2022 it was still above the average of those same quarters in the years prior to the pandemic. In fact, if we compare the observed level of acquisition of financial assets between the end of 2019 and Q2 2022 with the «theoretical» acquisition that would have occurred over the same period if households had allocated the same percentage of their disposable income as they did in 2015-2019, then the «excess» acquisition of these assets amounts to more than 150 billion euros.

Inflation has eroded households' financial wealth

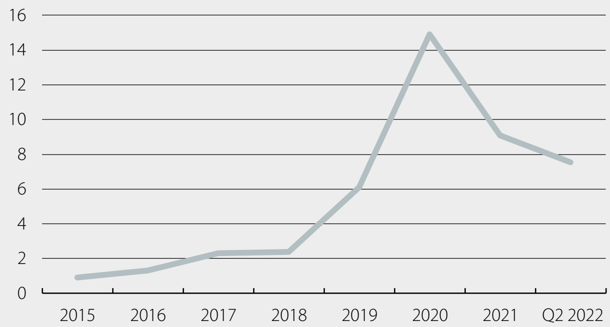
A 224-billion-euro increase in the stock of financial assets seems high, but we have to bear in mind that we are in

Spain: households' financial assets
(EUR millions)



Source: *BPI Research, based on data from the Bank of Spain.*

Spain: household financial savings rate *
Acquisition of financial assets/GDI (%)



Notes: ** Unlike the standard savings rate, which is determined based on the portion of gross disposable income (GDI) which is not allocated to final consumption expenditure, the financial savings rate includes only the portion of savings that is allocated to the acquisition of financial assets. We use the ratio of this acquisition divided by GDI.*
Source: *BPI Research, based on data from the Bank of Spain.*

an inflationary context in which rising prices have significantly eroded the value of assets in real terms. Indeed, the accumulated inflation between the end of 2019 and Q2 2022 amounts to 12.4%. In particular, by deflating the stock of financial assets in order to assess their value in real terms, we see that it is clearly lower in Q2 2022 than it was at the end of 2019 (see third chart). This is despite the significant increase in the stock in nominal terms. Thus, the significant increase in these assets driven by the savings amassed during the pandemic has not prevented a fall in the stock of assets in real terms.

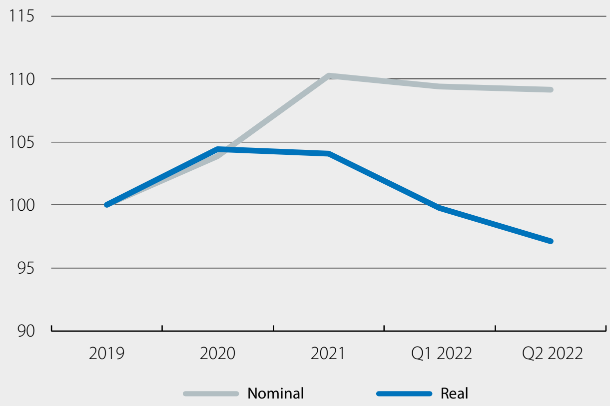
In other words, the increase in the stock of financial assets in nominal terms has not been sufficient to prevent a loss of their purchasing power due to the high inflation. In addition, it should be borne in mind that the increase in financial wealth may have been concentrated

1. Throughout this article, when we talk about households we are including non-profit institutions serving households (NPISHs).
2. Gross financial assets, i.e. we do not take into account the stock of financial liabilities, which has remained fairly stable since the pandemic.
3. However, a portion of the savings amassed during the pandemic were spent on acquiring real estate rather than financial assets, resulting in an «over-investment» in non-liquid assets.

among those with higher incomes, who have a greater capacity to save and a lower propensity for consumption, as suggested by an analysis conducted by CaixaBank Research on the savings accumulated during the pandemic, based on internal data.[4]

This simple exercise has significant implications in the complex economic context in which we currently find ourselves. Firstly, while the savings accumulated during the pandemic will cushion the fall in consumption, it seems that it will not be enough to prevent a contraction in consumption in real terms. In particular, if we analyse the historical relationship between real consumption and its main determining factors (gross disposable income, the stock of financial assets and other relevant macroeconomic variables such as inflation, interest rates and home prices, etc.), we see that consumption is very likely to register a negative growth rate next year. This consumption forecast is consistent with a moderate fall in the savings rate in 2023, which makes sense insofar as we believe that precautionary saving in the face of the heightened uncertainty ought to largely mitigate the fall in the savings rate.

Spain: stock of financial assets
Index (100 = 2019)



Source: *BPI Research, based on data from the Bank of Spain.*

4. See the article «To borrow or not to borrow: a dilemma that depends on what was saved during the pandemic» in the MR11/2021. In particular, this article shows that in the case of households on low and medium-low incomes (the first two income quintiles), in 2021 they will have already consumed all the excess savings which they accumulated during 2020 due to the pandemic.

Activity and employment indicators

Year-on-year change (%), unless otherwise specified

	2020	2021	Q4 2021	Q1 2022	Q2 2022	Q3 2022	09/22	10/22	11/22
Industry									
Industrial production index	–9.5	8.8	1.7	1.6	4.6	4.7	3.6	...	...
Indicator of confidence in industry *(value)*	–13.6	0.6	5.0	6.8	0.4	–5.2	–5.2	–4.0	–7.7
Manufacturing PMI *(value)*	47.5	57.0	56.9	55.8	53.2	49.2	49.0	44.7	45.7
Construction									
Building permits *(cumulative over 12 months)*	–12.8	4.7	24.6	31.6	18.8	8.7	5.6	...	...
House sales *(cumulative over 12 months)*	–12.5	9.6	32.5	41.8	33.6	23.0	20.1	...	...
House prices	2.1	3.7	6.4	8.5	8.0	...	–	–	–
Services									
Foreign tourists *(cumulative over 12 months)*	–77.3	64.7	64.7	313.4	311.7	208.4	208.4	167.2	...
Services PMI *(value)*	40.3	55.0	57.4	52.2	55.9	51.0	48.5	49.7	51.2
Consumption									
Retail sales	–7.1	5.1	0.6	0.4	1.2	0.0	0.4	1.0	...
Car registrations	–29.3	158.0	–17.1	–7.5	–10.3	3.1	12.7	11.7	10.3
Consumer confidence index *(value)*	–22.7	–12.8	–13.1	–17.6	–26.4	–33.0	–32.7	–31.6	–28.7
Labour market									
Employment [1]	–2.9	3.0	4.3	4.6	4.0	2.6	–	–	–
Unemployment rate (% labour force)	15.5	14.8	13.3	13.6	12.5	12.7	–	–	–
Registered as employed with Social Security [2]	–2.0	2.5	3.9	4.5	4.8	3.5	3.3	3.0	2.7
GDP	**–11.3**	**5.5**	**6.6**	**6.7**	**6.8**	**3.8**	–	–	–

Prices

Year-on-year change (%), unless otherwise specified

	2020	2021	Q4 2021	Q1 2022	Q2 2022	Q3 2022	09/22	10/22	11/22
General	–0.3	3.1	5.8	7.9	9.1	10.1	8.9	7.3	6.8
Core	0.7	0.8	1.7	3.0	4.9	6.2	6.2	6.2	6.3

Foreign sector

Cumulative balance over the last 12 months in billions of euros, unless otherwise specified

	2020	2021	Q4 2021	Q1 2022	Q2 2022	Q3 2022	09/22	10/22	11/22
Trade of goods									
Exports *(year-on-year change, cumulative over 12 months)*	–10.0	21.2	21.2	26.2	22.2	23.3	23.3	...	...
Imports *(year-on-year change, cumulative over 12 months)*	–14.7	24.8	24.8	36.1	35.2	38.1	38.1	...	...
Current balance	**6.8**	**11.5**	**11.5**	**8.5**	**9.6**	**6.7**	**6.7**	...	...
Goods and services	16.3	17.9	17.9	14.2	16.2	15.1	15.1	...	...
Primary and secondary income	–9.5	–6.4	–6.4	–5.7	–6.7	–8.5	–8.5	...	...
Net lending (+) / borrowing (–) capacity	**11.9**	**22.4**	**22.4**	**19.8**	**22.5**	**19.1**	**19.1**	**...**	**...**

Credit and deposits in non-financial sectors [3]

Year-on-year change (%), unless otherwise specified

	2020	2021	Q4 2021	Q1 2022	Q2 2022	Q3 2022	09/22	10/22	11/22
Deposits									
Household and company deposits	7.5	6.1	5.8	5.2	5.4	5.3	5.2	4.1	...
Sight and savings	12.3	10.3	9.2	9.3	9.2	8.2	7.6	6.1	...
Term and notice	–16.5	–24.4	–27.6	–26.8	–25.4	–19.2	–15.7	–11.4	...
General government deposits	1.0	15.5	19.4	19.3	15.6	6.6	–0.3	–1.9	...
TOTAL	**7.1**	**6.7**	**6.6**	**6.0**	**6.0**	**5.4**	**4.8**	**3.7**	**...**
Outstanding balance of credit									
Private sector	1.2	0.3	–0.1	0.2	0.8	1.3	1.2	1.0	...
Non-financial firms	4.9	1.1	–1.0	–0.5	0.7	2.4	2.1	2.0	...
Households - housing	–1.8	0.2	1.0	1.3	1.4	1.1	1.0	0.7	...
Households - other purposes	0.8	–1.2	–1.2	–1.1	–0.5	–0.9	–0.7	–0.6	...
General government	3.0	15.3	11.6	3.4	1.9	–3.5	–3.8	–2.9	...
TOTAL	**1.3**	**1.1**	**0.6**	**0.4**	**0.9**	**1.0**	**0.8**	**0.7**	**...**
NPL ratio (%) [4]	**4.5**	**4.3**	**4.3**	**4.3**	**4.1**	**3.8**	**3.8**	**...**	**...**

Notes: *1. Estimate based on the Active Population Survey. 2. Average monthly figures. 3. Aggregate figures for the Spanish banking sector and residents in Spain. 4. Period-end figure.*
Source: *BPI Research, based on data from the Ministry of Economy, the Ministry of Public Works, the Ministry of Employment and Social Security, the National Statistics Institute, the State Employment Service, Markit, the European Commission, the Department of Customs and Special Taxes and the Bank of Spain.*

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