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MONTHLY REPORT • ECONOMIC AND FINANCIAL MARKET OUTLOOK
MARCH 2023

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March 2023

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

BPI Research (UEEF)
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Date this issue was closed:
3 March 2023

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Growth of the Portuguese economy: from less to more

In order to take the pulse of economic activity, we usually look at GDP growth. From this perspective, the most recent dynamics of the Portuguese economy are frankly better than expected. If we broaden our perspective to the last decades, and compare Portugal's progress with other European economies, we also see a positive scenario, albeit very concentrated on recent years. It is also important to analyse the factors that drove growth in order to qualify what appears to be a good performance.

Let's bring some numbers into this. The Portuguese economy closed 2022 with growth rate of 6.7%, the highest growth rate in the last 32 years, higher than what we projected at the beginning of last year, before the start of the war in Ukraine, and clearly higher than what was considered in mid-2022, when it was feared that the impact of the conflict could be substantial. So, for the time being, the Portuguese economy is resisting the impact of the energy crisis better than its main European partners. It has also recovered better from ground lost during the pandemic. In fact, at the end of 2022, activity in Portugal was around 3 percentage points above 2019 levels, higher than the average of the countries that make up the euro zone (2.3% above), placing Portugal in the group of countries with the greatest cyclical boost after the pandemic.

In a longer term perspective, the conclusions are less favourable, but it still depends on the period we choose to observe. Since 2000, taking only the growth rate of GDP in volume as a reference, effectively only Italy and Greece have grown less than Portugal on average terms. But looking at the periods since recent crises, the conclusions are more encouraging. In cumulative terms, the Portuguese economy has recovered around 7.9% since the sovereign debt crisis and around 16% since the years preceding the international financial crisis, outperforming Spain (5.2% and 12.4%), Finland (7.2% and 10.9%), Italy (-3.5% and 3.5%) and Greece (-20.6% and 5.5%). These differences are not minor values, especially when they concern such long periods of time.

However, the underlying drivers of growth are just as important, if not more so. In other words, quality is as or more important than quantity. In the case of the Portuguese economy, GDP growth has been conditioned by demographic trends. Specifically, since 2000, the Portuguese population has stagnated, in contrast to average annual growth rates of 0.7% in Spain, 0.1% in Germany, 0.5% in France and 0.2% in Italy. Looking at a more recent period, in the last decade, it can be seen that there have been systematic declines in the resident population in Portugal since 2010, a movement that was interrupted in the year of the pandemic. In fact, over the last 3 years, according to the latest estimates, the population has grown by an average of 0.2% per year, accelerating to 0.5% in 2022 when the movement was strongest.

It is thus important to analyse the behaviour of GDP per capita instead, and in this comparison the reading of the Portuguese economy's performance in terms of economic growth is more favourable and the most recent trend is one of improvement. In 2022, this measure was 19% above 2000 levels. However, despite comparing well with the rest of the periphery (Spain 14%, Italy 1.6% and Greece 1%), when compared with countries with similar geographical dimensions or population, Portugal falls short. For example, the Netherlands, Austria, Finland and Denmark increased their per capita wealth by close to 25% in this period. This better performance reflects the reinforcement of productivity as a lever to improve the living standards of the population and to accelerate convergence.

Despite not being among the best performers, it is noteworthy that Portugal's trajectory has been improving in the last decade. In fact, with reference to the international financial crisis or the sovereign debt crisis, we also see evident progress: GDP per capita is respectively 12% and 20% above 2012 and 2007 levels, respectively. Specifically, compared to the years prior to the financial crisis, Greece, meanwhile, is 21% below, Spain has stagnated, and Italy is 3% below.

The path taken by an economy is not written in stone. It depends on government policies and implementation and on the entrepreneurial and innovative capacity of the local population. Compared to major European countries, the Portuguese economy is somewhere in the middle and recent trends are positive. Let's see if they are sustainable or merely based on transitory factors.

Paula Carvalho

Chronology

FEBRUARY 2023

1 The Fed raises rates by 25 bps up to the 4.50%-4.75% range.
2 The ECB raises rates by 50 bps, placing the depo rate at 2.50% and the refi rate at 3.00%.
6 A magnitude 7.8 earthquake strikes Türkiye and Syria, with the highest death toll since 2010 and the fifth highest this century.

JANUARY 2023

1 Croatia joins the euro area and the Schengen Area.
8 China reopens its borders to foreign travellers after three years.

DECEMBER 2022

14 The Fed raises official interest rates by 50 bps.
15 The ECB raises official interest rates by 50 bps and announces that it will reduce reinvestments under the APP.

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.

Agenda

MARCH 2023

2 Spain: registration with Social Security and registered unemployment (February).
Euro area: CPI flash estimate (February).
10 Portugal: S&P rating.
16 Spain: quarterly labour cost survey (Q4).
Portugal: industrial production prices (February).
Governing Council of the European Central Bank meeting.
17 Spain: S&P rating.
21-22 Federal Open Market Committee meeting.
22 Portugal: home prices (Q4).
23 Spain: loans, deposits and NPL ratio (Q4).
23-24 European Council meeting.
24 Spain: Q4 GDP (2nd estimate).
Spain: balance of payments and NIIP (Q4).
Portugal: general government key figures (2022).
30 Spain: CPI flash estimate (March).
Euro area: economic sentiment index (March).
Portugal: NPL ratio.
31 Spain: household savings rate (Q4).
Spain: state budget execution (February).
Portugal: CPI flash estimate (March).

APRIL 2023

3 Portugal: industrial production (February).
4 Spain: registration with Social Security and registered unemployment (March).
12 Spain: financial accounts (Q4).
Portugal: services sector turnover (February).
14 China: GDP (Q1).
24 Spain: loans, deposits and NPL ratio (February).
27 Spain: labour force survey (Q1).
Portugal: business and consumer confidence indicator (April).
Euro area: economic sentiment index (April).
US: GDP (Q1).
28 Spain: GDP flash estimate (Q1).
Spain: CPI flash estimate (April).
Spain: state budget execution (March).
Euro area: GDP (Q1).
Portugal: GDP flash estimate (Q1).
Portugal: CPI flash estimate (April).

From «soft landing» to «no landing»: higher interest rates over a longer period of time

On the «catwalk» of fashionable economic expressions, the phrase «higher for longer», used with reference to interest rates, has been particularly notable in recent weeks, reflecting the positive surprises that are building up in activity data and the persistence of inflationary pressures among key components of the consumer price basket, such as food and services. With the threat of a recession diminished in the short term by the strength of the labour market, concern is once again focused on inflation, and financial markets are now assuming further rises in official interest rates up to 4% in the eurozone and 5.5% in the US. The additional 75 bp compared to what was assumed at the start of the year has had an immediate impact across the yield curve, in particular on the shorter maturities, with 2 year bond yields in the US and Germany reaching fifteen-year highs.

This has led to the umpteenth shift in the economic narrative in recent months, this time from «soft landing» to «no landing», reflecting the intention of central banks to stay the course, to continue to raise rates and, once peaked, to remain in restrictive territory for longer than expected. The negative effects on growth of this new turn in monetary policy will be felt in the winter of next year, as the negative development in yield curves on both sides of the Atlantic are expected to widen. In other words, while we have escaped the worst, we are not yet out of the woods, given the complexity in assessing the potential effects of the biggest monetary tightening in four decades in a world that has continued accumulating debt.

According to data from the Institute of International Finance, despite a slight decline in 2022 (4 trillion dollars), total global debt amounts to 299 trillion dollars (338% of GDP), doubling in nominal terms the levels of 2006 (+50 p.p. as a percentage of GDP). In addition to the high leveraging of the non-financial corporate sector in China (160% of GDP), the most vulnerable part of the new monetary policy environment is the capacity of emerging countries to make repayments. Both because of their increase in total debt since the start of the pandemic (+20 trillion for a total of 95 billion dollars), and because of the high level of maturities that are due in 2023 (7 trillion dollars), in an environment in which the dollar is appreciating against the main currencies. Let us remember that, since 2020, three emerging countries (Zambia, Sri Lanka and Ghana) have defaulted on their debts.

The truth is that in a world as complex as today's, with different shocks interacting simultaneously and with distortions of all kinds affecting the transmission channels of monetary policy, it is difficult to measure the effects of interest rate rises on activity and inflation. Analyses recently published by the ECB reflect a significant dispersion of their effects, depending on the evaluation model. On average, across all estimates, for every 100 basis-point increase in interest rates, growth would fall below its potential by 0.7 p.p., and inflation by three tenths. Bearing in mind that the accumulated rise is assumed to be in the league of 400 or 450 b.p. by the end of the current tightening phase, the price to be paid in growth to try to bring inflation closer to target will be considerable.

Central banks are facing a very complex moment, with little certainty about the effects of their decisions and a need to show great flexibility in the face of possible surprises. Especially if the real villain is a structural insufficiency of supply, the result of a decade and a half of low levels of public and private investment and changes that are beginning to be perceived in the labour market in OECD countries (retirement of the baby boomers, reduced numbers of young workers or silent resignations of workers). This would limit the ability to correct the current inflationary forces (which are «sticky», for another buzzword) with demand-side policies. In any case, while the underlying currents such as the energy transition (or de-globalisation) take hold, in the short term we will have to get used to a world of higher interest rates. For now, the 10-year implied deposit facility (depo) rates are at average levels close to 3%. This is well above the levels we have been living with for the last decade and what we considered neutral even a few quarters ago.An important change with non-negligible effects.

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	5.00	3.75
3-month Libor	3.62	1.01	0.23	0.21	4.74	4.75	3.50
12-month Libor	3.86	1.48	0.34	0.52	5.47	4.50	3.50
2-year government bonds	3.70	1.04	0.13	0.62	4.41	4.00	2.80
10-year government bonds	4.70	2.57	0.93	1.45	3.62	3.20	2.80
Euro							
ECB depo	2.05	0.20	–0.50	–0.50	1.77	3.50	2.50
ECB refi	3.05	0.75	0.00	0.00	2.27	4.00	3.00
€STR	–	–0.54	–0.56	–0.58	1.57	3.41	2.48
1-month Euribor	3.18	0.50	–0.56	–0.60	1.72	3.36	2.42
3-month Euribor	3.24	0.65	–0.54	–0.58	2.06	3.31	2.35
6-month Euribor	3.29	0.78	–0.52	–0.55	2.56	3.38	2.46
12-month Euribor	3.40	0.96	–0.50	–0.50	3.02	3.44	2.56
Germany							
2-year government bonds	3.41	0.35	–0.73	–0.69	2.37	3.20	2.50
10-year government bonds	4.31	1.54	–0.57	–0.31	2.13	3.00	2.80
Spain							
3-year government bonds	3.62	1.69	–0.57	–0.45	2.66	3.23	2.93
5-year government bonds	3.91	2.19	–0.41	–0.25	2.73	3.38	3.15
10-year government bonds	4.42	3.17	0.05	0.42	3.18	4.10	3.80
Risk premium	11	164	62	73	105	110	100
Portugal							
3-year government bonds	3.68	3.33	–0.61	–0.64	2.45	3.46	3.20
5-year government bonds	3.96	3.94	–0.45	–0.35	2.53	3.57	3.38
10-year government bonds	4.49	4.68	0.02	0.34	3.10	4.05	3.80
Risk premium	19	314	60	65	97	105	100
EXCHANGE RATES							
EUR/USD (dollars per euro)	1.13	1.26	1.22	1.13	1.06	1.10	1.15
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	81.3	93.0	80.0
Brent (euros/barrel)	36.4	62.5	41.3	66.2	76.8	85.1	69.8

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	2.1	0.9	1.4
Euro area	2.2	0.8	–6.3	5.3	3.5	0.5	1.6
Germany	1.6	1.2	–4.1	2.6	1.9	0.0	1.4
France	2.2	1.0	–7.9	6.8	2.6	0.3	1.4
Italy	1.5	–0.3	–9.1	6.7	3.9	0.5	1.1
Portugal	1.5	0.5	–8.3	5.5	6.7	1.0	2.1
Spain	3.7	0.6	–11.3	5.5	5.5	1.3	1.9
Japan	1.4	0.4	–4.3	2.3	1.1	1.3	1.1
United Kingdom	2.6	1.3	–11.0	7.6	4.0	–1.7	–0.9
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	8.4	3.0	5.2	5.1
India	7.2	6.8	–6.7	9.0	7.3	6.0	6.7
Brazil	3.6	1.6	–3.3	5.0	2.9	0.9	1.8
Mexico	2.4	1.9	–8.0	4.7	3.1	1.4	2.5
Russia	7.2	1.3	–2.7	4.8	–2.1	–3.2	3.0
Turkey	5.5	4.5	1.9	11.4	5.6	3.0	3.2
Poland	4.2	3.7	–2.0	6.9	4.9	0.7	3.2
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	4.1	2.7
Euro area	2.2	1.4	0.3	2.6	8.4	5.3	2.7
Germany	1.7	1.4	0.4	3.2	8.6	5.9	3.0
France	1.9	1.3	0.5	2.1	5.9	4.3	2.6
Italy	2.4	1.4	–0.1	1.9	8.7	5.9	2.6
Portugal	3.1	1.1	0.0	1.3	7.8	5.5	2.8
Spain	3.2	1.3	–0.3	3.1	8.4	4.2	2.6
Japan	–0.3	0.4	0.0	–0.2	2.5	2.5	1.5
United Kingdom	1.6	2.3	0.9	2.6	9.0	5.7	2.9
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	2.0	1.5	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	9.3	5.1	4.0
Mexico	5.2	4.2	3.4	5.7	7.9	4.7	3.8
Russia	14.2	7.9	3.4	6.7	13.8	7.5	6.8
Turkey	22.6	9.6	12.3	19.6	72.3	36.4	29.0
Poland	3.5	1.9	3.7	5.2	14.9	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	–7.0	4.7	5.7	0.9	0.9
Government consumption	2.3	–0.3	0.3	4.6	2.4	1.0	1.0
Gross fixed capital formation	–0.4	–0.7	–2.2	8.7	2.7	2.5	8.2
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	4.7	1.1	2.3
Exports of goods and services	5.3	4.0	–18.6	13.4	16.7	4.3	6.1
Imports of goods and services	3.6	2.7	–11.8	13.2	11.0	4.5	6.3
Gross domestic product	**1.5**	**0.5**	**–8.3**	**5.5**	**6.7**	**1.0**	**2.1**
Other variables							
Employment	0.4	–0.5	–1.9	2.7	2.0	0.1	0.4
Unemployment rate (% of labour force)	6.1	11.4	7.0	6.6	6.0	6.4	6.1
Consumer price index	3.1	1.1	0.0	1.3	7.8	5.5	2.8
Current account balance (% GDP)	–9.2	–2.9	–1.2	–1.1	–1.4	–1.0	–0.3
External funding capacity/needs (% GDP)	–7.7	–1.6	0.1	0.6	–0.5	1.3	1.6
Fiscal balance (% GDP)	–4.6	–5.1	–5.8	–2.9	–1.1	–0.9	–0.8

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	4.4	0.7	2.3
Government consumption	5.0	1.1	3.5	2.9	–0.9	2.1	0.5
Gross fixed capital formation	5.6	–1.4	–9.7	0.9	4.3	–1.8	2.6
Capital goods	4.9	0.1	–13.3	6.3	3.8	–4.6	3.4
Construction	5.7	–2.9	–10.2	–3.7	4.2	–0.5	2.2
Domestic demand (vs. GDP Δ)	5.8	–0.3	7.6	6.5	2.6	1.0	1.9
Exports of goods and services	4.7	2.9	–19.9	14.4	14.9	1.1	2.0
Imports of goods and services	7.0	0.2	–14.9	13.9	7.7	–0.6	2.0
Gross domestic product	**3.7**	**0.6**	**–11.3**	**5.5**	**5.5**	**1.3**	**1.9**
Other variables							
Employment	3.2	–0.4	–6.8	6.6	3.8	1.1	1.4
Unemployment rate (% of labour force)	10.5	19.5	15.5	14.8	12.9	12.8	12.4
Consumer price index	3.2	1.3	–0.3	3.1	8.4	4.2	2.6
Unit labour costs	3.0	0.6	7.7	0.3	0.4	3.5	2.4
Current account balance (% GDP)	–5.9	–0.3	0.6	1.0	0.9	0.3	1.0
External funding capacity/needs (% GDP)	–5.2	0.1	1.1	1.9	1.5	1.5	2.0
Fiscal balance (% GDP) [1]	0.4	–6.5	–10.3	–6.9	–4.0	–4.0	–3.3

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

Forecasts

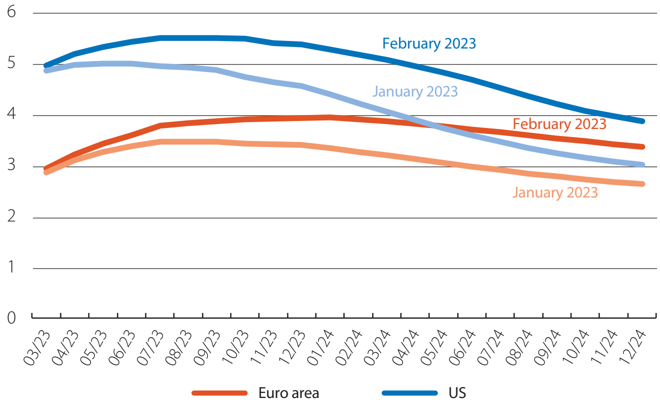
The markets anticipate further interest rate hikes

The strength of the economic data stirs the debate over whether there will be a hard or a soft landing. After a buoyant and upbeat January, the financial markets resumed the tone of volatility and reduced risk appetite throughout February, in a context in which positive surprises in the economic data failed to translate into good news for risky assets. Investors thus interpreted the strength in the macro indicators as fuel for inflation, which in turn would justify a more restrictive monetary policy on the part of the central banks. Thus, the debate on whether the global economy is facing a hard or a soft landing was overshadowed by the possibility of no landing at all, that is, a situation in which, despite the headwinds, global economic activity and inflation show resistance to moderating. In the financial markets, this change in tone resulted in a notable revision in investors' expectations regarding the future path of official interest rates, which led to further tightening of financial conditions around the world and truncated the gains that had been registered in fixed-income assets, equities and emerging currencies.

Higher rates and for longer. The publication in February of better-than-expected economic activity and employment data, both in the euro area and especially in the US, highlighted the blocs' economic resilience at the beginning of the year despite the tightening of financial conditions. However, the optimism, which had brushed aside the threats of economic recession, soon faded as it became apparent that this buoyancy was accompanied by the persistence of inflationary tensions. This situation triggered a restrictive bias in the discourse of the members of the Fed and the ECB. The shift was particularly pronounced in the case of the US monetary authority, going from Jerome Powell's comment on the beginning of the disinflation process at the start of February, to ending the month with most members indicating the need to raise reference rates more quickly and for longer in order to curb the price rally. Meanwhile, the ECB expressed its intention to raise interest rates by another 50 bps in March (to 3.00%), as it anticipated at its last meeting, and left the door open for further increases in the coming months. Investors, meanwhile, quickly revised upwards their expectations regarding the short- and medium-term monetary scenario, having previously anticipated the end of the cycle of interest rate hikes sometime around the summer. Thus, the money markets reflected expectations that Fed rates would peak at 5.50% before the summer and that ECB rates would do so in the autumn at around 4.00%, pushing back the prospect of any downward adjustments well into 2024 in both cases.

Expectations for Fed and ECB reference interest rates

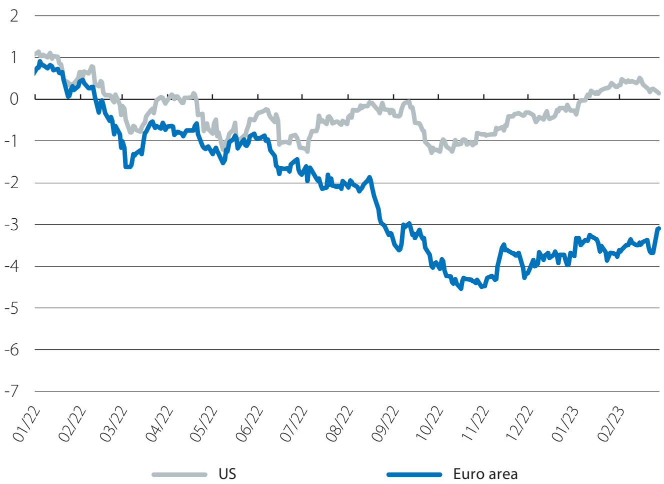
(%)



Note: *Forwards on the EFFR and the OIS of the euro area derived with the NSS model using market yield curves.*
Source: *BPI Research, based on data from Bloomberg.*

Financial conditions

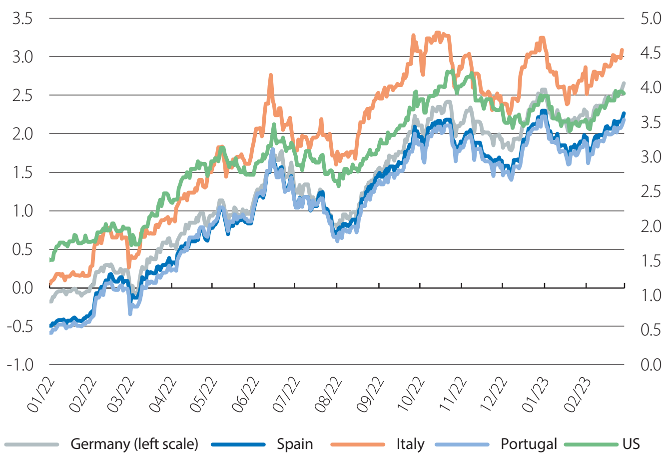
Index (0 = historical average)



Note: *A positive value indicates accommodative conditions, while a negative value indicates more restrictive financial conditions. The historical average benchmark corresponds to the period 1994-2008.*
Source: *BPI Research, based on data from Bloomberg.*

Interest rates on 10-year sovereign debt

(%) (%)



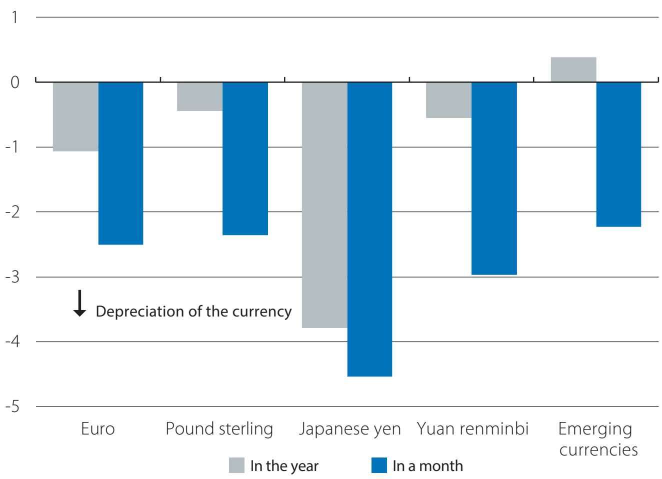
Note: *US, Spain, Italy and Portugal (right scale).*
Source: *BPI Research, based on data from Bloomberg.*

Sovereign debt yields spike. Within this new episode of volatility, the shift in the markets towards a scenario in which interest rates are expected to remain at restrictive levels for longer was reflected in the rise in interest rates throughout the sovereign yield curves on both sides of the Atlantic. In the US, the 2-year rate reached 4.8%, its highest level in 15 years, while the yield on 10-year treasuries ended up at the 4% mark. The euro area saw a similar movement in its yield curves, with the yield on the 10-year *bund* reaching 2.65%, its highest level since 2011. In both cases, the movements in the short section of the curve were more pronounced than in the long section. Despite the rise in yields, risk premiums in the peripheral countries remained favourable, with the Spanish spread remaining below 100 bps. On the other hand, the dollar capitalised on the upward shift in the US yield curve, as well as the increase in volatility in the money markets, appreciating against other major currencies. In particular, against the euro it appreciated around 3% in the month, although this trend could be reversed over the coming quarters (see the Focus «On the round trip movement of the (king) dollar» in this same report).

The price of energy products drops. The price of Brent oil closed February slightly down (–0.7% monthly), making it the fourth consecutive month of declines. Its price was affected by the increase in inventories in the US and by fears that the tightening of US monetary policy could cool global demand. However, the incipient improvement in the economic activity data in China and the scant prospect of an increase in supply from OPEC offset the downward pressures on oil. Similarly, the price of European natural gas (the Dutch TTF benchmark) fell by 19% in February, accumulating an 86% decline since the peaks of last August (although it is still 250% above its pre-crisis average). The price was below €50/MWh thanks to the high level of gas reserves in the EU, the surge in imports of liquefied natural gas and the mild weather.

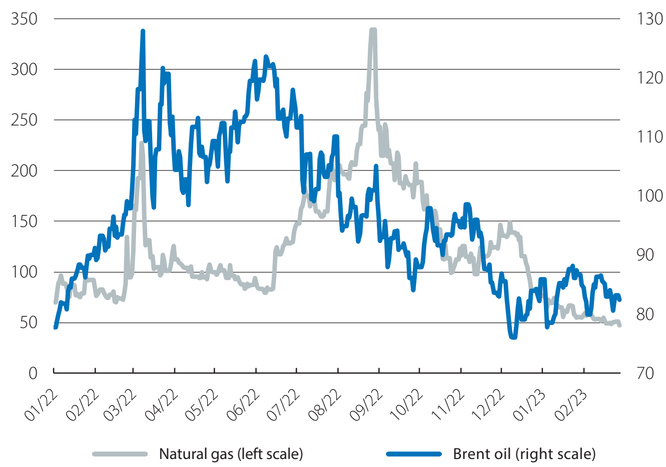
The shift in interest rate expectations reins in the stock market rally. The prospect of a scenario with higher interest rates for longer put a damper on investor sentiment regarding the state of the business cycle. This was particularly noticeable in the performance of the US stock indices, which ended the month down by more than 2%. The European indices performed somewhat better (Eurostoxx 50 +2%), especially the IBEX 35 which registered the highest gains (+4%), favoured by the composition of the indices and specifically the greater presence of sectors with a defensive bias compared to in the US. In emerging markets, on the other hand, price movements were dominated by profit-taking, with setbacks approaching 20% in year-on-year terms in view of the continued restrictive financial environment worldwide.

Currencies against the dollar
(%)



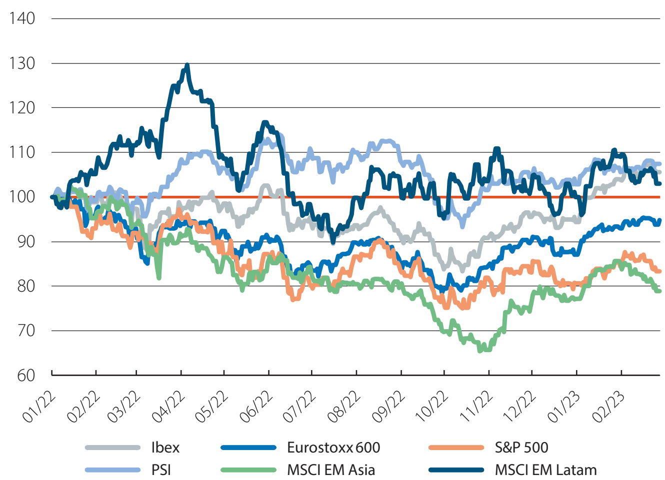
Source: *BPI Research, based on data from Bloomberg.*

Oil and gas prices
(€/MWh) *($/barrel)*



Note: *The natural gas price corresponds to the Dutch TTF.*
Source: *BPI Research, based on data from Bloomberg.*

Main international stock markets
Index (100 = January 2022)



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

On the round trip movement of the (king) dollar

In a year of widespread losses in the financial markets, if there is any asset that stood out for its positive performance during much of 2022, it was the US dollar. Its appreciation, in effective nominal terms, amounted to 16% in the first nine months of the year, marking the biggest advance since 2015 when the Federal Reserve ceased net bond purchases following the stormy taper tantrum episode.

The strength of the dollar last year was particularly pronounced against the euro. It closed below parity with the European single currency in 46 sessions of the year, reaching a low of 0.959 at the end of September, the lowest level since the euro's introduction two decades ago.

However, more than this appreciation, perhaps what has surprised analysts the most is how quickly it has reversed. Between the end of September and the end of February, the dollar depreciated by 6% in effective nominal terms and by 10% against the euro, trading at close to 1.07, a level not seen for almost a year.

Given how sharp this movement has been, in this Focus we explore what lay behind the change in trend and to what extent it could continue.

A green safe haven in a financial storm

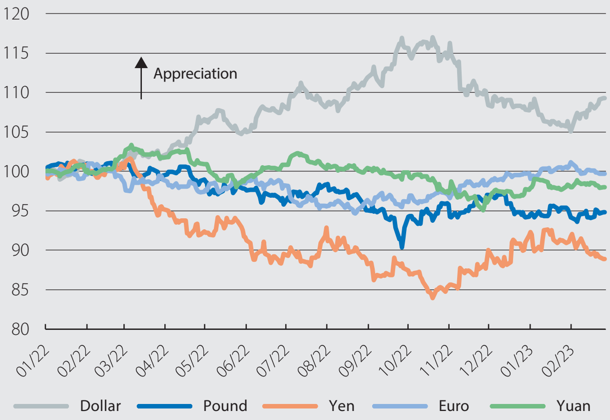
To answer these questions, we begin by analysing the factors behind the appreciation of the dollar up until October 2022.

Firstly, we highlight the demand for the dollar as a safe-haven asset. In a year overshadowed by the final throes of the pandemic, and above all by Russia's invasion of Ukraine, it is no surprise that investors, as is typical during episodes of uncertainty and volatility, opted to hedge some of the risk by increasing their «long» positions in the US currency (i.e. buying assets denominated in dollars). This factor is particularly relevant in the current context of inflationary tensions, disruptions in the commodity markets and, in particular, uncertainty regarding the energy supply.

On this latter point, the terms of external trade improved in the US, which is a net exporter of energy, compared to other major economic blocs, especially the EU. In fact, according to data from the balance of payments, the euro area closed 2022 with a negative current account balance (–0.8% of GDP versus +2.3% in 2021), making it the first year with an external deficit since 2011, at the height of the sovereign debt crisis. These factors exerted downward pressure on the euro's exchange rate with the dollar.

Currencies: nominal effective exchange rates

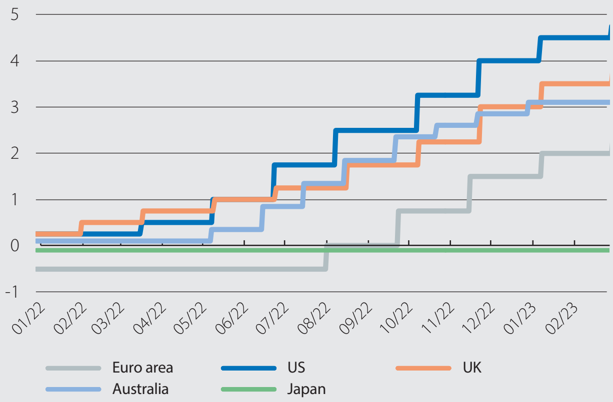
Index (100 = January 2022)



Source: *BPI Research, based on data from Bloomberg and the Bank for International Settlements.*

Official interest rates of major central banks

(%)



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

The US Federal Reserve, meanwhile, has been at the forefront of the monetary tightening process among advanced economies, with cumulative official rate rises of 450 bps and with the onset of quantitative tightening even before this summer. This decisive response widened the gap between US interest rates and those of other economic blocs, both in the money markets and in the sovereign debt markets, which favoured capital inflows into this country (see second chart).

Finally, the economic recovery in the US in the post-pandemic period has been faster and stronger than in other developed countries, due to the vast rounds of fiscal stimulus approved in recent years. In the euro area, by contrast, the strong growth in 2022 as a whole reflects, on the one hand, the rebound associated with the reopening process in the first half of the year, but also, on the other hand, the slowdown and virtual stagnation seen in the second half of the year, which was dominated by the energy crisis.

Euro/dollar exchange rate: a return to equilibrium?

Generally speaking, while still tangibly on the table, many of these factors have lost steam since November. Despite the extension of the war in Ukraine, the energy markets have stabilised, and with it the improvement in the terms of trade in the US has faded. Symmetrically, the terms of trade and the economic outlook for Europe have improved. The Fed, meanwhile, appears to be signalling that the end of monetary tightening is approaching, whereas for the ECB this seems like a somewhat more distant prospect.

Taken together, these factors help us to understand the unwinding of the dollar's rally, beginning in the autumn, particularly against the euro, which has recovered almost all of the ground lost since May last year, despite the volatility of recent weeks. Nevertheless, the single currency closed February still trading at historically low levels against the dollar, 6% below the average of the previous five years and 12% below the average of the last two decades. This suggests that, at least *a priori*, the trend of the last few months may still have some way to go.

Indeed, according to conventional econometric models, the euro/dollar (EUR/USD) exchange rate still lies below most estimates of the so-called «equilibrium» exchange rate. These estimates involve trying to determine the exchange rate of two economies based on their macroeconomic fundamentals, including both those which measure internal imbalances (related to potential growth, its components and its relationship with the business cycle) and those measuring external imbalances (such as the current account deficit or the international investment position), as well as variables which measure the gap in benchmark interest rates.[1]

According to some estimates, for example, the EUR/USD equilibrium exchange rate could lie at around 1.20, that is, around 10% higher than the rate at the end of February.[2] On the other hand, estimates based on the purchasing power parity (PPP) theory result in an exchange rate of between 1.20 (using the Big Mac index) and 1.30 (using the CPI).[3]

Despite the gap with the current EUR/USD rate, what is clear is that a hypothetical return to these equilibrium levels is unlikely to occur without volatility or periods with new ups and downs, fluctuations that are linked to a set of cyclical, contextual and structural factors. At CaixaBank Research, our baseline scenario projects that the euro is likely to appreciate against the dollar in the coming quarters, albeit very moderately, reaching 1.10 by the end of the year. In the medium term, we project that it could return to a level of around 1.25. The path we anticipate over the next two years is fairly in line with that expected by the consensus of analysts (1.11 in Q4 2023 and 1.14 in Q4 2024, according to Bloomberg).

Balance of risks

Our forecast scenario that the dollar could continue along a path of moderate depreciation in the medium term is based on a view of relative economic stability, with assumptions that (i) a recession in the world economy (both in the euro area and in the US) is avoided, (ii) inflation gradually returns to the 2% target rate, and (iii) central banks are able to bring the cycle of rate hikes to and end in the coming months and to begin bringing rates back down to neutral territory over the next year. Ultimately, this scenario depends on the central banks on both sides of the Atlantic being successful in their fight against inflation. Needless to say, the probability of these assumptions coming to fruition is closely tied to a set of imponderables linked to the impact of pre-existing shocks (e.g. greater persistence in the inflationary pressures or a larger effect of the monetary tightening process), as well as possible new unforeseen events (e.g. geopolitical conflicts, natural or health disasters, as well as other external factors, such as a possible change in the direction of monetary policy in Japan).

1. The economic literature groups the equilibrium models of the real exchange rate into two main blocks: (i) estimates based on internal and external balances (fundamental equilibrium exchange rates, or FEER) and (ii) estimates based on a set of reduced general equilibrium equations (behavioural equilibrium exchange rates, or BEER). The more traditional approach of purchasing power parity, meanwhile, is based on the notion that, in the long run, a currency should be able to buy the same basket of goods and services in different places.
2. See William Cline (2017, 2018). «Estimates of Fundamental Equilibrium Exchange Rates». Peterson Institute for International Economics.

3. According to the IMF, the implicit exchange rate according to PPP theory is around 1.30 for the main euro area countries.

The appreciation of the dollar and American and European interest rates

Since the outbreak of the war in Ukraine and the intensification of inflationary pressures, US interest rates have risen steadily and significantly, galvanised by the Federal Reserve's rapid and aggressive monetary tightening policies. However, this does not necessarily mean that US bonds are more attractive than their European counterparts.

A key factor in the comparison is the exchange rate. Specifically, exchange rate movements between the moment when an investor sends capital abroad and when they repatriate that capital or the associated interest payments are another factor which determines the return on investment, in addition to being a source of uncertainty. In order to eliminate or «sterilise» the risk of exchange rate fluctuations, one possibility is to secure a future exchange rate at the same time that currencies are exchanged in the spot market.

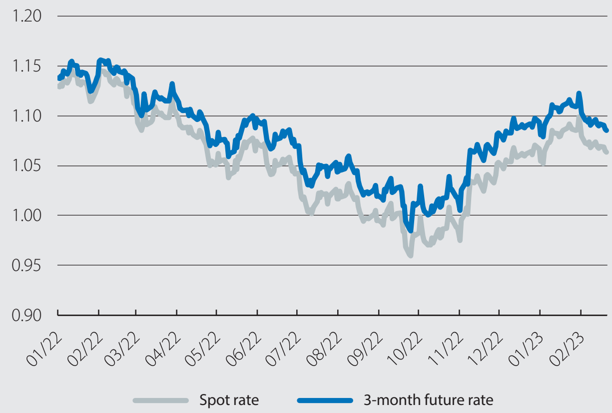
As a result of the interest rate hikes in the US, in 2022 the dollar registered a significant appreciation. However, the appreciation was more intense in the spot market than it was in the futures market. The gap that opened up between the two implicitly generated an appreciation of the euro. For instance, at the beginning of 2022 the spot rate was 1.13 dollars per euro while the three-month future rate was 1.14, assigning the euro an implicit increase in value of 0.7%. In the autumn, however, the euro/dollar exchange rate fell below 1 in the spot market and was above parity in the futures market, so the implicit appreciation of the euro reached over 3%.

The opening up of this gap and the greater implicit appreciation of the euro tended to reduce the effective interest received by a European investor holding US bonds: for example, when the spot exchange rate was virtually 1 dollar per euro, a European investor could get 100 dollars in exchange for 100 euros; but as the future exchange rate was greater than 1, when exchanging those 100 dollars back into euros they would become less than 100 euros.

Looking at the overall picture, we are faced with two forces. On the one hand, rising US interest rates increased the appeal of the dollar. On the other hand, the exchange rate movements in 2022 gradually dampened this appeal factor.[1] To see which force was more dominant, in the second chart we compare the German sovereign interest rate with its US counterpart «sterilised» against foreign exchange risk.[2] This shows how, apparently, despite lower interest rates, German rates were found to be higher from the point of view of a European investor once the foreign exchange risk is factored in.

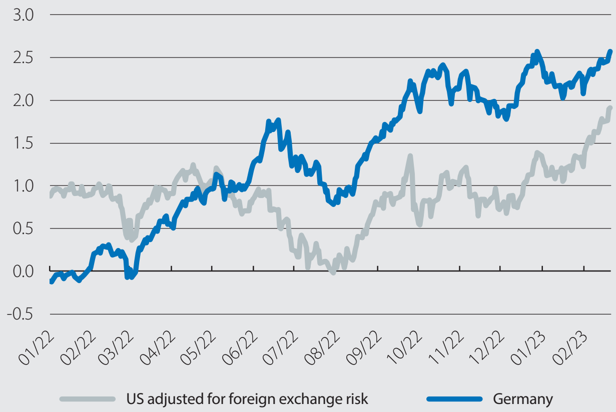
In short, the rise in US interest rates is a factor which causes the dollar to appreciate. However, the appreciation of the US currency in 2022 went well beyond this, reinforcing the view, as set out in this same report,[3] that the appreciation of the dollar was supported by other forces, such as its position as a safe-haven asset in a highly uncertain environment.

Euro-dollar exchange rate
(Dollars per euro)



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

10-year sovereign interest rates
(%)



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

1. Assuming that investments are «sterilised» against foreign exchange risk. An investor choosing to assume this risk and opting to repatriate the interest income at the spot exchange rate, rather than securing a future exchange rate, would have benefited *ex post* due to the fact that the dollar steadily appreciated between January and October 2022.
2. The relationship between the domestic interest rate and a foreign interest rate adjusted for the foreign exchange risk between the foreign and domestic currencies is known as Covered Interest Parity (CIP). See the Focus «Why do similar assets have differing yields?» in the MR03/2019.

3. See the Focus «On the round trip movement of the (king) dollar» in this same *Monthly Report*.

Interest rates (%)

	28-February	31-January	Monthly change (bp)	Year-to-date (bp)	Year-on-year change (bp)
Euro area					
ECB Refi	3.00	2.50	50	50.0	300.0
3-month Euribor	2.74	2.51	23	61.2	327.8
1-year Euribor	3.73	3.41	31	43.4	408.8
1-year government bonds (Germany)	3.21	2.78	43	61.0	390.0
2-year government bonds (Germany)	3.14	2.65	49	37.3	387.4
10-year government bonds (Germany)	2.65	2.29	37	8.0	272.3
10-year government bonds (Spain)	3.60	3.28	32	–6.2	274.2
10-year government bonds (Portugal)	3.51	3.19	32	–7.3	278.3
US					
Fed funds (upper limit)	4.75	4.50	25	25.0	450.0
3-month Libor	4.96	4.81	15	19.5	445.2
12-month Libor	5.69	5.34	35	20.9	451.5
1-year government bonds	4.98	4.65	32	29.1	410.0
2-year government bonds	4.82	4.20	61	39.0	347.5
10-year government bonds	3.92	3.51	41	4.5	219.3

Spreads corporate bonds (bps)

	28-February	31-January	Monthly change (bp)	Year-to-date (bp)	Year-on-year change (bp)
Itraxx Corporate	79	79	0	–11.1	3.2
Itraxx Financials Senior	88	88	0	–10.8	0.1
Itraxx Subordinated Financials	154	156	–2	–17.8	–9.5

Exchange rates

	28-February	31-January	Monthly change (%)	Year-to-date (%)	Year-on-year change (%)
EUR/USD (dollars per euro)	1.058	1.086	–2.6	–1.2	–4.9
EUR/JPY (yen per euro)	143.990	141.320	1.9	2.5	12.6
EUR/GBP (pounds per euro)	0.880	0.882	–0.2	–0.6	5.4
USD/JPY (yen per dollar)	136.170	130.090	4.7	3.9	18.5

Commodities

	28-February	31-January	Monthly change (%)	Year-to-date (%)	Year-on-year change (%)
CRB Commodity Index	548.5	557.0	–1.5	–1.1	–10.8
Brent ($/barrel)	83.9	84.5	–0.7	–2.4	–20.1
Gold ($/ounce)	1,826.9	1,928.4	–5.3	0.2	–6.1

Equity

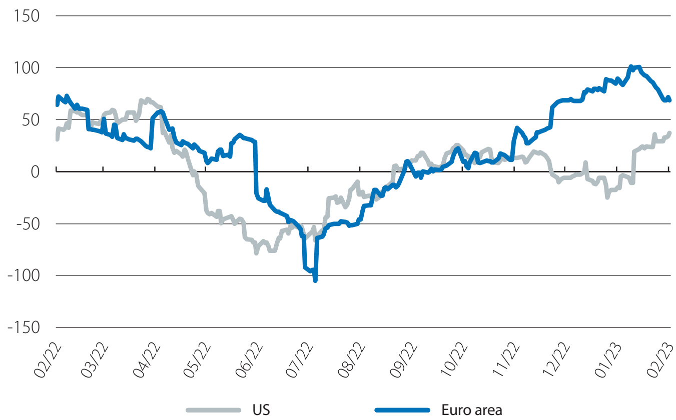
	28-February	31-January	Monthly change (%)	Year-to-date (%)	Year-on-year change (%)
S&P 500 (USA)	3,970.2	4,076.6	–2.6	3.4	–7.8
Eurostoxx 50 (euro area)	4,238.4	4,163.5	1.8	11.7	12.5
Ibex 35 (Spain)	9,394.6	9,034.0	4.0	14.2	14.7
PSI 20 (Portugal)	6,057.2	5,886.3	2.9	5.8	10.2
Nikkei 225 (Japan)	27,445.6	27,327.1	0.4	5.2	2.2
MSCI Emerging	964.0	1,031.5	–6.5	0.8	–18.1

Cautiously optimistic about the international economy

The macroeconomic outlook continues to show encouraging signs in a challenging environment. Economic activity has been performing better during the winter than had been feared back in the summer. Notably, confidence continues to improve and headline inflation may have already peaked, thanks to the substantial reduction in energy prices (85% in the case of gas, versus the August highs) and the normalisation of global supply chains. Overall, the latest signs suggest that economic activity in the major developed economies and in China is holding up better during Q1 than had been anticipated a few months ago. This is obviously good news, but we should not indulge in excessive optimism. Firstly, the geopolitical risk, far from subsiding, remains ever present a year into the war in Ukraine. Moreover, the impact of the rate hikes approved by most central banks has not yet fully translated to economic activity and monetary policy will remain restrictive, given the persistence of the core inflation indices. Indeed, the strength of the latest economic activity data and the persistence of inflation in the major economies has raised the risk that interest rates could climb even higher and that they could also remain high for longer, as reflected in the change in market expectations, which we set out in the financial markets economic outlook section.

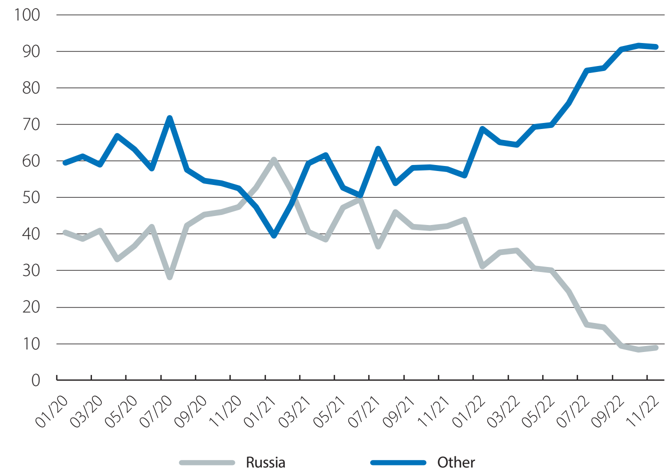
The euro area begins the year with an encouraging outlook for Q1 2023. In fact, in February the PMIs exceeded the critical 50-point threshold in the major economies (Germany, 50.7; France, 51.7; and the euro area, 52.0). This development was driven by the marked improvement in confidence in the services sector (clearly in expansionary territory), given that confidence in manufacturing fell yet again (the eighth consecutive month at contractionary levels). The PMI price component in the euro area, meanwhile, fell yet again and reached 16-month lows, although it remains very high. This reinforces the view there will be greater inertia in inflationary pressures than had been hoped for, and the data corroborate this outlook: euro area headline inflation has been falling from its October highs (10.6% vs. 8.5% in February) thanks to the decline in the energy component, while the pressures in the core components continue their slow but steady upward trickle, with core inflation (excluding energy and all food) peaking in February at 5.6%. In this context of high inflation, the growth in wage demands has stabilised at around 4.0% year-on-year at the end of last year, according to the indicator produced by the ECB. Despite the good performance of the economy in Q1 2023, it is premature to assume we will see a significant rebound in economic activity after the spring, given the major challenges the region still faces. Although gas prices have fallen substantially, they are still double their pre-war value. In addition, the ECB has made it clear that it will

Economic Surprise Index *
Level



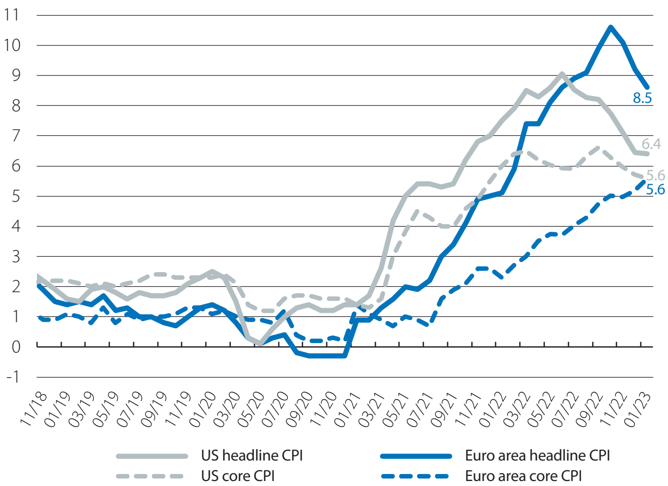
Notes: *Defined as the weighted historical standard deviations of the differences between the published data and analysts' expectations. A positive value indicates that the published data was better than expected, while a negative value suggests that the release disappointed.*
Source: *BPI Research, based on data from Citigroup, via Refinitiv.*

EU: gas imports
(% of the total)



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

US and euro area: CPI
Year-on-year change (%)



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

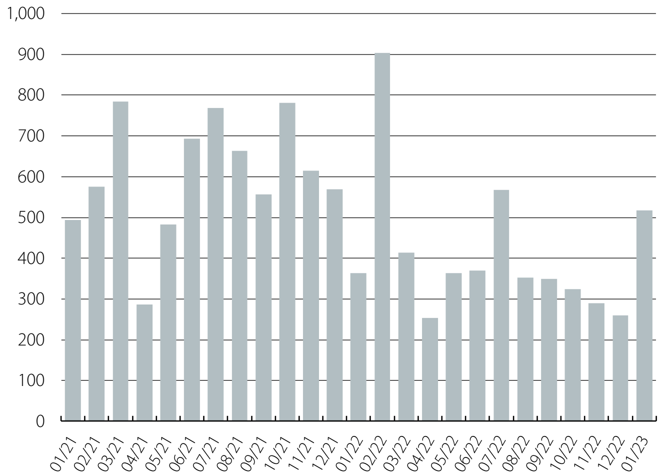
continue to raise interest rates, with the consequent restriction on activity this entails.

A surprisingly buoyant start to the year in the US. After registering a far from negligible annualised growth rate of 2.7% in Q4 2022, the latest indicators have shown significant strength at the beginning of 2023: retail sales growth in January (3.0% month-on-month) offset the cumulative decline in the previous two months; manufacturing output managed to grow by 1.0% on a monthly basis in January; the same month also saw the creation of more than 500,000 jobs, and the PMI surpassed the critical 50-point threshold in February for the first time in eight months. In this context, inflation continued to fall in January, in both the headline index (6.4%) and the core index (5.6%), albeit at a slower pace than in previous months. This scenario of positive surprises in economic activity, with inflation still at relatively high levels, helps to explain the recent messages from the Fed emphasising that interest rates will continue to rise.

Russia performs better than expected in 2022, despite the sanctions. The Russian statistics office announced that the economy contracted by 2.1% in 2022, which is compatible with a growth of 0.5% quarter-on-quarter in Q4 2022. However, the start of 2023 is unlikely to be so rosy as the impact of two of the sanctions imposed in December will begin to be felt, namely: the EU ban on imports of Russian oil and the cap on oil prices imposed by the G7. In order to counter these measures, Russia has significantly increased its sales of crude oil to China and, above all, to India, while announcing that it will cut production by around 500,000 barrels a day.

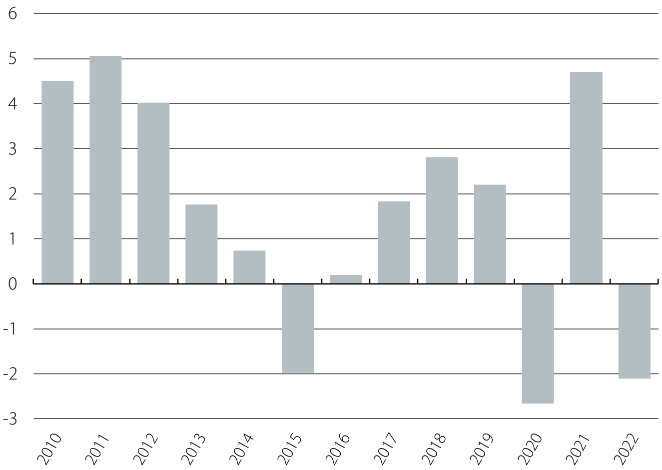
Türkiye faces the consequences of the earthquake. The recent buoyancy of the Turkish economy (it grew by 0.9% quarter-on-quarter in Q4 2022) has been abruptly interrupted by the devastating earthquake that has ravaged the south-east of the country, along the border with Syria. In addition to the irreparable cost in human lives, it has also dealt a heavy blow to economic activity, given that the area affected accounts for around 10% of Türkiye's GDP. The good news is that the damage to key infrastructure appears to be limited, and this could make it easier for the economy to make a quick and strong recovery after an initial shutdown, thanks to the reconstruction works which will cost between an estimated 6% and 10% of GDP. However, the earthquake could also have political consequences: the elections on 14 May will be held under the shadow of the earthquake's impact and the social discontent over what many consider to be a slow and inadequate reaction from Erdoğan's government. In addition, given the high number of people who have been displaced following the earthquake (some 13 million people), the feasibility of holding the elections on the planned date is beginning to be questioned.

US: non-farm payrolls
(Thousands of people)



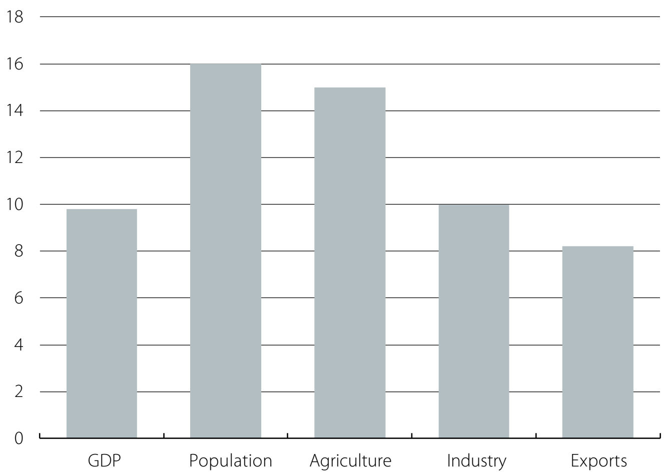
Source: *BPI Research, based on data from the BLS, via Refinitiv.*

Russia: GDP
Annual change (%)



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

Türkiye: area affected by the earthquake
(% of country total)



Source: *BPI Research, based on data published by Capital Economics.*

Analysing the tightness in the US labour market

The unemployment rate in the US stood at 3.4% in January, a level not seen since the 1960s, while job creation in the same month reached more than 500,000 jobs, a rate twice the average observed between 2015 and early 2020. Moreover, based on the data available up to December, in the US there are 1.9 job vacancies for every unemployed person. This is well above the historical average of 0.65 and demonstrates just how tight the world's largest economy's labour market is.

Supply shock or demand shock in the labour market?

When we say there is stress in the labour market, we are referring to the fact that there are many more companies seeking to hire workers than there are people looking for jobs. The first question we must ask ourselves is thus whether this post-pandemic tightness is the result of higher job demand (more companies wanting to hire) or a fall in supply (fewer workers). The sum of the total number of employees plus the unfilled job vacancies, which serves as an indicator for total job demand, is not far from its historical trend, suggesting that we are not facing a demand shock. On the other hand, if we perform a similar calculation for the supply of jobs,[1] we see that the pandemic did indeed trigger a major supply shock, as there are now around 4.5 million fewer workers than would be expected.

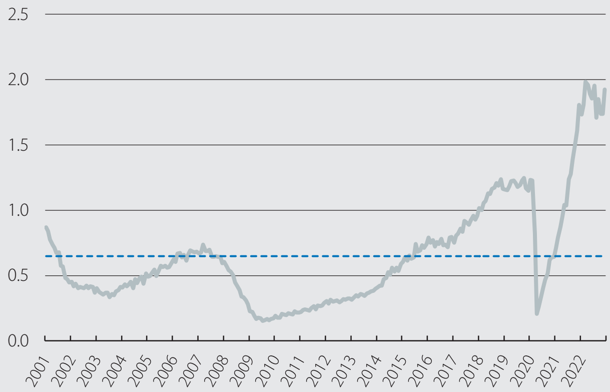
There are two factors that can explain most of this lower job supply: lower immigration and a reduction in the labour participation rate. The first factor explains approximately 1.2 of the 4.5 million fewer workers, as since the beginning of 2019 a change is apparent in the data regarding the number of people born outside the US who are seeking work in the country. If the growth trend of this population segment observed between 2015 and 2019 had continued, then by the end of 2022 there would have been just over 47 million people born outside the US over 16 years of age, rather than the 45.9 million reported by the BLS in January. The second factor is the fall in the labour participation rate – i.e. the number of people over the age of 16 who either work or would like to work – from 63.3% before the pandemic to the 62.4% registered in January, which equates to some 2.7 million fewer workers.

At the height of the pandemic, the decline in this rate was particularly pronounced and was attributed, in part,

1. In order to forecast the level of employment which we would «expect» to see, we use the latest US population estimates (2017) to predict the population over 16 years of age and assume constant unemployment and labour participation rates (3.5% and 63.3%, respectively) since the beginning of the pandemic.

US: job vacancies per unemployed person

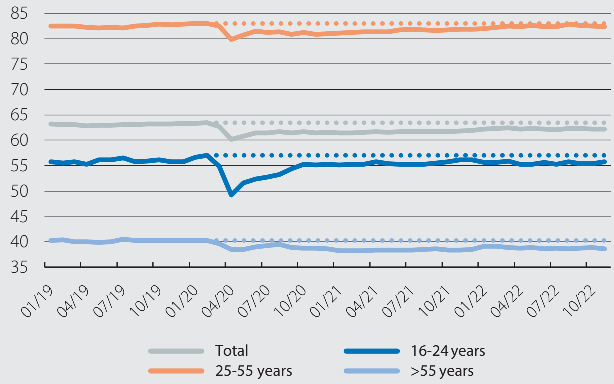
Ratio



Note: *The dashed line indicates the historical average.*
Source: *BPI Research, based on data from the BLS.*

US: labour participation rate by age group

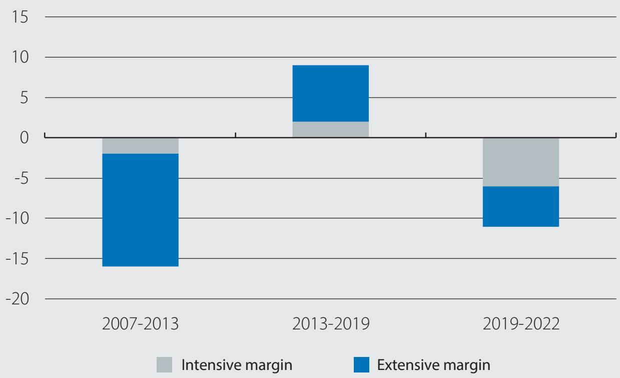
(%)



Note: *The dashed line marks the level of February 2020.*
Source: *BPI Research, based on data from the BLS.*

US: breakdown of the change in total hours worked

Annual change (%)



Source: *BPI Research, based on data from D. Lee et al. (2023). «Where Are the Workers? From Great Resignation to Quiet Quitting». National Bureau of Economic Research, No. w30833.*

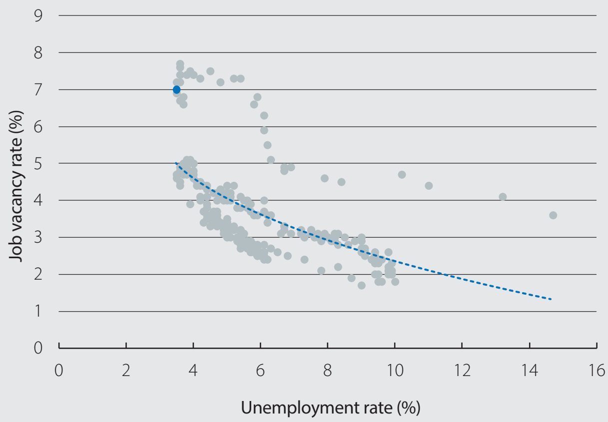
to temporary factors such as the fear of working in jobs more exposed to human contact or the fact that many people were unable to combine work with caring for minors or elderly people.[2] Nevertheless, these factors should no longer play a significant role. In fact, the factor that is now driving this lower rate is, above all, the departure of the population over 55 years of age from the labour market. The changes in composition within this (large) age range have been particularly pronounced between 2016 and 2022, as the relative weight in the labour market of the population between 55 and 59 years of age (whose labour participation rate is much higher than that of the population over 60) has fallen.[3]

On the other hand, it is important to note that this fall in the number of workers has occurred in the extensive margin of the labour supply, that is, the number of people who work. But at the same time as the number of people who are in the labour market is falling, those who remain active in it are working fewer hours, thus reducing the intensive margin. This phenomenon has been named quiet quitting and is due to the desire of many workers to strike a better work-life balance. Thus, as can be seen in the third chart, according to the data from a recent investigation, the reduction in the hours worked between 2019 and 2022 in the US is explained by a reduction in both the extensive and the intensive margin, with the intensive reduction being most notable among men with university studies and between the ages of 25 and 39.[4]

Will the Fed manage to balance job supply and demand?

This mismatch between the supply and demand for jobs is leading to wage dynamics which are not exactly helping the Federal Reserve to bring inflation back down to its 2% target. In order to fill their vacancies and attract workers, businesses must offer higher wages, which in turn drives up inflation. For this reason, through its rate hikes, the Fed is trying to rebalance the supply and demand for jobs and hopes to do so without triggering an unemployment rally: monetary tightening alone will not encourage workers who are outside the labour market to join it, but it should discourage businesses from hiring more people, thereby reducing the number of job vacancies.

US: Beveridge curve



Note: *In blue we mark the latest available data*
Source: *BPI Research, based on data from the BLS.*

So will the Fed manage to reduce the job vacancy rate without necessarily increasing unemployment? The answer is not clear, and the conclusion of the debate over whether there will be a recession in the US will largely depend on how this episode unfolds. There are arguments in favour of both outcomes: on the one hand, the Beveridge curve, which links the vacancy rate to that of unemployment, is not linear and, provided the historical relationships are maintained, at the point at which it currently lies there should be some scope to reduce the number of job vacancies without an excessive rise in unemployment.[5] In addition, given the difficulties in filling vacancies in recent years, many firms may choose not to destroy jobs if they fear that they will find it difficult to find replacement workers later on.[6] On the other hand, job vacancies are not evenly distributed across the different US economic sectors. In fact, vacancies are highly concentrated in accomodation and food services sector (precisely where the hourly wage is lower). Thus, if we assume that the Fed's rate hikes will cool demand (and thus destroy job vacancies) to a relatively similar extent across all sectors, then it could lead to job destruction in the rest of the sectors and thus increase the unemployment rate.

2. This phenomenon, which was particularly intense in 2021, was named the great resignation. For further details, see «US: (in)complete recovery of the labour market» in the MR07/2021.
3. In fact, the change in composition within the population over 55 accounts for 2.4 million of the 2.7 million fewer workers discussed above.
4. See D. Lee *et al.* (2023). «Where Are the Workers? From Great Resignation to Quiet Quitting». National Bureau of Economic Research, No. w30833.
5. See B. Bok *et al.* (2022). «Finding a Soft Landing along the Beveridge Curve». FRBSF Economic Letter, 24.
6. In fact, the employment report for January documented fewer redundancies than usual for this month of the year, which could be explained by companies' fear of difficulties in finding workers in the future.

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

UNITED STATES

	2021	2022	Q1 2022	Q2 2022	Q3 2022	Q4 2022	12/22	01/23	02/23
Activity									
Real GDP	5.9	2.1	3.7	1.8	1.9	0.9	–	–	–
Retail sales (excluding cars and petrol)	17.5	8.7	11.5	7.8	8.5	7.0	7.3	7.4	...
Consumer confidence *(value)*	112.7	104.5	108.1	103.4	102.2	104.2	109.0	106.0	102.9
Industrial production	4.9	3.8	4.8	4.5	3.9	2.1	1.1	0.8	...
Manufacturing activity index (ISM) *(value)*	60.7	53.5	57.7	55.0	52.2	49.1	48.4	47.4	47.7
Housing starts *(thousands)*	1,605	1,556	1,720	1,647	1,450	1,405	1,371	1,309	...
Case-Shiller home price index *(value)*	267	306	299	313	310	303	302	...	...
Unemployment rate *(% lab. force)*	5.4	3.6	3.8	3.6	3.6	3.6	3.5	3.4	...
Employment-population ratio *(% pop. > 16 years)*	58.4	60.0	59.9	59.9	60.0	60.0	60.1	60.2	...
Trade balance [1] *(% GDP)*	–3.6	–3.7	–3.9	–4.0	–3.9	–3.7	–3.7	...	...
Prices									
Headline inflation	4.7	8.0	8.0	8.6	8.3	7.1	6.5	6.4	...
Core inflation	3.6	6.2	6.3	6.0	6.3	6.0	5.7	5.6	...

JAPAN

	2021	2022	Q1 2022	Q2 2022	Q3 2022	Q4 2022	12/22	01/23	02/23
Activity									
Real GDP	4.1	0.0	0.5	1.7	1.5	0.6	–	–	–
Consumer confidence *(value)*	41.4	37.7	34.8	33.1	31.2	29.6	30.3	31.0	31.1
Industrial production	15.6	–2.6	–0.6	–3.6	4.0	0.6	–0.8	–3.1	...
Business activity index (Tankan) *(value)*	0.0	–1.3	14.0	9.0	8.0	7.0	–	–	–
Unemployment rate *(% lab. force)*	5.1	4.6	2.7	2.6	2.6	2.5	2.5	2.4	...
Trade balance [1] *(% GDP)*	1.4	–0.6	–1.0	–1.9	–3.0	–3.8	–3.7	–5.1	...
Prices									
Headline inflation	–0.7	–0.3	0.9	2.4	2.9	3.9	4.0	4.4	...
Core inflation	–1.4	–0.8	–0.9	0.8	1.5	2.8	3.0	3.2	...

CHINA

	2021	2022	Q1 2022	Q2 2022	Q3 2022	Q4 2022	12/22	01/23	02/23
Activity									
Real GDP	8.4	3.0	4.8	0.4	3.9	2.9	–	–	–
Retail sales	12.4	–0.8	1.6	–4.9	3.5	–2.7	–1.8	...	...
Industrial production	9.3	3.4	6.3	0.6	4.8	2.8	1.3	...	...
PMI manufacturing *(value)*	50.5	49.1	49.9	49.1	49.5	48.1	47.0	50.1	52.6
Foreign sector									
Trade balance [1,2]	681	889	728	824	908	889	905.1	...	...
Exports	30.0	7.1	15.7	12.9	10.0	–6.8	–9.9	...	...
Imports	30.0	1.1	10.6	1.2	0.6	–6.5	–7.5	...	...
Prices									
Headline inflation	0.9	2.0	1.1	2.2	2.7	1.8	1.8	2.1	...
Official interest rate [3]	3.8	3.7	3.7	3.7	3.7	3.7	3.7	3.7	3.7
Renminbi per dollar	6.5	6.7	6.3	6.6	6.9	7.1	7.0	6.8	6.9

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

	2021	2022	Q1 2022	Q2 2022	Q3 2022	Q4 2022	12/22	01/23	02/23
Retail sales *(year-on-year change)*	5.4	...	6.1	1.1	–0.6	–2.6	–2.8	...	...
Industrial production *(year-on-year change)*	9.0	...	–0.2	0.4	1.7	1.5	–1.7	...	...
Consumer confidence	–7.5	...	–13.7	–22.6	–26.9	–26.9	–22.0	–20.7	–19.0
Economic sentiment	110.7	...	111.2	103.8	96.5	96.5	97.1	99.8	99.7
Manufacturing PMI	60.2	...	57.8	54.1	49.3	49.3	47.8	48.8	48.5
Services PMI	53.6	...	54.1	55.6	49.9	49.9	49.8	50.8	52.7
Labour market									
Employment (people) *(year-on-year change)*	1.4	...	3.0	2.6	1.7	1.5	–	–	–
Unemployment rate *(% labour force)*	7.7	6.7	6.8	6.7	6.7	6.7	6.7	6.7	...
Germany *(% labour force)*	3.6	3.1	3.1	3.0	3.1	3.0	3.0	3.0	...
France *(% labour force)*	7.9	7.3	7.3	7.5	7.2	7.2	7.2	7.1	...
Italy *(% labour force)*	9.5	8.1	8.5	8.1	8.0	7.8	7.8	7.9	...
Real GDP *(year-on-year change)*	5.5	3.5	5.5	4.3	2.3	1.9	–	–	–
Germany *(year-on-year change)*	2.8	1.9	3.5	1.7	1.4	0.9	–	–	–
France *(year-on-year change)*	7.2	2.6	4.8	4.2	1.0	0.5	–	–	–
Italy *(year-on-year change)*	7.3	3.9	6.5	5.1	2.5	1.4	–	–	–

Prices

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

	2021	2022	Q1 2022	Q2 2022	Q3 2022	Q4 2022	12/22	01/23	02/23
General	2.6	8.4	6.1	8.0	9.3	10.0	9.2	8.6	8.5
Core	1.5	3.9	2.7	3.7	4.4	5.1	5.2	5.3	5.6

Foreign sector

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

	2021	2022	Q1 2022	Q2 2022	Q3 2022	Q4 2022	12/22	01/23	02/23
Current balance	2.6	–0.8	1.8	0.7	–0.8	–0.8	–0.8	...	...
Germany	7.4	3.8	6.6	5.4	4.2	3.8	3.8	...	...
France	0.4	–2.0	0.1	–0.4	–1.3	–2.0	–2.0	...	...
Italy	3.0	–0.7	2.1	1.0	–0.6	–0.7	–0.7	...	...
Nominal effective exchange rate [1] *(value)*	**94.3**	**90.8**	**92.5**	**90.2**	**88.9**	**91.6**	**92.6**	**93.0**	**93.0**

Credit and deposits of non-financial sectors

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

	2021	2022	Q1 2022	Q2 2022	Q3 2022	Q4 2022	12/22	01/23	02/23
Private sector financing									
Credit to non-financial firms [2]	3.5	6.7	4.4	6.1	8.4	7.8	6.3	6.1	...
Credit to households [2,3]	3.8	4.4	4.4	4.6	4.5	4.0	3.8	3.6	...
Interest rate on loans to non-financial firms [4] *(%)*	1.2	1.8	1.2	1.4	1.8	2.9	3.4	3.5	...
Interest rate on loans to households for house purchases [5] *(%)*	1.3	2.0	1.4	1.5	2.1	2.9	3.1	3.5	...
Deposits									
On demand deposits	12.6	6.2	9.1	7.7	6.3	1.8	0.0	–1.3	...
Other short-term deposits	–0.8	4.5	–0.3	0.9	5.3	12.0	14.0	15.1	...
Marketable instruments	11.6	3.7	0.7	2.0	4.2	7.7	11.3	13.3	...
Interest rate on deposits up to 1 year from households *(%)*	0.2	0.5	0.2	0.2	0.4	1.1	1.4	1.5	...

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.*

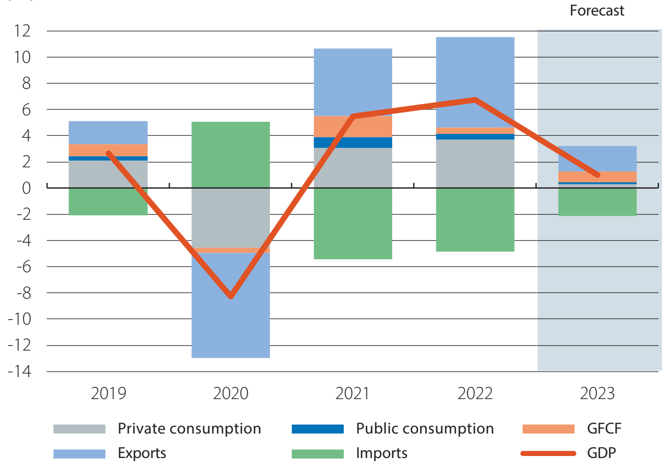
Good signs in 2023, despite elevated interest rates and inflation

Confirmed growth of 6.7% in 2022. Exports and consumption were the components that most contributed to this result, reflecting a strong recovery in tourism and in the consumption of durable goods, namely automobiles. Expenditure on non-food goods and services also grew positively, while expenditure on food goods contracted by 2.3%. While the behaviour of the various components of private consumption shows that inflation has led lower income families to spend less in their consumption of foodstuffs, there is a perceptible concentration of surplus savings in higher income families, allowing these savings to be channelled into the acquisition of other goods and services, further normalising consumption patterns. Meanwhile, while there are still few indicators available for the beginning of 2023, what we have is indicative of a more positive outlook than that implied in our forecasts for GDP in Q1 2023.Indeed, confidence indicators improved in January and February and consumption-related indicators - car sales and card withdrawals and payments - grew at a good pace at the beginning of the year. For now we maintain our forecast that the economy will grow by just 1% in 2023, but the risks are skewed slightly upwards.

February inflation with good and bad news. The good news is that global CPI has dropped for the fourth consecutive month, to 8.2%, according to INE's flash estimate (8.4% in January). This is mainly due to the decrease in the inflation of energy products (–2.2% in monthly terms, from a year-on-year rate of 7.1% to 2%). The bad news come from the data on core inflation and on food products. Core inflation recorded its first drop in 15 months in January, to 7%, but recovered again to 7.2%. Prices for unprocessed food continue their upwards march, experiencing levels inflation unseen at least since joining the single currency at 20.1%. The global CPI data places our forecast for average inflation in 2023 at 5.5%, with risks of a downward revision. However, in a context of rising inflation in other countries of the euro zone, the underlying conclusion is that this phenomenon will persist.

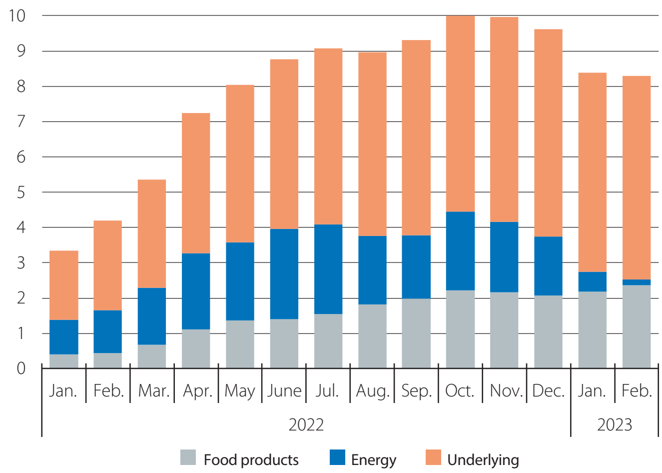
The job market meanwhile is beginning to signal a reversal of its trajectory. More specifically, the unemployment rate increased to 6.5% in 4Q 2022, an increase of 0.7 pp compared to 3Q and +0.2 pp compared to the same quarter of 2022. In turn, the employed population fell in quarterly terms for the first time since Q1 2021 (–0.5%, –26,200 jobs), while still remaining substantially above that recorded in the pre-pandemic period (+2.4%, +117,000 jobs). The quarterly reduction in employment is largely explained by a reduction in consulting, scientific, technical and similar activities (–11,400), Public administration, defence and social security (–11,100), and human health and social support activities (–12,400). It is possible that the post-COVID normalisation of activity in some sectors explains this fall, at least in part, which could be the case of activities associated with health and social support, for example. Despite this behaviour, for the year as a whole, the unemployment rate decreased to 6.0% (6.6% in 2021), while

GDP: contribution by components
(%)



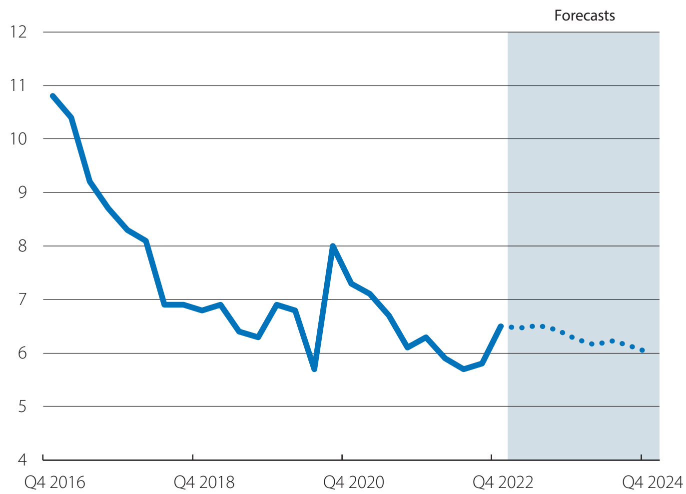
Source: *BPI Research, based on data from INE.*

CPI: contributions for year-on-year variation
(%)



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

Unemployment rate: background and forecasts
(%)



Source: *BPI Researc,h based on data from INE.*

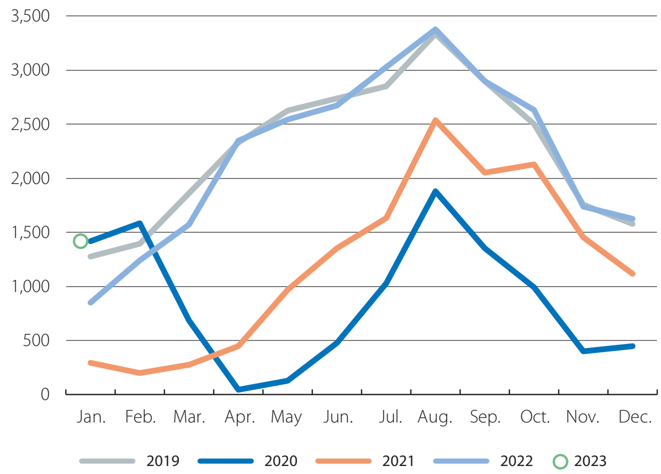
the employed population increased by 2.0%, reaching its highest value since 2009. Meanwhile, registered unemployment continues to rise, at +4.9% quarter-on-quarter in January (–9.5% year-on-year), with unemployment in some sectors in January increasing more than the average growth of the 5 years prior to the pandemic, such as construction (+4.3% in January 2023, compared to the average of 1.2%) or trade (+8.5%, compared to the average of 5.5%).

Tourism is off to a good start in 2023, with around 1.5 million guests recorded in January. Compared to January 2020, this represents growth of 3.2%, and of 72.5% in year-on-year terms, prolonging the positive atmosphere of 2022. With full 2022 data now available for the sector, we would firstly highlight that total income in tourist establishments exceeded 2019 levels by 16.5%, although the number of guests as a whole still fell short of the pre-pandemic period (–2%). Another major highlight was the performance of tourists from the USA, which increased by 25% compared to 2019, dethroning German tourists as the fourth most important source country. For 2023, we expect a more favourable year supported by lower energy prices (reflected in air fares), one-off events such as the World Youth Days, and the recovery of tourists from China.

In 2022, the current and capital account recorded a deficit equivalent to 0.4% of GDP. This situation essentially reflects a worsening of the current account balance, resulting from a worsening of the deficit in the goods account (via the increase in the price of imports) and the reduction of the surplus in the income account, the result of a decrease in European funds allocated to final beneficiaries and an increase in dividend payments. The outlook for 2023 is for a return to surplus, reflecting a reduction in the current account deficit and an increase in the capital account, which will benefit from the receipt of NGEU funds. The current account, while remaining in deficit, will improve compared to 2022, reflecting a reduction in the energy deficit associated with a more benign behaviour in the prices of energy goods and good prospects for the tourism sector.

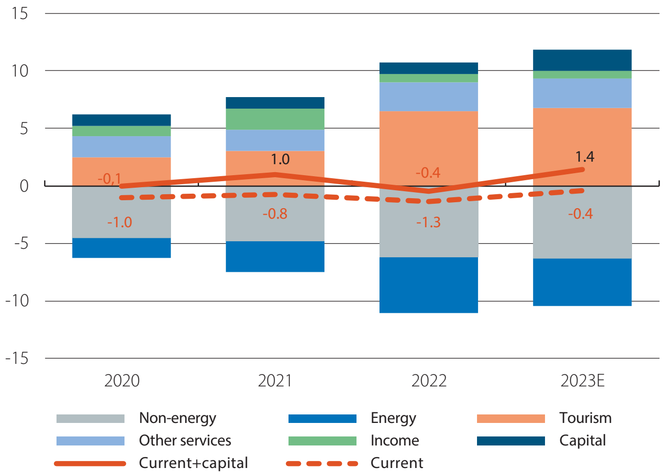
Non-financial private sector deposits declined significantly in the first month of the year. This behaviour in the month of January stands out in the entire historical series of data, available since 1980, with a reduction of almost 4 billion compared to the end of 2022, a phenomenon largely explained by the fall in deposits of private individuals (–2.54 billion euros). This behaviour is probably related to the demand for more attractive savings instruments, such as Savings Certificates, whose net subscriptions increased by 2.909 billion euros compared to December, reaching a historical maximum (since the earliest records from 1998) of 22.534 billion euros. Despite this historic drop, the amount of non-financial private sector deposits remains at very high levels, around 98% of GDP (compared to 105% at the end of 2022, when deposits surpassed 249.7 billion euros, a historical record) and continue to record significant year-on-year growth rates (5.1%). In turn, the credit portfolio of the non-financial private sector continued to decelerate (0.9% year-on-year, compared to 1.3% in December), with the housing credit portfolio increasing 2.6% year-on-year (2.7% in December) while that of companies falls, 1.5% year-on-year (–1.0% in December).

Number of guests
(Thousands)



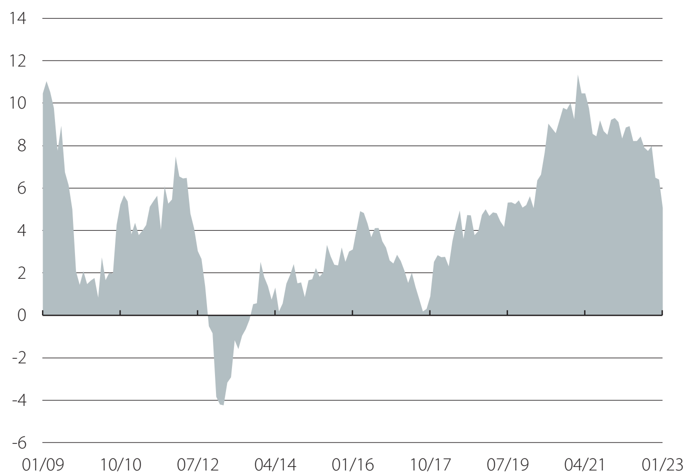
Source: *BPI Research, based on data from the National Statistics Institute of Portugal.*

Current and capital balance: components
(% of GDP)



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

Deposits from the non-financial private sector
Annual rate of change (%)



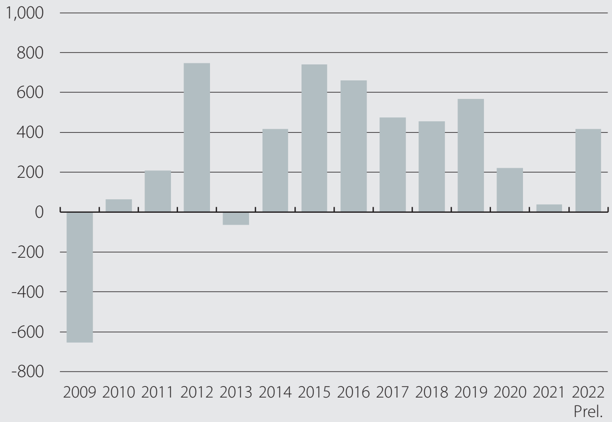
Source: *BPI Research, based on data from Banco de Portugal.*

Municipal taxes and the relationship with the residential real estate market in Portugal

In the last five years, house prices in Portugal have increased by around 63%, which means that a house that cost 100,000 euros in 2017 will now cost around 163,000 euros in 2022.[1] Likewise, the number of transactions has increased significantly, by around 32% over the last five years. In this article, we will look at how housing-related municipal taxes have evolved over this period and examine their relationship with the residential property market.

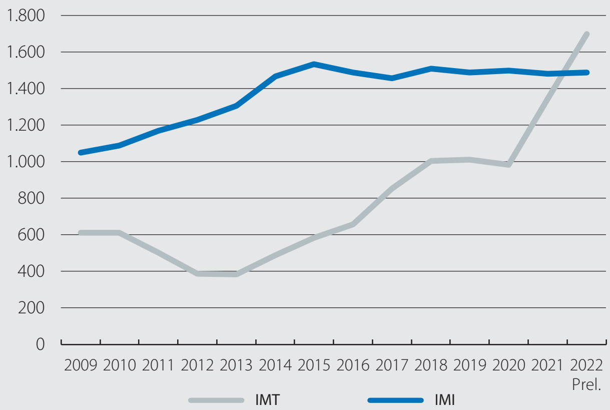
First of all, let us look at the budgets of municipal councils. Overall, municipal councils have recorded surpluses over the last 14 years, averaging around 0.2% of GDP (see first graph). To a large extent, municipal revenues are related to tax revenue and current transfers, each with a weight of around 37% in 2022 (above the 30% recorded in 2009). Tax revenue includes the so-called municipal taxes, which include the Municipal Property Tax (IMI),[2] the Municipal Property Transfer Tax (IMT),[3] the Municipal Surcharge[4] and the Single Circulation Tax (IUC).[5] Among these, the first two (IMI and IMT) accounted for about 82% of total tax revenue and 30% of total revenue in 2022[6] (about 77% and 23%, respectively, in 2009), and are an important source of funding for municipalities. Meanwhile, on the transfers side, the contribution of transfers made by the Financial Equilibrium Fund (FEF) is of particular weight, representing almost half of the current transfers in 2022.[7] In turn, the main expenditure of municipalities includes expenditure on staff, acquisition of goods and services (such as expenditure on fuel, rents, office supplies,

Portugal: Balance of Local Administrations
(Millions of euros)



Source: *BPI Research, based on data from the Directorate-General for Budget.*

Portugal: IMI and IMT revenue
(Millions of euros)



Source: *BPI Research, based on data from the Directorate-General for Budget.*

communications...), current transfers (e.g. transfers to parish councils), and the acquisition of capital or investment goods (including the acquisition of software, social equipment, works, roads...).These four items were responsible for more than 92% of the expenditure incurred by municipal councils in 2022 (above the approximately 87% they represented in 2009).

As we saw earlier, revenue collected through IMI and IMT is an important source of funding for municipal councils. In the last five years, these two taxes have increased together by almost 38%, with especially strong growth in the case of the IMT (98.5%) (see second graph). This behaviour is reflected in the change in the structure of municipal tax revenues. In 2017, IMI represented around 50% of the municipal tax revenue, a weight that dropped to 38% in 2022. In the opposite direction, the IMT went

1. The data for 2022 is not yet known, so the calculations use BPI Research forecasts for 2022.
2. Municipal tax paid by property owners, calculated on the taxable asset value, according to different rates depending on the type of property. Revenue relates to the municipality where the property is located.
3. Municipal tax, paid by the purchaser of the property, depending on the value of the deed of the contract or taxable value (whichever is greater), the rate, location and purpose. The revenue is collected by the municipal councils where the properties are located.
4. The municipal surcharge is a tax levied on the taxable income of the previous year and is not exempt from corporate income tax. It depends on location, turnover and jobs created/maintained.
5. Tax imposed on the owners of vehicles registered in the country, paid annually in the month of registration, by individuals and legal entities. The amount depends on the year of registration, fuel used, engine capacity and CO_2 emissions.
6. According to preliminary data in the national budget, released by the Directorate-General for the Budget.
7. In order to ensure financial balance, there is a distribution of resources between the State and the municipalities through the following transfers: general grants through the Financial Equilibrium Fund (FEF), specific grants through the Municipal Social Fund, a contribution equivalent to 5% of personal income tax and a contribution of 7.5% of VAT revenue from the accommodation, catering, communications, electricity, water and gas sectors.

from a weight of 29% in 2017 to 44% last year, as can be seen in the third graph.

Taking into account the formulation of the IMT, the amount collected depends on the value of housing transactions and/or the number of transactions, a relationship that is represented in the last graph. It is thus confirmed that an increase in the total value of house purchase transactions leads to an increase in IMT revenue. Likewise, a variation of 1% in the amount of transactions in 2022 lead to an increase of around 1.7% in IMT revenue (compared to 1.0% in 2017). This relationship with the residential property market does not occur with IMI revenue, as this tax depends on the number of existing houses and their taxable value, not new transactions. However, it is important to bear in mind that the amount of IMT revenue also depends on other factors not analysed in this article, such as changes in rates or regulation.

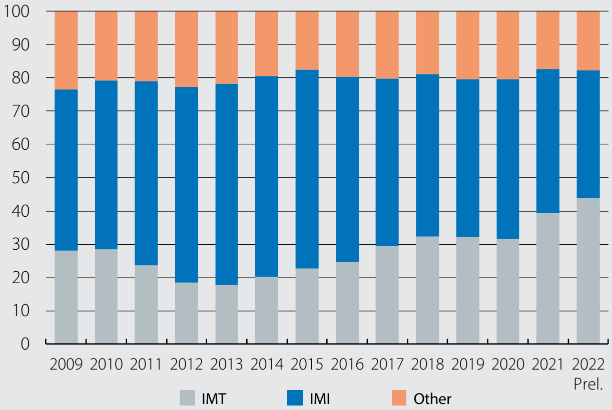
We do not yet have data on budgets for each municipality in 2022, but according to the 2021 accounts, it can be seen that some councils are more dependent on IMI and IMT revenues than others. For example, within the Lisbon Metropolitan Area, these revenues represented around 30% of total revenues in Sintra, a figure that reaches almost 50% in Cascais. In the Metropolitan Area of Porto, this percentage in Gondomar is around 24%, while in Vila Nova de Gaia it is around 40%.

Our outlook for the residential property market in Portugal in 2023 is for a slight correction in house prices, and a stronger correction in the case of transactions. In this context, it is possible that IMT revenue will decrease in 2023, but we estimate that it will continue at levels higher than the pre-pandemic period. As such, everything else remaining constant, we do not think there will be a problem in the financing of municipalities.

Vânia Duarte

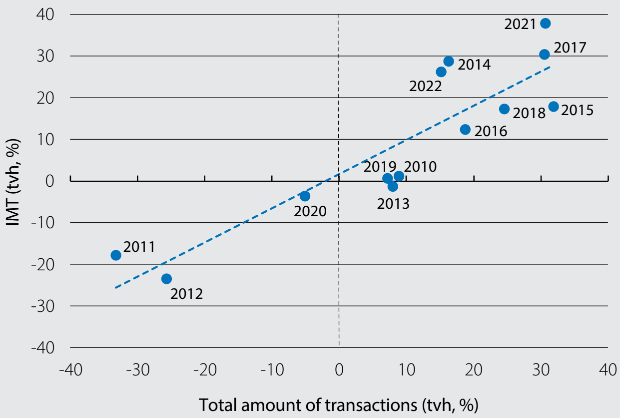
Portugal: IMI and IMT revenue

Weight in tax revenue (%)



Source: *BPI Research, based on data from the Directorate-General for Budget.*

Portugal: relation between IMT and total amount of house transactions



Source: *BPI Research, based on data from the Directorate-General for Budget and the*

Cereals in Portugal: no risk of shortages, but a need for more production

Recent global events[1] have made concerns about Portugal's dependence on external suppliers in the cereals market more pressing. The continued urbanisation of rural land, changes in eating habits, the increase in irrigated land and the consequent change in crops in these areas and the stabilisation of prices paid to producers explain the reduction in the area dedicated to cereal crops and the consequent decrease in production in Portugal over recent decades.

The declining importance of cereal cultivation occurred primarily due to falling agricultural area used for cultivation and to the stagnation of the quantities produced. In 2020, the total cultivated area was 208,000 hectares, 64% less than in 2000, reflected in a reduction of about 30% in production. In the same period, consumption increased only marginally (5%), but enough for the degree of self-provisioning to fall to 20%. These figures place Portugal well below the global level of self-provisioning (which are higher than 50% pn average). Declining levels of self-provisioning occurred for all cereals, particularly those most consumed. In wheat, the drop was from around 20% in 2000 to 6% in 2021, while in corn it fell from 43% to 24%. Rye and oats, where Portugal was practically self-sufficient at the beginning of the century, currently have levels of supply of 49% and 27%, respectively.

The loss of economic importance of cereals is also evident in the value produced, which currently represents only 4% of total agricultural production, almost 3 percentage points less than in 2000. Corn is the most important cereal crop, representing 66% of total cereal production in 2022 (10 percent more than in 2020). This is followed by wheat, at 17% of the total produced, and rice at 10%.

Over the same period, total cereal consumption remains relatively stable, with an average annual growth of 0.2% between 2000 and 2022. By type of consumption, there was a drop in human consumption and in industrial use, and an increase in animal consumption, correlated with an increase in animal production. Tthe increase in barley consumption was particularly high, mainly used by the industrial sector, reflecting the growth in beer production (in annual average terms, total barley consumption increased by 5.8%, but the share destined for industry increased by 9%).

In this context of high dependency on imports to meet domestic consumption needs, the impact of the

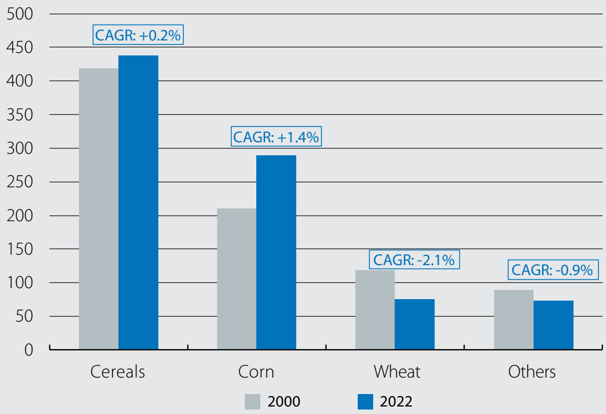
1. The pandemic and the war in Ukraine.

Cereal crop indicators

	2000	2021	CARG
Cultivated area (thousand hectares)	578	208	–4.7
Production (thousands of tons)	1,614	1,118	–1.7
Productivity (Kg/ha)	2,793	5,372	3.2
Total consumption (thousands of tons)	4,474	4,711	0.2
Human	1,303	1,207	–0.4
Animal	2,517	3,043	0.9
Industrial and others	654	461	–1.7
Self-provisioning (%)	34	19	–2.6

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

Cereals: evolution of production
(Current prices)



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

constraints associated with the war in Ukraine was felt especially in terms of the rise in net imports of cereals. In 2022, imports net of exports were about 43% more expensive than in 2021, explaining 95% of the worsening of the deficit compared to 2021. In fact, last year the cereal deficit reached 1.3 billion euros, 440 million euros more than in 2021,[2] with the dependence on foreign purchases of corn and wheat standing out in particular. Corn accounts for 52% of imported cereal tonnage and 50% of the cereal balance deficit. In the case of wheat, the percentages are 27% and 33%, respectively.

In terms of supplier structure, Portugal was less exposed to the suspension of supplies from Russia and Ukraine. Russia's importance is practically nil (on average it

2. In 2022, export figures were much more positive than those of imports, practically doubling in value (+98%) while imports increased by 56%. In terms of quantity, the former grew by 83% and the latter by 10%.

represented only 2% of cereal imports between 2017 and 2021), while Ukraine, although representing 10% of the total imported, only appears in 4th place, after Spain (20%), France (19%) and Brazil (17%). This diversity of suppliers made it easier for Portugal to find substitutes for the decrease in imports from Ukraine by 2022 (which still accounted for 8% of total cereal imports). Brazil took first place as a supplier with a share of 28% (taking advantage of the good agricultural year in that country).

In corn, which represents more than 50% of cereal imports, before the war Ukraine represented 37% of imports, slightly above Brazil's quota (32% of the total), which in 2022 now counts for a little more 50% of imports of this cereal.

In the case of wheat, the second most imported cereal by Portugal, Ukraine had little significance (2% of total imports) and France remained the main supplier with a share of almost 60%.

Taking into account the national structure of cereal imports and the ability to cover supply shortages with other suppliers, we think cereal shortages are unlikely, with the main risks mainly related to the evolution of prices, still very dependent on the situation in Ukraine. Yet in this regard too, the news is moderately positive. Benefiting from the agreement negotiated in July by the United Nations allowing the export of Ukrainian cereals from the port of Odessa and the good news regarding harvests in countries such as the USA and Brazil, the price of futures contracts for 2023 suggest some correction in the prices of the main cereals. In the case of corn and wheat, the two cereals most imported by Portugal, the implicit correction in the respective futures contracts is 7.4% and 12.6%. In barley, the third cereal which Portugal most imports, the correction is 26.7%. The fulfilment of this outlook will bring some relief both to the behaviour of the trade balance and to consumer prices.

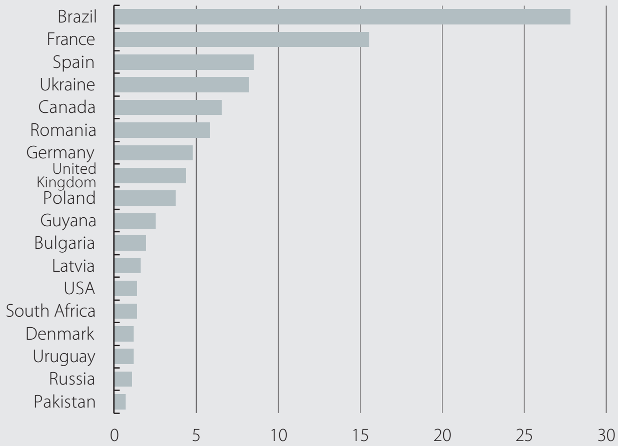
In the trade balance (of cereals), assuming stable quantities imported and exported, the incorporation of this correction in the unit price of imports and exports would be reflected in a reduction of the cereals trade balance deficit by about 34%, or 153 million euros less than in 2022.

On the consumer side, the correction compared to 2022 will be moderate, taking into account that prices will still be much higher than they were before the war, but the difference will start to be felt to the extent that average food inflation will still be around 10% in 2023, only 2 percentage points lower than the previous year.

The maintenance of historically higher prices may bring some advantages in terms of profitability, especially if the prices of other factors that affect producer prices, such as fertilisers and fuel, behave more positively, as is expected, benefiting from the regularisation of global supply chains, favouring increased production.

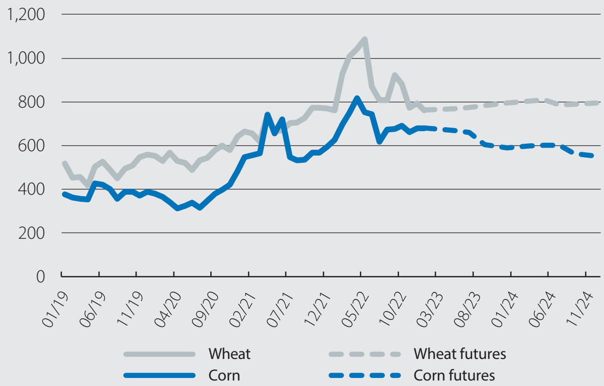
Teresa Gil Pinheiro

Cereals: origin of imports in 2022
(Quantities as a % of total cereal imports)



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

Cereals: prices and prices of futures contracts
(USD/BU)



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

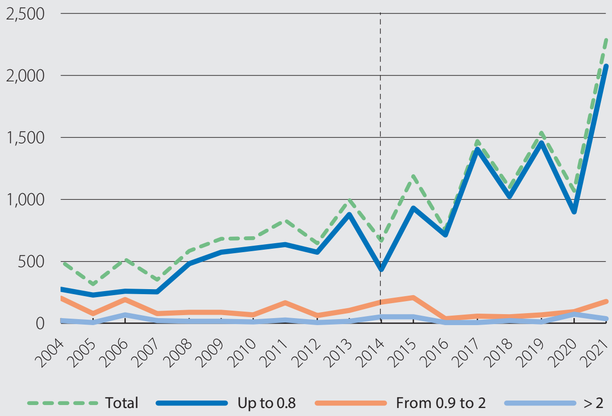
The olive oil sector in Portugal: a brief portrait

Olive oil plays an important role in Mediterranean culture, not only in terms of diet but also in symbolic and even religious terms. Economically speaking, olive oil was one of the country's first exports and is a traditional sector of the Portuguese business sector. This is clear from the fact that a third of the country's milling capacity is still owned by private individuals or cooperatives. It also provides an important source of income in rural areas, contributing to territorial cohesion. In this article, we intend to characterise some aspects of the sector and its recent evolution.

First of all, it is important to recall Portugal's relative position in this industry. In terms of production, according to FAO data, the European countries of the Mediterranean basin are responsible for around 65% of world production, headed by Spain, which is by far the largest world producer and alone produces over 40% of the total quantity. Portugal, with a production of around 120,000 tonnes, is eighth, which in terms of scale is over ten times less than Spain in relative terms. However, we must stress that there has been a significant growth in the quantity and quality of olive oil produced in Portugal. The CAGR of olive oil production between 2004 and 2014 was 3%, while in the period between 2014 and 2021 it soared to 19% (25% in the case of the best quality olive oil, extra virgin).[1] Currently, extra virgin olive oil production represents more than 90% of the total, though it represented only 55% in 2004. While several factors contributed to this increase in production, we highlight two. Firstly, the increase in the cultivation of intensive and super-intensive olive groves[2] and in olive production through investments made by the industry in the area around the Alqueva irrigation perimeter. The Alentejo region, which in 2004 produced 32% of the olive oil in Portugal, will produce 80% in 2021, in an area of olive groves that represents only half of the country's total olive grove cultivation area. In other words, in the Alentejo, between 2004 and 2021, and as a result of investment in intensive olive groves, the cultivated area grew by 33%, but olive oil production grew by over 1000%. This is a surprising increase in productivity, quite distinct from other regions of the country, and clearly visible from the moment when intensive olive groves start to yield[3] (see third graph).

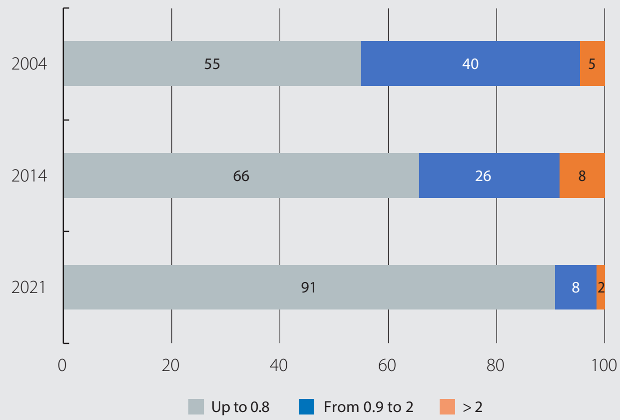
1. With acidity up to 0.8%.
2. The intensive and super-intensive olive groves differ from traditional groves mainly in the density of olive trees planted. Traditional density is 50 to 100 trees/ha; intensive density is 200 to 450 trees/ha; and super-intensive density is 1500 to 2000 trees/ha. Intensive and super-intensive modalities also allow for greater mechanisation of harvesting and a shorter period of time before the olive groves reach their peak yield.
3. The Alqueva dam began filling in 2002 and an intensive olive grove planted at that time will only reach its peak yield 8 to 10 years later.

Olive oil production by degree of acidity
(Thousands of hectoliters)



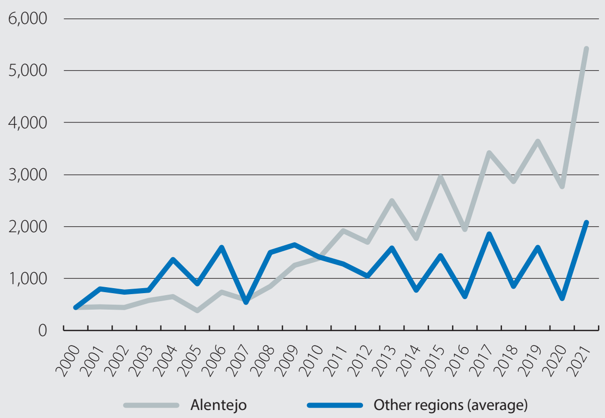
Source: *BPI Research, based on data from INE.*

Olive oil production by degree of acidity
(In % of total hectoliters produced)



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

Olive oil yield
(kg/ha)



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

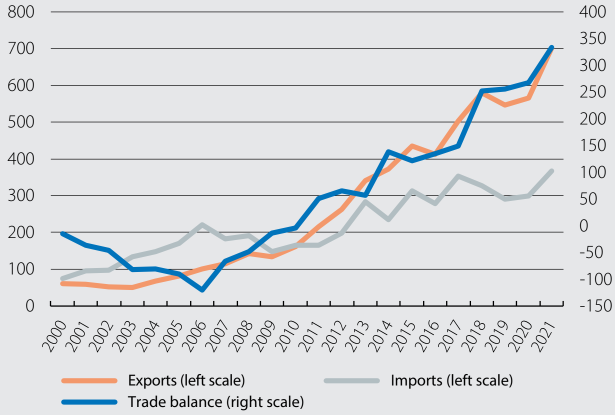
The second factor to be highlighted is the installation of mills with more modern technology,[4] enabling greater production to be obtained in less space and with fewer manual processes. Today, more than half of the mills in operation are highly mechanised, while there were only a few such mills in 2004. In short, we can say that in Portugal, the sector has been characterised in recent years by greater production of olives and olive oil (as a result of the irrigation made possible by the Alqueva and intensive olive groves), and by greater mechanisation at various stages of the value chain.

At this level of production, Portugal has a degree of self-sufficiency in olive oil of over 180%,[5] which is noteworthy because this is not the case for many important categories of products in the agri-food universe such as meat (at 81.6%) or pulses (18.6%), for example. This allowed the country to become a net exporter of olive oil from 2011, with a positive trade balance of more than 300 million euros. Along with wine, fruit and fish, this product is among the most representative of agri-food exports in Portugal (in terms of value). Spain (38%), Brazil (33%) and Italy (18%) are the main destinations for exported olive oil (in terms of value), and Spain is also the almost exclusive origin of the olive oil Portugal imports. Another positive aspect to note is the terms of trade for this product, which are favourable to Portugal, as can be seen in the last graph: in 2021, Portugal exported olive oil at an average price of 3.2 euros per kilogram, and imported at 2.7 eur/Kg. In these metrics, Portugal even compares well with the market leader, Spain, which between 2015 and 2021 had an average export price of 3.22 eur/Kg compared to 3.42 eur/Kg for Portugal.

However, it should not be thought that the trajectory we have presented is free of possible improvements and challenges. Firstly, diversification of export destinations would be desirable, in a context where over 90% of the value exported goes to four countries - Spain, Brazil, Italy and the USA. An improvement in the positioning of national brands is also desirable, placing the product more as a differentiated good and less as a commodity, as Italian producers have done.[6] Another positive development would be to achieve greater market share in countries that pay a higher price for olive oil, such as Germany.[7] In parallel, it is up to the national industry to have the creativity to take advantage of some tailwinds for the sector: olive oil is now recognised as a beneficial product for human health and its consumption has increased in the main non-producing countries, such as the USA and Brazil.

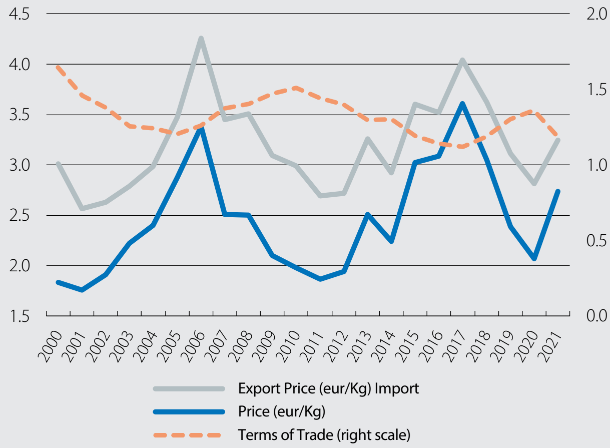
Tiago Belejo Correia

Olive oil trade balance
(Millions of euros)



Source: BPI Research, based on data from INE.

Terms of trade for Portuguese olive oil



Source: BPI Research based on data from INE.

4. Two stage continuous extraction system.
5. According to the National Statistics Institute's 2021 agricultural figures. The degree of self-sufficiency is the ratio between domestic production and domestic consumption.
6. The average export price of Italian olive oil between 2015 and 2021 was 4.42 eur/kg.
7. In 2021, Germany represented only 0.5% of the exported value of Portuguese olive oil, but the average export price between 2015 and 2021 was among the highest: 4.07 eur/Kg.

Activity and employment indicators

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

	2021	2022	Q1 2022	Q2 2022	Q3 2022	Q4 2022	12/22	01/23	02/23
Coincident economic activity index	3.4	6.0	7.1	6.7	5.4	4.7	4.7	4.7	...
Industry									
Industrial production index	4.5	0.5	–2.1	2.0	1.8	0.1	2.5	...	...
Confidence indicator in industry *(value)*	–5.3	–3.4	–0.1	–2.3	–4.7	–6.6	–6.9	–6.3	–5.0
Construction									
Building permits - new housing (number of homes)	13.5	...	46.0	–22.6	4.3	...	...	...	...
House sales	20.5	...	25.8	4.5	–2.8	...	–	–	–
House prices *(euro / m² - valuation)*	8.6	13.8	11.5	14.2	15.8	13.6	13.5	14.9	...
Services									
Foreign tourists *(cumulative over 12 months)*	51.5	158.6	259.9	298.1	244.4	158.6	158.6	154.0	...
Confidence indicator in services *(value)*	0.1	15.0	13.0	21.1	17.9	8.1	5.8	6.1	10.2
Consumption									
Retail sales	4.9	4.8	12.7	3.1	3.3	0.0	0.5	3.7	...
Coincident indicator for private consumption	5.0	4.4	6.9	5.2	3.2	2.3	2.3	2.4	...
Consumer confidence index *(value)*	–17.2	–29.7	–19.3	–30.5	–31.8	–37.0	–38.1	–37.0	–35.0
Labour market									
Employment	2.8	2.0	4.7	1.9	1.1	0.5	–0.5	...	...
Unemployment rate (*% labour force*)	6.6	6.0	5.9	5.7	5.8	6.5	6.7	...	...
GDP	**5.5**	**6.7**	**11.9**	**7.4**	**4.8**	**3.2**	–	–	–

Prices

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

	2021	2022	Q1 2022	Q2 2022	Q3 2022	Q4 2022	12/22	01/23	02/23
General	1.3	7.8	4.3	8.0	9.1	9.9	9.6	8.4	8.2
Core	0.8	5.6	3.1	5.5	6.5	7.2	7.3	7.0	7.2

Foreign sector

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

	2021	2022	Q1 2022	Q2 2022	Q3 2022	Q4 2022	12/22	01/23	02/23
Trade of goods									
Exports *(year-on-year change, cumulative over 12 months)*	18.3	23.1	21.2	18.9	22.7	23.1	23.1	...	...
Imports *(year-on-year change, cumulative over 12 months)*	22.0	31.2	33.3	31.5	35.2	31.2	31.2	...	...
Current balance	**–1.6**	**–3.2**	**–3.5**	**–4.4**	**–4.2**	**–3.2**	**–3.2**	**...**	**...**
Goods and services	–5.5	–4.9	–6.8	–6.4	–5.3	–4.9	–4.9	...	...
Primary and secondary income	3.9	1.7	3.3	2.0	1.1	1.7	1.7	...	...
Net lending (+) / borrowing (–) capacity	**2.1**	**–1.1**	**–0.1**	**–1.0**	**–1.9**	**–1.1**	**–1.1**	**...**	**...**

Credit and deposits in non-financial sectors

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

	2021	2022	Q1 2022	Q2 2022	Q3 2022	Q4 2022	12/22	01/23	02/23
Deposits [1]									
Household and company deposits	9.3	6.4	8.9	8.2	7.8	6.4	6.4	5.1	...
Sight and savings	16.3	7.3	15.3	12.9	11.2	7.3	7.3	5.3	...
Term and notice	1.2	5.2	1.1	2.3	3.3	5.2	5.2	4.7	...
General government deposits	–4.1	12.4	9.8	8.5	–0.1	12.4	12.4	22.3	...
TOTAL	**9.0**	**6.5**	**8.9**	**8.2**	**7.5**	**6.5**	**6.5**	**5.5**	**...**
Outstanding balance of credit [1]									
Private sector	2.9	1.3	2.8	2.5	1.9	1.3	1.3	0.9	...
Non-financial firms	2.2	–1.0	1.2	0.7	–0.5	–1.0	–1.0	–1.5	...
Households - housing	3.3	2.7	3.0	3.8	3.3	2.7	2.7	2.6	...
Households - other purposes	3.1	2.9	6.4	3.3	3.2	2.9	2.9	1.4	...
General government	3.8	–2.7	5.3	–1.3	–1.5	–2.7	–2.7	–2.9	...
TOTAL	**2.9**	**1.2**	**2.8**	**2.4**	**1.7**	**1.2**	**1.2**	**0.8**	**...**
NPL ratio *(%)* [2]	**3.7**	**...**	**3.6**	**3.4**	**3.2**	**...**	–	–	–

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, off to a good start to the year

The reading that emerges from the behaviour of the economic indicators suggests that the Spanish economy is gaining strength in these first few months of the year. Employment, consumption, activity in industry and services, as well as the foreign sector are all showing encouraging figures. There is just one big but: inflation, which in February continued to reflect major price tensions. Despite this, the conclusion of the analysis of the current situation is that the Spanish economy continues to withstand the challenging economic environment better than expected.

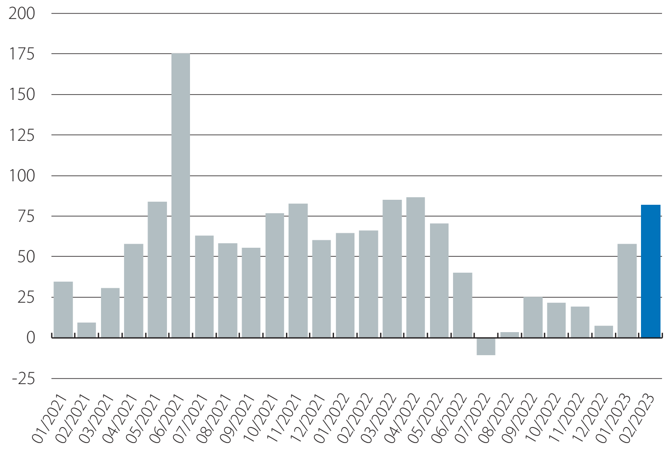
Employment once again provides a positive surprise. The February data for Social Security affiliation show that the labour market has got off to a strong start to the year. The average number of registered workers increased in February by 88,918 people, which is higher than a typical month of February (+71,000 on average in the period 2014-2019). Indeed, this is the best result in a month of February in eight years. After correcting for seasonality, the monthly growth stands at 81,808 people, the biggest increase since April last year. On the other hand, we continue to see the effects of the labour reform on the temporary employment rate, which fell to 14.2% (27.2% in December 2021).

The economic activity indicators kick off the year on a good footing. The manufacturing PMI returned to expansionary territory in February, rising above 50 points for the first time since June 2022 and reaching 50.7 points (48.4 in January). Furthermore, the counterpart indicator for the services sector advanced 4 points, to 56.7 points, placing it firmly within the expansionary zone. On the consumer side, CaixaBank Research's consumption tracker shows that activity registered with Spanish bank cards moderated its pace of growth in February, with a year-on-year growth rate of 7% compared to 10% in January, although this is still above the rate registered in Q4 2022 (6%).

The foreign sector continues to bring good news. The current account balance ended 2022 with a surplus of 0.9% of GDP, just 1 percentage point below the level of 2021. This impressive figure was achieved despite the trade deficit of energy goods standing at 4.3%, 2.2 pps more than in 2021, weighed down by the sharp rise in gas and crude oil prices during the course of the year. The trade balance of non-energy goods, meanwhile, also closed the year with a deficit (–0.9%), although in the closing months of the year it registered a surplus thanks to the recovery in exports in real terms and the containment of imports. On the services side, the balance of non-tourism services reached a surplus of 3.1% of GDP (1.6% in 2021), the highest in the historical series. Finally, the balance of tourism services registered a surplus of 3.7% of

*Spain: registered workers affiliated with Social Security **

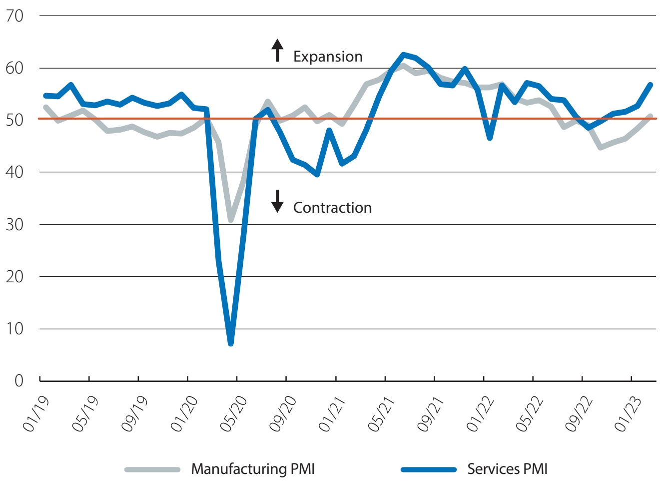
Month-on-month change (thousands of people)



Note: ** Seasonally adjusted series.*
Source: *BPI Research, based on data from the Ministry of Inclusion, Social Security and Migration (MISSM).*

Spain: PMI

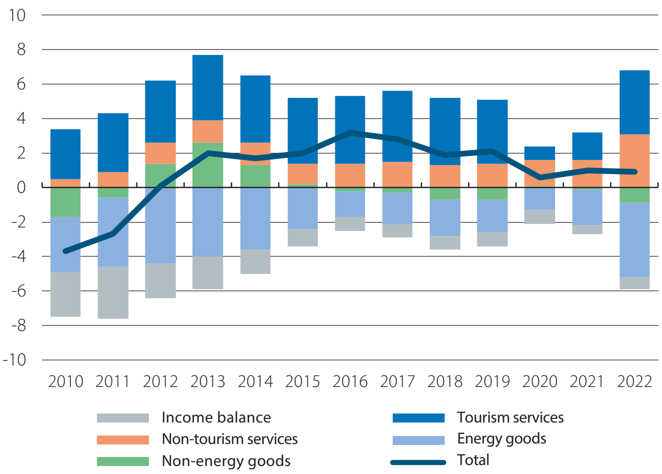
Level



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

Spain: balance of current account payments

(% of GDP)



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

GDP, thus recovering the levels of 2019. This figure was reached thanks to the lower spending of Spaniards abroad (1.4% of GDP in 2022 vs. 2.0% in 2019), which offset the fact that the income generated by international tourists in Spain was still below pre-COVID levels (5.3% of GDP in 2022 vs. 5.7% in 2019).

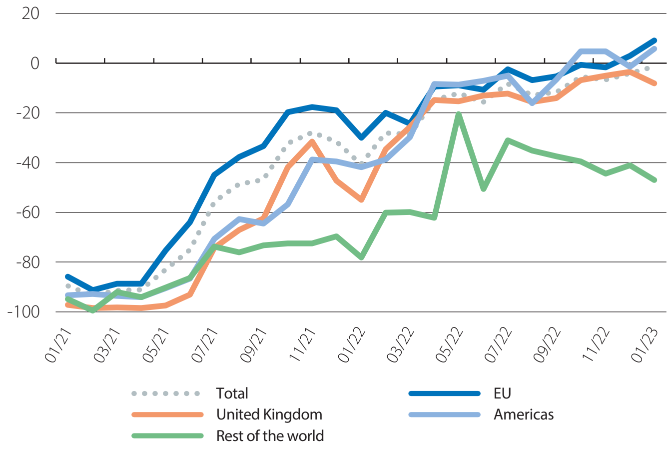
However, the latest data on international tourist arrivals confirm that tourism activity improved over the course of last year and that the start of 2023 is looking highly buoyant. The number of international tourists visiting Spain reached 4.1 million in January, which is just 1.2% below the figure for January 2019 and represents a year-on-year increase of 66.8%. By country of origin, tourists from the EU stand out, registering an all-time high for a month of January with 2.7 million tourist arrivals, 9.1% more than in January 2019. Also, the number of arrivals of American tourists has been very high, reaching 6.0% above the figure for January 2019. In contrast, British tourism remains relatively weak, with 8.1% fewer arrivals than in the same month of 2019.

The inflation rally continued in February. According to the CPI flash indicator, headline inflation rose in February for the second consecutive month, standing at 6.1%, 2 percentage points above the previous month. On the other hand, core inflation (which excludes energy and unprocessed food) rose once again, reaching 7.7%, also 2 percentage points above the figure for the month of January. That said, the monthly change reflected a significant growth rate for a month of February (+0.7% in February 2023 vs. 0.0% on average in the same month during the period 2017-2019), signalling that price tensions remain considerably high. In the absence of the breakdown by component, the National Statistics Institute noted that the main drivers of inflation were the increase in electricity prices, although they most likely continued to register a significant drop in year-on-year terms (–40.8% in January), and a new rise in food and beverage prices (+14.6% in January); while the moderation in the price of fuels helped to contain the advance of the CPI.

Home prices closed 2022 up, although their growth rate continues to moderate. The price of housing grew by 0.5% quarter-on-quarter in the final quarter of last year, thus overcoming the stagnation of Q3 (+0.0%). With this figure, the year-on-year rate stood at 3.3% at the year end, albeit with a declining trend over the course of the year (in Q1 it stood at 6.7%). In terms of housing demand, the signs of cooling are increasingly evident. In December, the first year-on-year decrease in the number of sales was recorded, according to the National Statistics Institute (–10.2%). Nevertheless, in 2022 as a whole there were some 650,000 sales (+14.7%), the highest figure since 2007. Thus, last year was one of significant growth in activity in the real estate market, but in recent months it has begun to show signs of slowing down.

Spain: international tourist arrivals by country of origin

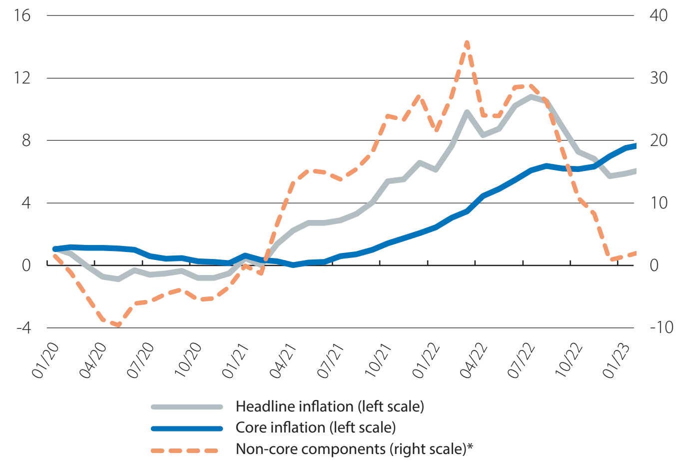
Change versus the same month of 2019 (%)



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

Spain: CPI

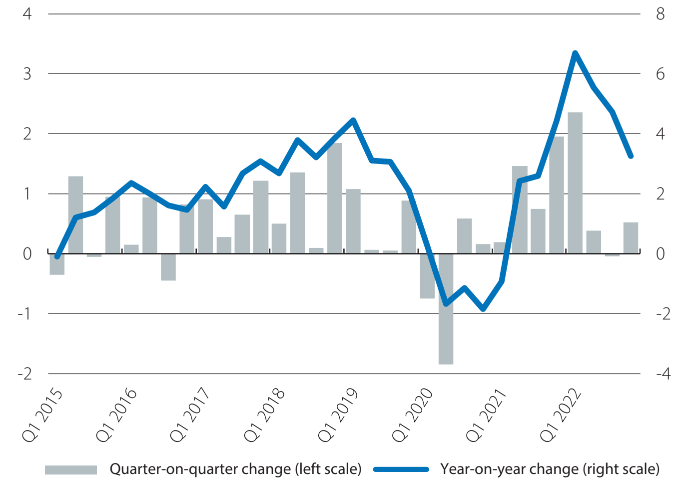
Year-on-year change (%) *Year-on-year change (%)*



Note: ** Aggregate of unprocessed food and energy products.*
Source: *BPI Research, based on data from the National Statistics Institute.*

Spain: home prices

QoQ rate of change (%) *YoY rate of change (%)*



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

Next Generation EU funds: current status and how they affect you

After the second year of disbursements of the European Next Generation EU (NGEU) funds, it is time to take stock. Spain included 28.4 billion euros from the Recovery and Resilience Mechanism, NGEU's main instrument, in the 2022 General Government Budget. Have expectations been met? Are the investments and reforms being implemented as planned?

Investments: many projects launched and a *crescendo* in the pace of execution

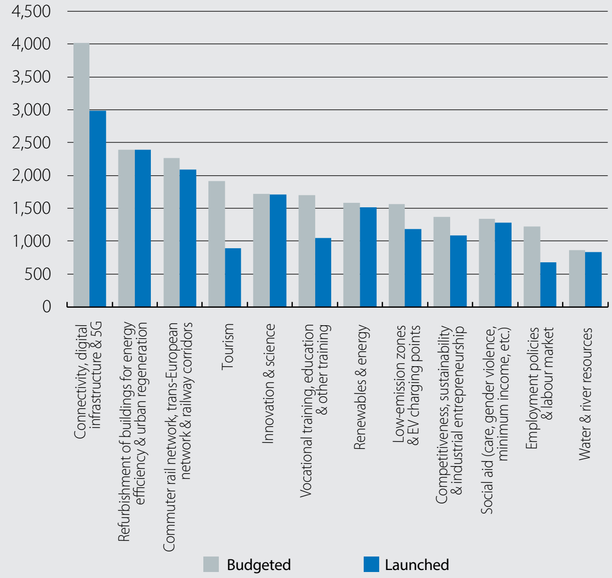
Many projects were launched in 2022 (see first chart), amounting to around 25.1 billion euros (88% of the total amount budgeted) according to budget execution data. This includes calls to apply for financial support and competitive tenders, as well as areas where funds have begun to be distributed to the regional, local and public institutions that are executing the investment programmes. However, when analysing the execution of funds, this estimate is too broad, as it includes projects in which the funds are available to the public sector (or will be imminently) but where the beneficiaries of the associated aid have not yet been selected. In other words, the money is still «in the pipeline». If we look at the projects that have been launched in 2021-2022 since the NGEU programme was kick-started, they come to over 47 billion euros, or 90% of the total budget.

However, if, rather than looking at the funds that have been budgeted for, we stick to the funds which have been allocated (or committed, in budgetary jargon), then we will get a slightly more precise idea of the rate at which the investments are reaching the real economy. Using this criterion, we find that the central government allocated funds worth 21.9 billion euros out of the 2022 budget (42.9 billion in 2021-2022).[1] This represents 77% of the total budget, although a portion of this amount was allocated to the autonomous community regional governments, local government corporations and public entities and companies in order for them, in turn, to launch the corresponding tender processes or calls for applications for the final recipients of the funding. In particular, of this sum of 21.9 billion that has been allocated, we estimate that around 6.2 billion (28%) has been awarded to private companies through calls for applications. Of this 6.2 billion, 2.2 billion was awarded in the first half of the year and 4.0 billion in the second half, suggesting an acceleration in the rounds of funding being granted to the private sector in the second half of the year.

1. The funds committed in 2021-2022 accounted for 81.5% of the total funds budgeted for in the two years as a whole.

Spain: NGEU funds, 2022 investments

(EUR millions)



Note: *The investments launched include funds that have already been transferred (and those which have not yet been transferred but are about to be) to autonomous community regional governments, local government corporations and public bodies, even if they have not yet published the associated funding programme.*
Source: *BPI Research, based on data from the General Comptroller of the State Administration (IGAE) up to November 2022.*

In the second chart, we can distinguish the main allocations of NGEU funds by the central government in 2021 and 2022.[2] Some of the biggest allocations include projects in railway infrastructure, the programme for funding SMEs and self-employed workers through loan guarantees, the Digital Kit programme to fund the digitalisation of self-employed workers and SMEs, and programmes in sustainable mobility and urban transformation, as well as energy projects with a clear commitment to sustainability (building refurbishments to improve energy efficiency).

If we want to be even more precise and drill down to the final layer, that is, the amount of funds that has reached the productive fabric of the economy, then the figure will be less than the funds allocated, since the beneficiaries have to present documentation before the payment is executed. If we focus on disbursements from the central government to the final recipients (i.e. payments to the private sector and payments of direct aid to other public entities, but excluding transfers to other public entities

2. In total, the central government awarded calls for funding in 2021-2022 amounting to 19.2 billion euros (including funds awarded to private companies, as well as direct aid awarded to other public entities where they are the final recipients and are not required to open a call for applications to subsequently pass on the funding). In addition to this, we must add 4.1 billion of funds awarded by the autonomous community regional governments to the final recipients.

where they in turn must publish a call for funding applications in order to subsequently allocate the funds, and aid for technological, university and educational centres) in terms of what was budgeted for in 2022, we find that the central government disbursed 8.2 billion euros, or 30% of the amount budgeted in that year.[3] However, the acceleration in the second half of last year was palpable: the central government disbursed funds amounting to almost 6.0 billion euros, tripling the amount disbursed in the first half of the year.

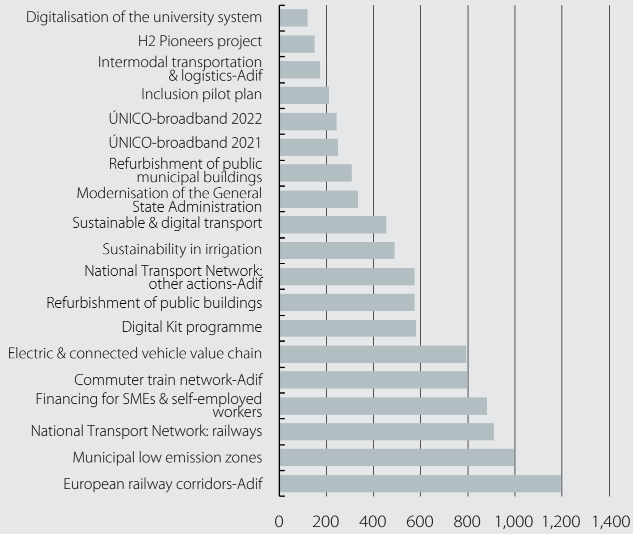
As for the so-called PERTE projects (Strategic Projects for Economic Recovery and Transformation), which have a high potential to drive the transformation of the economy and involve significant public-private collaboration, the calls for applications launched in 2021-2022 (i.e. the sum of the calls opened and those awarded) totalled 12.3 billion euros (almost 30% of the total of 47.0 billion euros in projects launched in 2021-2022). This sum included 4.9 billion allocated to the renewable energies PERTE project, 2.0 billion for the electric and connected vehicle PERTE project and 1.84 billion for the PERTE project related to the aerospace sector. It should be noted that, taking into account the reinforcement of the 18 billion in loans that are due to be channelled into the PERTE projects, the total public investment in these projects between 2022 and 2026 will exceed 40 billion euros.

As for 2023, the European funds are expected to play a greater role in the economy: there are many projects that have already been launched and that should crystallise by reaching the productive fabric of the economy, and a steady cruising speed is expected to be maintained in the rhythm of calls for applications and disbursements, as was observed in the second half of 2022. In addition, the figures announced for calls for funding applications in the first half of 2023 demonstrate how the budget is concentrated in just a handful of large-scale awards[4] and it should be the year in which major funding application processes are opened for some of the larger PERTE projects, such as the one related to renewable energies and green hydrogen, as well as the second round for the PERTE project related to the industrial chain of the electric and connected vehicle (in the first round, projects amounting to 793 million were awarded funding, representing only a portion of the almost 3 billion budgeted).

If everything that was anticipated in 2022 and a portion of what is budgeted for in 2023 is finally executed (the total figure could exceed 20 billion euros in execution),[5]

3. Data up to November 2022.
4. The five biggest calls for funding applications in the spheres of the green transition, digitalisation, trade and tourism, education and employment account for at least 70% of the total aid available in each of these sectors. Some 11.6 billion euros have been budgeted for in calls for funding in the first half of 2023.
5. By execution, we mean that the funds have been disbursed and the productive economic agents have access to them.

Main NGEU calls for funding applications awarded by the central government in 2021-2022
(EUR millions)



Source: *BPI Research, based on data from the Recovery, Transformation and Resilience Plan portal.*

then the macroeconomic impact on growth in 2023 would be substantial, potentially amounting to 1.0 pp. Ensuring that the funds are executed quickly in 2023 will also be key in order for the disbursement of the European funds to continue: the first disbursements depended primarily on reforms being carried out, but as we move forward the importance of meeting quantifiable targets related to the investments will gain weight. Even this year, in 2023, there will be quantitative targets to be met based on measurements since the Plan began. Among others, these targets will include: 231,000 refurbishment works carried out on at least 160,000 homes, a minimum fleet of 238,000 vehicles and charging points, 800,000 SMEs benefited from the Digital Kit, and an 8,500-MW increase in the installed capacity of renewables.

The reforms in 2022: the schedule has been met, pending finalisation of the second pensions reform

The schedule of reforms agreed upon by Brussels in the first half of 2022 was met, and this has allowed the European Commission to give the green light in February to the disbursement of European funds worth 6.0 billion euros, with Spain due to receive the full sum shortly once the European Council has given its final approval. Some of the key reforms that are planned include the law aimed at promoting company pension plans which will increase the maximum tax-deductible joint contribution of worker and company to 10,000 euros,[6] as well as the

6. However, a plan with tax incentives to facilitate mobility between alternative plans has not been established.

new system for self-employed workers' social security contributions based on a set of standardised criteria known as «modules».

In the second half of the year there was an acceleration in the passing of laws aimed at modernising general government administrations, such as the approval of the bill for a reform of public sector workers which, among other elements, introduces a component of their remuneration linked to annual performance reviews. In addition, Congress passed the Public Policy Assessment Act to evaluate, both *ex ante* and *ex post*, the results of public policies with the creation of a Public Policy Assessment Agency. According to the schedule of the Recovery Plan, we should learn more about how this agency will function in Q3 2023, and it would be desirable for the assessments to be conducted by independent and external evaluators. The Employment Act also came into force, which gives job seekers a maximum period of one month following their initial assessment to establish a tailored plan to find work, as well as boosting the use of digital tools and assessment mechanisms in how the state employment service (SEPE) operates.

However, in the sphere of pensions, the second part of the reform, focused on changes in how the number of years of social security contributions affects the calculation of a person's pension as well as an increase in the maximum contribution base and the maximum pension amount, is not yet finalised. It would be desirable for this reform to ensure the sustainability of the system by balancing the interests of all generations; this reform is the only milestone left to go in order for funds amounting to 10 billion euros, linked to the progress made in the second half of 2022, to be disbursed in mid-2023.

*Execution status of the PERTE projects **

(EUR millions, as of 14/12/2022)

PERTE project	Public funds	Awarded and open calls
Microelectronics	12.250	–
Renewable energies, hydrogen and storage	10.475	4.957
Electric and connected vehicle	4.295	2.018
Decarbonisation	3.100	–
Digitalisation of the water cycle	2.790	425
Aerospace	2.126	1.844
Social and care economy	1.808	380
State-of-the-art health	1.650	912
Agrifood industry	1.450	1.063
New language economy	1.101	298
Circular economy	792	192
Marine sector	310	250
Total	**42.146**	**12.339**

Note: ** Strategic Projects for Economic Recovery and Transformation.*
Source: *Portal of the Recovery, Transformation and Resilience Plan.*

The Spanish tourism sector, off to a strong start in 2023

Tourism activity continues to advance at a steady pace. In the midst of the low season for much of the sector, the figures published month by month continue to confirm strong demand despite the challenging economic environment that is affecting the global economy, particularly the European one. Will this dynamic continue in the coming months?

Encouraging pattern in tourism demand

The indicators for tourism activity continued to show signs of significant strength at the end of 2022. In December, the number of international tourist arrivals in Spain reached 4.1 million, just 4.4% below the figure for December 2019. This recovery in the volume of international tourists has occurred in an environment of rising prices in the sector. According to the January CPI data, accommodation prices were 18.6% above those of the same month of 2019, while leisure and catering prices were 14.9% higher. The combination of the recovery in volume and the price increases has led to tourism revenues already exceeding pre-pandemic levels. Specifically, the expenditure of international tourists in December was 4.5% above the same month of 2019.

Domestic tourism also performed well at the end of 2022, although by then it had already been above 2019 activity levels for the past three quarters. In December, the number of overnight stays by residents in tourist accommodation establishments was 2.9% higher than in the same month of 2019. One of the key drivers of this excellent performance is the slow recovery of residents travelling abroad. According to CaixaBank card data, card payments abroad in January this year were still 16.8% below the level of January 2019.

How will the high season begin?

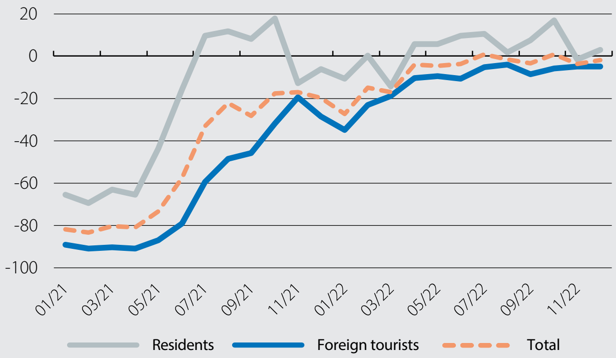
While the figures are very encouraging, it can be risky to judge tourism demand on the basis of low season performance. In this case, it is common practice to analyse the state of demand in the Canary Islands during the winter months – as it is high season there – in order to better understand the strength of tourism demand and anticipate the trend that we could observe when the high season begins on the mainland and in the Balearic Islands.[1]

If we stop to analyse the indicators of international tourism volumes in December in the Canary Islands, the conclusion we reach is that tourism demand is indeed showing great strength, even surpassing the levels of last summer. International tourist arrivals were 1.6% above

1. Em dezembro de 2019, Espanha no seu todo registou 4,9% das chegadas de turistas internacionais do ano, enquanto nas Canárias esta percentagem foi de 9,1%.

Spain: overnight stays in tourist accommodation establishments

Change versus the same month of 2019 (%)



Note: *Overnight stays in hotel establishments, tourist apartments, agritourism locations and campsites.*
Source: *BPI Research, based on data from the National Statistics Institute.*

the level of December 2019 and improved on the already good records registered in the summer (–1.0% vs. the summer of 2019). By country of origin, the strength of British tourism stood out, standing above the level of the same month in 2019 (+3.4%) and clearly on an upward path. On the downside, meanwhile, tourism from Germany and Norway remained weak, being the only source countries still below 2019 levels. It is also interesting to note that other European countries with a smaller share in Canary Island tourism are showing significant growth: the Netherlands, France, Ireland and Belgium registered double-digit growth compared to December 2019.

In addition to the good data from the Canary Islands, our indicator of interest in travelling to Spain, developed based on Google searches conducted in tourist source countries, continues to emit positive signals. Specifically, the interest indicator among EU tourists stood in positive territory in February (+4%), mainly due to the strong levels registered in the Netherlands, which rose +10%, and in Germany, which reached +7%, thus reversing the very poor figure noted in January (–17%). As for British tourists, the indicator is in negative territory, which contradicts the trend observed in the Canary Islands, although it is coherent with the difficult economic situation that the United Kingdom is currently going through. Finally, the strength of interest in countries such as the US and Japan could be an indication of a recovery in long-haul tourism, which remains very much incomplete in the case of Asian tourists.

In conclusion, the data from the Canary Islands indicate that tourism demand remains strong, confirming the readings we receive from the indicators for Spain as a whole. On the other hand, the Google search data lead us to anticipate the continued strength of EU tourist arrivals in the short term, to raise some doubts about the strength of British demand and to foresee a buoyant recovery in long-haul tourism.

Margin for growth in a context of eroded purchasing power

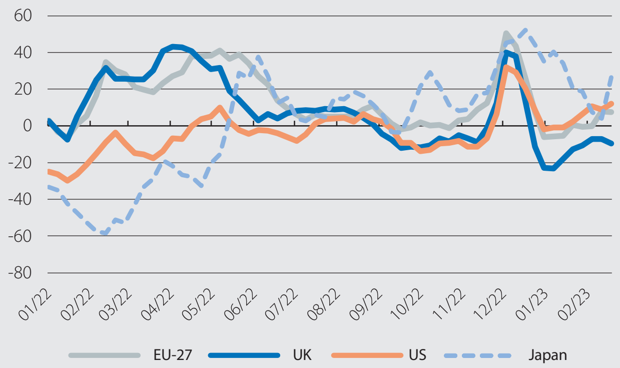
The encouraging figures and good outlook for tourism demand are occurring in an adverse macroeconomic environment in which households are seeing their purchasing power eroded by the inflation rally and the tightening of financial conditions. Thus, one would expect to see some degree of containment in tourism spending, being a non-essential form of consumption. However, given that we are emerging from a period with unusually high savings rates, we estimate that some European households still have room to adjust their savings rates, bringing them back down to around pre-pandemic levels, and thus to maintain their consumption levels.

If we analyse the evolution of household savings rates between Q3 2022 (the latest available data) and the same period in 2019 in the main source countries for tourists visiting Spain, only in the cases of Italy and Spain do we observe a lower savings rate in 2022. As can be seen in the second chart, in the United Kingdom the household savings rate stood at 9.0% in Q3 2022, considerably above the pre-pandemic level (5.2%). We observe a similar phenomenon in the cases of Germany, France and the Netherlands, with savings rates still 1.4 and 1.7 pps above 2019 levels.

We expect that this process of normalisation of savings rates will continue to contribute to the recovery of tourism consumption in the coming quarters, along with other growth drivers such as the expected recovery in long-haul tourism (from the US, Latin America and Asia), the higher propensity for domestic travel within the EU and the decongestion of airspace. For all these reasons, we expect that tourism sector activity levels in 2023 will exceed the 2019 benchmark and that the sector will thus definitively consolidate its recovery.

Weekly Google searches about travel to Spain

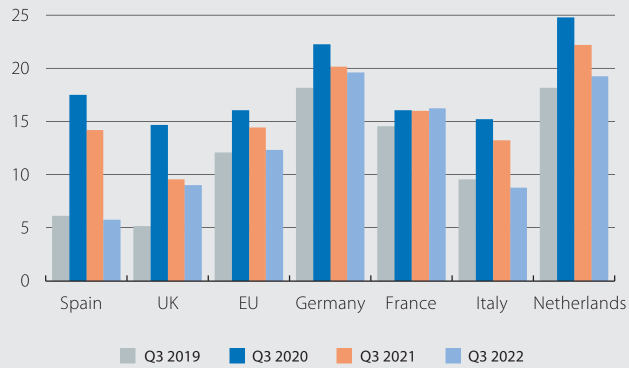
*Change versus the benchmark level (%) **



Notes: *We use search data for the word «Spain» in the United Kingdom, Germany, France, Italy, the Netherlands and the US in the official language of each country within the travel category.*
** The benchmark level is built using the weekly searches conducted between 2017 and 2019.*
Source: *BPI Research, based on Google Trends.*

Household savings rate in Q3 of each year

(% of gross disposable income)



Note: *Data corrected for seasonality and calendar effects.*
Source: *BPI Research, based on data from the National Statistics Institute, Eurostat and the ONS.*

Activity and employment indicators

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

	2021	2022	Q1 2022	Q2 2022	Q3 2022	Q4 2022	12/22	01/23	02/23
Industry									
Industrial production index	8.8	2.9	1.6	4.6	4.6	0.8	0.6	...	...
Indicator of confidence in industry *(value)*	0.6	–0.9	6.8	0.4	–5.2	–5.4	–4.8	–3.8	–6.0
Manufacturing PMI *(value)*	57.0	51.0	55.8	53.2	49.2	45.6	46.4	48.4	50.7
Construction									
Building permits *(cumulative over 12 months)*	4.7	–	31.6	18.8	8.8	–	...	...	...
House sales *(cumulative over 12 months)*	9.6	28.9	41.8	33.6	23.0	17.3	14.7	...	...
House prices	3.7	8.1	8.5	8.0	7.6	...	–	–	–
Services									
Foreign tourists *(cumulative over 12 months)*	64.7	129.5	313.4	311.7	208.4	129.5	129.5	...	...
Services PMI *(value)*	55.0	52.5	52.2	55.9	51.0	50.8	51.6	52.7	56.7
Consumption									
Retail sales	5.1	0.8	0.3	1.2	0.1	1.7	4.0	...	...
Car registrations	158.0	–3.0	–7.5	–10.3	3.1	2.6	–14.1	51.4	19.2
Consumer confidence index *(value)*	–12.9	–26.5	–18.2	–26.9	–32.5	–28.2	–25.3	–22.9	–22.1
Labour market									
Employment [1]	3.0	3.1	4.6	4.0	2.6	1.4	–	–	–
Unemployment rate (% labour force)	14.8	12.9	13.6	12.5	12.7	12.9	–	–	–
Registered as employed with Social Security [2]	2.5	3.9	4.5	4.8	3.5	2.7	2.4	2.3	2.4
GDP	**5.5**	**5.5**	**6.9**	**7.8**	**4.8**	**2.7**	–	–	–

Prices

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

	2021	2022	Q1 2022	Q2 2022	Q3 2022	Q4 2022	12/22	01/23	02/23
General	3.1	8.4	7.9	9.1	10.1	6.6	5.7	5.9	6.1
Core	0.8	5.1	3.0	4.9	6.2	6.5	7.0	7.5	7.7

Foreign sector

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

	2021	2022	Q1 2022	Q2 2022	Q3 2022	Q4 2022	12/22	01/23	02/23
Trade of goods									
Exports *(year-on-year change, cumulative over 12 months)*	21.2	22.9	26.2	22.2	23.3	22.9	22.9	...	...
Imports *(year-on-year change, cumulative over 12 months)*	24.8	33.4	36.1	35.2	38.1	33.4	33.4	...	...
Current balance	**11.5**	**11.8**	**8.5**	**8.5**	**7.0**	**11.8**	**11.8**	...	...
Goods and services	17.9	22.4	14.2	15.3	15.7	22.4	22.4	...	...
Primary and secondary income	–6.4	–10.7	–5.7	–6.8	–8.7	–10.7	–10.7	...	...
Net lending (+) / borrowing (–) capacity	**22.4**	**25.0**	**19.8**	**21.5**	**19.8**	**25.0**	**25.0**	**...**	**...**

Credit and deposits in non-financial sectors [3]

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

	2021	2022	Q1 2022	Q2 2022	Q3 2022	Q4 2022	12/22	01/23	02/23
Deposits									
Household and company deposits	6.1	4.9	5.2	5.4	5.3	3.7	3.2	2.9	...
Sight and savings	10.3	7.9	9.3	9.2	8.2	5.0	3.6	2.3	...
Term and notice	–24.4	–19.7	–26.8	–25.4	–19.2	–7.4	–3.4	0.2	...
General government deposits	15.5	9.6	19.3	15.6	6.6	–3.1	–0.8	5.8	...
TOTAL	**6.7**	**5.2**	**6.0**	**6.0**	**5.4**	**3.2**	**2.9**	**3.1**	**...**
Outstanding balance of credit									
Private sector	0.3	0.7	0.2	0.8	1.3	0.5	–0.4	–0.5	...
Non-financial firms	1.1	0.9	–0.5	0.7	2.4	0.9	–0.7	–0.5	...
Households - housing	0.2	1.0	1.3	1.4	1.1	0.2	–0.2	–0.8	...
Households - other purposes	–1.2	–0.6	–1.1	–0.5	–0.9	–0.1	–0.1	0.2	...
General government	15.3	0.2	3.4	1.9	–3.5	–1.1	0.6	–4.5	...
TOTAL	**1.1**	**0.7**	**0.4**	**0.9**	**1.0**	**0.4**	**–0.3**	**–0.8**	**...**
NPL ratio (%) [4]	**4.3**	**3.5**	**4.3**	**4.1**	**3.8**	**3.7**	**3.5**	**...**	**...**

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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