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MONTHLY REPORT • ECONOMIC AND FINANCIAL MARKET OUTLOOK

JULY-AUGUST 2023

BPI

MONTHLY REPORT - ECONOMIC AND FINANCIAL MARKET OUTLOOK
July-August 2023

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ÍNDICE

And finally inflation is coming down...

In June, the inflation rate in Portugal showed another significant downward movement. According to INE's preliminary estimate, the yoy rate stood at 3.4%, below 4% for the first time since January 2022, before the outbreak of war in Ukraine. Most recent signals from most price indicators are favourable. For now, the scenario is one of disinflation above the trend in the EMU as a whole (CPIH yoy stood at 5.5%), which in itself points to gains in external competitiveness. That is good news.

The biggest impetus for the recent disinflationary movement comes from energy prices, which began to escalate in early 2021 and peaked in the second quarter of last year following the outbreak of the Russia-Ukraine conflict. After rising by 24% in 2022, these prices have been retreating and should be a major contributor to the slowdown in headline inflation in the second half of the year, when the base effect will be more favourable. As in the upward phase, this trend has progressively spread to the other inflation classes. And there is a lot of evidence that this process has already begun. For example, ex-factory prices have been declining (in monthly terms) since April, which bodes well for the trend in consumer prices going forward.

Analysing the remaining CPI components, processed and unprocessed food prices also show a significant slowdown, to which official measures such as "zero VAT" on a broad basket of products contributed, but which also reflects the significant decline in the prices of the main raw materials and foods in the international market since the post-pandemic highs. Finally, the remaining classes of goods and services, the largest group accounting for around 80% of the price index, also recorded a slowdown, albeit more subdued, with the inflation rate for this group, known as core inflation, peaking at 7.3% in December, having fallen in June to 5.2%. This increased slowdown is because in Services (unlike in Goods), the dynamic is still one of price increases and the strength of tourism in the coming months should continue to sustain the trend.

The disinflationary signs are also evident when a finer analysis is made by sub-groups. For example, since July 2022 up to February, around 30% of items (goods and services) in the underlying CPI basket recorded price increases of more than 10%. However, since then this share has been shrinking, and in May (last data available at the time) it weighed "only" 17%. We recall that the dynamics of this class are crucial for the disinflation process, not only in Portugal but in the other euro area countries.

In our scenario, we assume that the trend towards a progressive slowdown in the pace of price growth will continue, even if this is not risk-free. Indeed, one of the key assumptions for this path is the absence of significant price pressures on international energy markets. Although depending on fortuitous factors such as the degree of adversity next winter, this hypothesis seems reasonable considering the current progress in Portugal and Europe in renewable energy production, the diversification of countries supplying natural gas and oil, and considering that global demand should evolve in a rather contained way in the context of cooling of the main economic blocs (USA and EMU) and of the slow recovery of activity in China. It seems, therefore, a credible premise.

Another element of risk is derived from the evolution of wages and the formation of so-called second-order effects. This has been one of the main concerns of the ECB in developing its monetary policy, especially in a context of almost full employment (in Europe). In Portugal, there has been some recovery in wages, narrowing the gap in relation to inflation (and accelerating recently), but even so, the regular gross wages of employees increased by around 4% in the 12 months ending in March, a variation that does not reflect the formation of adverse effects on expectations of price developments.

In all, it seems to us that there are good prospects for the inflation rate to maintain its positive movement, although it may return close to 4% when the price support measures are removed. What is certain is that from now on progress will be slower and more drawn out, but the disinflationary movement should not stop. Even so, reaching the 2% threshold is likely to remain some way off, perhaps by the end of 2024 (yoy) or 2025 (in average terms).

Paula Carvalho
Lisbon, 11 July 2023

Chronology

JUNE 2023

- **13** The People's Bank of China cuts rates by 10 bps.
- **15** The ECB raises rates by 25 bps, placing the depo rate at 3.50% and the refi rate at 4.00%.

MAY 2023

- **3** The Fed raises rates 25 bps, to the 5.00%-5.25% range.
- **4** The ECB raises rates 25 bp and places the depot rate at 3.25% and the refi rate at 3.75%.
- **5** The WHO declares the global COVID-19 health emergency over.

APRIL 2023

- **2** OPEC+ announces an additional production cut of 1.15 million barrels per day (bpd), bringing the total reduction to 3.66 bpd.
- **9** Kazuo Ueda becomes the new governor of the Bank of Japan.
- **19** The United Nations estimates that in 2023 India will overtake China to become the country with the biggest population in the world.

MARCH 2023

- **16** The ECB raises rates by 50 bps and places the depo rate at 3.00% and the refi rate at 3.50%.
- **18** Russia and Ukraine extend the deal allowing the export of grain and related foodstuffs and fertilisers via the Black Sea.
- **22** The Fed raises rates by 25 bps, placing them in the 4.75%-5.00% range.

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.

Agenda

JULY 2023

3 Portugal: industrial production (May).
4 Spain: registration with Social Security and registered unemployment (June).
11 Spain: financial accounts (Q1).
14 Spain: Moody's rating.
17 China: GDP (Q2).
20 Portugal: balance of payments (May).
21 Portugal: DBRS rating.
24 Spain: loans, deposits and NPL ratio (May).
25 Portugal: bank loan survey (Q2).
25-26 Federal Open Market Committee meeting.
27 Spain: labour force survey (Q2).
Governing Council of the European Central Bank meeting.
US: GDP (Q2).
28 Spain: GDP flash estimate (Q2).
Spain: CPI flash estimate (July).
Portugal: turnover in retail (June).
Euro area: economic sentiment index (July).
31 Spain: state budget execution (June).
Portugal: GDP flash estimate (Q2).
Euro area: GDP (Q2).
Euro area: CPI flash estimate (July).

AUGUST 2023

2 Spain: registration with Social Security and registered unemployment (July).
4 Spain: industrial production (June).
8 Portugal: turnover in the services sector (June).
9 Portugal: employment (Q2).
Portugal: international trade (June).
15 Japan: GDP (Q2).
17 Spain: foreign trade (June).
23 Portugal: non-financial sector debt (June).
25 Spain: loans, deposits and NPL ratio (June).
30 Spain: CPI flash estimate (August).
Euro area: economic sentiment index (August).
31 Portugal: GDP breakdown (Q2).
Euro area: CPI flash estimate (August).

The last mile

Now that the first half of the year is over, with the activity cycle overcoming obstacles of a very diverse nature and with significant sectoral (services better than industry) and regional (greater weakness in China and Europe) divergences, the feeling is that we are close to a turning point, from which the effects of the monetary contraction accumulated over the last year and a half (increases of 400 bp in key interest rates in the euro area) will become more evident. Especially if this latest belt-tightening that the world's major central banks seem poised to implement is confirmed, given the risk of an insufficient improvement in the trend of base prices in the coming months if the rebalancing between corporate margins and wages is not completed.

The hikes implemented after a pause of several months (Bank of Canada and Bank of Australia), the intensification of the move towards the «terminal rate» (+50 bp by the Bank of England), and the hardening of messaging (ECB and FED) reflect the fact that monetary authorities are now prioritising inflation targets over those of growth and financial stability. On a positive note, the resilience of the business cycle and the financial system to the biggest monetary tightening in decades is proving to be greater than expected, as the problem of US regional banks has been resolved.

The question is how long it will be necessary to keep interest rates in the restrictive bracket and what cost this will have in terms of jobs and growth before we see conclusive signs of effects on inflation. Everything will depend on the evolution of the factors that have supported activity in recent quarters: i) savings accumulated during the pandemic, ii) expansionary fiscal policy, iii) delays in the effects of monetary policy, iv) normalisation of supply bottlenecks, and v) resilience of labour markets. The positive effects of the first three factors will fade over time, and are unlikely to be offset by improvements in aggregate supply and labour market strength. As the BIS has just reminded us, greater coordination between monetary policy and fiscal policy would allow us to travel the last mile on the road to the ECB's goal and allow policy to return to the zone of stability.

Against this backdrop, investors have increased their risk appetite in recent weeks, with rises in equity markets and stability in the bond market, despite revised interest rate expectations. Market sentiment is that central banks will get inflation back to 2% in the next 18-24 months without triggering a recession. In any case, if the scenario gets complicated, markets anticipate a rapid reversal of monetary policy. Something central banks aren't exactly comfortable with.

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	3.50
3-month Libor	3.62	1.01	0.23	0.21	4.74	5.00	3.50
12-month Libor	3.86	1.48	0.34	0.52	5.47	4.50	3.10
2-year government bonds	3.70	1.04	0.13	0.62	4.41	3.50	2.60
10-year government bonds	4.70	2.57	0.93	1.45	3.62	3.20	3.00
Euro							
ECB depo	2.05	0.20	–0.50	–0.50	1.77	3.75	3.00
ECB refi	3.05	0.75	0.00	0.00	2.27	4.25	3.50
€STR	–	–0.54	–0.56	–0.58	1.57	3.66	2.98
1-month Euribor	3.18	0.50	–0.56	–0.60	1.72	3.62	2.83
3-month Euribor	3.24	0.65	–0.54	–0.58	2.06	3.57	2.69
6-month Euribor	3.29	0.78	–0.52	–0.55	2.56	3.72	2.74
12-month Euribor	3.40	0.96	–0.50	–0.50	3.02	3.86	2.80
Germany							
2-year government bonds	3.41	0.35	–0.73	–0.69	2.37	3.30	2.50
10-year government bonds	4.31	1.54	–0.57	–0.31	2.13	2.80	2.60
Spain							
3-year government bonds	3.62	1.69	–0.57	–0.45	2.66	3.15	2.82
5-year government bonds	3.91	2.19	–0.41	–0.25	2.73	3.23	2.99
10-year government bonds	4.42	3.17	0.05	0.42	3.18	3.90	3.60
Risk premium	11	164	62	73	105	110	100
Portugal							
3-year government bonds	3.68	3.33	–0.61	–0.64	2.45	3.35	3.07
5-year government bonds	3.96	3.94	–0.45	–0.35	2.53	3.40	3.20
10-year government bonds	4.49	4.68	0.02	0.34	3.10	3.85	3.60
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	1.12	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	85.0	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	–2.8	6.3	3.4	2.8	3.0
Developed countries	*2.7*	*1.4*	*–4.2*	*5.4*	*2.7*	*1.2*	*1.2*
United States	2.7	1.7	–2.8	5.9	2.1	1.2	0.8
Euro area	2.2	0.8	–6.3	5.3	3.5	0.9	1.3
Germany	1.6	1.2	–4.1	2.6	1.9	0.2	1.1
France	2.2	1.0	–7.9	6.8	2.6	0.7	1.0
Italy	1.5	–0.3	–9.0	7.0	3.8	1.1	1.0
Portugal	1.5	0.5	–8.3	5.5	6.7	2.5	1.5
Spain	3.7	0.6	–11.3	5.5	5.5	2.0	1.8
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	4.1	0.4	0.6
Emerging and developing countries	*6.5*	*4.9*	*–1.8*	*6.9*	*4.0*	*4.0*	*4.3*
China	10.6	8.0	2.2	8.4	3.0	5.7	4.9
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	1.9
Russia	7.2	1.3	–2.7	5.6	–2.1	–0.5	1.3
Türkiye	5.5	4.5	1.9	11.4	5.6	2.4	3.2
Poland	4.2	3.7	–2.0	6.9	4.9	0.7	2.7
INFLATION							
Global	4.1	3.7	3.2	4.7	8.7	6.6	4.8
Developed countries	*2.1*	*1.6*	*0.7*	*3.1*	*7.3*	*4.6*	*2.4*
United States	2.8	1.8	1.3	4.7	8.0	4.2	2.2
Euro area	2.2	1.4	0.3	2.6	8.4	5.5	2.6
Germany	1.7	1.4	0.4	3.2	8.6	6.0	2.9
France	1.9	1.3	0.5	2.1	5.9	5.0	2.4
Italy	2.4	1.4	–0.1	1.9	8.7	6.3	2.5
Portugal	3.1	1.1	0.0	1.3	7.8	5.0	2.8
Spain	3.2	1.3	–0.3	3.1	8.4	3.9	2.8
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	6.3	2.7
Emerging countries	*6.7*	*5.6*	*5.2*	*5.9*	*9.8*	*8.1*	*6.4*
China	1.7	2.6	2.5	0.9	2.0	1.5	2.1
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	5.3	4.5
Mexico	5.2	4.2	3.4	5.7	7.9	6.5	4.6
Russia	14.2	7.9	3.4	6.7	13.8	6.7	5.2
Türkiye	22.6	9.6	12.3	19.6	72.3	46.4	34.9
Poland	3.5	1.9	3.7	5.2	14.3	12.8	6.9

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	0.4	0.9
Government consumption	2.3	–0.3	0.4	4.6	2.4	1.0	1.0
Gross fixed capital formation	–0.4	–0.7	–2.2	8.7	2.7	5.0	8.2
Capital goods	3.2	2.6	–5.4	13.9	5.8	–	–
Construction	–1.5	–2.6	1.0	5.5	1.0	–	–
Domestic demand (vs. GDP Δ)	1.3	0.1	–5.3	5.7	4.8	1.3	2.3
Exports of goods and services	5.3	4.0	–18.8	13.4	16.7	4.3	6.1
Imports of goods and services	3.6	2.7	–11.8	13.2	11.0	4.6	6.4
Gross domestic product	**1.5**	**0.5**	**–8.3**	**5.5**	**6.7**	**2.5**	**1.5**
Other variables							
Employment	0.4	–0.5	–1.9	2.7	2.0	0.3	0.3
Unemployment rate (% of labour force)	6.1	11.4	7.0	6.6	6.0	7.1	6.9
Consumer price index	3.1	1.1	0.0	1.3	7.8	5.0	2.8
Current account balance (% GDP)	–9.2	–2.9	–1.2	–0.8	–1.4	–0.4	–0.2
External funding capacity/needs (% GDP)	–7.7	–1.6	0.1	1.0	–0.4	1.3	1.5
Fiscal balance (% GDP)	–4.6	–5.1	–5.8	–2.9	–0.4	–0.3	–0.1

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	4.5	0.6	2.0
Government consumption	5.0	1.1	3.5	2.9	–0.7	0.7	0.4
Gross fixed capital formation	5.6	–1.4	–9.7	0.9	4.6	0.8	2.9
Capital goods	4.9	0.1	–13.3	6.3	4.0	0.6	5.0
Construction	5.7	–2.9	–10.2	–3.7	4.7	0.7	1.7
Domestic demand (vs. GDP Δ)	4.6	–0.2	–6.4	4.5	3.2	0.6	1.8
Exports of goods and services	4.7	2.9	–19.9	14.4	14.4	5.1	1.6
Imports of goods and services	7.0	0.2	–14.9	13.9	7.9	2.2	1.9
Gross domestic product	**3.7**	**0.6**	**–11.3**	**5.5**	**5.5**	**2.0**	**1.8**
Other variables							
Employment	3.2	–0.4	–6.8	6.6	3.8	1.8	1.5
Unemployment rate (% of labour force)	10.5	19.5	15.5	14.8	12.9	12.6	12.2
Consumer price index	3.2	1.3	–0.3	3.1	8.4	3.9	2.8
Unit labour costs	3.0	0.6	7.7	0.3	0.4	2.6	2.6
Current account balance (% GDP)	–5.9	–0.3	0.6	1.0	0.6	0.8	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]	0.3	–6.5	–10.1	–6.9	–4.8	–4.2	–3.4

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

Forecasts

A positive month in the financial markets, albeit with a slowdown

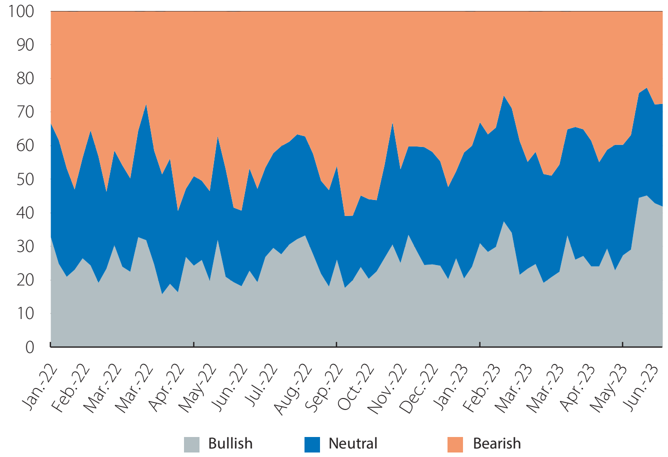
Inflation and monetary policy retake centre stage. The financial markets welcomed the month of June with greater risk appetite, spurred on by the resolution of the debt ceiling crisis in the US and the continued stabilisation of the episodes of financial stress experienced in March and April. The spring rally, however, was dampened by signs of persistent inflationary pressures and a tightening of the hawkish tone among the major central banks, with rates expected to be «higher for longer». The loss of strength in the main economic sentiment indicators at the end of Q2 2023, together with some turmoils in the geopolitical sphere, also triggered fears among investors of a possible global recession. In the financial markets, the complex scenario was reflected in ups and downs in the main risk-bearing assets, which on balance closed the month up, although reducing the gains registered during the first weeks of June.

Déjà vu? The central banks warn of further rate hikes... At their June meetings, the major central banks reiterated the need to maintain the restrictive bias in monetary policy in a scenario where policy rates, while increasingly close to the ceiling, would still climb a little more and would remain higher for longer. The month kicked off with unexpected rate hikes in Canada and Australia, where the central banks had decided to pause the rate hike cycle earlier this year. In the US, the Federal Reserve kept policy rates unchanged in the 5.00-5.25% range, in line with expectations, but surprised analysts by indicating that at least two more rate hikes were likely during the remainder of the year (as reflected in the dot plot). The implicit money market rates reflect a high probability of two additional rate rises, while rate cuts are not expected to begin until early 2024. On the other hand, as expected, the ECB did raise interest rates by 25 bps and placed the depo and refi rates at 3.50% and 4.00%, respectively. Moreover, spurred by the inertia in inflationary pressures according to the update of its macroeconomic scenario, the ECB signalled a further increase in rates was likely in July, albeit still following a data-dependent strategy. The latest messages from some ECB members have raised the possibility of further hikes in September – a scenario already reflected in the implicit money market rates.

... with some exceptions : Japan, China and other emerging economies. Other central banks in Europe also raised their official rates in June: by 50 bps in the United Kingdom and Norway and by 25 bps in Switzerland and Sweden. The Bank of Japan remained an outlier by leaving intact its policy of negative rates and its sovereign yield curve control strategy. Among emerging economies, there were two notable surprises. On the one hand, Turkey's central bank announced an increase in official rates of 650 bps, marking the first rise since March 2021 and potentially some degree of a return to a more orthodox monetary policy. In the opposite direction, the People's Bank of China surprised analysts with a 10-bp cut in

US: market sentiment

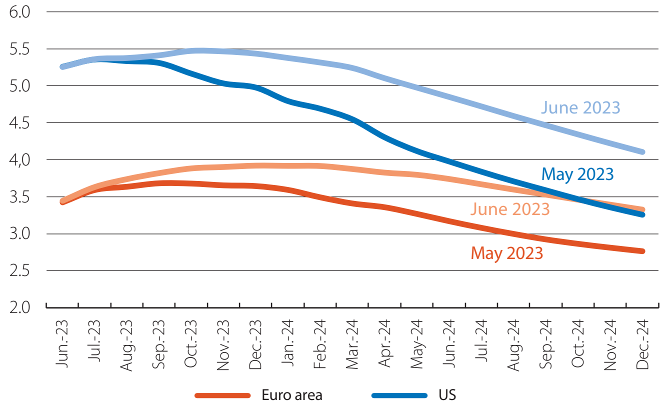
(%)



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

Expectations for Fed and ECB reference interest rates

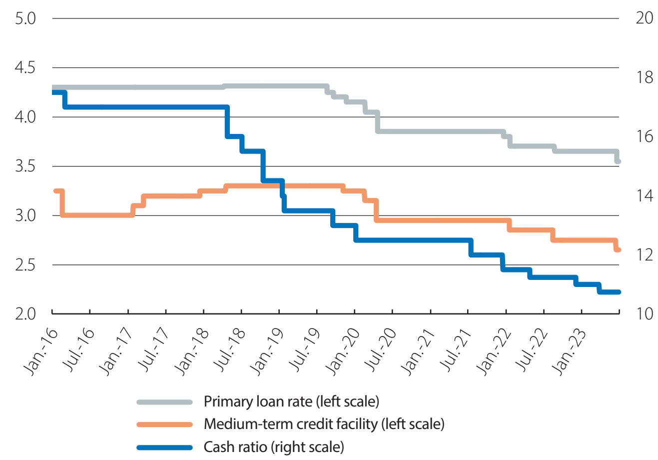
(%)



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

China's main interest rates and the reserve ratio for wholesale banking

(%) (%)



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

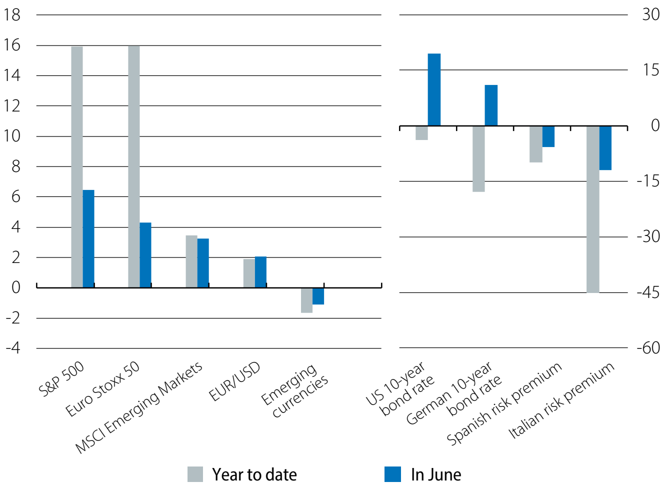
reference rates, marking the first rate reduction since mid-2022 and what could be the start of a set of economic stimulus measures. The central banks of Hungary and Vietnam also announced cuts to their official rates, while in other countries we saw the first signals of possible rate reductions this year (Chile and Brazil).

Sovereign yields move to the beat of monetary announcements. The adjustment in investors' expectations regarding the future path of official rates was transmitted to a rise in sovereign yields, particularly in the case of short-term bonds. As a result, the inversion of the main sovereign yield curves became even more pronounced: in the US, the spread in yields between 10-year and 2-year bonds reached –100 bps, its lowest since the 1980s, while in the case of the German yield curve this spread stood at –80 bps, the lowest level since 1992. Inter-bank rates, meanwhile, rose on both sides of the Atlantic, and in Europe the 12-month Euribor exceeded the 4.0% threshold for the first time since 2008. On the other hand, risk premiums for European peripheral debt extended their good performance, with declines of around 5 bps in June in both Spain (to 100 bps) and Portugal (to 70 bps), despite the confirmation that the ECB will cease investing all maturities under the APP. The narrower differential in official rates and the greater risk appetite led to an appreciation of the euro against the dollar, which closed the month trading close to the 1.10 threshold.

International stock markets resume their upward path. In equities, stock market indices rose in June, albeit with a slowdown over the course of the month (the global MSCI index climbed 6.0% in the first half of June before falling 0.3% in the second half) and with an uneven performance by country and sector. US stock markets performed particularly well (6.5% in June and 15.9% since the start of the year for the S&P 500), narrowing the gap that had opened up relative to European indices (4.3% in June and 16.0% since the start of the year for the Euro Stoxx 50). At the sector level, the prospect of a scenario with higher rates benefited the banking sector, while the technology sector registered a slight slowdown but nevertheless remained at the forefront of the stock market rally in the year to date. Emerging markets, for their part, benefited from the increased risk appetite, particularly in Latin American countries.

Commodities: the focus remains on demand. As had already been the case in recent months, the oil price continued to fluctuate in the 70-80-dollar range for a barrel of Brent. Indeed, not even the surprise announcement of production cuts in Saudi Arabia (of an additional 1 million barrels a day in July) nor the military uprising in Russia were sufficient to allay investors' fears of a cooling in demand. The weak tone in China's economic data also exerted downward pressure on industrial metal prices. On the other hand, the higher temperatures in the northern hemisphere along with certain supply disruptions in some producing countries fuelled a rebound in natural gas prices (the Dutch TTF came to trade at 40 €/MWh), albeit at levels substantially below those of a year ago.

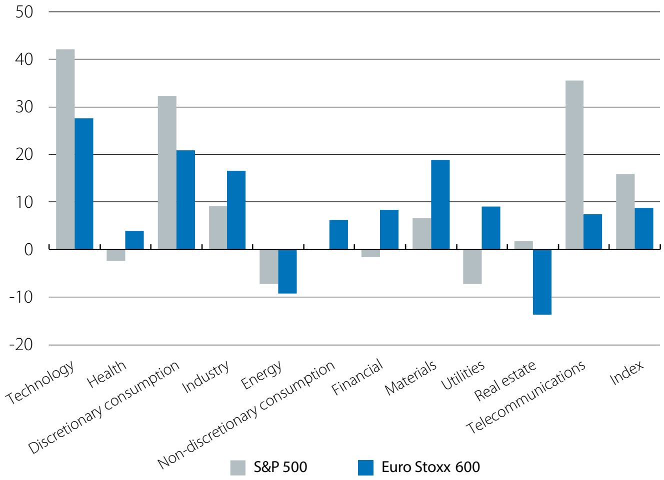
Change in select financial variables



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

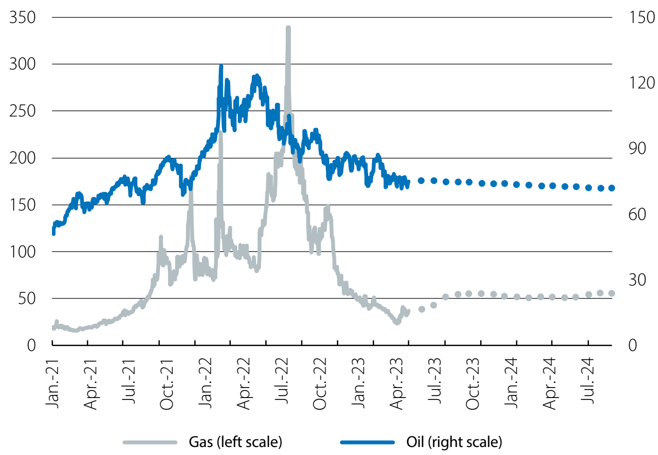
Change in S&P 500 and Stoxx Europe 600 sectors

(%, change since start of the year)



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

Oil and gas prices



Notes: *TTF natural gas and Brent oil. The dots indicate the prices of oil and gas futures contracts for each month.*
Source: *BPI Research, based on data from Bloomberg.*

Monetary policy has done (all?) the homework

Over the past two years, inflation and interest rates have transcended the realm of specialist economic debate to become a general topic of conversation in society. An example of this is the number of Google searches for the terms «inflation» and «interest rates», which reached an all-time peak in June 2022 and March 2023, respectively. Indeed, it is no coincidence that they follow this sequence, as central banks have raised interest rates in response to the inflation rally. In this article, we will try to set out what has happened in advanced economies in terms of inflation and interest rates, with the perspective provided by time, before speculating as to the likely course they will take over the coming months.

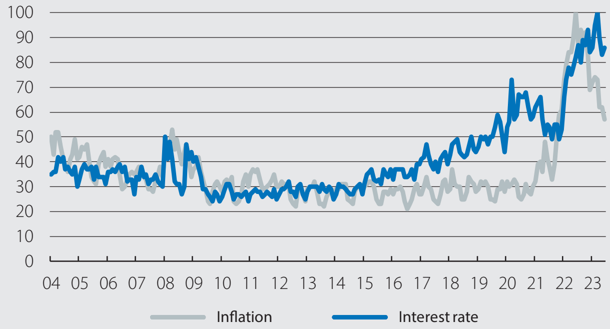
What has happened up until June 2023

The inflationary episode which began in 2021 has been global in nature, and while there have been some idiosyncratic nuances, we have seen common elements among the main advanced economies. Firstly, the end of the lockdowns to prevent the spread of COVID had two effects on inflation: on the one hand, households had accumulated savings which led to an increase in demand for goods and services when the restrictions were lifted. On the other hand, a change in consumption patterns was observed with a bias towards durable goods. Combined with the impact of the pandemic on global supply value chains, this caused bottlenecks and put pressure on prices (e.g. through an increase in the price of containers on shipping routes). Secondly, the outbreak of the war in Ukraine caused a spike in food, gas and oil prices, all of which are key products both at the beginning of the price formation chain and in the basket of final consumption goods. Thirdly, these dynamics were also transferred to other global commodities, such as industrial materials. A fourth and final common element has been the strength of labour markets: the unemployment rate has reached a 54-year low in the US and all-time lows in the euro area. This has allowed wages to rise, limiting somewhat the loss of purchasing power but also leading to higher costs for companies, although this has had only a moderate impact on consumer prices.

In this context, and in order to keep inflation expectations well anchored, central banks began to raise interest rates, some earlier than others (in October 2021 in New Zealand and in July 2022 in the case of the euro area).[1] Indeed, all of them except the Bank of Japan have taken monetary policy clearly into restrictive territory in an attempt to curb inflation, cool down the labour market and, in some cases, control the exuberance of the real estate markets.[2]

World: Google searches for inflation and interest rates

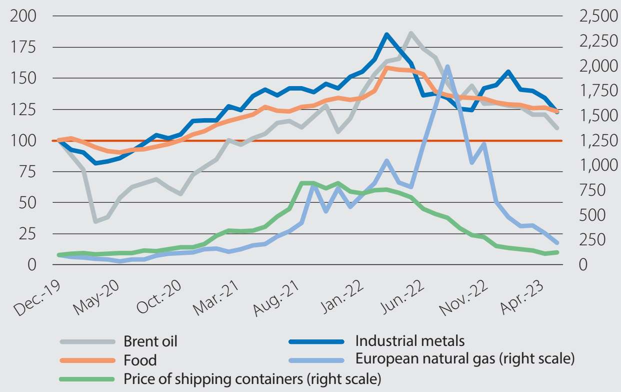
Index (100 = maximum)



Notes: *The numbers reflect the search interest relative to the maximum value. A value of 100 indicates the maximum popularity of the term, while 50 indicates that a term is half as popular relative to the maximum value.*
Source: *BPI Research, based on data from Google Trends.*

Price of different global commodities and services

Index (100 = December 2019) *Index (100 = December 2019)*



Source: *BPI Research, based on data from Bloomberg, the Food and Agriculture Organization and Freightos.*

By the end of 2022, many central banks appeared to be approaching the ceiling of the interest rates rises and had begun adjusting the speed at which they wanted to reach it. For instance, the Fed and ECB stopped raising interest rates by 75 or 50 bps in favour of implementing 25-bp rate hikes, while in the case of the Fed it even stopped raising rates at some meetings, as we saw last June. In addition, and as the fourth chart shows, what we have witnessed in 2023 up until June has been broadly in line with analysts' and investors' expectations (the gap between the orange dot and the grey bar is small in almost all regions).

1. In emerging economies, the rate hikes began somewhat earlier than in advanced economies and have been, in general, more aggressive.

2. See the Focus «Advanced economy housing markets in a scenario of tighter monetary policy (part I)» in the MR04/2023.

What could happen in the future

In recent months, we have seen a moderation of the main causes of the current high inflation, also visible in the second chart. On the one hand, energy prices, shipping container costs and the price of various materials have normalised, and even food prices are showing signs of moderation. On the other hand, the excess savings are starting to run out. In the US, the latest estimates by the San Francisco Fed suggest that only around 500 billion dollars of savings remain (2.1% of GDP), and they are not necessarily evenly distributed among different types of households.[3] Finally, although the rate of moderation varies across different components, disinflationary signals are beginning to emerge throughout the basket of consumer goods.[4]

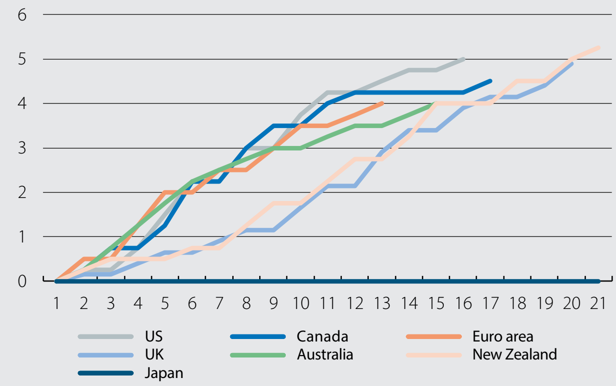
In this context of a moderation of inflation but resilient economic growth and labour markets, central banks are still aggressive in their rhetoric: they do not want to declare the fight against inflation over too soon. It is well known that monetary policy affects economic activity with a certain time lag, and even more so in the case of inflation. Therefore, calibrating exactly what interest rate level is needed today in order to cool down the economy by just the right amount to drive down inflation is a very difficult task. There is too much uncertainty to know what interest rate level is needed in order to bring inflation back down to the 2% target without causing too much of a slowdown. However, in the face of these considerations, central banks are finding resistance in the economic indicators, which invites them to continue raising interest rates. Faced with this dilemma, the new monetary policy strategy seems to involve further rate hikes, albeit limited to only a few and at a gradual pace, as expected by the financial markets (hence the small gap between the orange dot and the blue dot in each region in the fourth chart).

All in all, we believe that the upward path in official central bank interest rates still has some way to go, and both the Fed and the ECB are highly likely to raise rates again this July, although the end of the rate hike cycle should be close.

That said, beyond going into the details of whether the Fed or the ECB will raise rates by a further 25 or 50 bps, what does seem quite clear from the central banks' tone is that the restrictive interest rate environment will remain in place for some time to come. In other words, even if the Federal Reserve were to not raise interest rates any further (and even if it began to cut them

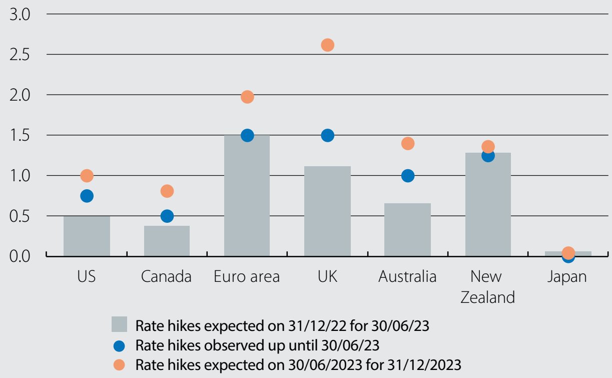
3. H. Abdelrahman and L.E. Oliveira (2023). «The Rise and Fall of Pandemic Excess Savings». Economic Letter. Federal Reserve Bank of San Francisco.
4. See the Focus «European inflation: beginning of the end or end of the beginning?» in this same report for further details on these disinflationary pressures, with an emphasis on the euro area.

The rate hike cycle of different central banks
(pps)



Notes: *On the horizontal axis, we show the number of months since the first rate hike of this cycle. On the vertical axis, we show how many pps official interest rates have risen since then.*
Source: *BPI Research, based on data from Bloomberg.*

Official rate hikes in 2023: actual vs. expected at different times
(pps)



Note: *Expectations are measured using implicit overnight interest rates in each region.*
Source: *BPI Research, based on data from Bloomberg.*

gradually in Q4), rates would remain at restrictive levels for much of 2024. To illustrate this, our forecasts anticipate that the interest rates of the Federal Reserve (upper target range) and of the ECB (depo rate) will stand at 3.50% and 3.00% at the end of 2024, respectively. This stance involving a sustained restrictive monetary policy, which moreover is supported by the reduction of the central banks' balance sheets, should be sufficient to moderate economic growth, cool down the labour markets and end up bringing inflation down to the 2% target. This is particularly the case when we consider the evidence that there is a time lag for the macroeconomic effects of monetary policy to materialise (it should be borne in mind that the tightening of monetary policy implemented last year was particularly agressive) and the fact that various intermediate-phase indicators (such as credit conditions) show that the transmission of monetary policy is working.

Interest rates (%)

	30-June	31-May	Monthly change (bp)	Year-to-date (bp)	Year-on-year change (bp)
Euro area					
ECB Refi	4.00	3.75	25	150.0	400.0
3-month Euribor	3.58	3.46	11	144.5	375.3
1-year Euribor	4.13	3.94	20	84.3	317.3
1-year government bonds (Germany)	3.59	3.17	42	98.9	320.5
2-year government bonds (Germany)	3.20	2.72	48	43.2	268.0
10-year government bonds (Germany)	2.39	2.28	11	–17.9	116.0
10-year government bonds (Spain)	3.39	3.33	5	–27.8	111.1
10-year government bonds (Portugal)	3.13	3.02	10	–46.1	85.5
US					
Fed funds (upper limit)	5.25	5.25	0	75.0	350.0
3-month Libor	5.55	5.52	3	77.8	325.3
12-month Libor	6.04	5.72	33	55.9	247.7
1-year government bonds	5.39	5.17	22	70.5	273.2
2-year government bonds	4.90	4.40	49	47.0	206.3
10-year government bonds	3.84	3.64	19	–3.8	95.6

Spreads corporate bonds (bps)

	30-June	31-May	Monthly change (bp)	Year-to-date (bp)	Year-on-year change (bp)
Itraxx Corporate	74	82	–7	–16.2	–45.9
Itraxx Financials Senior	85	93	–8	–14.0	–46.6
Itraxx Subordinated Financials	160	173	–13	–12.1	–91.4

Exchange rates

	30-June	31-May	Monthly change (%)	Year-to-date (%)	Year-on-year change (%)
EUR/USD (dollars per euro)	1.091	1.069	2.1	1.9	4.8
EUR/JPY (yen per euro)	157.440	148.950	5.7	12.1	11.7
EUR/GBP (pounds per euro)	0.859	0.859	0.0	–2.9	–0.3
USD/JPY (yen per dollar)	144.310	139.340	3.6	10.1	6.7

Commodities

	30-June	31-May	Monthly change (%)	Year-to-date (%)	Year-on-year change (%)
CRB Commodity Index	547.8	541.5	1.2	–1.3	–7.1
Brent ($/barrel)	74.9	72.7	3.1	–12.8	–40.0
Gold ($/ounce)	1,919.4	1,962.7	–2.2	5.2	6.0

Equity

	30-June	31-May	Monthly change (%)	Year-to-date (%)	Year-on-year change (%)
S&P 500 (USA)	4,450.4	4,179.8	6.5	15.9	16.3
Eurostoxx 50 (euro area)	4,399.1	4,218.0	4.3	16.0	27.6
Ibex 35 (Spain)	9,593.0	9,050.2	6.0	16.6	17.3
PSI 20 (Portugal)	5,920.3	5,729.4	3.3	3.4	–2.2
Nikkei 225 (Japan)	33,189.0	30,887.9	7.5	27.2	28.0
MSCI Emerging	989.5	958.5	3.2	3.5	–0.3

Thermal oscillation in the international economy

Economic activity and inflation, at different temperatures. The world economy ended the first half of 2023 with three major dynamics. Firstly, economic activity remained resilient in the face of the gloomy outlook anticipated at the end of 2022, supported by robust labour markets, the easing of the energy crisis, the normalisation of the bottlenecks, the recovery of confidence, China's reopening and the buoyancy of services (which continues to more than offset the weakness in manufacturing). Secondly, inflation has been steadily declining in all major international economies, whether the US, China, Japan, Russia, the euro area, Brazil, or even Turkey. However, much of this decline reflects the correction in energy inflation, while underlying price pressures are fading more gradually. Thirdly, financial conditions continued to tighten, both due to new central bank rate hikes and as a result of the transmission of past rate increases. However, these dynamics have tempered somewhat in recent months. The latest indicators suggest a further cooling of economic activity, while the tightening of monetary policy, which ought to have been topping out around now, appears to still have some way to go.

Signs of cooling in the global economy. Among the three major giants of the global economy, a cooling of economic growth in the US and the euro area has been projected for several quarters now. This is a result of the restrictive monetary policies (to fight inflation), but also due to a statistical effect related to COVID-19 (whose impact on GDP still lingered during 2022). In contrast with these two advanced economies, China accelerated rapidly in the early stages of the year, spurred on by the abandonment of the country's zero-COVID policy. However, various indicators suggest that this initial rebound has lost momentum in recent months. In June, the official composite PMI slowed to 52.3 points (–0.6 points versus May), while the manufacturing PMI was in contractionary territory and that of services registered a slowdown (from 54.5 points in May to 53.2 in June). This loss of steam will not compromise the authorities' GDP target («around 5%», which seems conservative given the base effects), although they have begun to announce supportive measures, such as the PBoC's first rate cuts in 10 months.

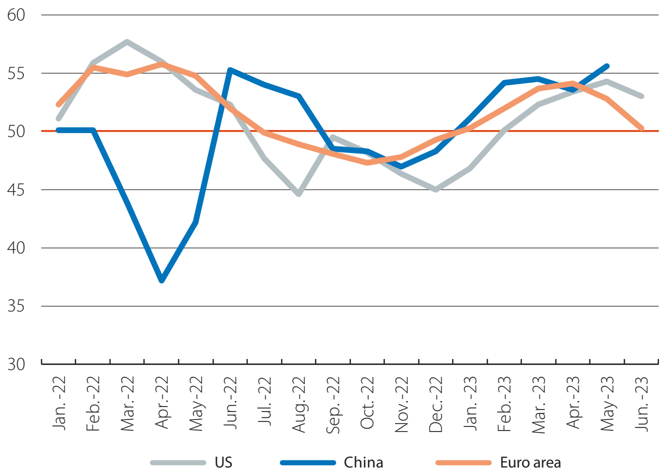
US economic activity remains strong amid the high interest rate environment. The sentiment indicators remained clearly within expansive territory in June (composite PMI at 53 points and consumer confidence at its highest level since January 2022). The labour market, meanwhile, continued to show significant strength and solid wage growth (+6.0% year-on-year in May, according to the Atlanta Fed's indicator), although initial unemployment claims approached 260,000 per week on average during the month (a low figure, but the worst since autumn 2021). On the other hand, the real estate sector offered new encouraging signals with a 12.2% month-on-month rise in new home sales. Overall, the Q2 data indicate quarter-on-quarter GDP growth of 0.4%, which would be a slight slowdown compared to the 0.5% of Q1 (revised upwards after a preliminary estimate of 0.3%).

The US registers its lowest inflation levels since March 2021. Headline inflation continued to moderate in May, slowing to

World: PMI
Index

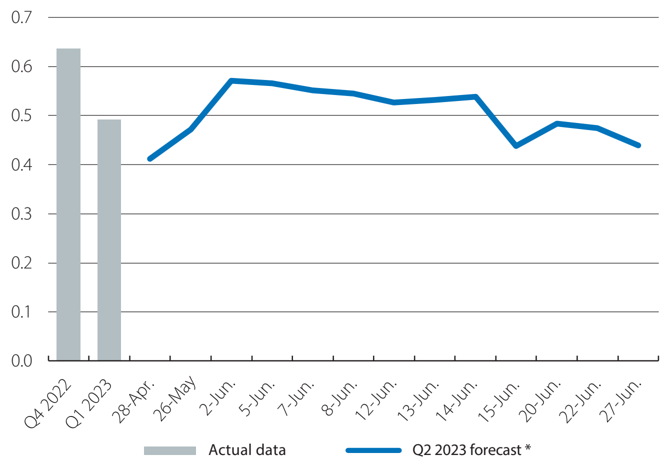
Source: *BPI Research, based on data from S&P Global.*

International economies: composite PMI
Index



Source: *BPI Research, based on data from S&P Global.*

US: GDP
Quarter-on-quarter change (%)



Note: ** Projection of the Atlanta Fed's GDPNow model.*
Source: *BPI Research, based on data from the Federal Reserve Bank of Atlanta and the BEA.*

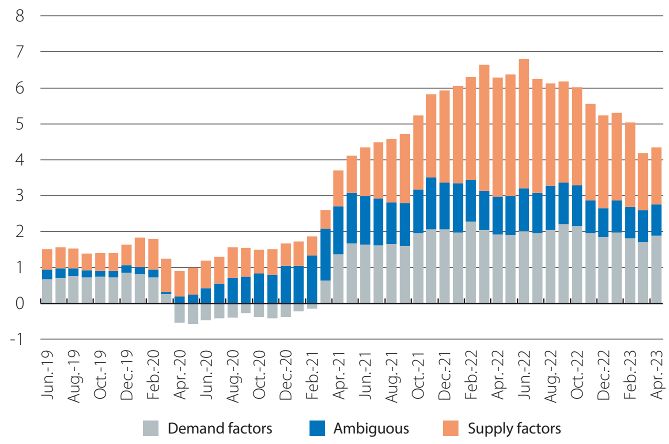
4.0% year-on-year (CPI data) and down 0.9 pps versus the previous month, mainly thanks to a sharp decline in energy prices (–3.6% month-on-month). The other components of the basket of consumer prices followed a similar pattern to the previous month, thus confirming the disinflationary pressures relative to 2022. Nevertheless, they still remain high, and core inflation is showing some persistence (which excludes food and energy), having fallen 0.2 pps to 5.3% year-on-year. That said, some underlying components offered positive signals. In particular, inflation in services excluding housing, an indicator closely monitored by the Fed, fell to 2.9% (three-month average of the annualised and seasonally adjusted month-on-month inflation), well below the 6.5% registered in 2022.

Signs of slowdown and disparities in the euro area. On the one hand, industry continues to show signs of weakness, with industrial production barely registering +0.2% year-on-year growth in April and the manufacturing PMIs persistently in contractionary territory (44.7 points on average during Q2 and 43.6 in June). Thus, services (PMI at 54.6 points on average in the quarter, although falling to 52.4 in June) and the labour market (with an unemployment rate of 6.5% in May, an all-time low) remain the main support factors for economic activity. On the other hand, there is also a contrast between the resilience of the economies of the periphery and the weakness of the core. In particular, the statistical revisions of Q1 GDP confirmed that Germany is in a technical recession (–0.3% quarter-on-quarter in Q1 2023 and –0.5% in Q4 2022). Added to the volatility of Ireland (–4.6% quarter-on-quarter) and the contraction of the Netherlands (–0.7%), this weighed down on the euro area as a whole (–0.1% quarter-on-quarter after an initial estimate of +0.1%), despite the buoyancy of Spain (+0.5%) and Italy (+0.6%) and moderate growth in France (+0.2%). Nevertheless, during the course of Q2 the disparities have gradually converged to the downside, with a widespread deterioration in confidence indices, both among different countries and between sectors. As such, the composite PMI for the euro area as a whole went from around 54.1 points in April to a timid 50.3 in June, teetering on the border between economic expansion and contraction. These cautions were also reflected in a downward revision of growth expectations for Germany (the Bundesbank anticipates GDP growth of –0.3% in 2023), although the latest data suggest a slight recovery in Q2.

European inflation falls slowly. In June, headline inflation for the euro area as a whole fell to 5.5% year-on-year (–0.6 pps versus May), while core inflation rose 0.1 pps to 5.4% year-on-year following two months of moderation. Energy, food and industrial goods contributed to the disinflation, but prices in services once again accelerated. However, this year-on-year growth in services was distorted by a base effect in Germany (linked to significant transport discounts in 2022) and core inflation is expected to return to a path of gradual correction in the coming months. In fact, one measure of inflation unaffected by these base effects hints at inflation being much lower, albeit still high (specifically, inflation momentum – i.e. the change in the three-month average HICP over the average for the immediately preceding three months, duly annualised and seasonally adjusted – suggests headline inflation of 3.8% and a core rate of 4.3% in June).

US: contribution to PCE inflation

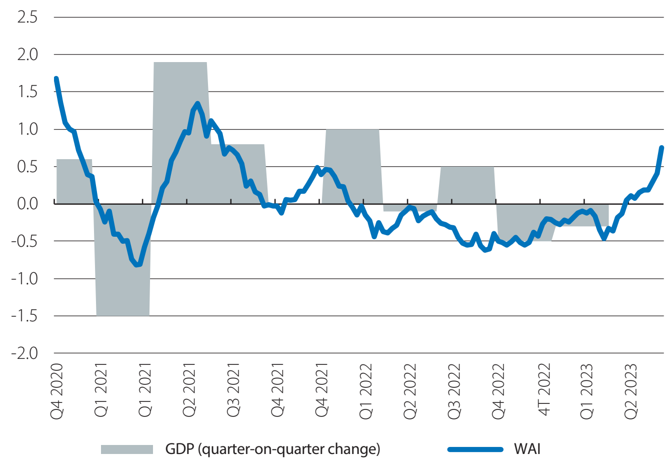
(pps)



Notes: *Contributions to the year-on-year inflation of the PCE Price Index. Demand and supply factors are identified based on the co-movement between prices and quantities of the components of the PCE.*
Source: *BPI Research, based on data from the Federal Reserve Bank of San Francisco.*

Germany: economic activity

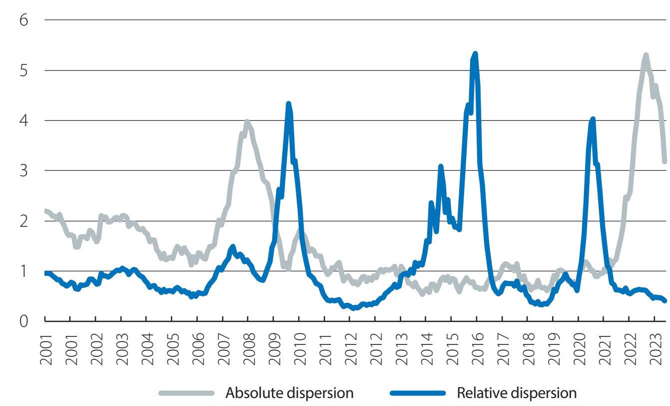
(%)



Note: *The WAI is the Weekly (economic) Activity Index produced by the Bundesbank.*
Source: *BPI Research, based on data from the Bundesbank and Eurostat.*

Euro area: dispersion of headline inflation between countries

Index



Note: *Absolute dispersion corresponds to the standard deviation between countries; relative dispersion is calculated by dividing this standard deviation by the 6-month moving average of inflation for the euro area as a whole.*
Source: *BPI Research, based on data from Eurostat.*

What is happening with industry in the world?

Since the beginning of the year, several indicators have been showing a clear divergence between activity in the manufacturing sector and the services sector. In fact, according to the global PMIs, manufacturing activity has been cooling since the beginning of last year (and is already stagnant or declining in some countries), while the services sector has shown a significant recovery.

Part of this divergence between manufacturing and services responds to their different cyclical nature. Consumption of durable goods and manufacturing production are highly cyclical and sensitive to changes in monetary conditions. It therefore follows that the significant tightening of global monetary conditions since the beginning of 2022 has ended up cooling activity in the industrial sector. However, there are other reasons why this discrepancy between the sectors is now at its peak since the 2008 financial crisis.

The consequences of the pandemic continue to linger

The outbreak of COVID and the lockdowns imposed led to unprecedented disruptions in global distribution chains. As they slowly began to reactivate, companies began to accumulate inventories as a «precaution». Moreover, as the restrictions were lifted, consumers shifted their spending to services at the expense of expenditure on goods, especially durable goods. These two factors explain why the industrial sector has such high inventory levels, which are now limiting production growth. In fact, the higher the inventories, the weaker the performance of new production in industry. This relationship is clearly evident in the PMI surveys, which reveal that the inventory problem is particularly acute in euro area countries. Moreover, with the global appetite for services still high, a substantial and sustained rebound in industrial activity in the coming months seems unlikely.

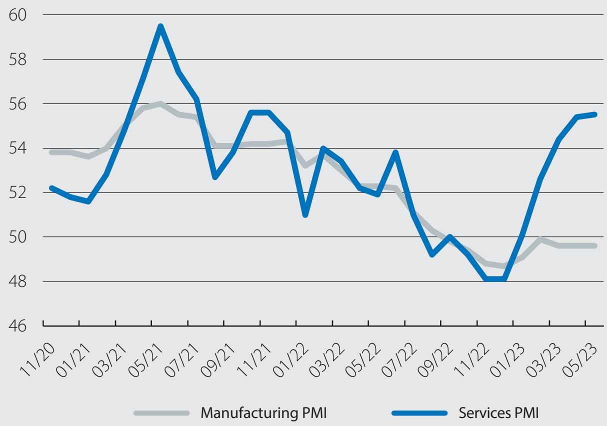
China: catalyst or burden?

Hopes that China's reopening would be the catalyst for the wider global economy, and for industrial activity in particular, are being dashed. The Chinese economy's strong start to the year, after the end of three years of zero-COVID policies, has given way to a phase of apathy: so far this year, its industrial production has grown by just 4% (9% on average between 2010 and 2019) and imports fell by 7%. The countries most affected by the weakness of Chinese imports are those with some of the closest trade ties, including South Korea, Japan, Taiwan and ASEAN countries, which together account for almost a third of Chinese imports, as well as the EU with 14%, the US with 8% and Australia with 7%.

Moreover, however, the Chinese economy is following a very different growth pattern from that shown in other recoveries: the driver of this recovery is private consumption,[1] particularly in services, which has a lower

Global: PMI

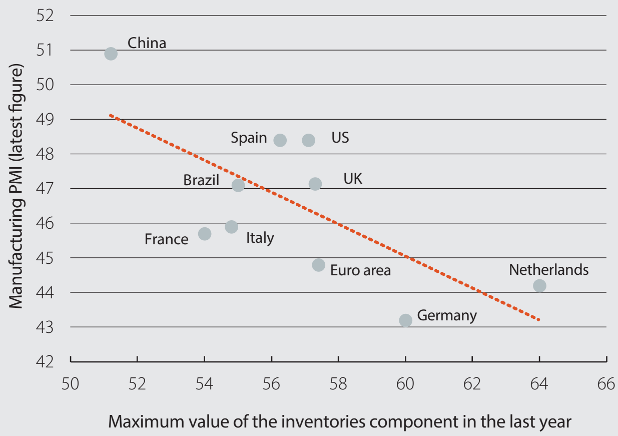
Index



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

Manufacturing PMI: inventories vs. production

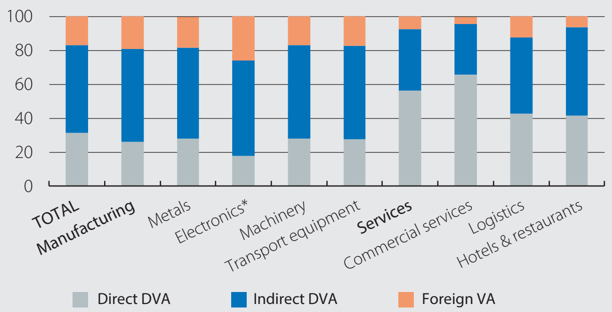
Index



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

China: breakdown of gross production

(% of total gross production and by sector)



Notes: *The total gross production and that of each sector is the sum of the direct domestic value added (direct DVA) originating directly in the final production sector, the indirect DVA originating in other sectors within the same country and later incorporated into the final product, and the foreign value added which is generated abroad and incorporated into imports. The calculation of the indirect DVA also includes the so-called reimported DVA (i.e. products or services originally generated within the same country before being exported and then reimported as part of an intermediate product or service and subsequently incorporated into the final product in the destination sector).*
** The electronics sector includes computers, electronics and electrical goods.*
Source: *BPI Research, based on data from the OECD.*

capacity to act as a catalyst and «pull» other domestic sectors and the international economy along with it. In the third chart, we break down the gross output of the Chinese economy into (i) the domestic value added (DVA) generated directly by a given sector (direct DVA); (ii) the DVA that a particular sector generates indirectly in other sectors within the country (indirect DVA), and (iii) the VA that is generated abroad and imported by China (foreign VA). In other words, both indirect DVA and foreign VA offer us an indication of the capacity of the domestic and foreign «pull effect», respectively, of each particular sector.

We see that the manufacturing sector has a significant foreign pull effect (in particular, in industries with more globally integrated value chains, such as electronics). On the other hand, services (in particular, face-to-face services, such as hospitality) have a much smaller foreign pull effect, which explains why the current pattern of the Chinese economy's recovery is not «pulling» the world economy up with it.

Indeed, the data support this viewpoint. For example, the growth of EU exports to China in the current year to date stands at just 2.0%, compared to rates of around 10% recorded between 2010 and 2019. In addition, the machinery and transport equipment sector is showing notable weakness:[2] this sector accounts for 50% of Europe's total exports to China and those exports have fallen by 8% this year (while exports to the rest of the world grew by 15%).[3]

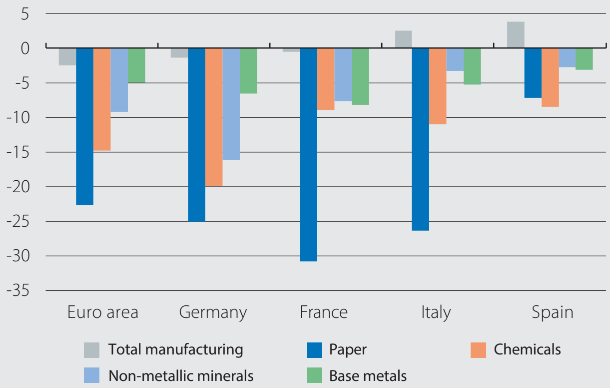
European industry faces its own challenges

The energy crisis unleashed by the war in Ukraine is particularly affecting industry in Europe. As part of its strategy to minimise the impact of the surge in energy prices over the past year and to decouple the continent from Russian gas supplies, the EU put forward a plan to cut gas usage by at least 15%, which was in force from August 2022 until 31 March 2024. This objective was broadly achieved during this period and has contributed to inventories being at record highs for this time of year. According to Eurostat data, since August 2022 gas consumption in Europe has been around 18% below the average for the same period of the previous five years. This adjustment, which has been carried out thanks to the efforts of both households and industry, is also reflected in the pattern of manufacturing activity.

In fact, the sectors hardest hit are those that are more energy-intensive: paper, chemicals, base metals and non-

Euro area: production in manufacturing and energy-intensive sectors

Cumulative change since the beginning of the war in Ukraine (%)



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

metallic minerals (including cement and concrete), which account for 65% of the total gas demand and 54% of the electricity consumed by all of industry in the EU. Moreover, Germany and Italy were the economies most exposed to Russian gas (in 2021, Russian gas accounted for more than 60% and 40% of their total gas imports, respectively), and this explains why their energy-intensive sectors have suffered more than the euro area average. Although the outlook for the energy scenario has improved in recent months, European industry faces significant challenges in its process of decoupling from Russia, as well as that of decarbonising the economy.[4]

A demanding environment for industry

The weakness of global industry is a consequence of several factors and we see no clear path for a sustained shift of trend in the short term. Consumers continue to prioritise spending on services over the consumption of durable goods, as they point out in various confidence surveys. Some of this lower demand for durable consumer goods is related to the persistence of tighter monetary conditions, which are expected to remain so for some time to come, and this will continue to weigh on manufacturing production. Moreover, even if China were to re-steer its growth pattern, it is expected to grow below 5.0% over the coming years, compared to 8% in the middle of the decade prior to the pandemic, so its ability to act as a catalyst to pull up global industry will also be reduced. In addition to all these factors, we must consider the structural changes resulting from the new deglobalisation trends. These trends will lead to a minimising of geopolitical risks in value chains, de-localising parts of these chains to countries that are geographically or politically closer – a topic which will no doubt be the focus of other articles in the future.

Luís Pinheiro de Matos and Rita Sánchez Soliva

1. Private consumption is estimated to have contributed 3 pps to the 4.5% growth of Q1 2023 (compared with 1.6 pps in the case of investment and 0.1 pps for foreign trade), whereas in previous recovery periods the «heavy lifting» was done by investment. For instance, following the 2008 financial crisis, in 2009-2010 China recorded average growth of 10% and an average contribution from investment of over 6 pps.
2. Under the definition used by Eurostat (SITC Rev. 3), the product range within the machinery and transport equipment sector is extensive and includes the vast majority of high-tech products. Among others, it includes industrial machinery, telecommunications, electrical and electronic products, as well as transport equipment.
3. We use monthly export data from Eurostat at the aggregate and sector levels. Most recent available data: April 2023. In addition, in the case of China, we must recall the «favourable» base effect related to the wave of lockdowns imposed in the country between February and May 2022.

4. See G. Sgaravatti, S. Tagliapietra and G. Zachmann (2023). «Adjusting to the energy shock: the right policies for European industry». Brief 11/2023, Bruegel.

European inflation: beginning of the end or end of the beginning?

Euro area inflation has been steadily declining (–5 pps since it peaked last autumn) for one clear reason: energy. The pressure exerted by energy prices has faded with an intensity and speed commensurate with their escalation in 2022. The question now is whether inflation will continue to fall sharply towards the 2% target or whether, like a sailing boat that has been guided out of port, it will encounter new winds that will give it renewed momentum. In other words, with the easing of energy prices, are we witnessing the beginning of the end of inflation or are we embarking on a new chapter of lower inflation than in 2022 but with more resistance to further declines?

Recent disinflation

The analogy between inflation and sailing is not unfounded. As the first chart shows, in the beginning, inflation was essentially an energy matter: this component was responsible for 50% of total inflation and it exerted significant upward pressure throughout 2021 and 2022. In 2023, its direct contribution has fallen to zero, but it has left in its wake higher inflation in the rest of the consumer basket: food, goods and services.

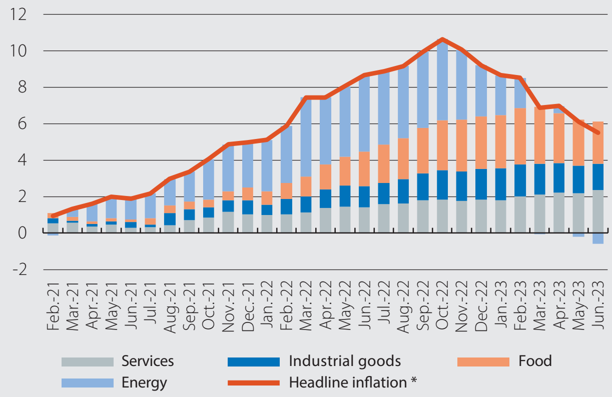
The higher inflation in these components is largely an indirect effect of higher energy costs in the production of food, goods and services. Moreover, food and industrial goods have suffered their own tensions (war in Ukraine and global bottlenecks), which feed back into the prices of the other components. With the easing of energy and food prices in the international markets and the complete normalisation of the bottlenecks (since several months ago now), all these indirect effects are also fading. In fact, there are already signs of disinflation in the latest data. In May, inflation fell for all major components of the euro area's HICP (with a synchrony not seen since 2013 and virtually continuing in June). In addition, the more «real-time» readings show inflation closer to the 3%-4% range than the 5%-6% indicated by the year-on-year measures (see second chart).[1]

There is an entire other battery of prices which support this hypothesis of a moderation in inflation. Consumer prices, captured by the CPI, are the end result of a price formation chain. The indicators available along this chain are virtually all moving in a single direction: from companies' own price-setting intentions (see third chart) to industrial production prices and farm-gate food prices (see fourth chart), we are seeing widespread disinflation

1. In year-on-year terms, inflation reflects not only the growth of prices in the last month, but also that of the previous 11 months. In contrast, quarter-on-quarter or month-on-month inflation (when seasonally adjusted and annualised) offers a more recent (but also more volatile) indicator.

Euro area: contribution to headline inflation

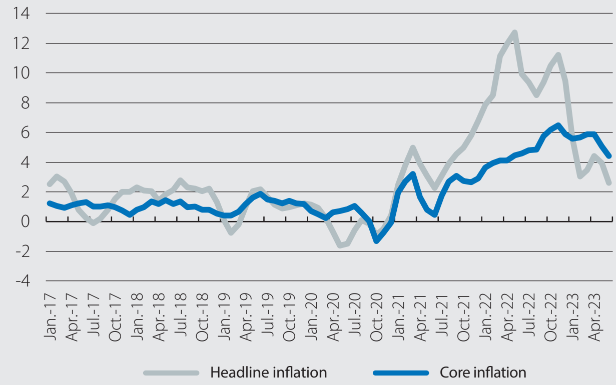
(pps)



Note: ** Year-on-year change.*
Source: *BPI Research, based on data from Eurostat.*

*Euro area: inflation momentum **

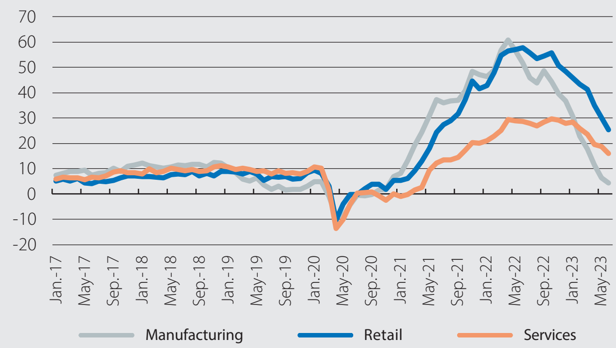
(%)



Note: ** The momentum is defined as the annualised change in the 3-month average of the HICP compared to the previous three months (with seasonally adjusted data).*
Source: *BPI Research, based on data from the ECB.*

Euro area: sales price intentions according to business surveys

*Balance (%)**



Note: ** Difference between the number of companies that expect to «increase» prices and those that expect to «reduce» prices.*
Source: *BPI Research, based on data from the European Commission.*

consolidating across all sectors. Furthermore, as this disinflation filters into the final stages of the chain, in the coming quarters it will become more visible in consumer prices.

Therefore, assuming that energy and food prices continue to ease and global supply chains continue to function smoothly, the winds of inflation will shift to another trend: the pressure coming from margins and wages, in an effort to mitigate the loss of purchasing power that this past inflation has imposed on businesses and households. Given the greater intensity of the labour factor in services compared to goods, this component of the CPI could be more sensitive to these wage dynamics. However, services also suffer the lagging effect of the original winds (energy, food and bottlenecks), as reflected by components such as transport services, restaurants and hotels or maintenance and repair services.[2] Like the rest of the basket of the consumer price index, prices in these types of services will lose momentum. Indeed, there are already signs of disinflation in various measures of underlying inflation (see fifth chart).

Next steps

In parallel with the fading of the original winds, in the coming months disinflation will be accompanied by volatility, base effects and the new winds of margins and wages. Firstly, not only are there idiosyncratic factors that will generate some sporadic volatility (such as the transport subsidies in Germany),[3] but the withdrawal of fiscal measures introduced to combat the energy crisis will have a significant base effect on euro area inflation: +0.5 pps in 2024, according to ECB estimates.[4]

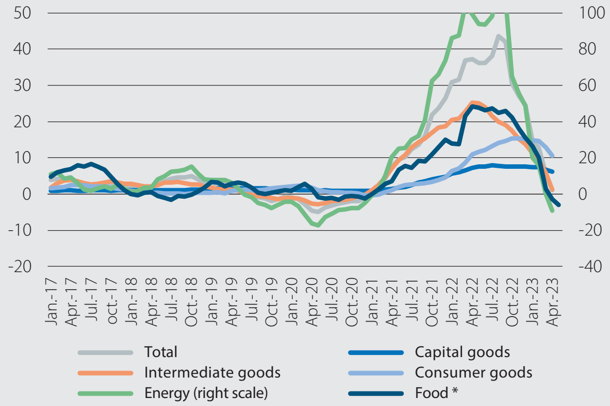
The Chinese economy could also play a role. On the one hand, the abandonment of the zero-COVID policy will help prevent distortions in the global supply chain like those which stressed prices in 2021-2022. On the other hand, the strength of the initial revival of the Chinese economy raised fears of pressures on international commodity prices, but the latest data show a loss of momentum which could provide an additional respite for European inflation.

Finally, various studies point to the growing role of margins and wages.[5] For monetary policy, one argument that offers some peace of mind regarding the role of margins is that their defence is limited by the strength of aggregate demand – and this looks set to diminish with the tightening of financial conditions.

As for wages, the available data suggest that, far from a spiral, they are following a pattern of growth which mitigates the loss of purchasing power. For instance, compensation per employee rose by 5.2% year-on-year in Q1 2023, accumulating 10% growth since Q4 2020. However, if we adjust this measure for inflation, this growth translates into a cumulative decline of 5%. For 2023, forecasts such as those of the ECB anticipate wage growth slightly above 5%, implying that real (i.e. inflation-adjusted) compensation per employee will remain 3% below the levels of prior to the war in Ukraine. In addition, the more up-to-date indicators such as the one produced by Indeed.com (see last chart) suggest that, beyond the «mitigating» wage rises of recent months, there is no new acceleration in wages. Against this figures, which are reasonably consistent with a

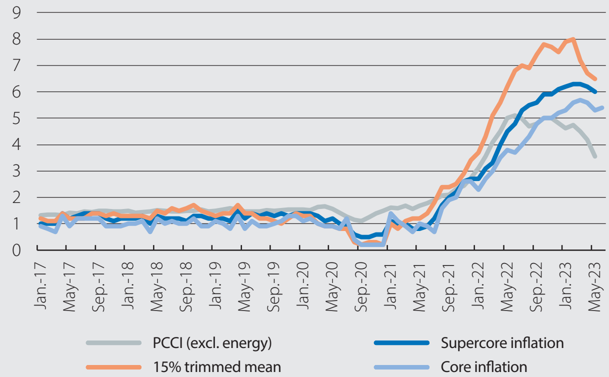
2. All of these categories have registered inflation of around 8% in recent months.
3. In particular, between June and August 2022, the German government launched a «9 euro ticket» that could be used to travel by bus and train throughout Germany. Between June and August 2023, this effect will work against the reduction in inflation and will be noticeable in the euro area as a whole (since Germany accounts for around 30% of the HICP).
4. ECB March 2023 macroeconomic projections.
5. See the recent entry on the IMF blog (26/06/2023), *Europe's Inflation Outlook Depends on How Corporate Profits Absorb Wage Gains*.

Euro area: production prices
Year-on-year change (%)



Note: ** Farm-gate prices compiled by the ECB.*
Source: *BPI Research, based on data from Eurostat and the ECB.*

Euro area: measures of underlying inflation
Year-on-year change (%)

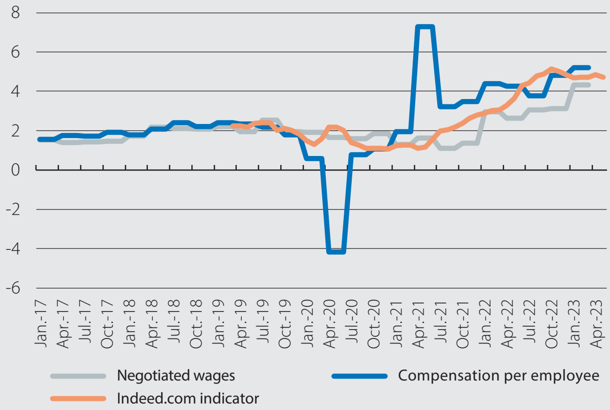


Note: *Core inflation excludes energy and food; the 15% trimmed mean inflation rate excludes the most volatile 15% of components; supercore inflation only includes those core components that are sensitive to the business cycle (output gap), and the PCCI (Persistent and Common Component of Inflation) is the average of a common low-frequency component among euro area countries.*
Source: *BPI Research, based on data from the ECB.*

scenario of gradual disinflation, monetary policy faces uncertainty over the future path of wages – an uncertainty which is accentuated by data showing employment at peak levels and unemployment at historic lows. The future is not yet written, but in the US, where the labour market has been clearly strained for some time and where wage growth has been slightly higher, studies suggest that the contribution of wages to CPI growth to date has been quantitatively modest.[6]

Euro area: wages

Year-on-year change (%)



Source: *BPI Research, based on data from Eurostat, the ECB and Indeed.com.*

6. See A.H. Shapiro (2023), «How Much Do Labor Costs Drive Inflation?», FRBSF Economic Letter, and B. Bernanke and O. Blanchard (2023), «What Caused the U.S. Pandemic-Era Inflation?» Hutchins Center Working Paper nº 86.

Chinese real estate sector: slow and steady

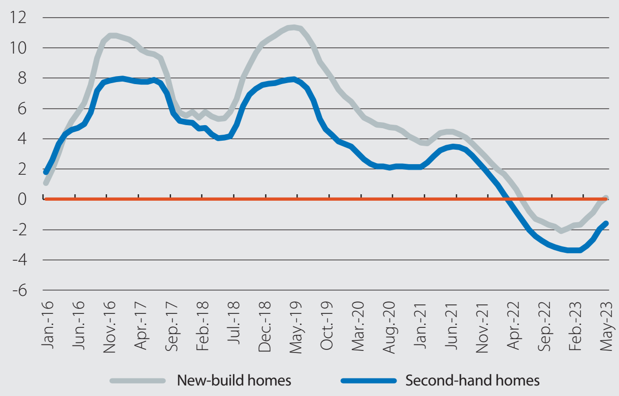
From its liberalisation in the 1990s up until the sharp correction experienced by the sector in 2021, China's real estate market was one of the driving forces of the country's economy. After years of strong growth, in 2016 the famous phrase «housing is for living, not for speculation» began to flood the headlines, reflecting the growing concern among policymakers for the sector's sustainability. Thus, following a first attempt in 2017, in August 2020 regulators intervened in the market with the famous «three red lines», which were restrictive policies that sought to control the excessive indebtedness of property developers.[1] It was in the context of these regulations that the high levels of debt of the major developers ended up leading to the problems encountered by Evergrande in mid-2021,[2] an event which triggered contagion among other developers and gave way to a phase marked by a correction in home sales and prices.

In an attempt to correct the situation, in early 2022 the country's main regulators announced an action plan to soften the restrictive measures taken in 2020 and alleviate the liquidity shortage for developers that Beijing considers «good quality». At this juncture, below we analyse the recent evolution of the real estate sector, focusing on home prices, sales and the financial health of the agents involved.[3]

The correction of the real estate sector

The benchmark used to assess Chinese real estate prices is the average price of new housing in the country's top 70 cities. This measure registered exceptional growth rates during the period between 2016 and 2019, reaching a peak of more than 11% in year-on-year terms in April

China: average price of housing in the 70 most important cities
Year-on-year change (%)



Source: *BPI Research, based on data from the National Bureau of Statistics of China.*

2019. Since then, new home prices have suffered a correction, with negative rates for most of 2022 and bottoming out in October, at which point they began to register a gradual recovery. According to the latest data, the average price of new-build homes rose slightly in May 2023 (+0.1% year-on-year vs. –0.2 in April and –0.8% in March), the first increase in the last 13 months.

However, the readings have become increasingly disparate, reflecting the divergent performance of the real estate market between different types of cities, classified as tier 1, tier 2 and tier 3 and below.[4] While the first two are now registering an increase in prices compared to 2022, the cities of the third tier and below continue to show substantial declines. The same goes for existing home prices.

The number of home sales, meanwhile, began to fall across the board in early 2022, although the growth rate had been flattening out since mid-2021. The maximum contraction was reached in May 2022, with a fall of more than 34% year-on-year. Recently, and after the abandonment of the zero-COVID policies, the sector began to show the first signs of recovery, with a rebound in sales this March. Following this initial rebound, which was mainly driven by the release of pent-up demand following the COVID-19 pandemic, since April the indicators have weakened somewhat, especially in the case of home sales initiated and residential land sales. The number of completed new-build homes was the exception, with year-on-year rates exceeding 30%, mostly thanks to policies that seek to guarantee the delivery of pre-sold homes.

1. They included a 70% limit on the liabilities-to-assets ratio, a 100% limit on the net leverage ratio and a minimum liquidity ratio (relative to short-term debt) of 1. Depending on how many «red lines» property developers fail to comply with, they face different limits to the growth of their debt and in extreme cases can lose access to credit.
2. Evergrande is the largest real estate developer in China and in the world in terms of assets. With liabilities of more than 300 billion dollars, in 2021 it defaulted on its bonds. After failing to meet its financial obligations, Evergrande found itself in cross default, whereby its failure to service one creditor's debt was sufficient for others to demand repayment of their loans. Its shares in Hong Kong were frozen, and it is estimated that the company has lost around 90% of its value since that year. In recent years, suppliers and creditors have demanded hundreds of billions of dollars in outstanding bills.
3. On the one hand, households have maintained relatively low mortgage debts, due to the high initial payments required to access a mortgage. However, mortgage debt has increased in recent years and the official figures do not include the portion of debt in the shadow banking sector. On the other hand, the major property developers continue to experience solvency problems. See the Focus: «China's real estate sector (part II): emergency landing or low-altitude flight?» in the MR03/2022 for further information on the financial situation, credit rating and debt structure of China's biggest property developers.

4. Tier 1 comprises the four most economically developed cities; tier 2, the next 15, and tier 3, the rest.

Current situation

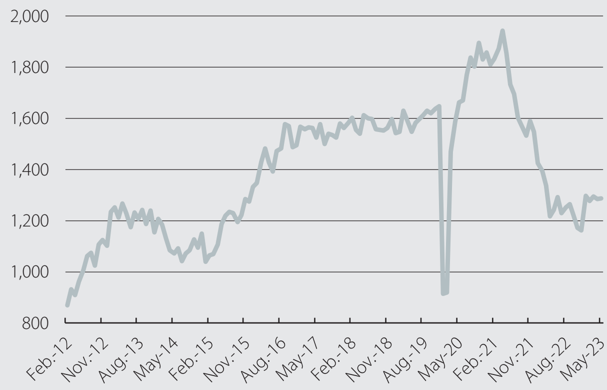
The current phase of the real estate cycle is different from those we could have found in the past, as the authorities are now adopting a much more cautious attitude when it comes to choosing and implementing expansionary measures to revive the real estate sector, prioritising a sustainable recovery that is free of imbalances. In addition, the outlook for the growth of housing demand has been revised, as it is now expected to be lower than previously projected.[5] Furthermore, the authorities are choosing to prioritise the allocation of resources to more strategic sectors, such as innovation and technological development.

Nevertheless, measures aimed at increasing flexibility in the sector have been adopted, although they are much more specific in nature. For instance, credit conditions for new home buyers have been relaxed (in April 2023, the average mortgage rate for new buyers was almost 160 bps lower than in October 2021), additional financial support has been given to property developers to ensure the delivery of pre-sold housing,[6] and greater political support has been given to urbanisation and public housing, among other measures. In addition, the recent round of interest rate cuts implemented by the People's Bank of China offers the sector some breathing room.

In short, the recent evolution of home prices and sales, as well as other more advanced indicators (such as the PMIs),[7] suggest that the real estate sector has initiated a recovery in 2023, albeit a gradual one. After an initially strong rebound, spurred on by pent-up demand following the pandemic, in the coming months the sector will receive more selective support from the authorities as the country seeks a more sustainable form of growth.

China: sale of new housing

*(Millions of m^2) **



Note: ** Seasonally adjusted and annualised.*
Source: *BPI Research, based on data from CEIC, Wind and Capital Economics.*

5. In particular, this decline in the outlook reflects the ageing of China's population (aggravated by the one-child policy in force from 1982 until 2015) and a lower rate of migration from rural to urban areas.
6. These measures include quantitative credit growth targets, bond-guarantee schemes, and non-performing loan grants for select developers. In addition, pre-sale collateral deposit requirements for eligible developers were also relaxed and the real estate loan concentration limits for banks were postponed.
7. The construction index produced by the National Bureau of Statistics of China has shown some very promising figures in the first five months of the year, and reached its peak (65.6 points) in March.

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

UNITED STATES

	2021	2022	Q2 2022	Q3 2022	Q4 2022	Q1 2023	04/23	05/23	06/23
Activity									
Real GDP	5.9	2.1	1.8	1.9	0.9	1.8	–	–	–
Retail sales (excluding cars and petrol)	15.8	9.3	8.9	9.4	7.5	5.9	3.8	3.9	...
Consumer confidence *(value)*	112.7	104.5	103.4	102.2	104.2	105.5	103.7	102.5	109.7
Industrial production	4.4	3.4	3.8	3.5	1.8	1.3	0.4	0.2	...
Manufacturing activity index (ISM) *(value)*	60.7	53.5	55.0	52.2	49.1	48.3	47.1	46.9	46.0
Housing starts *(thousands)*	1,606	1,551	1,636	1,446	1,405	1,375	1,340	1,631	...
Case-Shiller home price index *(value)*	267	306	313	310	303	302	304.8	...	...
Unemployment rate *(% lab. force)*	5.4	3.6	3.6	3.6	3.6	3.5	3.4	3.7	...
Employment-population ratio *(% pop. > 16 years)*	58.4	60.0	59.9	60.0	60.0	60.1	60.4	60.3	...
Trade balance [1] *(% GDP)*	–3.6	–3.7	–4.0	–3.9	–3.7	–3.6	–13.0	...	...
Prices									
Headline inflation	4.7	8.0	8.6	8.3	7.1	6.7	4.9	4.0	...
Core inflation	3.6	6.2	6.0	6.3	6.0	5.7	5.5	5.3	...

JAPAN

	2021	2022	Q2 2022	Q3 2022	Q4 2022	Q1 2023	04/23	05/23	06/23
Activity									
Real GDP	2.2	1.0	1.8	1.5	0.4	1.9	–	–	–
Consumer confidence *(value)*	36.3	32.2	32.4	31.0	30.4	30.7	35.4	36.0	36.2
Industrial production	5.8	0.0	–3.4	3.7	0.7	–1.8	0.2	3.1	...
Business activity index (Tankan) *(value)*	13.8	9.5	9.0	8.0	7.0	1.0	–	–	–
Unemployment rate *(% lab. force)*	2.8	2.6	2.6	2.6	2.5	2.5	2.6	2.6	...
Trade balance [1] *(% GDP)*	–0.3	–3.7	–2.0	–3.0	–3.8	–4.0	–14.9	...	...
Prices									
Headline inflation	–0.2	2.5	2.4	2.9	3.9	4.1	3.5	3.2	...
Core inflation	–0.5	1.1	0.8	1.5	2.8	3.0	4.1	4.2	...

CHINA

	2021	2022	Q2 2022	Q3 2022	Q4 2022	Q1 2023	04/23	05/23	06/23
Activity									
Real GDP	8.4	3.0	0.4	3.9	2.9	4.5	–	–	–
Retail sales	12.4	–0.8	–4.6	3.5	–2.7	5.8	18.4	12.7	...
Industrial production	9.3	3.4	0.6	4.8	2.8	3.2	5.6	3.5	...
PMI manufacturing *(value)*	50.5	49.1	49.1	49.5	48.1	51.5	49.2	48.8	49.0
Foreign sector									
Trade balance [1,2]	681	890	825	910	890	938	977.3	962.8	...
Exports	30.0	7.1	12.9	10.0	–6.8	0.1	8.0	–8.0	...
Imports	30.0	1.0	1.1	0.3	–6.4	–7.0	–7.9	–4.5	...
Prices									
Headline inflation	0.9	2.0	2.2	2.7	1.8	1.3	0.1	0.2	...
Official interest rate [3]	3.8	3.7	3.7	3.7	3.7	3.7	3.7	3.7	3.6
Renminbi per dollar	6.5	6.7	6.6	6.9	7.1	6.8	6.9	7.0	7.2

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

EURO AREA

Activity and employment indicators

Values, unless otherwise specified

	2021	2022	Q2 2022	Q3 2022	Q4 2022	Q1 2023	04/23	05/23	06/23
Retail sales *(year-on-year change)*	5.4	1.0	1.1	–0.5	–2.5	–2.5	–2.6	...	...
Industrial production *(year-on-year change)*	9.8	2.3	2.1	3.5	2.1	0.5	0.2	...	...
Consumer confidence	–7.5	–21.9	–22.7	–26.9	–26.9	–26.9	–17.5	–17.4	–16.1
Economic sentiment	110.7	101.9	103.9	96.5	96.5	96.5	98.9	96.4	95.3
Manufacturing PMI	60.2	52.1	54.1	49.3	49.3	49.3	45.8	44.8	43.4
Services PMI	53.6	52.1	55.6	49.9	49.9	49.9	56.2	55.1	52.0
Labour market									
Employment (people) *(year-on-year change)*	1.5	...	2.8	1.8	1.6	1.6	–	–	–
Unemployment rate *(% labour force)*	7.7	6.7	6.7	6.7	6.7	6.6	6.5	6.5	...
Germany *(% labour force)*	3.6	3.1	3.0	3.1	3.1	3.0	2.9	2.9	...
France *(% labour force)*	7.9	7.3	7.5	7.2	7.2	7.1	7.0	7.0	...
Italy *(% labour force)*	9.5	8.1	8.1	8.0	7.9	7.9	7.8	7.6	...
Real GDP *(year-on-year change)*	5.5	3.5	4.3	2.5	1.8	1.0	–	–	–
Germany *(year-on-year change)*	2.8	1.9	1.7	1.4	0.8	–0.5	–	–	–
France *(year-on-year change)*	6.8	2.5	4.0	1.1	0.6	0.9	–	–	–
Italy *(year-on-year change)*	7.3	3.9	5.0	2.5	1.5	1.9	–	–	–

Prices

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

	2021	2022	Q2 2022	Q3 2022	Q4 2022	Q1 2023	04/23	05/23	06/23
General	2.6	8.4	8.0	9.3	10.0	8.0	7.0	6.1	5.5
Core	1.5	3.9	3.7	4.4	5.1	5.5	5.6	5.3	5.5

Foreign sector

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

	2021	2022	Q2 2022	Q3 2022	Q4 2022	Q1 2023	04/23	05/23	06/23
Current balance	2.5	–1.2	0.6	–0.8	–1.2	–0.5	–0.4	...	...
Germany	7.8	4.2	6.0	4.7	4.2	4.4	4.7	...	...
France	0.4	–2.2	–0.4	–1.4	–2.2	–1.9	–1.8	...	...
Italy	3.1	–1.2	0.6	–1.1	–1.2	–0.8	–0.8	...	...
Nominal effective exchange rate [1] *(value)*	**94.3**	**90.8**	**90.2**	**88.9**	**91.7**	**93.1**	**94.5**	**93.6**	**...**

Credit and deposits of non-financial sectors

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

	2021	2022	Q2 2022	Q3 2022	Q4 2022	Q1 2023	04/23	05/23	06/23
Private sector financing									
Credit to non-financial firms [2]	3.5	6.7	6.2	8.5	7.9	5.7	4.6	4.0	...
Credit to households [2,3]	3.8	4.4	4.6	4.4	4.0	3.2	2.5	2.1	...
Interest rate on loans to non-financial firms [4] *(%)*	1.2	1.8	1.4	1.8	2.9	3.8	4.3	...	...
Interest rate on loans to households for house purchases [5] *(%)*	1.3	2.0	1.5	2.1	2.9	3.7	4.0	...	...
Deposits									
On demand deposits	12.6	6.3	7.8	6.4	1.8	–3.4	–6.2	–7.5	...
Other short-term deposits	–0.8	4.5	0.9	5.3	12.0	17.6	21.0	22.5	...
Marketable instruments	11.6	3.6	2.2	4.1	7.5	19.4	21.5	24.2	...
Interest rate on deposits up to 1 year from households *(%)*	0.2	0.5	0.2	0.4	1.1	1.8	2.3	...	...

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.*

Activity in a virtuous cycle?

Information available for Q2 suggests a more positive performance than previously anticipated, underpinned by consumption and tourism.Private consumption indicators - retail sales, car sales and ATM card payments - were strong in May, underpinned by a resilient labour market. Tourism indicators also remain buoyant, with the number of tourists and flights above 2019 levels. All this is reflected in economic sentiment, which improved in June among consumers and in the construction and services sectors. Some of these factors are expected to remain active in the second half of the year, namely the strength of tourism activity and the resilience of the labour market, to which we may add the boost to investment from European funds. In particular, the approval of investments financed by the European PT 2020 funds is likely to accelerate, as €2.9bn is still available until the end of 2023 (which if not used will have to be returned to the EU). Against this backdrop, we believe there is room for a slight improvement in our growth projections, a change we will make next month.

Inflation below 4% in June. The flash CPI estimate puts inflation in June below 4% (3.4%), something that has not happened since before the start of the war in Ukraine in January 2022. Underlying inflation also declined, to 5.2%, but more moderately (it had been 5.4% in May). Despite this, we again saw a significant monthly increase in unprocessed food prices (0.7%), after having fallen by –2.3% in May with the start of the application of the «zero VAT» measure. Base effects in energy (which will still be strong in July) and the yoy decline in output prices underpin the downward trend. However, we should not forget that part of the Portuguese inflationary phenomenon is imported and inflation is higher in the euro area (5.5%), with even the underlying component showing resilience in June (up 0.1 pp to 5.4%).

Economy registers external financing capacity in Q1 2023. In the year ending March, net lending stood at 0.4% of GDP, a significant improvement from –0.6% in 2022, a result of improvements in the general government and non-financial corporations sectors (see next paragraph). Among households, net lending continues to decline, standing at 0.4% of GDP at the beginning of 2023, mainly reflecting the reduction in savings, driven by a stronger increase in consumption (10.9% year-on-year) than in disposable income (8.2%). This resulted in a further decline in the household saving rate to 5.9% of disposable income, a level only comparable to those observed in 2008.

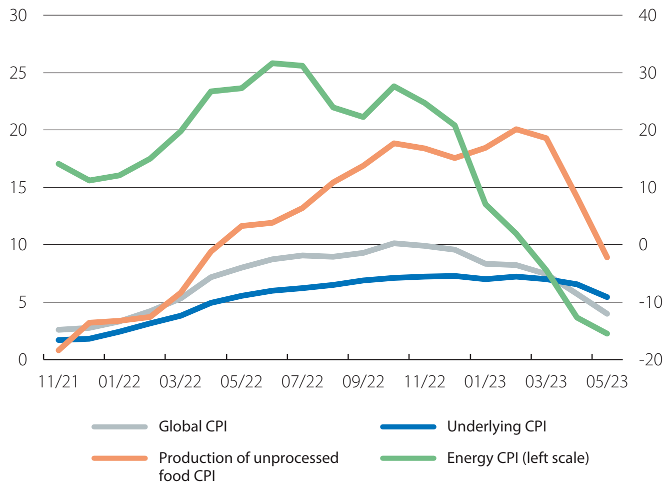
The public sector performed very well in Q1 this year, recording the first surplus in national accounts in the first 3 months of the year in at least the last 24 yearsequivalent to 1.2% of GDP, reflecting the impact of labour market strength and good momentum in tax collection activity.

Yoy variations
(Level)

	Apr.-23	May.-23	Jun.-23
Economic climate indicator	2.3	1.6	1.6
Economic sentiment indicator	102.1	99.0	99.9
Daily economic activity indicator	2.1	3.7	1.5
Retail sales	2.5	3.1	–
Car sales	27.8	54.6	–
Imports of capital goods (accum. year)	9.1	–	–
Cement sales	8.1	3.3	–
Electricity consumption	–5.6	–2.0	–
No. of non-resident tourists (thousands)	1,669.6	–	–
Number of flights (yoy 2019)	5.0	5.2	–
Variation in registered unemployment (thousands of people)	–19.0	–10.5	–
Variation in employment (thousands of people)	34.6	62.8	–

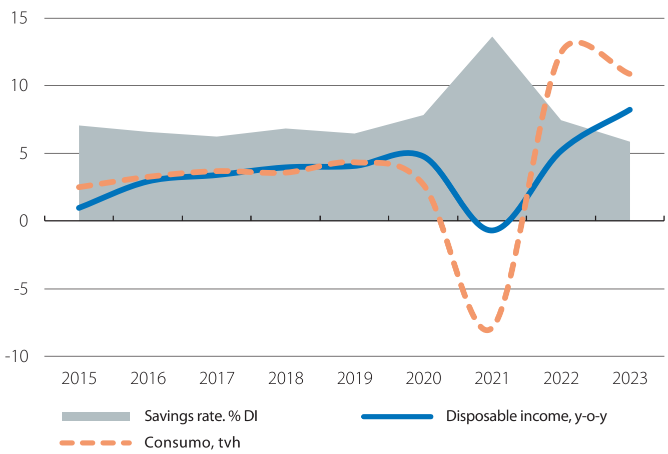
Source: *Banco BPI, based on data from INE, Banco de Portugal, EC.*

CPI: year on year variation
(%)



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

Families: Disposable income, consumption and savings
(%)



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

In fact, compared to the same period last year, the increase in revenue from taxes on income and wealth (12%), on production and imports (6% yoy), and social contributions and benefits (4% yoy) exceeded the increase in public consumption (4%) and investment (4%). The good performance in Q1 was also reflected in the achievement of a surplus in the year ending March equivalent to 0.1% of GDP, which compares with a deficit of 1.7% of GDP in the same period last year and 0.4% at the end of 2022.

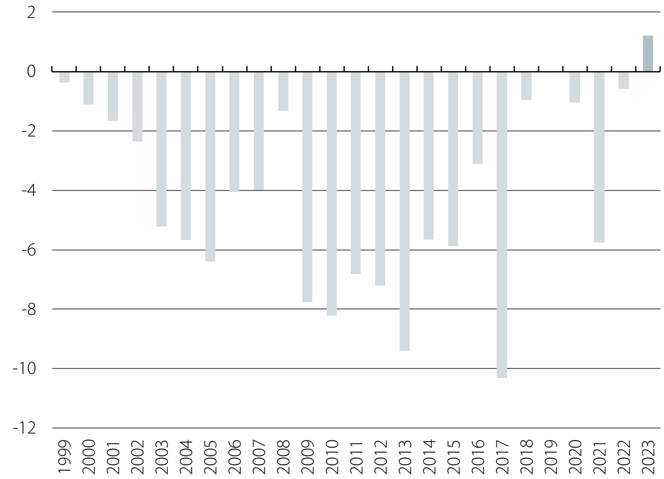
House prices enter 2023 on the rise. In Q1 2023. the House Price Index (HPI) grew by 1.3% qoq and by 8.7% yoy. Despite the number of transactions falling by more than 20% compared to the same period in 2022, the pace of qoq price growth was stronger than in Q4 2022 (1.1%), bucking the trend of a slowdown that had been in place for three consecutive quarters. Other data for May seems to support the idea that this market is very resilient. For example, the median bank appraisal value for housing was €1,510 per square metre (up €19 on April), and Confidencial Imobiliário's monthly survey indicates that property developers have positive expectations for prices (over 3 months).

In May, the downward trend in the loan portfolio and deposits continued. Starting with loans, there was a 1.1% yoy reduction in the loan portfolio of the non-financial private sector, driven by an increased decline in loans to non-financial corporations to –3.7% yoy and with loans for house purchases contracting by 1.5% for the first time since June 2020. Meanwhile, the stock of loans to households continues to grow, albeit at a more moderate pace (0.4% yoy in May vs. 0.8% in April), as a result of the 7% yoy growth in consumer loans.

In turn, deposits continue to contract, with total deposits contracting by 0.9% compared to May 2022 (–0.2% in April). Here the decrease in private deposits is the main factor behind this movement. In May, these decreased by 2.7% yoy (–1.6% in April); while those of companies continue to grow, but at a slower pace (1.4% vs. 1.6% in April). Meanwhile, financial system data in Q1 2023 show a small increase of 1 tenth in the NPL ratio, driven by a worsening, also of 1 tenth, of NPLs in consumer and other loans. The NPL ratio of non-financial corporations fell by 2 tenths to 6.3%. The solvency of the financial system improved in 1Q, with the CET1 ratio standing at 15.6% (15.4 in 4Q 22); and the *cost-to-income* ratio fell to 39.4%, down 12.6 percentage points, benefiting from a strong improvement in banking income.

Public sector: balance in 1Q (national accounts)

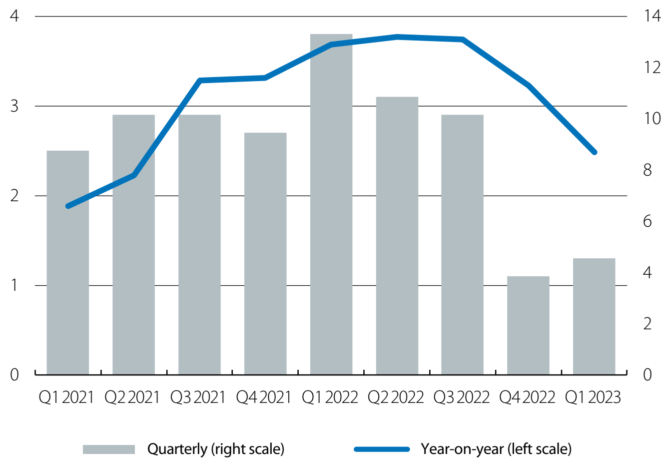
(%)



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

IPH: quarterly and year-on-year variation

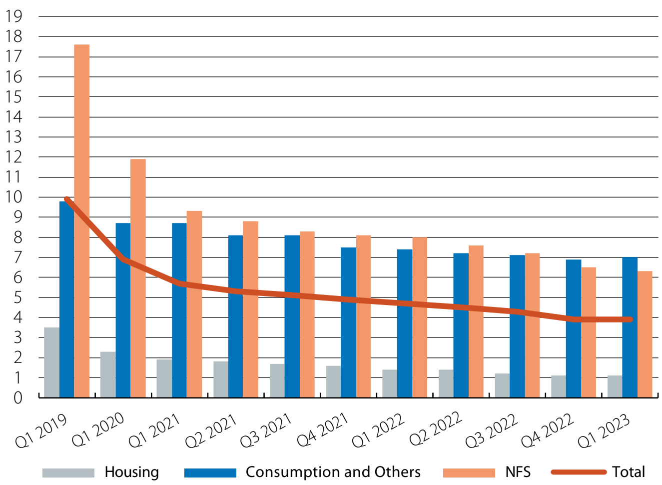
(%)



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

Banking system: NPL ratios

(%)



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

Back to the future: the new wave of tourists from the USA

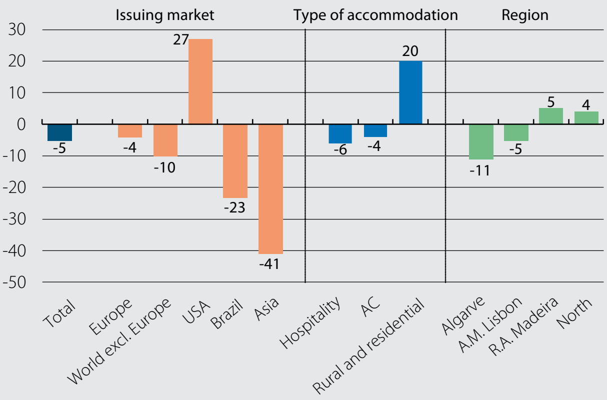
In the famous film mentioned in the title of this article, the protagonist has the opportunity to travel back in time to intervene and make the future more harmonious. Unfortunately, it is impossible to erase the black episode of the pandemic from the national tourism film. But the sector is still able to resume the course of the happy story it was living in recent years until 2019, when between 2013 and 2019 Portugal practically doubled the number of non-resident guests, surpassing 16 million in that year. The way the post-pandemic recovery has been unfolding has already been addressed in other articles,[1] but in this one we want to examine what has been happening in one of the current «star» source markets: the USA.

In 2022, the recovery of non-resident tourism compared to 2019 levels was not complete, as we can see in the first graph. In global terms, overnight stays were still 5% lower and the lag is even greater with our source markets outside Europe. This is the case with Asian tourists in particular, with the Covid zero policy having been very tough in China and lasting for almost the entirety of that year. Two regions that together accounted for 60% of overnight stays from foreigners - Algarve and Lisbon – also registered drops of 11% and 5% in overnight stays, respectively. The US appears here as an outlier in the positive sense, with overnight stays in 2022 surpassing the 2019 level by 27%. With this performance, the USA overtook Germany to become the fourth largest source of tourists to Portugal (second graph). This good trend continues in 2023, even becoming more pronounced. For example, the number of guests from the USA in Q1 2023 grew by an extraordinary 79% compared to Q1 2019, or by 116,000 more holidaymakers. This number explained more than a third of the total change in non-resident tourists between these two periods (342,000). We should also note the signs of diversification of the sector reflected in the good growth of visits from tourists from Canada and Poland. Bank card transaction volumes[2] are further evidence of this new wave of US tourism. In Q1 2023, US card spending was the third highest (behind that of France and the UK), and more specifically, spending on these cards in the «Accommodation» category accelerated an extraordinary +93.5% compared to the same period in 2022.

The numbers are illuminating, but what are the reasons behind this? The answer is multifaceted. First, there is an increase in applications for resident status and residents originating from the US. In 2021 (latest data made available by INE), applications for resident status more

Composition of overnight stays by foreigners in 2022

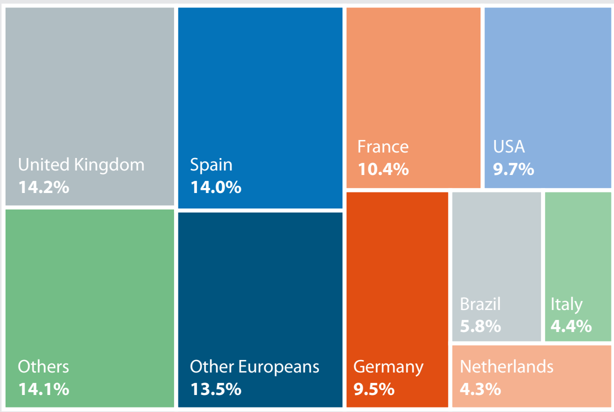
(%)



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

Foreign guests by country (2022)

In % of total foreign guests



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

than doubled and residents with US nationality increased by 44%. As early as 2022, we know that Portugal was the EU country most sought after by Americans interested in moving abroad, according to data from Google.[3] More Americans living (or interested in living) in the country has a multiplier effect, with a greater number of visits from family and friends but also more tourist visits with the aim of getting to know our country before potentially making the decision to move. On the other hand, there is an increase in installed air capacity on Portugal-USA flights. Flights to Portugal in summer 2019 travelled from 8 cities via 4 airlines, with a weekly frequency of 79 flights. For the summer of 2023, 5 airlines, more routes

1. See «Verão 2022: balanço da atividade turística» in the Monthly Information Document for December 2022.
2. Data from SIBS analytics.

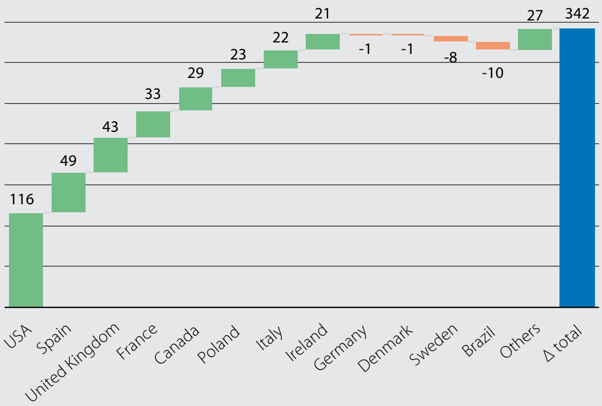
3. More than 41.2 thousand monthly searches in 2022, surpassing Spain (2nd most searched country with 38.9 thousand). See https://www.dnoticias.pt/2022/12/2/338723-portugal-destrona-a-espanha-como-o-destino-europeu-numero-1-para-norte-americanos-se-mudarem-para-o-exterior-em-2022/#

and 121 weekly flights are planned.[4] The «Close to US» campaign carried out by Turismo de Portugal and focused on the US market would also have had an effect. This campaign kicked off with a «take over» of all digital screens in New York's iconic Times Squar, in association with the launch of the Cristiano Ronaldo wax figure at Madame Tussauds New York. In addition to these emblematic actions, there is a broader plan with the presence of «Destination Portugal» in business platforms, namely fairs and workshops; the implementation of a public relations strategy targeting the main opinion makers in the country; and a strong digital marketing campaign. In addition, Portugal is benefiting from other non-price competitiveness factors valued in the current context, especially in the health and safety dimensions (fourth graph). Lastly, other (US domestic) factors generally support North American tourism include a historically low unemployment and resilience of private consumption; surplus savings accumulated in the pandemic period; and jet fuel prices at pre-Ukraine war levels.

But the importance of the US market derives not only from quantitative patterns, which we have already listed, but also qualitative ones. Among the main incoming markets, US tourists are among those with the second highest percentage of overnight stays in 5-star hotels (39%). Cross-referencing balance of payments export earnings data for travel and tourism[5] with guests and overnight stays data shows that US tourists are also the third highest earners of revenue per overnight stay: 543 euros. In other words, they boost higher value-added tourism, supporting the re-establishment of pre-pandemic levels of tourism in the Lisbon region (given that more than 50% of its overnight stays are in this region). This development in US tourism is thus an important contributor to a wider movement, with Portugal's tourism exports showing more marked growth than competitor countries, and therefore gains in market share. To try to materialise in numbers what US tourism could mean in 2023, we did a simple exercise of considering two scenarios. In the first, we assume that US guest growth continues until the end of the year at the same rate as it increased up to April (compared to 2019). In the second, we assume that US incoming tourism resumes its pre-pandemic level and Portugal maintains the share in this market observed in 2022.[6] The first scenario would translate into an increase in the number of guests compared to 2022 of 730,000 and an additional EUR 906 million in exports. The second scenario would result in an increase in the number of guests compared to 2022 of 345,000 and an additional €429 million in exports.

Q1 2023 v 1Q 2019: Change in nº of foreign tourists

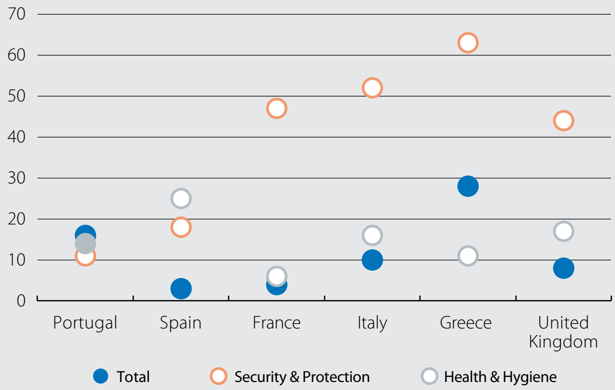
Thousands



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

Tourism Competitiveness

Ranking of countries in 2021 (ranging from 1 = best to 117 = worst)



Source: *BPI Research, based on data from the World Economic Forum (Travel & Tourism Development index). The ranking encompasses 117 countries.*

Regardless of whether any of these scenarios materialise, all the conditions are in place for US tourism to support 2023 as the year of all-time records in domestic tourism. It's time to return to the future.

Tiago Belejo Correia

4. Data from TravelBI (Turismo de Portugal): https://travelbi.turismodeportugal.pt/movimentos-aereos/capacity-aerea-estimada/5. These correspond to revenue obtained when an individual resident in another country travels to Portugal as part of a trip or temporary stay (recorded as a credit in the balance of services) 6. US incoming tourist arrivals totalled 99.2 million in 2019; 33.1 million in 2020; 18.7 million in 2021; and 80.7 million in 2022 (US data Department of Commerce, International Trade Administration, National Travel and Tourism Office (NTTO)). Portugal's share was 1.2% (2019); 0.4% (2020); 0.7% (2021), and 1.9% (2022).

Household financial wealth increases despite the reduction of savings

The household savings rate fell back to levels only seen in 2008, the year in which the international financial crisis broke out, indicating that there was an acceleration in the use of savings accumulated during the pandemic, mostly as a measure to mitigate the effects of the inflationary spiral that we saw in 2022 and which is only now beginning to give some respite. Thus, in 2022 the household savings rate stood at 6.1%, 0.8% less than the average recorded between 2015 and 2019 and clearly below the average savings rate recorded in 2020-2021. In absolute terms, the flow of savings amounted to €12.550 billion at the end of 2022, €680 million less than in 2021, but €3.1 billion above the average recorded between 2015-19, suggesting that there has been a strong unwinding of surplus savings, not only because of the rising cost of living, but also most likely because households have been normalising their consumption patterns.

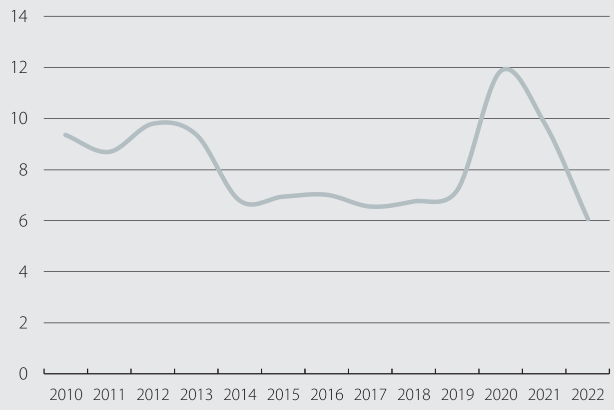
The decline in savings was accompanied by an acceleration in nominal consumption.[1] The latter grew by 12.5 per cent, clearly above the advance observed in disposable income, which increased by 7.8 per cent. The latter's advance lagged behind growth in employee remuneration (9.6%) and property income (10.3%), reflecting the 12.9% increase in income taxes paid by households.

In line with the reduction in accumulated savings, there was a decrease in the net acquisition of financial assets in 2022. This stood at 8 billion in 2022, compared with 24 billion in 2021 and an average of 11 billion between 2015 and 2019. Deposits and government savings products were the largest contributors to the increase in household financial assets, partly offset by the decline in investments in long-term securities, most likely affected by rising interest rates and the consequent fall in asset values, and in insurance and investment funds. Indeed, deposits increased by around €14 billion in 2022, after having already increased by around €12 billion in 2021; over the period 2015-2019, the average annual increase in deposits was 5.7 billion, showing that saving is still on household radars, despite the increase in consumer spending. At the same time, there was an increase in investments in government savings products, which can be explained by the fact that the returns offered exceed those of bank deposits. This trend will have strengthened in the first months of 2023, but the recent change in the remuneration conditions of these government savings

1. In this chapter, it should be noted that even in real terms, deflating consumption expenditure by the implicit consumption deflator grew at a very strong rate: 7.3%, largely outpacing growth in deflated disposable income (2.8%) and employee remuneration (4.5%).

Household savings rate

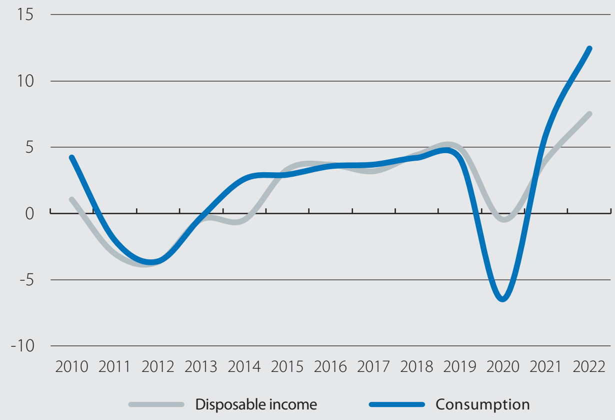
(% of available income)



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

Disposable income and consumption

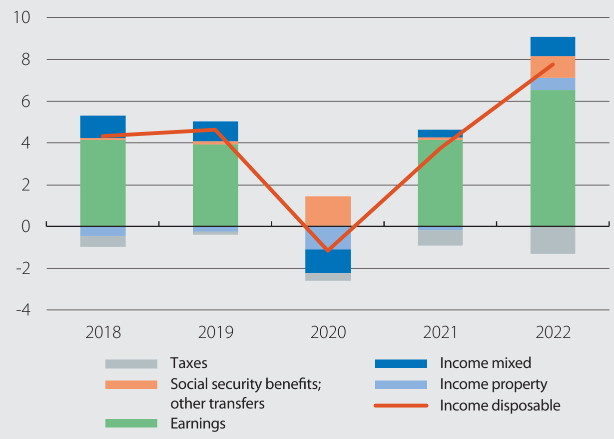
(Year-on-year change %)



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

Disposable income: contributions

(Percentage points and year-on-year change,%)



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

products (reduction of the interest rate of the new series of savings certificates to 2.5%, previously 3.5%) and the gradual revision of the remunerations practised by banks,[2] will tend to reduce the flow of savings applied in deposits in government products, especially in the second half of the year.

Overall, household financial assets amounted to 481 billion at the end of 2022, and their structure is dominated by deposits (47%), and the trend has been strengthening, accounting on average between 2015 and 2019 for 43% of applications. Secondly, investments in shares and other equity account for ¼ of household investments. But this increase in household financial investments was accompanied by an increase in their liabilities, which in 2022 totalled €178 billion, €7 billion more than in 2021, putting the increase in household net financial assets at just €1 million.

It should be noted that this increase in liabilities is accompanied by an improvement in debt ratios, which in 2022 represented 61.5% of GDP (57% in the euro area), 30 pp less than the maximum observed in 2009. And that loan coverage by household deposits remains at satisfactory levels, with deposits accounting for just under 140% of the stock of household loans.

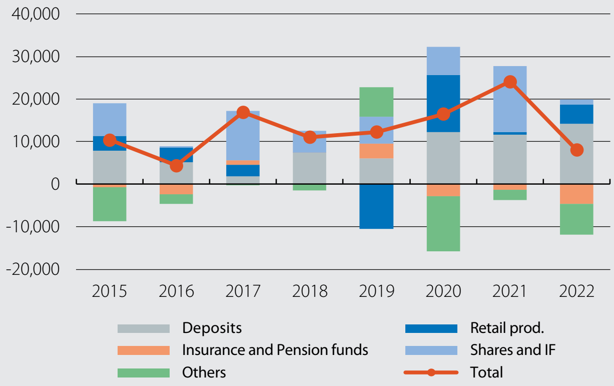
Compared to 2019, household financial assets increased by around €49 billion, an increase of 11.3%, as a result of the postponement of consumption decisions in the years of confinement and forced accumulation of savings. However, it is worth bearing in mind that this increase was lower than the increase in prices over the same period (12.3 per cent), which will have eroded some of the real value of household assets.

As a percentage of GDP, both gross and net household financial wealth still exceeded the average for the pre-covid period (2015-2019). The former represented 208% of GDP and the latter 126.5%.[3]

Teresa Gil Pinheiro

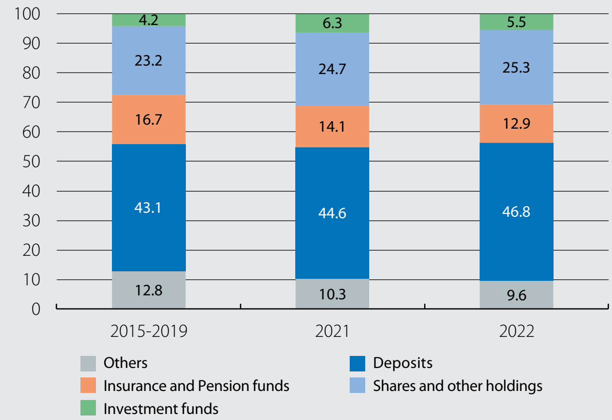
2. The banking transformation ratio (loans/deposits) was 78% at year-end 2022, highlighting the high degree of liquidity in the banking sector, limiting the incentive to revise (raise) interest rates offered to customers.
3. At a European level, there is still no data for 2022 and the indicators published by Eurostat do not fully coincide with the data from Banco de Portugal. Comparative information for 2021 places Portugal, in terms of household net financial wealth, about 10 percentage points below the euro area. Based on Eurostat data, Portugal's net financial wealth in 2021 represented 153% of GDP, which compares with 183% for the euro area as a whole, 161% in Germany, 197% in France, 243% in Italy and 165% in Spain.

Annual change in household financial assets
(Millions of Euros)



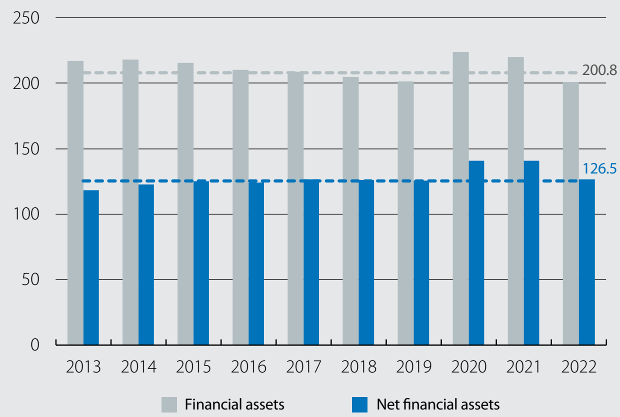
Source: *BPI Research, based on data from Banco de Portugal.*

Structure of household financial wealth
(% of total)



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

Household financial assets
(% of GDP)



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

Activity and employment indicators

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

	2021	2022	Q3 2022	Q4 2022	Q1 2023	Q2 2023	04/23	05/23	06/23
Coincident economic activity index	3.4	5.8	5.2	4.4	4.5	...	5.0	5.2	...
Industry									
Industrial production index	4.5	0.4	1.8	–0.3	1.0	...	–6.9	–4.5	...
Confidence indicator in industry *(value)*	–5.3	–3.4	–4.8	–6.3	–5.0	–5.6	–3.7	–5.5	–7.7
Construction									
Building permits - new housing (number of homes)	13.5	6.2	–3.2	13.5	7.6	...	–6.0	...	...
House sales	20.5	1.3	–2.8	–16.0	–20.8	...	–	–	–
House prices *(euro / m² - valuation)*	8.6	13.8	15.8	13.6	12.9	...	10.0	9.4	...
Services									
Foreign tourists *(cumulative over 12 months)*	51.5	158.6	244.4	158.6	116.9	...	89.0	67.4	...
Confidence indicator in services *(value)*	0.1	15.1	16.9	9.9	11.1	13.4	15.9	12.7	11.7
Consumption									
Retail sales	4.9	4.8	3.3	0.0	1.7	...	2.4	3.0	...
Coincident indicator for private consumption	4.9	4.1	2.8	2.1	3.0	...	4.0	4.5	...
Consumer confidence index *(value)*	–17.2	–29.7	–31.8	–37.0	–35.1	–29.4	–31.7	–29.8	–26.8
Labour market									
Employment	2.8	2.0	1.1	0.5	0.5	...	1.0	1.3	...
Unemployment rate (% *labour force*)	6.6	6.0	5.8	6.5	7.2	...	6.5	6.4	...
GDP	**5.5**	**6.7**	**4.8**	**3.2**	**2.5**	**...**	**–**	**–**	**–**

Prices

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

	2021	2022	Q3 2022	Q4 2022	Q1 2023	Q2 2023	04/23	05/23	06/23
General	1.3	7.8	9.1	9.9	8.0	4.8	5.7	4.0	3.4
Core	0.8	5.6	6.5	7.2	7.1	6.0	6.6	5.4	5.2

Foreign sector

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

	2021	2022	Q3 2022	Q4 2022	Q1 2023	Q2 2023	04/23	05/23	06/23
Trade of goods									
Exports *(year-on-year change, cumulative over 12 months)*	18.3	22.9	22.7	22.9	21.5	...	19.6	...	...
Imports *(year-on-year change, cumulative over 12 months)*	22.0	31.4	35.2	31.4	24.4	...	21.3	...	...
Current balance	**–1.6**	**–3.2**	**–4.2**	**–3.2**	**–1.1**	**...**	**–0.9**	**...**	**...**
Goods and services	–5.5	–4.9	–5.3	–4.9	–2.9	...	–2.3	...	...
Primary and secondary income	3.9	1.7	1.1	1.7	1.8	...	1.4	...	...
Net lending (+) / borrowing (–) capacity	**2.1**	**–1.1**	**–1.9**	**–1.1**	**1.5**	**...**	**1.6**	**...**	**...**

Credit and deposits in non-financial sectors

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

	2021	2022	Q3 2022	Q4 2022	Q1 2023	Q2 2023	04/23	05/23	06/23
Deposits [1]									
Household and company deposits	9.3	6.4	7.8	6.4	0.5	...	–0.8	–1.6	...
Sight and savings	16.3	7.3	11.2	7.3	–3.1	...	–5.0	–6.6	...
Term and notice	1.2	5.2	3.3	5.2	5.4	...	5.1	5.3	...
General government deposits	–4.1	12.4	–0.1	12.4	11.1	...	21.3	26.0	...
TOTAL	**9.0**	**6.5**	**7.5**	**6.5**	**0.8**	**...**	**–0.2**	**–0.9**	**...**
Outstanding balance of credit [1]									
Private sector	2.9	1.8	2.3	1.8	0.0	...	–0.6	–1.1	...
Non-financial firms	2.2	–0.4	0.1	–0.4	–2.1	...	–3.0	–3.7	...
Households - housing	3.3	3.2	3.8	3.2	1.5	...	1.1	0.5	...
Households - other purposes	3.0	2.9	3.3	2.9	0.0	...	–0.2	0.1	...
General government	3.8	–2.7	–1.5	–2.7	–2.0	...	–2.0	–1.5	...
TOTAL	**2.9**	**1.6**	**2.2**	**1.6**	**–0.1**	**...**	**–0.7**	**–1.1**	**...**
NPL ratio *(%)* [2]	**3.7**	**3.0**	**3.2**	**3.0**	**3.1**	**...**	**–**	**–**	**–**

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

The Spanish economy performs better than expected and than previously estimated

The National Statistics Institute has slightly revised up its GDP growth figure for Q1 2023, now placing it at 0.6% quarter-on-quarter, 0.1 pps higher than initially estimated. The figures for some quarters of 2022 have also been revised, although growth for the year as a whole has not changed (5.5%): while the fall in GDP in Q1 2022 was deeper (–0.5% quarter-on-quarter) than previously announced, the subsequent recovery was also greater, with strong growth in Q2 2022 (2.6%) and Q4 2022 (0.5%). With this new data, by Q1 GDP would have already exceeded the pre-pandemic level (Q4 2019), standing 0.1% higher, rather than 0.2% lower as originally estimated.

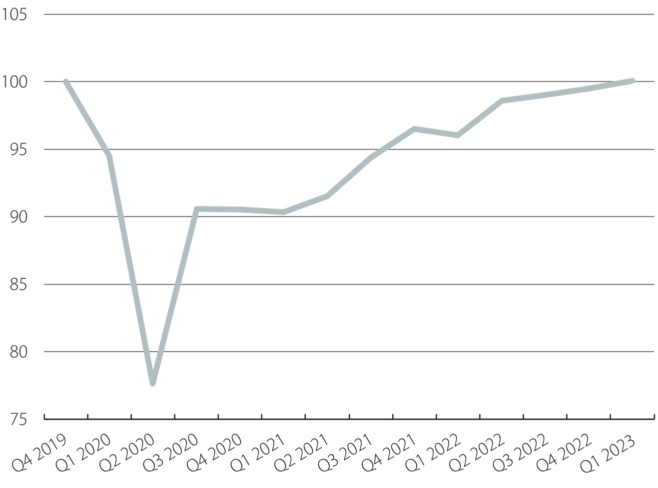
By component, the improvement in GDP in Q1 came exclusively from imports, the growth of which has been revised downwards, thereby increasing the contribution of net foreign demand to GDP growth. Indeed, the foreign sector is playing a key role in compensating for sluggish domestic demand, which is hampered by the impact of inflation and tighter financial conditions, although we can expect its positive contribution to GDP growth to be gradually diminished.

The indicators for Q2 offer mixed signals and point to a slight loss of buoyancy. Overall, the indicator scoreboard suggests that the economy continues to grow, but at a more moderate rate than in the previous quarter. On the one hand, industry is showing new signs of weakness. These include the decline in the manufacturing sector's Purchasing Managers' Index (PMI) to 48.0 in June, which is below the level that delimits expansionary territory (50) and marks a six-month low, and the fall in industrial production in April-May (–0.5% versus Q1). Also, household consumption continues to weaken, as shown by CaixaBank Research's consumption tracker, which notes 5% year-on-year growth in Spanish card transactions in Q2 (with data up to 21 June), falling short of the previous quarter (9%).

On the upside, the services PMI remains well above the growth threshold, standing at 53.4 in June. In addition, the tourism sector continues to show signs of strength, which leads us to anticipate a very good summer season: arrivals of foreign tourists in May exceeded 8.2 million, 3.8% above the same month in 2019 (+1.2% in April and –3.5% in Q1 2023), and the expenditure of these tourists was close to 8,500 million euros, exceeding the figure for May 2019 by 19.5%.

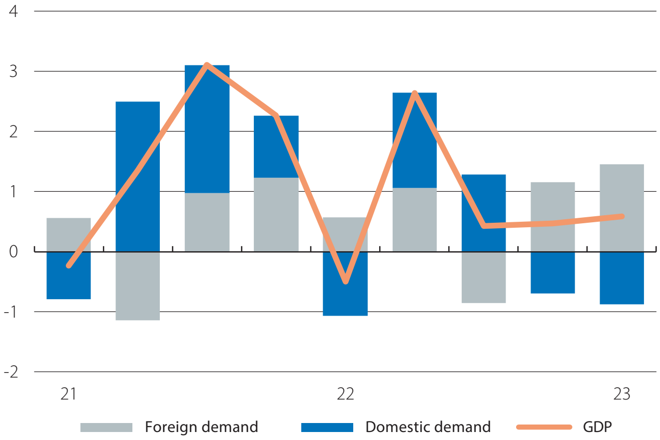
The labour market continues to perform well, although job creation is weakening. In June, the average number of workers affiliated with Social Security increased by 54,541 people, marking the weakest figure in that month since 2015. It also stands in stark contrast to the figure for June 2022 (115,000) and to the average for the month during the period 2014-2019 (74,000). In seasonally adjusted terms, employment registered a fall of 20,119 affiliates, the first decline since July last year; however, in Q2 as a whole,

Spain: GDP
Index (100 = Q4 2019)



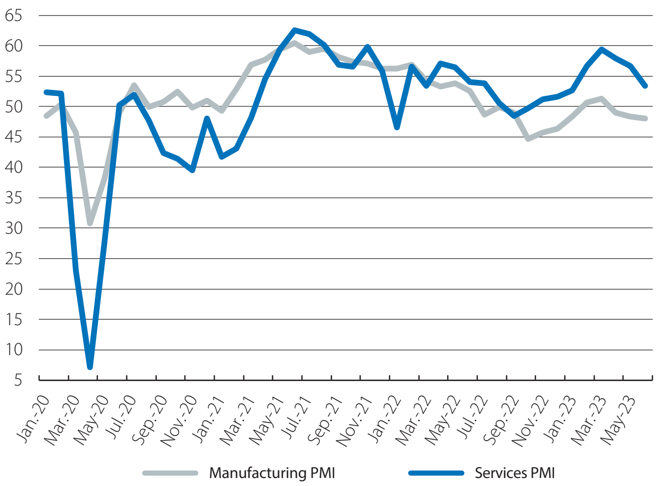
Source: *BPI Research, based on data from the National Statistics Institute.*

Spain: contribution to quarterly GDP growth
(pps)



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

Spain: PMI
Level



Source: *BPI Research, based on data from S&P Global.*

effective employment (seasonally adjusted affiliates not on furlough) grew by 1.4% quarter-on-quarter compared to 0.9% in the previous quarter.

Inflation continues to moderate, and no longer just because of the energy component: the flash estimate for June inflation of 1.9% (3.2% in May) marks the lowest since March 2021 and was a positive surprise compared to our forecasts, mainly due to a greater than expected base effect in the energy 1component. Core inflation (excluding energy and unprocessed food), meanwhile, continued to ease, albeit at a more moderate pace than the headline indicator, standing at 5.9% (6.1% in May). Based on these figures, and in the absence of the breakdown by component, we see downside risks to our 2023 headline inflation forecast (3.9% for the year); the forecast for core inflation (6.2% for the year) also presents downside risks, albeit relatively more moderate ones.

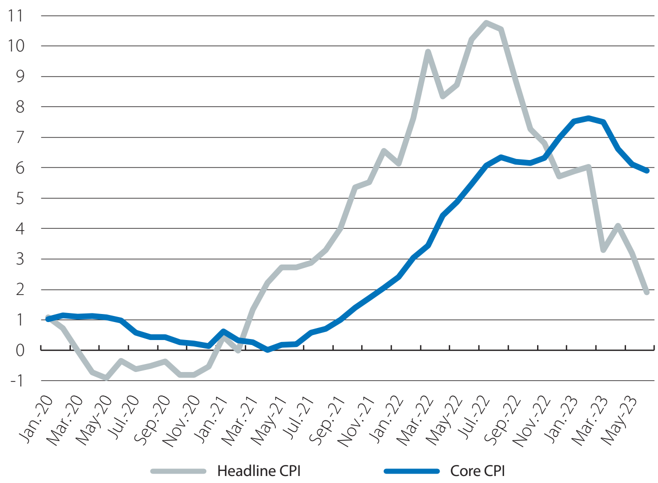
The inflation gap between Spain and the euro area has been in Spain's favour since September 2022. In June, with provisional data, the harmonised indicator for headline inflation (comparable with Europe) in Spain stood at 1.6%, 3.9 pps below the euro area average.

In the housing market, despite the fall in sales, the slowdown in prices is proving gentler than expected. Home sales fell by 3.4% in the first four months compared to the same period last year, while prices, according to the National Statistics Institute's index, provided an upside surprise in Q1 2023 by growing 0.6% compared to the previous quarter (–0.8% in Q4 2022). This price resistance is more evident in the case of new housing (3.0% quarter-on-quarter) than in existing homes (0.2%), reflecting the shortage of new construction projects.

Spain's foreign balance continues to show excellent figures. The current account balance registered a surplus in the first four months of the year of 12,167 million euros, an all-time high for a first quarter and a stark contrast to the deficit recorded in the same period of 2022 (–4,627 million). On the one hand, the tourism sector continues to produce very positive data, with a cumulative surplus up until April of 16,080 million euros, the highest figure of the series in that period. On the other hand, the trade deficit moderated to 10,954 million euros (–21,811 million a year ago): the energy deficit fell to 11,640 million from 16,155 million in the same period of 2022 and the balance of non-energy goods registered a surplus of 687 million, compared to a deficit of 5,656 million last year.

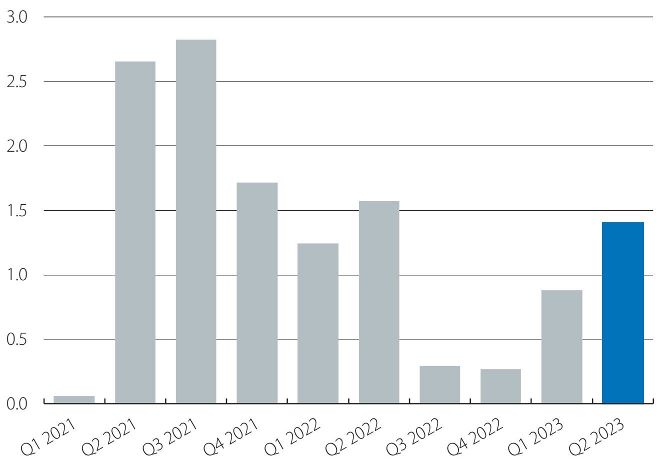
The boost from revenues facilitates the reduction of the public deficit in Q1. The consolidated general government deficit, excluding local government corporations, was 0.20% of GDP in the first three months of the year, down from the 0.35% registered in Q1 2019 and the 0.41% in the same period of 2022. Public revenues grew by a notable 9.3% year-on-year, driven by the strength of income and wealth tax collections as well as social security contributions. Expenditure, meanwhile, rose by 6.8% year-on-year, driven by an 8.5% increase in the social benefits component, which reflects the pension rise (8.5%) as well as the 5.5% increase in the total remuneration of public sector employees.

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



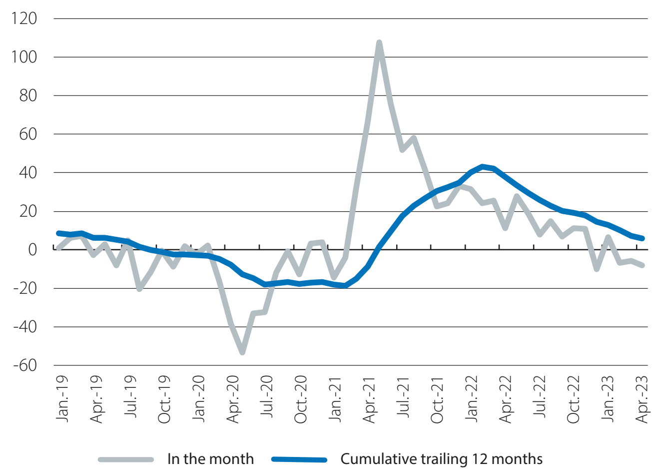
Source: *BPI Research, based on data from the National Statistics Institute.*

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



Note: *Seasonally adjusted series of the number of registered workers not on furlough.*
Source: *BPI Research, based on data from the Ministry of work, migration and social security (MITRAMISS).*

Spain: total home sales
Year-on-year change (%)



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

Are Spanish exports competitive?

In the last decade, the Spanish foreign sector has produced very good results and shown a remarkable resilience to numerous adverse economic events. The fact that the current account has remained positive for 11 consecutive years, even during the coronavirus pandemic, is proof of this. However, given the current context marked by a sharp rebound in inflation and the consequent increase in wage costs, it is worth analysing the evolution of the competitiveness indicators of the Spanish export sector.

Before we begin, we must first clarify that competitiveness is a concept with multiple facets. In this article, we will focus on analysing indicators related to the degree of competitiveness in price and costs, since the current operating environment has been affected by an energy crisis that has triggered a marked increase in companies' production costs. However, as already mentioned, this analysis will offer only a partial view of the competitiveness of our country's foreign sector, given that, although competitiveness in price and/or costs is important, there are other relevant factors which also play a part. These include elements such as the quality of the products and services being exported, or the degree of innovation they incorporate, to name just two. In any case, we will briefly analyse the evolution of the country's market share in exports, which after all are the result of the overall competitiveness of the economy.

Competitiveness in price/cost

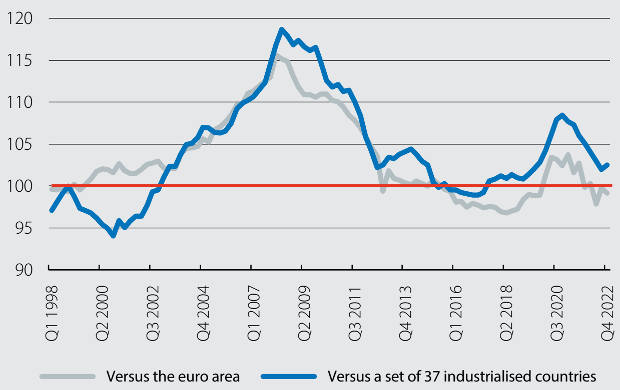
To measure cost competitiveness, we use the real effective exchange rate (REER). This measures the value of a currency against a weighted average of several foreign currencies corrected by a cost index. An increase in the REER implies that exports become more expensive and imports become cheaper; therefore, an increase indicates a loss of competitiveness in trade.

In the first chart, we show the evolution of the effective exchange rate, deflated using the unit labour costs (ULCs, which are the labour cost per unit of product) of Spain compared to those of the euro area and of a broader set of industrialised countries. Given that euro area countries share the same currency, the measure against the euro area corresponds to the ratio of Spain's ULCs versus a weighted average of euro area ULCs.

The competitiveness of the Spanish economy, as measured according to this index, suffered a sharp deterioration during the years leading up to the great recession. This deterioration was largely corrected during that downturn and the economy managed to maintain those gains throughout the expansionary period which lasted up until just before the outbreak of the pandemic in 2020. During the pandemic, there was a marked but temporary deterioration in competitiveness linked to the

Spain: real effective exchange rate based on unit labour costs

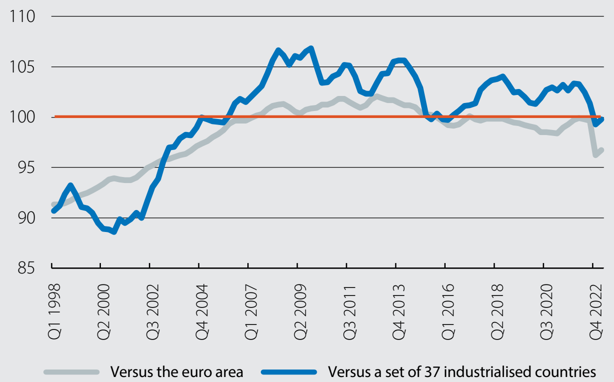
Index (100 = 2015)



Notes: *The 37 industrialised countries include the EU-27 plus Australia, Canada, the US, Japan, Norway, New Zealand, Mexico, Switzerland, the United Kingdom and Turkey. The measure relative to the euro area, which does not involve an exchange rate, corresponds instead to the ratio between unit labour costs in Spain versus those in the euro area.*
Source: *BPI Research, based on data from the Bank of Spain and Eurostat.*

Spain: real effective exchange rate based on the CPI

Index (100 = 2015)



Notes: *The 37 industrialised countries include the EU-27 plus Australia, Canada, the US, Japan, Norway, New Zealand, Mexico, Switzerland, the United Kingdom and Turkey. The measure relative to the euro area, which does not involve an exchange rate, corresponds instead to the ratio between inflation in Spain and that of the euro area. Both series have been smoothed by applying a seasonal adjustment.*
Source: *BPI Research, based on data from the Bank of Spain and Eurostat.*

fall in productivity, but this deterioration has been corrected practically in its entirety during 2021 and 2022. Overall, competitiveness measured using ULCs shows that Spain is in a similar situation to that which it experienced during the period 2014-2019. This was a very good period for our export sector, as demonstrated by the fact that the relative weight of exports of goods and services as a proportion of GDP went from around 26% in 2007 to close to 34% on average in the period 2014-2019 and to 42% in 2022.

In the second chart, we take another look at the evolution of the effective exchange rate, but this time deflated using the harmonised index of consumer prices (HICP). The previous measure, based on ULCs, allowed us to compare labour costs between countries, taking into account differences in productivity but ignoring other production costs, among other things. The measure based on inflation allows us to compare price levels between countries, but it is a price index based on the pattern of consumption, so the price of intermediate inputs in production processes is excluded from the calculation. In this case, the pattern in the effective exchange rate deflated using the HICP is particularly relevant, given the sharp rebound in inflation that has occurred in both Spain and the euro area since the end of 2021.

Once again, whether we compare it against the euro area or the broader sample of industrialised countries, in both cases we can see the marked deterioration in competitiveness during the first decade of the millennium. However, it is also apparent that since the great recession this deterioration has been gradually corrected, and this correction has not been altered by the recent inflation rally. In fact, in the most recent period characterised by inflation, Spain has seen an increase in its competitiveness compared to both the euro area as a whole and the industrialised countries analysed.

Competitiveness and export share

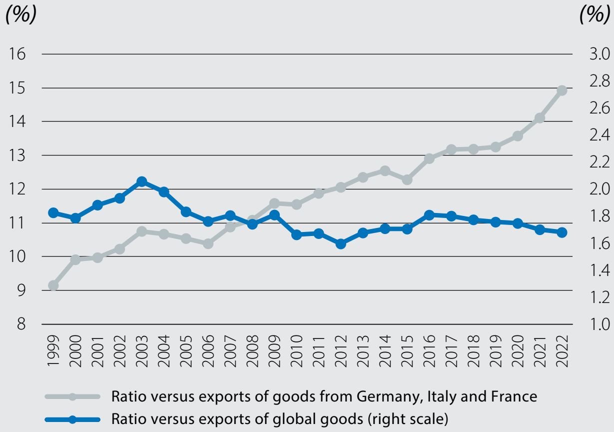
Finally, it is interesting to examine how Spanish exports of goods and services compare to the rest of the world in terms of total share, as this offers a more complete picture of Spain's competitiveness. This measure does not address the reasons why we can export, i.e. whether it is because we are competitive in costs or because we produce products with a high innovative component; rather, it summarises the result of this complex process that is selling abroad.

The third chart shows the evolution of exports of Spanish goods measured in terms of their percentage of the total exports of goods in the world, and as a percentage of the exports of Germany, France and Italy.

As can be seen, when we focus on the evolution of exports compared to our main competitors within the euro area, we see a very strong performance. Exports of Spanish goods have gone from representing around 10% of the exports of Germany, France and Italy in 2000-2007 to around 13% in 2014-2019, climbing to almost 15% in 2022. Nevertheless, when compared to the whole world, the pattern is much more restrained, with a very slight drop in Spain's share of exports.

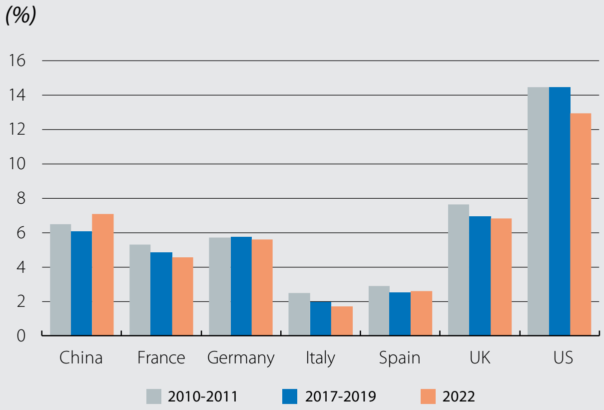
However, it is important to emphasise that behind this asymmetric behaviour is China's irruption in the export markets, having tripled its export share since the 1990s. This has been at the expense of most countries, which have seen substantial drops in their share of total global exports, including prominent exporters such as the US (from 12% between 1995 and 1999 to 8% between 2021 and 2022) and France (from 6% between 1995 and 1999

Ratio of exports of Spanish goods



Source: *BPI Research, based on data from the World Trade Organization.*

Share of service exports in the global total by country



Source: *BPI Research, based on data from the World Trade Organization.*

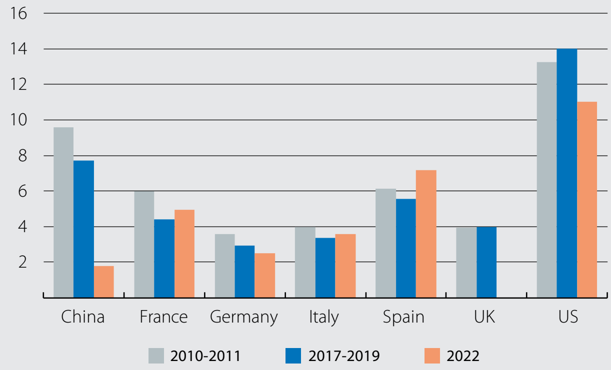
to just over 2% between 2021 and 2022). In this regard, the fact that Spain has managed to maintain a relatively stable share of global exports, at around 2%, and above its relative weight in terms of global GDP (around 1.5% on average between 2014 and 2019) for three consecutive decades is a hallmark of resilience.

As for the export share of services, we see a similar situation for Spain, which has kept its share stable at around 3% of global service exports. China has increased its share very slightly, capturing just over 7% of the market, while the United Kingdom and the US have lost a substantial portion of their share (–1 pp and –2 pps, respectively). France and Germany have remained relatively stable. It should be noted that the structure of the global services market is more balanced than that of goods in terms of competitors. For instance, while in goods China has practically 18% of the market compared to a combined 24% for France, Germany, Italy, Spain, the United Kingdom and the USA, in the case of services, China's share is reduced to 7% while that of the aforementioned group of countries rises to 34%.

Finally, we looked at tourism services, since Spain plays an especially important role globally in this sphere. While Spain's market share has always been well above the relative weight of its GDP in the world economy (around 6% versus approximately 1.5%), in 2022 its market share has risen significantly to reach 7% of the global market. The sharp fall in service exports from China also stands out, having gone from a share of tourism exports of around 8% prior to the pandemic to just 2% in 2022.

In conclusion, in this article we have reviewed the evolution of some competitiveness indicators for Spain's foreign sector. Based on the price/cost indicators reviewed, or the evolution of the share of our exports of goods and services in the global market, we see that the performance of our foreign sector underscores its strength despite the many adverse shocks of recent years. We expect our foreign sector to remain competitive in the coming years, although this does not mean that the growth of our exports will be immune to the effects of the economic slowdown in our trading partners as a result of the monetary policy tightening cycle that we are witnessing across many parts of the world.

Share of tourism service exports in the global total by country
(%)



Source: *BPI Research, based on data from the World Trade Organization.*

The changing composition of the immigrant population in recent years

The demographic dynamics of the Spanish population, in particular the inexorable ageing process and a very low birth rate, are leading to negative natural growth. Hence the vital importance of migratory flows for ensuring demographic sustainability and the level of employment: since the mid-1990s, the foreign population has been an increasingly important group, and this has helped with increasing and rejuvenating the total population and labour force.[1] According to the latest data from the LFS (Q1 2023), foreigners accounted for 12.1% of the total population (5.74 million) and 13.3% of all employment (over 2.7 million workers), compared to the 9.2% and 10.8%, respectively, which they represented in 2015.[2] In this article, we analyse the evolution of immigration flows in recent years, as well as possible changes in their geographical distribution and some of their socio-economic characteristics.

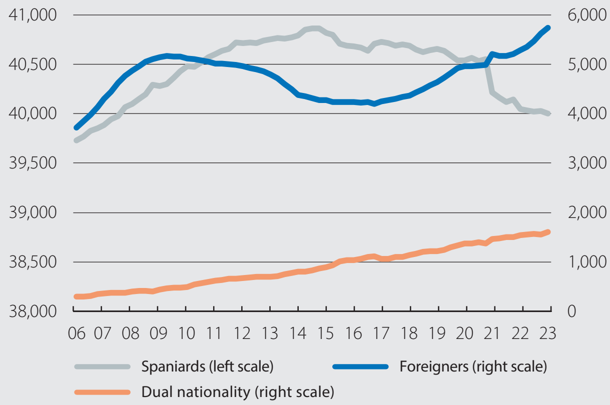
In mid-2015, the total population began to rise – a trend that was interrupted during the pandemic,[3] but which resumed in mid-2021. Since then, the rate of annual population growth has accelerated to 1.0% in Q1 2023 – a rate not seen since before the 2008 financial crisis. In all, the cumulative population growth since Q3 2015 comes to around 1.4 million people (+3.0%). This increase has been made possible by the growth of the foreign population, which is up by more than 1.5 million,[4] as well as those with dual nationality, up by 600,000. The population with only Spanish nationality, in contrast, has fallen by 709,200.

By region, the increase in the foreign population has been widespread, although four regions (Madrid, Catalonia, Valencia and Andalusia) stand out and account for two thirds of this total increase (almost a million more foreigners since Q3 2015). In these regions, except in Andalusia, the national population has also increased, making them the regions with the biggest total population growth in absolute terms (in relative terms, the Balearic Islands stand out, with an increase of 10.1%, followed by Madrid, the Canary Islands and Murcia). Thus,

1. It should be borne in mind that foreigners have a much higher activity rate than nationals: 69.3% compared to 56.4% in Q1 2023.
2. The analysis in this article is performed by comparing the latest data with Q3 2015, since that is when there is a shift in the population trend and it begins to rise.
3. Q1 2021 saw the biggest fall in the Spanish population series (–333,200 people), essentially due to the decrease in the number of births (the population under 15 years of age dropped by 294,000) and, to a lesser extent, to higher mortality among the older age groups, where COVID-19 had a greater impact.
4. The majority come from Latin America (921,000) and just 37,000 are citizens of EU countries.

Spain: population by nationality

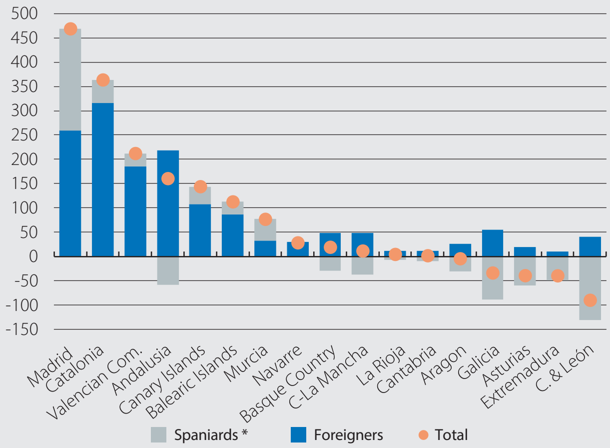
(Thousands) *(Thousands)*



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

Spain: population change by region from Q3 2015 to Q1 2023

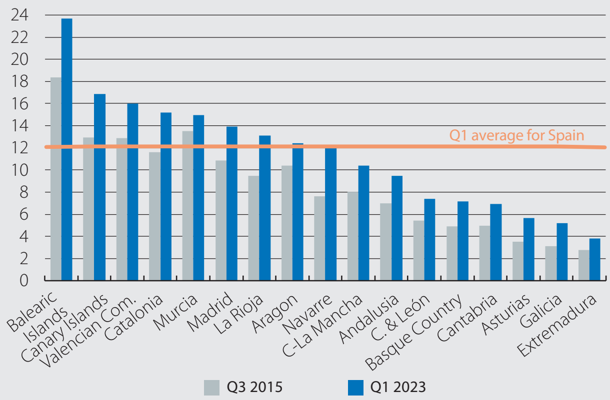
(Thousands)



Note: ** Includes those with dual nationality.*
Source: *BPI Research, based on data from the National Statistics Institute (LFS).*

Spain: relative weight of the foreign population by region

(%)



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

the foreign population has increased as a proportion of the total in all regions, especially in the archipelagos and Navarre (between 4 and 5 points); at the opposite end of the spectrum we find Murcia and Extremadura, where the growth has been below 2 points. Whereas in the Balearic Islands almost 24% of the population is foreign, the portion of foreigners in Extremadura is 20 points lower.

As for the distribution by age group, the growth of the total population since Q3 2015 has been concentrated in the older age groups, from 45 years and up (almost 2.9 million more), especially Spaniards (1.69 million) as a result of the ageing of the baby boomers. In contrast, there is a sharp fall in the population from 25 to 44 years of age (–1.62 million), where the increase in foreigners has been insufficient to offset the sharp decline in nationals (of more than two million). In general, the foreign population has increased in all age groups, but especially in the over-45 group (881,000). This pattern is partly driven by the high migratory flows that arrived in the early 2000s and reflects the fact that the ageing of the population is also affecting foreigners, albeit to a lesser degree than in the case of nationals.

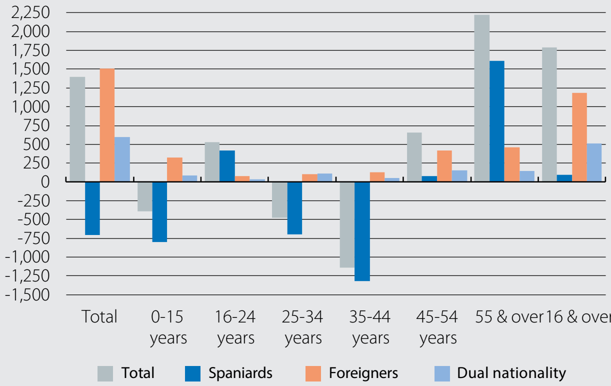
As a result of all this, there has been an increase in the relative weight of the foreign population in all age groups in recent years, especially in the youngest category (under 15 years) and in the 45 to 54 age group (13.4% vs. 8.7%). In the case of the former, foreigners account for 11.9% of all those under 15 years of age, which is 5 points more than in Q3 2015, reflecting both the younger age of the individuals arriving in our country and their higher birth rate. In the group aged 25 to 44, the growth has been somewhat lower, but foreigners now represent around 20% of the total. On the other hand, those over 55 years of age accounted for 6.3% of the population (4.0% in Q3 2015).

As far as the education level of foreigners is concerned, it is actually higher than is often believed. While it is true that the least educated individuals (with incomplete primary studies or no studies) make up a larger portion of the foreign population than among Spaniards (7.3% of those over 16 years of age vs. 5.1%) and those with higher education are proportionally fewer (23.7% vs. 34.1%), foreigners with secondary education make up the group that has grown the most in recent years: since Q3 2015 their numbers have increased by 751,000 (+35.9% vs. 3.9% for Spaniards) to represent 58.1% of the total, exceeding the figure of 2015 (56.8%) as well as that corresponding to Spanish citizens (49.7%).

As for the jobs performed by foreigners, in recent years we have seen a widespread increase in the relative weight of these workers across the board, although

Spain: population change by age group from Q3 2015 to Q1 2023

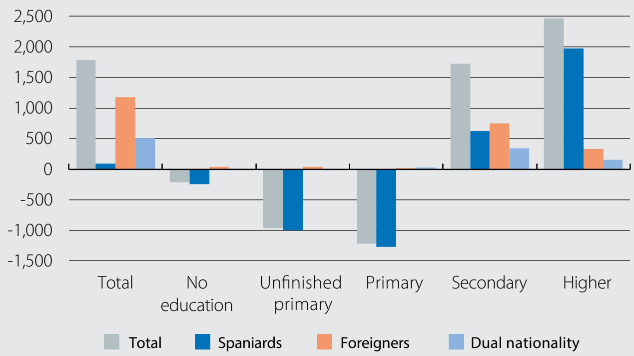
(Thousands)



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

Spain: change in the 16 & over population by nationality and education level (Q3 2015–Q1 2023)

(Thousands)



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

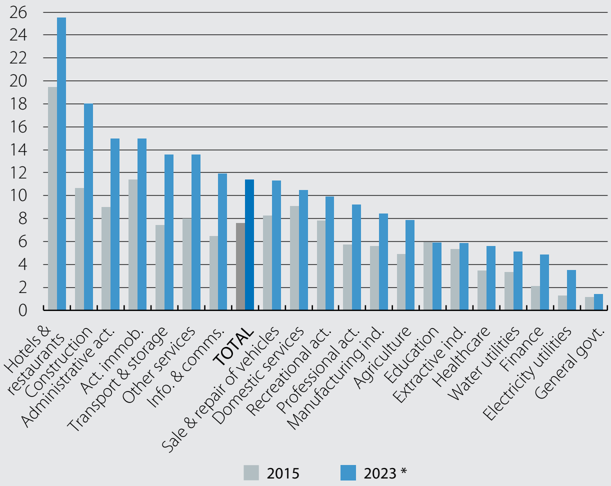
their presence is greater in elementary occupations and jobs with lower skills requirements. For example, in terms of Social Security affiliates, more than 25% of those employed in the hotel and restaurant industry and 18% in construction are foreigners, whereas in 2015 these percentages stood at 19.5% and 10.6%, respectively; in transport and storage there has also been a significant increase, going from 7.4% to 13.6%. At the other end of the scale, the role of foreigners is less relevant in the industrial branches of the economy, including extractive industries (5.9% vs. 5.3%) and manufacturing (8.4% vs. 5.6%).

The fact that the presence of foreign workers is greater at low qualification levels may indicate a certain over-qualification. This phenomenon, while not exclusive to foreign workers, is somewhat more pronounced among this group compared to Spaniards: on the one hand, the presence of foreign workers with higher education in elementary occupations is almost seven times higher

(12% vs. 1.8% for Spaniards);[5] on the other hand, a study by the National Statistics Institute[6] reveals that more than half of foreign workers (51.1%) – a percentage which rises to 57.5% in the case of Latin American citizens and is reduced to 46.9% for Spaniards – considers that they could perform more skilled tasks given their level of education, experience or training.

In the coming years, the ageing of the population will continue to determine the evolution of the labour supply; moreover, this process will accelerate in Spain and will be more intense than in the rest of the EU: the latest demographic projections by the National Statistics Institute suggest that the dependency ratio (the population aged 65 and above relative to the population aged between 16 and 64 years) will increase from 31% in 2021 to around 54% by 2050. In this situation with a reduced labour supply, migratory flows will play an essential role in maintaining the workforce. The National Statistics Institute itself forecasts that in the period 2030-2050 net annual inflows will be around 250,000 people (compared to less than 150,000 in 2021).

Spain: relative weight of foreign workers registered with Social Security by sector
(% of the total)



Notes: *Average number of workers affiliated with the General Scheme and the Special Scheme of Self-employed Workers.*
** May.*
Source: *BPI Research, based on data from the Ministry of Employment and Social Security.*

5. See Ministry of Inclusion, Social Security and Immigration (2022). «Informe sobre la integración de la población extranjera en el mercado laboral español» (content available in Spanish).
6. See National Statistics Institute (2015). Labour Force Survey. Module on the employment situation of immigrants, 2014.

New outlook for the Spanish real estate sector: slowdown in the housing market

The Spanish real estate market began to slow down in mid-2022 with the shift of direction of monetary policy. Although the ECB has raised benchmark interest rates by 4 pps for the moment, the pace of the slowdown has been gentler than anticipated, leading us to improve the sector's outlook for 2023. Nevertheless, we continue to expect a significant slowdown in the Spanish real estate market over the coming quarters, although a sharp market correction like the one experienced in 2008-2013 is unlikely.

A more moderate than expected decline in sales

In the current year to date, home sales have fallen by 3.4% year-on-year to 642,000 in April (trailing 12-month cumulative figure). The decrease is apparent in both the new-build segment (–4.0%) and in that of existing homes (–3.3%). Despite this decline compared to the exceptional levels reached in 2022 (650,000 sales), sales are still 16.7% above the same period in 2019.

Analysing the breakdown by type of buyer, purchases by foreign buyers are holding up considerably better than first and second-home purchases by Spaniards.[1] In particular, the number of purchases by foreigners fell by just 2.7% year-on-year in Q1 2023, compared to declines among Spanish buyers of –9.0% for second-home purchases and –12.1% for first-home purchases. In addition, this strength in sales among foreigners follows the significant rebound of 2022, when they grew by 30.7% compared to 6.4% growth for home sales as a whole. As a result, they now account for a much larger portion of total sales (19.5%, according to the Ministry of Transport, Mobility and Urban Agenda), and this is partly down to the fact that foreign buyers are less dependent on credit when purchasing property.

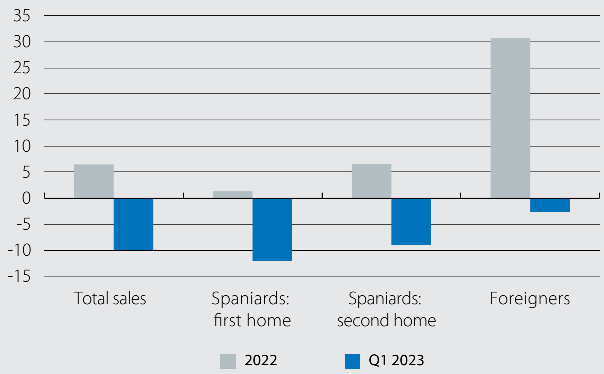
The housing supply struggles to take off

The housing supply remains very limited and insufficient to cover housing needs taking into account demographic trends. The number of construction permits for new homes (109,000 homes in the last 12 months to March) remains well below net household creation (241,000 in the last four quarters to Q1 2023, according to the LFS). It should be noted that the strength of household formation reflects significant immigration flows (the increase in the foreign population was 452,000 people in the cumulative four quarters to Q1 2023, according to

1. For the breakdown by type of buyer, we use data from the Ministry of Transport, Mobility and Urban Agenda. We consider that a buyer is purchasing a second home when the province where they reside differs from the home's location.

Spain: home sales by type of buyer

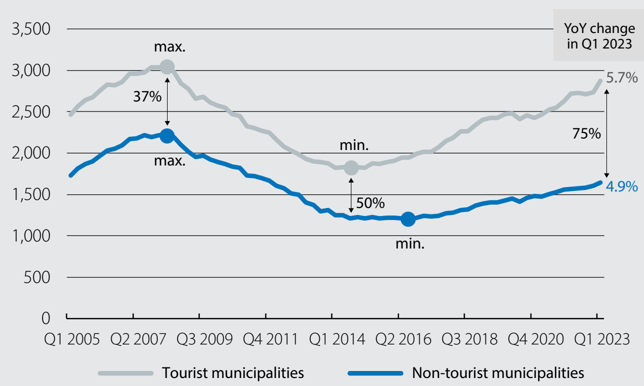
Change (%)



Source: *BPI Research, based on data from the Ministry of Transport, Mobility and Urban Agenda.*

Spain: housing prices in tourist and non-tourist municipalities

(Euros per m²)



Notes: *A municipality is classified as tourist (or non-tourist) if the percentage of spending registered with foreign cards on CaixaBank POS terminals was greater (or lower) than 10% of the total in 2019. The chart shows the average home price weighted by the number of inhabitants of each municipality. The percentages indicate the average price gap between the tourist municipalities and the rest.*

Source: *BPI Research, based on data from the Ministry of Transport, Mobility and Urban Agenda.*

the LFS) and this explains the high demand for housing in the areas of greater economic buoyancy. On the other hand, a key condition for determining supply is residential construction costs, which remain high despite showing signs of moderation. In particular, according to our projections (which take into account commodity futures prices on the international markets and our oil price projections in euros), residential construction costs in Spain could begin to decline in August and fall by around 5% on average in 2024 (in the absence of new shocks). Despite this decline, costs would still consolidate well above pre-shock levels (around 16% above the January 2021 level).

Housing prices remain resilient despite rising interest rates, especially for new housing

The greater resilience of demand, especially foreign demand, as well as the shortage in the supply of new housing and the high construction costs have been supporting home prices in recent quarters, despite the sharp rise in interest rates. The price of housing (according to the appraisal value published by the Ministry of Transport, Mobility and Urban Agenda) surged in Q1 2023 (2.2% quarter-on-quarter compared to 0.5% in Q4 2022), although in year-on-year terms it continued to register a slowdown (3.1% year-on-year compared to 3.3% in Q4 2022).

The second chart shows the evolution of housing prices in the municipalities classified as tourist and non-tourist areas based on the percentage of expenditure registered with foreign cards on CaixaBank POS terminals.[2] It can be seen that the average price of housing in tourist municipalities is higher than in non-tourist areas, and this gap has expanded to reach 75% today. In fact, the latest data corresponding to Q1 2023 show that the growth rate of housing prices is higher in tourist municipalities (5.7% year-on-year) than it is in the rest (4.9%). In fact, the average price of housing in tourist municipalities is very close to reaching a level similar to the previous high recorded in mid-2008, while in non-tourist areas it is still 26% below the peak.

Updated real estate sector forecasts for 2023 and 2024

The second half of this year will be key in determining the extent of the impact that the cumulative interest rate rises will have on the wider economy and, in particular, on the real estate sector. However, there are also several counterweight factors that will continue to support housing demand and prices, including a resilient labour market (we anticipate the creation of 390,000 jobs in 2023 and 270,000 in 2024 in terms of people in employment per the LFS), declining inflation (below 4% in 2023) and more dynamic wage growth (around 4%-5% in 2023, and around 3.5%-4% in 2024). In addition, high migration flows (the National Statistics Institute estimates that in 2023 and 2024 the foreign population will increase by some 490,000 people per year) will continue to sustain the demand for housing in areas with greater economic activity.

In terms of demand, we expect sales to decline considerably in the coming months, reaching around 500,000 in 2023 as a whole, a figure similar to that recorded in 2019 but 23% lower than that of 2022 (650,000). This forecast has recently been revised upwards (480,000 in the previous forecast)[3] due to the smaller than expected drop in sales in the first few months of the year. By segment, the biggest adjustment is expected to occur in sales of existing homes. In contrast, the number of new home purchases will remain in a similar range to the previous year (around 110,000 homes, in line with the number of new builds started in the last 12-18 months).

Similarly, we also revised our price forecast upwards due to the good figures for Q1. Specifically, we significantly improved the annual projection for 2023, from 0.2% to 2.9% (appraisal value per the Ministry of Transport, Mobility and Urban Agenda). Despite these upward revisions, it is important to note that they are due to the good performance observed to date and the short-term rigidity of prices to declines. Looking ahead to the coming quarters, in line with the weakening of demand and of the wider economy, we continue to expect a significant slowdown, as reflected in our 2024 forecast (1.1%).

Finally, the supply of housing will remain very limited (forecast of 90,000 construction permits in 2023), well short of net household creation. Faced with this combination of factors – cooling demand, legislative developments, structural problems in the sector and construction costs that remain high despite the recent moderation – we are unlikely to see a reversal of the current lack of housing supply in the coming quarters.

CaixaBank Research forecasts for the Spanish real estate sector

	2022	2023	2024
Housing prices (MITMA*), change (%)	5.0	2.9	1.1
Sales (thousands)	650	500	510
New construction permits (thousands)	109	90	105

Note: ** Ministry of Transport, Mobility and Urban Agenda.*
Source: *BPI Research.*

2. We classify municipalities as either tourist or non-tourist according to whether the spending registered with foreign cards on CaixaBank POS terminals was greater (or lower) than 10% of the total in 2019.

3. Forecast published in the Focus «Spanish real estate sector: 2022 recap and 2023 outlook» in the MR04/2023.

Activity and employment indicators

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

	2021	2022	Q2 2022	Q3 2022	Q4 2022	Q1 2023	04/23	05/23	06/23
Industry									
Industrial production index	8.8	2.8	4.4	4.6	0.8	1.4	–0.9	...	...
Indicator of confidence in industry *(value)*	0.6	–0.8	0.4	–5.1	–5.3	–4.4	–1.6	–5.4	–8.5
Manufacturing PMI *(value)*	57.0	51.0	53.2	49.2	45.6	50.1	49.0	48.4	48.0
Construction									
Building permits *(cumulative over 12 months)*	4.7	15.4	18.8	8.8	2.6	–1.9	0.1	...	...
House sales *(cumulative over 12 months)*	9.6	28.9	33.6	23.0	17.3	10.1	5.9	...	...
House prices	3.7	7.4	8.0	7.6	5.5	3.5	–	–	–
Services									
Foreign tourists *(cumulative over 12 months)*	64.7	129.8	312.5	208.8	129.8	...	...	...	...
Services PMI *(value)*	55.0	52.5	55.9	51.0	50.8	56.3	57.9	56.7	...
Consumption									
Retail sales	5.1	0.9	1.1	0.2	1.9	6.7	5.7	6.0	...
Car registrations	158.0	–3.0	–10.3	3.1	2.6	45.5	8.2	8.3	13.3
Consumer confidence index *(value)*	–12.9	–26.5	–27.0	–32.7	–28.1	–22.8	–20.3	–20.7	–16.5
Labour market									
Employment [1]	3.0	3.1	4.0	2.6	1.4	1.8	–	–	–
Unemployment rate (% labour force)	14.8	12.9	12.5	12.7	12.9	13.3	–	–	–
Registered as employed with Social Security [2]	2.5	3.9	4.8	3.5	2.7	2.5	3.0	2.9	2.6
GDP	**5.5**	**5.5**	**7.7**	**4.9**	**3.1**	**4.2**	–	–	–

Prices

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

	2021	2022	Q2 2022	Q3 2022	Q4 2022	Q1 2023	04/23	05/23	06/23
General	3.1	8.4	9.1	10.1	6.6	5.1	4.1	3.2	1.9
Core	0.8	5.1	4.9	6.2	6.5	7.6	6.6	6.1	5.9

Foreign sector

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

	2021	2022	Q2 2022	Q3 2022	Q4 2022	Q1 2023	04/23	05/23	06/23
Trade of goods									
Exports *(year-on-year change, cumulative over 12 months)*	21.2	22.9	22.2	23.3	22.9	20.5	18.0	...	...
Imports *(year-on-year change, cumulative over 12 months)*	24.8	33.4	35.2	38.1	33.4	24.0	19.5	...	...
Current balance	**11.5**	**7.3**	**7.8**	**6.1**	**7.3**	**21.5**	**24.0**	**...**	**...**
Goods and services	17.9	18.5	14.7	14.4	18.5	34.1	37.0	...	...
Primary and secondary income	–6.4	–11.2	–7.0	–8.3	–11.2	–12.6	–12.9	...	...
Net lending (+) / borrowing (–) capacity	**22.4**	**19.2**	**19.5**	**18.0**	**19.2**	**35.1**	**37.7**	**...**	**...**

Credit and deposits in non-financial sectors [3]

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

	2021	2022	Q2 2022	Q3 2022	Q4 2022	Q1 2023	04/23	05/23	06/23
Deposits									
Household and company deposits	6.1	4.9	5.4	5.3	3.8	1.7	...	...	...
Sight and savings	10.3	7.9	9.2	8.2	5.0	0.3	–2.6	–4.3	...
Term and notice	–24.4	–19.7	–25.4	–19.2	–7.3	7.7	27.7	38.6	...
General government deposits	15.5	9.6	15.6	6.6	–3.2	7.4	8.4	6.0	...
TOTAL	**6.7**	**5.2**	**6.0**	**5.4**	**3.2**	**2.1**	**...**	**...**	**...**
Outstanding balance of credit									
Private sector	0.3	0.7	0.8	1.3	0.5	–0.9	–1.9	–2.4	...
Non-financial firms	1.1	0.9	0.7	2.4	0.9	–1.0	–2.2	–2.8	...
Households - housing	0.2	1.0	1.4	1.1	0.2	–1.2	–2.1	–2.5	...
Households - other purposes	–1.2	–0.6	–0.5	–0.9	–0.1	–0.1	–0.4	–0.9	...
General government	15.3	0.2	1.9	–3.5	–1.1	–0.2	–4.5	–3.2	...
TOTAL	**1.1**	**0.7**	**0.9**	**1.0**	**0.4**	**–0.9**	**–2.1**	**–2.4**	**...**
NPL ratio (%) [4]	**4.3**	**3.5**	**4.1**	**3.8**	**3.7**	**3.5**	**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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