Spain and its territorial entities in 3Q2022: prepared for the slowdown, but Spain could avoid the recession

Macro perspectives for Spain and the Finances of its Regional Governments

3Q2022

BFF INSIGHTS

Note for the reader

The present document seeks to provide an overview of the performance of the Spanish economy during the third quarter of 2022, thus resting on BFF Banking Group's intention of promoting a broader and constructive debate on key market aspects that shape and impact the decision making of organizations

The assessment contained herein was produced by an external analyst for BFF Banking Group in September 2022 and it was built on available market statistics at time of reporting, which are under continuous updating.

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This Report has been originally written in Spanish. This is an English courtesy translation of the original document.

Author: Cristina Nogaledo Castaño
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PERSISTENCE OF HIGH INFLATION RATES ON A GLOBAL SCALE

The global economy continues to face major challenges, shaped by the lingering effects of three powerful forces: the Russian invasion of Ukraine, a cost-of-living crisis caused by persistent and rising inflationary pressures, and the slowdown in China.

The normalization of monetary and fiscal policies that provided unprecedented support during the pandemic is cooling demand as central bankers try to reduce inflation levels. But a growing share of economies are in a growth slowdown or contraction. The future health of the global economy critically depends on the successful calibration of monetary policy, the course of the war in Ukraine, and the possibility of further pandemic-related supply-side disruptions, for example, in China.

Global economic activity has continued to lose dynamism in the summer months, as a result of a series of adverse factors that interact with each other. The rise in world inflation has intensified to levels not seen in several decades, which is prompting a strong reaction from central banks, which, in turn, is giving rise to a tightening of financial conditions.

In addition, a very high portion of the acceleration in consumer prices is being determined, particularly in European countries, by the increase in the cost of many imported raw materials, **which is compressing the purchasing power of household income and non-financial companies.**

In turn, the rise in the price of numerous raw materials has been increased by the consequences of the war in Ukraine, which, additionally, has fueled uncertainty about the security of energy supply in Europe, and even about the possibility of produce a significant escalation of global geopolitical tensions.

The updated IMF estimates (October 2022, Figure 1) project that global growth will remain flat in 2022 at 3.2 percent vs the previous projection in July and will further slow to 2.7 percent in 2023, 0.2 percentage point lower than the July forecast, with a 25 percent chance that the global GDP growth could drop below 2 percent in 2023. More than a third of the world economy will contract this year or next, **while the three largest economies (the United States, the European Union and China) will remain stagnant.** In short, for the IMF the worst is yet to come.

The global economy continues to face major challenges, shaped by the lingering effects of three powerful forces: the Russian invasion of Ukraine, a cost-of-living crisis caused by persistent and rising inflationary pressures, and the slowdown in China.

FIGURE 1 **Updated growth forecasts by the IMF (October 2022)**

		Projections		Difference from July 2022 WEO Projections update 1/		Difference from April 2022 WEO 1	
	2021	**2022**	**2023**	**2022**	**2023**	**2022**	**2023**
World Output	6.0	3.2	2.7	0.0	-0.2	-0.4	-0.9
Advanced economies	5.2	2.4	1.1	-0.1	-0.3	-0.9	-1.3
United States	5.7	1.6	1.0	-0.7	0	-2.1	-1.3
Euro Area	5.2	3.1	0.5	0.5	-0.7	0.3	-1.8
Germany	2.6	1.5	-0.3	0.3	-1.1	-0.6	-3.0
France	6.8	2.5	0.7	0.2	-0.3	-0.4	-0.7
Italy	6.6	3.2	-0.2	0.2	-0.9	0.9	-1.9
Spain	5.1	4.3	1.2	0.3	-0.8	-0.5	-2.1
Japan	1.7	1.7	1.6	0.0	-0.1	-0.7	-0.7
United Kingdom 2/	7.4	3.6	0.3	0.4	-0.2	-0.1	-0.9
Canada	4.5	3.3	1.5	-0.1	-0.3	-0.6	-1.3
Other advanced economies 3/	5.3	2.8	2.3	-0.1	-0.4	-0.3	-0.7
Emerging markets and developing economies	6.6	3.7	3.7	0.1	-0.2	-0.1	-0.7
Emerging and developing Asia	7.2	4.4	4.9	-0.2	-0.1	-1.0	-0.7
China	8.1	3.2	4.4	-0.1	-0.2	-1.2	-0.7
India 4/	8.7	6.8	6.1	-0.6	0.0	-1.4	-0.8
ASEAN-5 5/	3.4	5.3	4.9	0.0	-0.2	0.0	-1.0
Emerging and developing Europe	6.8	0.0	0.6	1.4	-0.3	2.9	-0.7
Russia	4.7	-3.4	-2.3	2.6	1.2	5.1	0.0
Latin America and the Caribbean	6.9	3.5	1.7	0.5	-0.3	1.0	-0.8
Brazil	4.6	2.8	1.0	1.1	-0.1	2.0	-0.4
Mexico	4.8	2.1	1.2	-0.3	0.0	0.1	-1.3
Middle East and Central Asia	4.5	5.0	3.6	0.2	0.1	0.4	-0.1
Saudi Arabia	3.2	7.6	3.7	0.0	0.0	0.0	0.1
Sub-Saharan Africa	4.7	3.6	3.7	-0.2	-0.3	-0.2	-0.3
Nigeria	3.6	3.2	3.0	-0.2	-0.2	-0.2	-0.1
South Africa	4.9	2.1	1.1	-0.2	-0.3	0.2	-0.3
Memorandum							
World Growth Based on Market Exchange Rates	5.8	2.9	2.1	0.0	-0.8	-0.6	-1.0
European Union	5.4	3.2	0.7	0.4	-0.9	0.3	-1.8
Middle East and North Africa	4.1	5.0	3.6	0.1	0.2	0.0	0.0
Emerging market and Middle Income economies	6.8	3.6	3.6	0.1	-0.2	-0.2	-0.7
Low Income developing countries	4.1	4.8	4.9	-0.2	-0.3	0.2	-0.5
World Trade Volume (goods and services)	10.1	4.3	2.5	0.2	-0.7	-0.7	-1.9
Imports advanced economies	9.5	6.0	2.0	-0.2	-0.8	-0.1	-2.5
Imports emerging market and developing economies	11.8	2.4	3.0	1.3	-0.3	-1.5	-1.8
Exports advanced economies	8.7	4.2	2.5	-0.3	-1.0	-0.8	-2.2
Exports emerging market and developing economies	11.8	3.3	2.9	0.1	-0.4	-0.8	-0.7
Commodity prices (US dollars)							
Oil 6/	65.9	41.4	-12.9	-9.0	-0.6	-13.3	0.4
Nonfuel (average based on world commodity import weights)	26.3	7.3	-6.2	-2.8	-2.7	-4.1	-3.7
World consumer prices 7/	4.7	8.8	6.5	0.5	0.8	1.4	1.7
Advanced economies 8/	3.1	7.2	4.4	0.6	1.1	1.5	1.9
Emerging Market and Developing Economies 7/	5.9	9.9	8.1	0.4	0.8	1.2	1.6

Source: IMF. Note: Real effective exchange rates are assumed to remain constant at the levels prevailing during July 22, 2022-Ausgust 19, 2022. Economies are listed on the basis of economic size. The aggregated quaterly data are seasonally adjusted. WEO = World Economic Outlook. ***1/*** *Difference based on rounded figures for the current and July 2022 WEO forecasts. Countries whose forecasts have been updated relative to July 2022 WEO forecasts account for approximately 90 per cent of world GDP measured at purchasing-power-parity weights.* ***2/*** *See the country-specific note for the United Kingdom in the appendix WEO* ***3/*** *Excludes the Group of Seven (Canada, France, Germany, Italy, Japan, United Kingdom, United States) and euro area countries.* ***4/*** *For India, data and forecasts are presented on a fiscal year basis and GDP from 2011 onward is based on GDP at market prices with fiscal year 2011/12 as a base year.* ***5/*** *Indonesia, Malaysia, Philippines, Thailand, Vietnam.* ***6/*** *Simple average of prices of UK Brent, Dubai Fateh and West Texas Intermediate crude oil. The average price of oil in US dollars barrel was $69.42 in 2021; the assumed price,based on future markets, is $98.19 in 2022 and $ 85.52 in 2023.* ***7/*** *Excludes Venezuela, see the country specific notes in the appendix WEO.* ***8/*** *The inflation rates for 2022 and 2023, respectively, are as follows: 8.3 per cent and 5.7 per cent for the euro area, 2.0 per cent and 1.4 per cent for Japan, and 8.1 per cent and 3.5 per cent for the United States.*

The Russian invasion of Ukraine continues to powerfully destabilize the global economy. Beyond the increasing and senseless destruction of lives and livelihoods, it has led to a severe energy crisis in Europe that is dramatically increasing the cost of living and hampering economic activity. Gasoline prices in Europe have more than quadrupled since 2021, with Russia cutting gas deliveries to less than 20 percent of their 2021 levels, raising the prospect of power shortages through the coming winter and beyond. More broadly, the conflict has also pushed up food prices on world markets, despite the recent easing following the Black Sea grain deal, causing severe hardship for low-income households around the world. and especially in low-income countries.

A tightening of global financial conditions has been observed since September, due to the reaffirmation by the monetary authorities of the firmness of their commitment to fight inflation.

Since the end of August, **since the Fed's Jackson Hole symposium,** a tightening of global financial conditions has been observed. During August, the perception that central banks could choose, in light of the slowdown in activity, to moderate the pace of tightening monetary policies led to an increase in risk appetite, with increases in stock markets and a relaxation of interest rates. However, as of September, **the reaffirmation by the monetary authorities of the firmness of their commitment to fight inflation reversed these trends.** A relevant feature of the developments observed in the global financial markets is the generalized appreciation of the dollar, a development that may have relevant implications for other countries, such as the reinforcement of the rise in the price of raw materials, given that their international trade is usually denominated in the currency or the increased financial burden of agents indebted in that currency, as is common in many emerging economies.

Persistent and rising inflationary pressures have triggered a rapid and synchronized tightening of monetary conditions, coupled with a strong appreciation of the US dollar against most other currencies. Tighter global monetary and financial conditions will work their way through the economy, weighing on demand and helping to gradually subdue inflation.

So far, however, price pressures are proving to be more persistent than expected and a major source of concern for policymakers. We expect global inflation to peak at the end of 2022, but remain elevated for longer than expected, declining to 4.1 percent by 2024.

As of September, **there has been a notable deterioration in growth prospects in the United States, China and all the European economies** as a result of the cut in the supply of Russian gas and the uncertainty about the course of the war in Ukraine, as and as reflected in the most recent forecasts of the OECD and other public and private institutions. The downward revisions in the expected growth are notable in the case of Germany, which is remarkable given the close interrelations of this country with the rest of the European economies and, in particular, its weight in Spanish exports (approximately 10 % of merchandise exports and 11% of services exports in 2021).

Too much tightening risks pushing the world economy into an unnecessarily harsh recession. The cost of monetary policy errors is not symmetric.

In the United States, headline inflation moderated slightly in July and August, although the annual growth rate of prices remained above 8% in this period and underlying inflationary pressures accelerated to 6.3% in August. Among the rest of the advanced economies, inflation rates have recently risen in the United Kingdom, to 8.6% in August, with the expectation of further increases in the coming months, in Japan, to 3%, if well with core inflation still relatively contained, at 1.6% and in the EMU from 8.6% in June to 10% in September, with countries like Germany with an inflation rate close to 11% and 17% in Holland.

This increase in inflation, higher than expected, has been contributed by the rise in energy and food prices, mainly as a result of the war in Ukraine and the transfer of price increases in these products to the rest of the goods. and services in the consumer basket.

In China, **frequent lockdowns under its zero-COVID policy have hit the economy, especially in the second quarter of 2022.** In addition, the real estate sector, which accounts for about a fifth of economic activity in China, is rapidly weakening. Given the size of China's economy and its importance to global supply chains, this will weigh heavily on global trade and activity.

Mounting price pressures remain the most immediate threat to current and future prosperity by lowering real incomes and undermining macroeconomic stability.

Central banks around the world are now dead set on restoring price stability, and the pace of tightening has accelerated considerably. There are risks of both excessive tightening of monetary policy and insufficient. Tightening below what is necessary would further entrench the inflation process, erode the credibility of central banks and de-anchor inflation expectations. As history repeatedly teaches us, this would only increase the ultimate cost of controlling inflation.

On the other hand, **too much tightening risks pushing the world economy into an unnecessarily harsh recession.** Financial markets may also find it difficult to cope with too rapid a pace of adjustment. However, **the cost of these policy errors is not symmetric.** Misjudging the stubborn persistence of inflation once again could prove far more detrimental to future macroeconomic stability, by seriously undermining the hard-earned credibility of central banks.

As economies begin to slow and financial fragilities emerge, the case for a move to easier monetary conditions will inevitably grow stronger. When necessary, financial policy must ensure that markets remain stable, but central banks around the world must keep a steady hand with monetary policy firmly focused on controlling inflation.

These challenges do not imply that a major recession is inevitable. In many countries, including the United States, the United Kingdom, and the euro area, labor markets remain tight, with historically low unemployment rates and high levels of vacancies. The current environment, despite rapidly rising prices and wages, may still prevent a spiral of wages and prices, unless inflation expectations are unanchored.

In Spain, **inflationary pressures continue to be very high and generalized.** Although the HICP indicator shows a decrease in the general inflation rate of the Spanish economy in September, down to 9.0%, compared to August, in the third quarter as a whole the average rate of year-on-year increase in prices was slightly more than 1 pp above than the one observed in the previous quarter.

In this quarterly acceleration of inflation, in addition to energy, food and leisure services, hotels and tourism have played a prominent role. In this sense, **core inflation,** which excludes energy and food, **reached 4.8% in September.** The fact that, in September, more than 50% of the HICP items and more than 40% of the headings that make up core inflation registered year-on-year increases in prices above 4%, in January this year, these percentages were below 25% and 15%, respectively, reveals the widespread nature of current inflationary pressures in Spain.

In any case, the inflation rates in Spain would be even higher than the current ones were it not for some of the measures deployed by the authorities. In particular, the actions approved to contain the increase in the price of electricity would have contributed to reducing the rate of headline inflation in September by slightly more than 2 pp, with the contribution of the mechanism to limit the price of gas used in the generation of electricity slightly higher than 1 pp.

Looking ahead, the outlook for price developments has been revised upwards again, especially in the short term, to reflect the surprises that have already materialized and the intensification of some of the factors underlying the current inflationist pressures.

In any case, **medium-term inflation expectations seem to remain anchored around values compatible with the 2% target of the ECB's monetary policy** - although the former have picked up recently - and there are no apparent very pronounced wage pressures that could give rise to significant second-round effects on inflation.

Among the emerging economies, inflation remained contained in China, standing at 2.8% in September, while it fell slightly in Latin America, from 10.3% in June to 9.4% in August, mainly as a consequence of the evolution of prices in Brazil.

Risks to the outlook remain unusually high and to the downside. Monetary policy could be tightened more than necessary (or less than necessary) to reduce inflation. Monetary policy paths in the largest economies could continue to diverge, leading to further appreciation of the US dollar and cross-border

Risks to the outlook remain unusually high and to the downside in terms of GDP growth and to the upside regarding inflation dynamics.

tensions. More tension in energy and food prices could make inflation persist for longer. The global tightening of financial conditions could trigger a widespread debt problem in emerging markets.

The curtailment of gas supplies from Russia could depress output in Europe. A resurgence of COVID-19 or new variants could further dampen growth. A worsening of China's real estate crisis could spill over into the domestic banking sector and weigh heavily on the country's growth, with negative cross-border effects and geopolitical fragmentation could impede trade and capital flows, making co-operation on climate policy even more difficult. The balance of risks is firmly skewed to the downside, **with around a 25% chance that global growth will fall below 2.0% a year from now according to the IMF, in the 10th percentile among growth figures worldwide since 1970.**

2

EUROPE IS PARTICULARLY VULNERABLE IN THE CURRENT GEOPOLITICAL AND ECONOMIC BACKDROP

Europe is particularly exposed to some of the recent adverse developments. The vulnerability of the European continent to the war in Ukraine stems from its geographical proximity to the war scene and, especially, from its dependence on raw materials imported from Russia, and specifically gas, which is used as a primary energy source by households and companies, and also in the production of electricity.

We highlight the gradual improvement of bottlenecks and global supply chains, although the latter still continue to limit the normal development of activity and they are not expected to completely dissipate in the immediate short term.

The war has brought about ever-increasing disruptions to gas supplies, which Europe is coping with through several complementary ways, including geographical diversification of gas imports, use of limited short-term possibilities for the replacement of gas supplies by other energy sources and the reduction of consumption, all of which has resulted in a high use of gas storage capacity. However, **the actions carried out to date do not fully guarantee the absence of interruptions in gas supply during the coming winter,** especially in some Central European countries, which, in less favorable circumstances, could have severe effects on economic activity.

The impact of these factors has resulted in a **global downward revision in all geographical areas of the forecasts for economic growth.** Persistently high inflation rates, tighter financial conditions and prolonged supply distortions have led to a worsening of the short-term outlook. Beyond the most immediate quarters, the economic evolution depends crucially on the developments of the war in Ukraine.

An eventual improvement (as of today seems highly unlikely) of the uncertainty generated by the war should give rise to an improvement in activity, in a context in which some incipient signs are beginning to appear that the bottlenecks that have afflicted world production and transport could be starting to ease and that inflationary pressures could be reaching their peak, as indicated by the cheapening of most raw materials (after having reached very high price levels).

Regarding this last point, the recent cut approved by the OPEC+ group of two million barrels of oil per day may once again complicate the inflationary dynamic if the price of a barrel of oil, as some estimates begin to consider, **recovers or exceeds the $100 threshold.**

We highlight the gradual improvement of bottlenecks and global supply chains, although the latter still continue to limit the normal development of activity and they are not expected to completely dissipate in the immediate short term. In this sense, its future behavior will depend, among other aspects, on the evolution of the pandemic in China and the consequences, still uncertain, of the cutting off the supply of Russian gas to Europe.

Central Banks will continue tightening monetary policy

The trend is clear regarding the world central banks in the sense of maintaining or accelerating the normalization/tightening of their monetary policy. In a context of higher and more persistent inflation rates than estimated a few months ago, the main world central banks, both in advanced and emerging economies, have maintained or intensified their process of normalizing and tightening monetary policy.

Thus, for example, the US Federal Reserve raised its official interest rates by 75 basis points (bp) both at its July and September meetings, setting its target range at 3%-3.25% and it is expected a new increase of 75 bps at the next meeting on November 2 that would place them in the 3.75%-4% range. **The market manages a Fed terminal rate for this cycle in the range of 4.5-4.75%,** which would be reached between the first and second quarters of 2023.

In recent months, interest rate increases have also been significant by the European Central Bank (ECB), 50 bp in July and 75 bp in September, and another 75 bp is expected at the end of October meeting, while the Bank of England increased rates by 50 bp in both its meetings in August and September, up to 2.25, and a further hike of up to 100 bp could be in the cards in the next meeting amid an extremely volatile scenario that will hinge on who is elected as the next UK PM and the fiscal plans to be implemented by the new cabinet.

In addition, **in July the ECB approved the Transmission Protection Instrument (TPI),** which can be activated to counteract market dynamics that are not justified by economic fundamentals and that constitute a serious threat to transmission of monetary policy in the euro area as a whole.

Within the framework of these very generalized dynamics of tightening monetary policy, the most notable exceptions have been, among the developed economies, the Central Bank of Japan, which in its latest meetings has maintained the accommodative tone of its monetary policy unchanged, which would have contributed to the depreciation of its currency. Among the emerging economies, we would highlight the Central Bank of China, which in August reduced its main interest rates between 5 bp and 15 bp.

The tightening of monetary policy by central banks has increased volatility and yields in the rate market and has caused widespread declines in asset prices.

The tightening of monetary policy by central banks has increased volatility and yields in the rate market and has caused widespread declines in asset prices. In this context, the yields of long-term sovereign debt of higher credit quality are above the levels observed at the end of June.

Thus, for example, the yield on the ten-year sovereign bond in the United States has increased by around 120 bp, to 4.2%, while that of the equivalent German bond has increased by around 100 bp, to 2.4%. Moreover, throughout the third quarter, the long-term yield spread on European sovereign debt against the

German benchmark increased slightly in Spain, to 118 bp, and more sharply in Greece and Italy, to 272 bp and 240 bp, respectively.

As for the main world stock market indices, they show losses compared to the end of the second quarter, despite the revaluation experienced in July.

Furthermore, **in recent months the euro has continued to depreciate against the US dollar,** conditioned, among other factors, by expectations of a greater relative tightening of monetary policy in the United States, although it has appreciated against the pound.

3

SPAIN IS MORE RESILIENT TO THE DETERIORATION OF ECONOMIC ACTIVITY, BUT SIGNS OF LOSS OF DYNAMISM IN Q3 ARE EVIDENT

The removal of practically all the restrictions associated with the pandemic boosted household consumption above expectations, especially in leisure activities, restaurants and tourism, boosting GDP growth in the EU in the first half of 2022, **which has led to an upward revision of the average annual growth of GDP at the EU level expected for 2022,** but on the other hand, the disruptions in the supply of gas and the rise in its price and that of electricity, fundamentally, as a consequence of the evolution of the war in Ukraine, have increased uncertainty and have significantly eroded the purchasing power and confidence of households and companies, leading to a notable downward revision for 2023.

In Spain, signs of a loss of dynamism in economic activity have multiplied in recent months too, with 3Q22 QoQ GDP growth of 0.2%.

In Spain, signs of a loss of dynamism in economic activity have multiplied in recent months too. The lifting of most of the restrictions in the face of the pandemic, which had already boosted activity in the second quarter, has favored the continuation of the reactivation of international tourism in the summer months.

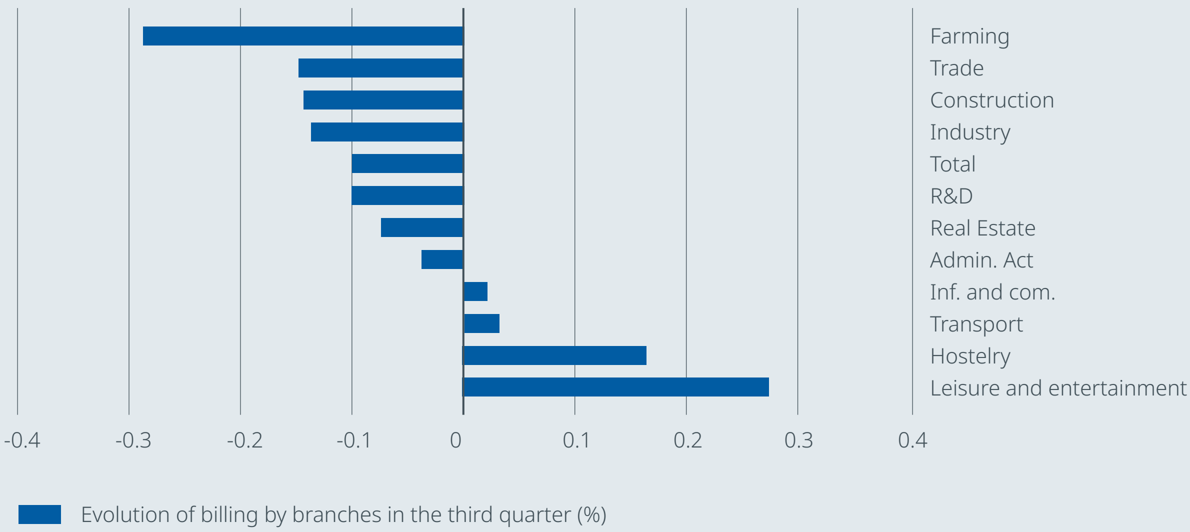
The slowdown in activity is already being observed and it is driven to the loss of purchasing power that has been experienced. Analyzing the latest trade dynamics (the prices of exports compared to those of imports), or the GDP deflator compared to consumption dynamics (the price of what we produce compared to what we consume), **an impoverishment is observed that will hardly be reversed short term.** This same scenario is faced by households and companies in the eurozone. Therefore, an adjustment is expected on the demand side throughout Europe, **which should reduce the contribution of exports to growth in Spain, in addition to containing the evolution of domestic consumption.**

It is possible that during the coming quarters there will be a stagnation or even a one-off intense drop in activity. The deterioration in the outlook has to do with the increasingly probable scarcity of some raw materials, the increase in their price and the translation that has been observed of this increase in the cost of production towards inflation. In addition, the financial burden of companies and families is expected to increase as the European Central Bank (ECB) advances in the withdrawal of monetary stimuli.

In addition, the rise in energy prices, which has been gradually spreading to a growing proportion of the goods and services in the household consumption basket, has reduced the purchasing power of these agents, which has translated into a weakening of the indicators that measure their spending. Likewise, the high cost of energy raw materials and insecurity regarding supply are affecting the production of the most electro-intensive industries.

As a whole, this decrease in industry and household income is also leading to a reduction in demand for the production of the rest of the branches. In any case, according to the latest edition of the Bank of Spain Survey on Economic Activity (EBAE), the deterioration in their activity perceived by companies in the third quarter of the year (Figure 2) **presents a notable heterogeneity by branch,** with a more favorable evolution in those that have benefited to a greater extent from the end of the restrictions associated with the pandemic, such as hospitality and leisure.

FIGURE 2 Evolution of business turnover by branches in the third quarter (%) (a)



Source: INE

(a) EBAE qualitative answers are translated to a numerical scale according to the following correspondence: significant decrease= -2, moderate decrease= -1, stability= 0, moderate increase=1, significant increase=2

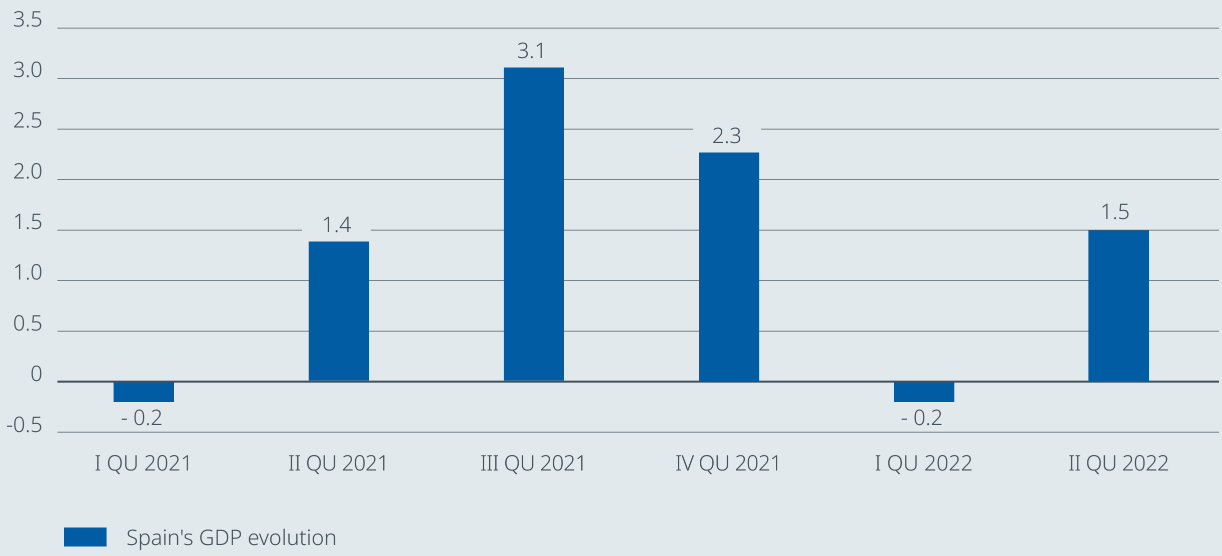
On the other hand, the central banks have decided to advance the increases in interest rates and, probably, raise the final level at which they expect to halt. As a consequence, the 12-month Euribor has risen by more than 250 basis points this year, which will increase the financial burden on the private sector. This could subtract around one point from GDP growth in household consumption during 2023. Moreover, the Government will also have to take into consideration that interest payments will begin to weigh down the improvement in the public deficit.

Various factors **would put downward pressure on the outlook for the growth rate of economic activity in the coming quarters.** In addition to the persistence of inflation, the reduction in agents' confidence and the maintenance of a high degree of uncertainty, all of which are highly influenced by the consequences of the current energy crisis and the armed conflict in Ukraine, it is likely that Inbound tourism loses some dynamism once the bulk of the demand dammed up after the pandemic has been satisfied.

Additionally, **a weakening of external demand** can be expected in a context of simultaneous tightening of monetary policy in numerous jurisdictions.

According to the latest information published by the National Institute of Statistics (INE), **in the second quarter the GDP of the Spanish economy grew by 1.5% quarter-on-quarter,** well above the 0.4% qoq anticipated by the consensus of analysts and also above the pace of growth that the GDP showed during the same period in the euro area as a whole and in some of its main economies.

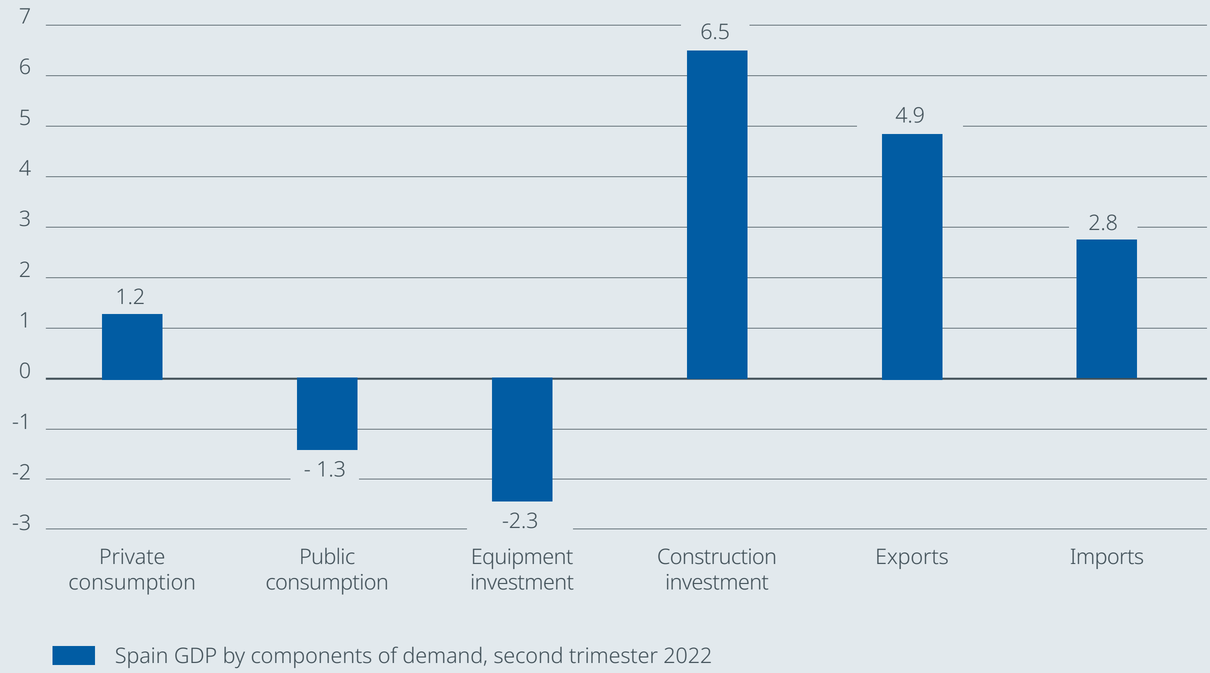
FIGURE 3 Quarter-on-quarter evolution of GDP in Spain (% qoq)



Source: INE

The Spanish GDP growth will gradually decelarate, to reach flat QoQ growth in 4Q22

FIGURE 4 Evolution by components of 2Q22 GDP in Spain (% qoq)



Source: INE

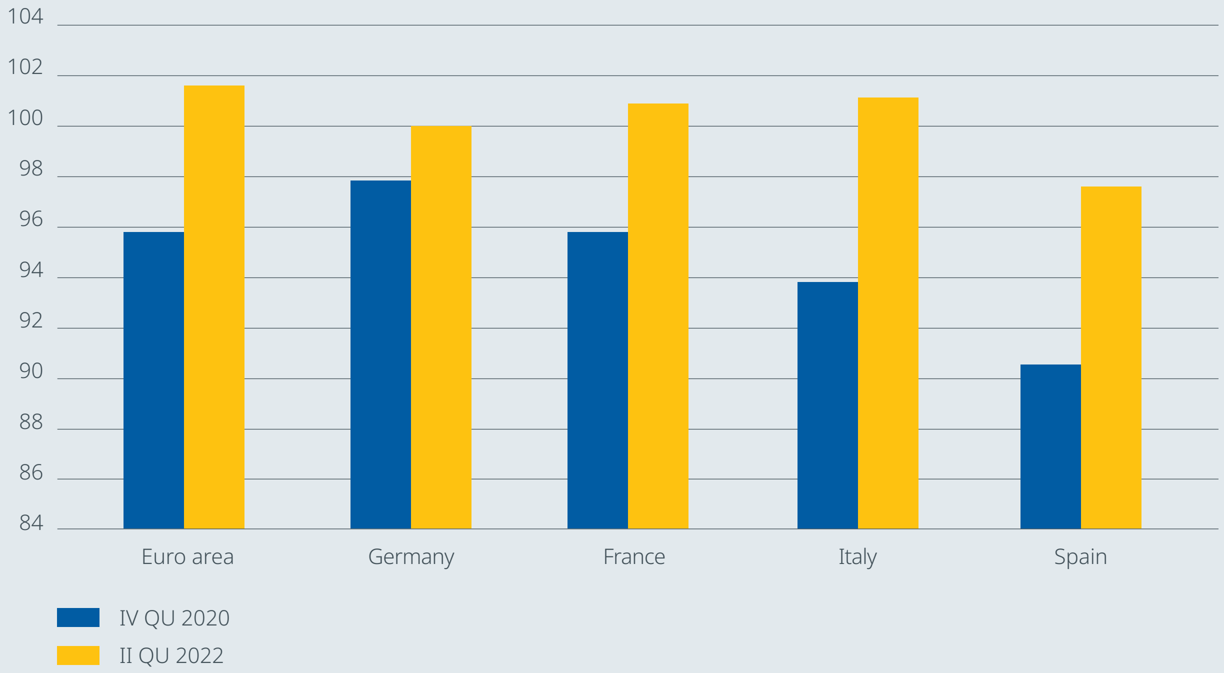
This growth was fundamentally supported by the dynamism of exports, **private consumption** (+3.1% qoq, Figure 3) and investment in construction. With regard to private consumption, among the factors that contributed to its dynamism were the positive effect of the vaccine and the elimination of restrictions on spending on services, both in hotels and recreational activities, despite the fact that sales of some durable goods, such as automobiles, have not recovered completely.

On the supply side, the greatest growth came from the market service activities, especially those linked to leisure and tourism.

With regard to the structure of external demand, an increase in total exports was confirmed, where it is worth highlighting the strong rebound in **consumption by non-residents** (29.3% qoq) which, if confirmed, would imply that the level of this item of demand would not only have recovered pre-crisis levels, but would also be at an all-time high.

Thus, the level of activity was 6.8% higher than that registered a year ago, and **2.2pp remain to reach the pre-crisis maximum reached in 4Q19** (Figure 5); despite this strong expansion of the GDP, on the other hand and in the euro area as a whole, the level of activity would already be almost 2 pp above that reference in the second quarter of the year.

FIGURE 5 Convergence of GDP with respect to pre-pandemic levels (4Q2019=100)



Source: INE

Under certain assumptions, about which there is a very high degree of uncertainty, economic activity could show greater dynamism from next spring. Specifically, throughout 2023 a progressive moderation of the prices of energy and food goods is contemplated in accordance with the paths of the futures markets, a very gradual mitigation of the bottlenecks and the economic consequences of the war in Ukraine, and a relatively contained pass-through of past cost and price increases to final product prices and wage claims. A greater relative deployment of investment projects associated with the **European Next Generation EU program** would also contribute to this economic reactivation in our country.

As we mentioned in the previous paragraphs, **the growth rate of the Spanish economy has slowed down significantly in the last three months.** In any case, a notable sectoral heterogeneity can be seen, since the activity branches most linked to tourism and leisure activities would have shown a relatively high growth in their business turnover in the third quarter, while in other activities, such as the industrial and agricultural, the companies would have registered decreases in their quarterly turnover. Other qualitative indicators, such as the PMIs, are also consistent with less buoyancy in activity during the third quarter, which would have been more evident in manufacturing than in services.

The rate of growth of registrations to the Social Security, whose strength had surprised on the rise during the first half of the year, also slowed down in the third quarter.

In the same way, **the rate of growth of registrations to the Social Security,** whose strength had surprised on the rise during the first half of the year, also slowed down in the third quarter. This moderation was quite generalized by activity, although the strong year-on-year growth in employment maintained by the service activities most associated with tourism stood out.

In addition, **the turnover of companies also slowed down,** according to the responses of these agents to the Bank of Spain Survey on Business Activity (EBAE). In any case, according to the results of the EBAE, the evolution of the activity would have presented a notable heterogeneity by sector. In particular, the activities that benefited the most from the end of the restrictions associated with the pandemic, such as hospitality and leisure, registered increases in turnover in the third quarter.

The rate of increase in consumption would have slowed down between June and September, in an environment marked by the rise in uncertainty, high inflation rates, the tightening of financing conditions and the deterioration of consumer confidence. **This slowdown in household spending would reflect, at least in part, a slowdown in the purchase of goods, especially durable goods.** Thus, for example, private vehicle registrations showed a notable drop between July and August.

On the other hand, various indicators of spending on services suggest that the path of recovery in spending on the hotel and catering industry would have continued in the third quarter, albeit at a lower rate than in the previous quarter, favored by the elimination of the restrictions associated with the pandemic.

Similarly, the greater uncertainty and the deterioration in the economic outlook have weighed on business investment in recent months. Several factors suggest that the buoyancy of business investment may have moderated over the course of the third quarter, even though there may have been some improvement in the severity of supply shortages.

In this sense, we highlight the declines suffered, until September, **by the industry confidence indicator,** as a reflection of greater uncertainty and the deterioration in the internal and global economic outlook.

Other factors that are contributing to the slowdown would be the **gradual tightening, already mentioned, in the financing conditions of companies,** in addition to the delay that would be occurring in the execution of investment projects associated with the European program Next Generation EU.

On the other hand, **investment in housing would also have lost dynamism in the third quarter,** in light of the increase in the cost of bank loans, the loss of dynamism in new construction permits and the cost increases in construction materials. This slowdown in housing investment is likely to continue into the remainder of 2022 and into the first quarters of 2023.

With regard to housing prices, these moderated their growth slightly in the second quarter, although they continued to show notable year-on-year increases, of 8% according to the INE, given the insufficiency of supply to meet a relatively vigorous demand.

International tourism has acted as a support for activity in the summer months, since the convergence of tourist activity towards pre-pandemic levels was more intense than expected, driven by the elimination of practically all restrictions on international mobility established in the phases of highest incidence of the disease.

The recovery of non-resident tourism was heterogeneous according to its geographical origin. Thus, European tourist arrivals in July were 7.1% below the level reached in 2019, while longer-distance tourist arrivals showed a more delayed convergence, especially in the case of Asian tourism. For its part, **nominal spending by non-resident tourists recovered to pre-pandemic levels throughout the summer,** despite the incomplete reactivation of tourist flows. This recovery reflected an increase in average daily spending caused, at least in part, by higher price levels and a longer average length of stay.

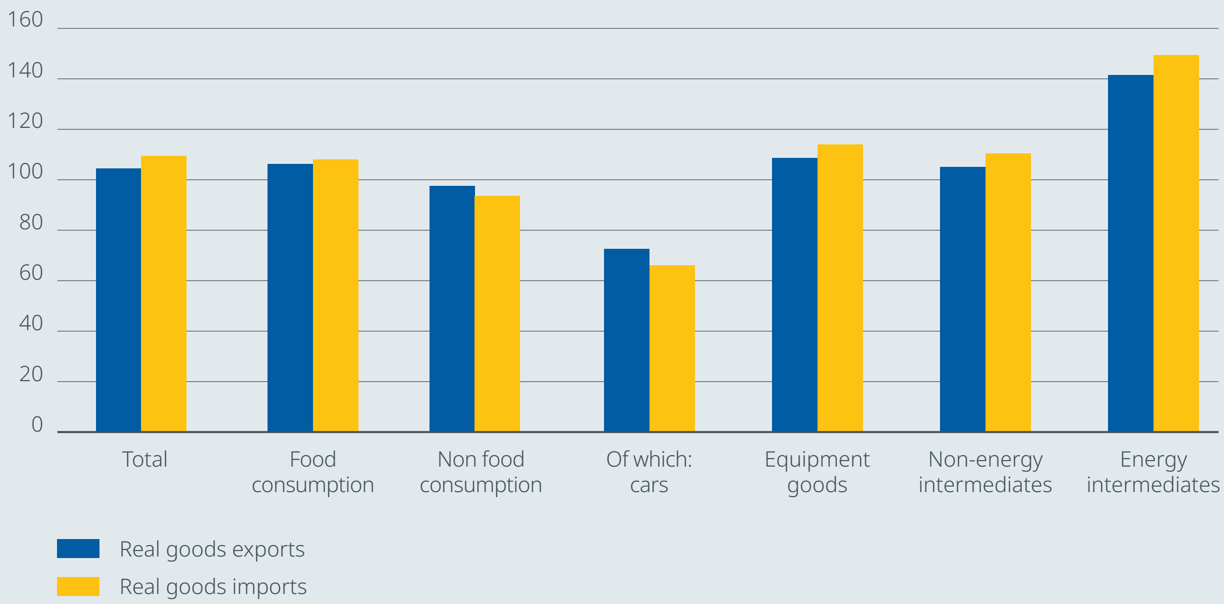
The consumption expenditure of non-residents in Spain is striking, as in the second quarter of 2022, would have been 16% higher than the level of three years ago. Given that, at the same time, a large part of Spaniards spent their holidays within the country, this would point to a level of capacity used at all-time highs in the tourism sector. Therefore, it is difficult to see how these numbers can be repeated in the following quarters, especially in a sector particularly affected by the pandemic, in which uncertainty would have affected investment.

A slowdown dynamic is also being observed in net exports of goods and services (Figures 6 and 7) despite global supply chains and the gains in competitiveness associated with the depreciation of the euro. Therefore, foreign transactions of non-tourism goods and services would have slowed down in the third quarter, in a context of downward revision of export markets.

International tourism will continue to support the economic activity in 2023, since the convergence of tourist activity towards pre-pandemic levels was more intense than expected, driven by the elimination of practically all restrictions on international mobility established in the phases of highest incidence of the disease.

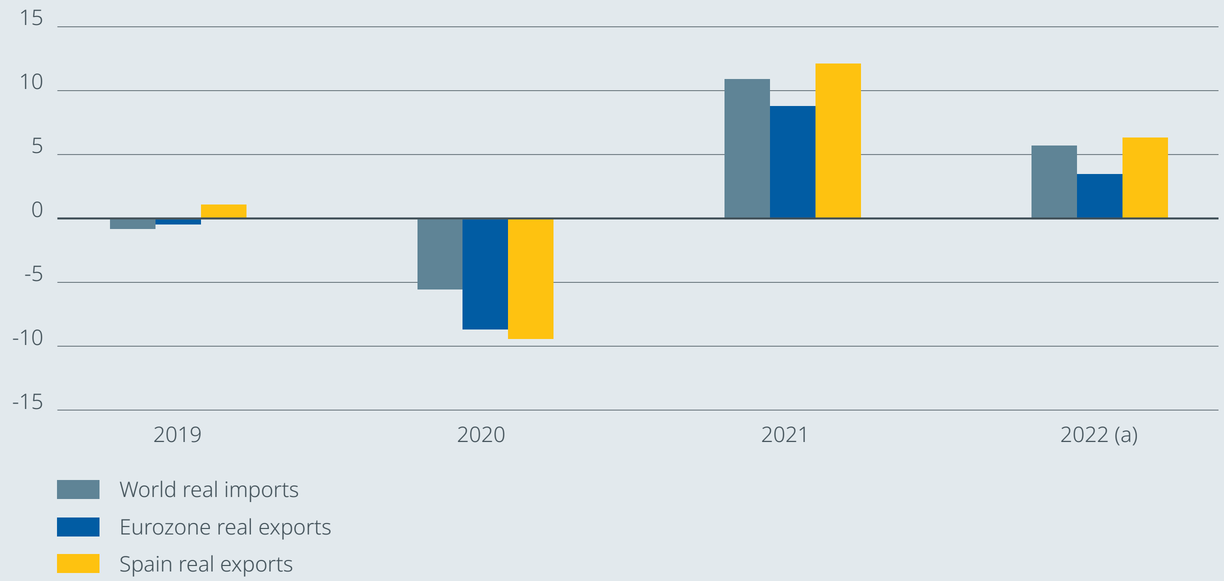
Spain is more resilient to the deterioration of economic activity, but signs of loss of dynamism in Q3 are evident

FIGURE 6 Real exports and imports of goods. January-July 2022 (in percentages over the same period in 2019)



Source: Bank of Spain

FIGURE 7 Evolution of trade in goods, in real terms (% interannual rate)



Source: Bank of Spain
(a) Variation rate for the January-July period 2022 over the same period of the previous year

In any case, in recent quarters real imports of goods have increased, driven by intermediate goods, both energy and non-energy, with greater intensity than exports, although the latter have maintained their world shares in real terms, with a somewhat more favorable performance than that shown by EMU sales.

For its part, up to July, the balance of goods with foreign countries has deteriorated significantly in nominal terms, registering a deficit of 4.5% of GDP in the accumulated 12 months, with a notable worsening of both the energy and non-energy components. energetic.

Consequently, we estimate that GDP growth in the third quarter of the year could have stood at **0.1% quarter-on-quarter.** By components of demand, the loss of strength in private consumption stands out, which is apparent from the weak tone of the most recent data on indicators, such as retail trade sales or private vehicle registrations, in a context in which, according to the European Commission indicator, consumer confidence has reached its lowest levels since 2013.

4

OUR MACRO SCENARIO FOR SPAIN IN 2022-2024

In short, the most recent monthly indicators for the Spanish economy point to a slowdown. Under these conditions, **after growing 4.5% this year, the GDP of the Spanish economy is expected to slow down to 1.4% in 2023 and resume greater dynamism in 2024, advancing 1.8%** (the Bank of Spain is much more optimistic about this with a growth forecast of 2.9%, Figure 8). The higher projected inflation rates, the less favorable financing conditions, the difficulties for companies in the branches most affected by the worsening of the energy crisis to carry out their activity, the increase in uncertainty and the weakening of global demand are factors which help to explain this notable downward revision of next year's GDP growth.

FIGURE 8 Bank of Spain: Macro projections of the Spanish economy in 2022-2024 (a). Annual variation rate (%)

	GDP				Harmonized index of consumer prices (HICP)				Harmonized index of consumer prices without energy and food				Unemployment rate (% active population) (b)			
	2021	**2022**	**2023**	**2024**	**2021**	**2022**	**2023**	**2024**	**2021**	**2022**	**2023**	**2024**	**2021**	**2022**	**2023**	**2024**
Oct-22	5.5	4.5	1.4	2.9	3.0	8.7	5.6	1.9	0.6	3.9	3.5	2.1	14.8	12.8	12.9	12.4
Jun-22	5.1	4.1	2.8	2.6	3.0	7.2	2.6	1.8	0.6	3.2	2.2	2.0	14.8	13.0	12.8	12.7

Source: Bank of Spain
Note: late published data of CNTR: second quarter of 2022
(a) Forecast closing date: 30th September 2022
(b) Annual average

FIGURE 9 Bank of Spain: Summary of macroeconomic projections for the Spanish economy 2022-2024

	2022	**2023**	**2024**
GDP	4.5% (+0.4 pp)	1.4% (-1.5 pp)	2.9% (+0.4 pp)
Inflation	8.7% (+1.5 pp)	5.6% (+3.1 pp)	1.9% (+0.1 pp)

Source: Bank of Spain

In general, **the consensus of analysts has revised growth for 2022 upwards,** which will exceed 4%, fundamentally as a result of a more intense increase in GDP in the second quarter of the year than was estimated in June. **The expected growth for 2023 has been revised slightly downwards,** due, among other factors, to higher projected inflation rates, less favorable financing conditions, increased uncertainty and weakening global demand.

After a growth of 4.5% this year, we estimate that the GDP of the Spanish economy will slow down to 1.4% in 2023 and resume more dynamism in 2024, advancing by 1.8%.

FIGURE 10 Projection of the main macromagnitudes of the Spanish economy. Annual variation rate (%) and % GDP

		October 2022 forecasts			June 2022 forecasts		
	2021	2022	2023	2024	2022	2023	2024
GDP	5.5	4.5	1.4	2.9	4.1	2.8	2.6
Private consumption	6.0	1.6	1.3	3.2	1.4	4.9	2.8
Public consumption	2.9	-1.5	0.0	0.9	-0.2	0.4	1.2
Gross fixed capital formation	0.9	4.7	1.7	2.6	6.5	2.1	2.4
Exports of goods and services	14.4	17.5	4.0	3.1	12.5	2.9	3.5
Imports of goods and services	13.9	8.2	3.1	2.4	7.0	4.0	3.1
National demand (contribution to growth)	5.2	1.1	0.9	2.5	2.1	3.2	2.4
Net external demand (contribution to growth)	0.3	3.4	0.5	0.4	2.0	-0.4	0.2
Nominal GDP	7.9	8.1	5.9	5.6	7.2	5.8	5.0
GDP deflactor	2.3	3.5	4.5	2.6	2.9	2.9	2.4
Harmonized index of consumer prices (HICP)	3.0	8.7	5.6	1.9	7.2	2.6	1.8
Harmonized index of consumer prices without energy and food	0.6	3.9	3.5	2.1	3.2	2.2	2.0
Employment (hours)	7.2	4.0	0.8	2.5	4.6	1.5	1.1
Unemployment rate (% active population) Annual average	14.8	12.8	12.9	12.4	13.0	12.8	12.7
Capacity (+) / Need (-) of financing of the country (GDP %)	1.9	2.6	2.7	3.4	3.1	3.2	3.0
Capacity (+) / Need (-) of financing of Public Administrations (GDP%)	-6.9	-4.3	-4.0	-4.3	-4.6	-4.5	-4.2
Public Administration debt (GDP %)	118.3	113.3	110.7	109.9	114.9	113.2	112.5

Source: Bank of Spain
Note: late published data of CNTR: second quarter of 2022
(a) forecast closing date: 30th September 2022

FIGURE 11 Summary of projections, central scenario Bank of Spain

	Forecasts october 2022 (a)					Differences with June forecasts		
Annual variation rate (%) unless otherwise indicated	2020	2021	2022	2023	2024	2022	2023	2024
GDP	-11.3	5.5	4.5	1.4	2.9	0.4	-1.5	0.4
Harmonized Index of Consumer Prices (HICP)	-0.3	3.0	8.7	5.6	1.9	1.5	3.1	0.1
HICP without energy and food	0.5	0.6	3.9	3.5	2.1	0.7	1.3	0.1
Unemployment rate (% active population) Annual average	15.5	14.8	12.8	12.9	12.4	-0.2	0.2	-0.3
Capacity (+)/ Need (-) of financing of Public Administrations (% GDP)	-10.1	-6.9	-4.3	-4.0	-4.3	0.3	0.5	0.0
Public Administrations Debt (% GDP)	120.4	118.3	113.3	110.7	109.9	-1.6	-2.5	-2.6

Source: Bank of Spain
(a) Forecasts closing date: 30th September 2022. Differences with June projections are calculated on rates of two decimal places.

FIGURE 12 **International environment and monetary and financial conditions. Annual variation rate (%) unless otherwise indicated (a)**

		Forecasts October 2022			Difference between current forecasts and June 2022 -b-		
	2021	**2022**	**2023**	**2024**	**2022**	**2023**	**2024**
Spain's exports markets -c-	9.8	6.3	2.6	3.2	1.8	-0.4	-0.2
Oil price in dolars/barrel (level)	71.1	102.9	79.5	74.2	-3.0	-13.9	-10.1
Monetary and Financial conditions							
Exchange rate dollar/euro (level)	1.18	1.04	0.98	0.98	-0.03	-0.07	-0.07
Effective nominal exchange rate against the euro zone -d- (level 2000=100)	120.7	111.3	107.3	107.3	-1.8	-4.6	-4.6
Short term interest rates (euribor 3 months, level) -e-	-0.5	0.3	2.9	3.0	0.4	1.6	1.4
Long term interest rates (10 year treasury bond yield) -e-	0.3	2.2	3.4	3.6	0.4	1.0	1.0

Source: Bank of Spain. ***-a-*** *Closing date for the preparation of assumptions: 23th August for the spanish export markets and 30th of September 2022 for the rest of the variables. The figures in levels are annual averages and the figures in rates are calculated from the corresponding annual averages.* ***-b-*** *The differences are in the rates for export markets, in level for the oil price and the exchange rate dolar/euro and the nominal effective exchange rate and percentage points for interest rates.* ***-c-*** *Closing date for the preparation of assumptions: 23th August for the spanish export markets and 30th September 2022 for the rest of variables. The figures in levels BCE for the euro zone in September.* ***-d-*** *A positive percentage change in the nominal effective exchange rate reflects and appreciation of the euro.* ***-e-*** *For the proyection period, the values in the table constitute technical assumptions, prepared by the Eurosystem methodology. These assumptions are based on negociated prices traded in future markets or on approximations to these, and should not be interpreted as a prediction of the Eurosystem on the evolution of these variables.*

To the above factors must be added some doubts about the recovery presented by the historical review of the national accounting series carried out by the INE. In particular, the level of investment has been revised downwards since 2020. INE estimates indicate that **the accumulation of machinery and equipment, excluding transport material, has gone from being 27% above the levels at the end of 2019 to only 3%.** The vision of the potential of the Spanish economy is very different in one case and the other. We have gone from wondering what structural changes would have led companies to accumulate so much capital, to thinking that the growth capacity of the Spanish economy remains barely unchanged.

For comparison purposes, the macroeconomic scenario that will be included in the **General State Budget project for 2023 (PGE 2023)** contemplates **real GDP growth of 4.4% in 2022 and 2.1% in 2023.** In the macro table of the 2023 PGE and by components, the slowdown vs 2022 is based on a **lower contribution of the foreign balance to growth** which, after contributing 2.9 pp in 2022, would go on to have a negative contribution in 2023 (-0.3 pp).

According to the Spanish government's forecasts, the negative contribution of external demand in 2023 would be partially offset by the evolution of national demand, which would contribute 2.4 pp in 2023 compared to 1.5 pp in 2022, due to the increase of gross fixed capital formation, especially in construction. Private consumption would maintain moderate growth rates in both years.

The macroeconomic scenario that will be included in the General State Budget project for 2023 (PGE 2023) contemplates real GDP growth of 4.4% in 2022 and 2.1% in 2023.

For the Spanish government, this scenario of moderate growth would be accompanied by a stagnation of full-time equivalent employment, while the unemployment rate would stand at 12.2% of the active population in 2023, compared to 12.8% that the Government expects on average for the year 2022.

Regarding the evolution of prices, the Government's scenario contemplates a slight reduction in the GDP deflator in 2023 to 3.8%, compared to the 4% expected for 2022, in a scenario of a sharp slowdown in the private consumption deflator.

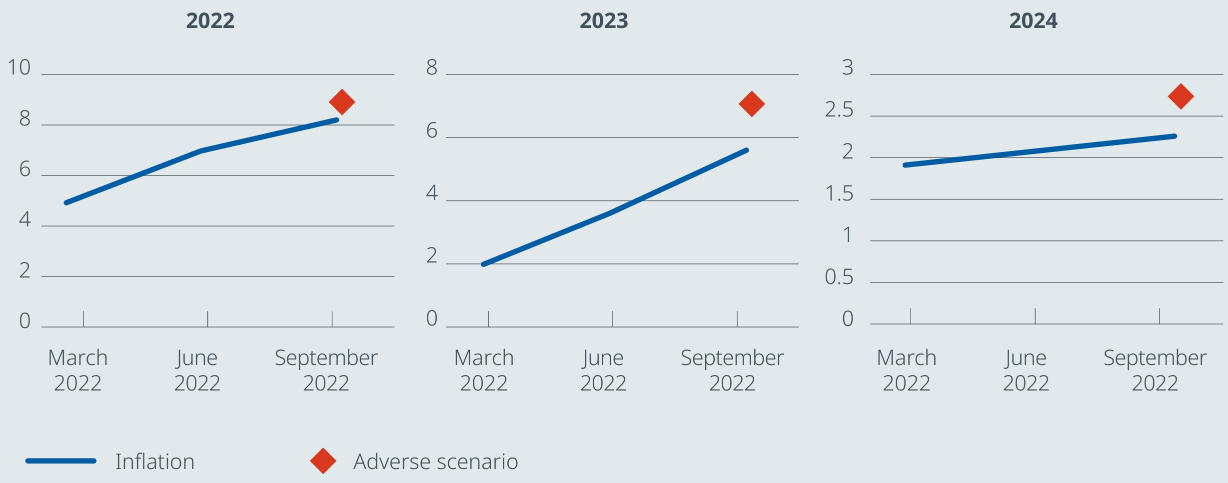
Returning to our base scenario, **we cannot rule out the possibility of a more adverse hypothetical scenario,** which would include, among other factors, the total loss of access to Russian gas, an intensification of supply problems, for example, as a result of a colder-than-usual winter—and an increase in economic and financial uncertainty, which would give rise to a rise in bank financing costs.

Under this more adverse scenario (Figure 13), real GDP in the EMU could be up to one point lower in 2023 than our baseline scenario, while inflationary pressures in the EMU (Figure 14) would be more intense and long-lasting.

FIGURE 13 Adverse scenario, EMU GDP growth

Source: Bank of Spain

FIGURE 14 **Adverse scenario, EMU headline inflation**



Source: Bank of Spain

The domestic demand faces several challenges in 2023

Looking ahead to 2023, household spending has been negatively affected by various factors. The increase in the price of raw materials and intermediate goods continues to reduce the purchasing power of households. Of particular importance has been the increase in both fuel and electricity prices. To the previous factors we must add, after a period of containment between 2020 and the end of 2021, a greater transfer to final prices of this rise in the cost of production to the extent that companies have been perceiving that the increase in input prices will remain longer than initially warned.

Additionally, **supply problems continue to limit car purchases.** Finally, **households are not using the wealth accumulated during confinement to consume at the expected rate.** The increase in demand observed in some services seems to be offset by a drop in spending on other goods. The latter would be the result of the exhaustion of the impulse that certain components of the consumption basket would have had during the pandemic.

Household savings, as a percentage of disposable income, **remains around its historical average.** In this regard, it is possible that the uncertainty about the evolution of the economy and the increase in inflation are causing households to delay some decisions or encouraging investment in housing.

A more uncertain environment has affected private sector confidence, which may have a negative impact on spending. The possibility of a winter with restrictions on energy consumption in Europe cannot be ruled out. **This would intensify bottlenecks in the industry and reduce the willingness of European citizens to travel to Spain.**

We expect a rebound in activity from spring 2023, but subject to high uncertainty.

Rising inflation and the response from central banks have led to a correction in equity markets. The consequent decrease in the financial wealth of families and companies can translate into an increase in precautionary savings. In fact, and according to the Bank of Spain estimates, the recent increase in financial volatility would result in 0.4 pp lower GDP growth in 2023.

Finally, we do expect that the positive impact of the effectiveness of the vaccines and the elimination of restrictions on consumption may end once the summer is over. The possibility of a "cliff effect" in household spending during the latter part of 2022 or the first part of 2023 is significant.

In addition, **it must be taken into account that a good part of the savings accumulated during confinement are held by high-income households**. The longer it goes unused, the more likely it is to remain as financial wealth.

We expect a rebound in activity from spring 2023, but subject to high uncertainty

The activity will regain a growing momentum from spring, when it will be driven by the **combination of various factors.** These include a **gradual easing of the prevailing tensions in the energy markets,** which would bring with it a progressive recovery of agents' real income, an improvement in confidence and a strengthening of foreign demand, **the gradual resolution of the alterations that persist in global supply chains** and a greater relative deployment of funds linked to the Next Generation EU (NGEU) program.

Tourist flows from abroad, which have practically recovered the levels prior to the health crisis, will also act as a support for activity, although their dynamism will be moderated in the short term due to the effects of the rise in inflation on the real income of the potential tourists.

As we have already mentioned, in 2023 GDP growth will moderate very significantly, reaching 1.4%yoy, as a result of the weakness of activity in the second half of this year and in the first quarter of 2023. We need to take into account in this regard that a lower output growth in the latter part of a year significantly limits, through carry-over effects, the average growth rate of the following year.

On the other hand, **the greater economic dynamism from the spring of 2023 will gradually intensify,** which will allow GDP growth to reach 1.8% in 2024. **The recovery to the pre-pandemic level of output would probably be delayed until the first quarter of 2024,** that is, about two quarters later than projected in our report from June.

The Spanish economy is better prepared than in 2011-2012

It is important to highlight that in this backdrop, **the Spanish economy is better prepared than in other recent recessive periods and continues its recovery,** which favors sectors with a relevant weight in GDP and intensive in the use of labor. Inflation has become the greatest risk, so it is necessary to make decisions that help distribute costs equitably and prevent it from becoming entrenched, which would increase the risk of recession.

We expect the slowdown in activity to be limited and short-lived, thanks to various factors. The first has to do with the wealth accumulated during confinement. According to INE estimates, **households would have around 130 billion euros invested in ready-to-use assets**, which could sustain consumption during the coming quarters despite the risks surrounding the economy and soften the impact of several of the negative elements previously described.

In addition to consumption, these resources could be used to purchase housing, as has happened in previous quarters. Although interest rates have begun a normalization process, credit conditions continue to be attractive, **especially in an environment where the price of real estate assets is expected to continue to rise. In this regard, the housing prices could increase by 7.4% in 2022 and 3.6% in 2023.**

The increase in interest rates finds the Spanish economy better prepared, although it is still exposed to the risk of financial fragmentation in the euro area. The debt of families and companies has been reduced intensely and is currently at levels similar to those of the rest of the eurozone countries.

Additionally, recent years have served for the private sector to accumulate assets that can help soften the impact of a greater financial burden. More vulnerable may be the situation of the public sector, with high debt levels. The risk here is that of a liquidity crisis, where the perception of a lack of commitment to these objectives leads to an increase in the cost of financing sovereign debt.

In turn, an increase in the financial burden of public administrations can deteriorate the perception of the sustainability of public finances or of the countries' commitment to comply with the necessary adjustments and reforms. The resulting vicious circle could cause a new crisis in Europe.

The incomplete progress in completing the banking union prevents this from being the first line of defense and requires imaginative solutions but with less impact and protection.

In any case, even here we can find **reasons for optimism.** The Treasury has increased the maturities of the debt, and the evolution of revenues has managed to reduce the imbalance in public finances beyond what was expected. This will limit short-term liquidity needs and the impact of the rise in interest rates on the deficit.

Uncertainty about economic policy will increase as next year's municipal and regional elections draw closer. The country still

In this backdrop, the Spanish economy is better prepared than in other recent recessive periods and continues its recovery.

has a reform agenda ahead of it to continue accessing NGEU funds and, probably, along with the importance of a long-term fiscal plan, to receive support from the ECB in the debt markets.

The measures implemented to reduce the impact of rising fuel and electricity prices **may have to persist over time,** given that the cost of gasoline and gas are expected to remain high for at least the next year. **This will slow down the pace of deficit reduction.**

That is why it is important to focus the aid on the most vulnerable groups, make it clear that the support will be temporary and respect the price mechanism to encourage the transition towards a more sustainable production model. In this sense, the increases in the Minimum Vital Income, in non-contributory pensions and the help of 200 euros for those residing in households whose income in 2021 has not exceeded 14,000 euros are welcome. More doubtful is the efficiency and progressivity of the indiscriminate subsidy for fuel consumption, the reduction of taxes on the production and consumption of electricity or the limitation of the increase in rents.

We revise upwards the inflation levels in 2022-2024

We have to acknowledge **that inflation has surprised on the upside both in Europe and in Spain in recent months,** which is largely due to higher prices for energy and food raw materials than expected at the time, and to a more rapid transmission of said increase in the prices of other goods and services; this combination of factors entails a higher starting point.

This upward revision is motivated, among other factors, by the surprises that have recently been observed in the increase in prices, by the new paths foreseen in the future for energy prices and by the fact that we consider a more depreciated euro.

We have revised upwards the rate of increase in prices throughout the entire projection horizon, so that significantly higher and more persistent inflation rates than those anticipated in our June report are contemplated.

We have revised upwards the rate of increase in prices throughout the entire projection horizon, so that significantly higher and more persistent inflation rates than those anticipated in our June report are contemplated. In particular, **we forecast average inflation in 2022 of 8.7%, gradually moderating to 5.6% and 1.9% in 2023 and 2024, respectively.**

The projection period envisages **a gradual moderation in the rate of change of the headline HICP from its current level.** This basically responds to the expected reduction in the growth rate of the energy and food components, in line with the paths of the prices of oil, gas and food raw materials in the futures markets.

However, **we do not expect core inflation to decline from its current high levels until next spring.** The reason is that, in the coming months, **the transfer of the companies' recent cost increases to their selling prices will continue.** Eventually, the culmination of this transmission, together with the continuation of recent signs of a gradual fading of the persistent distortions affecting global supply chains, **will allow a gradual moderation of core inflation.**

Thus, the underlying component will reach 3.9% this year, and will moderate to 3.5% and 2.1% in 2023 and 2024, respectively.

As is logical, these perspectives regarding the evolution of inflation in Spain are also subject to **extraordinary uncertainty** and will depend, among other aspects, on the evolution of the prices of raw materials and the reaction of wages and margins businesses in the face of rising consumer prices and production costs.

These inflation forecasts rest on two very relevant assumptions. On the one hand, the available evidence indicates that the prices of non-energy goods and services have responded to energy price shocks more quickly in the current inflationary episode than they have, on average, in the past.

For this reason, it is assumed that companies' pass-through of past energy cost increases to final sales prices **is already in a relatively advanced stage of completion.**

On the other hand, **the response of wages to the rise in inflation has been moderate YtD.** Looking to the future, it is considered that this response **will continue to be relatively contained,** which will prevent feedback phenomena from being triggered between wage growth and final price growth.

5

RISKS FOR OUR 2022-2024 BASE SCENARIO IN GDP GROWTH AND INFLATION

The risks to these projections are oriented downwards for activity and upwards for inflation. In particular, the main risk derives from the materialization of developments in the energy markets that may differ significantly from those contemplated in the central scenario. These risks, which, in principle, would be located fundamentally in the gas market, could manifest themselves both through the evolution of prices, which may follow a lower or higher path than that of the central scenario, and through the quantities, so that greater supply problems than those considered or a complete absence of restrictions on the use of gas can be observed.

The more recent geopolitical developments have exacerbated the risk of extreme scenarios that could endanger the solvency of families and companies and the stability of the financial system as a whole.

There is a lot of uncertainty about whether European economies will be able to find alternative energy sources to Russian gas at reasonable prices and whether energy saving measures will be effective. To date, all the forecast scenarios for the European economies are based on the assumption that a general rationing of energy demand will not be necessary in the coming months.

The risk scenarios that reflect this hypothesis suggest that the European economies could record a contraction in activity in 2023, which would affect Spain's growth path, even though its energy supply is more secure. Also noteworthy are the warning signs issued by the European Systemic Risk Board, which indicates that **the more recent geopolitical developments have exacerbated the risk of extreme scenarios that could endanger the solvency of families and companies and the stability of the financial system as a whole.**

On the other hand, the high prices of food products and fertilizers **accentuate the risk of a food crisis in some emerging economies.** On the positive side, the set of measures that some European economies are introducing to mitigate the impact of the energy crisis on economic activity could attenuate the decline in their activity.

Domestically, the deterioration in household purchasing power and confidence is another source of downside risks. Despite the favorable behavior of employment, **the deterioration in the purchasing power that Spanish households are registering as a result of the decline in real wages is a relevant one.** In the first half of 2022 there has been a contraction in compensation per real employee of close to 6%, thus exceeding the contraction observed in the fourth quarter of 2012, of 5.2%.

Likewise, **a rapid tightening of financing conditions is taking place.** This, together with the deterioration of their confidence, which is at records similar to those observed in the months of strict confinement experienced at the beginning of the pandemic, could lead to a greater increase in savings for precautionary reasons than that considered in our base scenario.

Another source of uncertainty is associated with the degree of pass-through of recent price and cost increases to the rest of the prices in the economy and to wages. In this sense, the intensity with which the transmission of higher production costs to final prices has been taking place in recent months would have raised the probability of triggering significant second-round or feedback effects between prices and wages, and therefore an additional aggravation of the inflationary process, with adverse consequences on foreign competitiveness and on activity and employment.

In addition, the persistence of the current episode of high price growth **increases the risks of de-anchoring medium-term inflation expectations,** which have risen, albeit modestly, in recent months.

The rate at which investment projects associated with the NGEU program could filter into the economy is also a source of additional uncertainty going forward, after the delays that appear to have occurred in recent quarters. Also, in the current context of high uncertainty, **a possible rebound in saving for precautionary reasons that weighs down household spending and the dynamism of aggregate consumption cannot be ruled out.**

Finally, the combination of the monetary normalization process and the deterioration in the economic outlook **is leading to a tightening of the financing conditions of financial markets** that could give rise to a potentially disruptive episode in said capital markets.

In any case, the accumulated losses in the real value of the income of companies and families, together with the higher interest rates that are projected, increase the vulnerability of those agents with a less healthy economic and financial situation, which could affect their spending levels to a greater extent than what is incorporated in the current projections.

The rate at which investment projects associated with the NGEU program could filter into the economy is also a source of additional uncertainty going forward.

6

FISCAL CONSOLIDATION OF THE SPANISH PUBLIC ADMINISTRATIONS IN 2022

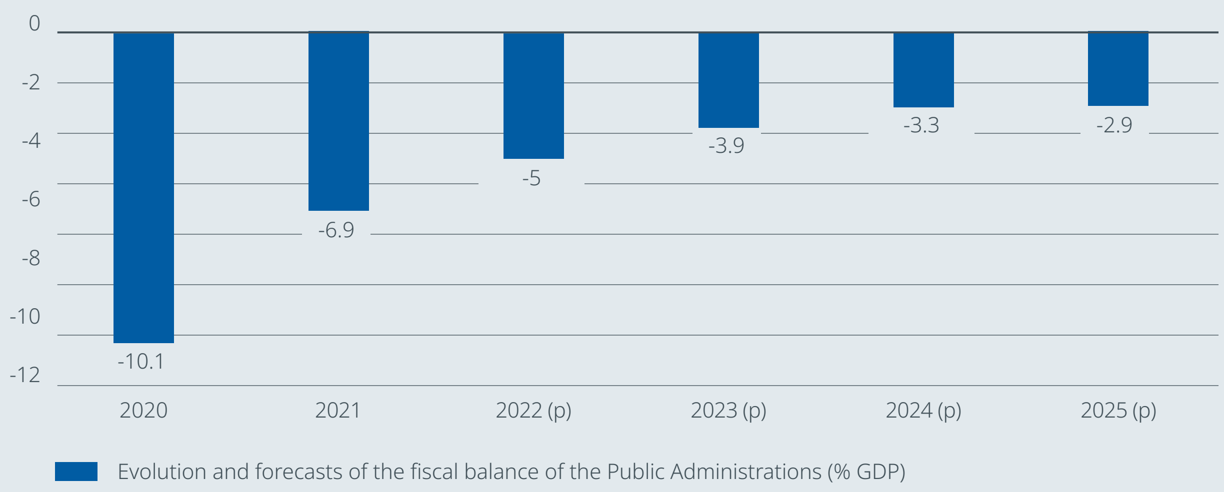
Until July, the aggregate revenues of the Spanish Public Administrations (AAPP) have maintained very high growth rates, supported, fundamentally, by the notable advance in the economic activity and prices.

However, in recent months, **tax collections have again surprised on the rise in relation to their macroeconomic determinants,** although to a lesser extent than in the two previous years.

The strength in public revenues, together with the expected slowdown in public spending, has led to **a reduction in the general government deficit, up to 4.3% of GDP in July** (accumulated over 12 months).

Despite the extension of the suspension of fiscal rules for 2023, **the Spanish government expects an improvement in the deficit path up to 3.9% GDP thanks to the positive dynamics expected for tax collection** (Figure 15). This would imply an improvement of more than one percentage point compared to the deficit at the end of 2022, in line with the forecasts brought to Brussels in the Stability Program, which contains a downward deficit trend until it is below the 3% mark in 2025.

FIGURE 15 Evolution and forecasts of the fiscal balance of the Public Administrations (% GDP)



Source: Ministry of Finance

Regarding fiscal policy, the new measures approved since the closing date of the June projection exercise entail an increase in the 2022 public deficit of 0.8 pp of GDP. All these measures are temporary in nature, except for the 0.1 pp of GDP increase in defense spending.

As a whole, the amount of the temporary measures that have been approved since the beginning of this year in relation to the rise in energy prices and the consequences of the war would amount to

The tone of fiscal policy, measured by the change in the primary structural balance, would be moderately expansionary this year and would become contractive in 2023.

1.3 pp of GDP. In any case, we expect a greater reduction in the public deficit this year, given that the increase in tax revenue for the year as a whole will far exceed, according to the latest information available, the cost of the new measures.

Looking ahead to 2023 and 2024, AIReF estimates that in each of those years, the temporary levies on the energy sector and credit institutions and financial credit establishments will imply a temporary improvement in the public balance of 0.3 pp of GDP. In the absence of sufficient information, other assumptions included are the increase in public wages in line with the increase expected in the private sector and a certain closing of the gap between the tax collection observed and the lower one that would derive from its historical relationship with the tax bases.

Finally, the data available on the pace of execution of the NGEU program lead to a downward revision of the estimated expenditure for 2022 and 2023, and a slight upward revision of that for 2024. Overall, **the PRTR would have increased the level of GDP by 0.7 pp in 2021, 1.9 pp in 2022 and 2.8 pp in 2023 on a cumulative basis compared to a scenario without such Plan.**

As a consequence of the various temporary measures approved, the tone of fiscal policy, measured by the change in the primary structural balance, **would be moderately expansionary this year and would become contractive in 2023,** once the former measures are withdrawn. In 2024, the increase in pensions —given that they are revalued with the CPI of the previous year— above the potential growth of the economy, together with a certain reduction of the tax collection gap, would once again favor an expansive fiscal policy tone.

The evolution until August shows that the State deficit continues the downward path that began in 2021 as a consequence of the economic reactivation and job creation driven by the progress of the vaccination process that has allowed the impact of the pandemic to subside.

Specifically, **the State (Central Administration) deficit in the first eight months of 2022 has been reduced by 57%yoy.** Until August 2022, the Central Administration has registered a deficit equivalent to 1.82% of GDP, compared to 4.59% in August 2021. In this way, the deficit stands at 23,833 million, which represents a decrease of 57 % compared to the 55,413 million in the same period of the previous year.

This significant improvement in the public deficit is due to an increase in non-financial revenues of 32.3%yoy, compared to the behavior of expenses, which grow at a rate of 5%yoy. Tax collection in August reached EUR 131,308 million, 78.8% of total resources, and grows 24.1%yoy compared to August 2021.

In the individual breakdown, taxes on production and imports increase by 16%yoy. Specifically, VAT revenues rose by 20.8%yoy. Current taxes on income and wealth grew by 36.3%yoy due to the personal income tax, which increased by 44.7%yoy mainly due to income from the first installment of the income tax return. For its part, the Non-Resident Income Tax rose by 59.3%yoy. Revenues from the Corporates Tax grows by 31.6%yoy, if the extraordinary revenues derived from the merger of two large entities that was collected in 2021 is deducted.

In the aggregate of Public Administrations (data up to July 2022, Figure 16), the overall deficit of the Central Administration, the Social Security Funds and the Autonomous Communities, excluding financial aid, stands at 24,015 million, equivalent to 1 .84% of GDP. If the balance of the aid to financial institutions is included for an amount of 397 million, the deficit stands at 1.87% of GDP.

FIGURE 16 Fiscal Deficit (-)/ Surplus (+) of the Public Administrations: July 2021-2022

	Millions of euros		Variation		% GDP	
By Public Administration	**2021**	**2022**	**Millions euros**	**%**	**2021**	**2022**
Central Administrations	-53,301	-20,079	33,222	-62.3	-4.42	-1.54
State	-53,229	-22,021	31,208	-58.6	-4.41	-1.68
Central Administrations Organisms	-72	1,942	2,014	-2,797.20	-0.01	0.15
Autonomous Communities	517	-4,289	-4,806	-929.6	0.04	-0.33
Social Security Funds	-4,873	353	5,226	-107.2	-0.4	0.03
Social Security System	-3,205	-612	2,593	-80.90	-0.27	-0.05
SPEE	-1,706	872	2,578	-151.10	-0.14	0.07
FOGASA	38	93	55	144.7	0.00	0.01
Public Administrations	-57,657	-24,015	33,642	-58.3	-4.78	-1.84
Financial help (net balance)	-639	-397	242	-37.9	-0.05	-0.03
Public Administrations with financial help	-58,296	-24,412	33,884	-58.1	-4.83	-1.87
GDP used	1,206,842	1,307,256				

Source: Ministry of Finance

As far as the Autonomous Communities are concerned, the regional Administration recorded a deficit in July 2022 of 4,289 million, which is equivalent to 0.33% of GDP (Figure 17). This result is due to an increase in expenses of 10.1%yoy, while revenues grow at a rate of 6.1%yoy.

FIGURE 17 Fiscal Surplus (+)/ Deficit (-) of the Autonomous Communities, July 2021-2022. Base 2010

	2021		2022	
	Millions euros	**% GDP**	**Millions euros**	**% GDP**
Andalusia	504	0.31	384	0.22
Aragon	-135	-0.36	21	0.05
Asturias	42	0.18	71	0.28
Balearic Islands	1,063	3.69	128	0.41
Canary Islands	1,268	3.01	72	0.16
Cantabria	28	0.2	-40	-0.27
Castile La Mancha	-39	-0.09	-584	-1.27
Castile Leon	-51	-0.09	26	0.04
Catalonia	-890	-0.39	-1,526	-0.62
Extremadura	-28	-0.13	-144	-0.64
Galicia	-79	-0.12	-76	-0.11
Madrid	260	0.11	-165	-0.07
Murcia	-218	-0.68	-464	-1.33
Navarra	-429	-2.07	-432	-1.92
Rioja	-36	-0.41	32	0.34
Valencia	-412	-0.37	-1,624	-1.33
Basque Country	-331	-0.46	32	0.04
Total Autonomous Communities	517	0.04	-4,289	-0.33
GDP used	1,206,842		1,307,256	

Source: Ministry of Finance

Transfers between Public Administrations reached EUR 73,208 million, registering an increase of 4.4%yoy compared to the previous year. Of that amount, 3,086 million derive from compensation for the VAT revenues not received as a result of the implementation in 2017 of the Immediate Supply of Information (SII-VAT).

Among regional expenses, the compensation of employees grew by 2.9% yoy due to the 2% salary increase set for 2022, compared to 0.9% in 2021. Intermediate consumption rose by 4.4% to stand at 21,526 million, of which 13,251 million correspond to healthcare expenditure, with an increase of 5.5%.

The Social Security Funds until July 2022 register a surplus of EUR 353 million, compared to the 4,873 million deficit in the same period of 2021. In terms of GDP, the Social Security surplus stands at 0.03%, while which a year ago marked a deficit of 0.40% of GDP.

This performance is the result of a growth in regional revenues of 3.0%yoy (the good performance of social security contributions stands out with a growth of 5.7%yoy) compared to the 1.3% yoy decrease in expenses.

Finally, **the first execution data for 2022 of the Local Corporations,** corresponding to the second quarter of the year, show that the Local Entities have registered a deficit of EUR 988 million, which is equivalent to 0.08% of GDP, compared to the deficit of EUR 1,134 million reached in the same period of 2021.

Regarding **the public debt/GDP ratio,** it is **revised downwards** in the forecast horizon, mainly due to the increase in nominal GDP and the improvement in the primary balance, so that we consider a feasible debt/GDP ratio in the range of 110% in mid-2024 from the peak figure of 120% in the second quarter of 2020.

In relation to public debt, the government places the debt/GDP ratio by 2022YE at 115.2% GDP. Given the expected nominal growth and the expected consolidation in public finances, the reduction in the debt/GDP ratio for the end of 2023 stands at 112.4%.

We have revised downwards the Spanish public debt/GDP ratio, so that we consider a feasible debt/GDP ratio in the range of 110% in mid-2024 from the peak figure of 120% in the second quarter of 2020.

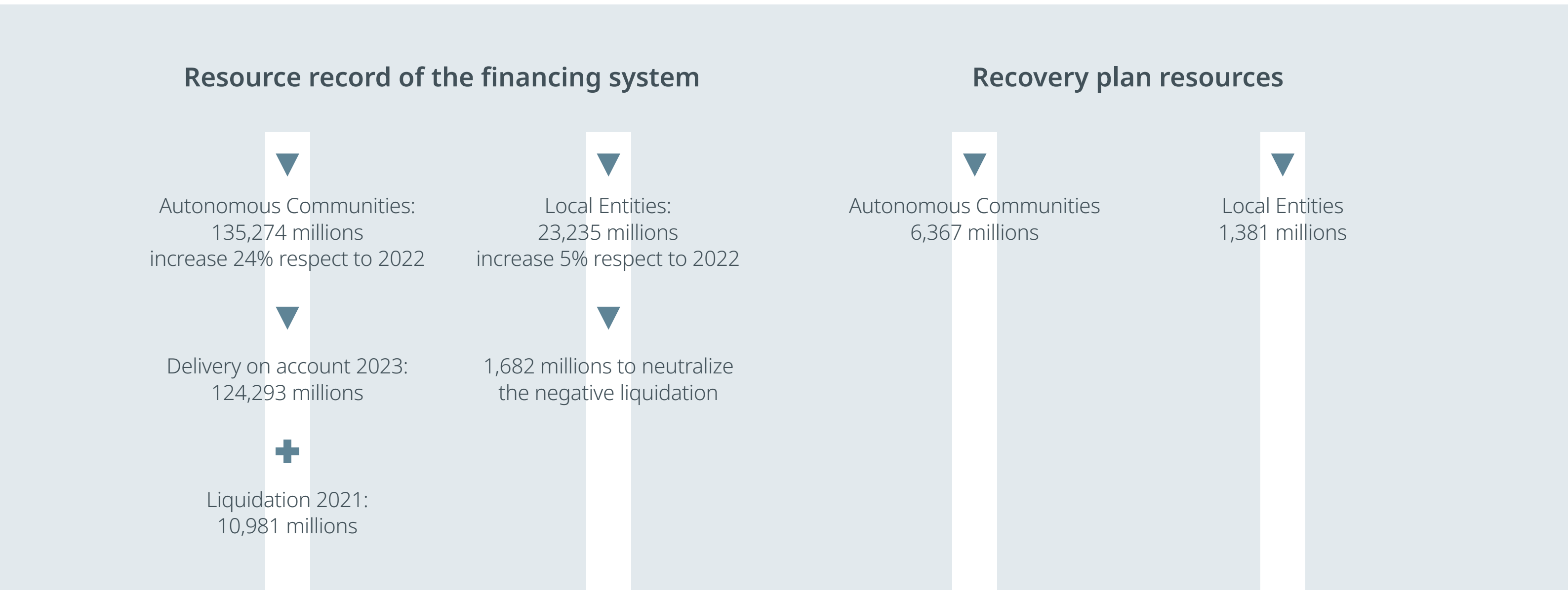
7

FINANCING OF THE TERRITORIAL ENTITIES IN 2022: AUTONOMOUS COMMUNITIES AND LOCAL ENTITIES

The commitment of the Central Administration with the financing of public administrations continues. It started during the pandemic by providing extraordinary resources to the Autonomous Communities to guarantee the provision of essential public services to citizens and in the 2023 State Budget, **the financing for the regions and local entities is increased again.**

Specifically, the regions will receive 135,274 million as payments on account and for the settlement of the 2021 financing system. This represents an unprecedented figure and implies **an increase in financing of 24% compared to this year** (Figure 18). In the case of the local entities, the payments on account and positive settlement in 2021 will translate into 23,235 million, 5% more than in 2022.

FIGURE 18 Resources for the Autonomous Communities in the 2023 State Budget



Source: Ministry of Finance

At the aggregate level and on the revenues side, the State Budget for 2023 contemplates an increase in non-financial revenues of 6% compared to the closing forecast for 2022, up to 307,445 million euros. An improvement that is largely explained by economic growth, job creation and regulatory changes in tax matters.

In the individual breakdown, an increase of 7.7%yoy in personal income tax collection is expected, up to EUR 113,123 million. The Corporates tax will register a similar increase, of 7.7% to EUR 28,519 million, while in Special Taxes the forecasted growth is 8.2%, to 22,287 million euros. In the case of VAT, the tax collection forecast is estimated at 86,093 million, which represents 5.9% more in relation to the settlement advance of 2022.

The regions will receive 135,274 millions as payments on account and for the settlement of the 2021 financing system. This represents an unprecedented figure and implies an increase in financing of 24% compared to this year.

Regarding the pace of execution of the Recovery Plan (PRTR), the latest data available from the Ministry of Finance corresponding to the end of September show that a total of EUR 43,686 million have already been authorized, EUR 37,213 million have been committed and obligations for EUR32,989 million have been recognized. A relevant part of these funds has been assigned to the Autonomous Communities, for a total value of EUR 18,920 million, of which EUR 14,745 million were assigned through sectoral conferences and EUR 4,176 million through other instruments, such as subsidies and agreements.

8

THE EXTRAORDINARY LIQUIDITY MECHANISM OF THE REGIONS IN 2022

On September 27, the Spanish government, through the Government Delegate Commission for Economic Affairs (CDGAE), agreed to allocate to the Autonomous Communities for the fourth quarter of 2022 a total of 4,491.6 million euros from the Financing Fund of the Autonomous Communities (Figure 19). Specifically, 4,085.8 million euros are allocated to the Regional Liquidity Fund (FLA) and the remaining 405.8 million to the Financial Facility (FF) compartment.

The total amount of 4,491.6 million euros will be distributed among the Autonomous Communities adhered to the Financing Fund as follows:

FIGURE 19 Disbursement of the Extraordinary Liquidity Funds in the fourth quarter of 2022 (EURmn)

Millions of euros

Autonomous Communitites	Section 1 Maturities 1	Section 2 Negative settlements 2	Section 3 Deficit 2022 (0.6% GDP) 3	Total (4=1+2+3) Amount	%
Andalusia	152.85	55.82	197.10	405.77	9.03
Full financial facility	152.85	55.82	197.10	405.77	9.03
Aragon	265.30	8.06		273.36	6.09
Balearic Islands			81.98	81.98	1.83
Castile La Mancha	350.00			350.00	7.79
Catalonia	1,604.03	31.20	189.53	1,824.76	40.63
Extremadura	163.55	9.95		173.50	3.86
Murcia	245.66	7.32	52.24	305.22	6.80
Rioja		2.48	14.18	16.66	0.37
Valencia	854.82	22.81	182.72	1,060.35	23.61
Total regional liquidity fund	3,483.36	81.82	520.65	4,085.83	90.97
Total FF+RLF 2022	3,636.21	137.64	717.75	4,491.60	100.00

Source: Ministry of Finance

Andalusia requested its adhesion to the Financial Facility (FF) compartment in 2022 and communicated its intention to combine this financing with that from the financial markets, a request that was accepted by the Ministry of Finance. For this reason, Andalusia presented an update of its Multiannual Debt Plan (PPE) for the period 2022-2024, in compliance with the CDGAE agreement of July 5, 2018, which allows combining financing from the Financing Fund for Autonomous Communities, with the raising of resources through the market in 2022.

Spanish regions will receive a last disbursement of EUR 4.5bn in 4Q22 from the extraordinary liquidity mechanisms.

The communities assigned to the Autonomous Liquidity Fund (FLA) compartment and that have requested an allocation for 4Q22 are **Aragon, Balearic Islands, Castille-La Mancha, Catalonia, Extremadura, Murcia, La Rioja and Valencia.**

For the 4Q22 and as occurred in previous quarters, no allocation is included for the Autonomous Communities of **Asturias, the Canary Islands, Castille-Leon, Galicia, Madrid, Navarre and the Basque Country,** since they have not requested financing charged to the FLA and FF from the 2022 Financing Fund.

To date, **the Financing Fund for the Autonomous Communities has distributed a total of 32,558.98 million euros to the Autonomous Communities throughout 2022,** including the REACT-EU Liquidity Fund, as detailed in Figure 20.

FIGURE 20 Extraordinary liquidity funds disbursed in 2022 (EURmn)

Millions of euros

	FFCCAA 2022					
Autonomous Communities	**1Q**	**2Q**	**3Q**	**4Q**	**REACT-UE Fund**	**Total**
Andalusia	260.78	342.64	2,002.29	405.77		3,011.48
Asturias					30.00	30.00
Aragon	582.55	231.81	0.00	273.36		1,087.72
Balearic Islands	534.65	76.51	515.03	81.98		1,208.17
Cantabria	190.15	37.42	234.92	0.00		462.49
Castille La Mancha	963.20	205.07	797.87	350.00		2,316.14
Catalonia	4,855.39	850.35	4,916.43	1,824.76	815.00	13,261.93
Extremadura	177.87	214.91	247.56	173.50		813.84
Murcia	302.13	278.70	778.49	305.22	89.57	1,754.11
Rioja	110.35	129.10	64.13	16.66	16.50	336.74
Valencia	2,781.07	983.13	2,847.81	1,060.35	604.00	8,276.36
Total Autonomous Communities	10,758.14	3,349.64	12,404.53	4,491.60	1,555.07	32,558.98

Source: Ministry of Finance

With regard to transfers on account by the State, the Ministry of Finance has disbursed a total of 83,457.10 million euros in concept of payments on account to the normal-status Autonomous Communities and to the Cities with Statute of Autonomy of Ceuta and Melilla during the first three quarters of 2022, compared to 78,489.42 million euros in the same period of 2021.

To date, the Financing Fund for the Autonomous Communities has distributed a total of 32,558.98 million euros to the Autonomous Communities throughout 2022, including the REACT-EU Liquidity Fund

This means that these territorial entities have had in the first nine months of 2022 a volume of resources from the State account transfers **higher by 4,967.67 million euros** than the resources that they received in the same period of 2021, which represents a6.3% increase. The disbursement of the State account transfers is carried out monthly through two payments to the normal-status Autonomous Communities and the Cities of Ceuta and Melilla: one at the beginning of the month and another at the end.

In this way, the regional financing system is complied with, which operates through payments on account of the tax resources that are estimated to be collected throughout the year as personal income tax (the regional rate) and the percentages established by the law for the VAT and Special Taxes, that the State advances.

To the above figures, which are the result of the estimation of tax revenue based on the economic forecasts included in the 2022 State Budget, we need also to add the payments on account by the State of the Global Sufficiency Fund and the transfer from the Fundamental Public Services Guarantee Fund.

In total, in the year 2022 the normal-status Autonomous Communities and the Cities of Ceuta and Melilla will receive 111,276 million euros in payments on account, **the highest figure in the historical series.**

9

EXTRAORDINARY RESOURCES DISBURSED TO THE AUTONOMOUS COMMUNITIES IN 2022

In addition to the resources provided by the Autonomous Financing System, the 2022 State Budget included two extraordinary financing items destined for the normal-status Autonomous Communities and Cities with a Statute of Autonomy.

The first of these items was distributed in March and provided 3,067 million euros to these administrations to compensate for the economic loss caused by the implementation of the Immediate Information Supply System on VAT (SII-VAT).

The other extraordinary financing item allocated to increase the regional financing in 2022, up to 4,404 million euros, has made it possible to cover the loss of revenues that the regions have experienced in 2022 due to the negative 2020 settlement. In July, more than 3,323 million euros were distributed to the Autonomous Communities and in August the rest of the endowment was disbursed, for an amount of more than 1,080 million euros.

These measures are in line with the political commitment since the beginning of the pandemic not only to protect the resources of the financing system, but also to strengthen the financial situation of the Autonomous Communities by providing them with extraordinary funds, as it has been doing in recent years.

Thus, in 2020 a non-reimbursable fund of 16,000 million euros was designed so that the 17 Communities and Cities of Ceuta and Melilla could face the economic cost of the pandemic, and in 2021 an additional 7,000 million euros were distributed to manage direct aid to SMEs, as well as another non-refundable extraordinary provision of 13,486 million.

The extraordinary State transfers that the reigons have received in 2020-2022 are in line with the political commitment since the beginning of the pandemic not only to protect the resources of the financing system, but also to strengthen the financial situation of the Autonomous Communities by providing them with extraordinary funds, as it has been doing in recent years.

10

AVERAGE PAYMENT TIME FOR SUPPLIERS

The Average Payment Period (PMP) of the Autonomous Communities as of July reached 23.05 days (Figure 21),which represents an increase of 0.71 days compared to June 2022, so that it has already been 20 consecutive months, since December 2020, below the 30 days threshold, which is the maximum period established by law.

FIGURE 21 Average payment time to suppliers of the regions as of July 2022 (days)

Autonomous Communitites	Paid operations ratio	Operations pending payment ratio	APP Global
Andalusia	12.61	22.61	16.3
Aragon	27.16	57.03	46.59
Asturias	24.72	59.82	38.40
Balearic Islands	10.23	29.45	20.29
Canary Islands	11.85	27.1	16.81
Cantabria	13.94	26.85	19.83
Castile La Mancha	11.82	25.75	14.71
Castile Leon	20.89	26.42	23.00
Catalonia	26.57	28.55	27.46
Extremadura	7.84	17.50	9.78
Galicia	9.86	30.13	13.86
Madrid	14.33	47.17	26.26
Murcia	6.06	24.07	14.11
Navarra	25.49	31.41	28.65
Basque Country	26.26	22.63	24.90
Rioja	21.87	19.3	21.15
Valencia	14.71	22.84	17.20
Total Autonomous Communities	17.42	32.04	23.05

Source: Ministry of Finance

This historical data is due, in large part, to the resources transferred by the Central Government to the regional governments, something that has made it possible to mitigate the impact of the crisis on the companies and SMEs that are suppliers to the regional governments.

The average payment time of the Central Administration stands at 45.44 days; the ratio of transactions paid stood at 41.15 days, while the ratio of transactions pending payment reached 50.87 days. The Local Entities in the assignment model have an average payment time of 58.94 days in the first seventh months of the year, which represents a decrease of 10.81 days in relation to the same month of the previous year.

For its part, the PMP registered in the Social Security Funds remained unchanged and stands at 9.29 days in the seventh month of the year.

The Average Payment Period (PMP) of the Autonomous Communities as of July reached 23.05 days. It has already been 20 consecutive months, since December 2020, below the 30 days threshold, which is the maximum period established by law.

In relation to the composition of the PMP of the Autonomous Communities, the ratio of paid operations stands at 17.42 days and that of operations pending payment at 32.04 days. This represents a decrease of 0.94 days in the ratio of transactions paid and an increase of 2.94 days in the ratio of transactions pending payment, compared to the previous month.

No region presents this month a PMP greater than the 60-day period, the limit from which the Ministry of Finance begins to apply the measures provided for in the stability regulations.

As for the commercial debt of the Autonomous Communities, this is estimated at 3,417.42 million euros, equivalent to 0.26% of the national GDP. This represents an increase of 161.97 million euros with respect to the previous month. Payments of a commercial nature made in July amounted to 5,462.49 million euros, which represents a decrease of 5.61% compared to those made in the same month of 2021. Of these, 3,481.35 million correspond to healthcare payments, which represents a decrease of 9.66% in relation to July of the previous year.

With regard to local entities, there is a clear asymmetric distribution. Thus, while 115 local entities, which account for 75.7% of the total Spanish population, have a PMP less than or equal to 30 days, on the contrary, 17 of them have an excessive PMP given that they exceed the 60 days threshold regarding their payment to suppliers. For the largest local entities, the PMP data is shown in Figure 22.

FIGURE 22 Average payment time to suppliers of the largest local entities as of July 2022 (days)

By local entity	Paid operations ratio	Operations pending payment ratio	APP Global
Barcelona	6.97	15.55	8.10
Malaga	21.17	21.80	21.38
Madrid	9.09	40.97	22.45
Zaragoza	17.14	31.40	25.55
Palma	17.95	29.33	25.73
Murcia	13.49	38.04	26.16
Valencia	24.68	36.15	29.43
Coruna	20.52	50.52	31.43
Seville	23.51	70.74	46.96
Palmas Gran Canaria	24.39	320.36	150.65

Source: Ministry of Finance

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Contacts:
+39 02 7705 8342
insights@bff.com