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MONTHLY REPORT • ECONOMIC AND FINANCIAL MARKET OUTLOOK
MARCH 2024

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March 2024

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

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Date this issue was closed:
5 March 2024

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Lights and shadows in an economy in transition

In the first two months of the year, the main trends that marked the performance of the international economy in the last part of 2023 continued to be present: i) growth close to 3% with divergences between the strength of the US and most of the emerging countries and the weakness of China and, above all, the eurozone; ii) stability in energy prices despite the challenging geopolitical scenario that is altering maritime traffic flows between Asia and Europe; iii) continuity of the disinflationary process on both sides of the Atlantic, with some resistance to the decline in the services sectors; iv) the strength of public and private consumption in the face of investment that is still not gaining traction, despite being supported by expansionary fiscal programmes (IRA, NGEU, etc.), and the upturn in defence spending; v) the weakness of industry, with the exception of the technology sector (especially that linked to AI), which contrasts with the positive performance of the services sector; vi) strength of the labour market little affected by monetary tightening and vii) good performance of the stock markets (+6% in the MSCI Global at the end of February), reflecting investor confidence in the positive effects that the soft landing scenario will have on company results.

In this phase of continuing to wait for the start of the monetary easing process, the only slight adjustment to be seen in the first few weeks of the year has been the narrowing of the gap between the financial markets' monetary policy outlook and the opinion that the central banks have been anticipating in their latest projections and communiqués. Investors are now discounting only 100 basis points of easing in 2024 (150 basis points in December) and postponing the first cut until June (previously they expected it in March/April), which has triggered a correction in the long end of the government bond yield curve of between 20 and 60 basis points. This change is linked to the feeling that inflation is entering a zone where further progress will be more difficult, since the positive effects of energy flexibilization and the disappearance of global bottlenecks are diminishing, which will give a greater role to services prices. And this is where the monetary authorities need a little more certainty (and confidence) about the dynamics that these items will follow in the coming months, bearing in mind that their evolution will be marked by factors that are still subject to uncertainty, such as the evolution of wages or housing-related costs. The question is whether the divergence between activity data on both sides of the Atlantic will become more marked in the coming months. In any case, the monetary scenario discounted by investors remains clearly positive for the economic outlook in the second half of the year, since from April onwards there should be year-on-year decreases in the 12-month Euribor.

Thus, maintaining the trend of recent quarters, we continue to see more light than shade in the complex transition that the economic cycle is going through, affected by the disruptions suffered on the supply side, both due to the accumulation of unexpected negative shocks (Covid, bottlenecks, etc.) and the first signs of changes caused by demographics, the energy transition, innovation (AI) or the search for strategic autonomy on the part of the major powers. All this while the demand side reflects changes in consumer preferences following the pandemic, or the extraordinary activism taken on by monetary and fiscal policy in recent years. This process of continuous change will continue to dominate economic behaviour in the medium term, so a normalisation of economic performance after the storms of recent years seems to be more of a wish than a reality. This implies considerable uncertainty about the future behaviour of variables such as potential growth or the neutral interest rate.

In this context, trying to look for signs amidst the excess noise still present in the economic scenario, we have updated our economic and financial forecasts, slightly revising upwards the global growth forecast for 2024 (from 2.9% to 3%), thanks to the improvement in forecasts for advanced economies (from 1.1% to 1.4%). Most of this evolution is explained by the improved projections for the USA (2.2 per cent against 0.8 per cent previously), while we have kept the forecast for Europe unchanged (0.7 per cent in 2024 and 1.7 per cent in 2025), where we have revised the GDP forecast for the Portuguese economy down slightly to 1.6 per cent this year (2.3 per cent in 2025). As far as inflation is concerned, we have made virtually no adjustments to the forecasts for 2024 (5.2 per cent worldwide, 2.5 per cent in the OECD and 7.2 per cent in emerging countries) and 2025 (3.2 per cent worldwide, 2 per cent in the OECD and 4.2 per cent in emerging countries), when inflation will be close to the central banks' targets. This will allow the FED and the ECB to begin the monetary easing phase in June, in which we expect to see 4 cumulative easings up to a total of 100 basis points on both sides of the Atlantic in 2024. With these moves by the central banks, the German 10-year bond would close this year at 2 per cent (2.8 per cent for the Spanish bond). For 2025, we expect the process of lowering interest rates to continue, with a further 100 basis points in the US (75 b.p. in the case of Europe).

Chronology

JANUARY 2024

11 NASA confirms that 2023 was the warmest year since records began (1880).
19 Japan becomes the fifth country to land on the Moon.

FEBRUARY 2024

22 The US returns to the Moon after more than 50 years with the landing of Odysseus, the first commercial module to touch down on the lunar surface.

NOVEMBER 2023

10 The EU's Copernicus programme reports that 2023 saw the hottest January-October period on record globally, 1.43°C above the 1850-1900 average, and records in the months of June, July, August, September and October.

DECEMBER 2023

13 COP28 (United Nations Climate Change Conference) ends with a commitment to transition away from fossil fuels.
20 The European Council approves the reform of EU fiscal rules.

SEPTEMBER 2023

14 The ECB raises rates by 25 bps, placing the depo rate at 4.00% and the refi rate at 4.50%.

OCTOBER 2023

7 A new war breaks out between Hamas and Israel.
20 Greece regains an investment grade sovereign rating after S&P raises it to BBB–.

Agenda

MARCH 2024

1 Portugal: S&P rating.
Euro area: CPI flash estimate (February).
4 Spain: registration with Social Security and registered unemployment (February).
7 Governing Council of the European Central Bank meeting.
11 Portugal: international trade (January).
15 Spain: quarterly labour cost survey (Q4).
Spain: Moody's and S&P ratings.
19-20 Federal Open Market Committee meeting.
21-22 European Council meeting.
22 Spain: loans, deposits and NPL ratio (Q4).
Portugal: Fitch rating.
25 Portugal: general government aggregates (2023).
Portugal: GDP breakdown (Q4).
26 Spain: GDP flash estimate (Q4).
27 Spain: CPI flash estimate (March).
Euro area: economic sentiment index (March).
28 Portugal: portfolio of loans and deposits (February).

APRIL 2024

2 Spain: registration with Social Security and registered unemployment (March).
Portugal: employment and unemployment (February).
Portugal: industrial production (February).
3 Euro area: CPI flash estimate (March).
10 Spain: financial accounts (Q4).
11 Governing Council of the European Central Bank meeting.
15 China: GDP (Q1).
18 Portugal: balance of payments (February).
22 Spain: loans, deposits and NPL ratio (February).
25 US: GDP (Q1).
26 Spain: labour force survey (Q1).
29 Spain: CPI flash estimate (April).
Euro area: economic sentiment index (April).
30 Spain: GDP flash estimate (Q1).
Portugal: GDP flash estimate (Q1).
Portugal: CPI flash estimate (April).
Euro area: GDP (Q1).
Euro area: CPI flash estimate (April).
30-1 May: Federal Open Market Committee meeting.

Investment is capital

Investment is once again in focus. It is increasingly clear that rapid technological change and the emergence of new countries with the capacity to compete globally, especially China, will put economies that fail to update their productive fabric out of the game. What's more, this is happening in a context of growing mistrust of multilateral institutions and, in general, between the different economic blocs. Even the relationship between the US and Europe, which seemed unbreakable a few years ago, is under suspicion. Donald Trump's continuous warnings of a generalised increase in customs duties if he wins the election, are a clear early warning.

Announcements of measures to strengthen domestic production capacity and reindustrialisation plans have been made in recent years in practically every country, and have become more pronounced in the wake of the pandemic and the energy crisis. In this context, investment is a key thermometer for measuring the impact of announced measures. Investment is the benchmark variable for assessing which countries are expanding and modernising their capital stock.

The recent evolution of total investment in the main developed economies is rather weak. In 2023, fixed capital investment grew by 0.6 per cent in the US, 0.9 per cent in the eurozone and 0.9 per cent in Portugal. These figures contrast with those recorded during the last expansionary cycle. Between 2014 and 2019, it grew by an average of 4.6 per cent a year in the US, 3.9 per cent in the euro area and 6.4 per cent in Portugal.

However, the aggregate figures hide important details. In the US, growth in total investment is penalised by the sharp drop in residential investment, which is more affected by rising interest rates, although towards the end of last year it began to show signs of recovery. Investment in non-residential construction is recovering dynamically and in 2023 grew by a remarkable 13.0 per cent. But above all, the dynamism of investment in intellectual property rights stands out, with an average growth of 8.0 per cent over the last three years; in computer equipment and software, 3.9 per cent, and in research and development, 5.2 per cent. As a result, private non-residential investment in the US is already more than 10 per cent above pre-pandemic levels.

In the eurozone and Portugal, the details are also important, although the message is not as positive as in the case of the American economy. As in the US, investment in housing has also seen notable falls in many eurozone countries, which penalises the aggregate view. On the other hand, investment in transport equipment stands out, which is growing strongly and in 2023 advanced 14.3 per cent in the eurozone as a whole (with data up to the 3rd quarter) and 18.6 per cent in Portugal, surpassing the average growth in the pre-pandemic years. Investment in machinery is also growing at a remarkable rate in the eurozone as a whole and is 3.0% above pre-pandemic levels. In this area, the Portuguese economy performed more poorly last year, but is clearly above pre-pandemic levels. In fact, investment in this component slowed to 4.1 per cent in 2023, which is 3 percentage points less than in the five years prior to the pandemic, but is 18.7 per cent above the 2019 level. On the other hand, in Portugal, the evolution of investment in intellectual property rights stands out. Although it slowed down in 2023, it was very dynamic in previous years and is 13.6 per cent above pre-pandemic levels.

The recovery in investment should be consolidated over the next few years. The easing of financial conditions, which has already begun and which should be consolidated from the second half of the year when the Fed and the ECB begin to lower interest rates, could act as an important catalyst. An additional element of support that could be added at the end of the year is the recovery of industry, a particularly investment-intensive sector. Some indicators are beginning to suggest that the sector may have reached its lowest point and could begin to recover if the energy crisis is finally overcome. The upturn in industrial production, particularly of capital goods, as well as the sector's activity indices should be emphasised. In this respect, the containment of the war in Ukraine and the conflict between Israel and Hamas is fundamental if the incipient recovery is to materialise.

In the case of the Portuguese economy, we expect that the execution of the NGEU European funds will stimulate public and private investment. In 2023, 3.6 billion euros were paid out to the final beneficiaries, equivalent to 46 per cent of the funds received, suggesting the need to accelerate the rate of execution of the funds received. In addition, it will be important not to neglect the reforms agreed with the EC so that there are no delays in receiving the next tranches, which is essential if the programme is to be fully implemented within the planned timetable, which ends in 2026. In this sense, the pace of implementation achieved is just as important as the fact that the programmes implemented manage to transform and boost the Portuguese economy in a lasting way. For this to happen, good investment performance is essential.

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

Financial markets

	Average 2000-2007	Average 2008-2020	2021	2022	2023	2024	2025
INTEREST RATES							
Dollar							
Fed funds (upper limit)	3.43	0.77	0.25	4.50	5.50	4.50	3.50
3-month SOFR	3.62	0.99	0.21	4.74	5.37	3.85	2.85
12-month SOFR	3.86	1.42	0.52	5.48	4.95	3.40	3.00
2-year government bonds	3.70	0.99	0.66	4.30	4.46	3.40	2.80
10-year government bonds	4.69	2.44	1.46	3.62	4.01	3.50	3.10
Euro							
ECB depo	2.05	0.15	–0.50	1.77	4.00	3.00	2.25
ECB refi	3.05	0.69	0.00	2.27	4.50	3.50	2.75
€STR	–	–0.55	–0.58	1.57	3.90	2.93	2.30
1-month Euribor	3.18	0.42	–0.60	1.72	3.86	2.83	2.33
3-month Euribor	3.24	0.57	–0.58	2.06	3.94	2.74	2.36
6-month Euribor	3.29	0.70	–0.55	2.56	3.93	2.76	2.40
12-month Euribor	3.40	0.86	–0.50	3.02	3.68	2.78	2.45
Germany							
2-year government bonds	3.41	0.27	–0.69	2.37	2.55	1.90	2.00
10-year government bonds	4.30	1.38	–0.31	2.13	2.11	2.00	2.20
Spain							
3-year government bonds	3.62	1.53	–0.45	2.66	2.77	2.32	2.42
5-year government bonds	3.91	2.01	–0.25	2.73	2.75	2.46	2.57
10-year government bonds	4.42	2.96	0.42	3.18	3.09	2.90	3.00
Risk premium	11	158	73	105	98	90	80
Portugal							
3-year government bonds	3.68	3.05	–0.64	2.45	2.33	2.54	2.66
5-year government bonds	3.96	3.63	–0.35	2.53	2.42	2.61	2.75
10-year government bonds	4.49	4.35	0.34	3.10	2.74	2.80	3.00
Risk premium	19	297	65	97	63	80	80
EXCHANGE RATES							
EUR/USD (dollars per euro)	1.13	1.26	1.13	1.06	1.09	1.12	1.15
EUR/GBP (pounds per euro)	0.66	0.84	0.85	0.87	0.86	0.83	0.87
EUR/GBP (yen per euro)	129.56	126.06	128.82	142.85	156.99	158.00	146.00
OIL PRICE							
Brent ($/barrel)	42.3	77.3	74.8	81.3	77.3	78.0	73.0
Brent (euros/barrel)	36.4	60.6	66.2	76.8	70.9	69.2	63.9

Forecasts

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

International economy

	Average 2000-2007	Average 2008-2020	2021	2022	2023	2024	2025
GDP GROWTH							
Global	4.5	2.9	6.3	3.5	3.0	3.0	3.2
Developed countries	*2.7*	*1.0*	*5.6*	*2.6*	*1.6*	*1.4*	*1.7*
United States	2.7	1.5	5.8	1.9	2.5	2.2	1.6
Euro area	2.2	0.3	5.9	3.4	0.5	0.7	1.7
Germany	1.6	0.8	3.1	1.9	–0.1	0.2	1.3
France	2.2	0.3	6.4	2.5	0.9	0.6	1.4
Italy	1.5	–1.0	8.3	4.1	1.0	0.6	1.6
Portugal	1.5	–0.2	5.7	6.8	2.3	1.6	2.3
Spain	3.7	–0.3	6.4	5.8	2.5	1.9	2.2
Japan	1.4	0.1	2.6	0.9	1.9	0.8	1.0
United Kingdom	2.7	0.3	8.7	4.3	0.1	0.0	0.6
Emerging and developing countries	*6.5*	*4.4*	*6.9*	*4.1*	*4.0*	*4.0*	*4.2*
China	10.6	7.5	8.5	3.0	5.2	4.6	4.4
India	7.2	5.7	9.0	7.3	7.5	6.7	5.5
Brazil	3.6	1.2	4.8	3.0	2.9	1.8	1.8
Mexico	2.3	0.7	5.7	4.0	3.2	2.1	2.1
Russia	–	1.0	5.9	–1.2	3.6	1.5	1.3
Türkiye	5.5	4.3	11.4	5.5	4.5	2.6	3.5
Poland	4.2	3.2	6.9	5.5	0.1	2.6	3.2
INFLATION							
Global	4.2	3.7	4.7	8.7	6.9	5.2	4.0
Developed countries	*2.1*	*1.5*	*3.1*	*7.3*	*4.6*	*2.5*	*2.0*
United States	2.8	1.7	4.7	8.0	4.1	2.6	2.0
Euro area	2.2	1.3	2.6	8.4	5.4	2.2	2.1
Germany	1.7	1.4	3.2	8.7	6.0	2.5	2.2
France	1.9	1.3	2.1	5.9	5.7	2.4	2.0
Italy	2.4	1.3	1.9	8.7	5.9	1.5	2.0
Portugal	3.1	1.0	1.3	7.8	4.3	2.3	2.0
Spain	3.2	1.2	3.1	8.4	3.5	3.0	2.5
Japan	–0.3	0.4	–0.2	2.5	3.3	2.0	1.5
United Kingdom	1.6	2.2	2.6	9.1	7.3	2.8	2.3
Emerging and developing countries	*6.7*	*5.5*	*5.9*	*9.8*	*8.5*	*7.2*	*5.4*
China	1.7	2.6	0.9	2.0	0.2	0.8	1.7
India	4.5	7.3	5.1	6.7	5.7	5.0	4.5
Brazil	7.3	5.5	8.3	9.3	4.8	4.3	3.7
Mexico	5.2	4.1	5.7	7.9	5.5	4.5	3.9
Russia	14.2	7.5	6.7	13.8	5.9	5.4	4.5
Türkiye	22.6	9.8	19.6	72.3	53.9	52.6	29.0
Poland	3.2	2.0	5.2	13.2	10.8	4.2	3.1

Forecasts

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

Portuguese economy

	Average 2000-2007	Average 2008-2020	2021	2022	2023	2024	2025
Macroeconomic aggregates							
Household consumption	1.7	–0.1	4.7	5.6	1.6	0.9	1.7
Government consumption	2.3	–0.2	4.5	1.4	1.2	1.8	1.0
Gross fixed capital formation	–0.4	–0.8	8.1	3.0	2.4	3.4	5.2
Capital goods	3.2	2.0	15.3	5.5	–	–	–
Construction	–1.5	–2.3	7.4	1.3	–	–	–
Domestic demand (vs. GDP Δ)	1.3	–0.4	6.0	4.7	1.2	1.8	2.2
Exports of goods and services	5.3	2.2	12.3	17.4	4.2	2.8	5.4
Imports of goods and services	3.6	1.5	12.3	11.1	2,2	3.2	5.3
Gross domestic product	**1.5**	**–0.2**	**5.7**	**6.8**	**2.3**	**1.6**	**2.3**
Other variables							
Employment	0.4	–0.6	2.2	2.2	2.0	1.1	1.4
Unemployment rate (% of labour force)	6.1	11.0	6.7	6.2	6.5	6.7	6.5
Consumer price index	3.1	1.0	1.3	7.8	4.3	2.3	2.0
Current account balance (% GDP)	–9.2	–2.7	–0.8	–1.4	1.2	1.2	1.6
External funding capacity/needs (% GDP)	–7.7	–1.5	1.0	–0.4	2.3	2.6	3.0
Fiscal balance (% GDP)	–4.6	–5.1	–2.9	–0.3	0.7	0.4	0.6

Forecasts

Spanish economy

	Average 2000-2007	Average 2008-2020	2021	2022	2023	2024	2025
Macroeconomic aggregates							
Household consumption	3.6	–0.9	7.2	4.8	1.7	2.4	2.3
Government consumption	5.0	1.3	3.4	–0.2	3.8	2.9	1.6
Gross fixed capital formation	5.6	–2.0	2.8	2.4	0.6	0.3	3.1
Capital goods	4.9	–0.8	4.4	1.9	–1.8	–0.2	3.8
Construction	5.7	–3.4	0.4	2.6	2.2	–0.2	2.8
Domestic demand (vs. GDP Δ)	0.2	0.1	0.3	0.1	0.0	0.1	0.1
Exports of goods and services	4.7	1.1	13.5	15.2	2.4	0.2	2.1
Imports of goods and services	7.0	–1.0	14.9	7.0	0.3	1.2	2.3
Gross domestic product	**3.7**	**–0.3**	**6.4**	**5.8**	**2.5**	**1.9**	**2.2**
Other variables							
Employment	3.2	–0.9	7.1	3.7	3.2	2.4	1.8
Unemployment rate (% of labour force)	10.5	19.2	14.8	12.9	12.1	11.8	11.4
Consumer price index	3.2	1.2	3.1	8.4	3.5	3.0	2.5
Unit labour costs	3.0	1.2	1.0	0.9	5.9	4.4	2.5
Current account balance (% GDP)	–5.9	–0.2	0.8	0.6	2.5	2.3	2.5
External funding capacity/needs (% GDP)	–5.2	0.2	1.9	1.5	3.5	3.3	3.5
Fiscal balance (% GDP)[1]	0.3	–6.8	–6.8	–4.7	–4.1	–3.4	–2.9

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

Forecasts

The markets adjust to calls for «patience»

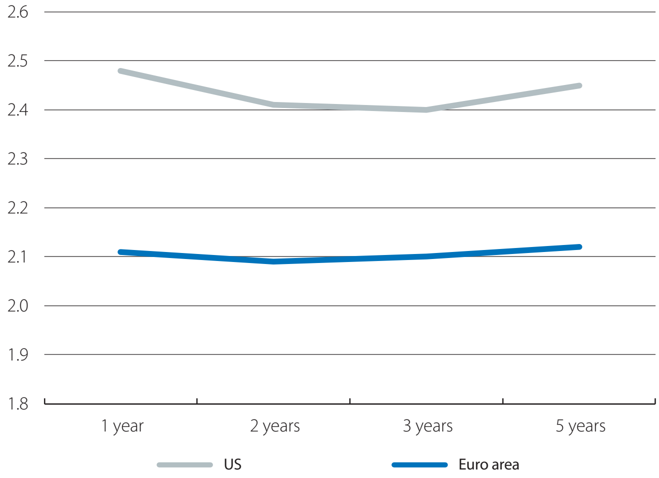
Investors postpone their expectations of rate cuts. The downward resistance of core inflation in the world's major economies led investors to revise their monetary policy expectations as February progressed and to reorganise their forecasts regarding the timing of interest rate cuts. Thus, given the insistence of the messages coming from Fed and ECB officials, pointing out that the battle against inflation is not yet over and that the so-called last mile will be more difficult than anticipated, the financial markets began to soften the aggressive rate cut expectations which they had been reflecting earlier in the year, especially in the US. Despite this change of circumstances, and amid abrupt fluctuations in sovereign debt yields, risk-bearing assets continued to perform well, including equities, where the resilience of business earnings led several of the major stock market indices to reach record highs.

The central banks remain cautious. The consumer price and industrial cost data for February confirmed the most cautious investors' suspicions that the pace of the slowdown in prices had reduced significantly compared to the previous months on both sides of the Atlantic. In both cases, the increased pressures on prices linked to energy and the obstacles in trade (triggered by the tensions in the Red Sea), the recovery of wages in the face of the lost purchasing power, as well as the resilience of the US business cycle all prompted investors to raise their outlook for short-term inflation (1-year inflation swaps in both economies rose by around 40 bps), placing it slightly above 2% for the next few years. In parallel, and as a result of this upward revision of price expectations, the financial markets also began to revise their expectations regarding the timing and magnitude of the Fed and ECB's planned interest rate cuts. This impetus to revise the outlook was only reinforced by the large number of statements given by members of both central banks.

At the Fed, there is unanimous concern about the risk of lowering rates too soon given the strong employment and inflation data, as was reflected in the minutes of the latest FOMC meeting. The central bank's messages show an inclination for taking a careful approach, based on the observation of the upcoming data on inflation, the labour market and household consumption, and a slower reduction in interest rates compared to the timing anticipated by the market. In this regard, investors postponed their expectations for the first rate cut in the US from March/May to June, while anticipating a 100-bp total reduction in 2024 as a whole. In the euro area, although the current economic situation in the region is somewhat weaker, ECB members were also very cautious about the risk of lowering interest rates too soon, highlighting the need to keep an eye on the trajectory of

Inflation swaps at different maturities

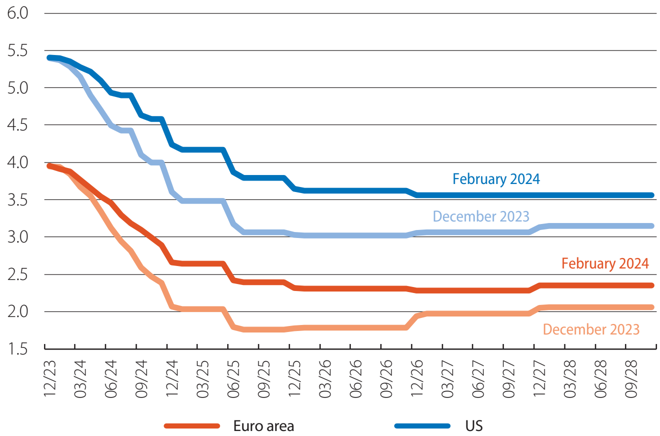
(%)



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

Expectations for Fed and ECB reference interest rates

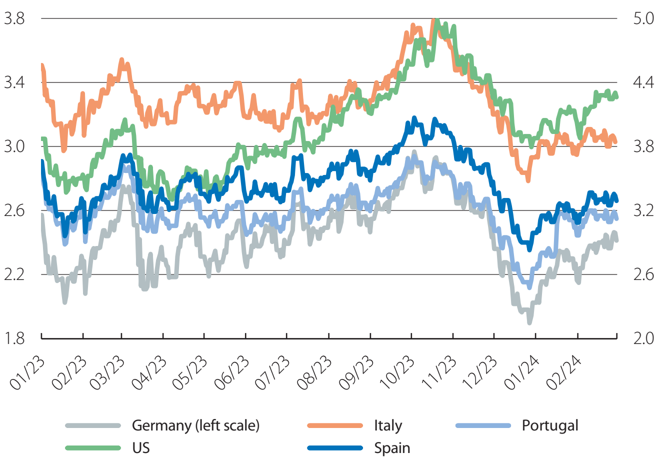
(%)



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

Yields on 10-year sovereign debt

(%) (%)



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

inflation, which could be influenced by factors such as wage negotiations, business margins and productivity. Thus, like in the US, the markets also pushed back their expectations regarding the first ECB rate cut to June, anticipating a total reduction of 100 bps during 2024.

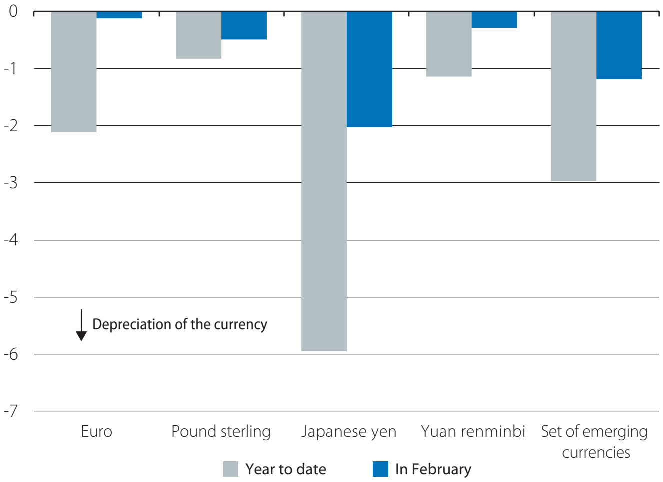
Sovereign yield curves shift upwards. The impact of the postponement of interest rate expectations in the US and euro area was mostly felt in the fixed-income markets, and in sovereign yield curves in particular. The publication of less benevolent than expected inflation data in the US caused a sharp rebound in treasury yields throughout the curve, which shifted upwards and remained at their new levels for the rest of the month, fuelled by the messages of patience from members of the Fed. The interest rate on the 2-year bond, which reliably captures expectations for the fed funds rate, rose to levels not seen since the Fed's «pivot» in December and ended the month at around 4.6% (+41 bps). This situation was monetised by the exchange rate of the dollar, which continued to appreciate against the rest of the major currencies. Meanwhile, the yield on the 10-year treasury once again surpassed the 4% barrier and exceeded 4.3%. In the euro area, sovereign yield curves behaved much like in the US, induced by the ECB's reluctance to lower rates. Thus, the German 2-year bond accumulated an increase of some 50 bps in the month, while in the longer stretches of the yield curve the better performance of the peripheral economies' debt favoured a narrowing of risk premiums.

Equities remain immune to the delay in rate reductions. In February, and despite the monetary outlook, investors maintained their appetite for equities, attracted above all by the broadly positive business earnings announced for Q4 2023. Tech and AI firms provided the greatest support for the main stock market indices, which, in the case of the S&P 500, Germany's Dax and France's CAC, reached new all-time highs. Meanwhile, in China, the implementation of measures in the stock markets to regain investor confidence and the deployment of aid to the real estate sector favoured gains in the country's main indices.

Commodity prices remain contained. In this context, the strength of the dollar and the fear of cooling demand helped to contain the prices of the major commodities, with the exception of the Brent oil barrel. The easing of the oil supply deficit as a result of an increase in output from non-OPEC countries, especially the US, was almost neutralised in the markets by the rising tensions in the Red Sea, causing the price of a barrel to remain at around 83 dollars for much of the month. On the other side of the coin, European natural gas (Dutch TTF) fell to 25 euros/MWh in a context marked by a high supply of liquefied natural gas and healthy gas reserves, amid milder weather conditions than usual on the continent.

Currencies against the dollar

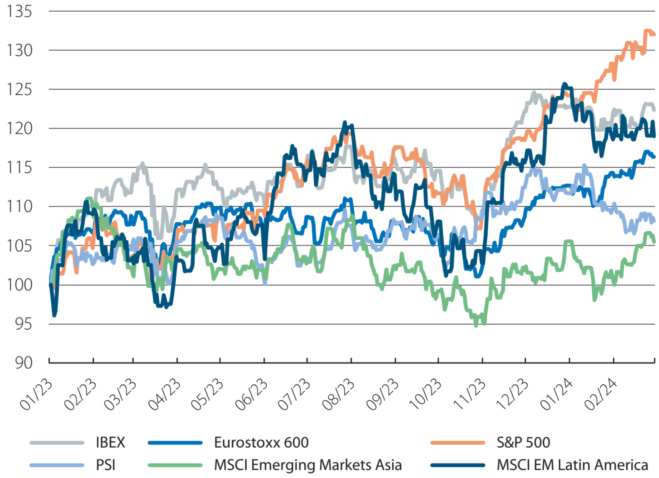
(%)



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

International stock markets

Index (100 = January 2023)



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

Commodity prices

	Measure	Price	Change (%) Last month	Year to date	2022	2023
Commodities	Index	96.1	–2.7	–2.6	13.8	–12.6
Energy	Index	30.9	–3.9	0.6	33.5	–25.6
Brent	$/barrel	82.8	–0.9	7.5	10.5	–10.3
Natural gas (Europe)	€/MWh	25.5	–9.4	–21.3	8.5	–57.6
Precious metals	Index	215.4	–0.5	–3.7	–1.9	4.1
Gold	$/ounce	2,027.2	–0.3	–1.7	–0.3	13.1
Industrial metals	Index	136.0	–2.7	–4.6	–4.4	–13.7
Aluminium	$/MT	2,191.5	–3.6	–8.1	–15.3	0.3
Copper	$/MT	8,474.0	–0.8	–1.0	–13.9	2.2
Agricultural comm.	Index	58.5	–4.1	–6.3	13.2	–9.3
Wheat	$/bushel	582.5	–3.0	–7.2	2.8	–20.7

Note: *Data as of 28 February 2024.*
Source: *BPI Research, based on data from Bloomberg.*

Risks in the US commercial real estate sector

At the end of January, New York Community Bancorp (NYCB) shares, a bank specialised in the office and multi-family residential real estate sector in the New York metropolitan area, plummeted 38% in a single day, after reporting losses and increasing provisions. Is this a new indication of latent risks in the US commercial real estate sector?

What happened?[1]

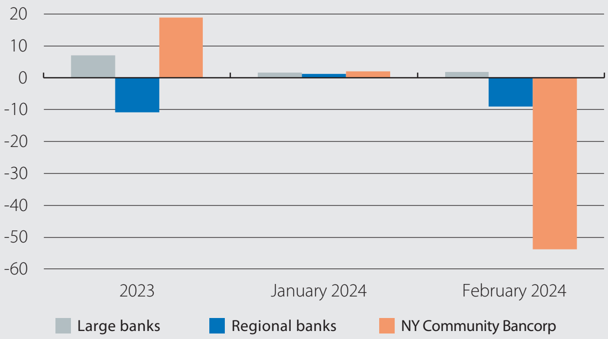
In the space of just a few months, NYCB went from being a small, specialised institution to being a bank with over 100 billion dollars in assets following the acquisition of Flagstar Bank, based in the state of Michigan, and Signature Bank, one of the banks that failed in the wake of the turbulence of March 2023. Following these changes, at the end of January the bank announced a 70% dividend cut aimed at boosting liquidity, in addition to sharply increasing its provisions (by over 700%) to protect against the risk of potential losses in its loan portfolio. While both decisions were presented as measures aimed at adapting to regulatory requirements, they occurred in the midst of weakness in the US commercial real estate sector and they were announced together with the bank's Q4 2023 losses (in addition to the acknowledgement of issues with two large loans, one related to office buildings and the other to apartment buildings). The financial markets heavily penalised these announcements, causing NYCB's share price to plummet, and it is currently down more than 50% since then. Additionally, the episode caused some contagion, with other regional bank stocks currently trading 10% down as part of a risk-off movement in the face of fears that the troubles in the US commercial real estate sector could begin to cause difficulties for the most exposed banks. In contrast, the big banks, with much less exposure, were barely affected by the unease.

Not all of the sector is equal and neither are all of the risks

The commercial real estate sector is diverse and includes various different segments, each one with its own characteristics and risks, so not all of them are necessarily in trouble. On the one hand, the retail segment (ranging from shops to florists, to cafés and any other retail establishment) has benefited from the strength of consumption in the US economy, while the industrial segment (mainly warehouses and distribution centres) has been spurred on by the rapid growth of e-commerce since the pandemic.

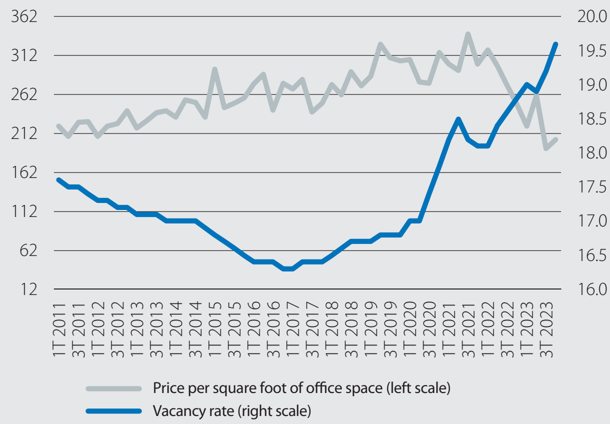
1. The cut-off date for this article was 29 February. Since then, and up until the cut-off date for this Monthly Report, NYCB has undergone a change of leadership after identifying weaknesses in its internal controls related to loans, it has revised its reported losses upwards and has received an injection of capital of 1 billion dollars. The cumulative loss in its share price as of the close of this report was 65%.

US: stock market performance of bank indices
Change (%)



Notes: *Large banks captured by the S&P 500 Banks index; regional banks captured by the S&P 500 Regional Banks index. January is considered up until 29/01/2024, the day before the NYCB report, and February is considered from 30/01/2024 to 29/02/2024.*
Source: *BPI Research, based on data from Bloomberg.*

US: office space statistics
(Dollar/square foot) *(%)*



Source: *BPI Research, based on data from Bloomberg and Real Capital Analytics.*

The situation in the multi-family homes and office segments is different. The former has seen a recent rise in vacancy rates. In addition, some cities such as New York, Los Angeles and San Francisco have implemented price controls which limit rent increases in certain areas. However, generally speaking the sector does not appear to be suffering from a structural problem, since the lack of housing supply in the US, along with the high interest rates (which cool the demand for mortgages and thus for home purchases), can be expected to act as supports in the medium term.

In contrast, the office segment is currently going through a rough patch, and it is doing so in the midst of structural changes, especially those derived from the habits adopted after the pandemic, with remote and/or hybrid work having become the new norm and reducing the demand for office space. Office vacancy rates have surged and are now approaching 20% across the country as a whole. Moreover, the occupancy rate of newly built offices is at a low: according to data from Bloomberg, of the 24.5 million square feet of construction completed in 2023, only 4.8 million were occupied.[2] Thus, oversupply has limited rental prices and depreciated the value of properties; so much so that office property prices have fallen by as much as 40% since the peak reached in 2021.

In addition, there is the risk posed by refinancing. A study published by the NBER[3] estimates that, in 44% of office loans, the market value of the property is lower than the outstanding loan balance associated with it. Moreover, in a context of high interest rates, it is estimated that in 2024 and 2025, loans to the tune of 150 billion and 300 billion dollars, respectively, will mature and need to be refinanced.

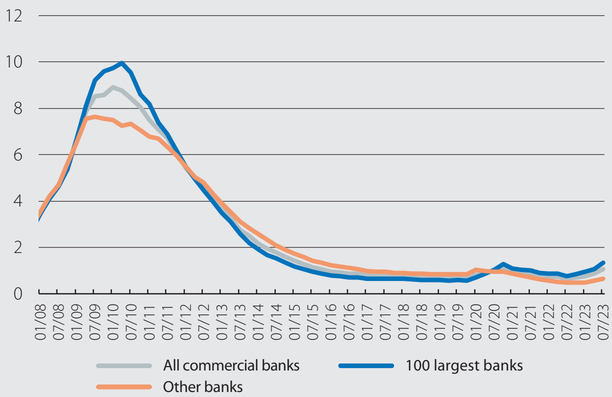
Not all banks are equal and neither is their exposure

According to data from the Fed, the market for loans to the commercial real estate sector is worth 3.5 trillion dollars (as of October 2023), of which 2.7 trillion is in the hands of commercial banks. This amount represents, in aggregate, 25% of the total loan portfolio of US banks and 13% of their assets. However, the proportions vary and exposure to the commercial real estate sector is most relevant in regional banking: for the 25 biggest banks, which hold 30% of all the commercial real estate loans that are in the hands of commercial banks, this sector represents only 13% of their loan portfolio, and the office segment specifically represents just 3%. In contrast, for the rest of the small regional banks, which hold the remaining 70% of the loans to the sector, it is 44% of their portfolio.

Beyond the extent of the banking sector's exposure, other figures are more reassuring. Delinquency rates remain historically low for now. The median loan-to-value ratio in regional banks for commercial real estate loans is 58%, a conservative figure. In recent simulations conducted by the St. Louis Fed, they estimate that if the entire portfolio of commercial real estate debt were to lose 10% of its value, the banks that would fall into insolvency would account for just 2% of the assets of the entire American banking system. In this regard, the words of Fed Chair Jerome Powell and Treasury Secretary Yanet Yellen offer a balanced analysis of the situation:

2. Equivalent, in the metric system, to a constructed floor space of 2.2 million square metres, of which 445,000 square metres were occupied.
3. See Xuwewi *et. al.* (2023). «Monetary Tightening, Commercial Real Estate Distress and US Bank Fragility», NBER Working Paper Series, December.

US: NPL ratios for commercial real estate loans
(%)



Source: *BPI Research, based on data from the Federal Reserve Bank of St. Louis.*

both have acknowledged that the weakness of the commercial real estate sector poses a problem, insofar as some small and regional banks have significant exposure and it is likely that there will be losses, but it is a source of risk which they have been monitoring for a long time, they consider it to be «manageable» and they are «working with them [small banks]». After all, over the coming quarters, and beyond the respite that the Fed's first rate cuts may provide, the structural difficulties in the sector are likely to persist, especially in the offices segment, and the environment can be expected to remain challenging.

Interest rates (%)

	29-February	31-January	Monthly change (bp)	Year-to-date (bp)	Year-on-year change (bp)
Euro area					
ECB Refi	4.50	4.50	0	0.0	150.0
3-month Euribor	3.94	3.91	3	2.8	115.4
1-year Euribor	3.75	3.57	18	23.6	0.4
1-year government bonds (Germany)	3.43	3.15	28	17.2	18.3
2-year government bonds (Germany)	2.90	2.43	47	49.7	–30.3
10-year government bonds (Germany)	2.41	2.17	25	38.7	–30.0
10-year government bonds (Spain)	3.29	3.09	20	29.6	–37.8
10-year government bonds (Portugal)	3.12	2.97	15	46.7	–45.4
US					
Fed funds (upper limit)	5.50	5.50	0	0.0	75.0
3-month SOFR	5.33	5.32	2	0.2	42.8
1-year government bonds	5.00	4.71	29	23.6	–1.9
2-year government bonds	4.62	4.21	41	36.9	–25.8
10-year government bonds	4.25	3.91	34	37.1	25.8

Spreads corporate bonds (bps)

	29-February	31-January	Monthly change (bp)	Year-to-date (bp)	Year-on-year change (bp)
Itraxx Corporate	55	60	–5	–3.2	–23.8
Itraxx Financials Senior	64	70	–6	–2.9	–23.8
Itraxx Subordinated Financials	117	131	–14	–5.4	–36.8

Exchange rates

	29-February	31-January	Monthly change (%)	Year-to-date (%)	Year-on-year change (%)
EUR/USD (dollars per euro)	1.081	1.082	–0.1	–2.1	1.3
EUR/JPY (yen per euro)	162.060	158.950	2.0	4.1	11.5
EUR/GBP (pounds per euro)	0.856	0.853	0.4	–1.3	–3.5
USD/JPY (yen per dollar)	149.980	146.920	2.1	6.3	10.1

Commodities

	29-February	31-January	Monthly change (%)	Year-to-date (%)	Year-on-year change (%)
CRB Commodity Index	524.4	521.5	0.6	2.8	–5.0
Brent ($/barrel)	83.6	81.7	2.3	8.5	–0.8
Gold ($/ounce)	2,044.3	2,039.5	0.2	–0.9	11.3

Equity

	29-February	31-January	Monthly change (%)	Year-to-date (%)	Year-on-year change (%)
S&P 500 (USA)	5,096.3	4,845.7	5.2	6.8	29.0
Eurostoxx 50 (euro area)	4,877.8	4,648.4	4.9	7.9	15.7
Ibex 35 (Spain)	10,001.3	10,077.7	–0.8	–1.0	7.3
PSI 20 (Portugal)	6,158.0	6,322.8	–2.6	–3.7	3.2
Nikkei 225 (Japan)	39,166.2	36,286.7	7.9	17.0	42.3
MSCI Emerging	1,020.9	975.8	4.6	–0.3	3.7

The trends in the international economy continue

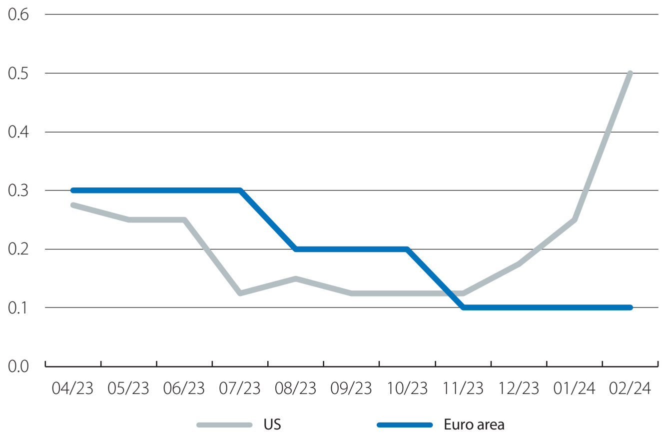
Continuity in the international scenario. The latest data suggest that the dynamics experienced at the end of last year are persisting. Thus, the US economy continues to display a significant capacity for growth, while the euro area still struggles to find the necessary momentum to definitively ward off the spectre of recession. In China, meanwhile, the problems in the real estate sector are forcing the authorities to implement various measures to limit their impact on the growth of the economy as a whole.

The euro area begins the year with a weak outlook. In fact, the PMIs for February confirm that economic activity remains somewhat apathetic (composite index +1 point, to 48.9, still below the 50-point threshold that indicates growth), weighed down by the difficulties in industry and the lack of momentum in the services sector. In addition, the economic sentiment index recorded its second consecutive fall in February (–0.7 points, to 95.4, well short of the 100-point mark that indicates growth at around the historical average), mainly due to the deterioration of the services sector. The performance of these indicators suggests that in the early stages of 2024 the euro area continues to suffer from the lack of momentum which characterised it in 2023. Moreover, all the indicators suggest that, once again, the economy will stagnate in Q1 and a fall in economic activity cannot yet be ruled out.

Germany has the worst outlook and the one with the greatest risks. The GDP of the largest economy in the region already ended 2023 with a setback (–0.3% quarter-on-quarter in Q4) and risks starting 2024 the same way, as the Bundesbank is warning. In fact, in February, the composite PMI fell to 46.1 points, weighed down by a manufacturing sector that has been in contractionary territory for 20 consecutive months and a services PMI that recorded its fifth consecutive month below the 50-point threshold in February. In addition, the low levels of the Ifo in February (85.5, compared to the value of 100 that is compatible with growth at around its long-term average) and the persistent weakness in consumer confidence suggest that Q1 will bring few positive surprises. With regard to France and Italy, various business climate indicators suggest that the situation is somewhat better than in Germany, but in February they remain at levels compatible with practically stagnant economic activity. Against this backdrop of weak economic activity, euro area inflation declined slightly in February (headline inflation at 2.6% and the core index at 3.1%).

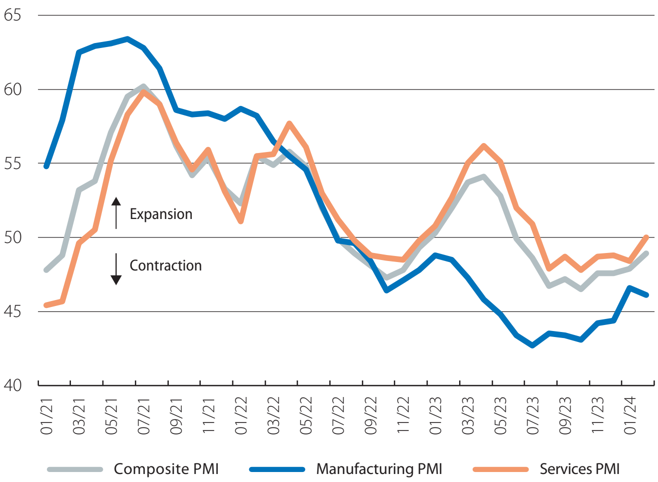
The economy got off to a good start this year. Expectations for the economy remain broadly positive and have not been altered by the poor performance shown in January by some indicators. In this regard, the setbacks suffered in January by retail sales (–0.8% month-on-month vs. +0.4% previously) and industrial production (–0.1% vs. 0.0%) are largely explained by rather adverse weather conditions. Also, the sharp drop in orders of durable goods in January (–6.1% vs. –0.3%) is due to the decline in orders of transport equipment (orders for commercial aircraft were down almost 60%), whilst orders

*Global: GDP growth forecasts for Q1 2024 **
Quarter-on-quarter change (%)



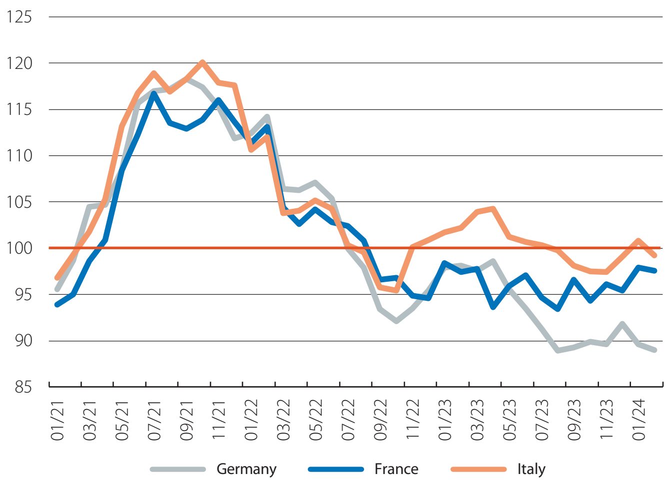
Note: ** Median of Reuters consensus forecasts.*
Source: *BPI Research, based on data from Refinitiv.*

Euro area: PMI
Index



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

Euro area: economic sentiment
Index (100 = average since 2000)



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

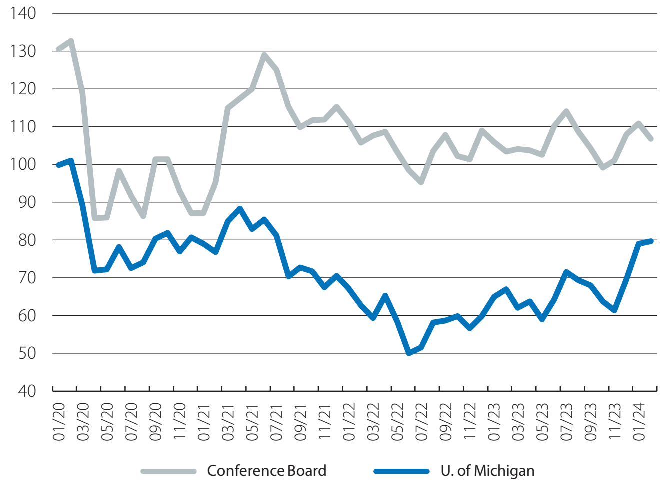
for non-defence capital goods (a proxy for investment in capital goods) grew by 0.8%. Therefore, this weak start to the year does not appear to be a sign of an imminent change of trend. In fact, the PMIs for February were well above the 50-point threshold that indicates growth, both at the aggregate level (51.4) and individually for manufacturing (51.5) and services (51.3). As for household spending, the Conference Board's Consumer Confidence Index, despite falling in February (106.7 vs. 110.9), is showing a January-February average that is well above the previous quarter's average. The buoyancy still shown by the labour market (in January 353,000 jobs were created, with an unemployment rate that remained at 3.6%) supports the prospect that household spending is likely to remain robust in the short term.

The decline in US inflation is occurring very gradually. On the other hand, the situation in the residential sector on the demand side is improving timidly. Sales of existing homes increased by 3.1% in January, reaching 4.0 million units in annualised terms, and sales of new homes rose by 1.5% in January, to 661,000 annualised units. In any case, these figures are still 25% and 6.5% lower, respectively, than their pre-COVID long-term averages, highlighting the margin for improvement that exists as 30-year interest rates (the main benchmark used for mortgages) gradually converge with the outlook for US rates. In this context of economic buoyancy, inflation is falling, but more slowly than in previous quarters due to the resistance of the shelter component (which accounts for over 35% of the headline CPI): in January, headline inflation dropped 0.3 pps, to 3.1%, while the core index remained unchanged at 3.9%. The evidence of strength in the US economy, coupled with the slow correction of inflation, explain the sharp movements in the financial markets in recent weeks and the adjustments in market expectations regarding when the Fed will carry out its first rate cut in over two years (see the Financial Markets Economic Outlook section).

China's residential sector is the major burden on its economy. The celebration of the Lunar New Year (LNY) in China affects the publication of the monthly indicators, limiting our ability to analyse the Chinese economy at the beginning of this year. Among the limited available indicators, those related to domestic spending during the LNY holidays, such as retail sales and spending at restaurants, grew by a robust 8.5% year-on-year. On the other hand, the problems in the residential sector persist: home sales fell in January by 35% year-on-year, further increasing the already high inventories of housing and pushing down prices, which in January fell at a year-on-year rate of 1.2% (–0.9% previously). The official composite PMI, meanwhile, remained stable at 50.9 points in February, only marginally in expansive territory. In this context, the People's Bank of China continues to take measures to stimulate credit (the mortgage benchmark rate has been reduced by 150 bps since last year) and to boost liquidity in the system by cutting back the cash ratio. However, in addition to the problems in the residential sector, consumption and investment decisions could be impacted by the deterioration of the deflationary situation in the economy: in January, the year-on-year change in consumer prices was –0.8% (–0.3% previously) and in the case of production prices, –2.5% (–2.7% previously).

US: consumer confidence

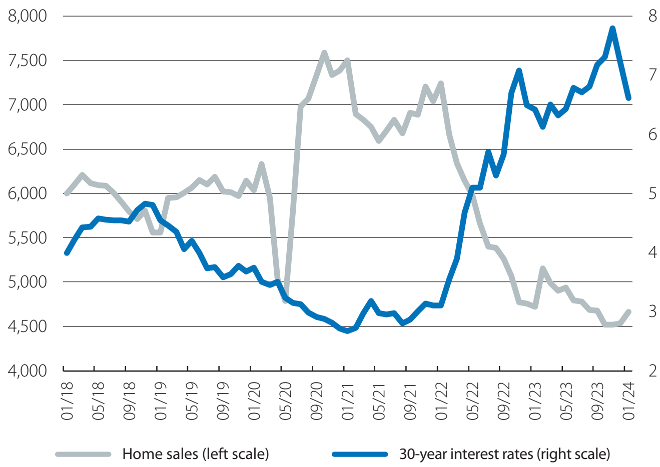
Index



Source: *BPI Research, based on data from the Conference Board and the University of Michigan.*

US: home sales and interest rates*

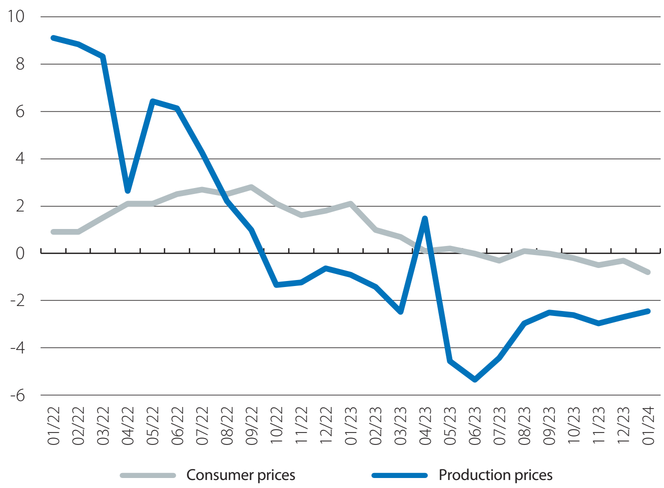
(Thousands of annualised units) *(%)*



Note: ** New homes and existing homes.*
Source: *BPI Research, based on data from the Census Bureau, the National Association of Realtors and Freddie Mac.*

China: evolution of prices

Year-on-year change (%)



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

US inflation's last mile

One of the key elements of our new forecast scenario for the international and US economies is the prediction that the central banks will begin to cut interest rates in mid-2024. However, this easing of monetary policy is dependent on inflation continuing to fall towards the 2% target, and this path – which has been dubbed the «last mile» – is neither free from hurdles nor will it necessarily be fast. Focusing on the case of the US, what factors will help it to reach 2%?

US headline inflation stood at 3.1% in January (0.3 pps less than in December and 1.0 pp less than the 2023 average), while core inflation, which excludes energy and food, remained at 3.9% (4.8% in 2023). These figures are still somewhat higher than the Federal Reserve would like, but there are several indicators and nuances that suggest that the inflationary pressures are moderating more than this 3.1% would indicate.

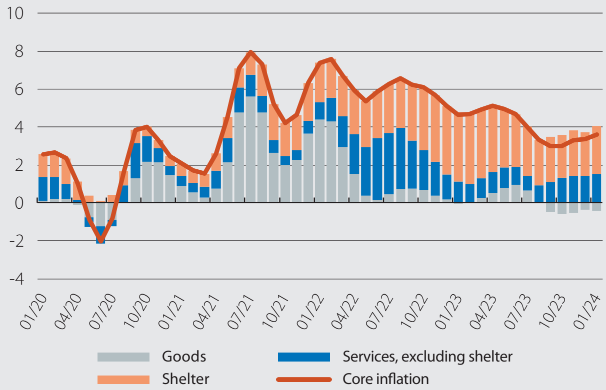
To observe the most immediate inflationary pressures, it is helpful to look at so-called inflation momentum,[1] as this indicates what the year-on-year inflation would be if the inflationary pressures of the last three months were to prevail for a 12-month period. Thus, as can be seen in the first chart, the momentum of core inflation has abandoned the levels above 5%, standing in January at 3.6%. At first glance, this figure is still high and suggests that the undesirable high inflation is persisting. However, the chart helps us to identify three phases of the inflationary process and, through this analysis, we can anticipate a good outlook for the coming months.

In a first phase of the cycle, between mid-2021 and early 2022, it was goods that drove up inflation, as a result of the bottlenecks in global distribution chains and the rise in energy and other commodity prices. These inflationary pressures have not only now dissipated, but the prices of goods are exerting deflationary pressure. In a second phase, during the middle two quarters of 2022, US inflation received a new boost through services, reflecting, above all, the buoyancy of the labour market, the pent-up savings accumulated during the previous months and changes in consumption patterns following the lifting of restrictions after the pandemic (see second chart). Since the start of 2023, however, this element has also ceased to be a source of concerning inflationary pressures, with a similar contribution to inflation momentum as it had prior to the pandemic.

Thus, since the end of 2022 we have found ourselves in a third phase in which the shelter component, which accounts for 35% of the consumer price index basket

US: core inflation momentum and its contributing components

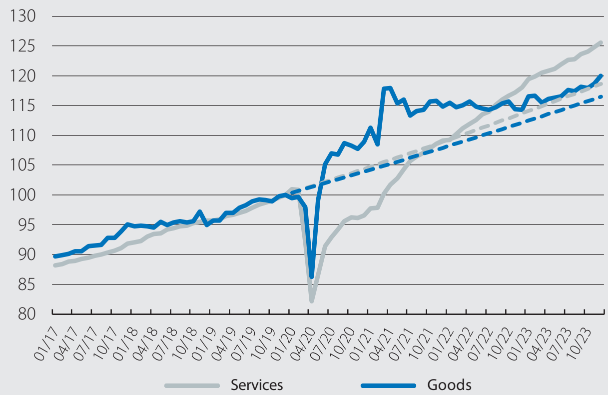
Annualised seasonally-adjusted quarter-on-quarter change (%)



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

US: consumption of goods and services

Index (100 = December 2019)



Note: *The dashed line shows a projection following the trend observed between 2017 and 2019.*
Source: *BPI Research, based on data from the Personal Consumption Expenditures Price Index of the Bureau of Economic Analysis.*

and measures rental prices (observed and equivalent for home owners), has become the main contributor to the high levels of inflation. Its momentum is currently 5.5% and its year-on-year inflation as high as 6.1%, to the surprise of most analysts. In addition, its contribution to core inflation momentum at the end of 2023 was 2.5 pps, while its average contribution between 2012 and 2019 was 1.3 pps. Therefore, if these values were to normalise, core inflation momentum would be 2.4%, much closer to the Fed's target. As we explained in a previous article,[2] the price of rents measured using alternative indicators to those of the Bureau of Labor Statistics (such as the Zillow Rent Index) is falling sharply, which sooner or later should translate into lower inflation rates in the shelter component. In fact, according to a report published

1. The annualised change in the three-month average of the seasonally-adjusted CPI compared to the previous three months.

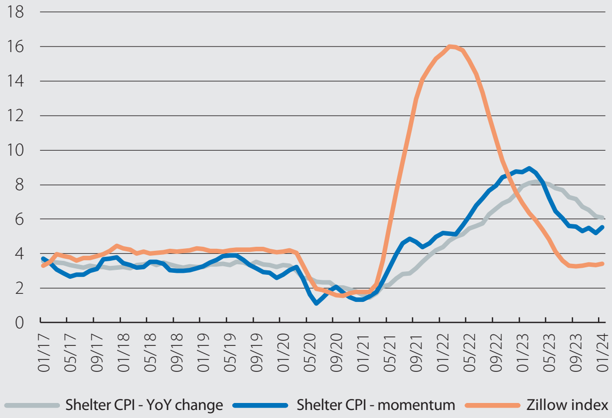
2. See «The importance of rents in US inflation» in the MR09/2023.

by the Joint Center for Housing Studies of Harvard University, the tensions in the rent market are clearly moderating and this process looks set to continue in the coming months. The report points out that the price of new rents rose in Q4 by just 0.2% year-on-year, far from the +15.3% registered at the beginning of 2022, and that of the 150 rental markets which they monitor, only 8 registered year-on-year increases of more than 5% in that quarter (146 markets in Q1 2022, with 25 reporting increases in excess of 20%).[3] All of this allows us to be optimistic about the outlook for the shelter component, and as Fed Chair Jerome Powell stated in January, there is no doubt that these de-escalation dynamics in the rental market will eventually filter through to the official inflation measures. The only question is when this will happen and to what extent.[4]

However, there are several risks surrounding this expectation of a moderation in inflation. Firstly, while the contribution from services excluding shelter has normalised with respect to the tensions observed in mid-2022 (the second element we mentioned earlier), the latest figures published since November do not leave the Fed any room for complacency. Specifically, services, excluding shelter, have gone from averaging a momentum of 3% in Q3 2023 to one of 5.4% in January. Indeed, the price of services is more closely linked to wages than certain goods, so given the expectations that the labour market will remain robust in 2024, we should not assume that inflation's path towards 2% will be plane sailing. Secondly, the current geopolitical landscape poses a significant source of risk, and while the economic implications of the ongoing conflicts are limited for now (not so for the humanitarian implications), both container shipping costs and commodity prices (e.g. oil, gas or other industrial materials) could be stressed in the event of any escalation, potentially driving up inflation once again. Thirdly, the strength of US domestic demand – driven not only by household consumption but also by the current fiscal deficits, which are likely to continue regardless of who wins the presidential election on 5 November – requires us to exercise caution in declaring the fight against inflation over.

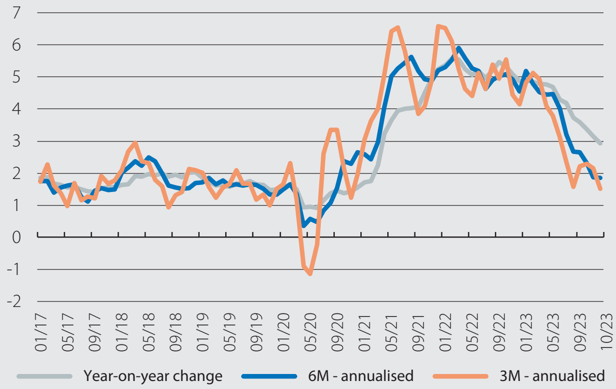
In any case, while all these uncertainties exist, the disinflationary process has made significant progress in 2023 and should, in theory, continue in 2024 provided that the risks mentioned above do not materialise. In addition, it should be recalled that the Fed's inflation target is not referenced to the CPI, but rather to the Personal Consumption Expenditures (PCE) index and

US: rental prices
Year-on-year change (%)



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

US: Personal Consumption Expenditures Price Index
(%)



Source: *BPI Research, based on data from the Bureau of Economic Analysis.*

its inflation was 2.4% year-on-year in January (0.7 pps less than the CPI, largely because of the lower relative weight of shelter in the PCE index, at less than 15%). Moreover, in December the momentum of the PCE index was already below 2%, and this is a metric which the Fed usually refers to as a good indicator of inflationary pressures. All this opens the door to the possibility of interest rate cuts. Just as in the case of shelter, it is not so much a question of whether the Fed will lower rates, but when and by how much.

3. See «America's rental housing 2024», Joint Center for Housing Studies.
4. *We think that's coming, and we know it's coming. It's just a question of when and, and how big it'll be.* Transcript of the press conference of the FOMC meeting of 30 and 31 January 2024.

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

UNITED STATES

	2021	2022	Q1 2023	Q2 2023	Q3 2023	Q4 2023	12/23	01/24	02/24
Activity									
Real GDP	5.8	1.9	1.7	2.4	2.9	3.1	–	–	–
Retail sales (excluding cars and petrol)	15.8	9.3	5.9	3.2	2.3	1.2	5.6	2.2	...
Consumer confidence *(value)*	112.7	104.5	105.5	106.1	104.5	103.7	108.0	110.9	106.7
Industrial production	4.4	3.4	1.3	1.0	0.9	0.5	1.2	0.0	...
Manufacturing activity index (ISM) *(value)*	60.7	53.5	48.3	47.8	47.2	47.1	47.1	49.1	47.8
Housing starts *(thousands)*	1,606	1,551	1,375	1,378	1,385	1,388	1,562	1,331	...
Case-Shiller home price index *(value)*	267	307	303	302	302	303	321.7	...	...
Unemployment rate *(% lab. force)*	5.4	3.6	3.5	3.5	3.5	3.5	3.7	3.7	...
Employment-population ratio *(% pop. > 16 years)*	58.4	60.0	60.1	60.2	60.3	60.3	60.1	60.2	...
Trade balance [1] *(% GDP)*	–3.6	–3.7	–3.6	–3.5	–3.2	–3.1	–2.8	...	...
Prices									
Headline inflation	4.7	8.0	6.7	6.3	5.8	5.3	3.4	3.1	...
Core inflation	3.6	6.2	5.7	5.6	5.6	5.5	3.9	3.9	...

JAPAN

	2021	2022	Q1 2023	Q2 2023	Q3 2023	Q4 2023	12/23	01/24	02/24
Activity									
Real GDP	2.6	1.0	2.6	2.3	1.7	1.0	–	–	–
Consumer confidence *(value)*	36.3	32.2	30.7	31.2	32.2	33.5	37.2	38.0	39.1
Industrial production	5.8	0.0	–1.8	–1.8	–2.0	–0.7	0.6	–3.2	...
Business activity index (Tankan) *(value)*	13.8	9.5	1.0	5.0	9.0	12.0	–	–	–
Unemployment rate *(% lab. force)*	2.8	2.6	2.5	2.5	2.6	2.6	2.5	2.4	...
Trade balance [1] *(% GDP)*	–0.3	–3.7	–4.0	–4.0	–3.9	–3.9	–1.6	–1.3	...
Prices									
Headline inflation	–0.2	2.5	4.1	3.9	3.6	3.4	2.6	2.1	...
Core inflation	–0.5	1.1	3.0	3.2	3.5	3.8	3.7	3.5	...

CHINA

	2021	2022	Q1 2023	Q2 2023	Q3 2023	Q4 2023	12/23	01/24	02/24
Activity									
Real GDP	8.4	3.0	4.5	6.3	4.9	5.2	–	–	...
Retail sales	12.4	–0.8	5.8	10.7	4.2	8.3	7.4	...	...
Industrial production	9.3	3.4	3.2	4.5	4.2	6.0	6.8	...	...
PMI manufacturing *(value)*	50.5	49.1	51.5	49.0	49.7	49.3	49.0	49.2	49.1
Foreign sector									
Trade balance [1,2]	681	899	948	946	901	...	868.8	...	...
Exports	30.0	7.1	0.1	–5.4	–10.8	...	–0.8	...	...
Imports	30.0	0.7	–7.2	–7.0	–8.5	...	0.2	...	...
Prices									
Headline inflation	0.9	2.0	1.3	0.1	–0.1	–0.3	–0.3	–0.8	...
Official interest rate [3]	3.8	3.7	3.7	3.6	3.5	3.5	3.5	3.5	3.5
Renminbi per dollar	6.5	6.7	6.8	7.0	7.2	7.2	7.1	7.2	7.2

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

EURO AREA

Activity and employment indicators

Values, unless otherwise specified

	2021	2022	Q1 2023	Q2 2023	Q3 2023	Q4 2023	12/23	01/24	02/24
Retail sales *(year-on-year change)*	5.4	1.0	–2.6	–1.9	–1.8	–0.7	–0.8	...	...
Industrial production *(year-on-year change)*	9.8	2.3	0.3	–1.2	–4.7	–3.6	1.2	...	...
Consumer confidence	–7.5	–21.9	–26.9	–26.9	–26.9	–26.9	–15.1	–16.1	–15.5
Economic sentiment	111.2	102.1	96.5	96.5	96.5	96.5	96.4	96.1	95.4
Manufacturing PMI	60.2	52.1	48.2	44.7	43.2	43.9	44.4	46.6	46.5
Services PMI	54.4	52.1	52.8	54.4	49.2	48.4	48.8	48.4	50.0
Labour market									
Employment (people) *(year-on-year change)*	1.5	...	1.6	1.4	1.3	1.2	–	–	–
Unemployment rate *(% labour force)*	7.7	6.7	6.6	6.5	6.5	...	6.5	6.4	...
Germany *(% labour force)*	3.6	3.0	2.9	3.0	3.0	...	3.1	3.1	...
France *(% labour force)*	7.9	7.3	7.1	7.4	7.4	...	7.6	7.5	...
Italy *(% labour force)*	9.5	8.1	7.9	7.7	7.6	...	7.2	7.2	...
Real GDP *(year-on-year change)*	6.1	3.5	1.3	0.6	0.0	0.1	–	–	–
Germany *(year-on-year change)*	3.3	1.9	–0.1	0.1	–0.3	–0.2	–	–	–
France *(year-on-year change)*	6.8	2.6	0.9	1.2	0.6	0.7	–	–	–
Italy *(year-on-year change)*	8.6	4.2	2.3	0.6	0.5	0.6	–	–	–

Prices

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

	2021	2022	Q1 2023	Q2 2023	Q3 2023	Q4 2023	12/23	01/24	02/24
General	2.6	8.4	8.0	6.2	5.0	2.7	2.9	2.8	2.6
Core	1.5	3.9	5.5	5.5	5.1	3.7	3.4	3.3	3.1

Foreign sector

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

	2021	2022	Q1 2023	Q2 2023	Q3 2023	Q4 2023	12/23	01/24	02/24
Current balance	3.1	–0.6	–0.4	0.3	2.0	4.5	4.5	...	...
Germany	7.7	4.4	4.6	5.3	8.6	14.0	14.0	...	...
France	0.4	–2.0	–1.9	–1.8	–1.9	–2.5	–2.5	...	...
Italy	2.4	–1.5	–1.4	–1.1	–0.1	0.3	0.3	...	...
Nominal effective exchange rate [1] *(value)*	**94.3**	**90.9**	**93.4**	**94.6**	**95.9**	**95.1**	**94.8**	**95.1**	**94.8**

Credit and deposits of non-financial sectors

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

	2021	2022	Q1 2023	Q2 2023	Q3 2023	Q4 2023	12/23	01/24	02/24
Private sector financing									
Credit to non-financial firms [2]	3.5	6.7	5.7	3.9	1.0	0.1	0.5	0.2	...
Credit to households [2,3]	3.8	4.4	3.2	2.1	1.0	0.5	0.4	0.3	...
Interest rate on loans to non-financial firms [4] *(%)*	1.2	1.8	3.8	4.5	5.0	5.2	5.2	5.1	...
Interest rate on loans to households for house purchases [5] *(%)*	1.3	2.0	3.7	4.3	4.7	4.9	4.9	4.8	...
Deposits									
On demand deposits	12.8	6.3	–3.9	–8.1	–11.3	–10.7	–9.7	–9.9	...
Other short-term deposits	–0.8	4.5	17.6	22.5	23.2	21.0	20.9	19.8	...
Marketable instruments	11.6	3.7	19.4	22.0	20.4	19.9	19.5	22.5	...
Interest rate on deposits up to 1 year from households *(%)*	0.2	0.5	1.9	2.5	3.0	3.3	3.3	3.2	...

Notes: *1. Weighted by flow of foreign trade. Higher figures indicate the currency has appreciated. 2. Data adjusted for sales and securitization. 3. Including NPISH. 4. Loans of more than one million euros with a floating rate and an initial rate fixation period of up to one year. 5. Loans with a floating rate and an initial rate fixation period of up to one year.*
Source: *BPI Research, based on data from the Eurostat, European Central Bank, European Commission, national statistics institutes and Markit.*

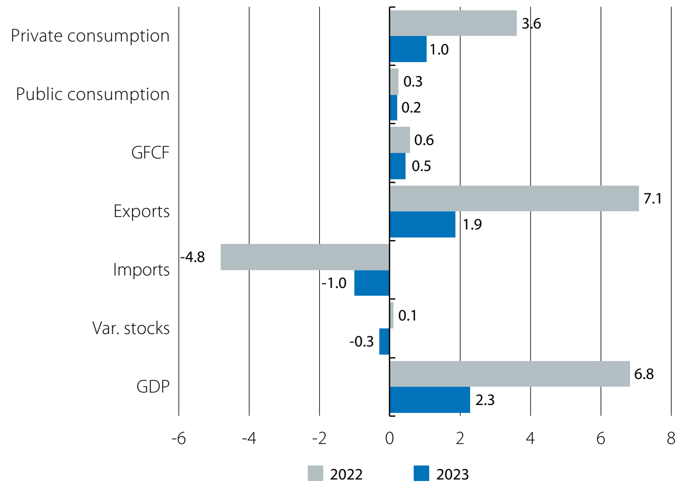
Adjusted scenario, with signs of resilience persisting

Economic growth of 2.3% in 2023 has been confirmed. Domestic demand contributed 1.4% to real GDP growth, with consumption contributing 1% and GFCF 0.5%. Private consumption rose 1.6% year-on-year, with durable goods still heavily influenced by the recovery in car sales. GFCF rose by 2.4% with an acceleration in investment in transport equipment (+18.7%) and growth of 4.2% in investment in machinery and equipment. The contribution from external demand was 0.9%, a result of 4.2% growth in exports, with services continuing to grow by double digits (10.6%) and goods slowing to 1.1% due to weak growth in some of the main trading partners. Imports rose by 2.2%, goods by 1.6% and services by 5.4%. In the external sector, the terms of trade improved as a result of the fall in the implicit import deflator (–4.0%), greatly influenced by the behaviour of energy prices, which fell significantly compared to 2022. The export deflator also slowed, but remained positive (0.7%), contributing to the improvement in the terms of trade. The final result for 2023 and the expectation that 2024 will be marked by a trend from less to more, as a result of the impact that disinflation will have on the ECB's monetary policy, led us to revise the expected growth for 2024 from 1.8% to 1.6%. The first indicators for 2024 suggest more moderate growth in Q1. The daily activity indicator is growing at an average rate of 5.1% in the first two months of the year (5.5% in Q4). In February, the sentiment of economic agents continued to improve in practically all areas - consumption, industry, construction and trade - allowing the economic sentiment indicator to recover to the 100 level last month, suggesting a moderate expansion of activity.

Inflation resumes its downward trajectory in February. After a rate of 2.3% in January, which interrupted four consecutive months of decline, inflation in February stood at 2.1%. This movement was accompanied by underlying inflation (2.2%, after 2.4% in January). In monthly terms, the increase in prices was very modest (0.06% in the overall CPI and 0.07% in the underlying CPI), but this reinforces our idea that inflation will fall gradually over the course of the year, and that further increases cannot be ruled out. By component, inflation in energy products increased the most (4.2% year-on-year; 1.7% monthly), due to an increase in fuel prices at national retailers. On the other hand, unprocessed food prices fell by –0.88% in February, despite the end of the zero VAT measure in the previous month.

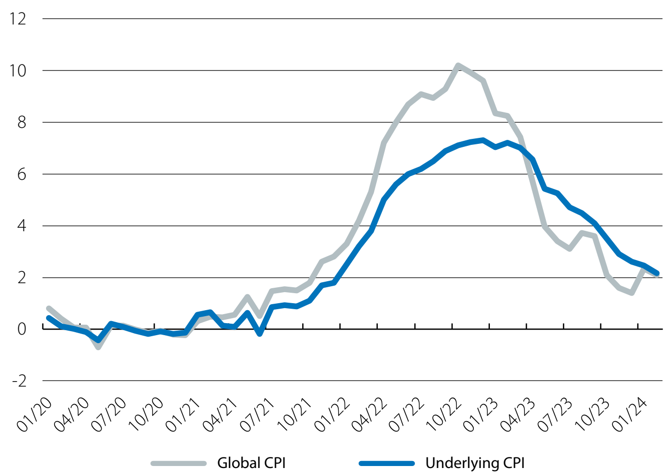
Is the attractiveness of the Portuguese job market here to stay? In 2023 as a whole, employment grew again by around 2%, similar to the previous two years, with the number of people employed reaching its highest level since 2008. More than half of the increase in employment occurred in construction and accommodation & catering. However, the unemployment rate increased slightly (from 6.2% in 2022 to 6.5% in 2023), as the unemployed rate rose by 8.6%, to the highest level since 2010. Indeed, the capacity for employment to absorb the growing working population (which increased by 2.4% in 2023, or by almost 125,000 people) is decreasing.

GDP and contribution of components
Annual variation and contribution in pp



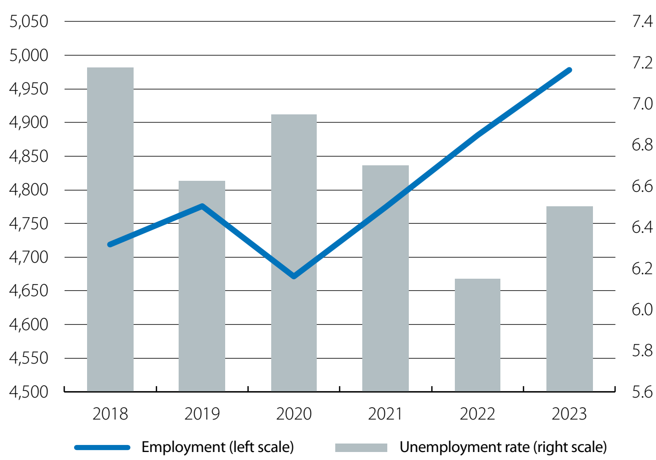
Source: *BPI Research, based on data from INE.*

CPI
Year-on-year change (%)



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

Employment trends and the annual unemployment rate
(Millions of individuals) *(%)*



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

This context should continue throughout 2024, with employment continuing to develop positively, but at a slower pace than in the last three years. The slowdown in economic activity expected for 2024, the uncertainty that still prevails (in economic, financial and geopolitical terms), and persistent high costs will restrict companies' ability to hire, mitigated by labour shortages. Meanwhile, the unemployment rate stabilised in January at 6.5%, with employment rising to the highest monthly figure since the start of the series (1998).

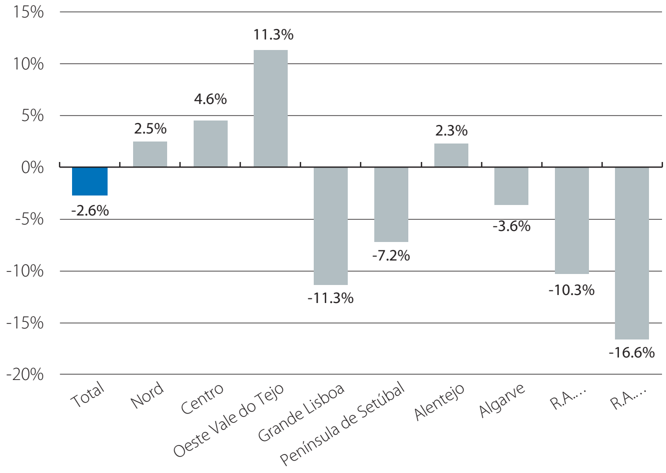
Tourism kicks off in 2024 with 1.5 million guests and 3.5 million overnight stays in January. This represents an increase in tourists of 1.8% and a drop in overnight stays of 0.1% compared to January 2023. This modest scenario is mainly explained by the dynamics of resident tourism, which weakened. In fact, in year-on-year terms, resident tourists were –1% and overnight stays from residents –2.6%, with a very significant drop in overnight stays in Greater Lisbon (–11%) and Madeira (–17%). Despite this moderation, January's figures continue the trend seen in 2023 of surpassing pre-pandemic levels (+16% in guests and +18.6% in overnight stays). For 2024, we expect new growth in the sector, albeit more restrained. Our central scenario does not contemplate recession in the Eurozone (Portugal's main tourist market), and this will continue to support growth in the sector along with some recovery in purchasing power. However, the post-pandemic rebound effect is exhausted and there will be no contribution from *one-off* events like in 2023 (World Youth Day).

Current account closes 2023 with a surplus equivalent to 1.4% of GDP, the highest level since March 2017, interrupting a 3-year cycle of deficit. Compared to 2022, when the current account recorded a deficit of 1.1% of GDP, the main corrections occurred in the energy account (with the deficit shrinking by 2.1% to 2.7%) and an increase in surpluses in the services account, both in tourism (+7.1% of GDP, an increase of 0.7%) and other services (+3.5% of GDP, an improvement of 0.9%). Only the balance of non-energy goods worsened, from a deficit of 6.1% of GDP in 2022 to –6.7% in 2023. Finally, the capital account recorded a surplus of 1.4% of GDP (0.9% in 2022), benefiting from the funds received under the NGEU, contributing to an external financing capacity of 2.7% of GDP.

The loan portfolio continues to fall as financing costs worsen, but non-performing loans are not deteriorating. The portfolio of loans to the non-financial private sector continued to shrink in January by –1.4%. The reduction was generalised to mortgage loans (–1.4%) and corporate loans (–2.5%), while consumer loans accelerated (from 2.0% in December to 3.8% in January). This dynamic competes with the evolution of financing costs, as illustrated by the evolution of the implicit interest rate in mortgage contracts: in January, this increased by 0.06% to 4.657% (the highest since March 2009), although at a slower rate than that seen in 2023 (average monthly increases of 0.22%). This is reflected in a less pronounced increase in average monthly instalments than in the second half of 2023. Even so, the average instalment rose by 89 euros year-on-year to 404 euros. Despite this trajectory, non-performing loans continue to fall. In the case of housing and consumption, it is close to the minimum values (0.2% and 2.7%, respectively) and slightly higher in the case of companies (2.0%).

Resident overnight stays by region

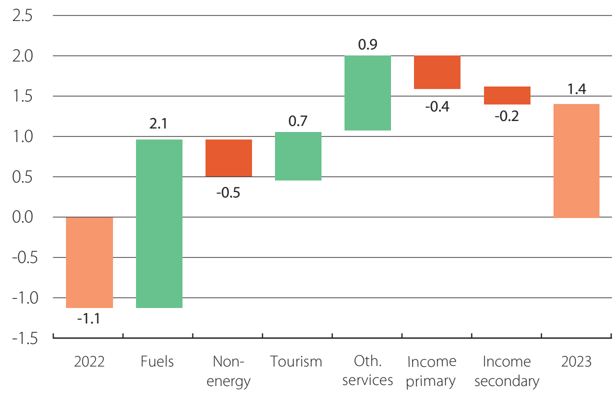
Var. January 2024 vs. January 2023



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

Current account evolution

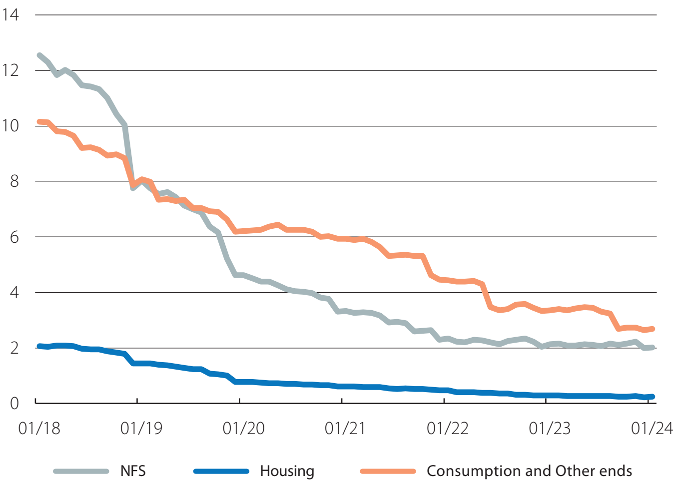
% of GDP and variation in pp



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

Non-performing loans ratio, by segment

(%)



Source: *BPI Research, com base nos dados do Banco de Portugal.*

New year, new European budgetary rules: Portugal in focus

Faced with enormous challenges, substantially higher levels of public debt than in the recent past, and the enormous complexity of the previous budgetary regulatory framework, the European Commission (EC) has put forward a new proposal for budgetary rules. This article aims to understand how Portugal is positioning itself to comply with these new rules.

Part 1: understanding the context - where we are starting from

The European Union's tax rules were born out of the need to coordinate the different tax policies of Member States and to ensure sound public accounts and the sustainability of public debt. In this context, the Stability and Growth Pact was born in 1997, with two main objectives: to keep budget deficits below 3% of GDP and public debt ratio below 60% of GDP.

The rules for meeting these objectives have undergone numerous changes over recent years, but when they were suspended in 2020 (in the context of the pandemic), they included two strands: i) the preventive arm (focusing on the medium-term objective and the stability programmes, applied to countries that comply with the deficit and debt rules)[1]; and ii) the corrective arm (aimed at correcting high deficits and/or public debt ratios, within the scope of the Excessive Deficit Procedure).

Part 1: understanding the context - What's behind the recent change in budgetary rules?

The COVID-19 pandemic, the outbreak of war in Ukraine, and the subsequent need to support families and companies when the prices of some goods (particularly energy) sharply increased contributed to a significant increase in the public debt ratios of Member States (see table). In addition, new challenges (climate and the digital transition, the need to increase defence spending) have been added to older ones (Europe's ageing population and increased competitiveness).

Alongside these challenges and context, critics pointed to the enormous complexity of the previous budgetary rules.

Part 1: understanding the context - the new budgetary rules

The new fiscal rules aim to reformulate the preventive arm of the SGP, while keeping the deficit and debt benchmarks unchanged. While there are still some steps to be completed before the new framework comes into force, it is expected that the state budgets for 2025 will be designed on the basis of the new rules.

The new approach will take into account the specificities of each country, taking into account the heterogeneity of fiscal positions, the level of public debt, and economic challenges. In this context, each member state will have to present a medium-term structural budget plan (which will replace the current Stability and Growth Program), with a timeframe of 4 years.[2]

Monitoring net primary expenditure[3] will make it possible to assess whether the country is in line with the reduction of public debt and the sustainability of public accounts. It is up to the EC to provide member states that do not meet the debt and deficit requirements with information on the technical path for expenditure, in

Public debt ratio in Eurozone countries

	2019	2020	2021	2022	Δ 2022 *vs.* 2019
Eurozone	**84.1**	**97.2**	**94.7**	**90.9**	**6.8**
Ireland	57.1	58.1	54.4	44.4	–12.7
Greece	180.6	207	195	172.6	-8
Cyprus	93	114.9	99.3	85.6	–7.4
Portugal	116.6	134.9	124.5	112.4	-4.2
Croatia	70.9	86.8	78.1	68.2	–2.7
Netherlands	48.6	54.7	51.7	50.1	1.5
Luxembourg	22.4	24.6	24.5	24.7	2.3
Lithuania	35.8	46.2	43.4	38.1	2.3
Latvia	36.7	42.2	44	41	4.3
Germany	59.6	68.8	69	66.1	6.5
Belgium	97.6	111.8	108	104.3	6.7
Slovenia	65.4	79.6	74.4	72.3	6.9
Italy	134.2	154.9	147.1	141.7	7.5
Austria	70.6	83	82.5	78.4	7.8
Finland	64.9	74.7	72.5	73.3	8.4
Slovakia	48	58.9	61.1	57.8	9.8
Estonia	8.5	18.6	17.8	18.5	10
Malta	40	52.2	54	52.3	12.3
Spain	98.2	120.3	116.8	111.6	13.4
France	97.4	114.6	112.9	111.8	14.4

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

1. The approach uses two pillars: i) each country would have to ensure convergence towards a certain Medium-Term Objective, defined by the structural balance; and ii) the growth in net expenditure should not exceed the growth in potential GDP. In addition, the public debt ratio was to converge to 60% of GDP, which meant reducing the gap by 1/20 per year, on average, for 3 years.

2. The deadline can be extended to 7 years if growth-enhancing reform and investment plans are presented.
3. Includes expenditure net of discretionary revenue measures (measures taken deliberately) and excluding interest expenditure, expenditure on cyclical unemployment, expenditure on EU programmes financed entirely with European funds, and *one-off* and other temporary expenditure.

order to ensure that, at the end of the period, public debt is on a clear downward path or remains at prudent levels, even in an adverse scenario, and that the deficit is sustainably below 3%.

Despite the greater flexibility, there are still some requirements with the introduction of two safeguards. The first is related to debt sustainability, which requires an average annual reduction in public debt of at least 1% if the ratio exceeds 90% of GDP, or 0.5% if the ratio is between 60%-90%. The second relates to the resilience of the deficit, which requires a minimum structural margin of 1.5% of GDP for countries with a budget deficit, in order to ensure that they have room to manoeuvre to deal with unexpected events without breaking the 3% deficit mark.

Part 2: the new budgetary rules in the Portuguese context

In this new context, we estimate that Portugal will have to achieve a primary balance surplus of around 1% in the medium term in order to comply with the deficit resilience safeguard. This has been the country's reality for the last 9 years (excluding the pandemic period), with an average primary balance of around 2% of GDP. Therefore, and considering the current outlook for the country's public accounts (the EC estimates a primary balance of 2.4% and 2.3% in 2024 and 2025, respectively), compliance with this rule seems assured.

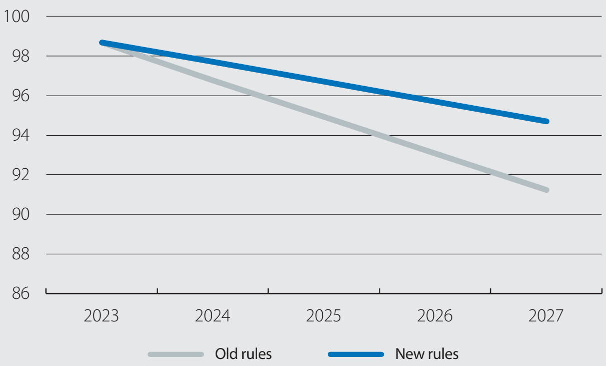
Looking at the debt safeguard, the new framework is less demanding than the previous one: considering that 2023 ended with a ratio of 98.7% of GDP, the *gap* of 39% compared to the target of 60% of GDP would require an annual adjustment of 1.9% (equivalent to 1/20) under the previous budget rules. Under the new rules, this minimum adjustment decreases to 1%.

Nonetheless, multiple challenges are expected in the coming years. In fact, a return to nominal economic growth rates closer to the long-term trend is expected, i.e. around 4.5% on average over the next four years, which implies that the real growth and inflation effect will make a smaller contribution to reducing the public debt ratio. Likewise, all other things being equal, it would make the significant amount of tax revenue seen in the last two years unviable.[4] We estimate that, in this context, tax revenue will grow, on average, by just over 4.0% per annum over the next four years (compared to an average increase of around 13% in 2022-2023). This scenario, all other things being equal, would imply that the budget surplus would be around 0.6% of GDP between 2024 and 2027, which, if confirmed, would release the country from complying with the deficit safeguard.

4. In fact, tax revenue will have exceeded the budget by around 10 billion euros over the two years.

Portugal: public debt in accordance with the minimum adjustment required by budgetary rules

(% GDP)



Source: *BPI Research.*

However, this context is compounded by the expected increase in interest charges as old financing, contracted since 2015, is replaced by new financing (assuming a scenario in which rates stabilise close to/slightly below current levels). Even if interest rate rises are excluded from the recommendations until at least 2027, in a *stress* scenario, we estimate that the requirement for a primary balance surplus could rise to above 1.5%[5], achievable in a normal context, but more complicated in a scenario of economic contraction and worsening unemployment (for example, during the pandemic, the average primary balance was –1.7%).

Portugal also faces three specific challenges: the maturity of the Troika's loans[6] (which will require market financing at an uncertain cost), the fact that a large portion of the public debt (around 17%) is held by private individuals (which, despite its greater stability, is also more costly), and, finally, political cycles (which may require taking on additional responsibilities in a context of increased fragmentation of the Portuguese Parliament and the need to find common ground).

In short, this new proposal takes advantage of greater flexibility while at the same time maintaining a certain level of rigour (with deficit and debt safeguards). According to current circumstances, Portugal seems prepared to meet the new requirements, despite the challenges it faces in the medium term.

Vânia Duarte

5. Rough estimate in an acute crisis scenario such as a strong supply-side shock.
6. Between 2025 and 2027, Portugal will have to repay around 16% of the loans under the Economic and Financial Assistance Programme, with the greatest effort concentrated between 2031 and 2033, when it will have to disburse almost 40%.

The identity card of Portuguese companies: from birth rate to investment

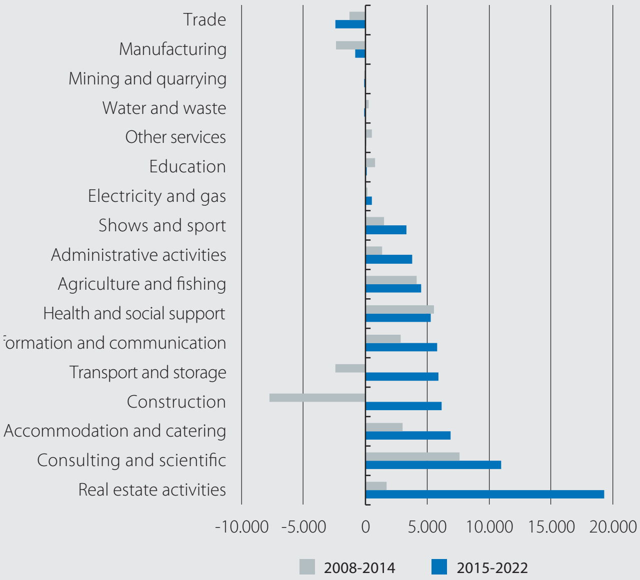
The return on capital is profit, but in pursuit of this goal companies can benefit society and the economy in many ways: generating employment and innovation, satisfying certain consumer needs more efficiently, and safeguarding market competition, the rule of law, and institutions. Underlying all of this is the need to invest, which sometimes means resorting to credit. Thus debt and investment are often two sides of the same coin, an inseparable binomial. In this article, we aim to briefly characterise Portuguese companies[1] and assess how this binomial has evolved.

When discussing NFCs in Portugal, we must emphasise that we are dealing with a set of businesses that is growing in number, but which remains very atomised. Indeed, there were more than 516,000 NFCs by the end of 2022 and this number has been growing steadily since 2009 (there were 377,000 that year). Of these, 89% are micro-enterprises and only 0.3% are large companies. Despite this, large companies employ 29% of the people working for NFCs and generate 38% of GVA. The main disadvantage associated with a business fabric of this nature is its limited capacity for financial and management resources to compete with large corporations. On the other hand, smaller companies have greater flexibility and agility in decision-making and in adapting to market changes.

New companies usually start out small, believing they can bring something different to the market or fill a gap, a process which would facilitate the process of «creative destruction».[2] In other words, the high and growing number of micro and small businesses is not necessarily bad if they are companies active in innovative sectors or if they are born as part of a process of replacing «zombie companies». Data from Portugal seem to corroborate this more benign scenario. Between the post-troika period and 2022, the Consultancy & Scientific Activities sector, which by its nature contrbutes more innovation and added value, was the sector in which the second highest number of companies were created in net terms.[3] The construction sector also saw a high number of companies created in this period (6,904), but this was still insufficient to make up for the net losses that occurred during the years of the international financial crisis and the troika (–7,739). These new companies that have «replaced» those that have disappeared are expected to be more

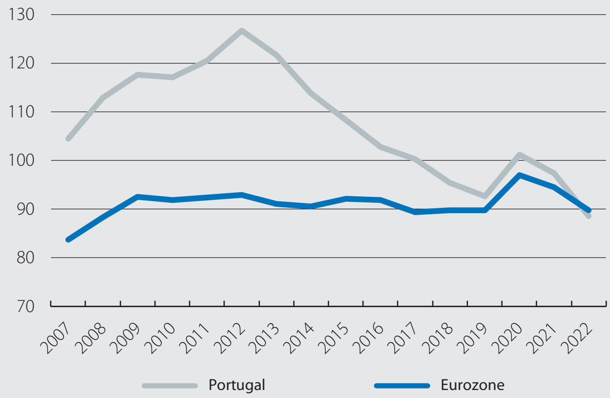
1. Only non-financial companies, i.e. «NFCs».
2. This famous concept by economist Joseph Schumpeter is, according to the author, at the heart of capitalist dynamics and is usually accompanied by an increase in the productivity of capital and labour.
3. In this period, the sector with the highest net creation of companies was Real Estate Activities and the third was Accommodation & Catering, by definition linked to the dynamism of Tourism and Local Accommodation.

Net creation of companies
(Number)



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

Division of NFCs
(% of GDP)



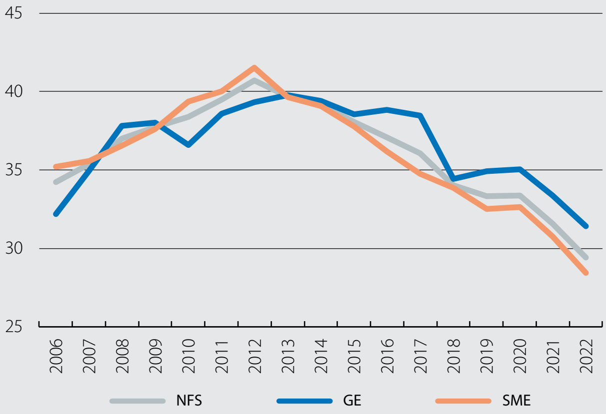
Note: *NFC debt = debt securities + loans + trade credits and advances.*
Source: *BPI Research, based on data from Eurostat.*

robust in financial and operational terms. On the other hand, there are sectors in which net business creation was negative in both periods: Trade, Mining and quarrying, and Manufacturing. With regard to trade, we believe that in the first period this was associated with the real downturn in consumption in the context of the economic crisis, high unemployment, and loss of household income; in the more recent period, it is likely due to a change in consumption patterns, with the pandemic and the intensification of online commerce. In the case of industry, a more detailed analysis of data by sub-sector would be necessary, though these figures can be seen as part of a broader movement towards subcontracting in the economy. There is also the possibility of a change in structure in favour of the concentration of larger companies.

But are the companies that resisted and were born in this challenging economic cycle more financially robust and less indebted? Some economic and financial data and ratios seem to corroborate this thesis. Here we present three. Firstly, the debt of NFCs (as a % of GDP) has shown a downward trend since 2012 (second graph). From that year until 2019, NFCs reduced the weight of their debt in relation to GDP by 34% and followed a path of convergence with the debt of Eurozone NFCs. This cycle of debt reduction was briefly interrupted in the context of Covid, associated with measures to support business activity and financing at a time of several *lockdowns* with very severe constraints on activity in some areas. Companies are carrying less debt, which is shown by the ratio of the percentage of assets leveraged by Borrowings (third graph). This trend is clearer in SMEs and after 2012, with 28% of assets leveraged by loans obtained in 2022 (it used to be over 40%). Thirdly, we look at the proportion of NFCs' Cash and Assets (fourth graph). In accounting terms, cash and cash equivalents on a company's balance sheet are a heading that includes highly liquid resources that are free to move (such as cash and demand deposits, for example). Also in this case the curve is quite enlightening: again from 2012 onwards, the weight of cash and cash equivalents continued to increase. This shows greater leeway for cash payments, greater negotiating capacity, the possibility of more easily dealing with customer defaults, better financial management with remuneration of resources, and finally support for investment with own funds.

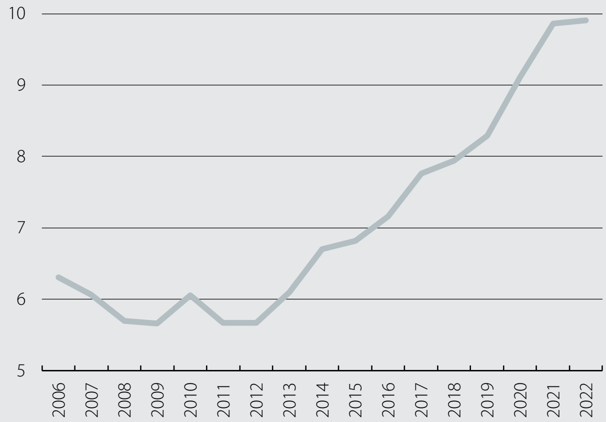
And how have these investments performed, given these companies are less indebted? We summarise the panorama in the last graph. In particular, NFCs have b een increasing their weight in investment made by the economy as a whole, with a clearly positive trend line and now accounting for close to 70% of all GFCF. When we look at the proportion of GDP and GVA, the outlook is not so encouraging, with GFCF of NFC remaining in line with the historical average trend, despite some fluctuations. In other words, the share of resources generated by NFCs allocated to investment is practically stagnant. Several explanatory hypotheses can be put forward for this, including some more associated with the role of the State, including high taxes and excessive bureaucratic and legislative red tape; and others of a more operational nature, including less recourse to debt (as we have already shown), tighter lending criteria by credit institutions (due to a more demanding regulatory environment), and little human and financial critical mass given the small size of NFCs. Finally, there are reasons of a more technical nature: the weight of NFC investment in machinery and equipment has also been decreasing, while it has increased in the case of intellectual property products. These intangible products are by nature a weak guarantee for traditional credit and have lower financing requirements.

NFCs: financing obtained
(In % of assets)



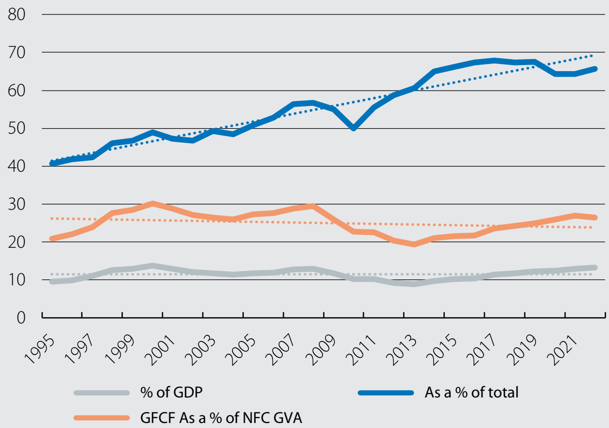
Source: *BPI Research, based on data from Banco de Portugal.*

NFCs: availabilities
(In % of assets)



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

NFCs: investment (GFCF)
(%)



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

On the other hand, they require potential financiers to have much more in-depth prior knowledge of the business and a real capacity to generate *cash-flow* to attract capital.

Tiago Belejo Correia

Activity and employment indicators

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

	2022	2023	Q1 2023	Q2 2023	Q3 2023	Q4 2023	12/23	01/24	02/24
Coincident economic activity index	5.7	3.3	3.5	3.6	3.3	2.8	2.6	2.5	...
Industry									
Industrial production index	0.4	–2.8	1.0	–5.0	–4.6	–2.5	–5.0	...	...
Confidence indicator in industry *(value)*	–3.4	–7.4	–5.0	–5.6	–9.4	–9.5	–9.2	–8.2	–7.7
Construction									
Building permits - new housing (number of homes)	6.2	4.9	9.8	1.2	9.4	–0.8	–7.2	...	...
House sales	1.3	...	–20.8	–22.9	–18.9	...	–	–	–
House prices *(euro / m² - valuation)*	13.8	9.1	12.9	9.1	8.1	6.4	5.3	4.4	...
Services									
Foreign tourists *(cumulative over 12 months)*	158.9	19.1	117.2	52.6	24.9	19.1	19.1	16.1	...
Confidence indicator in services *(value)*	15.1	7.5	11.1	13.4	5.8	–0.2	1.1	5.1	7.1
Consumption									
Retail sales	5.5	1.1	1.2	1.7	0.6	0.8	1.1	...	...
Coincident indicator for private consumption	3.8	2.4	1.9	2.7	2.8	2.2	2.0	1.9	...
Consumer confidence index *(value)*	–29.7	–28.6	–35.1	–29.4	–22.8	–27.2	–28.2	–26.9	–24.4
Labour market									
Employment	2.2	2.0	1.4	2.8	2.2	1.6	1.8	2.0	...
Unemployment rate (*% labour force*)	6.2	6.5	7.2	6.1	6.1	6.6	6.5	6.5	...
GDP	**6.8**	**2.3**	**2.5**	**2.6**	**1.9**	**2.2**	–	–	–

Prices

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

	2022	2023	Q1 2023	Q2 2023	Q3 2023	Q4 2023	12/23	01/24	02/24
General	7.8	4.4	8.0	4.4	3.5	1.7	1.4	2.3	2.1
Core	5.6	5.1	7.1	5.7	4.4	3.0	2.6	2.4	2.2

Foreign sector

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

	2022	2023	Q1 2023	Q2 2023	Q3 2023	Q4 2023	12/23	01/24	02/24
Trade of goods									
Exports *(year-on-year change, cumulative over 12 months)*	23.2	–1.0	21.6	11.8	3.0	–1.0	–1.0	...	...
Imports *(year-on-year change, cumulative over 12 months)*	31.7	–4.1	24.5	12.5	1.1	–4.1	–4.1	...	...
Current balance	**–2.8**	**3.6**	**–1.2**	**1.5**	**4.1**	**3.6**	**3.6**	**...**	**...**
Goods and services	–4.7	3.3	–2.8	–0.3	2.1	3.3	3.3	...	...
Primary and secondary income	1.9	0.4	1.6	1.9	2.0	0.4	0.4	...	...
Net lending (+) / borrowing (–) capacity	**–0.5**	**7.2**	**1.5**	**4.5**	**7.3**	**7.2**	**7.2**	**...**	**...**

Credit and deposits in non-financial sectors

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

	2022	2023	Q1 2023	Q2 2023	Q3 2023	Q4 2023	12/23	01/24	02/24
Deposits [1]									
Household and company deposits	6.4	–2.3	0.5	–2.1	–2.6	–2.3	–2.3	–1.1	...
Sight and savings	7.3	–14.8	–3.1	–9.0	–9.4	–14.8	–14.8	–15.2	...
Term and notice	5.2	14.8	5.4	7.5	6.9	14.8	14.8	17.8	...
General government deposits	12.4	–12.4	11.1	1.4	5.5	–12.4	–12.4	–22.5	...
TOTAL	**6.5**	**–2.6**	**0.8**	**–2.0**	**–2.4**	**–2.6**	**–2.6**	**–1.7**	**...**
Outstanding balance of credit [1]									
Private sector	1.7	–1.5	0.0	–1.2	–1.8	–1.5	–1.5	–1.4	...
Non-financial firms	–0.6	–2.1	–2.1	–3.5	–3.5	–2.1	–2.1	–2.5	...
Households - housing	3.2	–1.4	1.5	0.1	–0.9	–1.4	–1.4	–1.4	...
Households - other purposes	2.9	0.2	0.0	0.4	–0.8	0.2	0.2	1.6	...
General government	–2.7	–5.5	–2.0	0.6	–1.4	–5.5	–5.5	–4.0	...
TOTAL	**1.6**	**–1.6**	**–0.1**	**–1.1**	**–1.8**	**–1.6**	**–1.6**	**–1.5**	**...**
NPL ratio *(%)* [2]	**3.0**	**...**	**3.1**	**3.1**	**2.9**	**...**	–	–	–

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

The Spanish economy, a good start to the year

The indicators made available in the first two months of the year show encouraging signs that suggest an improvement in the pace of economic growth in Q1. In the case of economic activity, they indicate a highly buoyant services sector, with thriving tourism activity, and an improvement in the weak tone that industry had been showing, all while job creation is even accelerating. Real estate activity, meanwhile, is cooling more gradually than expected and inflation is taking longer to moderate.

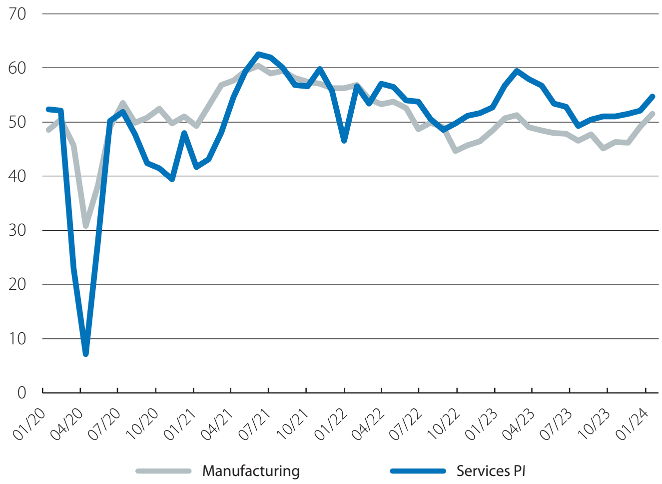
Economic activity kicks off 2024 on a good footing. The signs are particularly encouraging in the industrial sector, which had been showing significant weakness. In particular, in February the Purchasing Managers' Index (PMI) for the manufacturing sector increased by 2.3 points to 51.5, placing it in expansive territory (above 50 points) for the first time in 11 months, thanks to the increase in production and new orders in response to an improvement in demand, mainly from the domestic market. There were also encouraging developments in employment in the industrial sector, where the number of registered workers grew by 1.9% year-on-year in February. The PMI for the services sector, meanwhile, has consolidated its position in expansionary territory, standing at 54.7 points (previously 52.1), the best figure since May 2023. On the consumption side, the outlook for households is improving, and the consumer confidence indicator published by the European Commission stood at –17.4 points in February (–18.8 the previous month), the best figure in six months.

Job creation gains traction in the opening weeks of the year. The average number of registered workers increased in February by 103,621 people. This was the best figure in a month of February since 2007 and comfortably surpassing that of last year (88,918) and the typical increase in this month (70,615 on average in the months of February during the period 2014-2019). Correcting for seasonality, employment shows a monthly increase of 73,492 registered workers. This is the biggest increase since April 2023 and places the average monthly growth so far in Q1 at 55,924 workers, a figure significantly higher than the average in Q4 2023 (31,248); the quarter-on-quarter growth rate of effective employment (seasonally-adjusted registered workers not on furlough) intensified to 0.5% (0.4% in the previous two quarters). In addition, there was a marked improvement in permanent hiring, causing the temporary employment rate to continue to fall to 12.7%, 20 pps less than in the previous month. As for registered unemployment, it fell by 7,452 people, a decrease which contrasts with the increase recorded in February last year (+2,618) and which exceeds the average decline in the months of February during the period 2014-2019 (–4,267).

Inflation resumes its downward path in February. Following the one-off increase in the previous month, headline inflation

Spain: Purchasing Managers' Indices

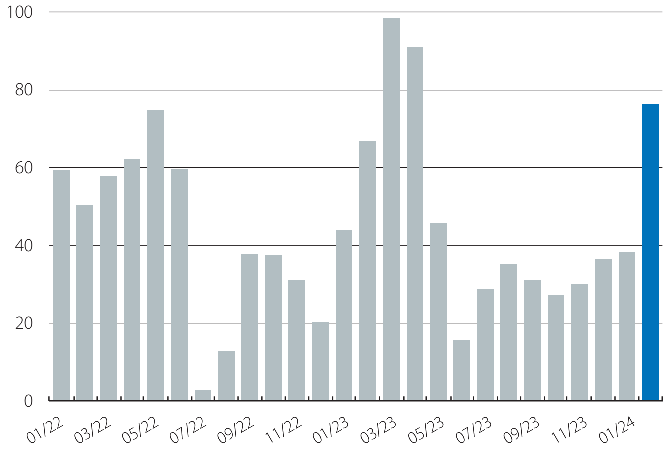
Level



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

Spain: registered workers affiliated with Social Security *

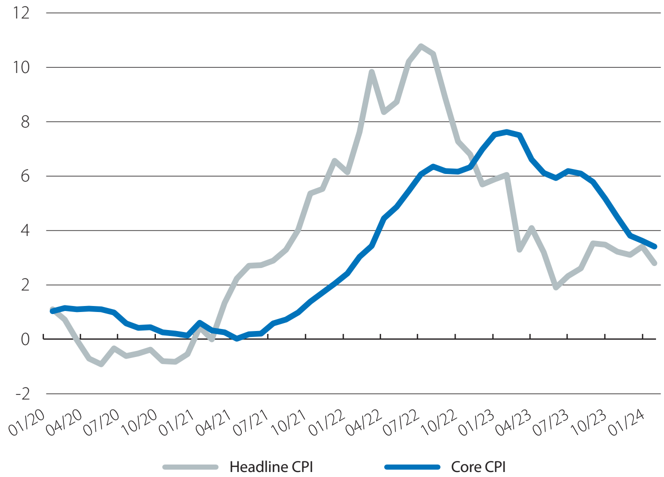
Month-on-month change (thousands of people)



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

Spain: CPI

Year-on-year change (%)



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

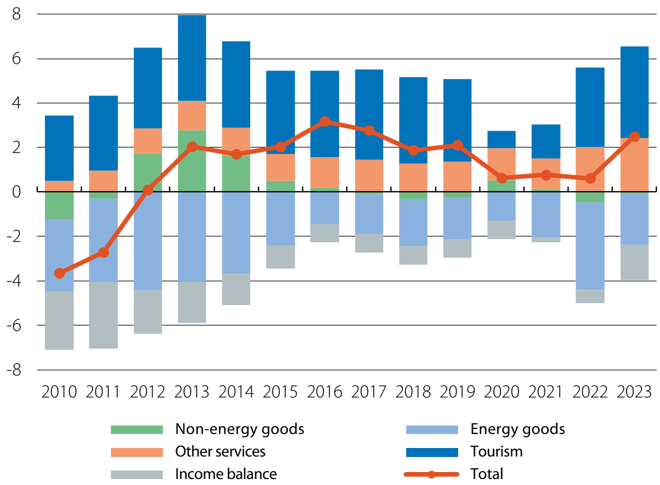
fell in February according to the flash indicator published by the National Statistics Institute and stood at 2.8%, 60 pps less than in January and the lowest rate since August 2023. In the absence of the breakdown by component, the National Statistics Institute has indicated that this result is mainly driven by the decline in inflation of the non-core components: the stability of food prices – compared to the rise of a year ago – and the fall in electricity prices – partly offset by the rise in fuel prices. Core inflation (excluding energy products and unprocessed food) also continued to decline, albeit less rapidly than headline inflation, falling by 20 pps to 3.4%; we need to look back to March 2022 to find a lower rate.

Significant increase in the current account surplus in 2023, marking its 12th consecutive year with a positive balance. The current account balance ended 2023 with a surplus of 2.5% of GDP, which is 1.9 points more than last year and represents the best result since 2017. With the exception of the income balance, affected by the rise in interest rates, all the other sub-balances contributed to the improvement of the foreign trade balance. On the one hand, the trade deficit of goods fell sharply to 2.4% of GDP (–4.4% in 2022) thanks to the correction of the energy deficit (–2.3% vs. –3.9%), in a context marked by rapid price declines and, to a lesser extent, a reduction in the deficit of non-energy goods (–0.1% vs. –0.5% in 2022), given the fall in imports. In turn, the balance of trade in services recorded historic surpluses, for both non-tourism services (2.4% of GDP vs. 2% previously) and tourism services (4.1% vs. 3.6% in 2022).

In the case of tourism, following the record results of 2023, with almost 85.2 million international tourists who spent over 108 billion euros, the latest data confirm that tourism activity remains buoyant, even in the low season: in January, the number of foreign tourists arriving in our country reached 4.77 million, representing a 15.3% year-on-year increase and up 13.6% compared to January 2019. CaixaBank's consumption indicator, meanwhile, showed an increase in foreign bank card activity of 22.6% year-on-year in the first two months of the year, compared to 18.5% in Q4 2023.

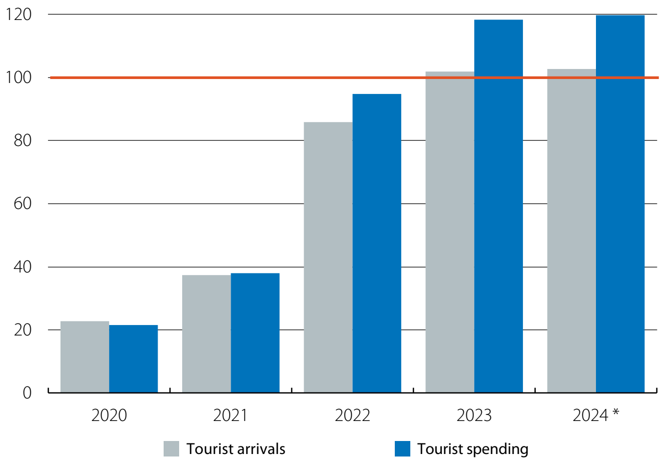
Housing demand behaved better than expected in 2023. Last year saw the completion of 587,000 sale transactions, making it the second best year since 2007, albeit 9.7% below the exceptional figure for 2022 (650,265 sales). In fact, the cooling of demand has been less pronounced than had been anticipated at the start of the year, thanks to sales of new homes holding up well (–4.8% annual change compared to –10.8% in the case of existing homes) as well as purchases by foreigners, which now account for 15% of all transactions compared to 13% in the pre-pandemic period 2015-2019. In view of this trend in demand, the pace of growth in home prices has once again intensified: the year-on-year rate of change in home appraisal valuations accelerated in Q4 2023 to 5.3% from the previous 4.2%.

Spain: current account balance
(% of GDP)



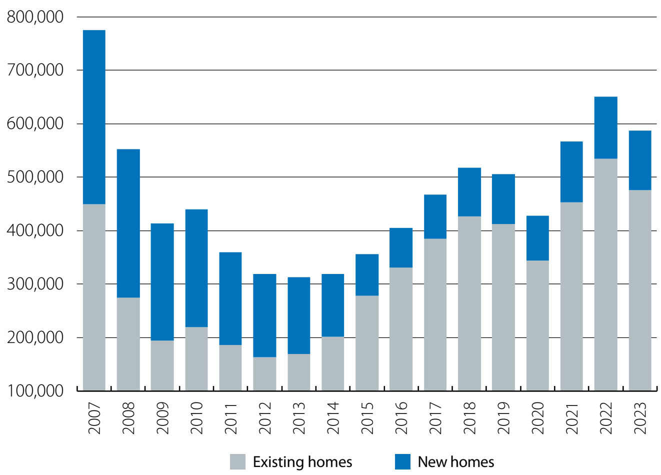
Source: *BPI Research, based on data from the Bank of Spain.*

Spain: foreign tourism indicators
Index (100 = 2019)



Note: ** 12-month cumulative data to January.*
Source: *BPI Research, based on data from the National Statistics Institute.*

Spain: home sales
Units



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

The CaixaBank Research real estate clock: from slowdown to expansion

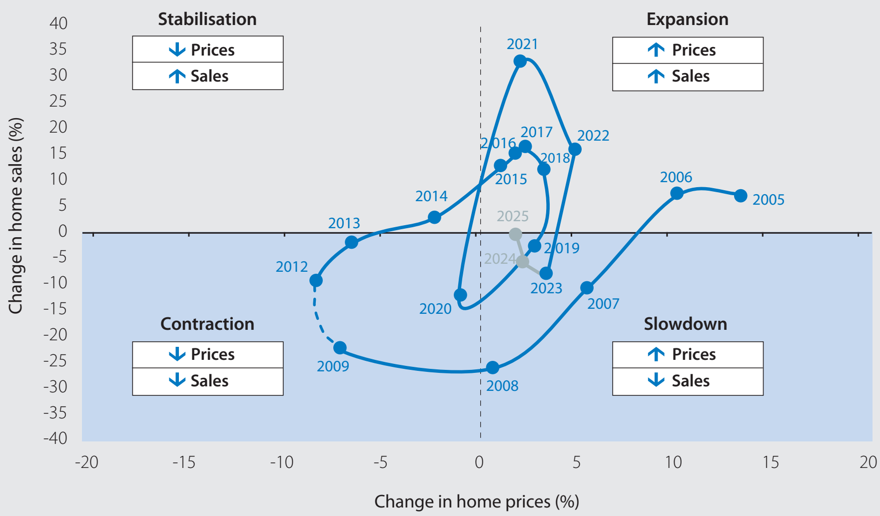
Spain's real estate market slowed in 2023, but more gently than anticipated. Despite the sharp rise in interest rates, several factors have supported the sector, including a resilient labour market, significant immigration flows, the imbalance between the short supply of new housing and the high demand, and the improvement in household finances.

In 2024, the main factor that will support the real estate sector is the decline in interest rates. In fact, the 12-month Euribor started the current year at around 3.6%, well below the peak of this cycle in October 2023 (4.16%), and the financial markets anticipate that it could end the year at around 2.50%-2.75%. In any event, it is important to bear in mind that interest rates are expected to remain well above the levels of 2021, before the monetary tightening cycle. On the other hand, the economic factors that have supported the real estate sector in 2023 will remain present in 2024, although they will lose some intensity. In particular, the Spanish economy will continue to enjoy significant growth, at around 2%, although it will slow down relative to the 2.5% registered in 2023.

Taking all these factors into account, we anticipate that the gentle slowdown in the real estate sector will continue during the first half of the year, as interest rates remain high and the economic environment continues to show signs of relative weakness. However, in the second half of 2024, as the downward path of interest rates takes hold and economic activity gains traction, we expect the real estate market to regain vigour and record new growth. Thus, 2024 will be a year of transition in which the CaixaBank Research real estate clock will remain in the slowdown quadrant, before giving way to 2025, when we expect the housing market to return to expansive territory.[1]

In particular, we expect home prices to grow by 2.7% and 2.5% in 2024 and 2025, respectively, with around 550,000 sales transactions per year. These forecasts reflect our recent upward revision as a result of the resilience of the real estate market in 2023, the improved economic outlook for 2024 and the expectation that the ECB will announce its first interest rate cut before the summer.[2]

CaixaBank Research real estate clock for Spain



Note: *The period 2010-2011 is excluded due to the effect caused by tax incentives.*
Source: *BPI Research, based on data from the National Statistics Institute (INE), the Ministry of Transport, Mobility and Urban Agenda (MITMA) and CaixaBank Research forecasts.*

1. For a description of the movements of the real estate clock in recent years, see the Focus «The CaixaBank Research real estate clock: slowdown in sight», in the MR09/2022.
2. See the *Real Estate Sector Report* S1/2024 for further details on the recent performance and future outlook for Spain's real estate sector.

Next Generation EU funds: how has the third year of European funding gone?

With the third year of disbursements of European NGEU funds now behind us, it is time to take stock. Spain included 35.94 billion euros from the Recovery and Resilience Facility – the main instrument of the NGEU programme – in its 2023 General Government Budget, a figure that includes funds from previous budgets that were not allocated at the time. Have expectations been met? Are the investments and reforms being implemented as planned?

How are the disbursements of the funds received from the European Commission going?

The total sum of the subsidies allocated to Spain in the first phase of the Recovery Plan amounts to 69.5 billion, which will be disbursed up until 2026, conditional on certain milestones being met in relation to the materialisation of investments and reforms. Of that amount, to date Spain has received 37 billion from the European Commission. In total, Spain will have access to 163 billion of NGEU funds from the Recovery and Resilience Facility: the aforementioned 69.5 billion will be increased by an additional 10.3 billion in grants from the Addendum and up to 83.2 billion in loans.

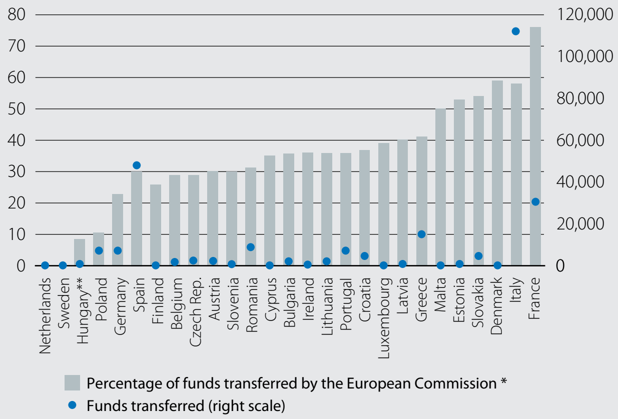
Looking at the amount of funds requested from the European Commission by Member States as the NGEU milestones are met (most of which has already been disbursed) relative to the total sum of NGEU funds allocated to each country from the Recovery and Resilience Facility[1], including loans, Spain[2] has so far requested a lower percentage (30%) than other economies such as France (76%) and Italy (58%). Two factors that can explain this are the fact that, unlike Italy, Spain has not yet applied for any loans[3] and the Commission's most recent disbursement to Spain dates back to February 2023 (they are currently examining Spain's request for the fourth payment of 10 billion). However, a comparison in absolute terms reveals that Spain is the country that has received the second most funds to date.

How is the execution of the projects going?

Focusing on the domestic sphere, in 2023 many of the budgeted projects were activated (see second chart), with a total value of around 28.45 billion euros (almost

NGEU funds 2021-2023

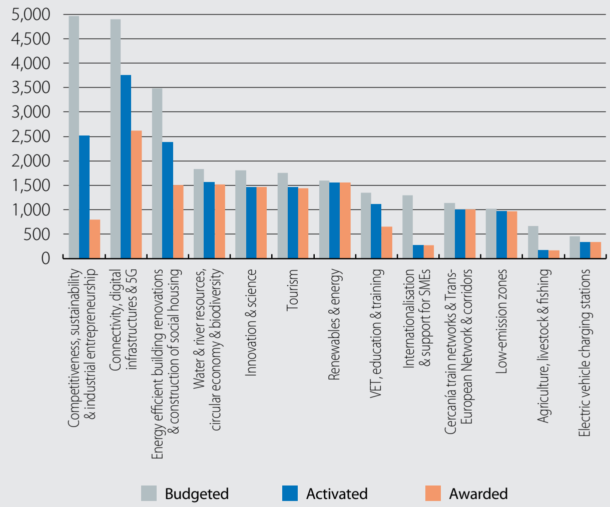
(%) *(EUR millions)*



Notes: ** Over the total sum of grants and loans that countries have said they will request from the Recovery and Resilience Facility. In Spain, for example, 83.2 billion in loans are included in the denominator, although some institutions estimate that the take-up will end up being lower. ** Corresponds to pre-financing for REPowerEU.*
Source: *BPI Research, based on the snapshots from the European Commission's mid-term evaluation.*

Spain: NGEU funds activated and awarded by the General State Authority in 2023

(EUR millions)



Note: *The investments activated include funds transferred (and those not yet transferred, but about to be) to autonomous communities, local government corporations and public bodies, even if they have not published the associated aid programme.*
Source: *BPI Research, based on data from the General Comptroller of the State Administration (IGAE) up until November 2023.*

80% of the amount budgeted for 2023), according to budget execution data. This figure includes calls for grant applications and open competitive tenders, as well as items where funds have begun to be distributed to the regional and local authorities and public institutions responsible for executing investment programs.

However, when it comes to assessing the degree of execution of funds, this estimate is too broad, as it

1. See the European Commission's evaluation report of February 2024.
2. In the case of Spain, there are 163 billion euros available, including 79.8 billion in grants (69.5 billion in the initial phase plus just over 10 billion in the Addendum) and 83.2 billion in loans that Spain can apply for.
3. France has stated that it will not apply for any loans, resulting in a smaller denominator and a higher percentage of disbursements to date relative to the total.

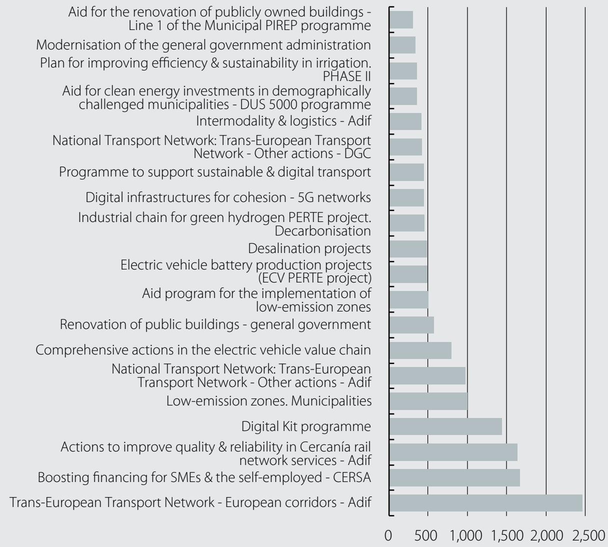
includes projects where funds have been (or will be imminently) made available to the public sector, but in which the final beneficiaries of the associated aid have not yet been confirmed.

If, rather than looking at the projects that have been activated, we focus on the funds that have actually been allocated, we will have a rather more precise idea of the rate at which the investments are reaching the real economy. With this criterion, in relation to the 2023 budget we find that the general government awarded funds amounting to 23.5 billion euros, and that between 2021 and 2023 a total of 66 billion has been awarded, representing 95% of the 69.5 billion that makes up the first phase of the Plan. Although this sum of 66 billion includes around 20 billion euros of calls for grant applications and tenders awarded to private companies and self-employed workers,[4] it should be taken into account that a substantial portion of this (over 30 billion) was not allocated to final recipients, but rather directed to autonomous communities,[5] local government corporations and public entities and enterprises in order for them, in turn, to launch the corresponding tender processes or calls for grant applications in order to identify the final recipients.

Therefore, delving down one more layer and looking at the amount of funds that has reached the productive economy, this figure will be less than the funds awarded, since there are entities that have not yet designated beneficiaries as well as beneficiaries which have to submit documentation before the payment can be disbursed. If we focus on disbursements by the government to final recipients (i.e. payments to the private sector and payments of direct aid to other public entities excluding those which require a subsequent call for bids in order to award the funds) in relation to the amount budgeted in 2023, we find that up to November the state disbursed some 8.8 billion euros.[6] While this amount may seem low, if we consider that there tends to be a surge in expenditure at the end of the year, that payments were also made from funds already awarded but not paid in previous years, and that the autonomous communities also channelled some 2 billion of funds to the productive economy in 2023, we estimate that the total execution[7] in 2023 was just over 16 billion euros, compared to 24 billion in the period 2021-2022 as a whole. Thus, the level of execution in this first phase of the Plan has been more than 40 billion, representing 59% of the 69.5 billion available (this figure was 34.5% at the end of 2022). Thus, we can see that the rate of execution is steadily picking up after a somewhat hesitant initial start.

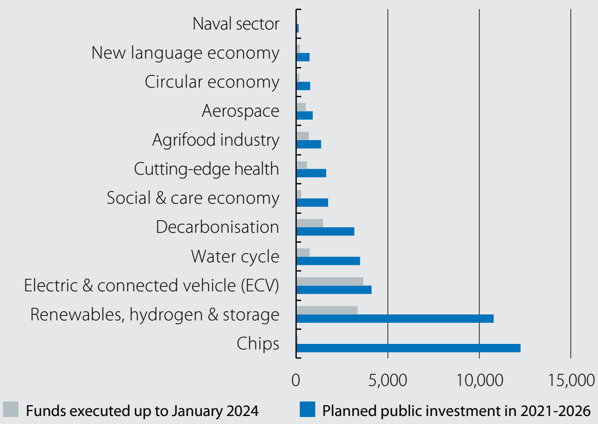
In the third chart, we can distinguish the main calls for bids for NGEU funds awarded by the state between 2021 and 2023. These include railway infrastructure projects, the funding programme for SMEs and self-employed workers through guarantees, the Digital Kit programme to help fund the digitalisation of self-employed workers and SMEs, and programmes in sustainable mobility and urban transformation, as well as in energy with a clear commitment to sustainability (renovation of buildings to improve energy efficiency).

Main NGEU calls for bids awarded by the state in 2021-2023
(EUR millions)



Source: *BPI Research, based on data from the Recovery Plan online portal.*

PERTE projects
(EUR millions)



Source: *BPI Research.*

4. See the *Fourth Recovery Plan Report* published by the Ministry of Economy in December 2023.
5. In particular, of the 26.5 billion awarded to autonomous communities, the ones that have been allocated the most funds are Andalusia (€4.077 bn), Catalonia (€3.963 bn), the Community of Madrid (€2.875 bn) and the Community of Valencia (€2.471 bn).
6. Data to November 2023.
7. By execution we refer to funds for the final recipient that have been allocated and justified.

Progress in PERTE project investments

As for the Strategic Projects for Economic Recovery and Transformation (abbreviated in Spanish as «PERTE»), significant progress was achieved in 2023. The calls for bids that have been awarded since the launch of the PERTE projects in 2022[8] amount to almost 12 billion euros (of which 7 billion correspond to 2023), out of a total amount due to be deployed, including the corresponding funds under the Addendum, of just over 41 billion.

The various PERTE projects vary widely in terms of both their budget and their current degree of execution. Among those allocated the biggest budgets, particularly good progress has been made in the PERTE projects related to electric and connected vehicles (3.67 billion executed) and renewable energies (3.35 billion), while those related to chips and the water cycle, on the other hand, are still in their initial stages.

Looking ahead to the execution of projects in the remainder of 2024, there are many projects underway which we should see crystallise and reach the productive economy. The new budgets should begin to include new funds from the Addendum to the Recovery Plan which will be deployed in 2024-2026 (up to 83.2 billion in loans and 10.3 billion in additional grants), which will largely serve to provide a significant boost to the PERTE projects; indeed, of the 93.5 billion of the Addendum, almost 27 billion will be used to reinforce these projects.

The reforms continue to roll out, but the important tax reform is missing

With regard to the reforms required in order to receive the disbursements, the vast majority of the calendar of reforms agreed with Brussels was met in 2023. In particular, the second part of the pension reform,[9] the Housing Act, the Jobs Act and the Universities Act were all adopted. The first three were scheduled for the second half of 2022, but were approved in the first half of 2023 and are now being examined by the Commission with a view to approving the disbursement of 10 billion euros requested by Spain corresponding to the fourth NGEU payment. All that remains to be completed is the reform of unemployment benefit, which was rejected by Spain's Congress in January. For 2024, two additional disbursements are expected: one of 7.2 billion (6.4 billion in grants and 0.8 billion in loans) corresponding to the milestones that were scheduled for the first half of 2023, including the entry into force of a tax reform which is still pending, and another of 18.4 billion (3.6 billion in grants and 14.8 billion in loans) corresponding to the milestones of the second half of 2023. With good progress being made on the reform agenda, the quantitative milestones related to the execution of the investments will take on a more important role, although some of them – such as the number of homes to be renovated or the number of electric vehicle charging stations to be installed – will be examined later than initially planned (in Q4 2024 and 2025, respectively, i.e. a year later than first intended).

If everything that remained outstanding from the 2023 budget is executed in 2024, then the total execution figure for the year could be around 20 billion, meaning that the NGEU programme's contribution to GDP growth this year could be as high as 0.4 pps. In short, these funds will continue to be one of the key drivers of growth. Beyond the short term, time is of the essence, as the Commission has reiterated that the deadline for all milestones to be met is 31 August 2026. It will therefore be essential to effectively channel the loans under the Addendum and to select the appropriate associated projects in order to make the most of these funds and ensure they have a structural impact which contributes to our economy's long-term and sustainable growth.

8. These amounts related to the PERTE projects have been included within the total figures for funds awarded mentioned above and are not in addition to those figures.
9. For a detailed analysis, see the article «Reforming the pension system: in search of sustainability» in the Dossier of the MR06/2023.

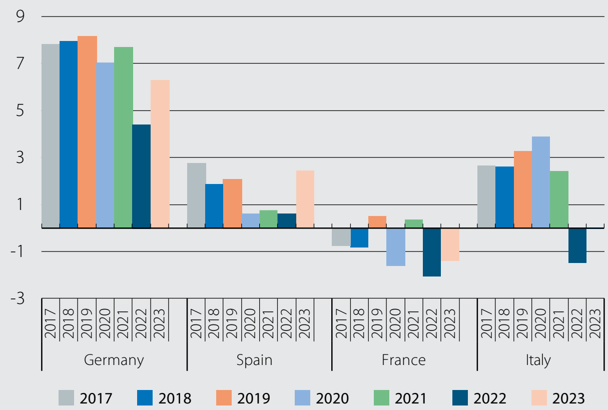
Spain's current account balance in the European context

2023 was an exceptional year for Spain's foreign sector. With a current account surplus of 2.5% of GDP, the strong performance of Spain's foreign sector is particularly noteworthy when compared to the other large European economies. The Spanish economy has now accumulated 12 consecutive years with a current account surplus, surpassed only by Germany among Europe's major economies.

From 2019 to 2022, the current account balances of the major European countries deteriorated significantly due to the outbreak of the pandemic and the energy shock. However, neither the impact of these shocks nor the subsequent recovery has been equal across all countries. In particular, during 2022, a year greatly affected by the increased cost of energy imports, Spain's current account balance registered the smallest decline. Moreover, besides the German economy, Spain was the only other major European economy that managed to avoid a foreign deficit for the year as a whole. The deterioration of the balance between 2019 and 2022 amounted to 4.7 pps of GDP in Italy, 3.8 pps in Germany and 2.6 pps in France, while in Spain it was just 1.5 pps.

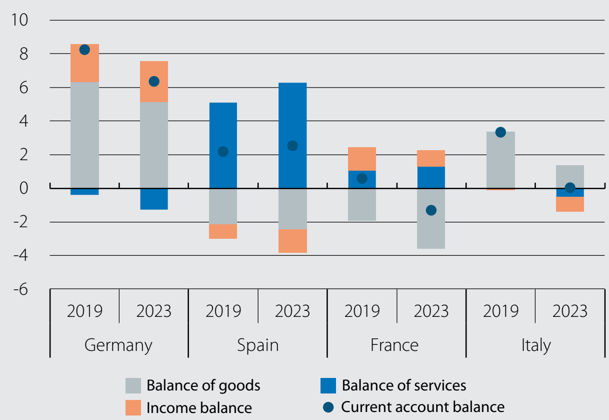
Following the rise in the cost of energy imports in 2022, the recovery of the foreign sector was particularly rapid in 2023 and the four largest economies in the euro area have improved their current account balances, although only Spain has managed to surpass the 2019 figure.

Current account balance
(% of GDP)



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

Current account balance by component
(% of GDP)



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

Differing dynamics: services as the main driving force

The second chart shows, for each of the four major euro area economies, the role that each sub-balance has played in the change in the overall current account balance since 2019.

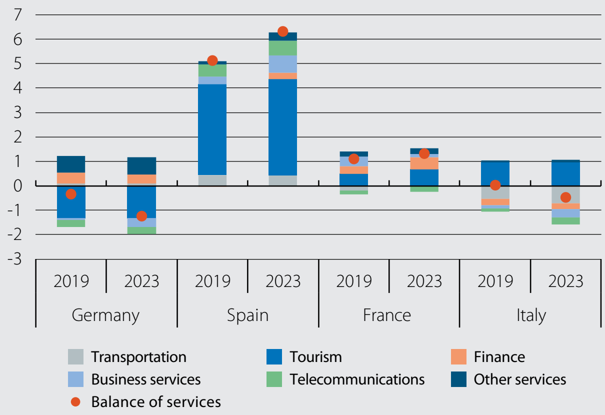
In the case of Spain, the marked increase in the surplus of the trade in services balance stands out, having gone from 5.1% of GDP in 2019 to 6.3% in 2023 (with data up to Q3 2023), offsetting the deterioration of the trade deficit in goods and the income balance. This pattern contrasts with that of other European countries, where services account for relatively small deficits or surpluses.

In the case of Germany, the lower current account surplus in 2023 is attributable to reductions in the balance of trade in both goods and services, partially offset by a slight improvement in the income balance. The French economy, meanwhile, has gone from a slight surplus in 2019 (0.5% of GDP) to a deficit of 1.4% of GDP in 2023, mainly caused by the increase of the trade deficit in goods, which has reached –3.6% of GDP. Finally, Italy is the economy that lies the furthest from the surplus it recorded in 2019, having gone from a large surplus (3.3% of GDP) to a slight deficit in 2023 of 0.04% of GDP, mostly due to a very substantial fall in its trade in goods surplus (1.3% of GDP in 2023 vs. 3.4% of GDP in 2019), although its services and income balances have also deteriorated.

Within Spain's services balance, both tourism and non-tourism services have performed very well. While tourism is the biggest contributor to the overall surplus, contributing a surplus of 3.9% of GDP up until Q3 2023 (3.7% in 2019), telecommunications, transportation and other services, including commercial services, have also made a positive contribution. In fact, 65% of the improvement in the balance of trade in services since 2019 is attributable to the improvement in non-tourism services, which have driven up the pre-pandemic surplus by 1 pp, compared to a 0.23-pp increase provided by tourism services.

The performance of Spanish tourism is particularly impressive when compared to that of France and Italy, where tourism revenues also play a significant role in the economy. Along with tourism, all other branches of activity in Spain's services sector generated a higher surplus than in any other European economy, with the exception of the financial sector in France and other services in Germany. This certifies the exceptional performance of Spain's services sector in the context of the euro area and its ability to act as a driving force for foreign trade.

Composition of the balance of trade in services
(% of GDP)



Note: *2023 corresponds to the cumulative data for the four quarters to Q3 2023.*
Source: *BPI Research, based on data from Eurostat.*

Activity and employment indicators

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

	2022	2023	Q1 2023	Q2 2023	Q3 2023	Q4 2023	12/23	01/24	02/24
Industry									
Industrial production index	2.8	–0.7	1.3	–1.8	–1.9	–0.2	–0.2	...	...
Indicator of confidence in industry *(value)*	–0.9	–6.5	–4.5	–5.4	–8.2	–8.1	–6.4	–5.1	–4.5
Manufacturing PMI *(value)*	51.0	48.0	50.1	48.5	47.3	45.9	46.2	49.2	51.5
Construction									
Building permits *(cumulative over 12 months)*	15.4	1.1	–1.8	1.7	4.3	0.2	–0.9	...	...
House sales *(cumulative over 12 months)*	29.0	0.5	10.2	3.5	–3.0	–8.8	–9.7	...	...
House prices	7.4	3.9	3.5	3.6	4.5	...	–	–	–
Services									
Foreign tourists *(cumulative over 12 months)*	129.8	18.7	90.7	40.6	21.8	18.7	18.7	16.9	...
Services PMI *(value)*	52.5	53.6	56.3	56.0	50.9	51.2	51.5	52.1	54.7
Consumption									
Retail sales	0.9	6.0	6.7	6.1	6.9	4.4	3.1	...	...
Car registrations	–3.0	18.5	45.5	9.9	6.9	11.9	10.6	7.3	9.9
Consumer confidence index *(value)*	–26.5	–19.2	–22.5	–19.0	–16.1	–19.2	–18.5	–18.8	–17.4
Labour market									
Employment [1]	3.1	3.0	1.8	2.9	3.5	3.8	–	–	–
Unemployment rate (% labour force)	12.9	12.1	13.3	11.6	11.8	11.8	–	–	–
Registered as employed with Social Security [2]	3.9	–	2.5	2.8	2.7	2.6	2.7	2.6	2.7
GDP	**5.8**	**2.5**	**4.1**	**2.0**	**1.9**	**2.0**	–	–	–

Prices

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

	2022	2023	Q1 2023	Q2 2023	Q3 2023	Q4 2023	12/23	01/24	02/24
General	8.4	3.6	5.1	3.1	2.8	3.3	3.1	3.4	2.8
Core	5.1	6.1	7.6	6.2	6.0	4.5	3.8	3.6	...

Foreign sector

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

	2022	2023	Q1 2023	Q2 2023	Q3 2023	Q4 2023	12/23	01/24	02/24
Trade of goods									
Exports *(year-on-year change, cumulative over 12 months)*	22.9	–1.4	20.5	12.3	4.5	–1.4	–1.4	...	...
Imports *(year-on-year change, cumulative over 12 months)*	33.4	–7.2	24.0	10.7	–1.2	–7.2	–7.2	...	...
Current balance	**8.2**	**36.6**	**22.1**	**28.2**	**35.2**	**36.6**	**36.6**	**...**	**...**
Goods and services	16.3	60.1	31.6	42.8	54.6	60.1	60.1	...	...
Primary and secondary income	–8.1	–23.5	–9.5	–14.6	–19.4	–23.5	–23.5	...	...
Net lending (+) / borrowing (–) capacity	**20.7**	**51.4**	**36.3**	**42.1**	**49.4**	**51.4**	**51.4**	**...**	**...**

Credit and deposits in non-financial sectors [3]

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

	2022	2023	Q1 2023	Q2 2023	Q3 2023	Q4 2023	12/23	01/24	02/24
Deposits									
Household and company deposits	4.9	0.6	1.7	0.4	–0.3	0.4	0.8	...	...
Sight and savings	7.9	–4.5	0.3	–4.0	–6.9	–7.6	–7.4	–7.6	...
Term and notice	–19.7	51.9	7.7	40.1	69.5	90.4	100.8	106.2	...
General government deposits	9.6	8.7	7.4	6.8	11.3	9.4	0.5	–0.4	...
TOTAL	**5.2**	**1.1**	**2.1**	**0.8**	**0.5**	**1.0**	**0.8**	**...**	**...**
Outstanding balance of credit									
Private sector	0.7	–2.5	–0.9	–2.2	–3.4	–3.7	–3.4	–3.1	...
Non-financial firms	0.9	–3.4	–1.0	–2.7	–4.6	–5.2	–4.7	–4.3	...
Households - housing	1.0	–2.6	–1.2	–2.4	–3.4	–3.3	–3.2	–3.0	...
Households - other purposes	–0.6	–0.2	–0.1	–0.4	0.0	–0.5	–0.5	–0.4	...
General government	0.2	–3.4	–0.2	–3.3	–4.6	–5.5	–3.5	–2.0	...
TOTAL	**0.7**	**–2.6**	**–0.9**	**–2.3**	**–3.4**	**–3.8**	**–3.4**	**–3.1**	**...**
NPL ratio (%) [4]	**3.5**	**3.5**	**3.5**	**3.5**	**3.5**	**3.6**	**3.5**	**...**	**...**

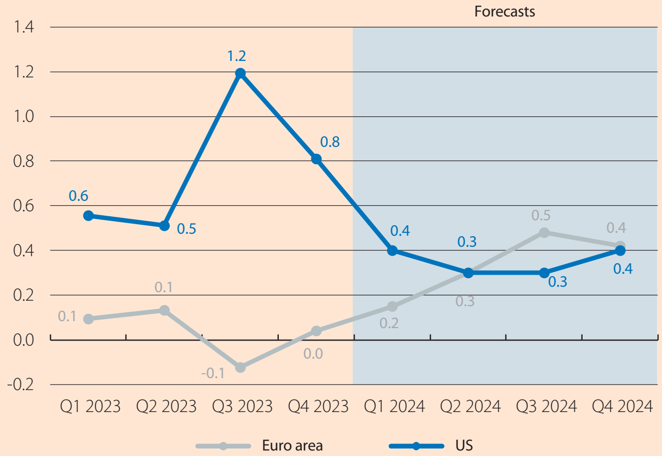
Notes: *1. Estimate based on the Active Population Survey. 2. Average monthly figures. 3. Aggregate figures for the Spanish banking sector and residents in Spain. 4. Period-end figure.*
Source: *BPI Research, based on data from the Ministry of Economy, the Ministry of Public Works, the Ministry of Employment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

New economic scenario for the international economy

In recent quarters, the global economy has shown remarkable resilience and we estimate that it could have grown by around 3.0% in 2023. One of the main drivers of growth last year was the US, which showed remarkable dynamism that has led it to exceed all expectations. Gone are the scenarios anticipating that the monetary tightening in a context devoid of fiscal stimulus would drag the economy into recession – a possibility that was even raised by the Fed. The reality is that US GDP achieved an average quarter-on-quarter growth of 0.8% (above its long-term pre-COVID average), with an exceptional second half of the year, which placed GDP growth for 2023 as a whole at 2.5%, compared to the 0.5% expected at the beginning of last year. This buoyancy in the economy has led to a complete change in the discourse and there are those who even defend a no landing scenario for the American economy. Our stance is somewhat more conservative and we continue to anticipate a slowdown throughout the year, ending up at quarter-on-quarter rates of between 0.3%-0.4%, slightly below its potential. However, the knock-on effect of a particularly dynamic second half of 2023, coupled with a more expansive start to the year than initially estimated, leads us to revise our 2024 growth forecast up to 2.2%, almost 1.4 pps above the initial forecast.

GDP: euro area and US

Quarter-on-quarter change (%)

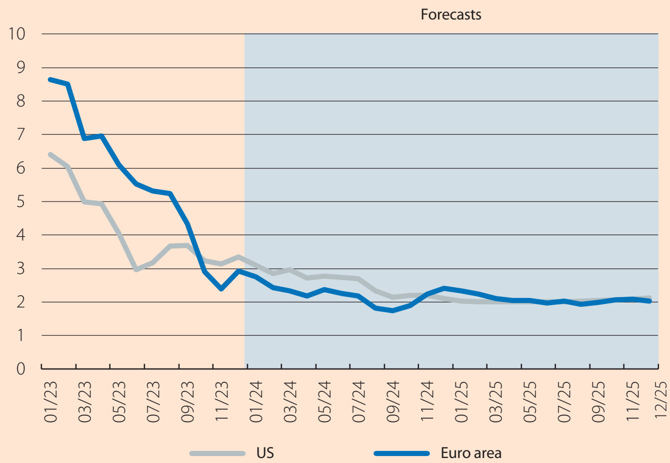


Source: *BPI Research, based on data from Eurostat and the Bureau of Labor Statistics.*

It is feasible that during this year private consumption, the great driver of growth in 2023, could lose some steam, given that the savings buffer accumulated during the pandemic has been practically exhausted: having reached more than 8.0% of GDP at the end of 2021, it currently amounts to only 0.7%. Moreover, the labour market is likely to begin to «normalise» in an orderly manner, resulting in lower job creation than today, more in line with an economy experiencing slower growth and very low unemployment. We can also expect to see a cooling of public spending, given the need to control rising fiscal deficits (in excess of –8.0% of GDP in 2023, according to IMF estimates), which in the coming years will remain heavily weighed down by the pressure of population ageing on public spending and the heavy interest burden generated by public debt at record highs (above 123% of GDP in 2023, according to the IMF). However, some of the loss of momentum which we anticipate for overall consumption will be offset by investment, especially residential, which would benefit from a lower rate environment.

CPI: euro area and US

Year-on-year change (%)



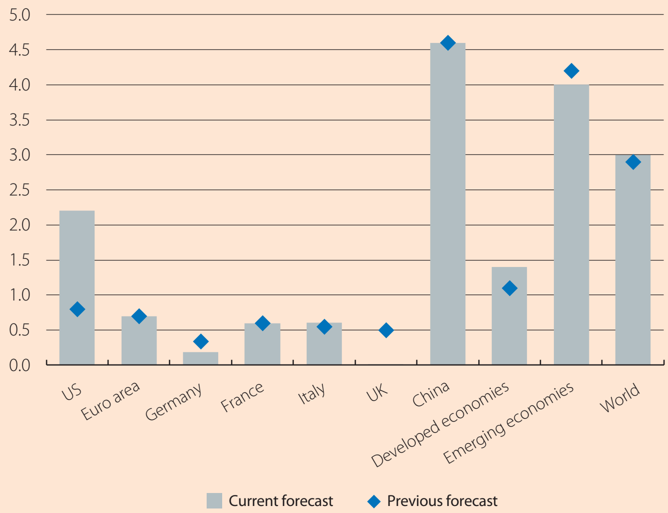
Source: *BPI Research, based on data from Eurostat and the Bureau of Labor Statistics.*

In this context of timid cooling in the US economy, inflation is converging on the 2.0% target somewhat slower than expected due to downward resistance shown by core inflation measures, especially the shelter component (see Brief Note), which accounts for over 40% of core inflation and responds with a time lag. However, we continue to predict declining inflation, despite the possibility of momentary rebounds (see the Focus «US inflation's last mile» in this same Report).

As for the euro area, our expectations continue to suggest significant weakness: not only did the region avoid a technical «recession» at the end of 2023 by the skin of its teeth, but it has also remained weak at the start of the current year (see the International Economy - Economic Outlook section). This apathy is most pronounced in Germany and France, where in February their respective governments applied a significant downward revision to their growth forecasts for 2024: to 0.2% in Germany, down from 1.3%; and to 1.0% in France, down from the previous 1.4%. Our forecast scenario has always been rather cautious and we have been pointing out how the euro area economy is struggling to recover growth rates close to its potential, with 2024 beginning with practical stagnation.

That said, we continue to believe in the euro area economy's ability to recover, especially from the summer onwards: consumption and investment will be favoured by the decline we anticipate in inflation and interest rates. In addition, we must take into account the positive impact that the execution of the remaining European funds will have on growth: the Commission estimates that a further 100 billion euros of NGEU funds will be granted this year, after some 290 billion (less than 35% of the total) has already been distributed since 2021. The Commission estimates that, thanks to these NGEU funds, the real GDP of the EU will be 1.4% higher in 2026 than in a scenario without them. All these factors will help to offset a smaller fiscal boost than that of previous years, since, after years of highly expansionary fiscal policies to combat the impact of COVID and the war in Ukraine, the Stability and Growth Pact was revived on 1 January and governments will therefore have to gradually begin to adjust their fiscal policies in order to converge towards the medium-term deficit and debt targets of 3.0% and 60% of GDP, respectively.

GDP growth forecasts for 2024
Annual growth (%)



Source: *BPI Research.*

As a result, we keep our euro area growth forecast for 2024 virtually unchanged at 0.7%, with a minimal downward adjustment to the forecast for Germany (–0.1 pp, to 0.2%), which is offset by marginal upward revisions for Italy and France (to 0.6% in both cases) as well as by the substantial buoyancy we continue to see in Spain's economy (+0.5 pps, to 1.9%) (see the article «New economic scenario: improved outlook for the Spanish economy in 2024» in this same Dossier). However, the risks for these forecasts are concentrated on the downside, with Germany being the main source of uncertainty. Its industrial sector continues to be weighed down by the loss of competitiveness and the increase in costs associated with gas prices, which despite moderating remain twice as high as pre-war levels, in a context of falling exports due to the global economic slowdown.

Against this backdrop of economic apathy, and following a sharp fall in inflation in 2023, both in the headline index (5.4%, after standing at 8.4% in 2022) and in the core components (4.9% vs. 3.9% in 2022), we continue to expect inflation to decline during the course of 2024. In fact, the good data at the end of 2023 and the decline in future energy prices anticipated by the markets lead us to lower our 2024 forecast for headline inflation to 2.2% (previously 3.1%) and that of core inflation to 2.6% (previously 3.0%).

Global outlook

The improvement in the US growth forecast explains why we have raised our estimated growth in 2024 for developed economies as a whole by 0.4 pps to 1.4%, after 1.6% in 2023. For emerging markets, meanwhile, we cut the estimated growth for 2024 by 0.2 pps to 4.0% (4.0% expected in 2023), and we keep the forecast for the BRIC countries, Turkey and Mexico practically unchanged; although, with presidential or parliamentary elections being held this year in India, Mexico and Russia, the data could be more volatile than usual. As a result, the world's growth (aggregated in purchasing power parity terms) in 2024 is revised up by 0.1 pp, to 3.0%, thus equalling the growth expected to have been achieved in 2023. With regard to inflation in 2024, the revisions are much more modest: we maintain the projected inflation for the world economy virtually unchanged at 5.2%, since the 0.2-pp downward revision to 2.5% for the developed bloc is almost entirely offset by the upward revision of just over 0.1 pp, to 7.2%, of inflation for emerging economies. Many of these forecasts are based on a fairly contained energy price outlook, with no major tensions between supply and demand on the forecast horizon. In fact, for the crude oil price, we anticipate a modest reduction which would lead it to trade at around 78 dollars a barrel in December 2024 (with no significant changes from the previous scenario), while in the case of gas prices we consider it feasible that they could end the year trading at around 35 euros/MWh, almost 18 euros below what was previously estimated.

Monetary policy outlook

As already mentioned, the lowering of interest rates is one of the key determining factors for the economic outlook, especially in advanced economies. The sharp fall in inflation throughout 2023 and the expectation that prices will continue to slow down in 2024, albeit more gradually, opens the door for the Fed and the ECB to begin lowering rates in the coming quarters. Our forecast is that the first cuts will come in June and, given the communicative power of this first cut, they will continue in the following months. However, after more than two years with inflation significantly above the 2% target, and against a background with a strong labour market on both sides of the Atlantic, we believe that both the Fed and the ECB will maintain an anti-inflationary bias and opt to bring rates down gradually, in the absence of any changes to the scenario. Thus, our forecasts contemplate 100 bps of cuts from the Fed and the ECB during the year as a whole, ending 2024 with the fed funds rate at 4.50% and the depo rate at 3.00%, respectively.

The new macroeconomic scenario reflects new data, but the framework unchanged

With the publication of almost all the main macroeconomic data for 2023, we have adjusted our macroeconomic analysis. This revision focused primarily on GDP and its components, inflation, the labour and the real estate markets, and generally reflects only minor adjustments to most of the variables, with the exception of the change in forecasts for the larger residential real estate market, which we explain below.

New Macroeconomic Scenario

	2022	2023	2024	2025	2026	Accum. 2024-2026
GDP						
Feb. 2024	6.8	2.3	1.6	2.3	2.5	6.6
Sep. 2023	6.8	2.4	1.8	2.5	2.4	6.7
Inflation rate						
Feb. 2024	7.8	4.3	2.3	2.0	2.0	6.5
Sep. 2023	7.8	4.6	2.4	2.1	2.0	6.6
Property prices						
Feb. 2024	12.6	8.1	3.5	2.0	2.5	8.1
Other 2023	12.6	7.1	–0.1	1.2	2.5	3.6
Unemployment rate						
Feb. 2024	6.2	6.5	6.7	6.5	6.5	0.0
Sep. 2023	6.0	6.6	6.5	6.3	6.1	–0.5

Source: *BPI Research.*

Starting with economic activity, the revision of the GDP growth outlook between 2024 and 2026 does not reflect a substantial change in Portugal's economic environment, but merely the incorporation of new data and adjustments to the ECB's monetary policy outlook. Indeed, in cumulative terms, we expect the economy to grow by 6.6% over the next three years, just 0.1% less than we expected in September. Starting with 2024, we have revised the growth forecast to 1.6%, 0.2% less than expected in September, which basically anticipates more moderate growth in the first half of the year, when monetary conditions are still restrictive, and a sharper recovery in the second half of the year, when the consolidation of the disinflationary process is reflected in the reduction in the degree of restrictiveness of the ECB's monetary policy. In 2024, growth will be particularly driven by domestic demand, as private consumption continues to be supported by a resilient labour market, and by investment, which will tend to be supported by European funds. In this scenario, we anticipate stronger growth in imports than in 2023, while exports could be a little weaker, reflecting the fragility of activity in the main trading partners. For 2025 and 2026, we anticipate a scenario in which quarterly growth is close to the average seen in the 5 years prior to the pandemic, benefiting from the implementation of the structural changes necessary to receive European funds.

The inflation rate performed better than expected in 2023, with prices decelerating more than expected in the last few months of the year. As a result, inflation stood at 4.3% last year, 0.3% less than we predicted, which in itself would translate into a downward revision of the outlook for inflation in 2024. However, other factors will also contribute to the behaviour of prices throughout this year: on the one hand, we expect energy goods to evolve favourably, as global demand will be weak, and because there will be an increase in the supply of crude oil from non-OPEC producers (offsetting OPEC's cuts). But this factor, which would tend to reinforce the disinflationary process, will be offset by the impact of the end of zero VAT on food and the incorporation of changes in some administrative prices, namely rents and *utilities*. As a result, the change to our scenario is very marginal, reflected in 2024 in a revision of the inflation rate to 2.3%, just 0.1% less than we predicted in September. However, the revision of the underlying inflation forecast, which does not take energy and food prices into account, reinforces the expectation that the disinflation process will be consolidated. In fact, we revised our estimate for average underlying inflation in 2024 to 2.4%, 0.4% less than we expected in September.

In the labour market, we adjusted the outlook for job creation and the unemployment rate. In short, we anticipate that the economy will continue to create jobs, with the shortage of labour continuing to be highlighted as one of the main problems for business development. Indeed, this is the first obstacle to activity mentioned by the construction and public works sector, and the second in the industrial and services sectors. In addition, the fact that the ratio of job vacancies per unemployed person remains high compared to its historical behaviour supports the continued resilience of this market. However, we have revised our estimates for the unemployment rate upwards, as we anticipate that immigration will continue to more than compensate for the natural balance (albeit on a smaller scale than in recent years), implying an increase in the labour force. This is coupled with the expectation that companies' capacity to create jobs will decrease, reducing or delaying their ability to absorb new workers. We have thus revised our forecast for the unemployment rate in 2024-25 by another 0.2% and by another 0.4% in 2026. Even so, it will continue to be characterised by a high degree of resilience, supporting private consumption.

Finally, the property market, where the revisions were more substantial. We start with the fact that the final figure for 2023 is not yet known, but we know that price growth in Q3 was stronger than we thought in September and preliminary indicators for the last quarter of 2024 suggest that the pace of price growth will exceed our September forecast. Thus, we have a first effect associated with the revision of the drag effect, which is estimated at over 2%, 1.7% more than we anticipated in September. In addition to this, there are also factors supporting the market, such as the increase in immigration, which has an impact on the demand for housing, the shortage of supply, and improvement in the criteria for accessing mortgage loans, namely the increase in fixed-rate operations and the fact that the level of defaults on this type of loan remains low. These factors favour stronger than previously expected growth in residential real estate prices, though the outlook remains one of moderation in the pace of expansion, reflecting lower demand due to financing costs remaining high, especially in the first half of the year.

Again this year, the scenario is subject to a high degree of uncertainty, this time resulting from the outbreak of war in the Middle East. So far, the changes that this war has brought about in the maritime transport of goods has not translated into significant changes in production and transport costs, leading us to anticipate that there will be no discernible impact on the disinflation process, allowing central banks to begin the cycle of cutting key rates in the middle of the year. However, this is a latent risk and the possibility of the conflict spreading to other countries could change this situation, causing commodities to become more expensive and even disrupting their supply, delaying the reduction of inflation, prolonging the restrictive monetary environment, and impacting on the decisions of economic agents. However, as this is not the central scenario, we remain reasonably optimistic about the evolution of the Portuguese economy in 2024.

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