

Economic note

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1. "Megashocks..."

The autumn meetings of the International Monetary Fund (IMF) and the World Bank, which take place every two years outside Washington DC, recently took place in Marrakech, Morocco. The meetings in Marrakesh, in a city recently devastated by an earthquake that left thousands dead, could well be understood as an allegory for the state of the world economy: a picture after intense shocks, but with a remarkable capacity for rapid response and recovery. What they now call "resilience", in short.

The global economy has been riding on the back of high-impact events since 2020. Events that ECB President Christine Lagarde referred to at the meetings as "megashocks". The pandemic led to an unprecedented fall in the GDP of economies, although public policies to support households and business credit contained the social and employment effects. An exercise and effort that was also an unprecedented public policy success.

The pandemic was followed by Russia's aggression against Ukraine, which is still continuing, with devastating effects on inflation. The rapid changes in product demand brought about by the pandemic (falling demand for services, rising demand for goods, especially electronics) had been followed by an accelerated recovery that was already putting pressure on prices in some segments of the economy and worsened by higher energy and some food prices as a result of the war.

To all this must be added the third of the "megashocks", referred to by Lagarde, that the global economy has faced: the merry-go-round of macroeconomic policy responses. The pandemic was met by both a further easing of general financial conditionalities (via a further decline in interest rates and/or a further increase in asset purchases by central banks) and an expansion of public spending. And an important factor not to forget: this loosening of monetary conditions and expansion of public spending took place in a more or less coordinated fashion around the world. This is logical given the global nature of the pandemic, but very exceptional, as there are few episodes of such a high degree of "coordination" of policies, all in the same direction, across the globe.

Monetary and fiscal expansion was followed by exactly the opposite: a sudden, sharp, forceful and across-the-board tightening of monetary policy in response to the effects of the war in Ukraine.

2. ... and "megatrends".

The effects of these high-impact events or "megashocks" cannot fail to be analysed in the context of other events that seriously affect the world economy and which have a different speed but a major importance: what we might call "megatrends". Always far from the day-to-day focus, but with transformational capacities beyond any doubt.

The first megatrend is largely a consequence of the events discussed in the previous section. The pandemic and the war in Ukraine have been the trigger for the silent movement of "de-globalisation": the relocation of production along lines closer to geopolitical affinities. For all practical purposes it is still a slow process, with little change in reality. These changes are slow and take time to materialise, but the trend has begun, as the IMF has recently highlighted.

Companies are progressively beginning not to expand their productive capacities in geopolitically distant countries (China, as a clear example) and to locate new capacities in other countries, and then even continue with changes in installed capacities. According to the IMF, foreign direct investment in geopolitically related countries has risen from 40% in the first decade of this century to 50% in 2020-22.

The long-term effects will not be small: it is estimated (IMF) that an alignment of world trade with geopolitical preferences could lead to a decline in world imports, which could reach 30%, with consequent impacts in terms of efficiency and prices. The effects would be particularly relevant for the EU, with impacts doubling those of the US and China in terms of trade volume impacts.

The second "megatrend" concerns demographics. The progressive withdrawal from the labour market of the so-called '*baby boom*' generation may mean that, in the coming decades, the working-age population in some OECD countries will fall by as much as 25%-30%. This will necessarily have a major impact, most obviously on pension systems. Of course, the overall impact will depend on many factors, but particularly on the evolution of immigration in the various countries, which could make it possible to compensate, at least partially, for this decline in the labour force. We will also have to keep an eye on technological developments, such as, for example, the potential effects of Artificial Intelligence (AI), which are so difficult to predict.

AI can be understood as the first industrial revolution affecting skilled jobs. Some studies speak of major impacts on the number of skilled jobs as a consequence of the massive use of AI, but the history of the technology and its application also allows us to be "techno-optimistic". Since the industrial revolution, employment has continued to grow and

productivity per worker has reached levels unimaginable a couple of centuries ago, despite the intensive use of technological advances.

3. Labour markets are holding up... but for how long?

While the effects of these "megatrends" are becoming apparent - let us not forget that, despite their lack of visibility, they are working relentlessly - the developed economies have experienced a gradual slowdown as a result of the interest rate hikes implemented by the central banks and the effects of inflation on the real incomes of economic agents. Expectations have further deteriorated in recent weeks due to the outbreak (or rather the return of outbreaks) in the Middle East.

But if there is one element to highlight in the performance of the European and North American economies in recent quarters, it is the general resilience and strength of employment. Despite the interest rate hikes and the deterioration in agents' expectations, employment has remained stable or increased in most countries. Companies do not seem willing to adjust via employment and are resisting layoffs, surely aware of the difficulties their recovery would entail should the economy rebound.

As long as employment is sustained, private consumption, which accounts for more than two thirds of GDP in developed economies, will hold up. In this context, an escalation of the conflict in Israel could have very negative effects, as it could dampen these positive developments.

4. Spanish economy doing well, thank you

The Spanish economy has performed well in 2023, exceeding expectations and being one of the fastest growing European economies.

This year could close with growth of slightly less than 2.5%, much higher than the figures of just under 1% that were being used just over a year ago. How is it possible that this performance has occurred in a context that has become progressively more complicated (higher interest rate rises than anticipated at the end of 2022, a complicated geopolitical context...)?

Part of the explanation, as we have mentioned in previous notes, lies in the dynamism of public spending. But there are four additional elements that reinforce this good performance by the Spanish economy and which, fortunately, are not likely to disappear in the short term.

The first is, as we have seen, employment, which has withstood the impact of the pandemic and the times that followed. The response to the pandemic allowed for less job destruction thanks to the ERTES. The subsequent relative labour shortages prevented firms from quickly shedding workers at the first sign of a slowdown in the economy. This good labour market performance has also been made possible by the remarkable containment of wages

in the context of the rapid acceleration of inflation that we have experienced over the past two years.

The second element has to do with this good performance of employment, the containment of wage costs and the more recent moderation of inflation, which have allowed the Spanish economy to become more competitive in recent years. This is not evident in the balance of trade in goods - energy goods have increased considerably in price and had a very negative impact on our balance of trade - but it is, for example, in tourism exports or, even more interestingly, in exports of non-tourism services (e.g. consultancy and advisory services, construction, transport, financial services and telecommunications). These sectors have significantly increased their exports abroad in recent years.

In addition, and thirdly, it should be noted that, while before the 2008 financial crisis the economy's need for external financing (from the rest of the world) was very high - with a current account deficit to be financed each year of close to 10% of GDP - we now have a current account surplus; in other words, the Spanish economy is capable of "repaying debt" abroad or financing the rest of the world. This is a real anomaly in the case of our country and is the other side of the coin of a private sector that, in general terms, does not show very high levels of indebtedness after the notable process of "deleveraging" (debt reduction) of Spanish households and companies in the last decade.

Finally, there is an element that explains the good differential performance of the Spanish economy in the last two years that has passed somewhat "under the radar", but which is very relevant: immigration.

The figures for the influx of foreigners from 2018 -and especially in 2022 and 2023- can be compared with the years 2002-2007, when more than half a million people entered Spain each year. Between 2018 and so far in 2023 (INE data), this represents a figure of 2 million people, almost 4% of the total population - currently close to 48 million. In 2022 alone, the number approached 600,000 people, at a similar rate to that observed so far in 2023.

This significant increase in the population, which is, moreover, in general terms, of working age, explains this good differential behaviour of the Spanish economy. It represents a significant population *shock* - with logical consequences in terms of consumption, housing needs, etc. - and would also help to explain the observed containment of wages.

5. We face a 2024 that is better than it looks... with the permission of the Middle East.

The set of elements described in the previous sections allows us to maintain a certain optimism about the performance of the Spanish economy in 2024. Despite the political uncertainty associated with the current *impasse* in the formation of a government in Spain and the possibility of a new round of elections, the elements that have underpinned the positive differential performance of the Spanish economy should be maintained.

On the one hand, after the rapid and forceful rise in interest rates, everything points to the fact that we are probably at or close to the highs. Inflation is receding, the slowdown in many sectors is already a reality and companies will find their new equilibrium sooner rather than later at the new level of interest rates which, on the other hand, will probably remain at high levels for longer than initially anticipated.

On the other hand, there is no sign that the behaviour observed in immigration in recent quarters will slow down, which will continue to underpin consumption, employment and wage restraint.

And, finally, the other elements should continue to support the Spanish economy, such as the good performance of tourism and non-tourist services exports, and the continued dynamism of public spending despite political uncertainty.

For all these reasons, the Spanish economy could well surprise, once again, positively and exceed forecasts in 2024. That is, with the exception of the Middle East... and the absence of new actors in the conflict, notably Iran.