Economic activity holds up

Can you imagine living through the current context without any information on how the economy is doing? I am referring to objective, reliable data such as employment, production, wages or prices. Most likely, it would be utterly bewildering. In the current circumstances, each person's perception of the economic situation is very different and may be heavily influenced by the sector in which they work or the region in which they live. Fortunately, we have data which we can use to check our impression of the economic reality. The key indicators that tell us about the economic situation for the quarter just ended have been released this month, and they are very helpful for getting our bearings in these very uncertain times.

Thus, we can say that the rate of economic activity growth slowed during Q1, but with important nuances when we assess the particular situation in each country. It is the US economy that has suffered one of the sharpest slowdowns relative to the pace of progress it had been enjoying in recent quarters. GDP registered a negative growth rate in Q1 2022, with a quarter-on-quarter decline of 0.4%. However, this poor figure should be interpreted with caution, since the major growth drivers such as consumption and investment continued to show steady progress. In the euro area, the economic activity data have maintained a modest pace of progress in line with expectations, with growth at 0.2%, and there have been no major differences between the major countries. While Italy's GDP fell by 0.2%, France's remained flat, and Germany's and Spain's advanced by 0.2% and 0.3%, respectively.

The labour market, which normally lags behind changes in economic activity, continues to offer broadly positive figures. In the US, we have seen a highly buoyant labour market for some months now and the labour shortages are still present, with an unemployment rate that remains close to historic lows. In the euro area, the figures are also maintaining a very positive trend and in March the unemployment rate fell to 6.8%, a historically low level by European standards. In the euro area too, and especially in countries such as Germany and France, labour shortages are proving to be a limiting factor for growth capacity.

In Spain, the labour market is holding up well despite the various adversities it is currently facing. The rate of employment growth remains strong, standing at 1.1% in Q1 2022 in quarter-on-quarter (and seasonally adjusted) terms, and the number of hours actually worked (a particularly useful indicator in the context of the pandemic) has shown particularly high growth, reaching 3.2% quarter-on-quarter. Moreover, the good performance of the labour market is being accompanied by a notable fall in the incidence of temporary employment, as the number of wage earners on permanent contracts is increasing very significantly, while those on temporary contracts is decreasing.

Despite the resilience shown by economic activity to date and the good figures in the labour market, the economic outlook has been deteriorating over the past few months. To a large extent, this is due to the sharp rise in inflation in the major developed countries. However, once again, the nuances are very important. In the US, prices have increased across all components of the consumer price index, and this is also going hand in hand with a sharp rise in wages, which are growing at over 5%. In European countries, in contrast, the bulk of the price increase is due to higher energy and food prices, while the contagion to other goods, although present, is still limited.

These nuances are very important when assessing the reaction of the central banks. All the indicators suggest that the Fed will have to carry out a rapid and significant rise in interest rates over the coming months in order to curb economic activity and, indirectly, inflationary pressures. This year the Fed will most likely end up raising the reference rate by around 2 pps, the steepest rate hike since 1995. In the euro area, the ECB is also expected to raise interest rates. However, given that the inflationary pressures are lower, we expect it to do so much more gradually, raising the reference rate by between 0.50 and 0.75 pps over the course of the year.

But beyond the rise in inflation and financing costs, and despite the marked deterioration in the growth outlook that this entails, the fact is that the growth rate anticipated by the consensus of analysts for 2022 and 2023 is still relatively high. The boost to economic activity that is likely to result from the end of the mobility and activity restrictions will be significant, provided there are no new mutations of the virus. Therefore, despite the downward revisions in recent months, we expect the US economy to grow by more than 3% this year, while the European economy could grow by around 2.6% and the Spanish economy, above 4%.

It is true that the risks surrounding this scenario are significant, especially those on the downside. The possibility of further tensions in energy prices, due to an escalation of the sanctions and counter-sanctions between Russia and European countries, is one of the sources of greatest concern. We will also have to closely monitor the implications of the new wave of infections and lockdowns in China, which could once again collapse global supply chains and increase supply problems in a number of sectors. Nevertheless, things could also end up going better than expected, even if it seems impossible today. There are no data for futurology, but we must try to consider all plausible scenarios, and just as we must not indulge in complacency when things are going well, we must also not fall victim to pessimism when times are hard.

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