2022 ECONOMIC AND INDUSTRY OUTLOOK

MAPFRE Economics

2022 Economic and Industry Outlook

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Presentation

Fundación MAPFRE is pleased to present a new edition of the MAPFRE Economics *Economic and Industry Outlook* report, which provides an overview of the main global macroeconomic and financial prospects and trends for 2022, as well as an assessment of their impact on the insurance business. As in previous years, the macroeconomic and insurance forecasts and comments in this report will be revised throughout 2022 through the publication of three quarterly updates.

As noted in the report, while economic recovery accelerated in the first half of 2021, growth was less marked in the second half due to price pressures arising from supply chain and logistical problems, mainly in maritime transport and ports; rising commodity prices, and energy costs; the concentration of demand on consumer goods to the detriment of services, and renewed uncertainty under the threat of the new Omicron variant. However, MAPFRE Economics predicts continued recovery in the coming year, albeit at a slower pace and with differences between developed and emerging economies, with the global economy growing by around 4.8% in the baseline scenario and 4.0% in a stressed scenario 2022.

As for the insurance industry, since greater sensitivity to risk among economic agents due to the COVID-19 pandemic will provide further stimulus to insurance demand, the outlook for this business in 2022 remains positive.

The *2022 Economic and Industry Outlook* is published as a part of Fundación MAPFRE's financial and insurance education activities, which aim to help educate citizens on these subjects and provide a work tool for those who require such information for decision making.

Fundación MAPFRE

Introduction

In the 2022 edition of the *Economic and Industry Outlook* report, MAPFRE Economics analyzes the outlook on economic performance globally and in the world's leading economies, sharing its vision of the environment that the insurance business will face this year.

After accelerating in the first half of 2021, the global economy slowed down due to the rise in commodity and energy prices, supply chain problems, the concentration of demand on consumer goods to the detriment of services, and uncertainty surrounding the return of social-distancing measures to stop the spread of the new COVID-19 variant. While the central banks in emerging countries have started to tighten their monetary policies in response to surging inflation, the developed markets keep them stable to continue encouraging economic recovery, although a policy shift is looming. Thus, the global economy is heading for slower growth than in 2021 and should expand by an estimated 4.8% in 2022 and 3.6% in 2023, with the developed markets taking the lead in closing the output gap over the next few years.

On the other hand, despite the reduced momentum and increased uncertainty in the worldwide economy, the greater aversion to risk among economic agents due to the pandemic will provide a significant stimulus to insurance demand. Therefore, the outlook on the insurance industry in 2022 remains positive. Also, the negative effects of the economic reopening on the loss ratio in some insurance lines will move towards correction, so insurance companies are likely to remain profitable despite the potential short-term impact of the rebound in inflation.

We hope that this new edition of our annual outlook report helps improve our readers' understanding of the global economic environment and the factors that may affect the insurance business in the new year.

MAPFRE Economics

Executive summary

2022 Economic and Industry Outlook

Economic outlook

Factors such as the spending of amassed savings, the continuation of governments' fiscal support policies, and ultra-lax monetary conditions established by the central banks helped the global economic recovery accelerate in the first half of 2021. However, the second half saw slower growth rates due to rising commodity and energy prices, problems in the supply chains, the concentration of demand on consumer goods to the detriment of services, which worsened bottlenecks, and uncertainty caused by the reinstatement of social-distancing measures against the new COVID-19 Omicron variant.

As a result, whereas central banks in the emerging countries have started to tighten their monetary policies, raising benchmark interest rates, the developed markets—despite the first rate hikes announced in countries like Australia, Canada, and the United Kingdom—are maintaining their monetary policies, for now, to continue spurring economic growth. The tapering process has started in the United States, where the Fed is entering an asset reduction phase, while the European Central Bank has announced plans to hold interest rates steady, moving with the trend of increased tolerance for inflation above 2% and defending the view that inflation is essentially transitory.

Based on this global economic context, this new edition of the *Economic and Industry Outlook* analyzes a scenario in which, even though the new Omicron variant has brought back restrictions and delayed normalization, the measures taken will be milder and less harmful to the economy thanks to past experience. Also, global risk aversion will remain on track to normalization (despite temporary upturns in the short term), converging towards the average values for the past five years in 2022. Therefore, the global economy will grow by around 4.8% in 2022, slowing to 3.6% in 2023. The emerging markets will do so slightly below that figure, while the developed markets will grow above it. The developed markets will also take the lead in closing the output gap in the coming years, accounting for two-thirds of its closure.

Meanwhile, in the *stressed scenario* considered in this report, restrictions would not reach the levels seen at the start of the pandemic. However, the situation would be considerably worse due to vaccines' ineffectiveness against new virus variants, overwhelmed health care systems, and rising case numbers. In this alternative scenario, the return to normal activity would be delayed, and the impact on supply chains would be more severe, with disruptions spreading to a wider range of goods and services, driving inflation up until the end of 2022. In this scenario, risk aversion falls just as in the baseline scenario, but more slowly, putting the brakes on global economic growth in both 2022 and 2023, an estimated 4.0% and 2.6% in each case.

It should be noted that in both scenarios, the developed economies are showing the first signs of tightening their monetary policies in 2022 and 2023 as they gradually normalize to meet governments' financial needs. Fiscal policy will follow in the footsteps of monetary policy, with more intermittent measures with less impact.

Industry outlook

After a year of robust recovery in the insurance markets worldwide, 2022 will be marked by a more complex environment and a slowdown in overall economic growth, which will be uneven in different economies worldwide. It will also be defined by persistent inflation, whose sharp rise is causing a shift towards less accommodative monetary policies and tightening even beyond the pre-pandemic levels in some emerging markets.

Despite the global economy losing steam and the growing uncertainty generated by new virus variants, the pandemic is causing increased risk aversion among economic agents that will further stimulate insurance demand. The outlook for the insurance business, therefore, remains positive for 2022. Meanwhile, the negative effects of reopening the economy on the loss ratio of some insurance lines (such as motors, life, or health) are moving towards correction, so the outlook remains favorable for insurance companies' profitability despite the potential short-term effect of the rebound in inflation.

A slight slowdown is expected in the Eurozone in 2022, although some economies, such as Germany and Spain, will accelerate with economic growth that will generally stimulate the insurance industry in the region. Supply chain disruptions (although they are starting to improve) will continue to affect the automotive sector, weighing on new registrations and negatively impacting the auto insurance business. This situation could reverse as the year goes on, considering the forecast of economic growth and the existence of a certain degree of pent-up demand amid these circumstances. The savings-linked Life insurance business will remain influenced by the low interest rate environment. However, the European Central Bank's monetary policy has started to shift towards the gradual withdrawal of the extraordinary monetary stimulus measures introduced in response to the pandemic, focusing on winding down its net bond-purchasing program.

Monetary policy in the United States will be adjusted more rapidly, a shift that should also involve interest rate hikes and even the Federal Reserve reducing its balance sheet. Equity continues to be perceived as an alternative to hedge against inflation in an environment of negative real interest rates, which boosts the performance of Life insurance products in which the policyholder takes the investment risk. However, the outlook is a bit more complicated for these types of insurance, as insurers must adapt their products to a new environment of risk-free interest rates and tensions around risk premiums in fixed income markets and increased volatility in equity. Meanwhile, the Life risk business could benefit from households' and companies' increased sensitivity to the risk of death due to the pandemic.

The outlook on the emerging markets is mixed, with a slowdown in economic growth that will affect the emerging Asian markets less than other regions, such as Latin America. Despite recovering much of the GDP it lost during the crisis, Latin America should have less momentum in 2022 against a backdrop of reduced fiscal stimulus, tightening monetary policies, high debt ratios, and greater pressure on its respective currencies due to the interest-rate hikes planned by the US Federal Reserve. Therefore, a marked slowdown is anticipated in the region, which could reduce growth in its insurance markets. However, the rate hikes underway in some of these markets (such as Brazil and Mexico) have generated a more favorable interest rate environment for the traditional Life business linked to savings and annuities. Other countries, such as Turkey and Argentina, will not have as much momentum after implementing less orthodox monetary policies and strengthening a situation of negative real interest rates.

Regarding reinsurance, natural disasters caused significantly higher overall losses in 2021 than in the two previous years, making it one of the costliest years on record for such catastrophes. These losses were driven by the events that struck the United States (such as Hurricane Ida) and Europe, where the low-

pressure Bernd weather system caused heavy rainfall and damage in western Germany, the Netherlands, Belgium, and Luxembourg. In Spain, the most significant event was the eruption of the Cumbre Vieja volcano in the south of La Palma, in the Canary Islands.

Finally, it should be noted that in December 2021, the European Insurance and Pensions Authority (EIOPA) published its latest financial stability report highlighting the risks it considers key for the insurance industry. The most significant risks, described in the last section of this report, include the macroeconomic risk (which remains high), the credit risk, and the market risk, along with emerging ones such as the cyber risk, which has moved to the forefront, and the so-called environmental, social, and governance (ESG) risks.

1. Economic outlook

1.1 The global economic outlook: renewed uncertainty in an atypical context

1.1.1 An atypical context

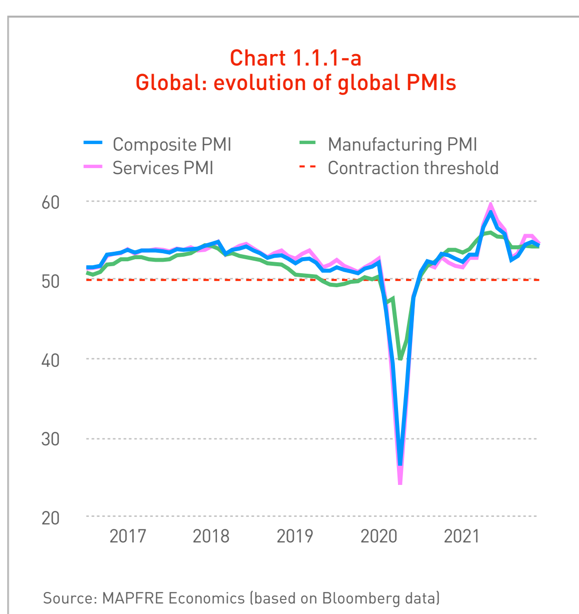
Economic recovery was characterized by a strong acceleration in the first half of 2021, boosted by positive traction at the end of 2020, the spending of amassed savings, the continuation of fiscal support policies, and ultra-lax monetary conditions by the central banks (especially in the developed markets), and less damaging restrictions for the economy. However, the second half of the year saw more moderate growth rates due to pricing pressures rooted in: (I) supply chain problems and logistical deficiencies, mainly in maritime transport and ports; (ii) the rise in commodity prices and energy costs; (iii) concentration of demand on consumer goods to the detriment of services, exacerbating bottlenecks; and (iv) renewed uncertainty and the return of social-distancing measures under the threat of the new COVID-19 version, Omicron.

In the case of bottlenecks, the supply chains and maritime transport crisis could continue until the second half of 2022. Meanwhile, the semiconductor shortage, which is causing delays in the manufacture of automobiles, household appliances, and electronic devices that are broadly connected to other sectors, could postpone the return to normal activity until 2023 (see Charts 1.1.1-a and 1.1.1-b).

Elsewhere, the increase in commodity and energy prices (one of the circumstances fueling global inflation) is due partly to the sudden increase of demand from economic reactivation and very specific factors that could be mitigated to a certain extent in the second half of 2022. Among the most relevant factors are the following:

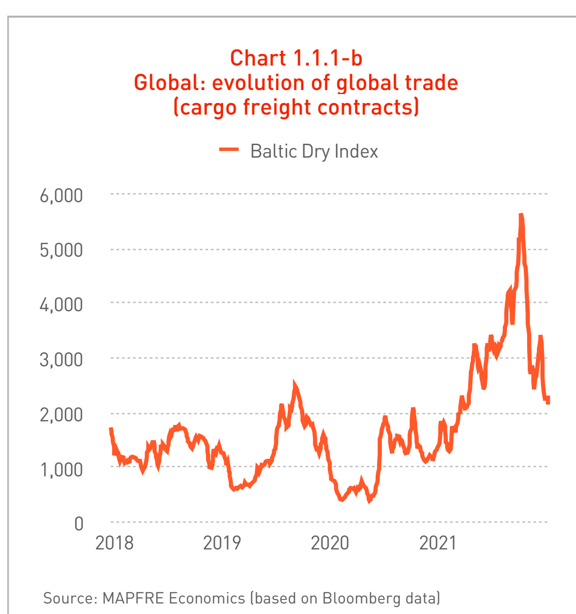
a) In terms of gas, the price increase is rooted in the sudden rebound in demand, stock shortages, and geostrategic dynamics between Russia, the United States, and the European Union with Ukraine as the epicenter of the conflict and the delays in Nord Stream 2, tensions between Algeria and Morocco,

Chart 1.1.1-a
Global: evolution of global PMIs



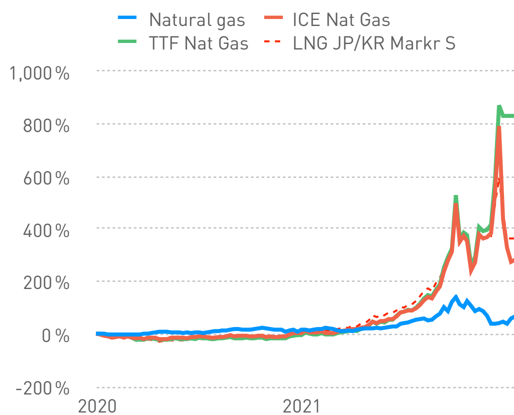
Source: MAPFRE Economics (based on Bloomberg data)

Chart 1.1.1-b
Global: evolution of global trade (cargo freight contracts)



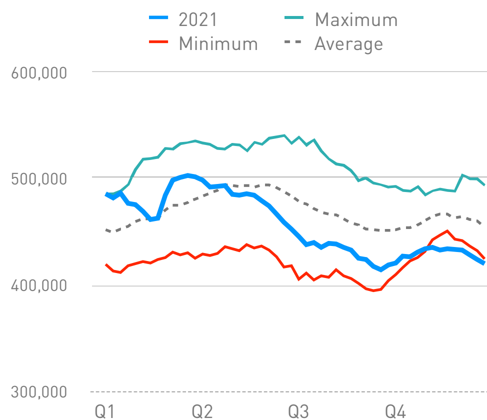
Source: MAPFRE Economics (based on Bloomberg data)

Chart 1.1.1-c
Global: gas futures



Source: MAPFRE Economics (based on Bloomberg data)

Chart 1.1.1-d
Global: crude oil inventories vs. historical levels



Source: MAPFRE Economics (based on data from the International Energy Agency)

and the potential for the problem to spread to other countries in Asia (Kazakhstan) due to the rerouting of transport in a bid for higher premiums (see Chart 1.1.1-c).

b) The increase in oil prices can be attributed to the Organization of Petroleum Exporting Countries' (OPEP) refusal to increase production, the declining investment in prospecting and exploration (amid pressures to reduce the use of fossil fuels), and the stronger focus on electricity (see Chart 1.1.1-d).

c) The high electricity prices, which are soaring in many parts of the world, depending on the source, generally originate from the low production of some clean energies (wind and hydro) and price increases affecting CO2 emission rights, gas, and coal. In the European Union, they have been influenced by the hasty energy transition, focused on channeling investment towards longer-term production phases to meet the *Net Zero* goals to the detriment of the stages closest to the consumer, which is exacerbating the problem. This energy pressure has led some countries to reconsider their more immediate strategies, either switching to a more balanced mix while reducing risks in the face of climactic variations or reducing energy dependency on third countries, where geostrategic interests may interfere with energy supply (Russia, Algeria, China). In particular, France has already announced plans to construct new nuclear power plants to become energy self-sufficient and reduce the flow of money abroad. In the context of its climate objectives, China has announced a 440-billion-dollar investment to build 150 nuclear power plants in the next 15 years, more than the rest of the world in the last 35 years.

At the same time, strong demand channeled towards consumer goods at the expense of services continues to aggravate bottlenecks (see Charts 1.1.1-e, 1.1.1-f, and 1.1.1-g). This phenomenon initially arose from the spending of amassed savings and momentum from economic policies but has been driven more recently by consumers—in consideration of the ongoing supply problems and amid fears of scarcity—making purchases early in anticipation of higher prices in the future. Although these factors will exacerbate supply problems in the short term, the role of consumption is expected to lose momentum throughout 2022. Consumer spending could also weaken in anticipation of greater fiscal pressure in the future, resulting from the withdrawal of the broad support measures introduced during the pandemic.

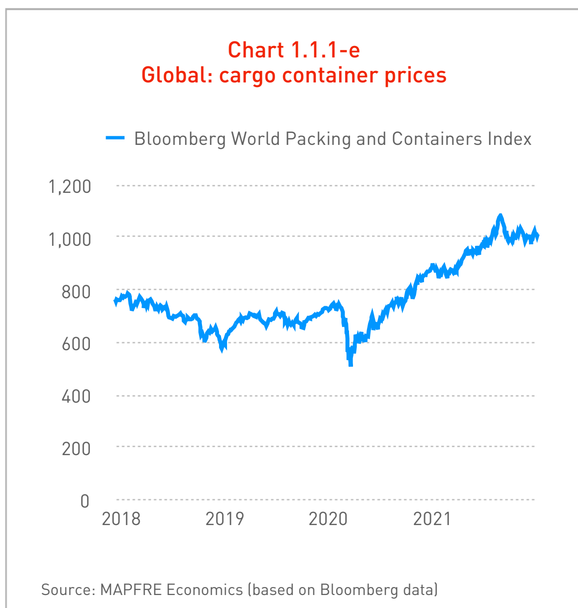


Chart 1.1.1-e
Global: cargo container prices

Source: MAPFRE Economics (based on Bloomberg data)

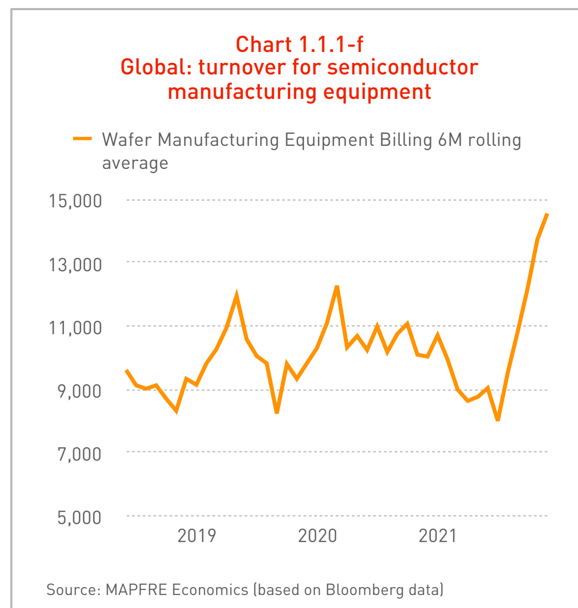


Chart 1.1.1-f
Global: turnover for semiconductor manufacturing equipment

Source: MAPFRE Economics (based on Bloomberg data)

Due to the above factors, inflation has been climbing for months in many parts of the world, leading the central banks of emerging countries to raise interest rates. The Central Bank of Russia announced seven rate hikes for 425 basis points (bps), the Bank of Brazil 725 bp, and the Bank of Mexico 150 bp, with the Bank of Turkey being the sole anomaly in this process. Although the first increases have been seen in developed countries in Australia, Canada, and the United Kingdom, rates are being held steady for now to continue spurring recovery, with central banks opting to start their return to normal by adjusting their balance sheets.

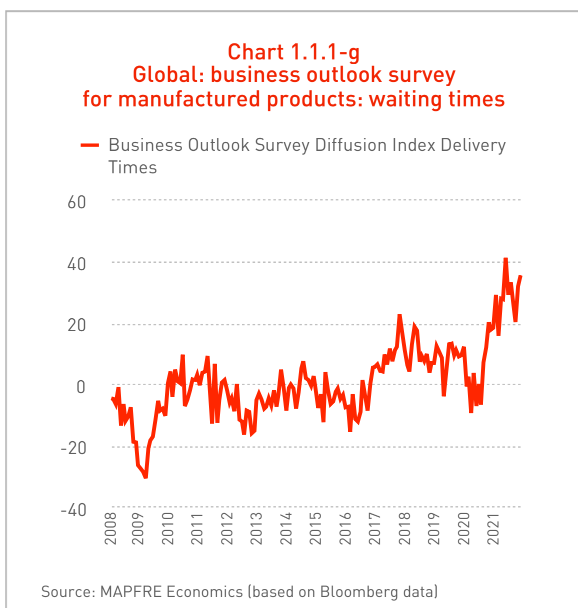


Chart 1.1.1-g
Global: business outlook survey for manufactured products: waiting times

Source: MAPFRE Economics (based on Bloomberg data)

In the United States, the Federal Reserve has already started tapering (reducing asset purchases), which is expected to culminate in the first quarter of 2022 and should lead to a reduction of assets. It should also raise interest rates three or four times throughout 2022. The European Central Bank (ECB) will keep interest rates stable in 2022 while scaling back its pandemic emergency purchase program (PEPP), to be partly offset by an increase in its conventional asset purchase program (APP), while embracing the trend of increasing the tolerance to inflation above 2%. In its statement, the ECB continues to defend the view that inflation will be transitory, while the Federal Reserve's faith in its temporary nature is starting to wane (see Chart 1.1.1).

Energy and other commodity prices will indeed fall again once supply problems are resolved and demand normalizes, and therefore general inflation should fall. However, it is also true that the rises observed in recent months are already being passed through to other products and services, as well as to salary demands, and are thus starting to affect core inflation. At this stage, it is difficult to anticipate the extent of

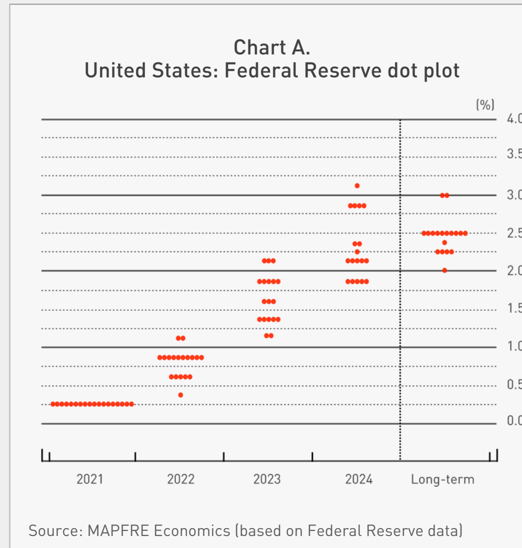
Box 1.1.1
Monetary Policy Update

Federal Reserve

The US Federal Reserve, at its December meeting, introduced new changes to its monetary policy with regard to the balance sheet by reducing asset purchases by 30 billion dollars per month (10 billion dollars of mortgage-backed securities and 20 billion dollars of treasuries, respectively). As for the benchmark interest rates, these remained unchanged in the range between 0% - 0.25%. However, their projections, via the Federal Open Market Committee (FOMC) *dot plot*, moved towards a steeper median slope in favor of three rate hikes in 2022, with broad consensus among members, and three additional hikes in 2023 (see Chart A).

On the macroeconomic front, GDP growth estimates for the United States remained relatively stable, with slight upward shifts in 2022 (4.0% vs. 3.8% in September) and downward shifts in 2023 (2.2% vs. 2.5% previously), anticipating a further recovery in the unemployment rate to around 3.5% in 2022-2023. On the inflation side, the revisions were upward, evidencing more persistent pressures that would place the PCE at 2.6% in 2022 and 2.1% in 2023.

Chart A.
United States: Federal Reserve dot plot



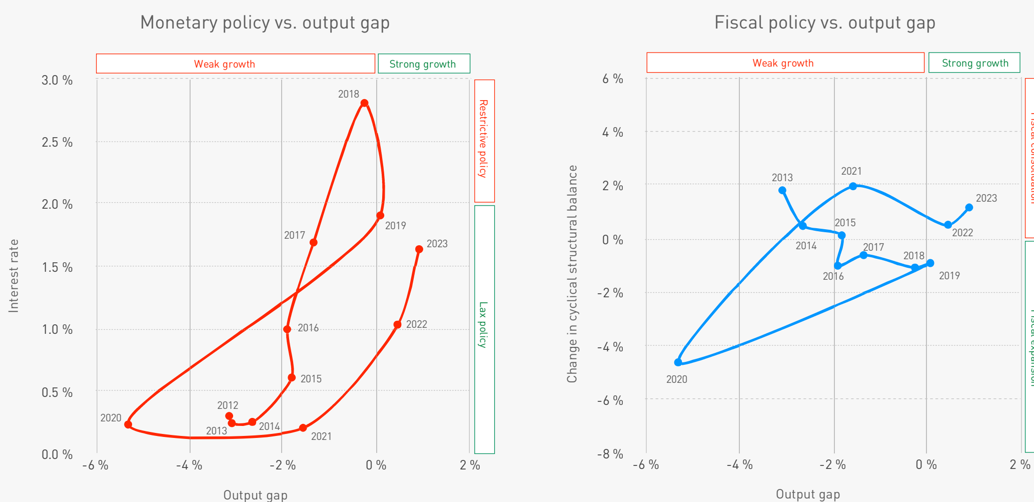
Source: MAPFRE Economics (based on Federal Reserve data)

As for the Fed's narrative, the turnaround in forecasts rests, on the one hand, on a strong labor market, a steadily expanding economy, and concomitant inflation. On the other hand, uncertainty is resurfacing due to the epidemiological factor after the appearance of the new COVID-19 variant, which, although it has the potential to reinstate restrictions and damage economic

Chart B.
United States: monetary and fiscal policies vs. output gap*

Monetary policy vs. output gap

Fiscal policy vs. output gap



Source: MAPFRE Economics

* Variables expressed as differences

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Box 1.1.1 (continued)
Monetary policy update

performance, advances in vaccination, new treatments, and accumulated experience could lead to more selective measures that are less damaging to the economy.

As illustrated in Chart B, the balance sheet and liquidity measures adopted by the Federal Reserve placed the US monetary policy stance in the loose zone during 2020. This was accommodative for the growth of public debt (a result of the necessary borrowing to address the pandemic) through fiscal policy, given the lower cost of financing.

Assessment

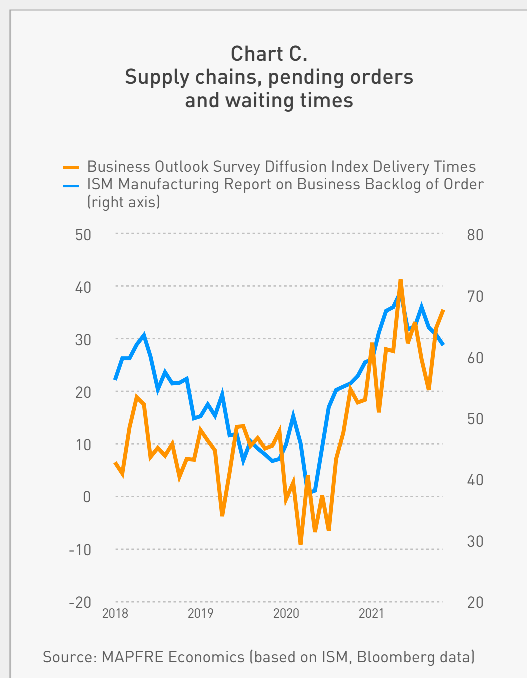
With the recovery of employment, allowing one of the FOMC's priorities to be met, and the output gap about to close, the current dominant rhetoric has started moving towards a mandate of price stability, as inflation rates are seen as less transitory, more persistent, and still rising. These price pressures continue to be dominated by rising energy costs, congested demand for consumer goods to the detriment of services and bottlenecks whose oxygenation capacity remains intermittent and uncertain (see Chart C).

Despite a certain loss of economic momentum in the second half of the year, the need to curb a more solid demand than expected, with an unbalanced composition towards consumer goods and not satisfied due to rigidities in supply, the grounds for continuing with monetary accommodation are fading and seem to give way to a progressive normalization path (see Chart D). In this sense, the adjustment should advance in an orderly, gradual, and flexible manner to adjust agents' expectations under proactive forward guidance while recovering maneuvering room in terms of monetary tools and institutional credibility.

In the near term, this adjustment is expected to lead to higher volatility, as the volume of asset purchases is reduced and normalization patterns shift towards interest rate changes. In this time frame, it is expected that as certain bottlenecks begin to dissipate and the trend in consumption fades, the mismatch between supply and demand will take on a more consistent structure.

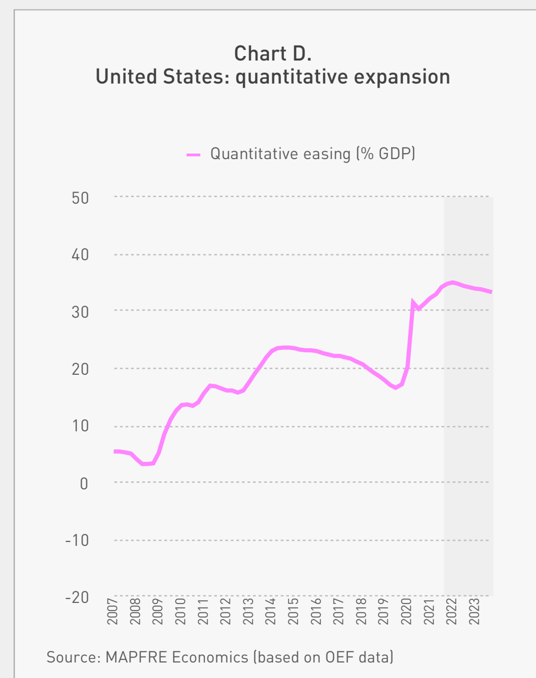
In the longer term, there is the expectation that economic conditions will remain favorable, and the Federal Reserve will be able to maintain its objective of completing the cycle of increases until reaching a neutral interest rate. However, the risk remains that reduced tolerance for higher inflation will accelerate the process or lead to structural damage that reflects a new type of equilibrium, given the current leverage levels, the

Chart C.
Supply chains, pending orders and waiting times



Source: MAPFRE Economics (based on ISM, Bloomberg data)

Chart D.
United States: quantitative expansion



Source: MAPFRE Economics (based on OEF data)

Box 1.1.1 (continued)
Monetary policy update

risk appetite, and the sensitivity to a less liquid environment, which could trigger a correction that disrupts the process.

European Central Bank

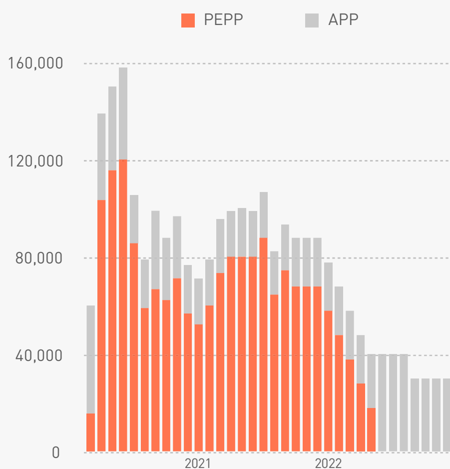
At its meeting on December 16, the European Central Bank (ECB) announced that interest rates would remain unchanged (0% for loan facilities and -0.5% for deposit facilities). In terms of the balance sheet, the ECB has reported that it will slow down the pandemic emergency purchase program (PEPP), which it could moderate to 10 billion euros per week until March 2022, while cushioning the effect by reinforcing the conventional asset purchase program (APP). The latter could increase to 40 billion euros per month during the second quarter and decrease to 30 billion from the third quarter of 2022 onward. Thus, the ECB will not discontinue the net acquisition of assets and will also extend the reinvestment of maturing securities acquired under the PEPP until at least the end of 2024 (see Chart E).

In addition, the ECB presented new macroeconomic forecasts that show a moderate revision in terms of GDP, situated at 4.2% for 2022 and 2.9% in 2023 (compared to 4.9% and 2.1% previously), and a rise in expected inflation, which should stand at 3.2% in 2022 and 1.8% in 2023 (compared to previous forecasts of 1.7% and 1.5%, respectively).

With this decision, and in line with the latest PMI data, with the services sector suffering the consequences of the continued spread of the virus and the manufacturing sector slightly weaker, its monetary policy decision has become more restrained and flexible. Although it keeps pace with the Federal Reserve's bottom line to implement a less accommodative policy in the future, the ECB's decision seeks to extend the tightening dynamic for a longer period of time. In the area of inflation, the basis of the increase in prices is still considered transitory, although of a more durable nature than anticipated. This persistence is mainly due to exogenous factors, such as the energy shock and global supply problems, with endogenous factors being of a far more limited nature (see Chart F).

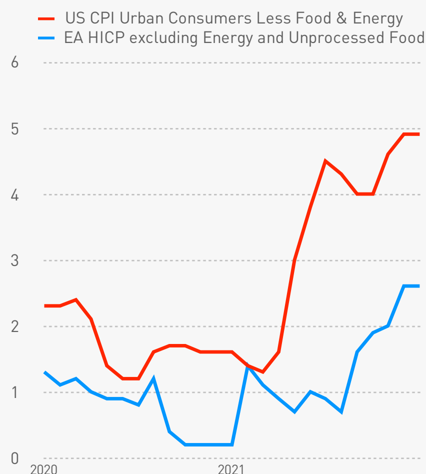
Thus, both the balance sheet and liquidity measures positioned the Eurozone's monetary policy stance in extremely loose territory in 2020. This allowed tremendous growth in public debt, a result of countries' necessary borrowing to address the pandemic through fiscal policy given the lower cost of financing (see Chart G).

Chart E.
Eurozone: monthly
PEPP and APP purchases
(millions of euros)



Source: MAPFRE Economics (based on ECB data)

Chart F.
Eurozone and the United States:
core inflation indicators



Source: MAPFRE Economics (based on Haver data)

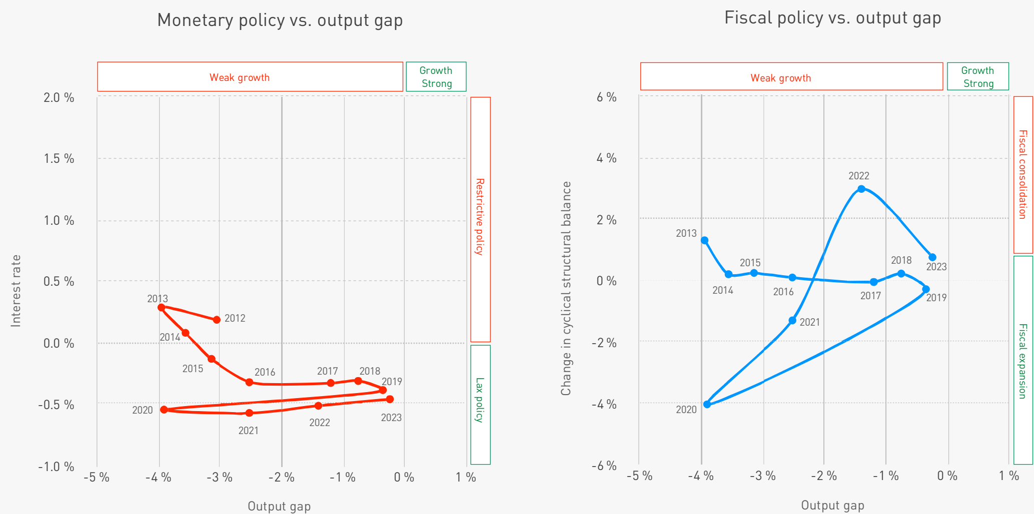
Box 1.1.1 (continued)
Monetary policy update

Assessment

With the messages at its last meeting, the ECB moderated the narrative around economic recovery and, with it, the prospects for changing the course of current policies, arguing: (i) renewed uncertainty regarding the pandemic and its economic consequences, (ii) problems on the supply side subject to persistent shocks, and (iii) the effect of high energy costs. Although domestic demand has been depressed by these factors, and the ghosts of monetary policy errors of the past represent a drag, the delayed materialization of fiscal policies along with excessive monetary accommodation could fuel the risk of an increase in inflation expectations and second-round effects, while causing it to lag behind its developed counterparts.

In the short term, the monetary policy stance is expected to remain accommodative, guaranteeing full economic recovery and allowing high inflation rates driven by limited factors at the risk that the channels that feed inflation will grow. On the other hand, and in the longer term, as the global monetary tightening cycle becomes more synchronized and consistent, the need to close the gap in interest rate differentials could lead to a change in the monetary policy bias in the Eurozone, more aggressive, not anticipated by the agents and under fiscal asymmetries that could trigger a potential event of fiscal dominance.

Chart G.
Eurozone: monetary and fiscal policies vs. output gap*



Source: MAPFRE Economics

* Variables expressed as differences

Click here to access the interactive version of this information

Chart 1.1.2-a
Global: daily COVID-19 infections and deaths vs. stringency index

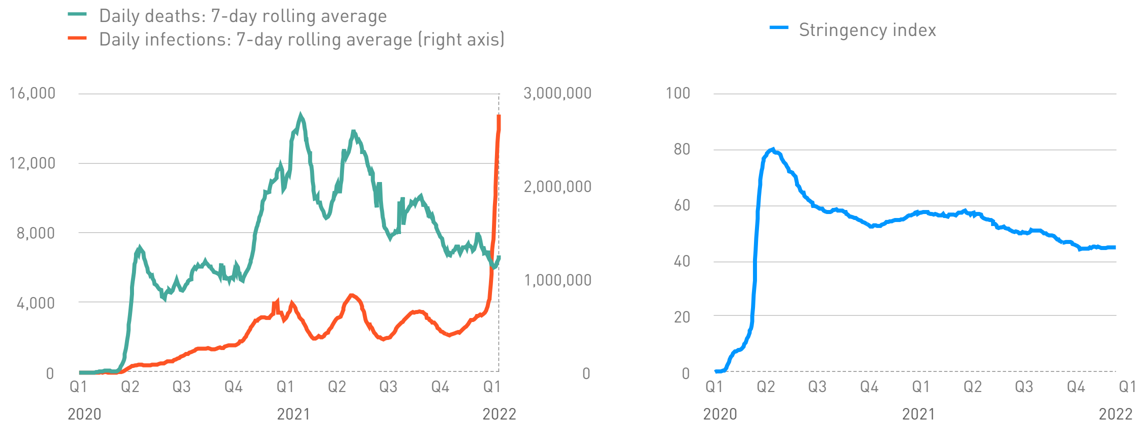


Chart 1.1.2-b
Developed countries: daily COVID-19 infections and deaths vs. stringency index

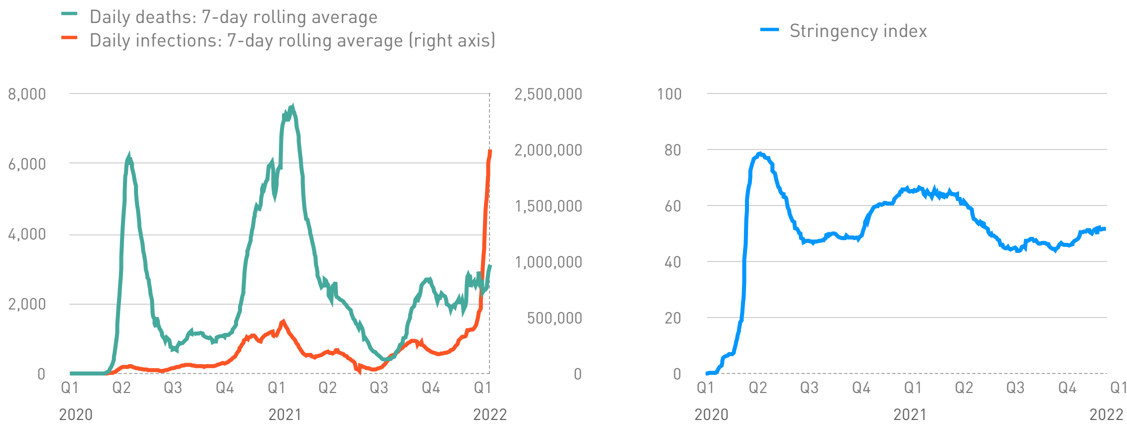
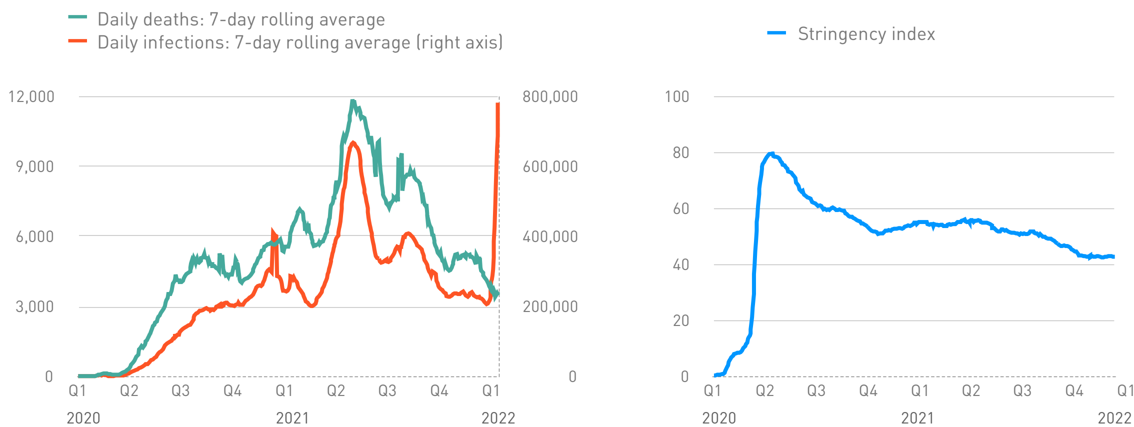


Chart 1.1.2-c
Emerging countries: daily COVID-19 infections and deaths vs. stringency index



Source: MAPFRE Economics (based on data from the Coronavirus Government Response Tracker, University of Oxford, updated 1/17/2022)

second-round effects due to salary and pension indexation. However, the impact is expected to differ by country depending on the specific nature of such indexation clauses in labor contracts.

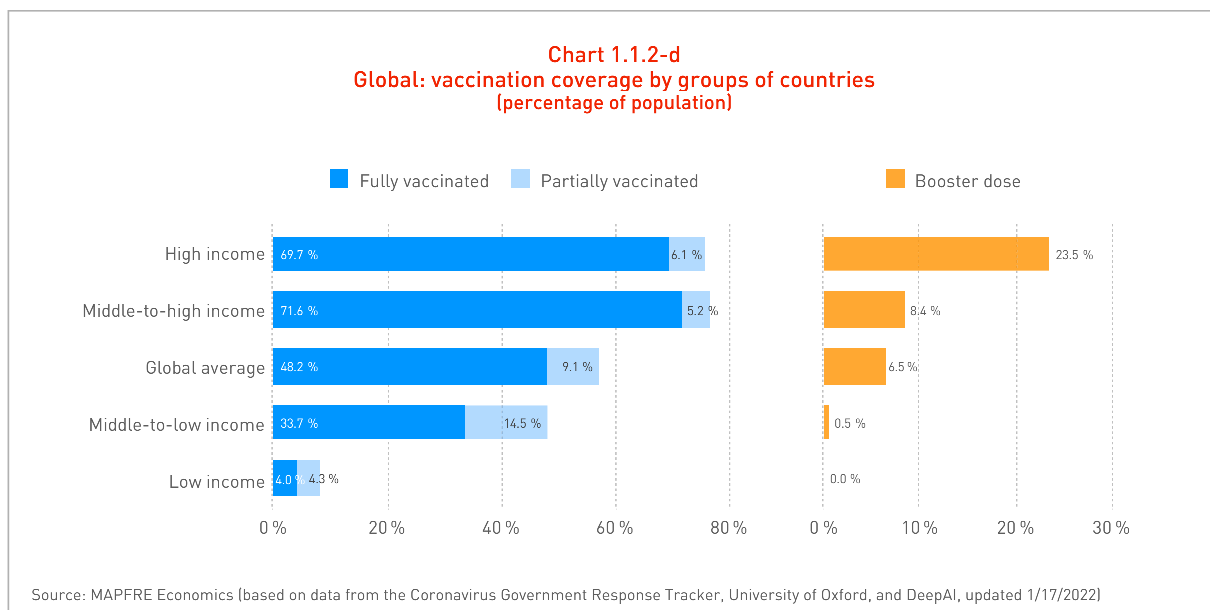
Therefore, fiscal and monetary support for economic recovery should be progressively reduced in the developed economies, in line with higher and more lasting inflationary pressures, although the shift should be gradual due to the accumulated vulnerabilities. In emerging markets, these measures have all but disappeared; the monetary ones due to the need to raise interest rates to combat inflation, and the fiscal ones due to the increase in public debt and the loss of fiscal space. In 2022, the emerging economies will also be affected by the monetary normalization process in the developed economies (especially the United States), which will generate more complex financial conditions and require domestic monetary policy to match this process, creating new challenges for economic reactivation in those countries.

1.1.2. Evolution of the pandemic

Regarding the new COVID-19 Omicron variant, which has approximately 30 changes to the spike protein compared to the Alpha variant, its impact, contagiousness, and the effectiveness of the current vaccines are difficult to predict, and these factors are decisive to quantify its economic consequences. As can be seen in Charts 1.1.2-a, 1.1.2-b, and 1.1.2-c, the new virus variant has spread rapidly, with increasing case numbers in both the developed countries (where it first appeared) and the emerging ones[1]. However, so far, the data shows that the rise in infections is losing its link to deaths, which, despite increasing slightly, are not as high as in previous COVID waves. Due to rising case numbers, some countries have reintroduced social-distancing measures, especially the developed countries, where the new wave initially appeared, and this is clear when analyzing the evolution of the stringency index shown in the charts mentioned above.

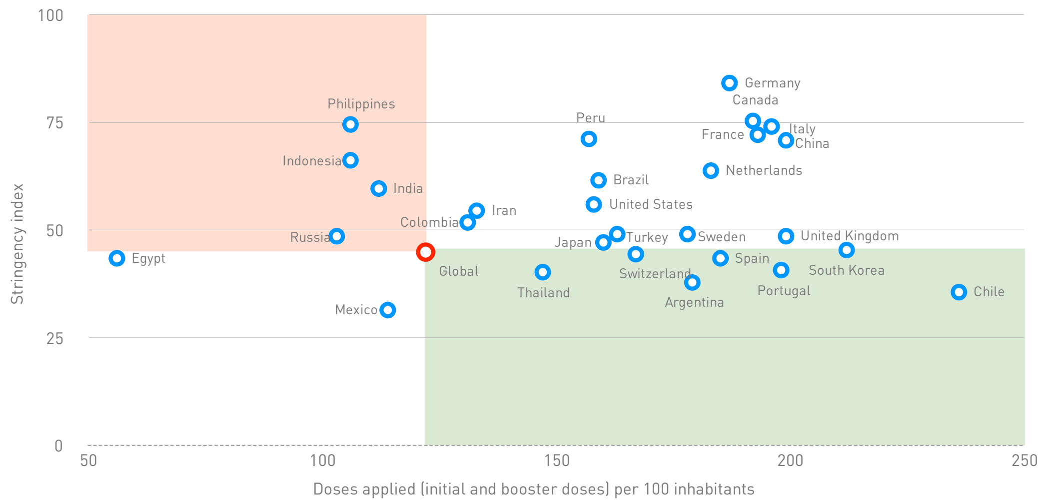
So far, one explanation given for the virus' reduced lethality in this new wave is the vaccination rate, equivalent to 57.3% of the global population (with at least one dose), with upper- and

Chart 1.1.2-d
Global: vaccination coverage by groups of countries
(percentage of population)



Source: MAPFRE Economics (based on data from the Coronavirus Government Response Tracker, University of Oxford, and DeepAI, updated 1/17/2022)

Chart 1.1.2-e
Selected countries: stringency index vs. vaccine administration



Source: MAPFRE Economics (based on data from the Coronavirus Government Response Tracker, University of Oxford, updated 1/17/2022)

upper-middle-income countries taking a clear lead (75.8% and 76.2% vaccination rates, respectively), compared to lower-middle-income and low-income countries (42.8% and 8.3%, in each case). These figures show the inequality in vaccine coverage worldwide, which is again reflected in the relative progress in applying booster doses, which shows similar behavior (see Chart 1.1.2-d). The data is important because vaccine inequality will have to be significantly addressed to end the pandemic worldwide due to the characteristics of this epidemiological phenomenon. Finally, Chart 1.1.2-e shows the situation of selected countries concerning the vaccination rate and its link with activity restrictions due to rising case numbers. In general, from this information it can be deduced that most countries, despite making significant advances on vaccination, have reinstated some social-distancing measures and activity restrictions to prevent their health care systems from being overwhelmed.

1.1.3 Scenarios and forecasts

Despite the risks of growing inflation and diminishing activity, economic recovery will continue next year, albeit at a slower pace and with differences between developed and emerging economies. There will also be differences within these groups, arising from both inherent vulnerabilities and structural factors, such as energy dependence, interconnectedness with global supply chains, and the economic importance of the services sector. On the positive side, economic growth could be stronger than expected if energy costs fall rapidly, inflation eases, supply chain problems are quickly solved, and consumer spending shifts to parts of the service sector that are still depressed.

Considering this general context, and in line with previous reports[2], our forecasts are based on two scenarios: a *baseline* scenario and a

stressed (alternative) scenario. In the first (*baseline scenario*), the economic impact is limited despite the return of restrictions and delayed normalization. In this case, based on past experience, measures less harmful to the economy are adopted selectively, as a succession of virus variants with weaker impacts is observed, with no net increase in hospitalizations compared to previous waves and the current vaccines remaining effective or being quickly adapted. In the second scenario (*stressed scenario*), the impact on economic activity is greater despite restrictions being less extreme than at the start of the pandemic. The scenario is much worse due to ineffective vaccines, overwhelmed health care systems (based on severity or contagiousness), and the reintroduction of stricter, more prolonged measures with economic repercussions to offset the rising case levels.

Therefore, in our central view (*baseline scenario*), after growing by an estimated 5.8% in 2021, the global economy will increase by around 4.8% in 2022 and 3.6% in 2023, with expansion slightly below this level in the emerging markets, and slightly above in the developed markets (see Table A-1 in the appendix to this report). In this scenario, the developed markets will play a leading role in closing the output gap in the next few years, accounting for two-thirds of its closure, a relevant factor for the monetary policy introduced from 2022 onward.

On the other hand, when our central scenario is under stress (*stressed scenario*), the return to normal activity is delayed, with epidemiological *shocks* that continue well into 2023, despite gradually involving measures less harmful to the economy. In this scenario, the impact on supply chains is far more adverse, with disruptions extending to a wider range of goods and services, driving up inflation until the end of 2022. Thus, the forecast in this scenario is for the world economy to grow by only 4.0% in 2022 and 2.6% in 2023 (see Table A-1 in the appendix to this report).

Our central view of the global economy also foresees oil maintaining its current course with elevated prices (80-85 USD/b) in the first half of the year before moving towards its equilibrium price (60-65 USD/b) from 2024, once global supply and demand factors have normalized.

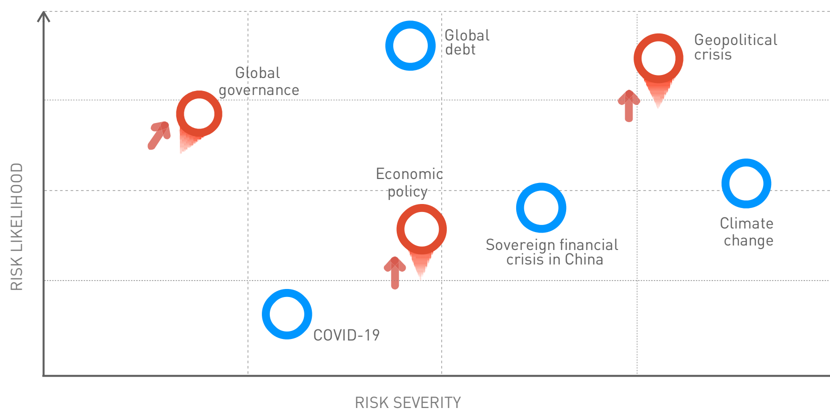
Global risk aversion (VIX) will remain on track to normalization (despite temporary upturns in the short term), converging towards the average values for the past five years in 2022 (20 bps). Global risk aversion is therefore slightly reduced in 2022-2023, driven by factors such as: (i) the reversal of global liquidity absorption, affecting the portfolio flows of emerging countries with tacit vulnerabilities; (ii) term premiums regaining importance as credit fundamentals; and (iii) inflation showing more persistent signs, promoting more aggressive monetary responses. Thus, risk aversion is reduced in the stressed version of our central view, albeit more slowly and with more frequent events. In this case, the term premium could be expected to improve gradually, with moderate increases in all sections of the interest rate term structure in the developed economies. In the emerging economies, however, this process could lead to the flattening of the risk-free yield curve[3], albeit with prospects for improvement in certain economies.

In both scenarios, monetary policy in the emerging economies will show the first signs of tightening in 2022 and 2023, gradually returning to normal to meet governments' financial needs and avoiding a bias towards premature tightening to tame inflation (see the aforementioned Box 1.1.1). On the other hand, as taxation is implicitly monetized, and amid the pressure on inflation expectations, fiscal policy would follow in the footsteps of monetary policy, providing less impactful and more intermittent measures (programs such as "Build Back Better" in the United States or the NGEU in the European Union are applied with a more flexible time structure and more selective stages). In this scenario, the US dollar remains stable at around 1.15 USD/EUR throughout 2022, although parities with emerging currencies maintain upward risks.

1.1.4. Risk assessment

Chart 1.1.4 shows the updated risk map for the global economy. The details of this analysis are presented below.

Chart 1.1.4
Short-term risk balance: vulnerabilities and global risks*



Source: MAPFRE Economics

*The arrow indicates the observed bias of the risk

Global governance

On the US side, the reconstruction of foreign policy could continue to deteriorate. Along with the disorderly withdrawal from Afghanistan and frosty relations with China on geopolitical and technological matters, the diplomatic crisis recently unfolded in Russia. When relations between the parties to the conflict (Russia, Ukraine, and the NATO member countries) are growing more militarized, diplomacy seems less likely to guarantee stability. On the domestic front, as other international factors, such as supply problems and high energy prices, continue to drive prices upward, Democrat approval ratings are sliding, which could cause inflation to be politicized amid growing dissatisfaction over the economy.

In the European Union, the governance risk is concentrated in the emerging countries, driven by the clash between populist diplomacy and the growing immigration crisis. This is seen to a lesser extent in the United Kingdom, where Brexit continues to weigh down trade relations between the two economies, as reflected in the latest data on financial service exports. In central Europe, despite the challenges for deployment of the NGEU, the energy crisis, and the worrisome status of the pandemic, the outlook on governance remains positive.

As for the emerging countries, Latin America continues to face the greatest risk of institutional fragility, driven by the economic and social impact of the pandemic. The events and mobilizations that characterized 2021, fueled by widespread discontent, could intensify in the short and medium term as: (i) growth estimates are reduced, slowing portfolio investment inflows, (ii) economic policy becomes more restrictive as inflation accelerates, and (iii) the pandemic and vaccination process continue to evolve erratically. Another factor is that 2022 is a big election year for the region, especially Brazil.

Global debt

As the world economy recovers and inflation rates climb, the record debt levels are starting to improve overall, albeit with growing divergences between regions. In the developed economies, monetary policy has continued to favor an accommodative scenario, allowing economic recovery to be consolidated and fiscal arithmetic to repair loss-making fiscal balances. With the support of deeply negative real interest rates, the result of massive asset purchases, and persistently low nominal interest rates, recovery is based on a fragile foundation of much higher debt stocks against a backdrop of degraded fiscal positions. At the same time, pressures on the

inflation side could trigger a race towards monetary normalization, at the risk of an upward spiral in wages and prices that erodes the current growth dynamics despite the threat of new shocks from the pandemic. The risk is more evident in the emerging economies, given their more advanced monetary tightening processes, higher inflationary pressures, and degree of external dependence. Countries like Brazil, Argentina, and Turkey are already showing these vulnerabilities through their currencies' weakness.

After reaching a new record high in the first half of 2021 (its highest since World War II), global debt showed a slight decrease in relation to GDP in the third quarter of 2021, standing at 350% (296 billion dollars); expansionary economic activity, supported by higher inflation rates, have helped reduce the total debt ratio.

In the developed markets, debt decreased by 1.4 trillion dollars last quarter, with the sharpest falls in Japan and the Eurozone and financial and non-financial corporations leading the deleveraging process, followed by the public sector. In contrast, the emerging markets saw their total debt increase by 1.1 trillion dollars, rising in all sectors due to more marked sources of vulnerability and more erratic management of the pandemic that put upward pressure on financing needs.

Economic policy

As the prospects for limited, transitory inflation disappear from the central scenario, making way for more persistent and higher structural pressures, the monetary reaction accelerates. The tightening of monetary policy (accompanied by debt servicing that is sensitive to the backdrop of lower asset purchases and higher interest rates) thus exacerbates fears of unsustainability and a return to austerity measures that will hinder economic performance.

At this time, an aggressive change in monetary planning is seen as unlikely, and the pattern should be one of gradual normalization, correctly signaled, and committed to not harming economic recovery or generating a situation of fiscal dominance. However, the risk of inflation that is more damaging to growth, the need to gain maneuvering room for future adjustments (encouraged by increasingly lower thresholds for intervention), and the process' repercussions on wages could intensify the rise in prices. This would lead to a more restrictive monetary reaction in which the disappearance of negative real interest rates could erode the debt burden, increasing the risk of recession and bringing forward a taper tantrum-type reaction that generates a more severe and asymmetric correction by levels of risk.

Geopolitical crisis

The global geopolitical framework shows a series of renewed risks at a time of widespread complexity and uncertainty that are expanding the current risk outlook. In terms of energy, global scarcity continues to worsen against a backdrop of erratic inventory-loading, high demand, restricted production, and the ongoing problem of the energy transition. As a result, geopolitical frictions are increasing between producing countries (United States, Saudi Arabia, Algeria, and Russia) and those with deficits, such as the European Union (with a structural deficit and the additional pressure of emission rights and its future orientation towards green energies) and Asian countries like China and India (present at all phases of the supply chain, strongly dependent on coal and extensive government support to bear the high costs).

Additionally, as Russia issues ultimatums regarding Ukraine's receipt of NATO weapons, there is a risk that diplomacy will fail and sanctions (like the paralyzing of Nord Stream 2, exacerbating Europe's energy problem, or economic isolation through exclusion from the SWIFT payment system) will be renewed, heightening the risk of militarized conflict.

At the same time, foreign policy in Asia remains marked by tensions around the Iran nuclear deal, which could collapse once again under Tehran's refusal, the shifting relations in Afghanistan, and the latent risk of conflict in Taiwan, where China's assertiveness and the United States' defensive posture are polarized, leading to an increase in military activity and a broader positioning of allies.

Sovereign financial crisis in China

At the macroeconomic level, the prospects for China continue to deteriorate due to growing energy problems, the direct impact on producer prices, the resurgence of COVID-19 cases (given the isolationist nature of the country's restrictions), and the delicate financial situation of real estate developers with Evergrande (officially declared to be in default) and the rating downgrades that are sweeping the sector. The People's Bank of China reduced its reserve ratio (RRR) by 50 bps in mid-December and further slashed reference rates in mid-January to ensure a soft landing for the economy as it attempts to tackle the real estate crisis.

At the international level, the reforms against the tech industry and growing geopolitical tensions over both Taiwan and the upcoming Winter Olympics could increase the risk of damaging foreign economic and investor sentiment. The risk of harmful (and, to a certain extent, disorderly) interventionist policies towards the private sector, coupled with the non-transparent treatment of offshore defaults in the real estate sector, could damage confidence and deteriorate expectations for a transition to a new model.

Climate change

The consensus on the risks around climate change was confirmed once again at the COP-26 meeting in October. Climate action was reinforced as a global priority with the political commitment to limit global warming to 1.5 degrees and achieve net-zero emissions by 2050 (although China has postponed its commitments). At the same time, confidence in ESG investments as a fundamental pillar was reinforced, as sustainable debt doubled in the third quarter of 2021 and could reach 1.5 billion dollars by the end of the year, while green bonds issuances hit a new high of 140 billion dollars. In contrast, the forum failed to address key issues such as the decarbonization of supply chains, which generate a large part of emissions, or global coal pricing strategies, due in part to the refusal of the main producers (Russia, Australia, Saudi Arabia) and the main consumers (China, India, and the United States) of fossil fuel-based energy to reach agreements.

COVID-19

The recent appearance of the new COVID-19 variant (Omicron) has dealt a major blow to the confidence gained through vaccines and the latest treatments. The risks of uneven vaccine coverage, with the developed countries applying boosters while the emerging and developing countries struggle to distribute the first dose, have materialized in a new strain that could reduce or even bypass the vaccine's protection. While it is still too soon to predict the consequences of this variant, the risk scenario continues to reflect the dangers of vaccine inequality between the emerging and advanced economies, which is clearly inconsistent with the goal of ending the pandemic worldwide. On a positive note, based on the experience gained in previous waves, restrictions are likely to be more selective, less harmful to the economy, and more effective in terms of health.

1.2. Forecasts and risk assessment in selected economies

1.2.1. United States

Energy and commodity prices, supply problems, and interest rate hikes set the pace for 2022.

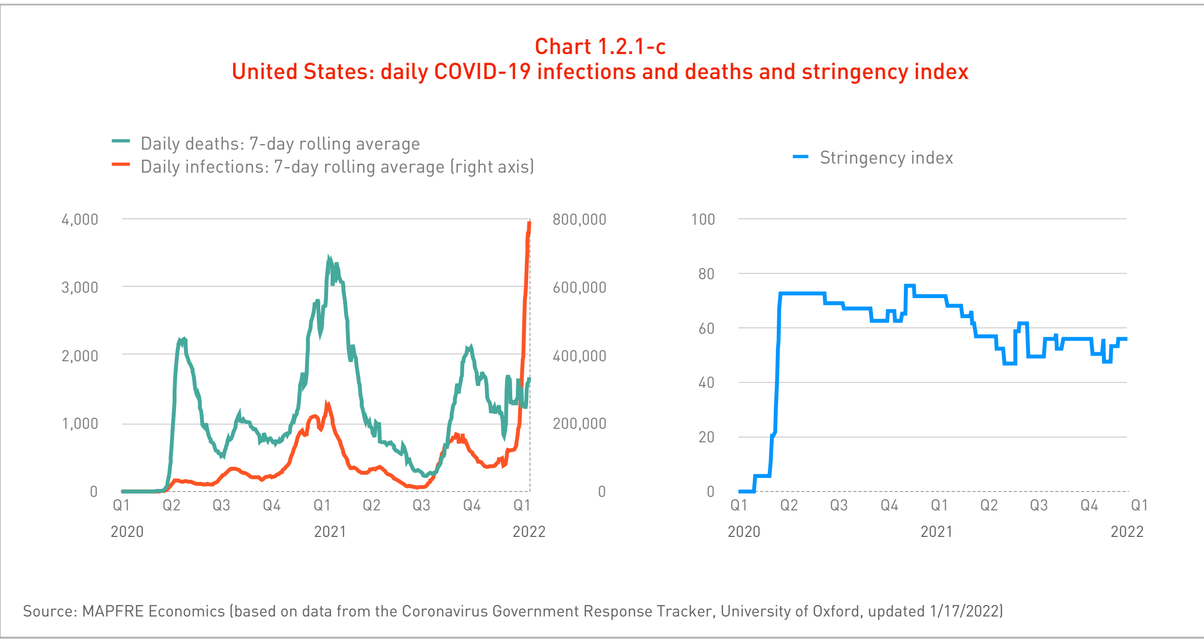
> **United States**
>
> - Economic growth will depend on supply problems being solved; it will reach an estimated 4.0% in 2022.
> - Inflation continues to climb, and the Federal Reserve has started tapering; interest rate hikes are anticipated.
> - If inflation becomes persistent, it will affect household consumption while the labor market remains strong.
> - The Omicron variant has increased uncertainty again, but the markets seem to have relaxed with regard to its danger.

Growth expectations for the US economy are moderating, and we now expect growth of 4.0% and 2.5% in 2022 and 2023, respectively, down from 5.7% and 4.4% (see Table 1.2.1 and Charts 1.2.1-a and 1.2.1-b). This is due mainly to the change in outlook on interest rates and the rise in energy and other commodity costs. In the United States, in particular, the supply chain crisis is affecting end consumers and industries, especially automobile and electronics manufacturing. Inflationary conditions will also reduce household purchasing power.

In terms of the pandemic, the most recent reports suggest that Omicron is not as dangerous as previous coronavirus variants, but the restrictions implemented to limit its spread may vary by state and political orientation. Therefore, there is fresh uncertainty regarding its impact on the economy. Case numbers are far above the levels observed in previous waves, and the vaccine rate has only advanced moderately, with at least one dose administered to 72.6% of the population and a booster to 20.7% (see Charts 1.2.1-c and 1.2.1-d). The risk generated by this situation could continue impacting supply chains. So far, a federal judge has blocked a vaccine mandate for health workers, and the government is applying pressure with another mandate for private-sector employees, a comparable measure that the courts will also have to interpret.

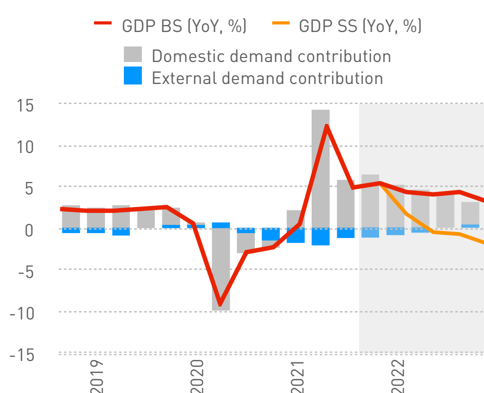
In terms of early indicators, PMIs in December fell slightly but remain strong, with the composite at 57.0, manufacturing at 57.7, and

Chart 1.2.1-c
United States: daily COVID-19 infections and deaths and stringency index



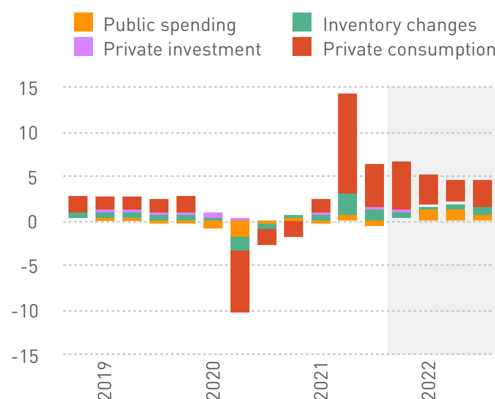
Source: MAPFRE Economics (based on data from the Coronavirus Government Response Tracker, University of Oxford, updated 1/17/2022)

Chart 1.2.1-a
United States: GDP breakdown and forecasts



Source: MAPFRE Economics (based on Federal Reserve data)

Chart 1.2.1-b
United States: domestic demand breakdown and forecasts



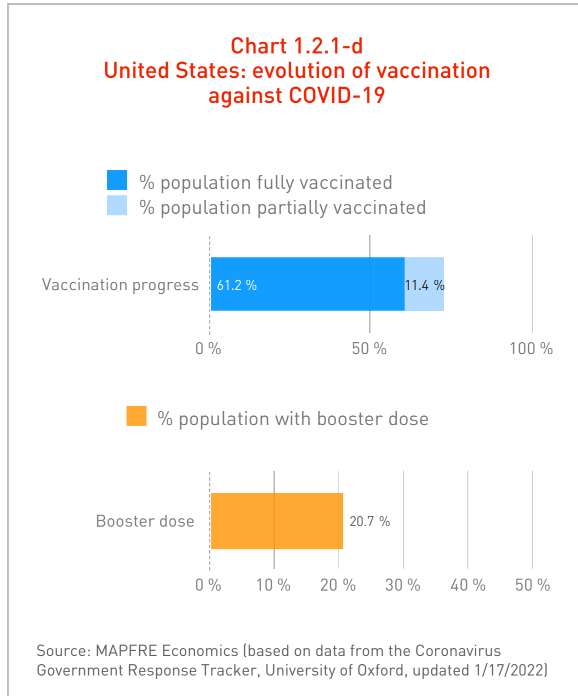
Source: MAPFRE Economics (based on Federal Reserve data)

Table 1.2.1
United States: main macroeconomic aggregates

	2017	2018	2019	2020	2021(e)	Baseline (BS) 2022(f)	Baseline (BS) 2023(f)	Stressed (SS) 2022(f)	Stressed (SS) 2023(f)
GDP (% YoY)	2.3	2.9	2.3	-3.4	5.6	4.0	2.5	-0.3	2.1
Domestic demand contribution	2.5	3.3	2.5	-3.3	7.1	4.2	2.4	-0.7	2.1
External demand contribution	-0.2	-0.3	-0.2	-0.1	-1.5	-0.2	0.1	0.4	0.0
Private consumption contribution	1.7	2.0	1.5	-2.6	5.7	2.8	1.8	-0.4	1.6
Total investment contribution	0.8	0.9	0.7	-0.3	1.4	0.6	0.6	-0.7	0.2
Public spending contribution	0.0	0.2	0.3	0.3	0.2	0.1	0.1	0.1	0.1
Private consumption (% YoY)	2.4	2.9	2.2	-3.8	8.1	4.0	2.5	-0.6	2.3
Public spending (% YoY)	0.0	1.2	2.0	2.0	1.3	0.9	0.8	0.9	0.8
Total investment (% YoY)	3.8	4.4	3.1	-1.5	6.3	3.0	2.9	-3.1	0.9
Exports (% YoY)	4.1	2.8	-0.1	-13.6	4.2	7.3	7.1	3.5	6.4
Imports (% YoY)	4.4	4.1	1.1	-8.9	13.6	4.1	4.9	-1.7	4.7
Unemployment rate (%, last quarter)	4.2	3.8	3.6	6.8	4.2	3.6	3.6	4.7	4.2
Inflation (% YoY, last quarter)	2.1	1.9	2.3	1.4	6.7	2.4	2.1	3.3	2.3
Fiscal balance (% of GDP)	-4.2	-6.1	-6.3	-15.3	-12.0	-5.9	-5.4	-7.3	-6.9
Primary fiscal balance (% of GDP)	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Trade balance (% of GDP)	-4.2	-4.3	-4.1	-4.3	-4.8	-4.4	-4.4	-4.1	-4.1
Current account balance (% of GDP)	-1.9	-2.1	-2.2	-2.9	-3.6	-3.3	-3.2	-2.9	-2.8
Official interest rate (end of period)	1.50	2.50	1.75	0.25	0.25	1.00	1.50	1.00	0.75
3-month interest rate (end of period)	1.69	2.81	1.91	0.24	0.21	1.04	1.64	0.78	0.85
10-year interest rate (end of period)	2.40	2.69	1.92	0.93	1.52	2.32	2.53	2.78	3.00
Exchange rate vs. US dollar (end of period)	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Exchange rate vs. euro (end of period)	1.20	1.15	1.12	1.23	1.13	1.18	1.20	1.14	1.18
Private lending (% YoY, average)	6.9	4.6	5.3	6.2	15.6	5.2	0.6	1.9	0.7
Household lending (% YoY, average)	3.4	3.5	3.0	3.4	6.5	7.6	7.1	7.3	7.3
P.S. non-financial lending (% YoY, average)	6.1	9.1	6.6	8.7	2.1	6.7	4.9	6.7	4.9
P.S. financial lending (% YoY, average)	2.9	2.2	2.2	5.6	4.2	2.2	1.5	2.7	3.4
Savings rate (as % pers. disp. income, avg.)	7.3	7.6	7.6	16.4	12.2	6.7	6.4	8.9	8.0

Source: MAPFRE Economics (based on Federal Reserve data)
Forecast end date: January 17, 2022

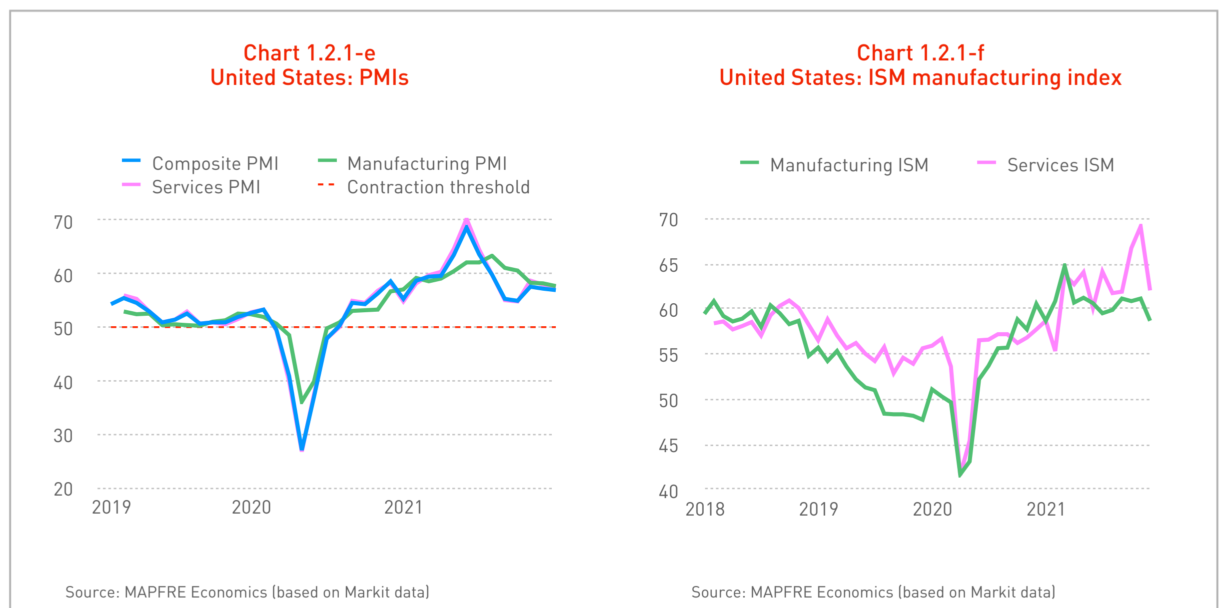
Click here to access the interactive version of this information



services at 57.6 points (see Charts 1.2.1-e and 1.2.1-f). Retail sales grew 18.2% year-on-year and rose 19.5% in November, excluding vehicles. Jobs continue to be created in the labor market (around 200,000 per week, non-agricultural), and unemployment fell to 3.9% in December. Consumer confidence improved in December, with the *Conference Board* index up to 115.8 and the University of Michigan index at 70.6. The Leading Economic Index (*Conference Board*) rose again to 119.9 in November, due mainly to the labor market indicators.

Inflation increased to 7.0% in December, with core inflation at 5.5%. Energy prices stabilized in December but are 29.6% higher than in the previous year. Automotive fuel is 49.5% more expensive, while general commodities have increased by 10.7% and food 6.3%. The pressure on energy prices should subside in 2022, but the impact is already being transferred to multiple areas.

In light of the inflation developments and improvement in the labor market, the Federal Reserve's Federal Open Market Committee decided at its December meeting to slow the pace of its monthly net asset purchases by 20 billion dollars for Treasury securities and 10 billion dollars for mortgage-backed securities. Starting in January, the Committee will increase its holdings of Treasury securities by at least 40 billion dollars per month and agency mortgage-backed securities by at least 20 billion dollars per month The Committee believes that further reductions in the pace of net asset purchases will likely be appropriate, and it is preparing to adjust the pace of purchases if warranted by changes in the economic outlook.



The chart showing the interest rate forecast by Committee members (*Dot Plot*) now signals three increases by 25 basis points (bps) in 2022 and three increases in 2023, with rates standing at 1.75% in 2023 (upper range). Federal Reserve Chair Jerome Powell, who has been reappointed for a further four years, said he expects inflation to subside in 2022, but the risks of it becoming more persistent are growing. For now, the interest rate on Federal Funds stands at 0.25% (upper range).

Meanwhile, the "Build Back Better" (BBB) investment plan, which would provide for substantial investments in climate, health, and education, was blocked in the Senate by a single vote, that of Senator Joe Manchin, and the counteroffer he made to the White House of 1.8 trillion dollars before Christmas is apparently no longer on the table. Democrats will have to completely rethink the composition of the investment plan. Congressional elections will be held on November 8, with the state primaries starting in Texas in March.

Supply problems in various sectors, generated by capacity limits in the ports and road distribution, continue to pose risks to the US economy. These problems affect various sectors, reducing supply when demand is strong and having repercussions on inflation. A solution to the semiconductor shortage impacting the automotive and electronics industry will be essential for our current forecasts to be maintained; otherwise, they will have to be revised downwards. The labor market is strong, but energy prices remain under pressure, and inflation will become persistent, even if it decreases due to the base effect in 2022. Official interest rate hikes are anticipated, which will impact the financial conditions of companies and households. On the positive side, the 1 trillion dollar infrastructure plan will be a major driver of economic activity in the US.

1.2.2 Eurozone

Recovery continues amid growing threats.

GDP in the Eurozone should increase by 3.9% in 2022 and by 2.7% in 2023 (see Table 1.2.2 and Charts 1.2.2-a and 1.2.2-b). However, there are growing uncertainties: new mobility restrictions that will impact tourism and businesses amid the surge in Omicron infections, supply chain issues that may take several months to resolve, high energy costs, and difficulties in reducing inflationary pressures.

The significant rise in COVID-19 cases, far exceeding those in previous waves, is noteworthy. Aside from causing mobility restrictions and social distancing measures to be reinstated, this situation could generate various disruptions in economic activity. However, due to the high vaccination rate (72.3% of the population has received at least one dose, and 28.1% the respective booster; see Charts 1.2.2-c and 1.2.2-d), the surge in infections has not been matched by an equivalent increase in deaths.

After remaining strong through the third quarter, recovery began to weaken in the last quarter of 2021 for the above reasons, especially the new restrictions, challenges for auto manufacturing and sales, and reduced production in some industries due to higher

Eurozone

- **Inflation is expected to subside; energy, CO2, and producer prices will be key.**
- **Supply chain problems will have to be solved to keep recovery on track.**
- **Vehicle registrations have dropped 30% year-on-year and 40% compared to the pre-pandemic level.**
- **GDP growth is projected to reach 3.9% in 2022 and 2.7% in 2023.**

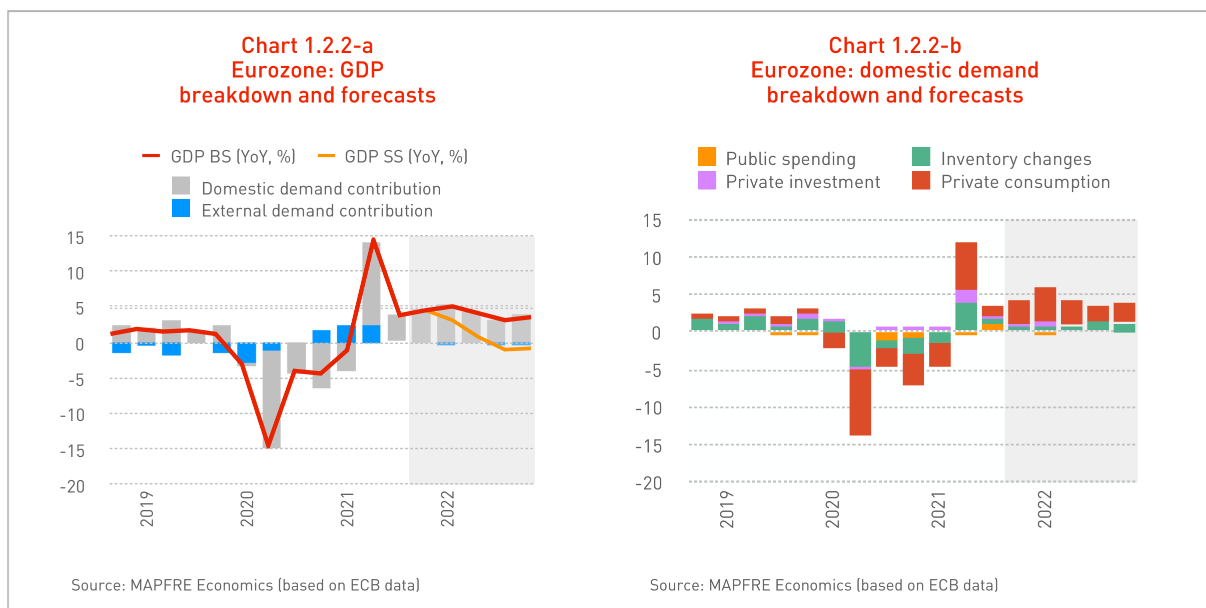


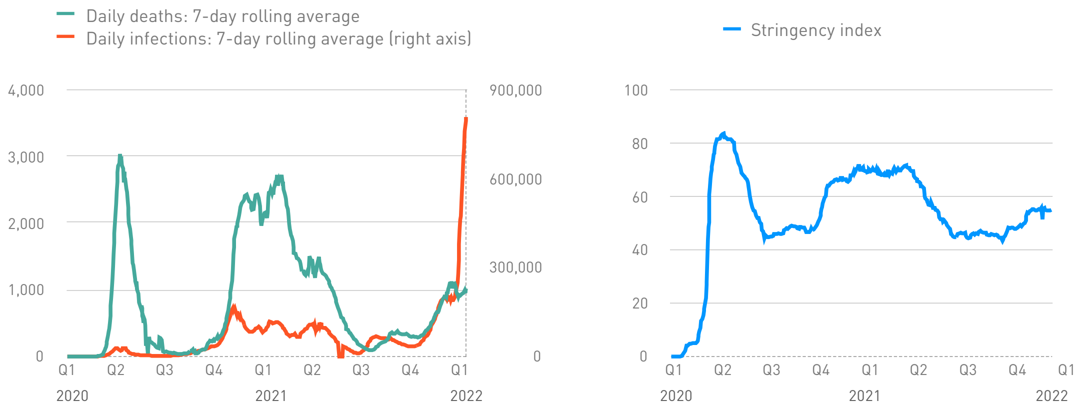
Table 1.2.2
Eurozone: main macroeconomic aggregates

						Baseline (BS)		Stressed (SS)	
	2017	2018	2019	2020	2021(e)	2022(f)	2023(f)	2022(f)	2023(f)
GDP (% YoY)	2.8	1.8	1.6	-6.5	5.1	3.9	2.7	0.5	2.0
Domestic demand contribution	2.3	1.7	2.4	-6.1	3.7	4.2	2.7	0.9	2.0
External demand contribution	0.5	0.1	-0.9	-0.4	1.4	-0.3	0.0	-0.4	0.0
Private consumption contribution	1.0	0.8	0.7	-4.2	1.8	3.2	1.8	1.4	1.7
Total investment contribution	0.9	0.6	1.5	-1.6	0.8	1.0	0.7	-0.1	0.2
Public spending contribution	0.2	0.2	0.4	0.3	0.8	0.2	0.2	0.2	0.2
Private consumption (% YoY)	1.9	1.4	1.4	-8.0	3.5	6.1	3.4	2.6	3.1
Public spending (% YoY)	1.1	1.0	1.8	1.3	3.7	1.0	0.8	1.0	0.8
Total investment (% YoY)	4.2	3.1	6.7	-7.3	3.7	4.6	3.5	-0.6	0.9
Exports (% YoY)	6.0	3.6	2.7	-9.4	9.5	5.5	4.0	2.0	3.1
Imports (% YoY)	5.5	3.7	4.8	-9.3	7.1	6.6	4.4	3.0	3.4
Unemployment rate (%, last quarter)	8.7	7.9	7.4	8.2	7.4	7.4	7.3	8.5	8.0
Inflation (% YoY, last quarter)	1.4	1.9	1.0	-0.3	4.4	1.1	1.3	2.2	1.5
Fiscal balance (% of GDP)	-0.9	-0.4	-0.6	-7.2	-6.0	-3.8	-2.6	-5.3	-4.4
Primary fiscal balance (% of GDP)	1.0	1.4	1.0	-5.7	-4.4	-2.4	-1.2	-3.8	-3.0
Trade balance (% of GDP)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Current account balance (% of GDP)	3.2	3.1	2.4	1.9	2.5	2.1	2.3	1.8	2.2
Official interest rate (end of period)	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
3-month interest rate (end of period)	-0.33	-0.31	-0.38	-0.55	-0.57	-0.51	-0.46	-0.55	-0.51
10-year interest rate (end of period)	1.13	1.17	0.32	-0.19	0.32	0.73	1.14	2.02	2.14
Exchange rate vs. US dollar (end of period)	1.20	1.15	1.12	1.23	1.13	1.18	1.20	1.14	1.18
Exchange rate vs. euro (end of period)	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Private lending (% YoY, average)	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Household lending (% YoY, average)	2.3	2.4	3.4	2.9	3.5	3.5	5.0	2.6	3.5
P.S. non-financial lending (% YoY, average)	1.2	1.9	2.0	2.5	2.4	1.5	2.7	-0.1	1.6
P.S. financial lending (% YoY, average)	1.5	-0.5	1.4	-2.5	1.3	2.5	2.8	2.8	3.7
Savings rate (as % pers. disp. income, avg.)	12.3	12.5	13.0	19.5	17.7	13.4	12.3	14.8	13.4

Source: MAPFRE Economics (based on ECB data)
Forecast end date: January 17, 2022

Click here to access the interactive version of this information

Chart 1.2.2-c
Eurozone: daily COVID-19 infections and deaths and stringency index

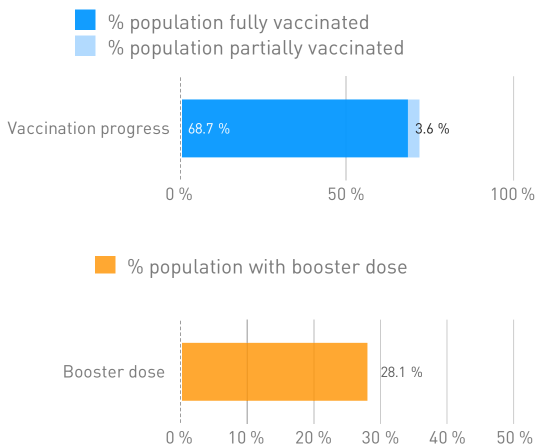


Source: MAPFRE Economics (based on data from the Coronavirus Government Response Tracker, University of Oxford, updated 1/17/2022)

energy costs. The rather slow implementation of EU recovery funds is also putting pressure on expectations for higher investment in 2022. A strategy for greater energy independence has proven essential in order to avoid exaggerated price volatility and even supply limitations in the future.

As for indicators, the Purchasing Managers' Index (PMI) in the Eurozone was down slightly in December, with the composite index at 53.3 points, manufacturing at 58.0, and services at 53.1. Confidence in retail trade improved ahead of Christmas, but consumer confidence dropped to -8.3 in December. The European Union survey on factory order levels reflects positive expectations, although it remains to be seen whether production can overcome the supply shortages (see Charts 1.2.2-e and 1.2.2-f). Due to the challenges in the auto industry, new car registrations were down 20.8% year-on-year in November.

Chart 1.2.2-d
Eurozone: evolution of vaccination against COVID-19



Source: MAPFRE Economics (based on data from the Coronavirus Government Response Tracker, University of Oxford, updated 1/17/2022)

Inflation in the Eurozone reached 5.0% in December, with core inflation remaining at 2.6%. Inflation is expected to soften in the coming months as energy prices fall, but with OPEC unwilling to expand production in a meaningful way and the European energy mix lacking quick fixes, the decline is likely to be slow. CO2 emission prices show no sign of decreasing, and the cost of natural gas is four times higher than it was a year ago. Producer prices are soaring for both finished products (+21.9%) and intermediates (+16.8%), a pressure that is likely to be passed on to the final product.

At its meeting on December 16, the European Central Bank (ECB) announced that interest rates would remain unchanged (0% for loan

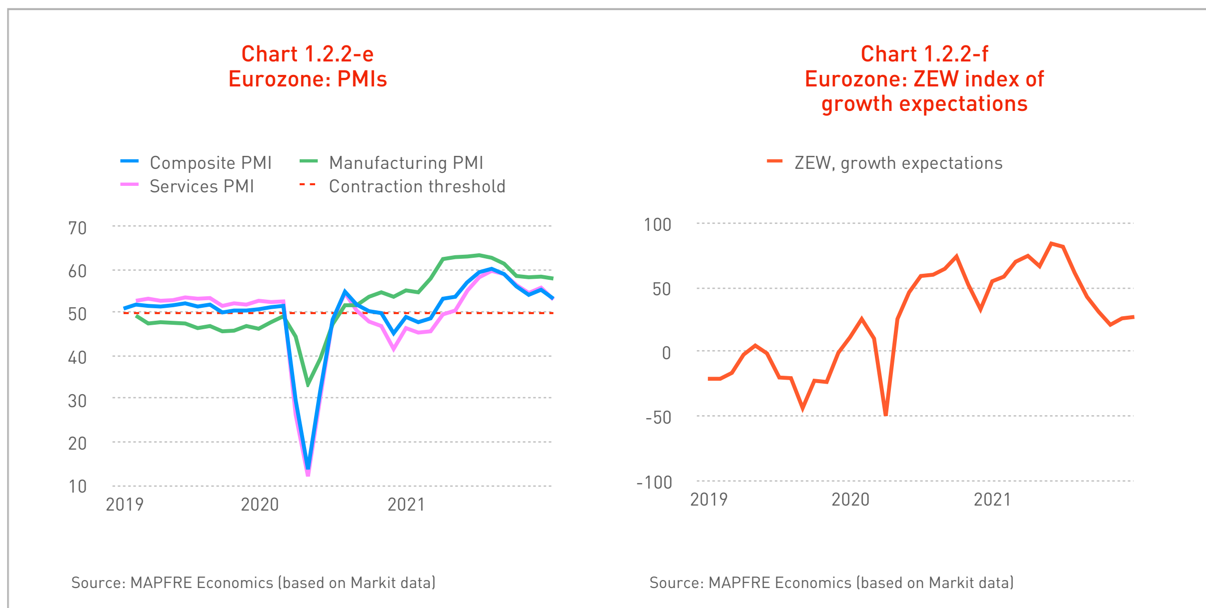


Chart 1.2.2-e
Eurozone: PMIs

Source: MAPFRE Economics (based on Markit data)

Chart 1.2.2-f
Eurozone: ZEW index of growth expectations

Source: MAPFRE Economics (based on Markit data)

facilities and -0.5% for deposit facilities). The bank will reduce the pace of the Pandemic Emergency Purchase Program (PEPP) significantly compared to the previous quarter, ending net asset purchases under this program at the end of March 2022. To cushion the impact, the conventional asset purchase program (APP) should be strengthened to 40 billion euros per month during the second quarter before being reduced to 30 billion from the third quarter of 2022. Also, the Governing Council has decided to extend the PEPP's reinvestment horizon; it now plans to reinvest the principal of securities acquired through the program as they mature at least until the end of 2024.

The risks to the Eurozone are higher with the upturn in inflation, mainly in energy. Producer prices are under stress and are likely to be passed on to consumers. Meanwhile, supply issues in the automotive and electronics industries should be resolved in the coming quarters. The implementation of further travel restrictions due to the new wave of infections will not play favorably for the recovery of tourism and services. The proper and timely use of European recovery funds, together with structural reforms, continue to be crucial to meeting expected growth rates.

1.2.3 Spain

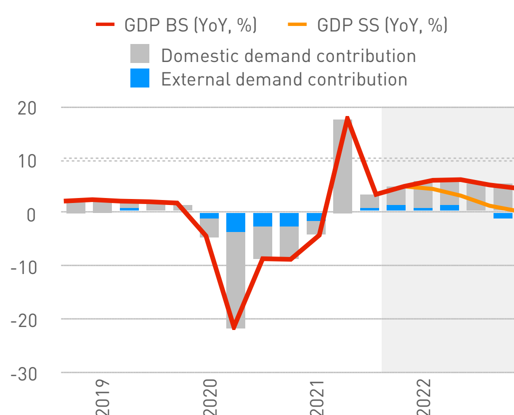
Growth in 2022 will depend on solving energy and supply chain problems and recovering a normal level of tourism.

Spain's GDP should grow by around 5.5% in 2022, based on the gradual improvement in employment, the anticipated increase in exports (as long as high energy costs and supply chain issues are overcome), and higher investment due to the arrival of EU recovery funds. By 2023, economic growth in Spain will moderate to 4.3% (see Table 1.2.3 as well as Charts 1.2.3-a and 1.2.3-b).

Spain

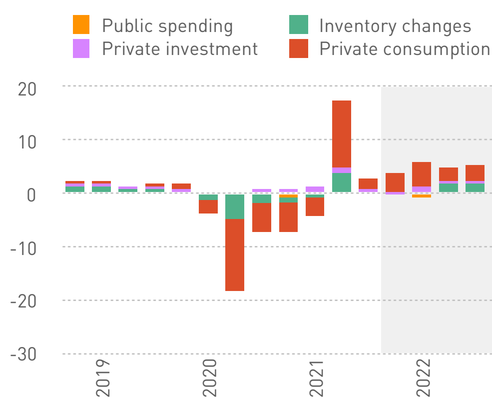
- The cost of energy is now the main concern for the normal operation of industry and services.
- Uneasiness over the Omicron variant is doing no favors for tourism in Spain.
- Second-round effects of inflation must be avoided to prevent a loss of competitiveness in the medium term.
- The end of the insolvency moratorium in June 2022 will reveal the scars of the crisis.
- The Spanish economy is projected to grow by 5.5% and 4.3% in 2022 and 2023, respectively.

Chart 1.2.3-a
Spain: GDP
breakdown and forecasts



Source: MAPFRE Economics (based on INE data)

Chart 1.2.3-b
Spain: domestic demand
breakdown and forecasts



Source: MAPFRE Economics (based on INE data)

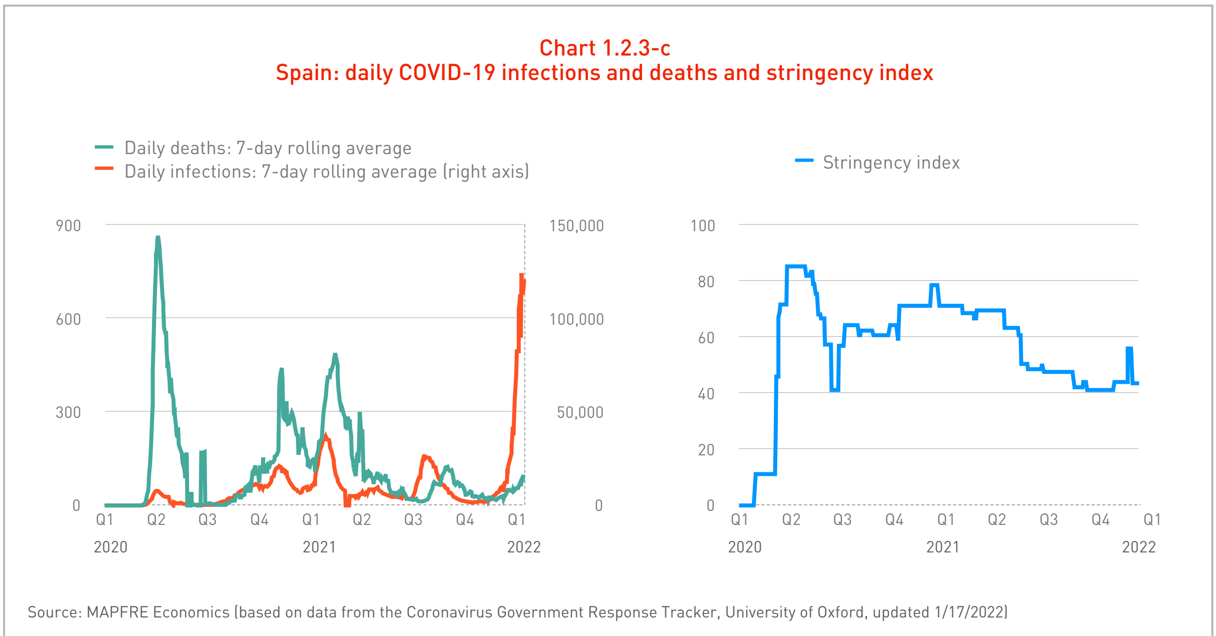
Table 1.2.3
Spain: main macroeconomic aggregates

						Baseline (BS)		Stressed (SS)	
	2017	2018	2019	2020	2021(e)	2022(f)	2023(f)	2022(f)	2023(f)
GDP (% YoY)	3.0	2.3	2.1	-10.8	4.9	5.5	4.3	2.3	3.0
Domestic demand contribution	3.2	2.9	1.6	-8.8	4.6	5.2	4.4	1.7	2.9
External demand contribution	-0.2	-0.7	0.5	-2.1	0.3	0.3	-0.1	0.6	0.1
Private consumption contribution	1.8	1.0	0.6	-6.8	3.1	3.3	2.5	1.5	2.0
Total investment contribution	1.3	1.2	0.9	-1.9	0.6	1.6	1.5	0.4	0.6
Public spending contribution	0.2	0.4	0.4	0.7	0.7	0.4	0.2	0.4	0.2
Private consumption (% YoY)	3.0	1.7	1.0	-12.0	5.4	5.8	4.4	2.6	3.5
Public spending (% YoY)	1.0	2.3	2.0	3.3	3.2	2.0	0.9	2.0	0.9
Total investment (% YoY)	6.8	6.3	4.5	-9.5	3.2	7.9	7.2	2.2	3.1
Exports (% YoY)	5.5	1.7	2.5	-20.2	12.3	7.5	4.5	4.5	3.4
Imports (% YoY)	6.8	3.9	1.2	-15.2	11.9	6.9	5.1	2.9	3.3
Unemployment rate (%, last quarter)	16.6	14.5	13.8	16.1	14.1	14.2	14.1	15.4	14.8
Inflation (% YoY, last quarter)	1.1	1.2	0.8	-0.5	5.9	1.1	1.5	2.3	1.7
Fiscal balance (% of GDP)	-3.0	-2.5	-2.9	-11.0	-7.2	-5.2	-4.0	-6.7	-5.8
Primary fiscal balance (% of GDP)	-0.5	-0.1	-0.6	-8.8	-5.1	-3.4	-2.2	-4.7	-3.8
Trade balance (% of GDP)	-1.9	-2.4	-2.2	-0.8	-1.6	-3.0	-3.6	-3.1	-2.9
Current account balance (% of GDP)	2.8	1.9	2.1	0.8	1.0	1.5	1.6	1.5	2.3
Official interest rate (end of period)	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
3-month interest rate (end of period)	-0.33	-0.31	-0.38	-0.55	-0.57	-0.51	-0.46	-0.55	-0.51
10-year interest rate (end of period)	1.57	1.42	0.47	0.06	0.60	1.18	1.67	2.76	2.94
Exchange rate vs. US dollar (end of period)	1.20	1.15	1.12	1.23	1.13	1.18	1.20	1.14	1.18
Exchange rate vs. euro (end of period)	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Private lending (% YoY, average)	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Household lending (% YoY, average)	-1.4	-0.3	-0.2	-0.9	0.0	2.1	3.8	1.2	2.0
P.S. non-financial lending (% YoY, average)	-1.1	-2.0	-0.8	1.8	3.3	2.8	2.8	-2.7	-1.5
P.S. financial lending (% YoY, average)	-5.9	3.8	-6.5	1.7	7.7	3.9	3.4	4.5	4.7
Savings rate (as % pers. disp. income, avg.)	6.2	5.9	8.6	15.8	11.1	7.1	5.5	7.7	6.2

Source: MAPFRE Economics (based on INE data)
Forecast end date: January 17, 2022

Click here to access the interactive version of this information

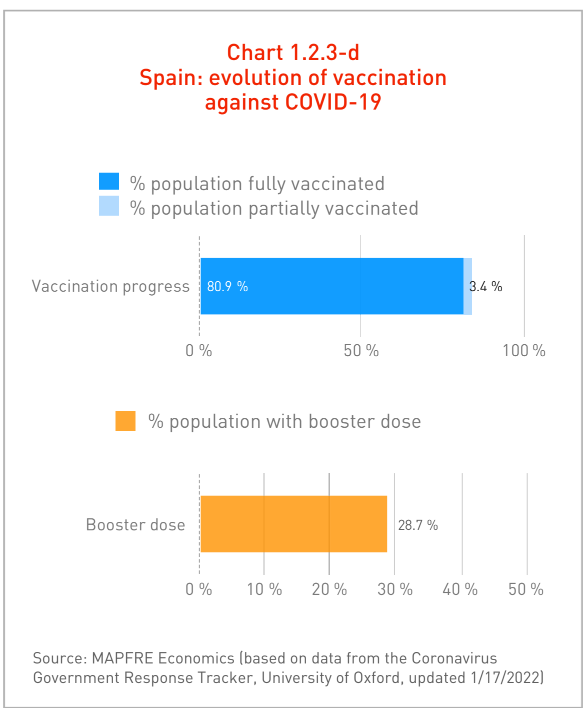
Chart 1.2.3-c
Spain: daily COVID-19 infections and deaths and stringency index



Source: MAPFRE Economics (based on data from the Coronavirus Government Response Tracker, University of Oxford, updated 1/17/2022)

For this scenario to take place, further border closures and lockdowns will have to be avoided because in the first few days of Omicron, at the end of 2021, a large number of hotel cancellations were observed. Case numbers have increased significantly (far above the levels observed in previous waves). However, deaths have not increased simultaneously due to the high vaccination rate (84.3% of the population has received at least one dose, and 28.7% a booster). Additionally, the stringency index has not increased to levels previously seen during the pandemic (see Charts 1.2.3-c and 1.2.3-d).

Chart 1.2.3-d
Spain: evolution of vaccination against COVID-19

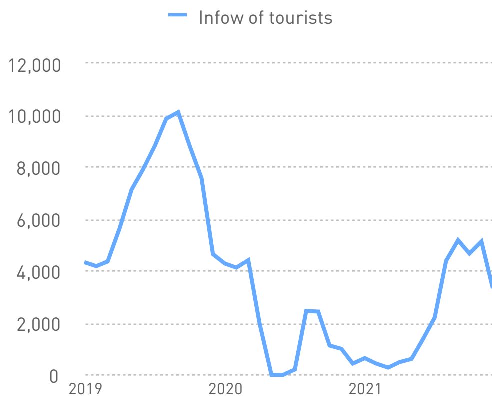


Source: MAPFRE Economics (based on data from the Coronavirus Government Response Tracker, University of Oxford, updated 1/17/2022)

The auto sector is very important to Spanish GDP, and vehicle production has dropped to half its pre-crisis level. Tourism has only partially recovered, at half its usual level (see Chart 1.2.3-e). Hopes are pinned on the European recovery funds being used properly to provide a boost in 2022-23, help transform the economy and generate more lasting productivity and employment gains. Part of these funds are expected to be used for energy production projects, which will play a fundamental role in reducing dependence on foreign energy and eliminating the current price volatility.

Purchasing Managers' Indexes (PMIs) fell in December, with the composite at 55.4, manufacturing at 56.2, and services at 55.8 points (see Chart 1.2.3-f). Service sector surveys fell again in December due to the new restrictions imposed. In December (-13.1), consumer confidence worsened, especially regarding the future economic situation. Retail sales improved compared to the previous year (+4.9% in November), while the manufacturing industry also declined (-3.8%), with significant

Chart 1.2.3-e
Spain: inflow of tourists
(%, YoY)



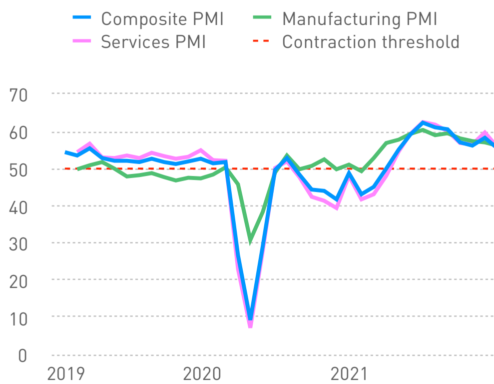
Source: MAPFRE Economics (based on INE data)

decreases in the automobile (-35%), electronics (- 6.8%), and plastics (-10.1%) industries.

In December, inflation reached a new high of 6.7% YoY (+1.3% MoM), driven by electricity and transportation. Core inflation rose to 1.7%, which is still a reasonable value, providing some hope that general inflation will subside. However, producer prices have soared (+33.1% in November) due to electricity and gas costs, leading many manufacturers to suspend or reduce production as they wait for costs to go back down. Second-round effects will determine the persistence of inflation through salary and pension increases. Unless the rise in salaries is moderate, the economy will be less competitive in the future.

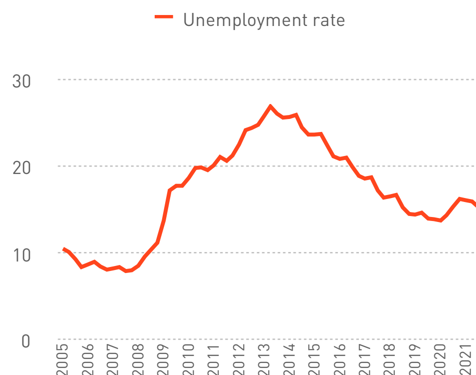
The main risks of 2022 concern inflation, due to electricity and gas bills, are rooted mainly in the increase in costs for producers and services. Spain's energy problem must be urgently resolved to keep its industry and services competitive. Tourism remains at half its normal level, so renewed concerns over the Omicron variant will harm the economy. Using EU funds effectively will be the key to recovery, and if this is not done, the impact will be significant. The semiconductor shortage must also be swiftly resolved, as it is severely impacting production in the automotive industry, a key sector of the Spanish economy. Lastly, the end of the insolvency moratorium in June 2022 will reveal the scars of the crisis.

Chart 1.2.3-f
Spain: PMIs



Source: MAPFRE Economics (based on Markit data)

Chart 1.2.3-g
Spain: unemployment rate



Source: MAPFRE Economics (based on INE data)

1.2.4 Germany

Stronger growth is expected for 2022, if the pandemic and supply chains allow it.

Germany's GDP grew by 1.7% QoQ in the third quarter of 2021 (2.5% YoY), with normal activity returning to a certain extent until the new COVID-19 variant ("Omicron") arrived in November and derailed growth at the end of the fourth quarter. During said period, consumption was up 6.2% QoQ (1.8% YoY), investments fell 2.2% QoQ (10.7% YoY), and exports dropped 1% QoQ (5.5% YoY). German GDP is expected to grow around 3.9% in 2022 and 2.9% in 2023, assuming that the supply chain normalizes, with consumption and investment rebounding and exports remaining strong (see Table 1.2.4 and Charts 1.2.4-a and 1.2.4-b).

As in most European countries, Germany has seen much higher case levels than in previous waves of the pandemic due to the Omicron variant, causing mobility restrictions and social distancing measures to be reinstated. However, death rates do not appear to be increasing along with infections, a factor attributed to widespread vaccination coverage, with 73.2% of the population immunized with at least one dose and 38.2% with the booster (see Charts 1.2.4-c and 1.2.4-d).

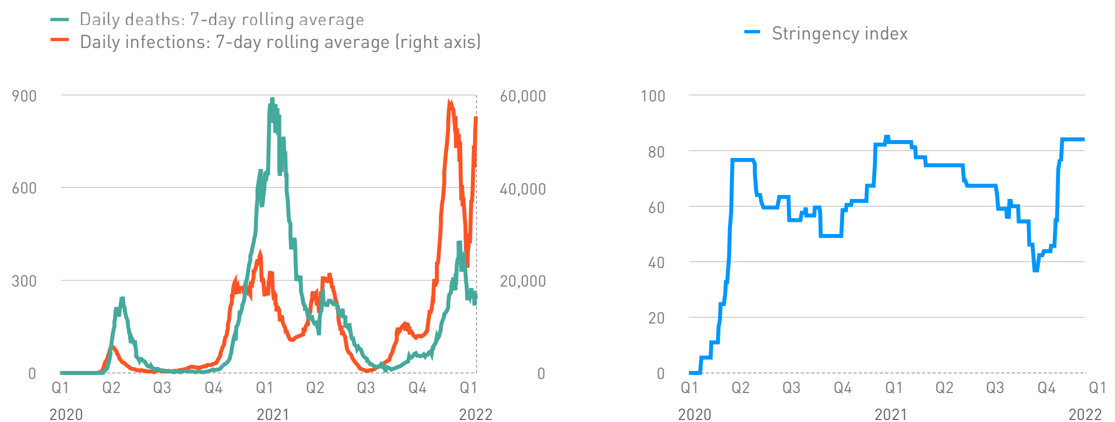
Germany

- German GDP is projected to grow 3.9% in 2022 and 2.9% in 2023.
- Industrial production, especially that of automobiles, is being hampered by problems in the supply chain.
- After rising to a surprising level in November, inflation should moderate in the coming months.
- The new coalition government is moving forward with a more social, digital, and green agenda.

The IFO Business Conditions Index for December fell to 94.7, the GFK Consumer Confidence Index dropped to -6.8 in January, and the Economic Outlook Index fell to 17.1 in December from 31.0 in November. Additionally, the Purchasing Managers' Indexes (PMIs) decreased in December, with the composite at 49.9, the services index at 48, and the manufacturing index at 57.4 points (see Charts 1.2.4-e and 1.2.4- F).

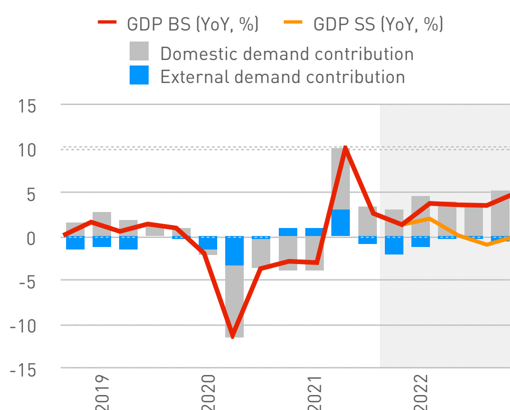
CPI inflation continued to climb in December, standing at 5.3%, while HCPI (harmonized) fell three-tenths to 5.7%, and the CPI without energy rose 3.6%. These levels have probably peaked due to the base effects of the previous year's VAT, so they are expected to start falling

Chart 1.2.4-c
Germany: daily COVID-19 infections and deaths and stringency index



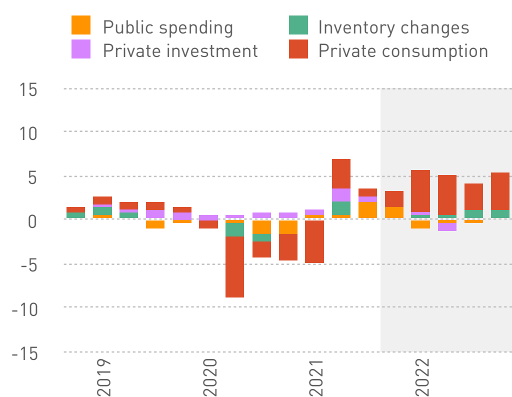
Source: MAPFRE Economics (based on data from the Coronavirus Government Response Tracker, University of Oxford, updated 1/17/2022)

Chart 1.2.4-a
Germany: GDP breakdown and forecasts



Source: MAPFRE Economics (based on DESTATIS data)

Chart 1.2.4-b
Germany: domestic demand breakdown and forecasts



Source: MAPFRE Economics (based on DESTATIS data)

Table 1.2.4
Germany: main macroeconomic aggregates

						Baseline (BS)		Stressed (SS)	
	2017	2018	2019	2020	2021(e)	2022(f)	2023(f)	2022(f)	2023(f)
GDP (% YoY)	3.0	1.1	1.1	-4.9	2.5	3.9	2.9	0.3	2.0
Domestic demand contribution	2.7	1.6	1.8	-4.0	2.3	4.4	3.3	1.0	2.4
External demand contribution	0.3	-0.5	-0.7	-0.9	0.2	-0.5	-0.4	-0.7	-0.5
Private consumption contribution	0.9	0.7	0.9	-3.2	0.2	4.2	2.4	2.5	2.2
Total investment contribution	0.7	0.7	0.4	-0.6	0.4	0.9	0.8	-0.2	0.1
Public spending contribution	0.3	0.2	0.6	0.8	0.6	-0.2	0.1	-0.2	0.1
Private consumption (% YoY)	1.7	1.4	1.6	-6.1	0.4	8.0	4.5	4.7	4.1
Public spending (% YoY)	1.7	1.0	3.0	3.5	2.9	-0.9	0.7	-0.9	0.7
Total investment (% YoY)	3.3	3.5	1.9	-3.0	1.7	4.3	3.5	-0.8	0.5
Exports (% YoY)	5.6	2.5	1.1	-10.1	7.3	5.7	3.9	1.9	2.9
Imports (% YoY)	5.7	4.0	2.9	-9.2	7.7	7.6	5.1	3.8	4.2
Unemployment rate (%, last quarter)	5.5	5.1	5.0	6.2	5.3	5.1	5.1	6.4	6.2
Inflation (% YoY, last quarter)	1.4	1.6	1.5	-0.2	4.9	1.1	1.7	2.2	1.9
Fiscal balance (% of GDP)	1.3	1.9	1.5	-4.3	-3.9	-1.7	-0.7	-3.3	-2.9
Primary fiscal balance (% of GDP)	2.3	2.8	2.3	-3.7	-3.4	-1.2	-0.2	-2.8	-2.4
Trade balance (% of GDP)	7.8	6.8	6.3	5.6	5.0	4.5	4.3	4.1	3.8
Current account balance (% of GDP)	7.8	7.9	7.6	6.8	6.5	5.7	5.7	5.3	5.3
Official interest rate (end of period)	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
3-month interest rate (end of period)	-0.33	-0.31	-0.38	-0.55	-0.57	-0.51	-0.46	-0.55	-0.51
10-year interest rate (end of period)	0.43	0.25	-0.19	-0.58	-0.18	0.20	0.57	0.93	1.23
Exchange rate vs. US dollar (end of period)	1.20	1.15	1.12	1.23	1.13	1.18	1.20	1.14	1.18
Exchange rate vs. euro (end of period)	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Private lending (% YoY, average)	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Household lending (% YoY, average)	3.2	2.3	4.7	4.3	4.9	5.7	9.4	4.7	7.6
P.S. non-financial lending (% YoY, average)	3.9	7.0	4.4	3.5	2.1	1.6	2.6	1.4	1.8
P.S. financial lending (% YoY, average)	-1.6	0.4	10.3	9.5	10.3	6.9	5.6	7.7	7.5
Savings rate (as % pers. disp. income, avg.)	10.6	11.3	10.7	16.2	15.1	10.1	9.1	11.2	9.6

Source: MAPFRE Economics (based on DESTATIS data)
Forecast end date: January 17, 2022

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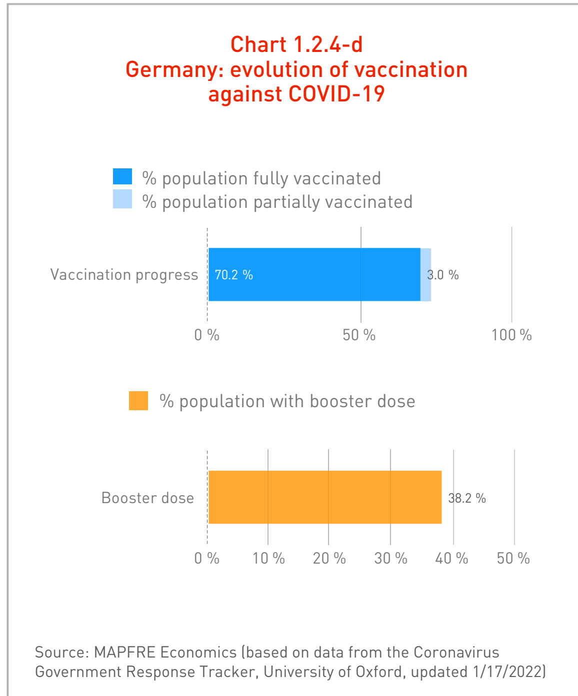


Chart 1.2.4-d
Germany: evolution of vaccination against COVID-19

Source: MAPFRE Economics (based on data from the Coronavirus Government Response Tracker, University of Oxford, updated 1/17/2022)

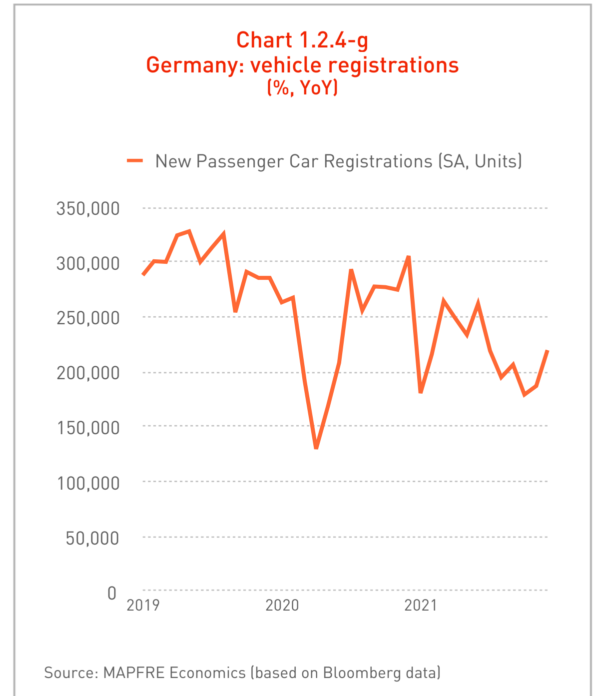


Chart 1.2.4-g
Germany: vehicle registrations (%, YoY)

Source: MAPFRE Economics (based on Bloomberg data)

from this point. While the increase in food prices (+6.0%) in December is worrisome, the cost of energy for homes (+18.3%) and fuel (+51%) is expected to begin dropping.

Resolution of the supply chain problems for industries, particularly the automobile industry, is an unknown factor and a risk for the coming months. As the use of capacity is high, it is expected that investment in 2022 will be fortified. There is a risk that energy costs will remain high, and producer prices will begin to be passed on to final products. If inflation and inflation expectations take root, a cycle of inflation may ensue, with higher interest rates hampering recovery.

After the three-way coalition reached an agreement in November, the new chancellor Olaf Scholz took office. The coalition was built on the pillars of digital and climate transitions in the German economy and the commitments to

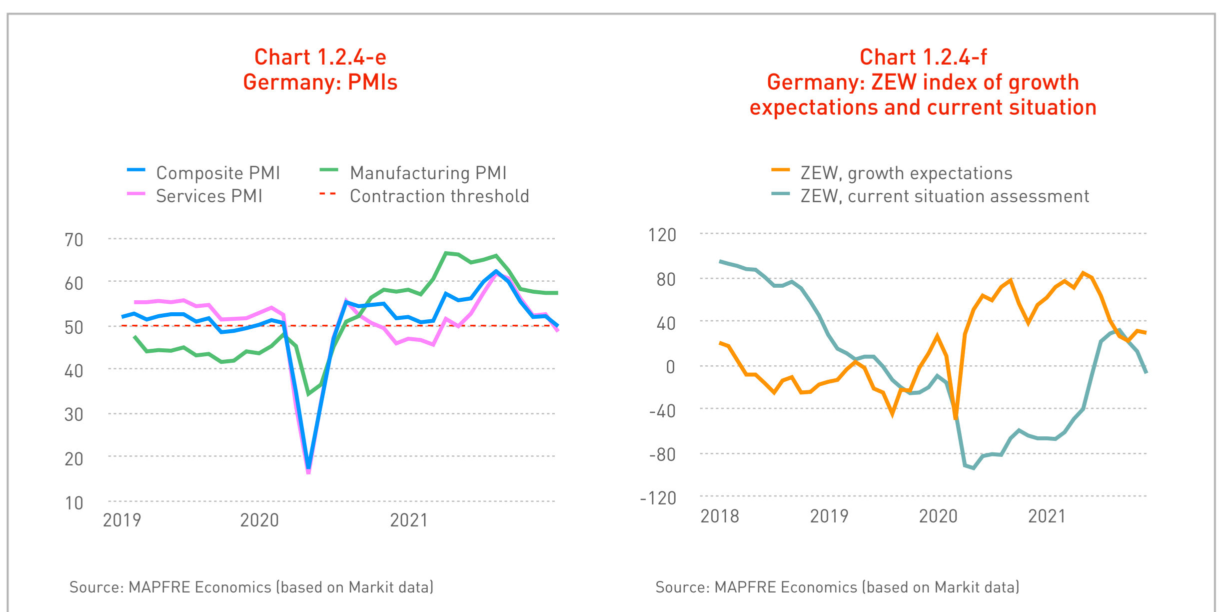


Chart 1.2.4-e
Germany: PMIs

Source: MAPFRE Economics (based on Markit data)

Chart 1.2.4-f
Germany: ZEW index of growth expectations and current situation

Source: MAPFRE Economics (based on Markit data)

increase the minimum wage and prevent pensions from losing their purchasing power. The deal is backed by several budgetary agreements to fund the social agenda and public investment.

1.2.5 Italy

The Italian government is focusing on reforms to address the endemic lack of growth.

Italy's economy grew by 2.6% QoQ (3.8% YoY) in the third quarter of 2021. Private consumption saw the strongest momentum (5.0% QoQ), and exports (3.2% QoQ) and investments (2.6% QoQ) also grew, while government spending fell for the second consecutive quarter (-0.8% QoQ). Industrial production remained weak (-0.6% MoM in October) despite showing an improvement year-on-year (2.0% YoY), continuing its slowdown due to supply chain problems. Car sales were 27.5% below the previous year's level (December). PMI indicators also slid in December, with the composite at 54.7, the manufacturing at 62.0, and the services indicator at 53.0 points (see Charts 1.2.5-a and 1.2.5-b). Therefore, we estimate that Italy's GDP will grow around 4.4% in 2022 and 2.5% in 2023, compared to an estimated increase of 6.3% by the end of 2021 (see Table 1.2. 5 and Charts 1.2.5-c and 1.2.5-d).

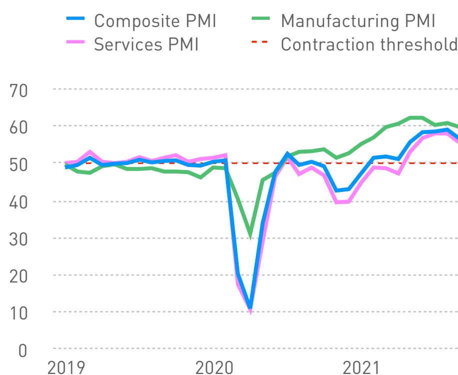
Inflation in December stood at 3.9% YoY (+0.4% MoM). Fuel (+21%), electricity (+35%), and transport services (9.6%) contributed to this rise. The increase in producer prices is especially worrisome (+27.1% in November, +25.3% in October) since these hikes should be passed on to final products.

M. Draghi's government must take advantage of the opportunity offered by European recovery funds to make progress with reforms addressing the Italian economy's endemic lack of growth; in fact, these are the conditions that the EU has set for it to receive the funds. Tax, justice, administrative, and land registry reform are some of its areas of focus, but the work will have to be continued by the next governments.

Italy

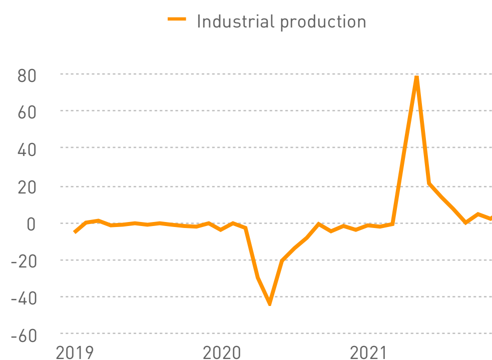
- The 2022 presidential elections are not expected to bring political instability.
- Inflation is a concern due to energy prices that are especially affecting producer prices.
- The funds from the European Union, reforms, recovery of investment and exports, and control of the pandemic are key elements for continued economic recovery.
- Italian GDP is expected to grow by around 4.4% in 2022 and 2.5% in 2023.

Chart 1.2.5-a
Italy: PMIs



Source: MAPFRE Economics (based on Markit data)

Chart 1.2.5-b
Italy: industrial production
(%, YoY)



Source: MAPFRE Economics (based on ISTAT data)

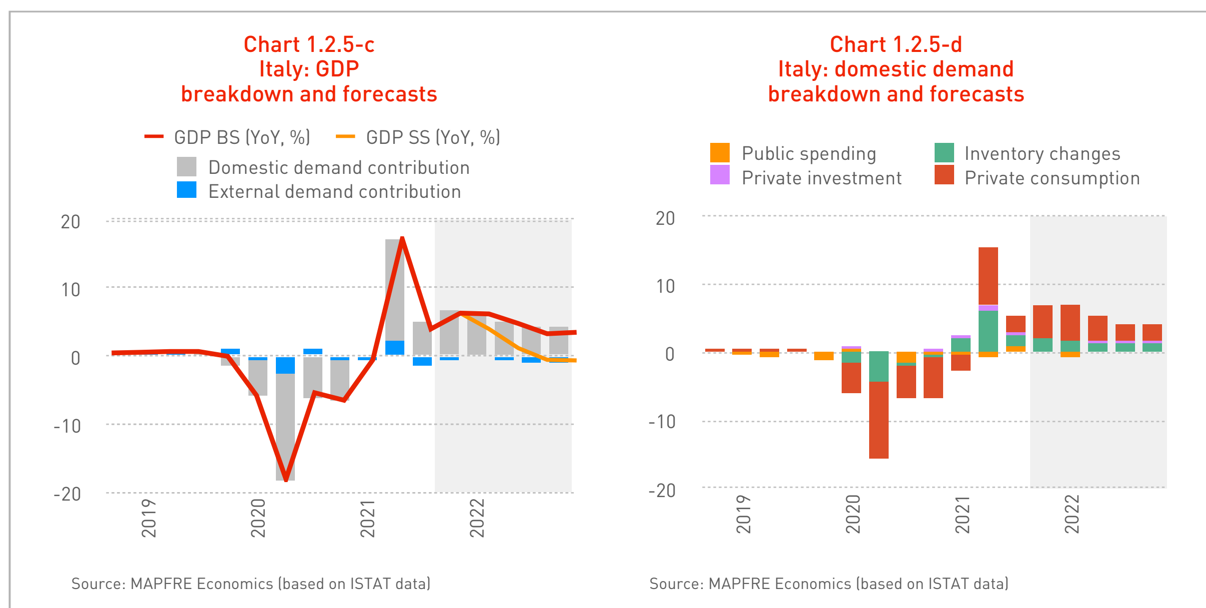


Table 1.2.5
Italy: main macroeconomic aggregates

						Baseline (BS)		Stressed (SS)	
	2017	2018	2019	2020	2021(e)	2022(f)	2023(f)	2022(f)	2023(f)
GDP (% YoY)	1.7	0.8	0.4	-9.0	6.3	4.4	2.5	0.9	2.0
Domestic demand contribution	1.7	1.1	-0.3	-8.3	6.3	5.0	2.8	1.4	2.2
External demand contribution	0.0	-0.3	0.7	-0.7	0.0	-0.6	-0.3	-0.5	-0.2
Private consumption contribution	0.9	0.6	0.1	-6.4	3.1	3.5	2.0	1.0	1.8
Total investment contribution	0.6	0.5	0.1	-1.7	3.2	1.3	0.6	0.3	0.1
Public spending contribution	0.0	0.0	-0.1	0.4	0.2	0.2	0.1	0.3	0.1
Private consumption (% YoY)	1.5	1.0	0.2	-10.8	5.3	5.9	3.3	1.7	2.9
Public spending (% YoY)	-0.1	0.1	-0.5	1.9	1.0	1.3	0.6	1.3	0.6
Total investment (% YoY)	3.4	2.9	0.7	-9.4	16.1	6.7	2.8	1.4	0.6
Exports (% YoY)	6.0	1.6	1.8	-14.7	12.8	7.1	3.5	3.3	2.6
Imports (% YoY)	6.5	2.8	-0.5	-13.4	13.9	9.6	4.7	5.3	3.4
Unemployment rate (%, last quarter)	11.0	10.6	9.8	9.8	9.2	9.2	8.9	10.2	9.6
Inflation (% YoY, last quarter)	0.9	1.1	0.5	-0.2	3.5	1.3	0.4	2.2	-0.2
Fiscal balance (% of GDP)	-2.4	-2.2	-1.5	-9.6	-9.4	-5.6	-4.3	-7.3	-6.3
Primary fiscal balance (% of GDP)	1.4	1.4	1.9	-6.1	-6.2	-2.6	-1.4	-4.1	-3.1
Trade balance (% of GDP)	3.1	2.6	3.4	4.1	3.3	1.4	2.1	1.3	2.2
Current account balance (% of GDP)	2.6	2.6	3.3	3.8	3.1	1.5	1.7	1.4	1.8
Official interest rate (end of period)	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
3-month interest rate (end of period)	-0.33	-0.31	-0.38	-0.55	-0.57	-0.51	-0.46	-0.55	-0.51
10-year interest rate (end of period)	2.00	2.77	1.43	0.52	1.19	1.76	2.33	3.27	3.47
Exchange rate vs. US dollar (end of period)	1.20	1.15	1.12	1.23	1.13	1.18	1.20	1.14	1.18
Exchange rate vs. euro (end of period)	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Private lending (% YoY, average)	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Household lending (% YoY, average)	1.2	1.8	2.2	1.2	3.5	5.5	5.4	4.5	3.7
P.S. non-financial lending (% YoY, average)	-3.0	-0.5	-0.7	2.8	0.0	1.0	2.9	-5.0	0.4
P.S. financial lending (% YoY, average)	-13.2	25.1	-5.8	-10.9	22.1	-1.0	-1.8	-3.7	-2.4
Savings rate (as % pers. disp. income, avg.)	9.7	9.6	9.5	17.0	14.1	9.3	8.7	11.6	10.8

Source: MAPFRE Economics (based on ISTAT data)
Forecast end date: January 17, 2022

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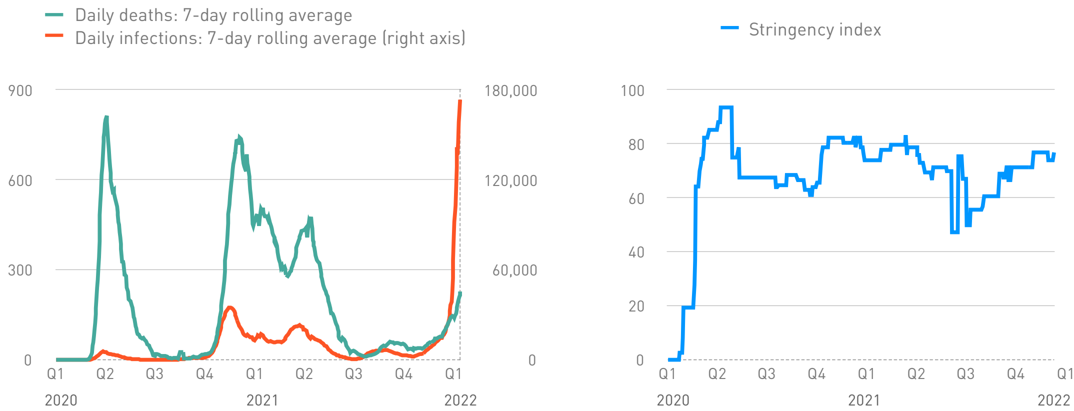
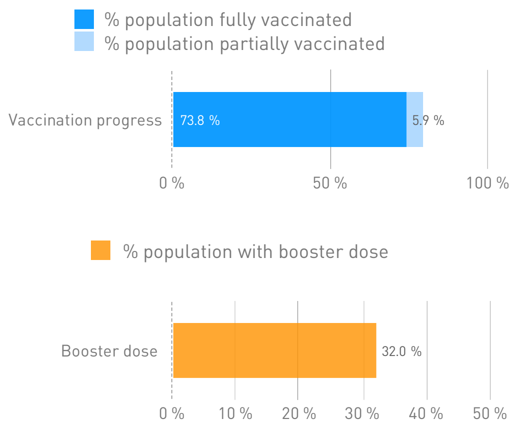
Chart 1.2.5-e
Italy: daily COVID-19 infections and deaths and stringency index



Source: MAPFRE Economics (based on data from the Coronavirus Government Response Tracker, University of Oxford, updated 1/17/2022)

In the political arena, Italy will hold presidential elections on January 24 and legislative elections in the spring of 2023. Mario Draghi is a candidate for the presidency, but in the central scenario, he will not be elected; in this case, early elections will not necessarily be held, but this is a possibility that must also be considered.

Chart 1.2.5-f
Italy: evolution of vaccination against COVID-19



Source: MAPFRE Economics (based on data from the Coronavirus Government Response Tracker, University of Oxford, updated 1/17/2022)

In terms of risks, the high energy prices are expected to fall, but they will continue to drive inflation in the meantime. There is also growing concern over the possibility of price increases taking root in other products, especially since producer prices are especially high. Designing a suitable long-term energy policy and reducing foreign dependencies will be fundamental to avoid future price increases like those currently observed. Furthermore, concerns over the pandemic show no signs of letting up, and the situation could again require closures or an increase in more permanent mobility restrictions.

The Omicron variant has caused a much higher infection rate than observed in previous waves, but so far, an equivalent increase in deaths has not been recorded. This can be largely attributed to the country's high vaccination rate, with at least one dose administered to 79.7% of the population and the booster dose to 32.0% (see Charts 1.2.5-e and 1.2.5-f). Finally, in terms of political stability, the presidential elections in early 2022 could generate turbulence and have implications for the government's stability.

1.2.6 United Kingdom

Amid rising inflation, the Bank of England has started to increase interest rates.

United Kingdom

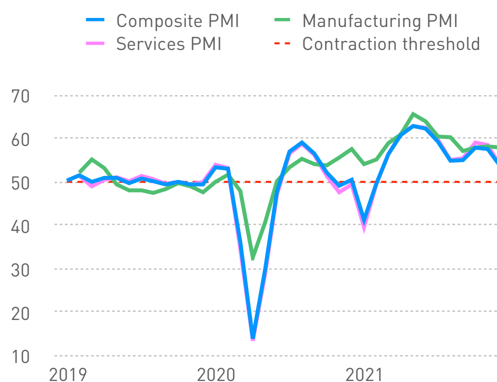
- **Headline inflation in November stood at 5.1%, with core inflation at 4.0%.**
- **A slowdown in general consumer spending and exports is already being observed, and this trend will accelerate if financial conditions tighten.**
- **High energy prices and supply chain problems are contributing to the slump.**
- **The UK economy is expected to grow 4.4% in 2022 and 2.8% in 2023.**

The UK will recover its pre-pandemic activity level in the first quarter of 2022, but recovery will not have been uniform. Private consumption has not fully recovered, with mobility stagnating between -20% (commuting to work) and -10% (footfall in shops). Exports also remain weak (-20%) due to both supply chain problems and the economic consequences of Brexit. Additionally, business investment is 5% below the 2019 level. GDP markedly decelerated in the third quarter of 2021, with growth of 1.1% QoQ compared to 5.4% QoQ in the second quarter. The year-on-year figures are less significant due to the base effects that distort them, but they were 6.8% growth YoY in the third quarter against 24.2% YoY in the previous quarter. Consumer spending increased 2.7% QoQ, government spending fell 0.5% QoQ, investment dropped 0.9%, exports were down 3.5% QoQ, and imports rose 1.1% QoQ.

Logistical problems from previous quarters have yet to be solved, and supply chain tensions continue to affect automobile manufacturing, especially due to the semiconductor shortage. Retail sales recovered in November (+2.7%), and vehicle registrations in December were 18% lower than the previous year. Consumer confidence (GFK) remains very low, at -15 (December), and has been negative since April 2016. The Purchasing Managers' Indexes (PMIs) fell in December, with the composite at 53.6, manufacturing at 57.9, and services at 53.6 points (see Charts 1.2.6-a and 1.2.6-b).

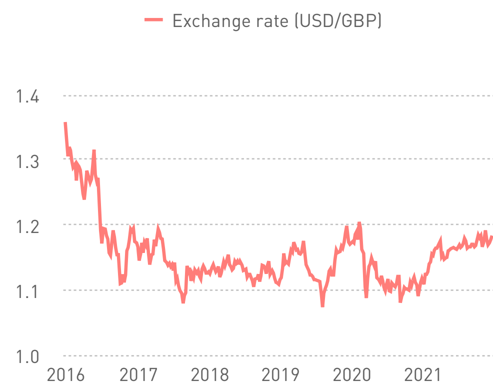
Regarding the evolution of the pandemic, like other European countries, the U.K. has seen a new wave of infections driven by the Omicron variant, with much higher cases than previously recorded, but only minimal activity restrictions have been reinstated. Also, due largely to the high vaccination rate, with 75.7% of the population having received at least one dose and 49.2% the booster (see Charts 1.2.6-c

Chart 1.2.6-a
United Kingdom: PMIs



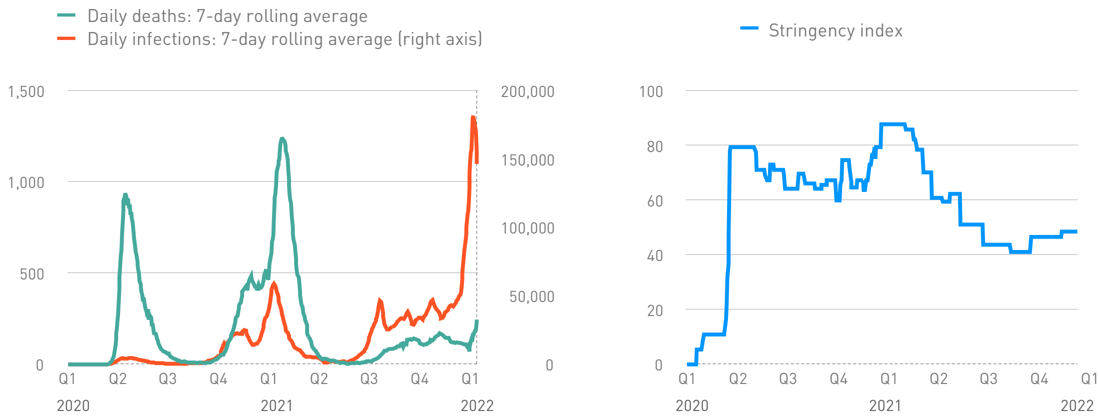
Source: MAPFRE Economics (based on Markit data)

Chart 1.2.6-b
United Kingdom: exchange rate



Source: MAPFRE Economics (based on Markit data)

Chart 1.2.6-c
United Kingdom: daily COVID-19 infections and deaths and stringency index

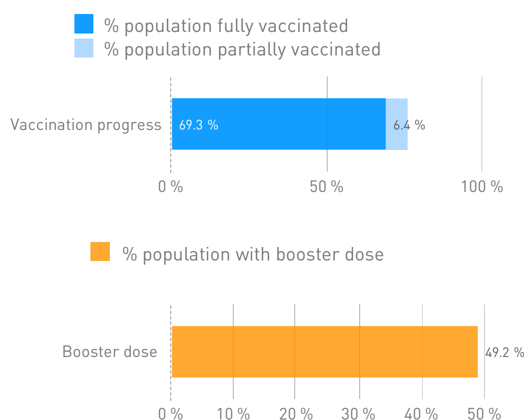


Source: MAPFRE Economics (based on data from the Coronavirus Government Response Tracker, University of Oxford, updated 1/17/2022)

and 1.2.6-d), this new wave has not caused an equivalent increase in deaths.

In this context, our GDP growth estimate for the United Kingdom stands at around 4.4% in 2022 and 2.8% in 2023. The British economy will potentially end 2021 with 7.0% growth (see Table 1.2.6 and Charts 1.2.6-e and 1.2.6-f).

Chart 1.2.6-d
United Kingdom: evolution of vaccination against COVID-19



Source: MAPFRE Economics (based on data from the Coronavirus Government Response Tracker, University of Oxford, updated 1/17/2022)

However, inflation continues to climb (5.1% in November), with core inflation at 4.0% The sectors seeing the strongest increases are energy (+23.2%), vehicles (+13.5%), especially used vehicles (+27.1%), and transport services (+7.5%). At its December meeting, the Bank of England raised interest rates by 15 bps to 0.25% and decided to maintain its stock of purchases of investment-grade non-financial corporate bonds, financed by the issuance of central bank reserves, at 20 billion pounds sterling. The committee also decided to maintain its stock of government bond purchases, financed by the issuance of central bank reserves, at 875 billion pounds sterling, bringing its total asset purchase target to 895 billion pounds sterling. The committee remains convinced that there are both upside and downside risks to inflation over the medium term and that a slight tightening of monetary policy over the forecast period should be necessary to achieve the 2% inflation target on a sustainable basis. The committee will assess the balance of risks for inflation over the medium term in light of emerging key data.

Therefore, the risks for the UK economy are building up: problems with distribution chains, the shortage of components for auto manufacturing, and rising fuel, gas, and electricity costs. Inflation appears to be taking

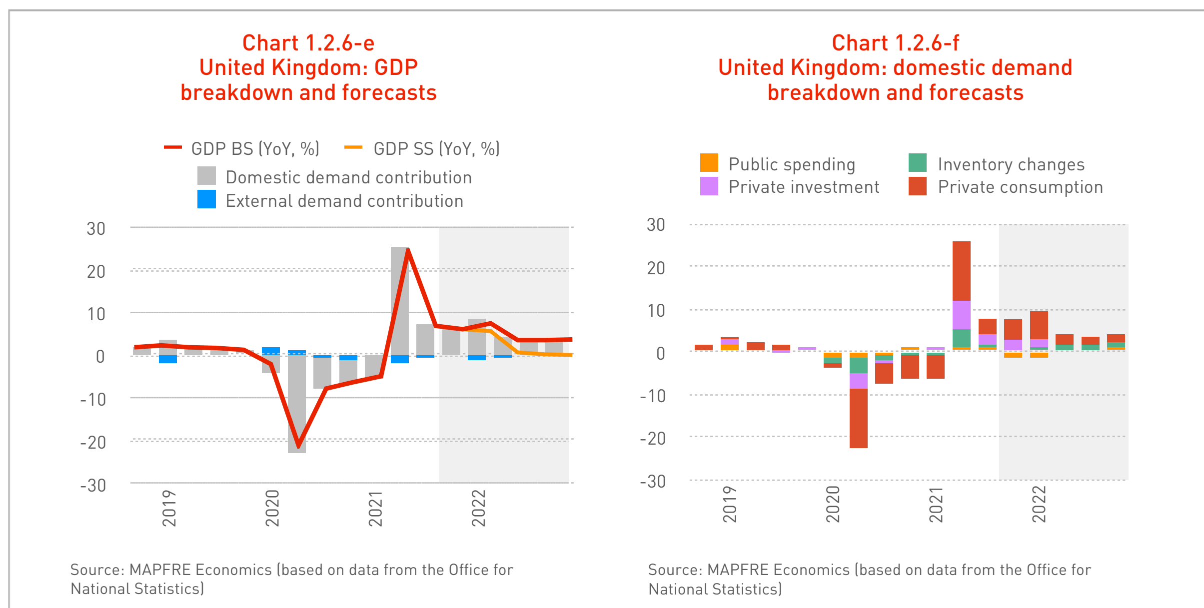


Table 1.2.6
United Kingdom: main macroeconomic aggregates

						Baseline (BS)		Stressed (SS)	
	2017	2018	2019	2020	2021(e)	2022(f)	2023(f)	2022(f)	2023(f)
GDP (% YoY)	2.1	1.7	1.7	-9.4	7.0	4.4	2.8	1.5	1.9
Domestic demand contribution	1.9	0.9	1.9	-9.8	8.1	6.5	3.9	1.7	1.8
External demand contribution	0.3	0.8	-0.2	0.4	-1.1	-2.1	-1.1	-0.2	0.1
Private consumption contribution	1.0	1.3	0.8	-6.4	3.5	3.5	1.6	1.0	1.0
Total investment contribution	0.6	0.0	0.1	-1.7	1.5	2.2	1.3	0.6	0.3
Public spending contribution	0.1	0.1	0.8	-1.1	3.1	0.8	0.3	0.2	0.3
Private consumption (% YoY)	1.6	2.1	1.2	-10.5	5.6	5.3	2.7	1.6	1.6
Public spending (% YoY)	0.6	0.4	4.2	-5.4	14.9	0.9	1.4	0.9	1.4
Total investment (% YoY)	3.3	-0.1	0.5	-9.4	6.1	7.3	3.9	3.2	1.6
Exports (% YoY)	5.7	2.8	3.4	-13.9	-1.2	8.0	4.3	5.1	3.4
Imports (% YoY)	2.9	3.1	2.9	-15.9	3.2	7.5	4.4	4.1	2.9
Unemployment rate (%, last quarter)	4.4	4.0	3.8	5.2	4.3	4.1	3.9	5.2	4.9
Inflation (% YoY, last quarter)	2.7	2.0	1.3	0.8	4.8	2.6	1.7	3.7	2.7
Fiscal balance (% of GDP)	-2.4	-2.2	-2.3	-13.0	-9.0	-4.2	-2.3	-5.2	-3.7
Primary fiscal balance (% of GDP)	0.4	0.4	0.0	-11.0	-6.3	-0.7	0.3	-1.6	-1.1
Trade balance (% of GDP)	-6.7	-6.5	-6.1	-6.1	-7.0	-6.4	-6.2	-6.5	-6.0
Current account balance (% of GDP)	-3.6	-3.9	-2.7	-2.7	-3.0	-3.2	-3.0	-3.2	-2.8
Official interest rate (end of period)	0.50	0.75	0.75	0.10	0.25	0.75	1.00	0.36	0.72
3-month interest rate (end of period)	0.52	0.91	0.79	0.03	0.26	0.82	1.10	0.36	0.79
10-year interest rate (end of period)	1.19	1.27	0.83	0.20	0.97	1.57	2.11	2.27	2.71
Exchange rate vs. US dollar (end of period)	1.35	1.28	1.32	1.36	1.35	1.42	1.43	1.37	1.40
Exchange rate vs. euro (end of period)	1.13	1.11	1.18	1.11	1.19	1.20	1.19	1.20	1.19
Private lending (% YoY, average)	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Household lending (% YoY, average)	4.0	3.1	2.1	2.9	3.5	3.3	4.6	3.1	3.7
P.S. non-financial lending (% YoY, average)	9.4	2.7	1.6	5.6	-1.3	1.6	2.2	1.5	1.8
P.S. financial lending (% YoY, average)	8.5	5.5	2.2	9.0	-5.6	6.4	4.9	7.2	7.0
Savings rate (as % pers. disp. income, avg.)	4.8	4.8	4.6	13.8	11.0	7.0	7.5	8.6	8.5

Source: MAPFRE Economics (based on data from the Office for National Statistics)
Forecast end date: January 17, 2022

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root, and the Bank of England predicts that it will be necessary to raise interest rates soon. If inflation becomes anchored, the subsequent tightening of financial conditions will lead to an economic slowdown.

1.2.7 Japan

The general elections in October gave the ruling coalition a majority.

The Japanese economy grew 1.2% YoY (-0.9% QoQ) in the third quarter of 2021, showing a loss of momentum. Consumer spending rose only 0.7% YoY, and government spending was up 0.3%. Exports grew by 4.7% year-on-year in November and imports by 6.1%. Retail sales increased by 1.9% in November, consumer confidence dropped again to 38.9, while new car sales fell 10% compared to the previous year. Industrial production, which fell in the first ten months of the year due to supply chain problems, picked up in November (+5.4%), with vehicle production dropping 38.4% year-on-year in October.

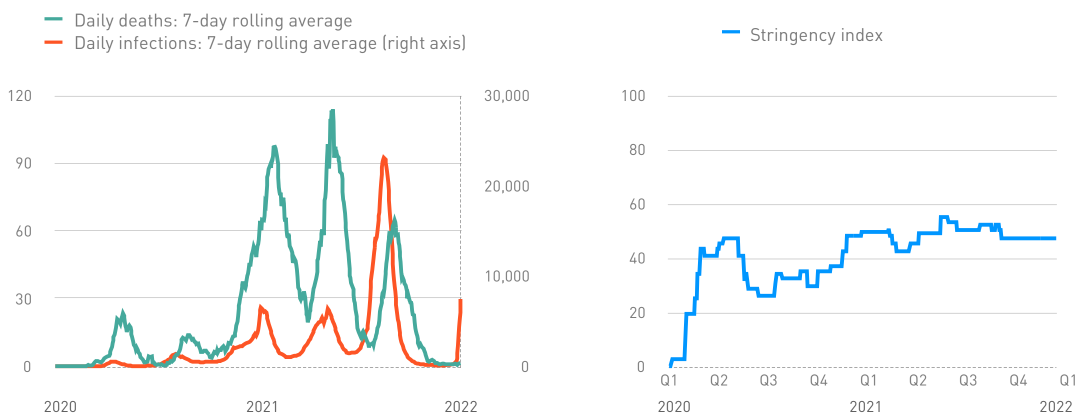
The new COVID-19 variant (Omicron) has increased the number of infections in Japan, although they remain below the figures recorded in the previous wave. Despite this, activity restrictions have barely eased, and the stringency index remains at the same levels as in the rest of 2021. Mirroring the trend observed worldwide, the increase in case numbers has not been matched by a rise in deaths, as the vaccination rate is high at 79.5% of the population (with at least one dose), although booster distribution has been limited, covering only 0.4% of the population (see Charts 1.2.7-a and 1.2.7-b).

In this context, the Purchasing Managers' Indexes (PMIs) fell in December, with the composite at 52.5, manufacturing at 54.3, and services at 52.1 points (see Chart 1.2.7-e). The Tankan Business Conditions surveys have also improved but remain below 2019 levels. We

Japan

- **Activity is slowing down due to a moderation in consumption.**
- **Industrial production rebounded by 5.4% in November, but vehicle sales are still 10% below the previous year.**
- **In November, inflation rose to 0.6%, although core inflation remains in negative territory (-1.2%).**
- **Expectations point to economic growth of 3.2% in 2022 and 1.7% in 2023.**

Chart 1.2.7-a
Japan: daily COVID-19 infections and deaths and stringency index



Source: MAPFRE Economics (based on data from the Coronavirus Government Response Tracker, University of Oxford, updated 1/17/2022)

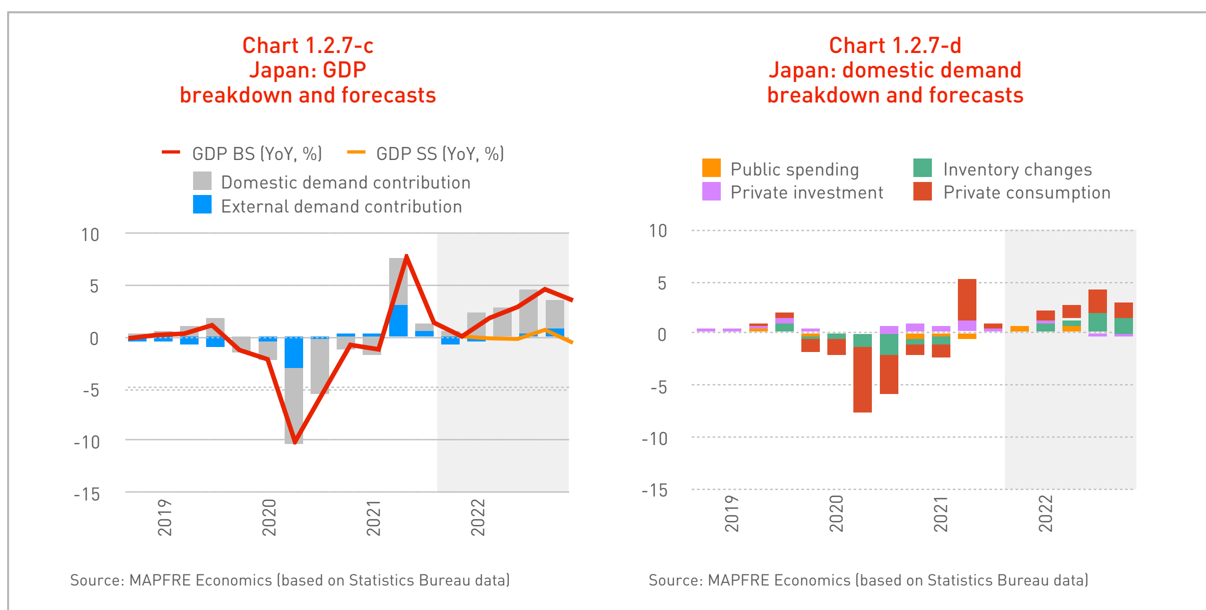


Chart 1.2.7-c
Japan: GDP
breakdown and forecasts

Source: MAPFRE Economics (based on Statistics Bureau data)

Chart 1.2.7-d
Japan: domestic demand
breakdown and forecasts

Source: MAPFRE Economics (based on Statistics Bureau data)

Table 1.2.7
Japan: main macroeconomic aggregates

						Baseline (BS)		Stressed (SS)	
	2017	2018	2019	2020	2021 (e)	2022 (f)	2023 (f)	2022 (f)	2023 (f)
GDP (% YoY)	1.7	0.6	0.0	-4.7	1.8	3.2	1.7	-0.1	1.1
Domestic demand contribution	1.2	0.5	0.5	-3.9	1.0	2.9	1.3	-0.2	0.6
External demand contribution	0.5	0.0	-0.5	-0.8	0.8	0.2	0.5	0.1	0.5
Private consumption contribution	0.6	0.1	-0.1	-3.2	0.6	1.5	0.7	0.0	0.3
Total investment contribution	0.4	0.1	0.2	-1.1	-0.2	1.1	0.7	0.0	0.1
Public spending contribution	0.0	0.2	0.4	0.6	0.6	0.0	-0.1	0.0	-0.1
Private consumption (% YoY)	1.1	0.2	-0.2	-5.9	1.2	2.9	1.3	0.0	0.6
Public spending (% YoY)	0.1	1.0	1.9	2.8	2.7	-0.1	-0.5	-0.1	-0.5
Total investment (% YoY)	1.7	0.2	0.8	-4.3	-0.6	4.5	2.8	-0.1	0.5
Exports (% YoY)	6.6	3.8	-1.5	-11.8	10.9	7.7	4.6	3.0	4.1
Imports (% YoY)	3.3	3.8	1.1	-7.3	5.7	6.4	2.4	2.6	1.6
Unemployment rate (%, last quarter)	2.7	2.4	2.3	3.0	2.8	2.4	2.3	3.3	2.8
Inflation (% YoY, last quarter)	0.6	0.9	0.5	-0.9	0.6	0.1	0.2	0.1	-0.2
Fiscal balance (% of GDP)	-3.1	-2.5	-2.9	-9.3	-8.5	-6.5	-4.7	-7.7	-6.6
Primary fiscal balance (% of GDP)	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Trade balance (% of GDP)	0.9	0.2	0.0	0.6	0.3	0.1	0.6	-0.1	0.6
Current account balance (% of GDP)	4.2	3.5	3.4	2.9	2.8	2.8	3.6	2.8	3.7
Official interest rate (end of period)	-0.06	-0.06	-0.07	-0.03	-0.02	-0.05	-0.05	-0.05	-0.02
3-month interest rate (end of period)	-0.02	-0.07	-0.05	-0.08	-0.05	-0.05	-0.05	-0.05	-0.03
10-year interest rate (end of period)	0.05	0.01	-0.02	0.04	0.09	0.05	0.01	0.38	0.30
Exchange rate vs. US dollar (end of period)	112.9	110.83	109.12	103.54	115.00	112.11	109.02	109.14	106.81
Exchange rate vs. euro (end of period)	135.4	126.90	122.59	127.05	130.25	132.29	131.19	124.16	126.06
Private lending (% YoY, average)	4.2	2.6	2.0	5.3	3.2	1.9	0.4	-1.0	-1.2
Household lending (% YoY, average)	2.2	2.5	2.3	2.4	2.1	0.8	0.8	-0.1	-0.6
P.S. non-financial lending (% YoY, average)	2.4	2.3	3.4	8.1	3.2	-1.1	-0.4	-1.2	-0.6
P.S. financial lending (% YoY, average)	8.0	6.3	2.9	17.0	5.0	-8.7	-3.3	-8.4	-2.4
Savings rate (as % pers. disp. income, avg.)	1.6	1.7	2.7	10.5	7.2	3.1	2.2	4.3	2.3

Source: MAPFRE Economics (based on Statistics Bureau data)
Forecast end date: January 17, 2022

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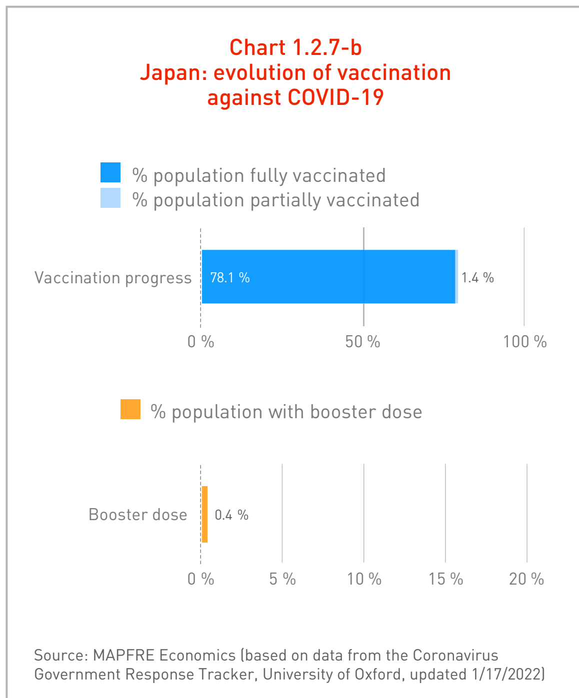


Chart 1.2.7-b
Japan: evolution of vaccination against COVID-19

Source: MAPFRE Economics (based on data from the Coronavirus Government Response Tracker, University of Oxford, updated 1/17/2022)

therefore expect Japan's GDP to grow 3.2% in 2022 and 1.7% in 2023 (see Table 1.2.7 and Charts 1.2.7-c and 1.2.7-d).

In addition, inflation stood at 0.6% in November, with core inflation at -1.2%. Inflation levels are much lower than in other developed economies, but in the context of rising energy prices, inflation expectations should climb in the coming months. Even though energy costs have transitory characteristics, other components show signs that the price increases could be extended, as observed in the CPI excluding fresh food. The Bank of Japan held interest rates negative at -0.10% at its December meeting. In order to meet its price stability target of 2%, the bank will continue its quantitative and qualitative monetary easing with yield-curve control where necessary to stay above the target in a stable manner (see Chart 1.2.7-f).

The main risks for the Japanese economy continue to be the slow recovery of services, which have not fully normalized, and supply chain problems affecting the production of automobiles, electronics, and other products, which will impact domestic consumption and exports.

In the political arena, the general elections held on October 31 gave the ruling coalition, formed by the Liberal Democratic Party (LDP) and the Komeito party, a comfortable majority. This will allow the coalition to remain in power for the foreseeable future. Prime Minister Fumio Kishida, who took office in September, has emerged stronger from the elections, which should allow him to pursue his reform goals.

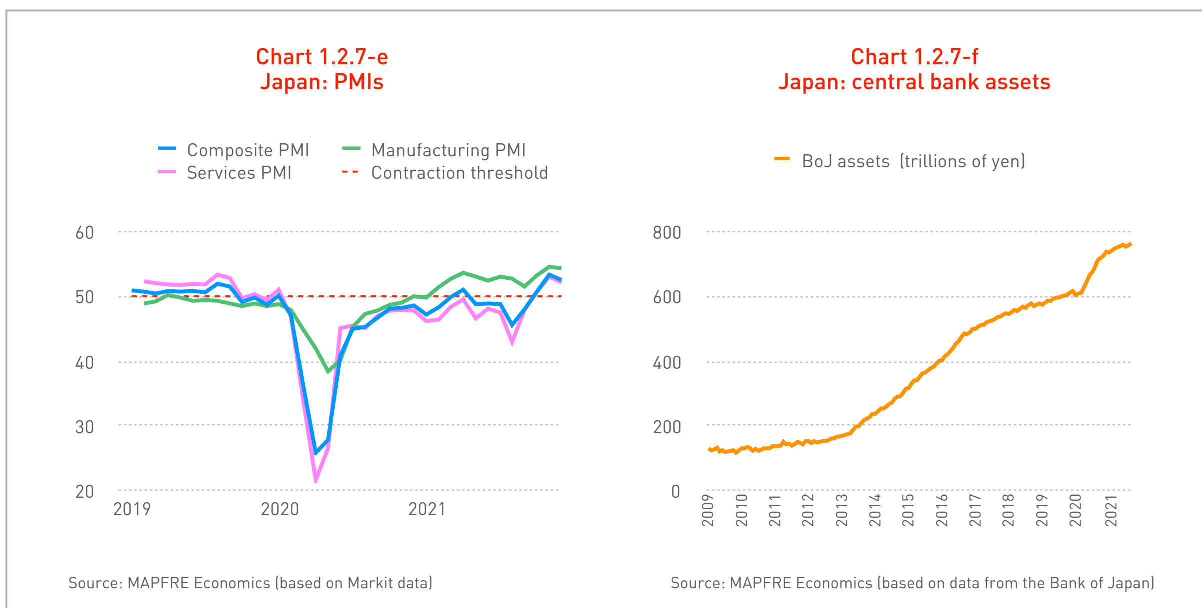


Chart 1.2.7-e
Japan: PMIs

Source: MAPFRE Economics (based on Markit data)

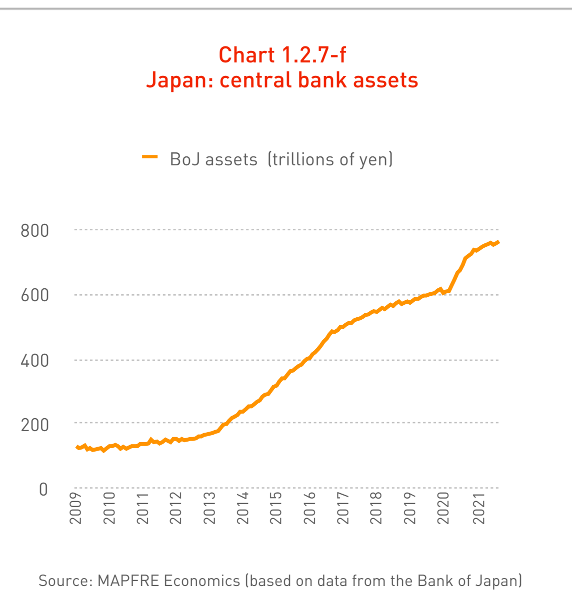


Chart 1.2.7-f
Japan: central bank assets

Source: MAPFRE Economics (based on data from the Bank of Japan)

1.2.8 Turkey

The policy of lowering interest rates, going against the current, caused its currency to fall 79% in 2021.

The Central Bank of Turkey lowered interest rates by 100 bps in December, to 14%, a counterintuitive move since inflation remains high (36%), but at the same time sought and desired by the Erdogan government. Although this has weakened the country's currency, the strategy aims to boost domestic investment and consumption (see Charts 1.2.8-a and 1.2.8-b). The decision is justified because individuals have limited exposure to foreign currency, and only exporting companies (more hedged) are significantly exposed to exchange rates. It was a risky move because Turkey's import costs will skyrocket with the soaring inflation in the rest of the world. Neither the central bank nor the treasury have attempted to intervene in the foreign exchange market; they are taking a chance on weak currency, while interest rates will favor domestic consumption and investment. The government believes that this strategy can improve its current account balance, a stabilizing factor for the currency. This strategy of disassociation with other currencies is risky, but its success or failure will soon be known. In any case, the central bank may need to quickly raise interest rates if risks to financial stability are identified.

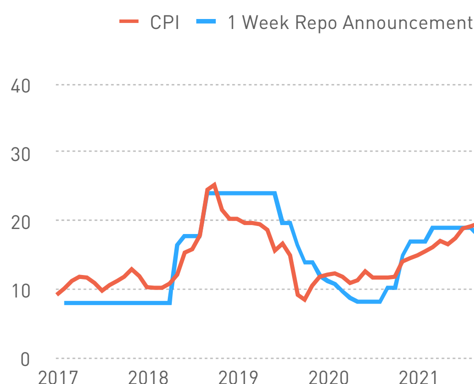
Turkey

- Inflation accelerated in December (36.1%) due to the depreciation of the currency, which lost 79% in 2021.
- In December, the central bank lowered interest rates by 100 basis points to 14.0%.
- The country's focus on low interest rates and depreciated currency poses risks for investment and financial stability.
- The Turkish economy is expected to grow 2.8% in 2022 and 2023.

As for the pandemic, the Omicron variant has driven an increase in infections, which remain below the peak observed during the wave in late 2020, while the stringency index has been declining since the last quarter of 2021. Deaths have not increased, declining since the third quarter of 2021. Although Turkey is behind the main developed countries in terms of vaccination, its program has been relatively successful, having administered at least one dose to 66.8% of the population and the respective booster to 26.7% (see Charts 1.2.8-c and 1.2.8-d).

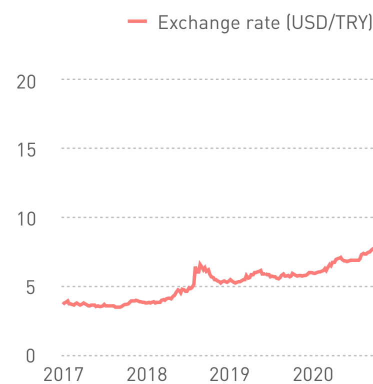
In this context, the GDP for the third quarter of 2021 grew by 2.7% QoQ and 7.8% YoY (seasonally adjusted). Private consumption and exports performed well in the third quarter, with

Chart 1.2.8-a
Turkey: inflation and interest rates



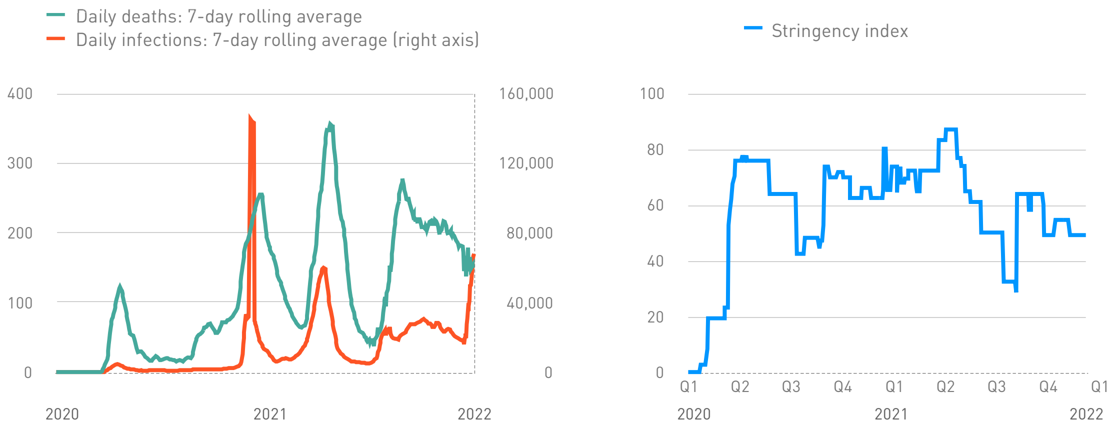
Source: MAPFRE Economics (based on CBRT data)

Chart 1.2.8-b
Turkey: exchange rate



Source: MAPFRE Economics (based on CBRT data)

Chart 1.2.8-c
Turkey: daily COVID-19 infections and deaths and stringency index

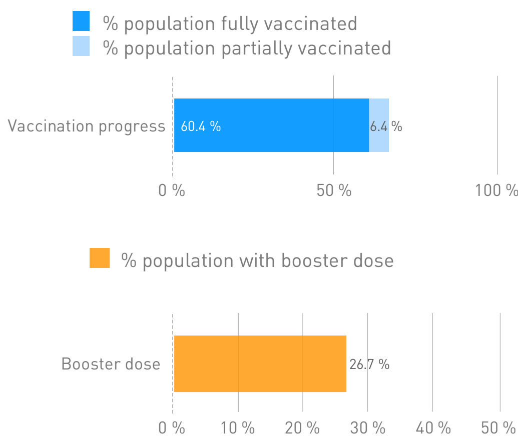


Source: MAPFRE Economics (based on data from the Coronavirus Government Response Tracker, University of Oxford, updated 1/17/2022)

consumption growing 9.1% YoY and 9.6% YoY (unadjusted), and exports up 25.6%. We therefore estimate that 2021 should end with growth of nearly 10.0%.

In 2022, the scenario could change rapidly. With the observed currency depreciation and inflation above 30%, many parameters could be affected, especially the foreign sector (exports and imports) and investment and consumption, as inflation and higher import prices erode purchasing power. The Purchasing Managers' Index (PMI) in the manufacturing sector stood at 51.2 points in December, and the survey on economic sentiment is moderating (97.6). The survey on expected retail sales for the next three months is stable, while consumer confidence is weaker (66.7). Therefore, Turkey's GDP is expected to grow by around 2.8% in both 2022 and 2023 (see Table 1.2.8 and Charts 1.2.8-e and 1.2.8-f).

Chart 1.2.8-d
Turkey: evolution of vaccination against COVID-19



Source: MAPFRE Economics (based on data from the Coronavirus Government Response Tracker, University of Oxford, updated 1/17/2022)

As stated above, inflation rose again in December to 36.1% YoY, accelerating in the month (13.6% MoM) and with core inflation at 31.9%, due largely to currency depreciation. By components (November data), the most significant elements in the measurement were food (+27.1%), housing (+23.8%), electricity (+22.1%), and transport (+22,7%), with the price of vehicles rising 14.6%. At its December meeting, the Central Bank of Turkey lowered interest rates (one-week Repo) by 100 bps, to 14.0%. The bank believes that lower rates will help reduce inflation, although for now, it is far from the 5% medium-term target. "Stability in the general price level will foster macroeconomic stability and financial stability through the fall in the country risk premium,

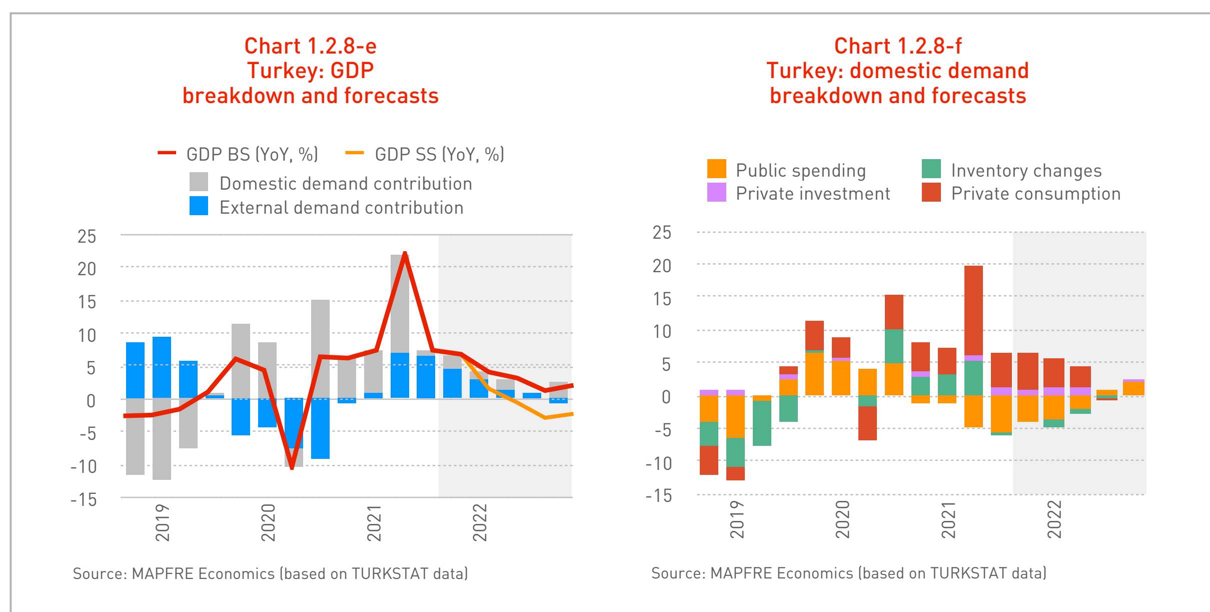


Table 1.2.8
Turkey: main macroeconomic aggregates

	2017	2018	2019	2020	2021(e)	Baseline (BS) 2022(f)	Baseline (BS) 2023(f)	Stressed (SS) 2022(f)	Stressed (SS) 2023(f)
GDP (% YoY)	7.5	3.0	0.9	1.8	10.0	2.8	2.8	-1.2	1.6
Domestic demand contribution	7.2	-0.6	-1.4	7.5	5.1	1.6	3.0	-2.5	1.8
External demand contribution	0.3	3.5	2.3	-5.7	4.9	1.2	-0.1	1.3	-0.2
Private consumption contribution	3.5	0.3	0.9	1.9	3.0	1.6	1.4	-1.0	0.9
Total investment contribution	2.4	-0.1	-3.1	1.9	1.4	-0.6	0.8	-1.6	0.2
Public spending contribution	0.7	0.9	0.6	0.3	0.7	0.6	0.3	0.7	0.3
Private consumption (% YoY)	5.9	0.6	1.5	3.2	11.7	2.9	2.4	-1.7	1.5
Public spending (% YoY)	5.0	6.5	4.1	2.2	5.2	4.5	2.0	4.5	2.0
Total investment (% YoY)	8.3	-0.2	-12.4	7.2	6.4	-2.5	3.3	-6.9	0.8
Exports (% YoY)	12.4	8.8	4.6	-14.8	22.4	9.4	3.4	6.5	2.2
Imports (% YoY)	10.6	-6.2	-5.4	7.6	-0.6	5.4	4.8	1.2	3.8
Unemployment rate (%, last quarter)	10.3	12.3	13.3	12.9	11.9	11.6	10.5	12.5	11.3
Inflation (% YoY, last quarter)	11.9	20.3	11.8	14.6	36.1	31.6	13.1	34.8	12.5
Fiscal balance (% of GDP)	-1.6	-1.9	-2.9	-3.5	-1.2	-1.7	-1.4	-2.1	-2.4
Primary fiscal balance (% of GDP)	0.2	0.0	-0.6	-0.8	1.7	1.2	1.2	0.8	0.3
Trade balance (% of GDP)	-6.8	-5.2	-2.2	-5.3	-3.7	-5.0	-5.2	-5.3	-5.2
Current account balance (% of GDP)	-4.7	-2.8	0.7	-5.0	-2.4	-2.7	-2.4	-2.7	-2.1
Official interest rate (end of period)	12.75	24.06	11.43	17.03	14.00	14.00	12.25	10.25	10.86
3-month interest rate (end of period)	14.61	24.07	10.76	17.53	15.63	15.37	13.47	11.58	11.89
10-year interest rate (end of period)	11.72	16.53	11.95	12.51	22.99	18.64	14.79	17.62	14.19
Exchange rate vs. US dollar (end of period)	3.79	5.29	5.95	7.44	13.32	13.86	14.63	15.66	15.54
Exchange rate vs. euro (end of period)	4.55	6.06	6.68	9.11	15.23	16.36	17.61	17.81	18.34
Private lending (% YoY, average)	20.9	20.2	8.4	30.1	25.9	35.1	10.2	37.2	8.7
Household lending (% YoY, average)	17.5	9.8	3.3	41.8	18.2	8.2	10.9	10.8	10.9
P.S. non-financial lending (% YoY, average)	21.8	18.2	5.5	29.0	14.3	8.1	15.9	2.3	12.0
P.S. financial lending (% YoY, average)	27.2	25.1	18.3	21.2	28.0	37.6	18.6	34.5	17.1
Savings rate (as % pers. disp. income, avg.)	32.3	32.0	30.4	21.0	25.3	19.7	16.7	20.3	17.1

Source: MAPFRE Economics (based on TURKSTAT data)
Forecast end date: January 17, 2022

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continuation of the reversal in currency substitution and the upward trend in foreign exchange reserves, and durable decline in financing costs," the monetary policy committee said in a statement.

The risks for the economy have increased. The focus on low real interest rates and a depreciated currency could have many drawbacks. This strategy has already been used, and the risks are high. There are doubts about whether the boost for exports will offset the difficulties created for external financing and imports. The central bank may have to increase interest rates again if it sees the financial markets lose stability.

Mexico

- **Oil exports have returned to pre-crisis levels, although the government has announced its intention to reduce them in the future.**
- **Private consumption has been recovering but remains below pre-pandemic levels, while investment still shows no sign of recovery.**
- **Inflation reached 7.4% in December, with core inflation also high at 5.9%.**
- **Interest rates are rising below inflation, attempting to support the economy.**
- **The Mexican economy is expected to grow around 2.6% in 2022 and 2.7% in 2023.**

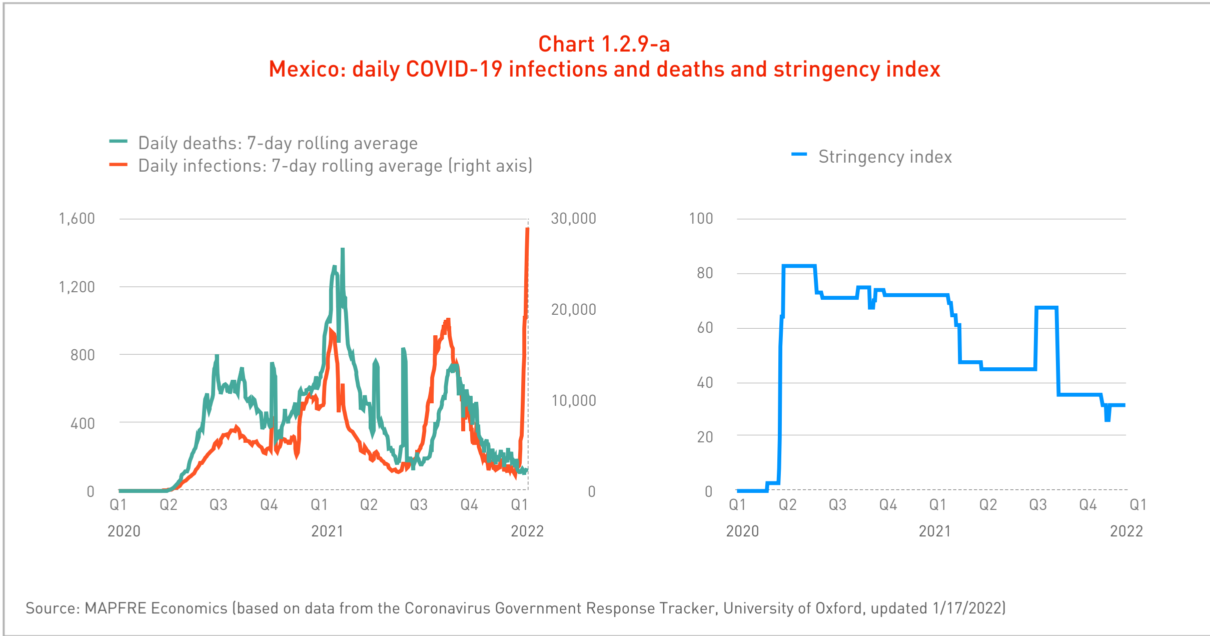
1.2.9 Mexico

The pace of growth is slowing down due to inflation and supply chain problems.

Since the start of 2022, COVID-19 cases have soared in Mexico, driven by the new Omicron variant and surpassing the record highs in the earliest days of the pandemic. As in most countries, so far, the increase in infections has not been accompanied by a rise in deaths, so the stringency index remains relatively low and has been dropping since the end of the third quarter of 2021. Mexico is behind other countries with a similar level of development in terms of vaccine coverage, with 62.9% of the population having received at least one dose, while there is no data on booster vaccines (see Charts 1.2.9-a and 1.2.9-b).

In this context, the Mexican economy slowed down in the third quarter of 2021, growing 4.6% YoY (-0.2% QoQ), which fell short of expectations. This was the result of the production slump due to the well-known problems with the delivery of components for automobile manufacturing and higher energy costs (especially gas), as well the persistent weakness in investment, and despite the relative recovery in private consumption levels.

Chart 1.2.9-a
Mexico: daily COVID-19 infections and deaths and stringency index



Source: MAPFRE Economics (based on data from the Coronavirus Government Response Tracker, University of Oxford, updated 1/17/2022)

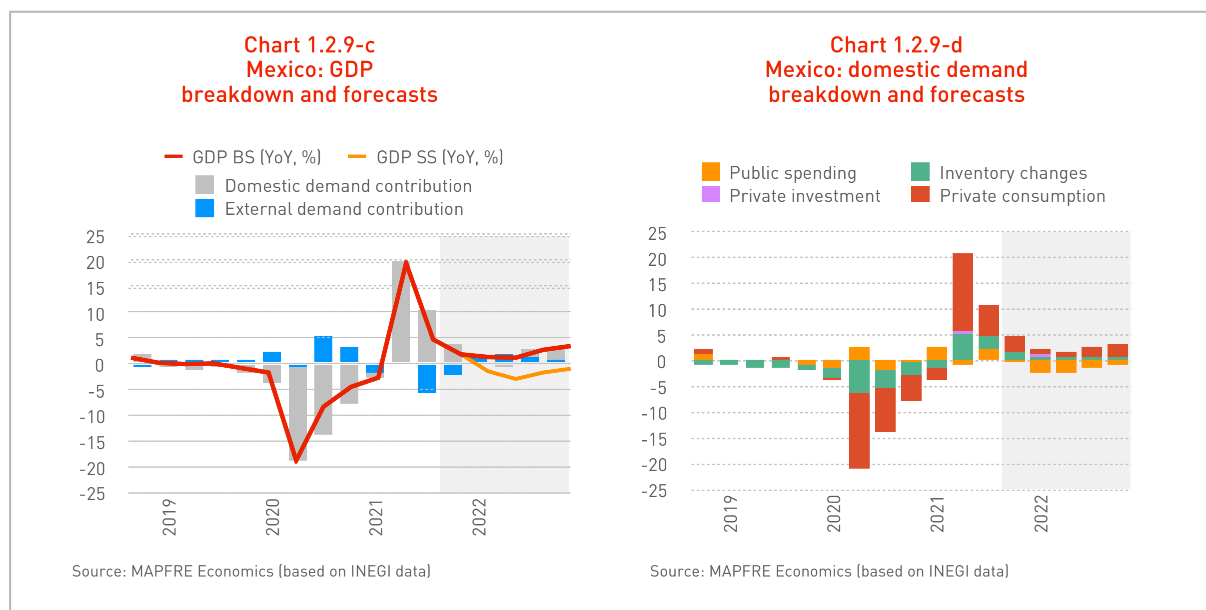


Table 1.2.9
Mexico: main macroeconomic aggregates

	2017	2018	2019	2020	2021(e)	Baseline (BS) 2022(f)	Baseline (BS) 2023(f)	Stressed (SS) 2022(f)	Stressed (SS) 2023(f)
GDP (% YoY)	2.3	2.2	-0.2	-8.4	5.2	2.6	2.7	-1.8	2.3
Domestic demand contribution	3.3	2.4	-1.0	-10.6	8.1	1.2	2.3	-3.8	2.1
External demand contribution	-0.9	-0.2	0.8	2.3	-2.8	1.4	0.4	2.0	0.2
Private consumption contribution	2.3	1.7	0.2	-7.0	5.5	1.7	2.0	-1.5	2.0
Total investment contribution	-0.2	0.2	-0.9	-3.1	2.3	0.6	0.5	-0.5	0.4
Public spending contribution	0.1	0.3	-0.2	0.0	0.3	0.3	0.3	0.3	0.3
Private consumption (% YoY)	3.4	2.6	0.4	-10.7	7.3	2.4	3.0	-2.3	3.0
Public spending (% YoY)	0.7	2.9	-1.8	0.1	1.4	2.1	2.3	2.1	2.3
Total investment (% YoY)	-1.1	0.8	-4.7	-17.9	10.6	3.2	2.5	-2.9	2.1
Exports (% YoY)	4.1	5.9	1.5	-7.2	6.4	8.7	5.5	3.2	5.3
Imports (% YoY)	6.8	6.4	-0.7	-14.2	14.4	5.1	4.6	-2.4	5.2
Unemployment rate (%, last quarter)	3.3	3.3	3.4	4.6	4.0	4.0	3.9	5.1	5.0
Inflation (% YoY, last quarter)	6.8	4.8	2.8	3.2	7.5	3.8	3.7	5.0	3.6
Fiscal balance (% of GDP)	-1.1	-2.0	-1.7	-2.8	-3.1	-3.0	-2.4	-3.6	-3.3
Primary fiscal balance (% of GDP)	1.4	0.6	1.1	0.1	-0.4	-0.5	0.0	-1.0	-0.7
Trade balance (% of GDP)	-0.9	-1.1	0.4	3.1	-1.2	-0.4	-0.2	0.4	0.5
Current account balance (% of GDP)	-1.8	-2.1	-0.3	2.4	-0.7	-0.3	-0.2	0.3	0.3
Official interest rate (end of period)	7.25	8.25	7.25	4.25	5.50	6.00	6.00	5.43	5.41
3-month interest rate (end of period)	7.66	8.63	7.45	4.47	5.86	6.25	6.25	5.52	5.52
10-year interest rate (end of period)	7.66	8.70	6.84	5.23	7.57	7.94	7.59	8.35	7.80
Exchange rate vs. US dollar (end of period)	19.67	19.65	18.93	19.88	20.50	21.63	21.84	23.92	23.06
Exchange rate vs. euro (end of period)	23.59	22.50	21.26	24.40	23.22	25.52	26.28	27.21	27.21
Private lending (% YoY, average)	12.1	10.4	9.0	5.2	-1.5	9.2	7.1	6.2	6.5
Household lending (% YoY, average)	9.9	8.4	6.2	1.6	4.5	7.5	7.3	6.7	6.9
P.S. non-financial lending (% YoY, average)	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
P.S. financial lending (% YoY, average)	1.7	-0.8	6.2	3.7	17.1	15.8	11.2	12.9	11.0
Savings rate (as % pers. disp. income, avg.)	10.7	12.3	16.4	22.2	22.9	20.5	19.1	21.7	19.8

Source: MAPFRE Economics (based on INEGI data)
Forecast end date: January 17, 2022

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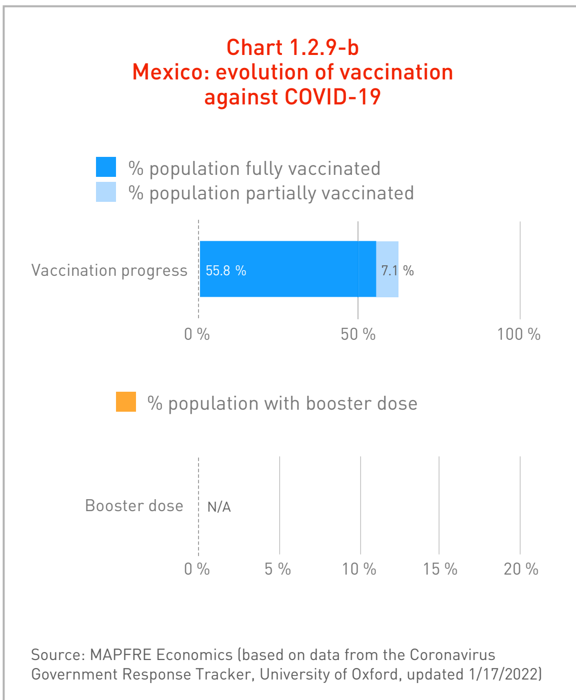


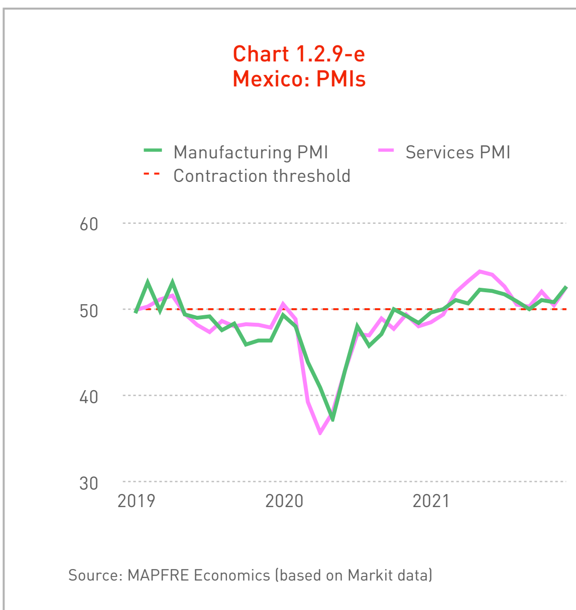
Source: MAPFRE Economics (based on data from the Coronavirus Government Response Tracker, University of Oxford, updated 1/17/2022)

As for indicators and surveys on economic conditions, the Purchasing Managers' Indexes (PMI) in December stood at 52.6 points for both manufacturing and non-manufacturing (see Chart 1.2.9-e). Industry confidence rebounded in October, but the production expectations component barely surpassed 50%, with a slight improvement in the export and investment components.

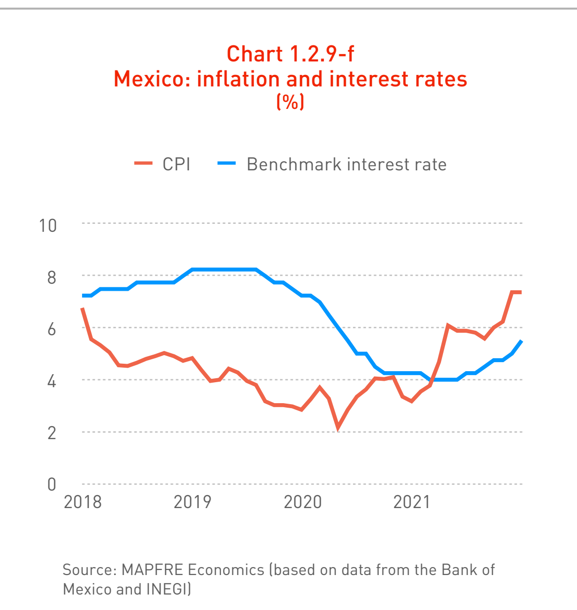
Manufacturing declined in 2021 due to parts supply problems. Oil exports performed well thanks to the increase in the international price of crude oil, recovering their 2018-2019 levels. However, the government has announced its intention to gradually reduce crude oil exports in the coming years to concentrate on refining activities.

We expect Mexico's GDP to finish the year with 5.2% growth. For 2022 and 2023, that growth is expected to moderate to around 2.6% and 2.7%, respectively. Consumer spending and investments will also moderate in 2022 (+2.4% and +5.1% in each case), while we expect an improvement in exports (+8.7%) as the supply chains normalize (see Table 1.2.9 as well as Charts 1.2.9-c and 1.2.9-d).

Inflation rose to 7.4% in December, with core inflation at 5.9%, an indication that inflation is taking root at higher levels; the trend continues in food (+7.7%), agricultural products (+16.4%), and energy (+10.5%). At its December meeting, the Bank of Mexico raised benchmark interest rates by 50 bps, to 5.50% (see Chart 1.2.9-f). The Governing Board of the central bank considers this trajectory for interest rates necessary to make inflation converge at the 3% target. Although prices are expected to ease somewhat in 2022, inflation expectations are anchoring at higher levels. The Governing Board should



Source: MAPFRE Economics (based on Markit data)



Source: MAPFRE Economics (based on data from the Bank of Mexico and INEGI)

therefore have to continue raising interest rates in 2022. However, its new composition could change this view and adopt a less restrictive monetary policy stance.

Risks for the Mexican economy are currently focused on the rise in inflation, the supply chain difficulties for industry, weak investments, and the possible rebound in coronavirus cases that could limit the growth of certain activities, especially in the service sector. On the positive side, the rise in oil prices is supporting exports and government revenue, and interest rates will continue to foster recovery as long as they remain moderately below inflation.

1.2.10 Brazil

Growth is being tempered by inflation, energy costs and obstacles in industry.

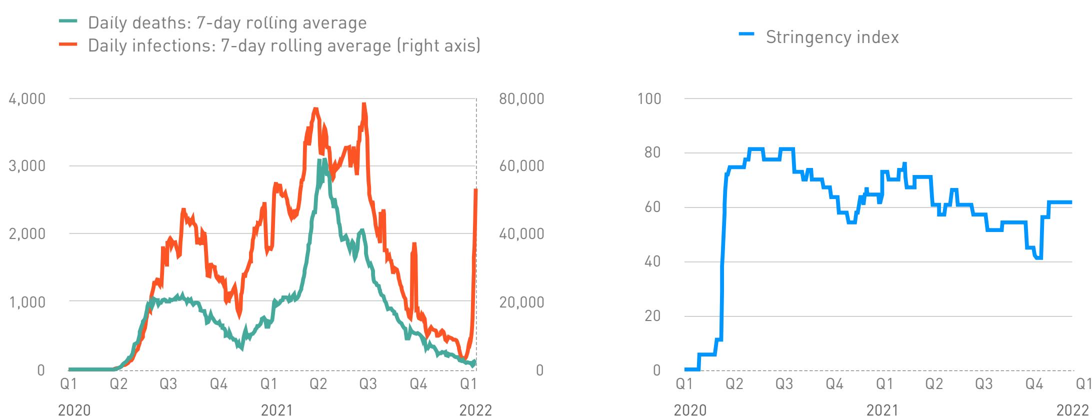
The new Omicron variant has started to increase case numbers in Brazil, which are still lower than in the largest wave to date, in the third quarter of 2021. While certain activity restrictions have been reinstated, deaths remain low. Brazil has one of the region's highest vaccination rates: 77.5% of the population has received at least one dose and 12.4% a booster dose (see Charts 1.2.10-a and 1.2.10-b).

Brazil

- **Inflation reached 10.1% in December, with pressure on electricity, fuels, and food.**
- **In December, the central bank raised interest rates to 9.25% and warned of continued hikes.**
- **Industrial activity, particularly in the automotive industry, is affected by the parts shortage and high energy prices.**
- **Brazil's GDP is expected to grow by around 0.5% in 2022 and 1.9% in 2023.**

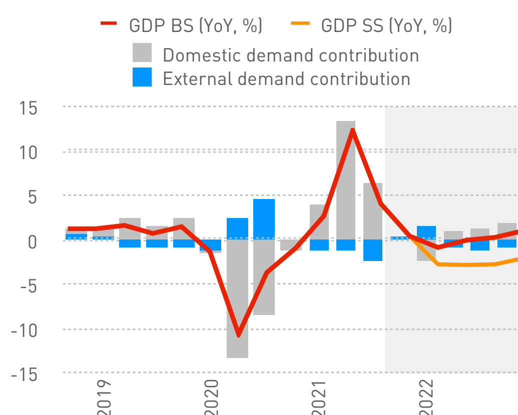
The Brazilian economy continued to lose momentum in the third quarter of 2021 (-0.1% QoQ and +4.0% YoY). Private consumption (+4.2%), investment (+18.8%), and exports (+4%) have recovered well, but the outlook for 2022 is less favorable. Private consumption is slowing down amid the increase in inflation and global supply chain problems, mainly affecting the auto manufacturing sector. New vehicle registrations in December remained 15% below their level in 2020. Decreases are also being observed in retail sales, fuel, and food. Industrial production is

Chart 1.2.10-a
Brazil: daily COVID-19 infections and deaths and stringency index



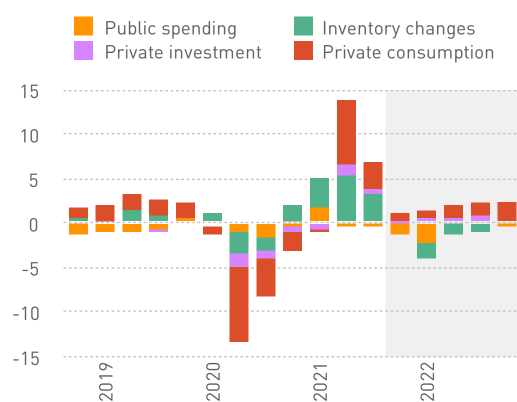
Source: MAPFRE Economics (based on data from the Coronavirus Government Response Tracker, University of Oxford, updated 1/17/2022)

Chart 1.2.10-c
Brazil: GDP breakdown and forecasts



Source: MAPFRE Economics (based on data from the Brazilian Institute of Geography and Statistics - IBGE)

Chart 1.2.10-d
Brazil: domestic demand breakdown and forecasts



Source: MAPFRE Economics (based on data from the Brazilian Institute of Geography and Statistics - IBGE)

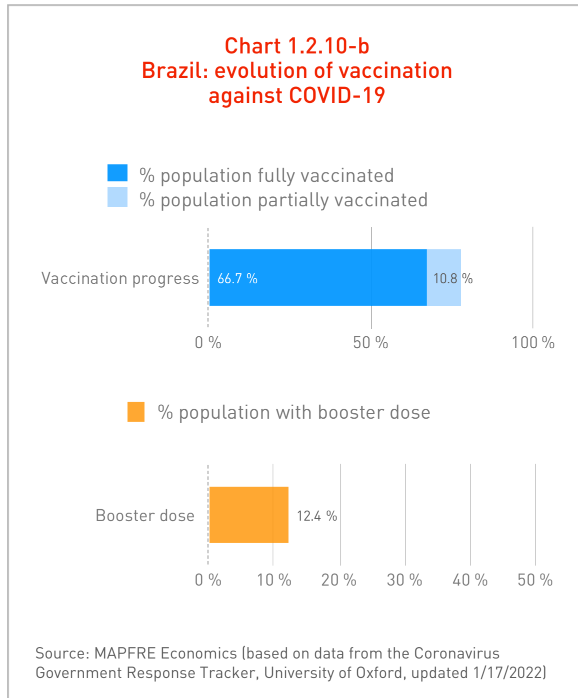
Table 1.2.10
Brazil: main macroeconomic aggregates

						Baseline (BS)		Stressed (SS)	
	2017	2018	2019	2020	2021(e)	2022(f)	2023(f)	2022(f)	2023(f)
GDP (% YoY)	1.6	1.7	1.2	-4.2	4.6	0.5	1.9	-2.6	1.2
Domestic demand contribution	2.0	2.4	1.8	-5.6	5.8	0.8	2.4	-2.8	1.5
External demand contribution	-0.4	-0.7	-0.6	1.4	-1.2	-0.3	-0.4	0.1	-0.4
Private consumption contribution	1.5	1.7	1.8	-4.0	2.5	1.3	1.9	-0.9	1.2
Total investment contribution	-0.4	0.9	0.7	-0.1	3.3	-1.0	0.5	-1.6	0.2
Public spending contribution	-0.1	0.1	-0.1	-0.8	0.3	0.5	0.1	0.5	0.1
Private consumption (% YoY)	2.2	2.4	2.6	-5.7	3.7	2.2	2.6	-1.3	1.8
Public spending (% YoY)	-0.7	0.8	-0.5	-4.5	1.7	2.7	0.5	2.7	0.5
Total investment (% YoY)	-2.6	5.2	4.0	-0.6	16.6	-5.0	2.4	-8.8	1.3
Exports (% YoY)	5.2	3.4	-2.5	-2.2	7.5	1.5	4.6	-1.5	3.6
Imports (% YoY)	7.2	7.1	1.3	-10.2	13.2	3.1	6.0	-2.0	5.1
Unemployment rate (%, last quarter)	11.9	11.7	11.1	14.2	12.0	11.7	11.0	13.0	12.4
Inflation (% YoY, last quarter)	2.9	3.7	4.3	4.5	9.8	5.3	3.3	7.1	3.5
Fiscal balance (% of GDP)	-7.8	-7.0	-5.8	-13.6	-4.5	-6.5	-6.0	-7.2	-7.4
Primary fiscal balance (% of GDP)	-1.7	-1.5	-0.8	-9.4	0.0	-1.4	-0.8	-2.1	-2.1
Trade balance (% of GDP)	2.8	2.3	1.4	2.2	3.4	2.0	2.0	3.4	3.0
Current account balance (% of GDP)	-1.1	-2.7	-3.5	-1.7	-0.5	-2.1	-2.3	-0.9	-1.5
Official interest rate (end of period)	7.00	6.50	4.50	2.00	9.25	11.50	8.50	9.63	8.18
3-month interest rate (end of period)	6.90	6.40	4.40	1.90	9.15	11.40	8.40	9.37	7.94
10-year interest rate (end of period)	10.21	9.24	6.81	6.98	10.31	11.82	11.09	11.47	11.70
Exchange rate vs. US dollar (end of period)	3.31	3.87	4.03	5.20	5.57	5.72	5.79	6.39	6.14
Exchange rate vs. euro (end of period)	3.97	4.44	4.53	6.38	6.31	6.75	6.97	7.27	7.24
Private lending (% YoY, average)	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Household lending (% YoY, average)	4.7	7.0	10.8	10.1	16.6	14.1	12.7	13.5	12.5
P.S. non-financial lending (% YoY, average)	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
P.S. financial lending (% YoY, average)	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Savings rate (as % pers. disp. income, avg.)	17.4	16.4	15.8	19.0	22.5	20.1	19.8	21.6	21.0

Source: MAPFRE Economics (based on data from the Brazilian Institute of Geography and Statistics - IBGE)
Forecast end date: January 17, 2022

Click here to access the interactive version of this information

Chart 1.2.10-b
Brazil: evolution of vaccination against COVID-19



Source: MAPFRE Economics (based on data from the Coronavirus Government Response Tracker, University of Oxford, updated 1/17/2022)

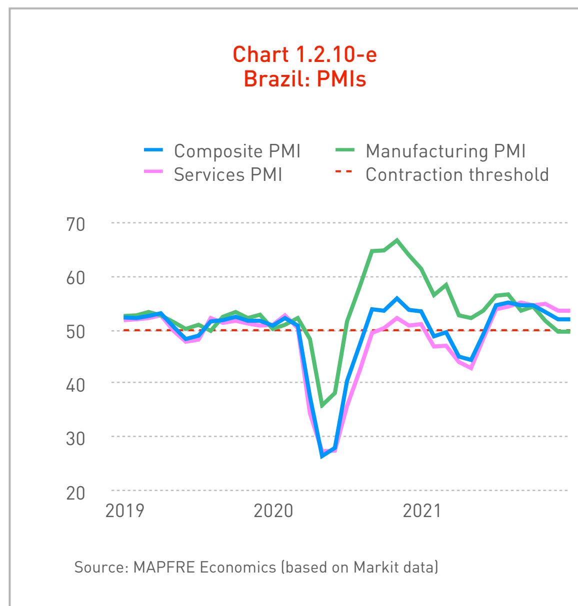
falling (-4.4% in November), and vehicle manufacturing slid from 250,000 units before the pandemic to 210,000 in December. The Composite Leading Indicators Index (OECD) also reflects a slight slowdown since the start of the year. Meanwhile, the Purchasing Managers' Indexes (PMIs) held steady in December, with the composite at 52.0, manufacturing at 49.8, and services at 53.6 points (see Chart 1.2.10-e).

Given this slowdown, which is also being driven by the increase in inflation and specifically energy prices (aggravated in Brazil by the water crisis), we have adjusted our 2022 projections to 0.5% (from our previous estimate of 1.7%) and 1.9% by 2023, while 2021 should end with GDP growth of 4.6% (see Table 1.2.10 as well as Charts 1.2.10-c and 1.2.10-d).

Inflation fell slightly to 10.1% (general IPCA) in December, with year-on-year increases in energy (+24%) electricity (+21%), gas cylinders (+37%), automotive fuels (+49%), and transport (+21%). Although energy prices are expected to ease in 2022, no significant downward price elasticity is expected in these countries with long histories of high inflation; while products and services quickly adjust to new costs, downward adjustments have more inertia.

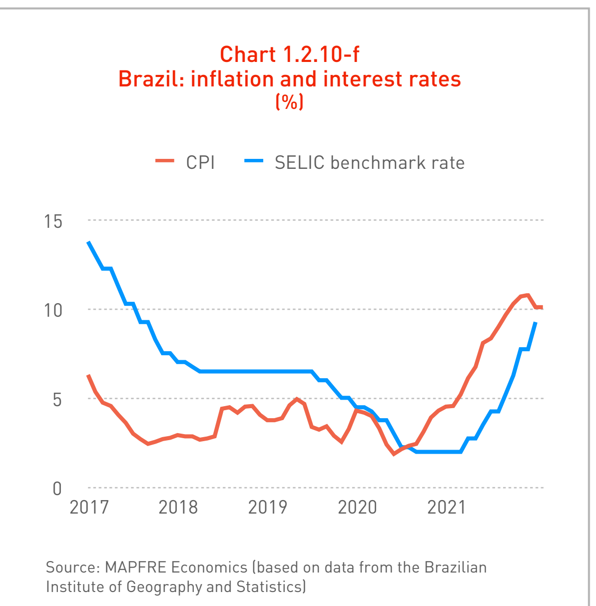
At its December 8 meeting, the central bank (BCB) raised SELIC interest rates for the seventh time this year, by 150 bps, to 9.25%, on account of rising inflation, and announced a further increase of the same magnitude at its February meeting. Due to the projected increase and the risk of decoupling from long-term inflation expectations, the bank considers a cycle of interest rate tightening to be appropriate (see Chart 1.2.10-f). Interest rates in 2022 are therefore expected to approach the

Chart 1.2.10-e
Brazil: PMIs



Source: MAPFRE Economics (based on Markit data)

Chart 1.2.10-f
Brazil: inflation and interest rates (%)



Source: MAPFRE Economics (based on data from the Brazilian Institute of Geography and Statistics)

level of 10.75% before falling again in 2023, to the extent that inflation allows it. The monetary policy committee emphasizes that the future steps for monetary policy could be adjusted to meet the inflation targets and will depend on the evolution of economic activity, the risk balance, and inflation projections and expectations.

The main risks for Brazil's economy are inflation and the impact of the drought on electricity prices, and the rise in food prices and interest rates, which are likely to affect consumer spending and investment. For a few more quarters, industrial production may also be affected by supply problems. Factors that work in its favor include progress on administrative and fiscal reforms. At the same time, the political debate ahead of the October 2022 presidential elections could generate further complications for economic development.

1.2.11 Argentina

Argentina aims to reach a new agreement with the IMF by the second quarter.

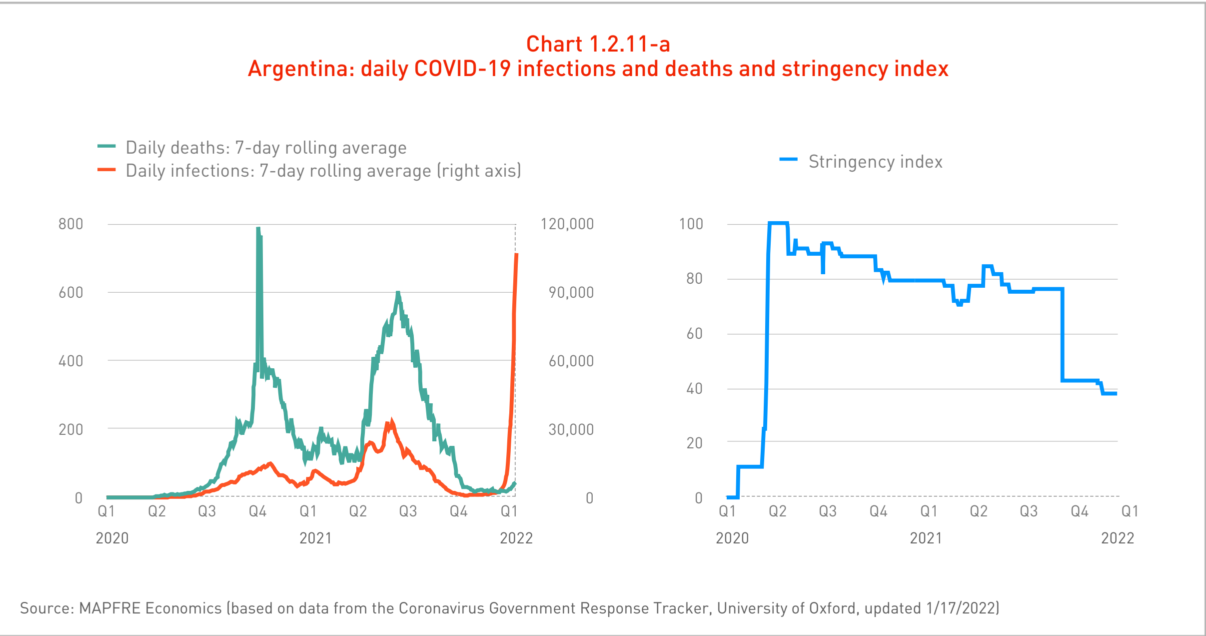
Like other countries in the region, Argentina is seeing a rise in infections driven by the new Omicron variant, which has far surpassed the previous average observed during the pandemic. Despite this situation, deaths remain low, and activity restrictions continue to be reduced. The country has made strong progress with its vaccination program, with 83.1% of the population receiving at least one dose and 6.4% receiving the booster (see Charts 1.2.11-a and 1.2.11-b).

Argentina

- **Argentina needs a new agreement with the IMF, which will require planning a path to fiscal consolidation.**
- **Inflation stood at 51.2% in November.**
- **The currency surpassed 103 ARS/USD, with the M3 money supply growing 58.3% in December.**
- **The anticipated growth for Argentine GDP is 2.9% in 2022 and 1.5% in 2023.**

The Argentine economy grew by 4.1% QoQ in the third quarter of 2021 (+11.9% YoY), with strong exports (+18.6% YoY), and consumption (+11.5%) and investments (+22.6%) also growing. GDP is therefore expected to increase by 9.3% by the end of 2021 after falling by 9.9% the previous year. Inflation and high energy costs are risks for growth in 2022, while the political risk has also increased, as the opposition now has the majority in congress. Activity indicators show a drop in industrial production of 13.3% YoY (November). Vehicle production recovered in 2021 but showed considerable volatility (-14.3%

Chart 1.2.11-a
Argentina: daily COVID-19 infections and deaths and stringency index



Source: MAPFRE Economics (based on data from the Coronavirus Government Response Tracker, University of Oxford, updated 1/17/2022)

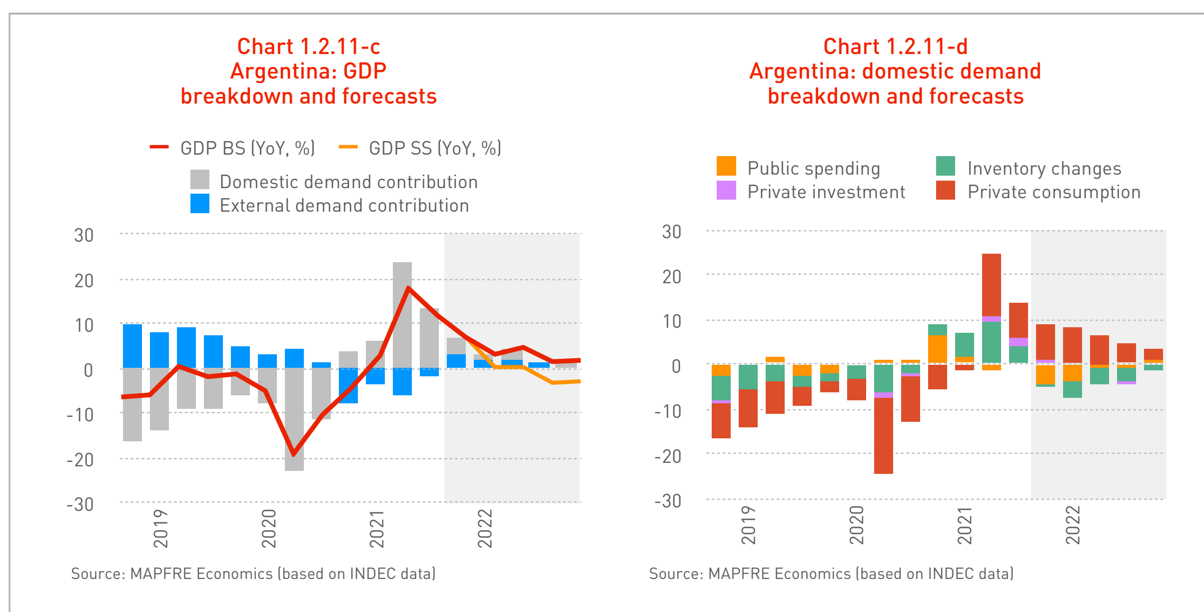


Table 1.2.11
Argentina: main macroeconomic aggregates

	2017	2018	2019	2020	2021(e)	Baseline (BS) 2022(f)	Baseline (BS) 2023(f)	Stressed (SS) 2022(f)	Stressed (SS) 2023(f)
GDP (% YoY)	2.8	-2.6	-2.0	-9.9	9.3	2.9	1.5	-1.3	0.7
Domestic demand contribution	6.6	-4.0	-8.8	-10.2	11.3	1.5	1.6	-3.4	0.7
External demand contribution	-3.8	1.4	6.8	0.3	-2.0	1.4	-0.1	2.1	0.1
Private consumption contribution	3.1	-1.7	-5.1	-9.3	6.0	3.8	1.2	1.4	0.5
Total investment contribution	2.8	-1.2	-2.7	-2.2	4.3	-2.3	0.3	-3.1	0.0
Public spending contribution	0.4	-0.3	-0.2	-0.5	1.0	0.0	0.1	0.0	0.1
Private consumption (% YoY)	4.2	-2.2	-7.3	-13.8	10.4	7.7	1.7	2.0	0.8
Public spending (% YoY)	2.6	-1.9	-1.2	-3.3	6.9	0.1	0.6	0.1	0.6
Total investment (% YoY)	13.4	-5.7	-15.9	-12.9	27.4	-14.1	1.7	-19.7	0.0
Exports (% YoY)	2.6	0.6	9.1	-17.3	9.3	2.9	2.3	-0.3	1.1
Imports (% YoY)	15.6	-4.5	-19.0	-17.9	17.1	-3.2	2.6	-9.5	0.6
Unemployment rate (%, last quarter)	7.2	9.1	8.9	11.0	9.3	8.1	7.5	9.3	8.5
Inflation (% YoY, last quarter)	23.3	47.4	52.2	36.4	51.2	44.7	31.5	48.2	30.0
Fiscal balance (% of GDP)	-5.9	-4.9	-3.8	-8.3	-3.7	-3.2	-1.3	-3.9	-2.4
Primary fiscal balance (% of GDP)	-3.8	-2.3	-0.4	-6.4	-2.2	-1.8	0.4	-2.5	-0.5
Trade balance (% of GDP)	-0.8	-0.1	4.0	3.8	4.2	3.6	3.5	4.4	4.5
Current account balance (% of GDP)	-4.8	-4.9	-0.8	0.9	1.8	0.8	0.4	1.1	0.9
Official interest rate (end of period)	28.75	59.25	55.00	38.00	38.00	30.00	27.50	27.83	26.81
3-month interest rate (end of period)	27.44	56.76	45.13	29.55	31.00	33.58	27.00	29.88	26.42
10-year interest rate (end of period)	5.91	10.86	19.36	14.61	18.40	16.26	13.53	16.44	14.93
Exchange rate vs. US dollar (end of period)	18.65	37.70	59.89	84.15	102.72	165.30	213.69	189.26	227.97
Exchange rate vs. euro (end of period)	22.37	43.17	67.28	103.26	116.34	195.05	257.14	215.36	269.09
Private lending (% YoY, average)	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Household lending (% YoY, average)	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
P.S. non-financial lending (% YoY, average)	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
P.S. financial lending (% YoY, average)	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Savings rate (as % pers. disp. income, avg.)	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A

Source: MAPFRE Economics (based on INDEC data)
Forecast end date: January 17, 2022

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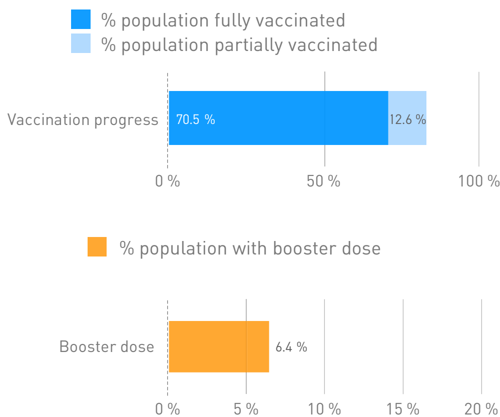
Chart 1.2.11-b
Argentina: evolution of vaccination against COVID-19

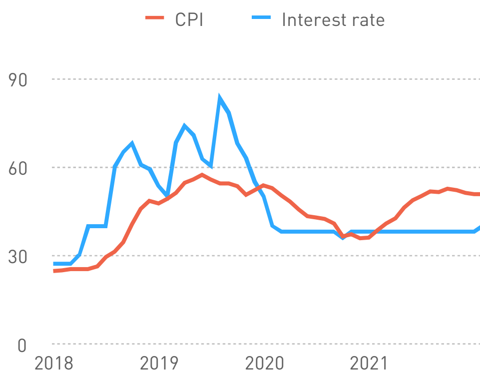


Source: MAPFRE Economics (based on data from the Coronavirus Government Response Tracker, University of Oxford, updated 1/17/2022)

MoM in December) due to worldwide parts delivery problems. Consumer confidence has also fallen again in recent months (37.8). Therefore, the Argentine economy is expected to grow by 2.9% in 2022, moderating in 2023 to around 1.5% (see Table 1.2.11 as well as Charts 1.2.11-c and 1.2.11-d).

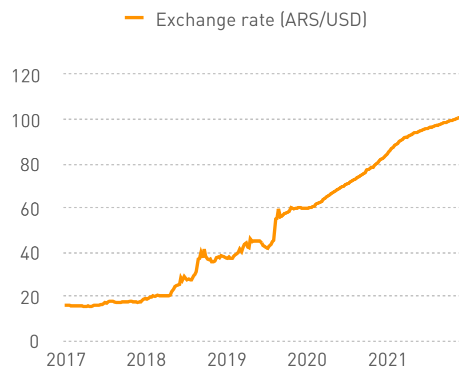
Meanwhile, inflation stood at 52.1% in November after rising continuously since the start of the year and stabilizing at the end of 2021. Increases have been observed in all areas, including food (50.5%), transportation (57.6%), and hospitality (63.4%). Due to regulated prices, electricity and gas rose less (+29.4%), while core inflation stood at 55.5%. At its January 6 meeting, the Central Bank of the Argentine Republic made a series of decisions to adjust monetary policy to support recovery and reinforce monetary, exchange rate, and financial stability conditions. These decisions intend to reorganize the interest-rate scheme and simplify the organization of systemic liquidity. In this regard, it decided to increase its 28-day LELIQ interest rate (benchmark rate) by two percentage points, from 38% to 40% per year. It also decided to expand the maximum limit for holding Liquidity Letters (LELIQ) to a 28-day term by an amount proportional to the private-sector term deposit stock for each financial institution. At the same time, the monetary authority made progress on creating a new 180-day LELIQ whose rate is set at 44% per year. With the M3 monetary base growing at 58.3% per year (December), the currency will continue its gradual depreciation; in January, it had exceeded 103 ARS/USD (see Charts 1.2.11-e and 1.2.11-f).

Chart 1.2.11-e
Argentina: inflation and interest rates (%)



Source: MAPFRE Economics (based on data from the Central Bank of the Argentine Republic)

Chart 1.2.11-f
Argentina: exchange rate



Source: MAPFRE Economics (based on data from the Central Bank of the Argentine Republic)

It should be noted that a new agreement with the International Monetary Fund (IMF) is imperative for Argentina, and the negotiations are focused on the trajectory for fiscal consolidation, the replenishment of foreign currency reserves, the reduction of monetary debt issuance, and inflation control. As the positions are still quite distant, this agreement is unlikely to be reached before the year's second quarter.

In the short term, risks for the Argentine economy are focused on the need to approve an economic plan for the coming years with an opposition-dominated congress and also to reach a new agreement with the IMF and approve it in congress. The opposition leader has already stated that his side will not support an agreement that includes a tax increase. Fiscal consolidation will be a critical issue in the medium term, and the opposition has indicated that it would support the agreement if it shows that the treasury will no longer be financed by the central bank in 2024. The opposition also wants the central bank to be independent by the end of 2023.

1.2.12 China

Economic slowdown, cautious consumers, and problems in the real estate sector.

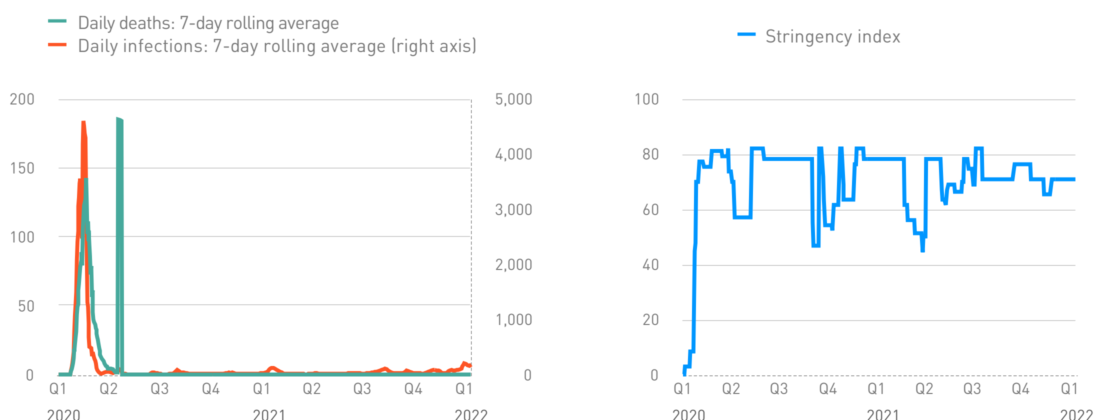
The pandemic remains under control in China. Despite the emergence of the new coronavirus variant, both infection and death rates remain very low, albeit at the cost of maintaining high levels of restrictions. Likewise, 84.8% of the population has been vaccinated with at least one dose and 8.4% with the booster (see Charts 1.2.12-a and 1.2.12-b).

In this environment, the Chinese economy has been stalling. Amid the solvency crisis impacting real estate companies (Evergrande, Fantasia, Kaisa, Sinic), both sales (-1.6%, in the third quarter) and construction (-1.8%) have stagnated in recent months. For now, it is believed that the risk in the real estate development sector lies mainly in the sales slump, a result of weak buyer confidence and low development volume. The authorities are closely monitoring the cash issues of these

China

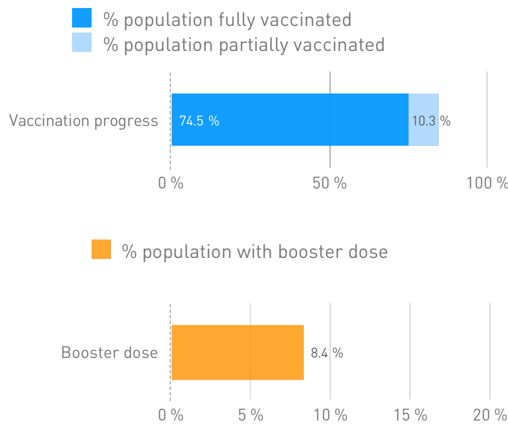
- Exports and non-real-estate investment will be the focus for the transformation of the production model.
- The aim is to reduce the weight of real estate development, a sector that remains in crisis due to the solvency position of some companies.
- Monetary policy sentiment is turning toward potential further stimulus as the economy loses momentum.
- Regulators are paying attention to systemic risks in the real estate sector.
- The Chinese economy is expected to grow by around 5.0% in 2022 and 5.5% in 2023.

Chart 1.2.12-a
China: daily COVID-19 infections and deaths and stringency index



Source: MAPFRE Economics (based on data from the Coronavirus Government Response Tracker, University of Oxford, updated 1/17/2022)

Chart 1.2.12-b
China: evolution of vaccination against COVID-19



Source: MAPFRE Economics (based on data from the Coronavirus Government Response Tracker, University of Oxford, updated 1/17/2022)

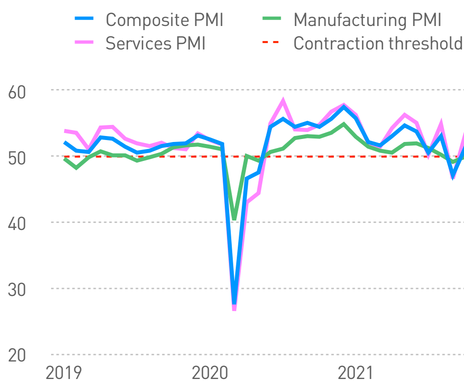
developers, and there is faith that they will manage the situation to avoid systemic risks. However, the authorities' recent measures to ease some of the restrictions on real-estate financing have failed to alleviate pressure in the market. Demand for home loans remained weak in December. Aware that the real estate sector is running out of steam, the government plans to promote the transformation of the growth model towards industry, energy, and infrastructure.

Additionally, exports remained strong (+20.9% in December), and imports lost momentum (+19.5% compared to +31.7% in the previous month), while the exchange rate continued to strengthen (see Chart 1.2.12.-c). Cautious consumer behavior and a decline from the highs of 2021 are expected. Government spending and investments in non-real estate sectors, such as industry, energy, and infrastructure, will be accelerated in a planned effort to transform the growth model.

As regards the leading indicators that predict performance in the coming months, the Purchasing Managers' Indexes (PMIs) continued to improve in December, as China is still the world's factory, with the composite index at 53.0, manufacturing at 50.9, and services at 53.1 points (see Table 1.2.12-c). Retail business surveys also remain positive, and industrial production has grown 10% year-to-date and 3.8% in November. In this context, we estimate that growth will slow from 8.1% in 2021 to 5.0% in 2022 and 5.5% in 2023 (see Table 1.2.12 and Charts 1.2. 12-e and 1.2.12-f).

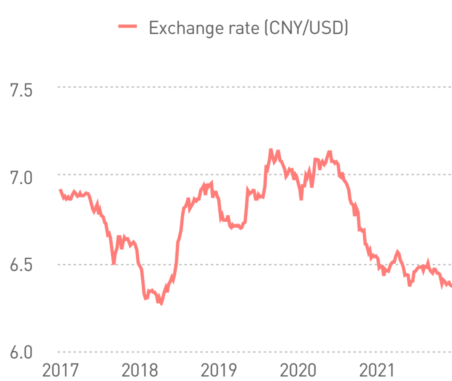
Meanwhile, inflation is becoming more moderate, with a 1.5% increase in December after rising 2.3% in November, driven by fuel (+22.5% YoY) as well as gas, electricity, and domestic fuel (+3.9% YoY). Food is falling (-1.2%), while core inflation stands at 1.2% In

Chart 1.2.12-c
China: PMIs



Source: MAPFRE Economics (based on Markit data)

Chart 1.2.12-d
China: exchange rate



Source: MAPFRE Economics (based on PBOC data)

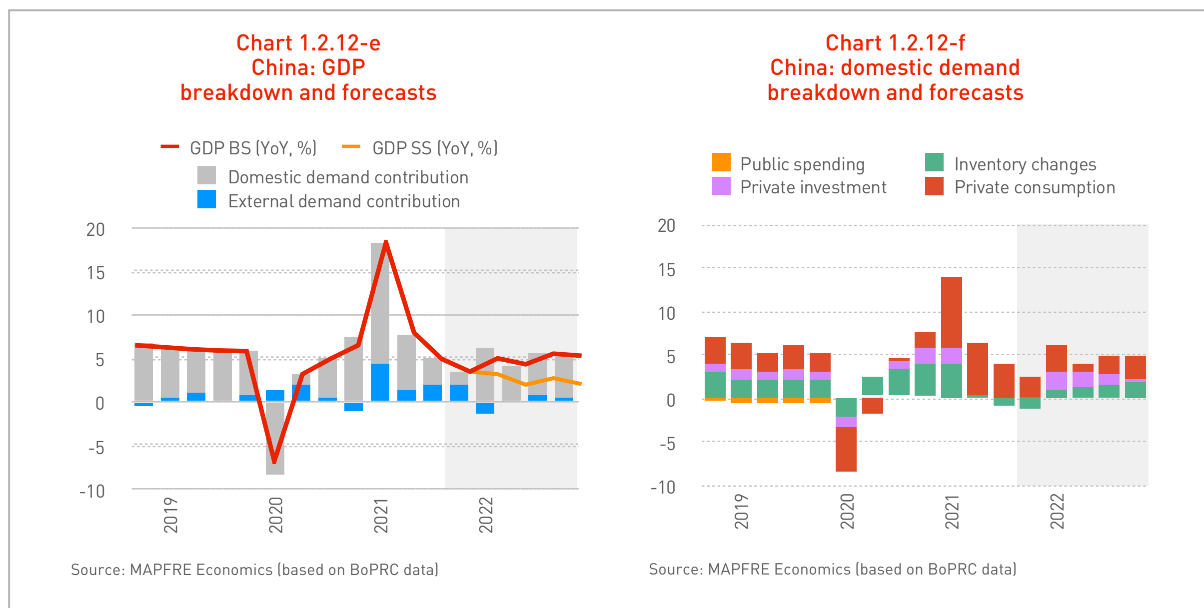


Table 1.2.12
China: main macroeconomic aggregates

						Baseline (BS)		Stressed (SS)	
	2017	2018	2019	2020	2021(e)	2022(f)	2023(f)	2022(f)	2023(f)
GDP (% YoY)	6.9	6.7	6.0	2.3	8.1	5.0	5.5	2.4	4.5
Domestic demand contribution	6.7	7.3	5.2	1.6	5.5	4.9	5.3	2.4	4.1
External demand contribution	0.2	-0.6	0.8	0.7	2.4	0.1	0.2	0.0	0.4
Private consumption contribution	3.7	3.2	2.5	-0.9	5.1	2.3	3.2	1.0	2.7
Total investment contribution	2.6	3.1	2.2	1.9	0.4	1.5	1.9	0.2	1.2
Public spending contribution	0.3	1.2	1.1	0.5	0.3	1.3	0.3	1.3	0.3
Private consumption (% YoY)	9.4	8.1	6.3	-2.4	12.7	5.6	7.7	2.6	6.6
Public spending (% YoY)	1.9	7.1	6.6	2.8	2.1	7.8	2.1	7.8	2.1
Total investment (% YoY)	6.2	7.3	5.1	4.5	1.1	3.7	4.8	0.5	3.1
Exports (% YoY)	6.7	4.4	2.3	2.0	17.7	5.6	4.3	1.5	3.3
Imports (% YoY)	7.8	6.5	-0.7	-2.2	6.7	5.8	10.0	1.2	7.9
Unemployment rate (%, last quarter)	2.9	2.9	3.1	3.5	3.4	3.3	3.2	4.1	3.6
Inflation (% YoY, last quarter)	1.8	2.2	4.3	0.1	1.9	2.7	2.4	3.8	2.8
Fiscal balance (% of GDP)	-4.8	-4.7	-5.6	-8.6	-7.2	-7.9	-6.9	-8.7	-8.1
Primary fiscal balance (% of GDP)	-1.8	-1.5	-2.2	-4.7	-3.5	-4.5	-3.6	-5.1	-4.5
Trade balance (% of GDP)	3.9	2.7	2.8	3.5	3.1	2.9	3.1	2.8	3.3
Current account balance (% of GDP)	1.5	0.2	0.7	1.9	1.9	1.8	1.4	1.8	1.6
Official interest rate (end of period)	3.25	3.30	3.25	2.95	3.00	3.00	3.00	2.93	2.77
3-month interest rate (end of period)	5.53	3.70	3.20	3.03	2.73	2.62	2.77	2.38	2.46
10-year interest rate (end of period)	3.88	3.23	3.14	3.14	2.78	3.48	3.70	4.68	4.92
Exchange rate vs. US dollar (end of period)	6.51	6.88	6.99	6.52	6.35	6.35	6.33	6.45	6.38
Exchange rate vs. euro (end of period)	7.80	7.87	7.85	8.00	7.19	7.49	7.61	7.34	7.53
Private lending (% YoY, average)	13.1	12.9	13.1	13.1	12.4	12.5	10.6	7.9	7.3
Household lending (% YoY, average)	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
P.S. non-financial lending (% YoY, average)	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
P.S. financial lending (% YoY, average)	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Savings rate (as % pers. disp. income, avg.)	29.5	28.8	29.0	33.0	30.4	29.7	28.0	30.6	28.7

Source: MAPFRE Economics (based on BoPRC data)
Forecast end date: January 17, 2022

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this environment, monetary policy could change its tune. A stalling economy with moderate inflation could require the support of monetary policy, which would represent a contrast with the Federal Reserve and the rest of the world. Thus, the central bank (PBOC) could adopt a more accommodative tone. China's monetary policy is conducted with various instruments, and one of the main ones is the reserve requirement ratio applied to banks. The PBOC reduced this ratio by 50 bps to 11.50% at its December meeting. Chinese currency gained strength against the dollar and the euro in 2021. However, as the authorities aim to prevent an excessive appreciation of the currency, the possibility that they will allow greater capital outflows cannot be ruled out.

In an attempt to control the heavily indebted real estate sector, the government has introduced regulations to limit its leverage. Evergrande is considered "too big to fail" and will be rescued. There is also trust in the government's ability to manage the tribulations of this sector because real estate and construction represent 20% of China's GDP. The anticipated slowdown in the real estate sector could take one percentage point off growth in 2022. Similarly, the high prices of electricity and other commodities will result in higher headline inflation and lower growth.

1.2.13 Indonesia

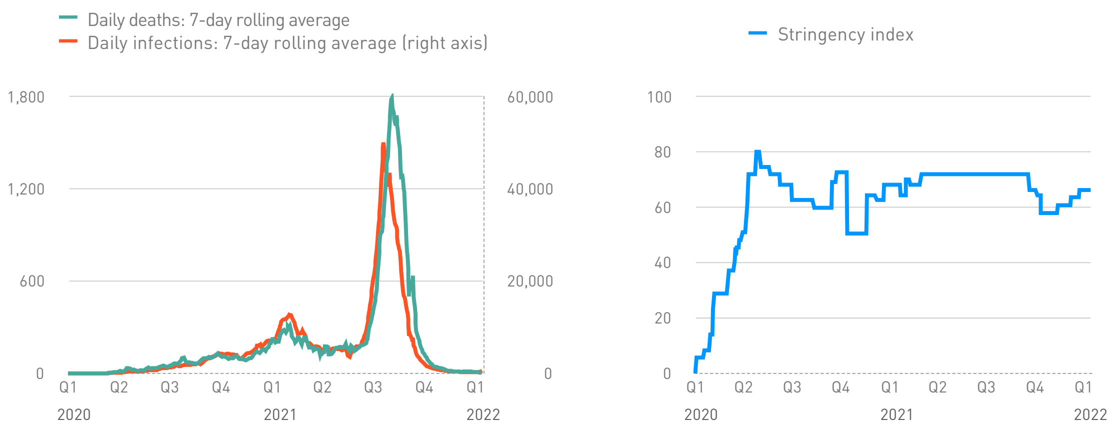
Strong exports are driving economic growth.

So far, COVID-19 infections and deaths remain very low in Indonesia after peaking in the third quarter of 2021. Nevertheless, the stringency index continues to be relatively high. Vaccines have been distributed to 56.3% of the population,

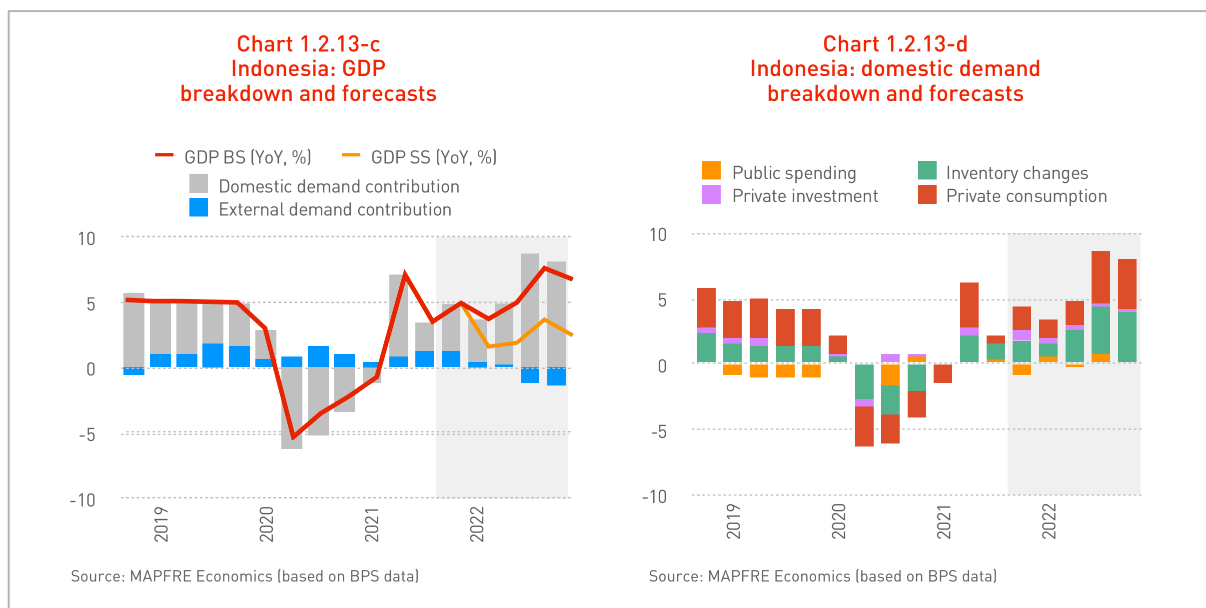
Indonesia

- **By 2022, economic growth in Indonesia is expected to reach 5.8%, largely driven by exports.**
- **High prices for palm oil and coal have greatly favored exports.**
- **Inflation is benign (1.9% in December), and the central bank is maintaining an accommodative monetary policy.**

Chart 1.2.13-a
Indonesia: daily COVID-19 infections and deaths and stringency index



Source: MAPFRE Economics (based on data from the Coronavirus Government Response Tracker, University of Oxford, updated 1/17/2022)



Source: MAPFRE Economics (based on BPS data)

Source: MAPFRE Economics (based on BPS data)

Table 1.2.13
Indonesia: main macroeconomic aggregates

	2017	2018	2019	2020	2021(e)	Baseline (BS) 2022(f)	Baseline (BS) 2023(f)	Stressed (SS) 2022(f)	Stressed (SS) 2023(f)
GDP (% YoY)	5.1	5.2	5.0	-2.1	3.7	5.8	6.4	2.4	5.2
Domestic demand contribution	4.8	6.2	3.6	-3.2	2.7	6.2	7.1	2.7	5.9
External demand contribution	0.3	-1.1	1.4	1.1	1.0	-0.5	-0.7	-0.3	-0.7
Private consumption contribution	2.8	2.8	2.9	-1.5	1.1	2.7	3.9	0.2	3.7
Total investment contribution	2.0	2.2	1.5	-1.6	1.3	3.0	3.1	2.0	2.0
Public spending contribution	0.2	0.4	0.3	0.2	0.4	0.3	0.5	0.3	0.5
Private consumption (% YoY)	5.0	5.1	5.2	-2.7	2.0	5.0	7.2	0.4	6.9
Public spending (% YoY)	2.1	4.8	3.3	1.9	4.9	3.6	6.0	3.6	6.0
Total investment (% YoY)	6.2	6.7	4.5	-4.9	4.1	9.1	9.1	6.0	6.1
Exports (% YoY)	8.9	6.5	-0.9	-7.7	24.0	2.2	1.6	-1.6	0.2
Imports (% YoY)	8.1	12.1	-7.4	-14.7	22.7	4.9	5.2	-0.2	3.7
Unemployment rate (%, last quarter)	5.3	5.1	5.1	6.7	6.1	5.8	5.3	6.9	6.3
Inflation (% YoY, last quarter)	3.5	3.3	2.7	1.6	1.8	3.9	3.0	6.4	2.9
Fiscal balance (% of GDP)	-2.6	-1.7	-2.2	-6.2	-4.6	-3.8	-3.3	-4.3	-4.0
Primary fiscal balance (% of GDP)	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Trade balance (% of GDP)	1.9	0.0	0.3	2.7	3.9	3.0	1.7	3.0	1.9
Current account balance (% of GDP)	-1.6	-2.9	-2.7	-0.4	0.4	-1.0	-1.8	-1.1	-1.7
Official interest rate (end of period)	4.25	6.00	5.00	3.75	3.50	3.75	4.25	4.51	1.89
3-month interest rate (end of period)	5.48	7.70	5.51	4.06	3.75	4.13	4.90	4.85	2.52
10-year interest rate (end of period)	6.31	7.98	7.10	6.10	6.38	7.05	7.27	8.02	7.21
Exchange rate vs. US dollar (end of period)	13,484	14,380	13,883	14,050	14,253	14,192	13,721	15,524	14,402
Exchange rate vs. euro (end of period)	16,171	16,465	15,596	17,241	16,143	16,746	16,511	17,659	16,997
Private lending (% YoY, average)	8.2	10.8	8.8	1.4	1.1	12.5	13.5	14.7	12.8
Household lending (% YoY, average)	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
P.S. non-financial lending (% YoY, average)	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
P.S. financial lending (% YoY, average)	15.1	5.6	-3.0	-6.0	-12.4	25.7	24.4	23.3	24.3
Savings rate (as % pers. disp. income, avg.)	23.6	24.0	22.8	21.4	25.1	23.9	23.2	25.5	23.5

Source: MAPFRE Economics (based on BPS data)
Forecast end date: January 17, 2022

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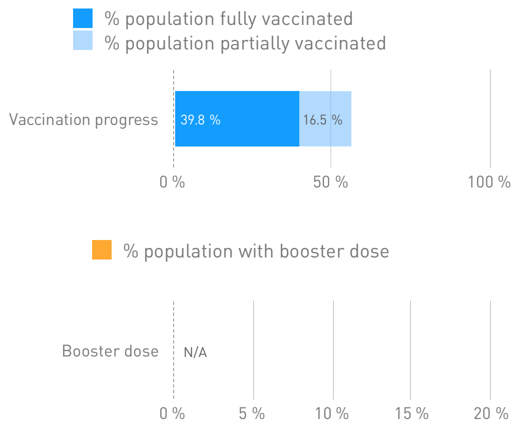
Chart 1.2.13-b
Indonesia: evolution of vaccination against COVID-19



Source: MAPFRE Economics (based on data from the Coronavirus Government Response Tracker, University of Oxford, updated 1/17/2022)

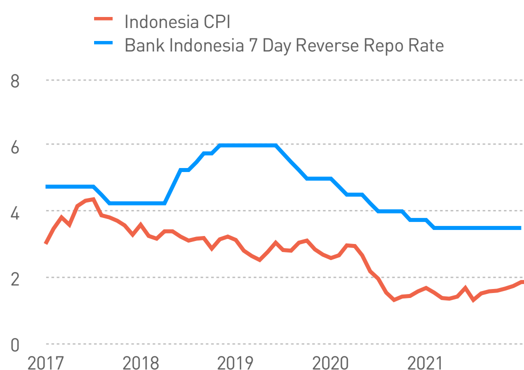
and there is no data on booster doses (see Charts 1.2.13-a and 1.2.13- b).

Indonesia's GDP grew by 3.5% YoY in the third quarter of 2021, driven mainly by exports (+29.2%), although imports were also strong (+30.1%). In contrast, investment grew by 3.7%, while private consumption rose by 1% and government consumption by 0.7%. Exports are what truly stood out, generating a strongly positive trade balance of 36 billion dollars in November (see Chart 1.2.13-f). This was mainly due to increases in the price of exported products (+22%), including palm oil, coal, and to a lesser extent, gas (Indonesia is a net exporter of gas and a net importer of oil). The trade balance should remain strong in the coming quarters as long as these commodity prices remain high and will continue to drive GDP in 2022. This surplus is also positive in terms of currency stability and offsets potential financial outflows.

In this context, we estimate that Indonesia's GDP will grow by around 5.8% in 2022 and 6.4% in 2023 (see Table 1.2.13 and Charts 1.2.13-c and 1.2.13-d). As for outlook surveys, household confidence, employment, and economic conditions are positive in terms of both the current situation and within six months. The manufacturing Purchasing Managers' Index (PMI) fell to 53.5 points in December (from 53.9 in November).

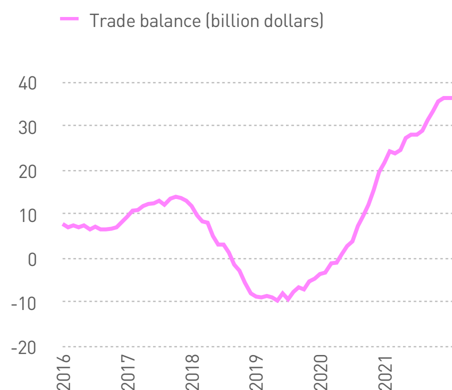
Inflation stood at 1.9% in December, with core inflation at 1.6%, much lower than the level observed in many parts of the world. Therefore, for now, Indonesia seems "immune" to rising energy and commodity costs and supply chain disruptions, given that the country is a net exporter. The Central Bank of Indonesia held interest rates at 3.50% at its December 16 meeting, and the first increase is expected by the end of 2022 (see Chart 1.2.13-e). The bank intends to keep the currency stable against a

Chart 1.2.13-e
Indonesia: inflation and interest rates (%)



Source: MAPFRE Economics (based on Markit data)

Chart 1.2.13-f
Indonesia: trade balance



Source: MAPFRE Economics (based on Bloomberg data)

backdrop of portfolio investment outflows and rate hikes in many emerging markets. However, the US Federal Reserve's tapering process will subject the currency to pressure throughout 2022.

In terms of risks for the Indonesian economy and the excellent performance of the trade balance, the current account balance also turned positive in the last quarter of 2021 (+0.2% of GDP), which reduces external financing risks. An increase in interest rates on global bonds would affect the financing of its public deficit, which has risen to more than 5% in the last two years amid the pandemic, due mainly to reduced revenue. However, the currency's behavior appears stable amid a positive trade balance that offsets the negative effects of investment flows.

1.2.14 Philippines

Recovery will be stronger in 2022 as activity normalizes.

The Philippines is seeing a rapid increase in COVID-19 cases, driven by the new Omicron variant and surpassing the levels recorded in the last wave during the third quarter of 2021.

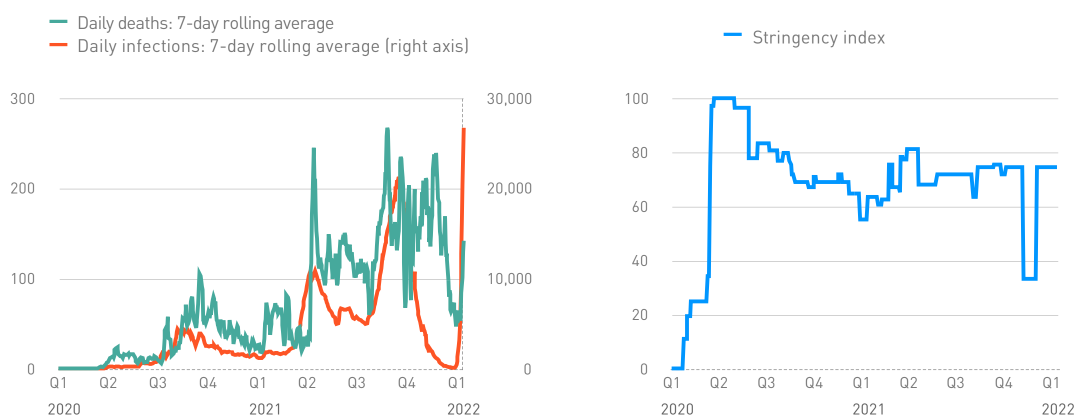
Philippines

- **Food and energy prices are easing a bit but remain under pressure.**
- **The central bank is holding interest rates stable to continue supporting recovery while tolerating some depreciation of its currency.**
- **The political debate is growing ahead of the presidential elections in May 2022.**
- **The Philippine economy is expected to grow by 6.5% in 2022 and 7.6% in 2023**

Unlike other countries, it has also recorded a rise in deaths, although the data seems to indicate a slower increase than observed in previous waves of the pandemic. This may be due to the country's limited vaccine coverage: only 50.5% of the population has been vaccinated with at least one dose, while just 1.6% has received a booster dose. This situation has caused activity restrictions to be reintroduced to a certain extent (see Charts 1.2.14-a and 1.2.14-b).

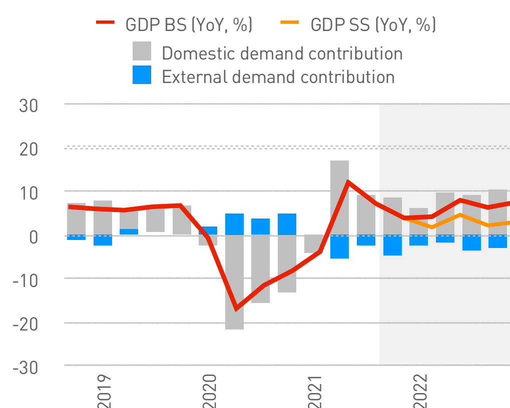
The Philippine economy showed higher-than-expected growth in the third quarter of 2021, expanding 7.1% YoY (not seasonally adjusted), a

Chart 1.2.14-a
Philippines: daily COVID-19 infections and deaths and stringency index



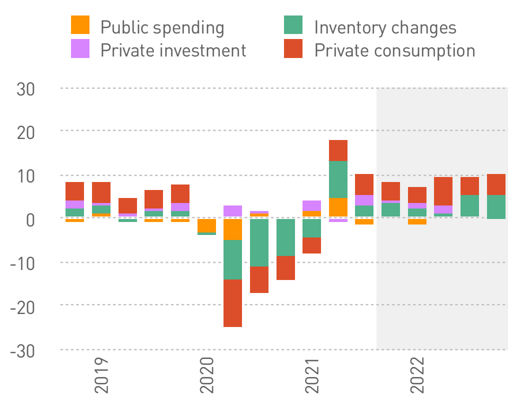
Source: MAPFRE Economics (based on data from the Coronavirus Government Response Tracker, University of Oxford, updated 1/17/2022)

Chart 1.2.14-c
Philippines: GDP breakdown and forecasts



Source: MAPFRE Economics (based on PSA data)

Chart 1.2.14-d
Philippines: domestic demand breakdown breakdown and forecasts



Source: MAPFRE Economics (based on PSA data)

Table 1.2.14
Philippines: main macroeconomic aggregates

						Baseline (BS)		Stressed (SS)	
	2017	2018	2019	2020	2021(e)	2022(f)	2023(f)	2022(f)	2023(f)
GDP (% YoY)	6.9	6.3	6.1	-9.6	4.6	6.5	7.6	2.8	6.6
Domestic demand contribution	7.9	8.8	6.3	-13.2	7.8	9.2	9.5	4.7	8.7
External demand contribution	-0.9	-2.4	-0.2	3.6	-3.2	-2.7	-1.9	-1.8	-2.1
Private consumption contribution	4.3	4.2	4.2	-5.8	2.7	5.1	5.1	1.3	5.0
Total investment contribution	2.7	3.5	1.0	-5.9	2.6	3.7	4.1	3.0	3.4
Public spending contribution	0.7	1.6	1.1	1.6	1.1	0.7	0.1	0.7	0.1
Private consumption (% YoY)	6.0	5.8	5.9	-7.9	3.8	7.0	7.0	1.8	6.9
Public spending (% YoY)	6.5	13.4	9.1	10.5	6.9	4.6	1.0	4.6	1.0
Total investment (% YoY)	10.6	12.9	3.9	-27.5	11.4	14.9	15.4	12.0	12.8
Exports (% YoY)	17.4	11.8	2.6	-16.3	6.8	9.3	18.0	5.8	16.7
Imports (% YoY)	15.1	14.6	2.3	-21.6	13.8	13.5	17.1	8.9	16.8
Unemployment rate (%, last quarter)	5.0	5.1	4.6	8.7	7.6	6.3	5.8	8.5	7.1
Inflation (% YoY, last quarter)	3.0	5.9	1.5	3.1	4.2	3.1	3.0	5.3	2.5
Fiscal balance (% of GDP)	-2.1	-3.1	-3.4	-7.6	-8.3	-7.4	-5.8	-8.5	-7.1
Primary fiscal balance (% of GDP)	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Trade balance (% of GDP)	-12.2	-14.7	-13.1	-9.3	-13.5	-14.5	-14.0	-15.1	-14.2
Current account balance (% of GDP)	-0.7	-2.6	-0.8	3.1	-1.5	-2.7	-2.7	-3.2	-2.8
Official interest rate (end of period)	3.00	4.75	4.00	2.00	2.00	2.00	2.50	4.12	2.33
3-month interest rate (end of period)	3.22	5.03	3.97	2.00	2.00	2.00	2.56	3.98	2.26
10-year interest rate (end of period)	5.70	7.05	4.44	2.97	4.72	5.21	5.40	6.67	6.10
Exchange rate vs. US dollar (end of period)	49.92	52.72	50.74	48.04	50.27	49.33	47.14	53.35	49.30
Exchange rate vs. euro (end of period)	59.87	60.37	57.01	58.94	56.93	58.21	56.73	60.69	58.18
Private lending (% YoY, average)	17.6	16.8	9.5	4.0	0.6	6.3	8.6	8.2	8.1
Household lending (% YoY, average)	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
P.S. non-financial lending (% YoY, average)	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
P.S. financial lending (% YoY, average)	9.4	10.3	6.9	-8.0	6.8	10.4	12.3	7.2	12.3
Savings rate (as % pers. disp. income, avg.)	7.1	6.4	5.0	5.6	3.7	5.6	7.0	7.7	7.9

Source: MAPFRE Economics (based on PSA data)
Forecast end date: January 17, 2022

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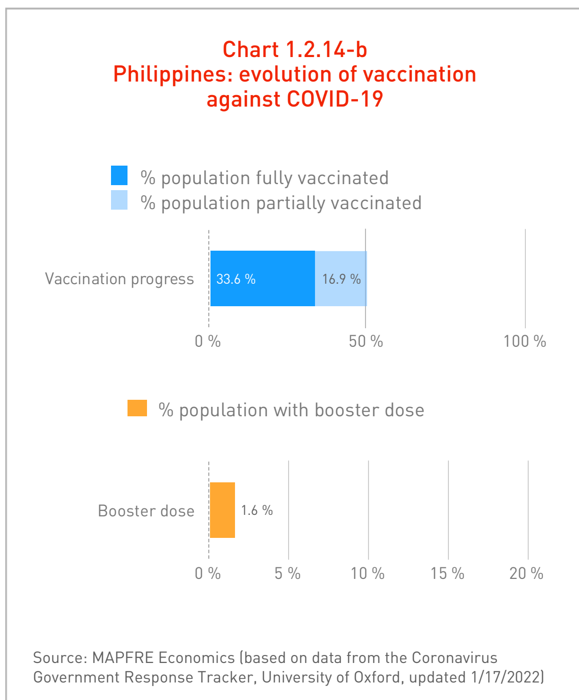


Chart 1.2.14-b
Philippines: evolution of vaccination against COVID-19

Source: MAPFRE Economics (based on data from the Coronavirus Government Response Tracker, University of Oxford, updated 1/17/2022)

result that was driven mainly by domestic demand. During this period, private consumption grew by 7.1% YoY and public consumption by 13.6% YoY. On the other hand, the recovery of investment has lost some steam. Imports are also slowing down, leading to weaker activity than in the previous quarter, possibly due to high ocean freight prices as well. The Purchasing Managers' Index (PMI) for manufacturing improved slightly in December, standing at 51.8 points from 51.7 points in November. Additionally, by sectors, the central bank surveys for the following quarter all visibly improved: industry, construction, and trade and services.

In this context, we have adjusted our growth forecast to 6.5% in 2022 and 7.6% in 2023 (see Table 1.2.14, and Charts 1.2.14-c and 1.2.14-d). Private consumption and exports are expected to remain strong next year, while investment and public consumption should be moderated. Given that unemployment has yet to return to pre-pandemic levels, consumer spending is surprisingly strong, which could still be due to the savings amassed during lockdown.

Inflation stood at 3.6% in December, down six-tenths compared to November, with increases in electricity and fuel (+13.3%) and transport (+8.8%), while food rose moderately (+3.9%), with meat being especially high (+11.3%). Core inflation stood at 3.0% (see Chart 1.2.14-e). The Central Bank of the Philippines (BSP) kept interest rates stable at its December meeting at 2.00% (Overnight Repo). The bank considers that new COVID-19 variants continue to present risks for the forecasts and inflation, and it believes that it has leeway to maintain support for the economy, although it will remain vigilant on risks for inflation.

Risks for the Philippine economy arise from internal and external factors that impact inflation, such as prices for energy, ocean freight, and the transport of goods.

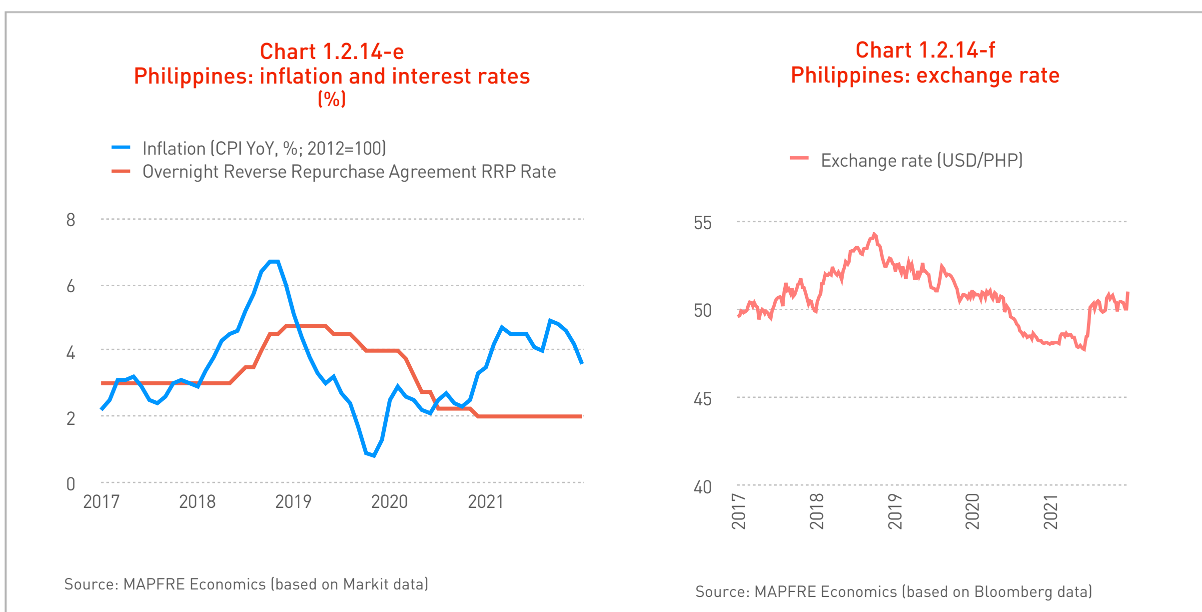


Chart 1.2.14-e
Philippines: inflation and interest rates (%)

Source: MAPFRE Economics (based on Markit data)

Chart 1.2.14-f
Philippines: exchange rate

Source: MAPFRE Economics (based on Bloomberg data)

Unemployment has also relatively increased, a sign that private consumption will weaken in the short term. The central bank's stance on monetary policy is to continue supporting recovery by holding interest rates steady, which will weigh on the currency, although the bank has shown tolerance for this last aspect (see Chart 1.12-f). Finally, the presidential elections in May 2022 could weigh on the volume of foreign direct investment.

2. Industry Outlook

2.1 The economic environment and its impact on insurance demand

2.1.1 Global markets

After a year of robust recovery in the insurance markets worldwide, 2022 will see a more complex environment, with slower growth in the global economy, estimated to reach around 4.8% (5.8% in 2021), which will be more disparate among different economies around the globe (especially in some of the emerging markets). The year will also be marked by the persistence of inflation beyond what was initially forecast and above the central banks' targets, motivating a shift towards less accommodative monetary policies. This environment of greater uncertainty, driven by new COVID-19 variants and economic growth that will accelerate in some economies (which have not yet fully recovered from the pandemic) while slowing down in others (which have already recovered), will be reflected in the insurance markets. These will also show disparate performance, while the insurance business is expected to decelerate slightly globally. Additionally, more persistent inflation than expected may impact the insurance industry's short-term profitability, especially if the situation continues over time and second-round effects are broad and persistent, increasing pressure on insurance prices. However, the negative impact of economic reopening on the loss ratio in 2021 for some lines of business (such as motors, life, or health) will move towards correction, so the outlook remains positive for the insurance business' profitability (despite the rise in inflation). This, together with the greater sensitivity to risk among economic agents, which continues to support insurance demand, paints a positive overall picture for the insurance business in 2022.

Economic recovery will continue to support the insurance industry in developed markets, but to a lesser extent as growth stalls in some markets. In contrast, the low interest rate environment will continue to weigh on the Life savings and traditional annuities business. This will be the case even as the central banks redirect their monetary policies and withdraw stimulus measures, which will happen gradually and with differing intensities depending on the situation in each economy. Elsewhere, the strong performance of the main stock indexes worldwide has driven the growth of Life insurance in which the policyholder assumes the investment risk. However, the fact that some indexes have reached historic highs introduces volatility and uncertainty as to whether they can be maintained over time and in terms of how the withdrawal of monetary stimulus may impact these markets. All of this could reduce the momentum of the Life investment business, which faces a more complex scenario in which the bond market will undoubtedly play a bigger role.

Meanwhile, the emerging markets show a mixed picture, with slower economic growth that will affect emerging Asia less than regions like Latin America, where some central banks already started withdrawing stimulus measures in 2021, and despite the tightening of monetary policy beyond pre-pandemic levels in response to soaring inflation (significantly above their monetary policy targets). In 2021, Latin America recovered a large part of the GDP lost in the previous year, driven by the rebound in the prices of oil, minerals, and general commodities, and by the strong economic performance of the United States and China (its two main business partners). However, it should receive less of a boost in 2022 against a backdrop of reduced fiscal and monetary stimulus, high debt ratios, and greater pressure on currencies due to the US Federal Reserve's anticipated monetary policy tightening. Expectations point to a marked deceleration for the region's economies, which could result in less growth for its insurance markets. However, the rate hikes underway have generated a

favorable interest rate environment for the growth of the Life savings and traditional annuities business, allowing a higher interest rate to be guaranteed in the new policies launched in the market and amid rising demand from households and companies for financial products to hedge against inflation and health and death-related risks.

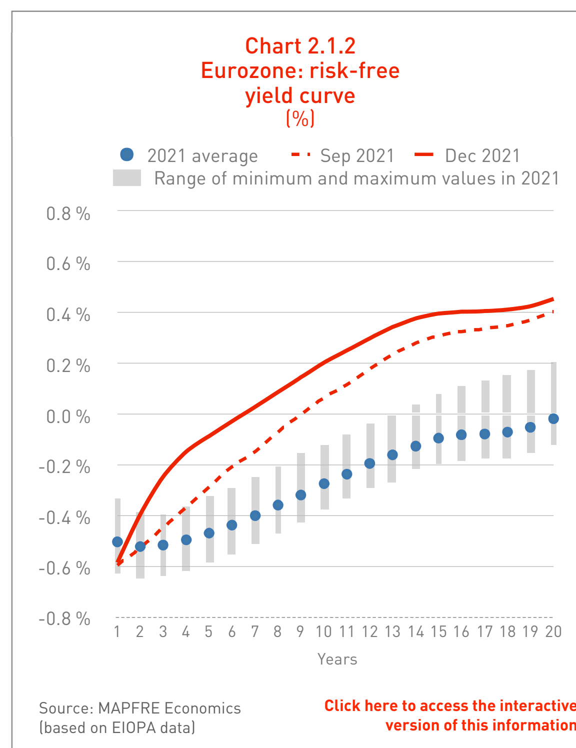
2.1.2 Eurozone

The Eurozone will surpass the pre-pandemic GDP levels in 2022, with anticipated growth of 3.9% compared to 5.1% in 2021 (-6.5% in 2020). While this represents a slight slowdown, it is still robust economic growth and favorable to the insurance industry. However, different economies in the monetary union will grow differently, and supply chain disruptions (although they have started to improve) will continue to affect the automotive sector in particular, due to the shortage of the chips needed for production. This will weigh on new vehicle registrations and negatively impact the auto insurance business, a situation that could be reversed as the year progresses. For this reason, the general expectations point to improvement, considering the economic growth forecast and a certain degree of pent-up demand.

Meanwhile, economic recovery and rising inflation are motivating a shift in the ultra-accommodative monetary policy of the European Central Bank (ECB), which has started to gradually reduce its net asset purchasing programs. However, this is against a backdrop of risk-free interest rates that will remain low and even negative in the short and medium sections of the curve, continuing to weigh down the Life savings and traditional annuities business.

In this regard, at its December meeting, the ECB decided to hold short-term interest rates at current levels (0% for main refinancing operations and -0.5% for the deposit facility). However, the risk-free yield curves produced by the European Insurance and Occupational Pensions Authority (EIOPA)[4], illustrated in Chart 2.1.2, show a new increase in all risk-free interest rates (except in short maturities), which are already clearly above the levels reached at the worst points of the crisis, with positive rates starting from maturities of more than six years (the rest remain negative, and for maturities of less than one year, they remain anchored below the highs seen in 2020). Therefore, despite a new rebound in risk-free interest rates, levels remain low, thereby favoring economic recovery and insurance activity (especially for its non-Life lines of business). This does, however, damage the traditional Life business and the profitability of insurance companies. Elsewhere, the Euro Stoxx 50 index (and, in general, the main stock markets worldwide) performed strongly in 2021, albeit with a slight increase in volatility due to the uncertainties surrounding coronavirus mutations. Despite this situation, it continues to perform well, favoring the growth of Life insurance products in which the policyholder assumes the risk of investment, especially in the negative real interest rate environment in which the Eurozone currently finds itself.

Chart 2.1.2
Eurozone: risk-free yield curve
(%)



Source: MAPFRE Economics (based on EIOPA data)

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2.1.3 Germany

In 2022, Germany's economic growth should accelerate to 3.9% compared to 2.5% in 2021 (-4.9% in 2020). However, this represents another downward revision of the growth estimate, motivated by persistent problems in the supply chains and the sharp rise in energy prices that should be corrected throughout the year. In any case, as private consumption will be the main driver of economic growth, followed by investment, the environment will be favorable for the insurance industry.

Germany's sovereign bond yield is rebounding significantly compared to the third quarter, with all maturities of more than ten years showing positive levels at the beginning of 2022. Despite the ECB's messages about the gradual withdrawal of the extraordinary monetary stimulus implemented amid the pandemic (due to the increase in inflation) and the upturn in Germany's sovereign bond yield, the environment remains complicated for the Life savings and traditional annuities business, given the low nominal interest rates (negative in the 10-year bond and shorter maturities), which entails a situation of negative real interest rates. The German DAX, in turn, continues to behave more laterally and is showing increased volatility, but at levels close to its all-time highs. This may complicate matters for Life insurance products in which the policyholder assumes the investment risk, especially for the marketing of such products to savers with a more conservative profile. Nevertheless, the environment remains positive for these products.

2.1.4 Italy

The forecast for the Italian economy in 2022 points to GDP growth of 4.4%, representing a slowdown compared to its 2021 growth of 6.3% (-9.0% in 2020). This growth remains robust and will allow the economy to surpass its pre-crisis level this year, driven by private consumption and investment (with the help of European recovery funds), and despite the burden of the foreign sector, a result of high energy prices and supply chain shortages that should be corrected throughout the year. In any case, the economic growth forecast for this year will continue to support business in the country's insurance market.

The ECB's progressive withdrawal of the extraordinary monetary stimulus to address the pandemic and, in particular, its reduction in the pace of net purchases of sovereign and corporate bonds is causing a rise in the risk premium and the term premium of Italy's sovereign debt, in line with inflation (3.9% in December). However, nominal interest rates remain depressed, below inflation, which entails a situation of negative real interests that complicates the sale of Life savings and traditional life annuity products. The FTSE MIB index started the year with a correction after reaching a 10-year high, which could slow the growth of Life insurance products in which the policyholder assumes investment risk. These products have been gaining importance in the Italian market in recent years against a sustained backdrop of low interest rates and, more recently, as an alternative to hedge against inflation.

2.1.5 Spain

The Spanish economy is expected to accelerate in 2022, driven by the growth of private consumption and investment (with the support of fiscal aid packages from the European Union), which will benefit the insurance market. We expect the economy to grow by 5.5% in 2022, compared to 4.9% in 2021 (-10.8% in 2020). For now, uncertainty remains high due to the Omicron variant, which is affecting key sectors for the Spanish economy, such as tourism. The supply shortage also continues to hamper production in certain sectors, such as the auto industry, weighing down exports and new vehicle registrations. However, the situation is expected to improve in the coming months and provide a boost for auto insurance, a business that has been impacted by these circumstances, with the potential for pent-up demand leading to growth in this line of business when the automotive sector normalizes (see Box 2.1.5).

The savings-linked Life insurance business will continue to be marked by the low interest rate environment, despite the rise in inflation and the shift in the ECB's monetary policy towards the gradual withdrawal of the extraordinary

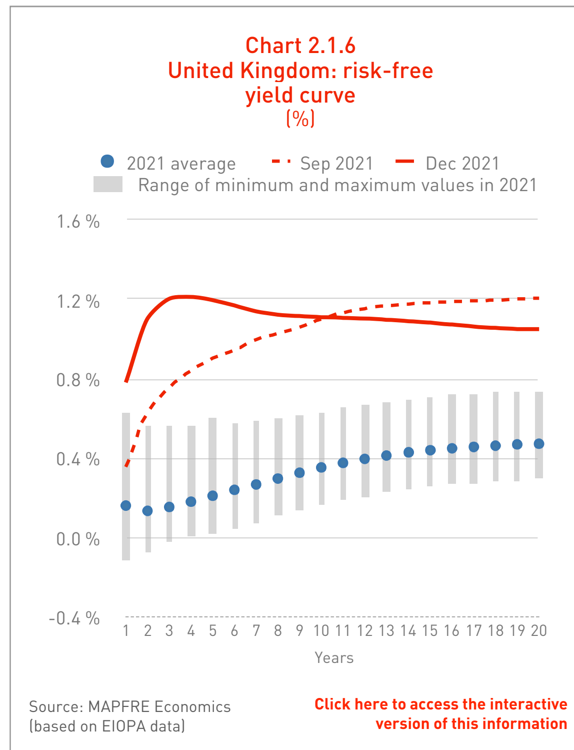
monetary stimulus measures it implemented to address the pandemic. For now, this will only affect asset purchasing programs, slowing the pace of net purchases of sovereign and corporate bonds, so premiums for Life savings and traditional life annuities are expected to remain well below the pre-crisis levels. Equity continues to be perceived as an alternative to hedge against the low interest rate environment and upturn in inflation in a context of negative real interest rates. This situation is boosting the performance of Life insurance products in which the policyholder takes the investment risk, which continue to gain ground in the Spanish market in terms of volume and number of insureds. Meanwhile, the Life risk business could benefit from households' and companies' increased sensitivity to the risk of death due to the pandemic.

2.1.6 United Kingdom

Expectations for the UK economy point to 4.4% GDP growth in 2022, down from 7.0% in 2021 (-9.4% in 2020), but still significant. This will allow the economy to exceed its pre-crisis level this year, driven by the strong performance of private consumption and investment, and despite the burden of the foreign sector, with high energy prices and supply chain shortages that should be corrected throughout the year. In any case, the economic growth forecast for this year will continue to support business in the country's insurance market.

With respect to Life savings and traditional annuities insurance, the EIOPA risk-free yield curves (see Chart 2.1.6) again show an upward movement of interest rates in the short and medium sections of the curve, which increases its positive slope in these segments. This is a result of the tightening of monetary policy by the Bank of England, one of the first central banks in a developed country to start raising interest rates; in December, it did so by 25 basis points (against expectations) due to the rise in inflation (5.1% in the month of November). However, uncertainties over the persistence of inflation and the future direction of monetary policy are generating distortions in the curve, whose longest sections showed a negative slope in December. This represents an improvement in the environment for the Life savings and the traditional annuities business on account of the

Chart 2.1.6
United Kingdom: risk-free yield curve
(%)



Source: MAPFRE Economics (based on EIOPA data)

upturn in interest rates and the increase in the term premium in the short and medium sections of the curve. Nevertheless, nominal interest rates remain low, standing below inflation, which continues to be a burden on this business. On the other hand, the FTSE 100 is approaching record highs and showing increased volatility, which may complicate the sale of Life insurance in which the policyholder assumes the investment risk, which is deeply rooted in this market. However, these products continue to be an alternative to hedge against the rise in inflation against a backdrop of negative real interest rates.

2.1.7 United States

The US economy is expected to continue growing robustly in 2022, albeit more moderately than in the previous year, expanding 4.0% compared to 5.6% in 2021 (-3.4% in 2020) amid the progressive tightening of the ultra-lax monetary policy that the Federal Reserve was applying in response to rising inflation. However, broad fiscal stimulus packages will continue to support economic growth, which is favoring the insurance business and should continue to do so in 2022 At the same time, the rise in inflation and upward pressure on salaries

Box 2.1.5
Spain: updated forecasts for premium growth

Update

The fourth quarter of 2021 saw a significant increase in the COVID-19 infection rate due to the emergence of the Omicron variant. However, its reduced lethality and the country's high vaccination rate (more than 80% of the adult population is fully vaccinated) limited hospital pressure, resulting in less severe social distancing measures than in earlier waves of the pandemic. Although economic uncertainty picked up slightly, it remained below the average recorded since March 2020, and while retail and services confidence (key to the Spanish economy) weakened, the recovery registered since mid-2020 (see Charts A and B) was maintained.

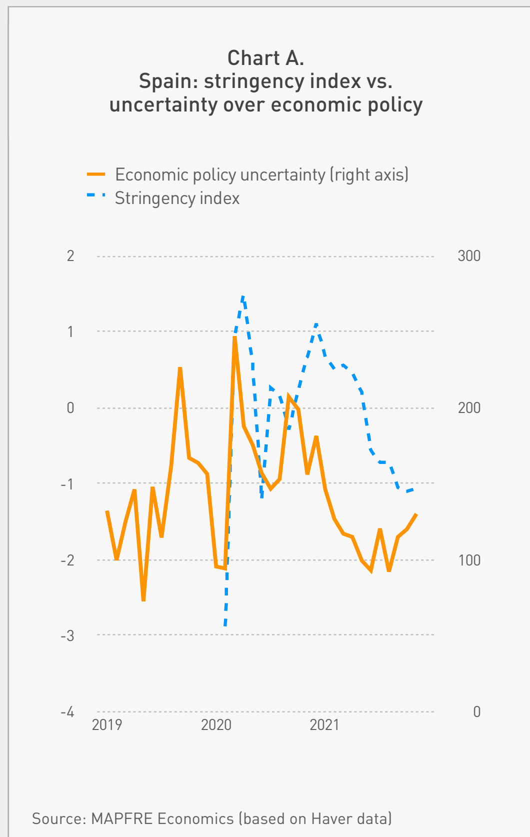
In this context, the Spanish insurance market grew 5%, measured in total premiums, with the Life segment contributing to this growth by slightly less than one-third (+7.9%), and the Non-Life segment by slightly more than two-thirds (+3.3% year-on-year).

Non-Life segment

The growth of the Non-Life segment was driven by the increase of the non-cyclical lines (Health and Private Multirisk), which contributed almost two-thirds of the recorded growth, as well as the cyclical lines, except for Motors (Commercial Multirisk and other lines), which together contributed slightly over one-third of the growth of Non-Life premiums (after subtracting nearly 60 basis points from growth a year earlier). The above is evidence of the cyclical recovery experienced by the Spanish economy, which we estimate will grow around 4.9% (in real terms) in 2021.

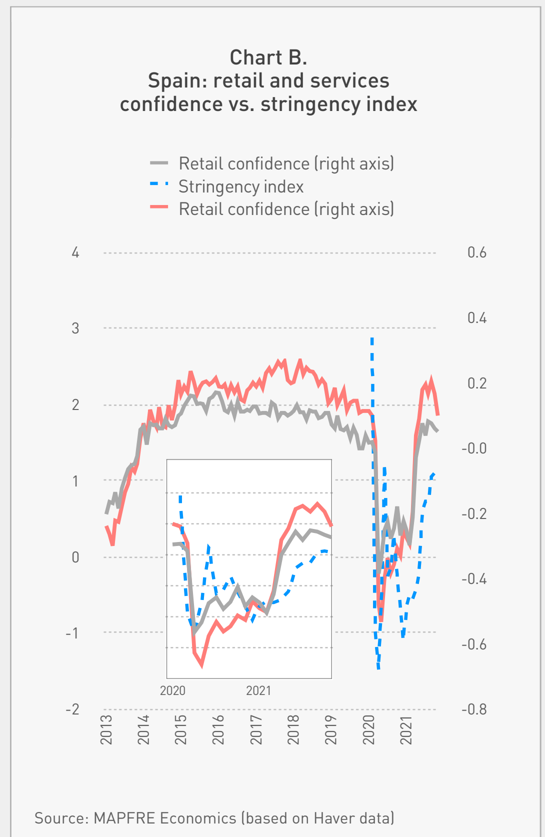
However, the Motors line of business remained sluggish, in response to what we identified as a structural issue in our report a year ago (2 million fewer registrations since 2019) and reflecting a lack of sensitivity to the rebound in consumption at this stage of the pandemic. In fact, the Motors line's contribution to premium growth went from

Chart A.
Spain: stringency index vs. uncertainty over economic policy



Source: MAPFRE Economics (based on Haver data)

Chart B.
Spain: retail and services confidence vs. stringency index



Source: MAPFRE Economics (based on Haver data)

Box 2.1.5 (continued)
Spain: updated forecasts for premium growth

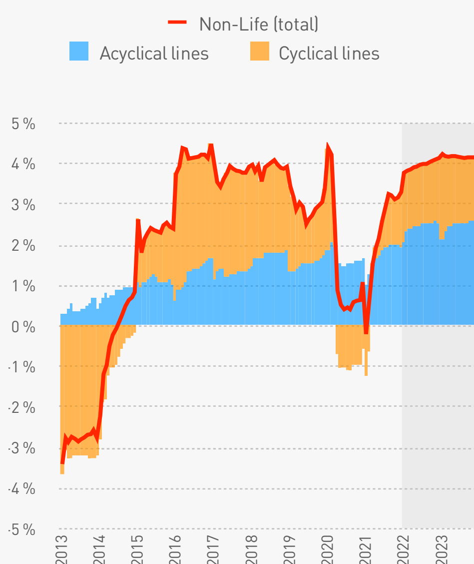
-0.6% in the fourth quarter of 2020 to -0.3% in the same period of 2021, a sign that the segment's problems persist.

Premium performance in the Non-Life insurance segment in 2021 was consistent with our forecast at the beginning of last year, when we anticipated 3.9% growth YoY (against the 3.3% actually achieved), driven precisely by the aforementioned cyclical and acyclical factors. In fact, due to the more marked development of our forecast for the Motors line of business, the figure was lower than estimated in our baseline scenario. In other words, our view of the then-emerging recovery and the factors driving it was accurate, and we identified the problems in some lines of business as well.

In our baseline scenario (*optimistic scenario*) for the year ahead, we see post-COVID normalization continuing without shock waves caused by variants or their management, with a vaccinated population that remains immune to uncertainties arising from the pandemic. However, in the alternative scenario (*pessimistic scenario*), this is not the case due to reasons we do not discuss. In short, we anticipate real growth of 5.5% in the Spanish economy in 2022 and less than half in the alternative scenario. This will impact demand for Non-Life insurance, strengthening demand for superior goods (insured by the Health and Private Multirisk lines), which will moderately accelerate its growth while limiting the further deterioration of the Motors line and accelerating demand for the rest of the cyclical lines We, therefore, expect Non-Life premiums to grow by around 4.0%, with the acyclical lines (Health and Private Multirisk) contributing two-thirds of this growth, and the cyclical lines (Commercial Multirisk and other lines) contributing one-third, while Motors will cease to weigh down growth. It should be noted that this 4.0% is very close to what we consider to be the long-term growth of nominal premiums in an environment of moderate inflation in the long term.

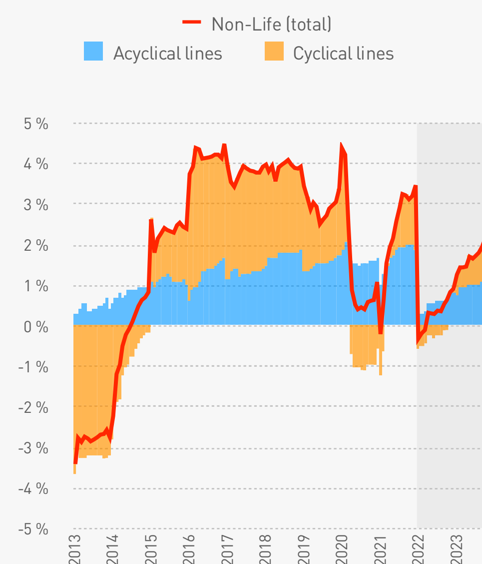
However, in a pessimistic scenario, confidence greatly deteriorates and has an impact through the real and financial channels of the economy. Many liquidity and activity problems become solvency problems and may have a structural impact. In this context, the contribution of

Chart C.
Optimistic scenario: contribution to growth of Non-Life lines
(%)



Source: MAPFRE Economics

Chart D.
Pessimistic scenario: contribution to growth of Non-Life lines
(%)



Source: MAPFRE Economics

Box 2.1.5 (continued)
Spain: updated forecasts for premium growth

Table A.
Non-Life (Optimistic scenario): premium growth forecasts, model of components vs model of fundamentals.
(year-on-year rate, %)

Period	Non-Life						
	Model of fundamentals[1]	Optimistic scenario					
		Total Non-Life	Motors	MRC*	Other	MRP**	Health
Q1	1.5 %	1.5 %	-1.8 %	4.3 %	1.2 %	3.7 %	3.9 %
Q2	3.4 %	3.4 %	-0.1 %	3.8 %	3.8 %	4.5 %	4.8 %
Q3	3.2 %	3.2 %	-0.9 %	7.7 %	4.5 %	5.4 %	5.0 %
2021 Q4	**3.3 %**	**3.3 %**	**-0.9 %**	**7.7 %**	**5.6 %**	**4.6 %**	**4.9 %**
Q1	4.2 %	3.7 %	-1.0 %	7.7 %	4.3 %	6.0 %	6.3 %
Q2	4.4 %	3.9 %	-0.7 %	7.7 %	4.4 %	5.9 %	6.3 %
Q3	4.3 %	3.9 %	-0.4 %	7.7 %	4.4 %	5.9 %	6.3 %
2022 Q4	**4.2 %**	**4.0 %**	**-0.1 %**	**7.7 %**	**4.5 %**	**5.8 %**	**6.3 %**
Q1	4.5 %	4.2 %	0.2 %	7.7 %	4.5 %	5.8 %	6.3 %
Q2	4.6 %	4.2 %	0.3 %	7.7 %	4.5 %	5.8 %	6.3 %
Q3	4.5 %	4.2 %	0.3 %	7.7 %	4.5 %	5.8 %	6.3 %
2023 Q4	**4.4 %**	**4.2 %**	**0.3 %**	**7.7 %**	**4.5 %**	**5.8 %**	**6.3 %**
Q1	4.4 %	4.2 %	0.3 %	7.7 %	4.5 %	5.8 %	6.3 %
Q2	4.4 %	4.2 %	0.3 %	7.7 %	4.5 %	5.8 %	6.3 %
Q3	4.4 %	4.2 %	0.3 %	7.7 %	4.5 %	5.8 %	6.3 %
2024 Q4	**4.4 %**	**4.2 %**	**0.3 %**	**7.7 %**	**4.5 %**	**5.8 %**	**6.3 %**

Source: MAPFRE Economics
1/ Average of scenarios according to the model of macroeconomic fundamentals

*Commercial Multirisk
**Private Multirisk

Table B.
Non-Life (pessimistic scenario): premium growth forecasts, model of components vs model of fundamentals.
(year-on-year rate, %)

Period	Non-Life						
	Model of fundamentals[1]	Optimistic scenario					
		Total Non-Life	Motors	MRC*	Other	MRP**	Health
Q1	1.5 %	1.5 %	-1.8 %	4.3 %	1.2 %	3.7 %	3.9 %
Q2	3.4 %	3.4 %	-0.1 %	3.8 %	3.8 %	4.5 %	4.8 %
Q3	3.2 %	3.2 %	-0.9 %	7.7 %	4.5 %	5.4 %	5.0 %
2021 Q4	**3.3 %**	**3.3 %**	**-0.9 %**	**7.7 %**	**5.6 %**	**4.6 %**	**4.9 %**
Q1	-0.2 %	-0.2 %	-1.6 %	-1.9 %	0.0 %	-0.1 %	1.5 %
Q2	0.2 %	0.2 %	-1.9 %	-1.6 %	1.1 %	0.4 %	2.0 %
Q3	0.4 %	0.4 %	-2.0 %	-1.6 %	1.9 %	0.4 %	2.2 %
2022 Q4	**0.8 %**	**0.8 %**	**-1.7 %**	**-0.4 %**	**2.0 %**	**1.1 %**	**2.5 %**
Q1	1.3 %	1.3 %	-1.4 %	0.7 %	2.7 %	1.6 %	2.9 %
Q2	1.6 %	1.6 %	-1.1 %	0.2 %	3.4 %	1.5 %	3.1 %
Q3	1.8 %	1.8 %	-0.8 %	1.4 %	3.7 %	1.6 %	3.2 %
2023 Q4	**2.1 %**	**2.1 %**	**-0.5 %**	**1.5 %**	**4.0 %**	**1.9 %**	**3.5 %**
Q1	2.1 %	2.1 %	-0.5 %	1.5 %	4.0 %	1.9 %	3.5 %
Q2	2.1 %	2.1 %	-0.5 %	1.5 %	4.0 %	1.9 %	3.5 %
Q3	2.1 %	2.1 %	-0.5 %	1.5 %	4.0 %	1.9 %	3.5 %
2024 Q4	**2.1 %**	**2.1 %**	**-0.5 %**	**1.5 %**	**4.0 %**	**1.9 %**	**3.5 %**

Source: MAPFRE Economics
1/ Average of scenarios according to the model of macroeconomic fundamentals

*Commercial Multirisk
**Private Multirisk

Box 2.1.5 (continued)
Spain: updated forecasts for premium growth

demand for acyclical lines (Health and Personal Multirisk) slows down, contributing half as much as in the baseline scenario, while the more cyclical lines (Commercial Multirisk, Motors, and other lines) contract sharply, reducing final demand. In this scenario, Non-Life demand grows below a nominal 1%, which implies a real contraction in demand, something that was ruled out in the optimistic scenario (see Charts C and D and Tables A and B).

Lastly, in long-term recovery, Non-Life demand would oscillate around 4.1%, a figure that emerges from both the fundamental approach and the component analysis (see the aforementioned Table A). In the alternative scenario, long-term growth is close to 2%, which implies a structural deterioration of the industry (see the aforementioned Table B). However, we consider this scenario to be highly unlikely.

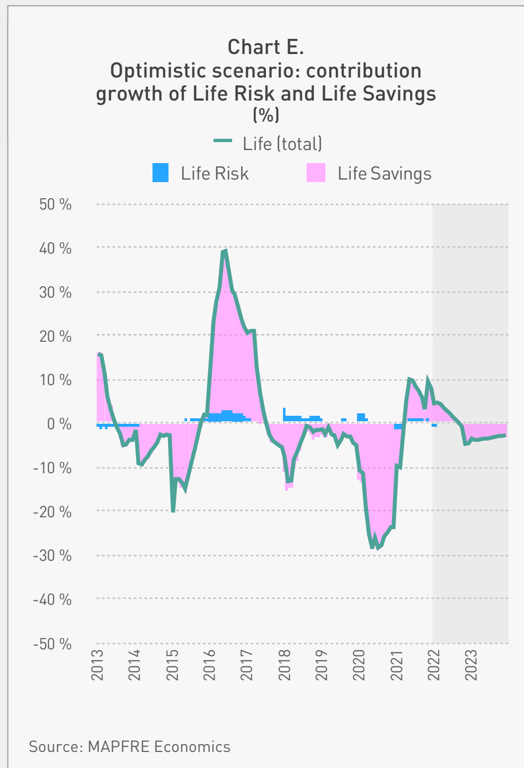
Life segment

Regarding the Life insurance segment, premiums increased by almost 8% in 2021, a surprising result due to the strong performance of the Life risk line (+3.5%), driven by the growth of the real estate market, which registered its best results since 2008, but fundamentally due to the significant 9.1% increase in the Life savings line. The contribution of the Life savings line allowed this segment of the Spanish insurance industry to record its highest growth in four years.

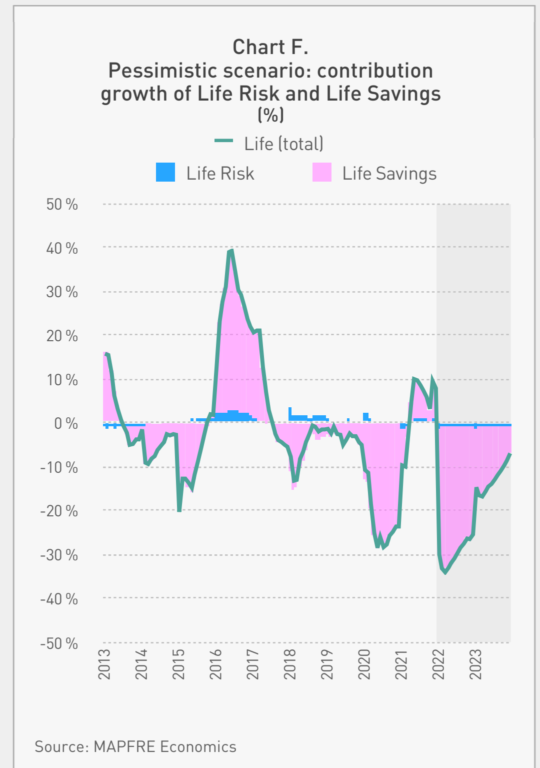
Our model of fundamentals anticipated very different performance from what was ultimately observed. The expectation was for Life savings to contract by nearly 7%, considering savings dynamics and interest rates, and by 25% to 45% based on how activity, uncertainty, and liquidity could affect the growth of this line of business. In this growth, a structural trend that was already weighing down the industry was accelerating cyclically (due to the COVID-19 pandemic) due to a low interest rate environment that we expected would last. However, we did not consider the non-linear nature of demand for savings products when uncertainty dissipates, and the need for liquidity through policy redemptions slows down, against a backdrop of reduced post-COVID-19 uncertainty, in which the aid mechanisms implemented (temporary workforce reduction plans, credit guarantees, etc.) also played a role. Overall, this situation would explain the growth in Life savings premiums, despite the general context that was expected to be unfavorable.

We consider that the fundamental context remains the same, the yield curve will remain low, and insurance production and demand will find few incentives going forward, at least until 2023/2024 (when monetary normalization is expected). For this reason, despite the temporary rebound in 2021, we expect demand in the Life segment to contract in 2022, when last year's good news and aid have been fully incorporated into agents' expectations. We, therefore, expect Life savings premiums to contract by around 4.6% in 2022, causing the Life business, in general, to do so by a similar amount. In a pessimistic scenario where the economy stagnates, confidence breaks down, and financial conditions and liquidity are stressed, the bailouts would return, and consumption would weaken. In that case, very severe but not unbearable contractions could be expected, further shrinking this segment of insurance demand (see Charts E and F and Table C).

Box 2.1.5 (continued)
Spain: updated forecasts for premium growth



Source: MAPFRE Economics



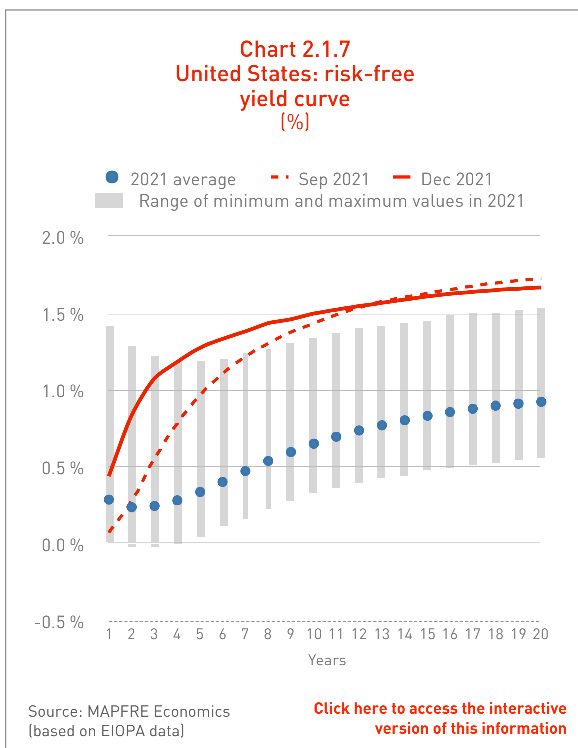
Source: MAPFRE Economics

Table C.
Life (optimistic and pessimistic scenario): premium growth forecasts, model of components vs model of fundamentals.
(year-on-year rate, %)

Period	Life						
	Model of fundamentals[1]	Optimistic scenario			Pessimistic scenario		
		Total Life	Savings	Risk	Total Life	Savings	Risk
Q1	-3.2 %	-3.2 %	-3.7 %	-1.9 %	-3.2 %	-3.7 %	-1.9 %
Q2	9.2 %	9.2 %	10.6 %	5.2 %	9.2 %	10.6 %	5.2 %
Q3	5.7 %	5.7 %	6.0 %	5.1 %	5.7 %	6.0 %	5.1 %
2021 Q4	7.9 %	7.9 %	9.1 %	3.5 %	7.9 %	9.1 %	3.5 %
Q1	8.1 %	2.1 %	2.2 %	-1.2 %	-43.7 %	-45.0 %	-3.2 %
Q2	8.7 %	0.1 %	0.1 %	-0.9 %	-38.8 %	-39.9 %	-3.0 %
Q3	7.9 %	-2.1 %	-2.2 %	-0.7 %	-34.3 %	-35.3 %	-2.8 %
2022 Q4	7.9 %	-4.5 %	-4.6 %	-0.4 %	-31.1 %	-32.0 %	-2.6 %
Q1	8.5 %	-3.8 %	-3.9 %	-0.2 %	-25.4 %	-26.2 %	-2.0 %
Q2	8.2 %	-3.4 %	-3.5 %	0.0 %	-19.6 %	-20.1 %	-2.0 %
Q3	7.7 %	-3.1 %	-3.2 %	0.0 %	-14.8 %	-15.2 %	-2.0 %
2023 Q4	7.4 %	-2.8 %	-2.9 %	0.0 %	-8.9 %	-9.1 %	-2.0 %
Q1	7.4 %	-2.8 %	-2.9 %	0.0 %	-8.9 %	-9.1 %	-2.0 %
Q2	7.4 %	-2.8 %	-2.9 %	0.0 %	-8.9 %	-9.1 %	-2.0 %
Q3	7.4 %	-2.8 %	-2.9 %	0.0 %	-8.9 %	-9.1 %	-2.0 %
2024 Q4	7.4 %	-2.8 %	-2.9 %	0.0 %	-8.9 %	-9.1 %	-2.0 %

Source: MAPFRE Economics
1/ Average of scenarios according to the model of macroeconomic fundamentals

Chart 2.1.7
United States: risk-free yield curve
(%)



Source: MAPFRE Economics (based on EIOPA data)

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may negatively influence the industry's profitability due to the increase in costs that this entails. This situation could start to be corrected as the shift towards a less accommodative monetary policy materializes, and interest rates begin to rise.

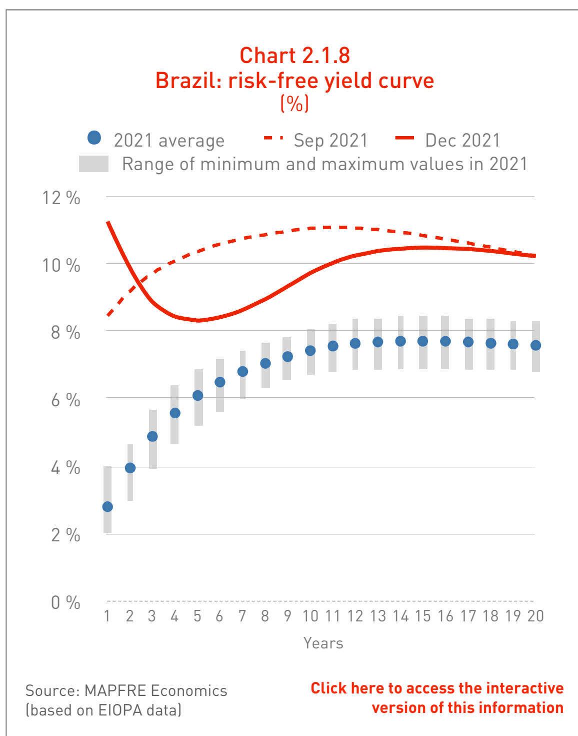
The Life business will also benefit from the anticipated economic growth in 2022 and from the increased sensitivity to the risk generated by the pandemic. However, it could be negatively impacted by the Federal Reserve's adoption of a less accommodative monetary policy, which would generate expectations of interest-rate hikes that could delay consumers' decisions to purchase Life savings and traditional annuities products until they materialize. Elsewhere, the equity markets have also been impacted with increased volatility and rotations in portfolio composition in the new interest rate scenario, which may complicate the sale of Life insurance products in which the policyholder assumes investment risk, very common in this market.

This shift in monetary policy is reflected in the recent EIOPA yield curves for the month of December (see Chart 2.1.7), with another increase in all sections of the curve, although earlier maturities remain markedly below the highs seen the previous year. A slight upturn in interest rates can also be observed in the medium sections of the curve (not in the long sections), which are clearly above the highs of the previous year, recovering steepness. Despite being able to offer a positive term premium, the interest rate environment remains unfavorable for the sale of savings products on account of the low interest rates and the expectation that there may be new increases affecting all sections of the curve. Meanwhile, the stock markets have performed exceptionally well in the past three years, although they may be starting to show signs of exhaustion after hitting historic highs and due to the impact that an interest rate hike would have (both in the risk-free component and the risk premium component on account of the reduction in asset purchase programs) on the value of bond portfolios. These showed weaker performance in 2021 but are expected to improve in 2022, as they will be able to offer higher returns.[5]. These factors somewhat compromise the outlook for the Life insurance business in which the policyholder assumes the investment risk, and companies will have to adapt their products to a new interest rate environment in fixed income and greater volatility and lower profitability in equities, depending on the risk profile of the policyholders.

2.1.8 Brazil

The Brazilian economy is expected to lose momentum in 2022, with estimated real GDP growth of 0.5% compared to its strong performance in 2021, when real GDP grew 4.6%, exceeding its pre-pandemic level (-4.2% in 2020). Economic reactivation and the increase in energy prices have caused a sharp rise in inflation, forcing the country's central bank to tighten its monetary policy and reverse the expansionary measures it adopted to combat the economic impact of the pandemic. The deceleration of the economy in 2022 could hamper the growth of Non-Life insurance, which experienced a marked rebound in 2021 (see Box 2.1.8).

Meanwhile, the Bank of Brazil continues to make decisive progress on tightening its monetary policy, raising interest rates again in December to 9.25% (its fifth rate hike in 2021

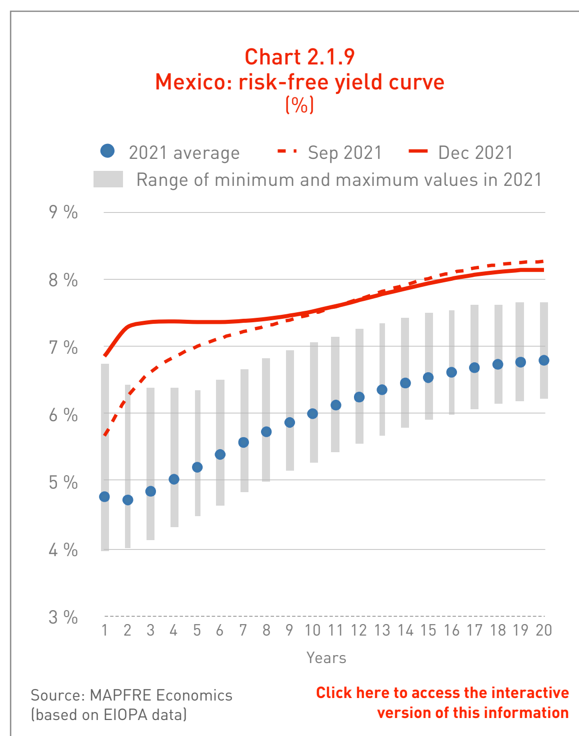


from 2%). It may apply a further increase in the first few months of 2022 before allowing them to stabilize. In the EIOPA risk-free yield curve (see Chart 2.1.8), we observe a sharp inversion of the risk-free yield curve and the central bank's marked intervention to fight inflation (which reached 10.06% in December, well above its target of 5%), with a curve with short-term rates significantly above the 2020 levels. This higher interest rate environment strongly favors the Life savings insurance business (focused on short-term interest rates), which could continue to see significant growth in business volume as an instrument used by households to protect their savings against the increase in inflation. This, together with the greater sensitivity to risk arising from the pandemic, could drive the growth of Life insurance products that offer protection against the risk of death.

2.1.9 Mexico

In 2022, the Mexican economy will grow by an estimated 2.6% compared to 5.2% the previous year, so it will not fully recover from its steep decline in 2020 (-8.4%). Albeit at a slower pace, the economy continues to show growth driven by the high price of oil and the recovery of the US economy. Therefore, the outlook for the insurance business is favorable and could further the recovery of lines of business that have yet to reach their pre-crisis premium levels. The higher loss ratio in life, health, and auto insurance due to the pandemic and the reopening process, which has impacted insurance companies' profitability, will also move towards correction in 2022. However, the rise in inflation, which increases the cost of claims, will continue to have a negative impact on their profitability.

Inflation remains high (7.36% in December), leading the Bank of Mexico to raise the official interest rate to 5.5% in December (from 4.75% in September), which was its fifth rate hike of 2021. In the EIOPA curves (Chart 2.1.9), a rise in risk-free market interest rates has been observed in the short and medium sections of a curve that has flattened in its medium section, with a positive term premium in the short section. This interest rate environment continues to be favorable for the Life savings and annuities insurance business, which is showing strong recovery, as it can offer higher interest rates and a term premium that remains positive in medium and long-term products. Another factor is the greater sensitivity to the risk generated by the pandemic, which may favor the growth of Life risk insurance, which offers protection against the risk of death, and



Box 2.1.8
Brazil: updated forecasts for premium growth

Update

The update provided here on premium growth forecasts in the Brazilian insurance market for the 2022-2024 is based on our model of cyclical and acyclical lines of business, applying high-frequency data collected from monthly indicators and their reaction to the levels of social restriction reflected in the stringency index. The graphics outlining the central scenario (optimistic scenario) and the stressed one (pessimistic scenario) appear in Charts A and B.

As illustrated by the aforementioned charts, the stringency index in Brazil continued to fall during much of the fourth quarter and until mid-December 2021, when the latest COVID-19 wave appeared with the Omicron variant. Although stringency stopped decreasing, restrictions stood at tolerable levels at the end of the month, and in any case, they were barely reflected in quarterly activity due to their late arrival. Up to December, a rebound is observed in capacity utilization, service revenue, and the REER; similarly, expectations in general improved for the third consecutive time, while inflation expectations picked up. Elsewhere, car production stagnated, lending slowed down, and uncertainty over economic policy deteriorated.

Market performance

In this context, Non-Life insurance premiums in Brazil grew by around 14% YoY (until November), outperforming the predictions of our models of both fundamentals (10%) and cyclical and acyclical components (5.7%) under the optimistic scenario. Our forecasts for the last quarter of 2021 were overshot due to the improved contribution of Motors premiums to the total, which our models did not predict, and which at year-end contributed almost one-third of Non-Life premium growth in the market. Given the cyclical situation, we did not foresee this effect, and although we correctly forecast the contribution of the rest of the lines (non-cyclical), the total result was higher growth for the Non-Life insurance segment than anticipated a year earlier.

In the Life segment, the Life VGBL line, which we include as part of the Brazilian life savings business, made a fundamental contribution to growth. It rose 16% in November 2021, contributing 90% of premium growth during the quarter. This growth was driven by the upswing in the yield curve ahead of the monetary cycle change that began in the third quarter of 2021, stronger demand, and households' reduced need for liquidity, which decreased the total redemption of Life policies during the third quarter of 2021 compared to the previous year.

Premium growth forecasts

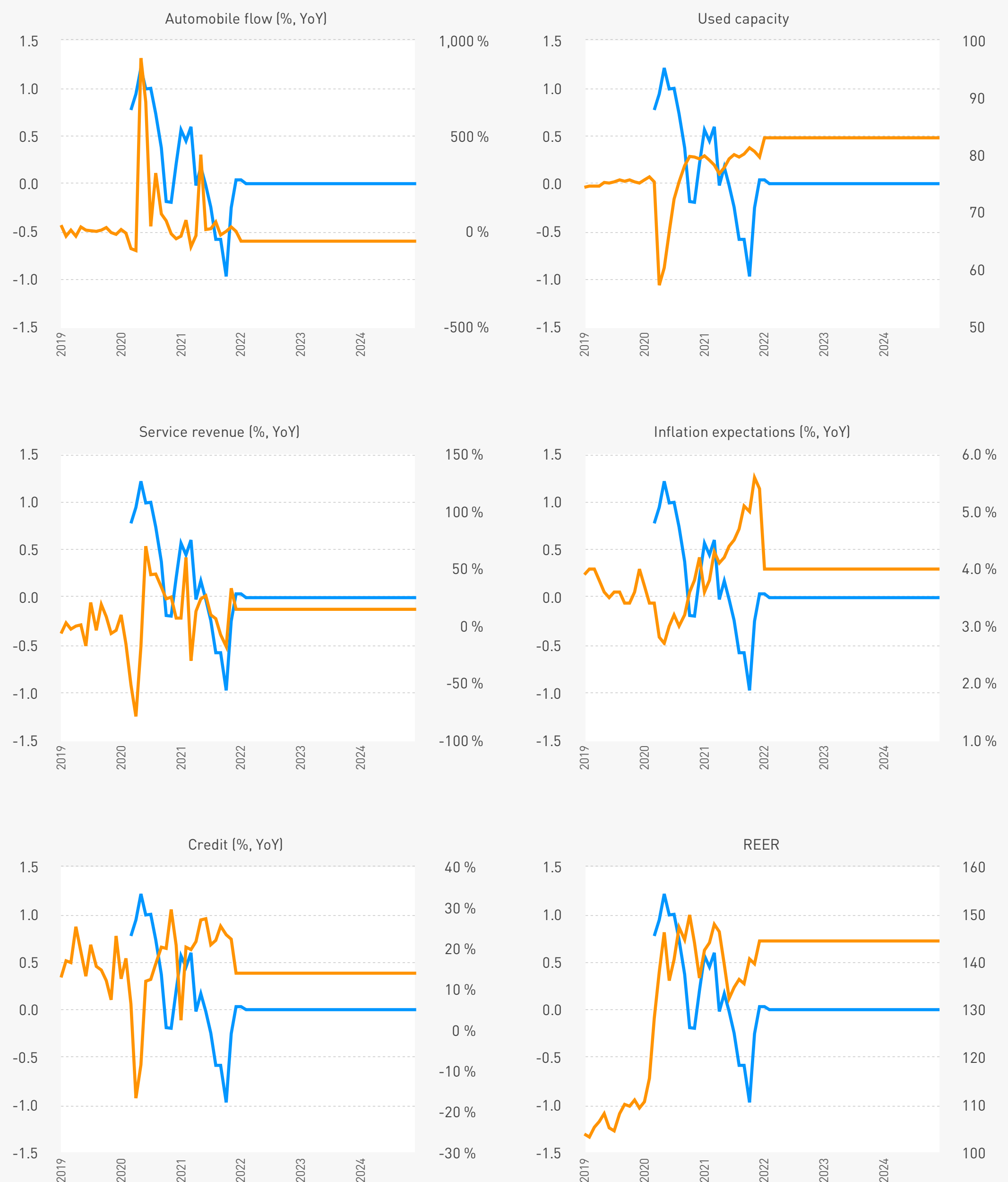
Regarding the premium growth forecasts for the Brazilian insurance market, the baseline scenario (*optimistic scenario*) assumes that the restrictions and the explanatory variables will stay where they are permanently. Meanwhile, the alternative or risk scenario (*pessimistic scenario*) contemplates a deterioration of all these variables due to a rise in the stringency index.

In the baseline scenario, despite the neutrality in stringency, and with confidence and activity unchanged, we believe that premium growth in the Non-Life insurance segment will slow down throughout our forecast period, increasing around 5.8% by the end of 2022. Non-cyclical demand (Health, Personal Risks, etc.) will contribute decisively to this growth, which could be around 9.4%, while demand that is more sensitive to business cycles (Motors) will noticeably slow down during the year, closing with growth of just 0.7%. In the alternative scenario (pessimistic scenario), the growth of demand for superior goods (acyclical) slows down, and that of Motors collapses, resulting in less than half the growth we predicted in the baseline scenario. As Brazil's inflation is expected to be slightly above 5% in 2021 in the baseline scenario, our real premium growth scenarios are zero in the optimistic scenario (given that the economy will expand by around 0.5 %) and negative in the pessimistic scenario, matching the growth of Brazilian GDP when analyzed from that perspective (see Charts C and D and Table A).

Box 2.1.8 (continued)
Brazil: updated forecasts for premium growth

Chart A.
Brazil: evolution of explanatory variables (optimistic scenario)
(YoY, %)

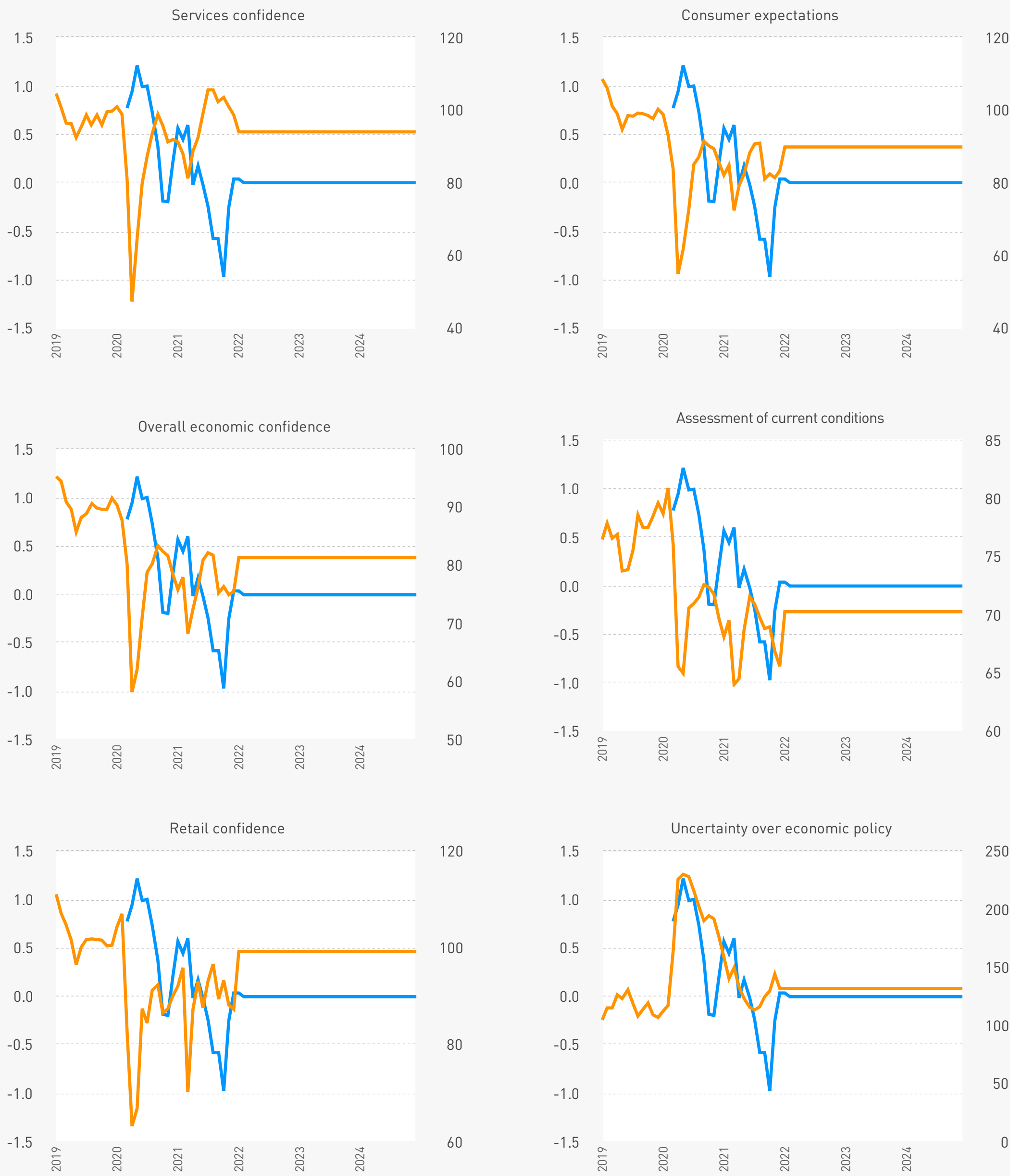
Analyzed variable (right axis) — Stringency index



Box 2.1.8 (continued)
Brazil: updated forecasts for premium growth

Chart A (continued).
Brazil: evolution of explanatory variables (optimistic scenario)
(YoY, %)

Analyzed variable (right axis) — Stringency index



Source: MAPFRE Economics

Box 2.1.8 (continued)
Brazil: updated forecasts for premium growth

Chart B.
Brazil: evolution of explanatory variables (pessimistic scenario) (YoY, %)

Analyzed variable (right axis) — Stringency index

Box 2.1.8 (continued)
Brazil: updated forecasts for premium growth

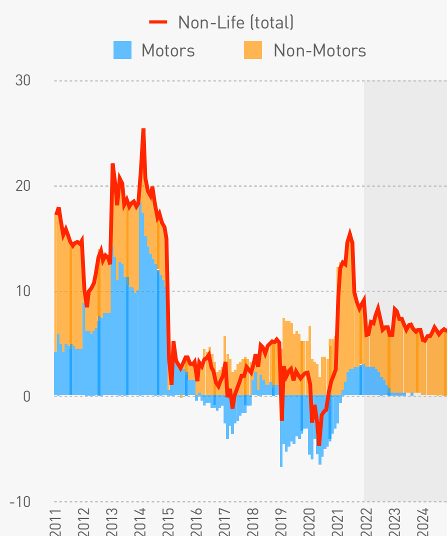
Chart B (continued)
Brazil: evolution of explanatory variables (pessimistic scenario)
(YoY, %)

Analyzed variable (right axis) — Stringency index

Source: MAPFRE Economics

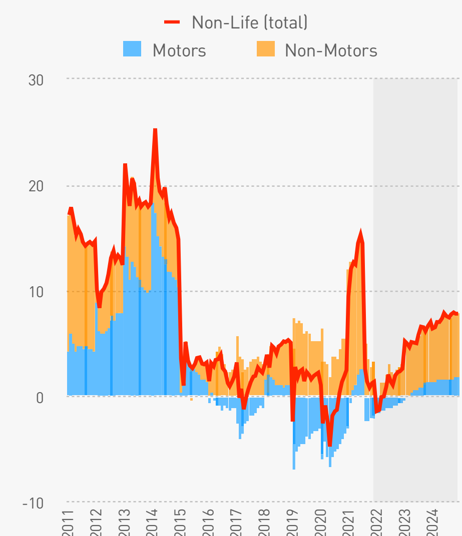
Box 2.1.8 (continued)
Brazil: updated forecasts for premium growth

Chart C
Brazil: contribution to growth of the Non-Life business (optimistic scenario) (%)



Source: MAPFRE Economics

Chart D
Brazil: contribution to growth of the Non-Life business (pessimistic scenario) (%)



Source: MAPFRE Economics

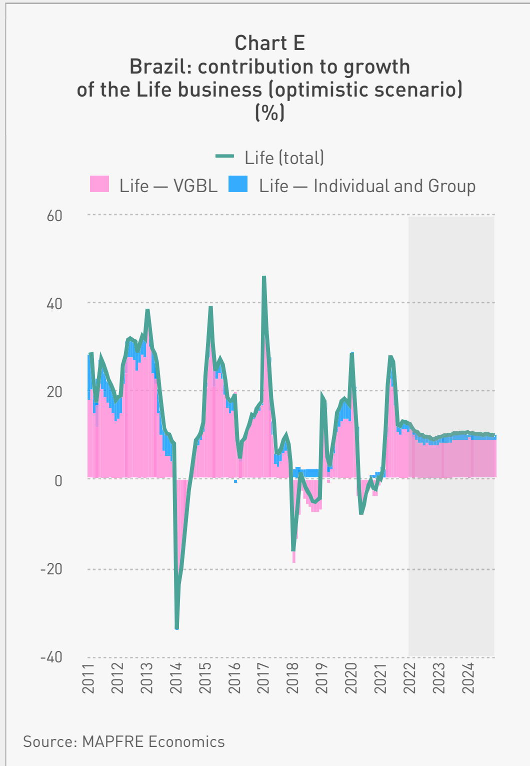
Table A.
Non-Life: premium growth forecasts, model of components vs model of fundamentals.
(year-on-year rate, %)

Period	Non-Life						
	Model of fundamentals[1]	Optimistic scenario			Pessimistic scenario		
		Total Non-Life	Motors	Non-Motors	Total Non-Life	Motors	Non-Motors
Q1	13.1 %	13.1 %	2.2 %	21.4 %	13.1 %	2.2 %	21.4 %
Q2	15.4 %	15.4 %	6.3 %	21.9 %	15.4 %	6.3 %	21.9 %
Q3	15.0 %	15.0 %	6.6 %	21.1 %	15.0 %	6.6 %	21.1 %
2021 Q4*	**14.2 %**	**14.2 %**	**7.4 %**	**19.2 %**	**14.2 %**	**7.4 %**	**19.2 %**
Q1	9.7 %	7.0 %	7.1 %	7.0 %	0.0 %	-3.5 %	2.2 %
Q2	9.9 %	8.3 %	5.7 %	9.9 %	2.1 %	-2.7 %	5.1 %
Q3	10.0 %	6.5 %	2.7 %	9.2 %	2.0 %	-1.8 %	4.4 %
2022 Q4	**9.9 %**	**5.8 %**	**0.7 %**	**9.4 %**	**2.6 %**	**-1.1 %**	**5.1 %**
Q1	9.7 %	7.3 %	0.7 %	11.6 %	4.7 %	0.5 %	7.2 %
Q2	9.6 %	6.3 %	0.6 %	9.7 %	5.0 %	2.1 %	6.8 %
Q3	9.4 %	6.4 %	0.6 %	10.2 %	6.5 %	2.9 %	8.8 %
2023 Q4	**9.3 %**	**6.3 %**	**0.6 %**	**10.0 %**	**7.1 %**	**3.9 %**	**9.1 %**
Q1	9.3 %	5.7 %	0.5 %	8.7 %	7.1 %	4.2 %	8.7 %
Q2	9.3 %	6.5 %	0.5 %	9.8 %	7.9 %	4.5 %	9.8 %
Q3	9.2 %	6.2 %	0.5 %	9.6 %	7.8 %	4.7 %	9.5 %
2024 Q4	**9.2 %**	**6.2 %**	**0.5 %**	**9.6 %**	**7.8 %**	**4.8 %**	**9.6 %**

Source: MAPFRE Economics
1/ Average of scenarios according to the model of macroeconomic fundamentals
* November figures

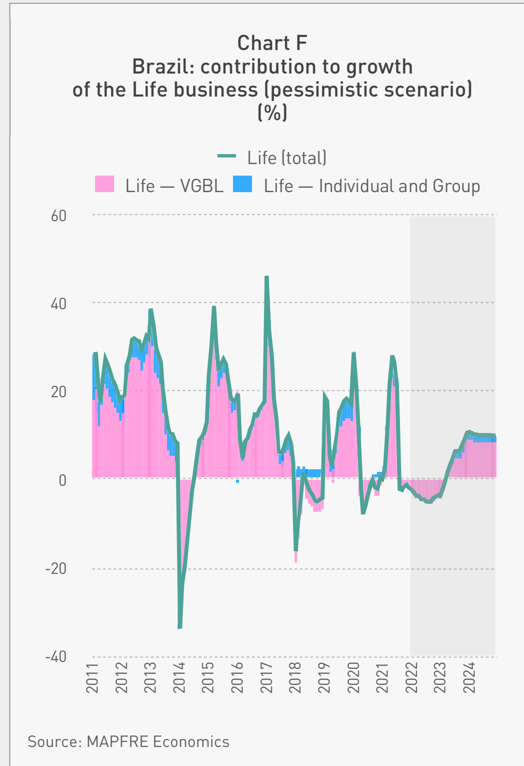
Box 2.1.8 (continued)
Brazil: updated forecasts for premium growth

Chart E
Brazil: contribution to growth of the Life business (optimistic scenario) (%)



Source: MAPFRE Economics

Chart F
Brazil: contribution to growth of the Life business (pessimistic scenario) (%)



Source: MAPFRE Economics

Table B.
Life: premium growth forecasts, model of components vs model of fundamentals.
(year-on-year rate, %)

Period	Life						
	Model of fundamentals[1]	Optimistic scenario			Pessimistic scenario		
		Total Life	VGBL	Ind. and Col.	Total Life	VGBL	Ind. and Col.
Q1	12.1 %	12.1 %	13.0 %	9.6 %	12.1 %	13.0 %	9.6 %
Q2	26.6 %	26.6 %	29.7 %	18.3 %	26.6 %	29.7 %	18.3 %
Q3	15.0 %	15.0 %	15.3 %	14.4 %	15.0 %	15.3 %	14.4 %
2021 Q4*	**15.2 %**	**15.2 %**	**16.0 %**	**13.0 %**	**15.2 %**	**16.0 %**	**13.0 %**
Q1	14.6 %	12.4 %	12.6 %	5.8 %	-5.2 %	-5.4 %	0.9 %
Q2	14.3 %	11.5 %	11.7 %	5.8 %	-6.2 %	-6.4 %	0.9 %
Q3	14.6 %	10.6 %	10.8 %	5.8 %	-7.0 %	-7.2 %	0.9 %
2022 Q4	**15.3 %**	**10.3 %**	**10.5 %**	**5.8 %**	**-5.3 %**	**-5.5 %**	**1.4 %**
Q1	15.6 %	11.2 %	11.3 %	5.8 %	-1.1 %	-1.2 %	2.4 %
Q2	15.5 %	11.5 %	11.6 %	5.8 %	4.9 %	4.9 %	3.9 %
Q3	15.5 %	11.7 %	11.9 %	5.8 %	6.9 %	7.0 %	4.4 %
2023 Q4	**15.2 %**	**11.8 %**	**12.0 %**	**5.8 %**	**12.2 %**	**12.4 %**	**5.8 %**
Q1	14.9 %	11.6 %	11.7 %	5.8 %	11.6 %	11.7 %	5.8 %
Q2	14.8 %	11.5 %	11.6 %	5.8 %	11.5 %	11.6 %	5.8 %
Q3	14.6 %	11.4 %	11.5 %	5.8 %	11.4 %	11.5 %	5.8 %
2024 Q4	**14.6 %**	**11.3 %**	**11.5 %**	**5.8 %**	**11.3 %**	**11.5 %**	**5.8 %**

Source: MAPFRE Economics
1/ Average of scenarios according to the model of macroeconomic fundamentals
* November figures

Box 2.1.8 (continued)
Brazil: updated forecasts for premium growth

Meanwhile, in light of forecasts for savings and short- and long-term interest rates, and in the absence of uncertainty shocks, Life premiums are expected to grow strongly. In this regard, we expect growth of almost 10.5% YoY in the Life VBGL segment in the optimistic scenario.

In the pessimistic scenario, lethargy and uncertainty would strongly influence activity and private savings, causing premiums in the Life segment to contract by more than 5% (see Charts E and F and Table B).

health insurance, which has experienced strong growth in Mexico throughout the crisis.

2.1.10 Argentina

Expectations for the Argentine economy point to continued growth in 2022, although the improvement will be far more moderate than in the previous year. Economic growth should reach 2.9% in 2022, compared to 9.3% in 2021 (-9.9 % in 2020). This growth, which will take the Argentine economy above its pre-crisis level, will continue to be driven mainly by private consumption, followed to a lesser extent by the foreign sector (investment is no longer driving its recovery and should subtract around 2.3 percentage points from GDP growth). Inflation appears to be stabilizing, but at high levels (51.2% in November 2021), while the currency keeps depreciating, a situation that continues to negatively affect insurance companies' profitability. In any case, the environment remains favorable for the Non-Life segments of the insurance business, closely linked to economic performance.

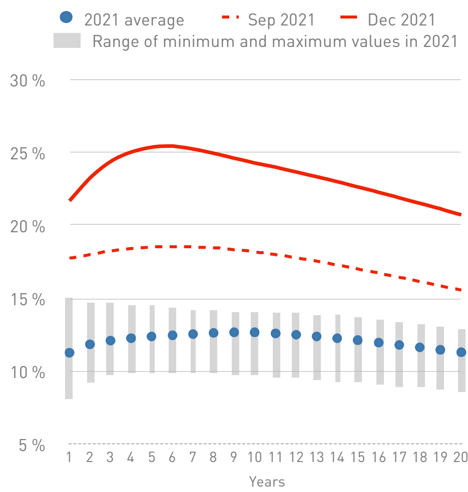
The central bank's benchmark interest rate was revised slightly upward in January by two percentage points, to 40%, compromising the sale of Life savings insurance products against a backdrop of negative real interest rates. This means that the traditional financial assets in which insurance companies tend to invest in supporting their Life insurance are unable to offset the loss of purchasing power as a result of high inflation. However, the expected economic growth and greater sensitivity to the risk of death due to the pandemic will continue to support the Life risk business, the driver of growth for the Life insurance business in Argentina.

2.1.11. Turkey

The forecast for the Turkish economy is looking more complicated, with real GDP growth expected to come in at around 2.8% in 2022 compared to 10% in 2021 (1.8% in 2020, when it was one of the few economies in the world that continued to grow despite the pandemic). The country's strong economic performance in the past year will come to a halt due to declining investment and a sharp downturn in domestic consumption against a backdrop of high inflation that is eroding disposable income in households, which makes the outlook complicated for the insurance business. For now, the Turkish central bank's decision to reduce interest rates suggests that inflation will remain high and that the turbulence around the exchange rate, which is suffering sharp depreciation, will continue. This situation continues to affect the problems associated with the structural imbalances of the economy (mainly its external private debt in dollars), which make it vulnerable to the weakness of the Turkish currency and feed inflation due to the increase in import prices. All these factors may have a negative impact on business and profitability in the insurance industry due to the rise in claims and operating costs as a result of inflation.

The Turkish central bank lowered the official interest rate at its December meeting, placing it at 14% despite the rise in inflation (which reached 36.08% that month). However, the EIOPA curves (see Chart 2.1.11) show a further increase in risk-free interest rates, with a curve that continues to trend upward in its short and medium sections. This leads to a complex interest rate scenario when it comes to selling

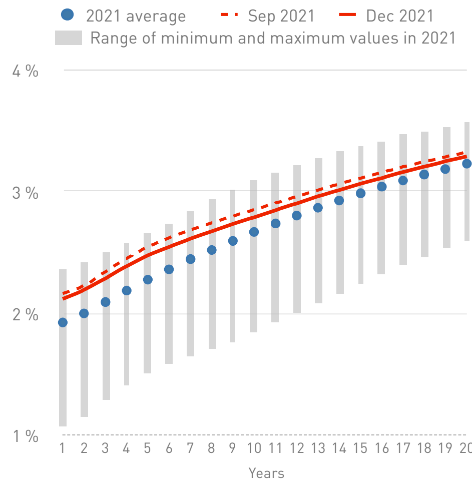
Chart 2.1.11
Turkey: risk-free yield curve
(%)



Source: MAPFRE Economics (based on EIOPA data)

Click here to access the interactive version of this information

Chart 2.1.12
China: risk-free yield curve
(%)



Source: MAPFRE Economics (based on EIOPA data)

Click here to access the interactive version of this information

Life savings insurance products, on account of the uncertainty regarding short-term rates and a term premium that may be offered for products with a longer term that fails to compensate for the loss of purchasing power caused by high inflation, which means that real interest rates are negative. However, the outlook is a bit more favorable for the Life risk business due to the greater sensitivity to the risk of death generated by the panoramic in an economy that, despite losing momentum, continues to grow.

2.1.12 China

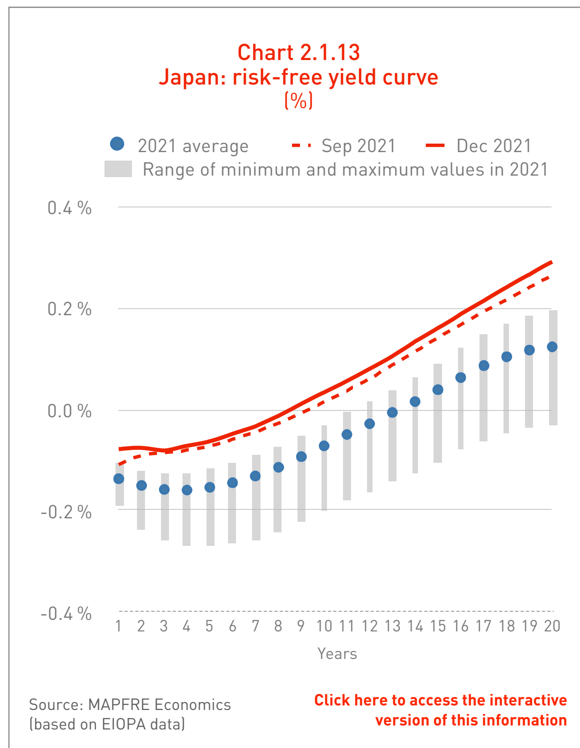
In China, the economic forecast for 2022 is for GDP to grow by around 5.0%, compared to the estimated growth of 8.1% in 2021 (2.3% in 2020). This represents a marked slowdown in activity, although it continues to be robust growth that is basically supported by domestic demand. This anticipated economic growth in 2022, despite the deceleration, will maintain a favorable environment for the insurance industry, assisted by the low level of insurance penetration in the Chinese economy. However, the slowdown in the real estate market may lead to lower growth for the insurance business than in the previous year.

As for the interest rate environment, although there has been a slight rise in inflation (basically a result of higher energy prices), its levels remain moderate, so the central bank continues to apply an accommodative monetary policy. In the EIOPA curves (see Chart 2.1.12), a slight relaxation in risk-free interest rates is again observed in all sections of the curve, which continues to slope upward. This interest rate environment is favorable for the Life savings and annuities insurance business, as it can offer higher medium- and long-term guaranteed rates than short-term rates. Meanwhile, the increased sensitivity to the risk of death due to the pandemic and the economic growth predicted for this year could boost the Life risk business.

2.1.13 Japan

The Japanese economy is expected to accelerate in 2022, growing 3.2% compared to 1.8% in 2021 (-4.7%, in 2020). This represents an upward revision of growth expectations for 2022 after 2021 was worse than expected due to supply chain problems and high energy prices. Private consumption and investment will be the main drivers of growth, which will be favorable to the insurance industry.

Chart 2.1.13
Japan: risk-free yield curve
(%)



Source: MAPFRE Economics (based on EIOPA data)

Click here to access the interactive version of this information

Meanwhile, the Bank of Japan has not altered its ultra-accommodative monetary policy in a situation where inflation has increased slightly but remains weak. The EIOPA curves (see Chart 2.1.13) show a slight upswing in risk-free interest rates in all sections of the curve, and the figures remain negative for maturities of up to eight years (down from nine in the previous quarter). Despite the above, the positive slope for term premiums over longer periods may bolster sales of Life savings and traditional annuities products. However, interest rates remain deflated in a sustained context that is expected to persist over time, representing an obstacle to the performance of the business lines indicated above. On the other hand, the interest rates of US Treasury bonds (which Japanese Life insurers use as an alternative investment to increase the profitability of their portfolios) are up, so they could restore some of the appeal of these investments to lever up their returns.

2.1.14 Philippines

In the Philippines, GDP growth is expected to accelerate in 2022 to an estimated 6.5%, compared to 4.6% in 2021 (-9.6% in 2020), which means it will surpass the pre-crisis level this year. This robust economic growth, driven by private consumption and investment, will benefit the insurance business, which the low penetration of insurance will boost in the country's economy.

As regards Life insurance, the Central Bank of the Philippines is keeping the benchmark rate for monetary policy at 2.0% despite the upturn in inflation. The return on the ten-year sovereign bond stood at 4.85% at the end of December, with the interest rate curve sloping upwards again. This is bolstering the sale of Life savings and traditional annuities products, as it is possible to guarantee higher medium- and long-term rates than short-term rates.

2.1.15 Reinsurance

Natural disasters caused significantly higher global losses in 2021 than in the previous two years. According to provisional data published by Munich Re[6], natural disasters caused total losses of around 280 billion dollars in 2021, of which approximately 120 billion dollars were insured. The largest losses from natural disasters occurred in the United States, approximately 145 billion dollars, of which around 85 billion dollars were insured. In December, a series of severe storms in several central and southeastern states caused exceptionally serious damage. Hurricane Ida, which made landfall on August 29 south of New Orleans and moved northeast, causing severe flooding (particularly in New Jersey and the New York metropolitan area), was the costliest natural disaster of the year, with total losses of 65 billion dollars (36 billion dollars of losses insured). The third-costliest event of the year, at an estimated 30 billion dollars (half of which were insured), was the cold snap that brought frigid temperatures to the southern part of the United States [-8°C (17°F)], leaving millions without power in the city of Houston, Texas.

In Europe, the low-pressure "Bernd" weather system caused heavy rainfall in western Germany and its neighboring countries, the Netherlands, Belgium, and Luxembourg. The rains were especially heavy in the German federated states of North Rhine-Westphalia and Rhineland-Palatinate. Total losses amounted to around 54 billion dollars, of which about 40 billion dollars occurred in Germany. In this case, around 13 billion dollars were insured, of which around 9.7 billion dollars were based in Germany, according to figures provided by the

German Insurance Companies' Association. This was the costliest natural disaster in Germany and Europe to date.

In Spain, the Cumbre Vieja volcano erupted in September in the south of La Palma, in the Canary Islands, an event legally defined as an "extraordinary risk" whose damages are compensated by the Insurance Compensation Consortium (ICC) of the Ministry of Economic Affairs and Digital Transformation. As of January 14, 2022, the ICC had paid 90.57 million euros to the insured parties affected by the volcanic eruption on the island of La Palma[7].

Finally, when it comes to the Asia-Pacific region, losses remained modest, with total economic losses of 50 billion dollars, of which 9 billion dollars were insured. According to information from Munich Re, around 57% of natural disaster losses in 2021 were uninsured worldwide. This insurance gap has narrowed in recent decades in industrialized countries, while in poorer countries, it remains unchanged at more than 90%.

2.2 Regulatory and supervisory trends

2.2.1 EIOPA Financial Stability Report 2021

On December 13, 2021, the European Insurance and Occupational Pensions Authority (EIOPA) published its latest Financial Stability Report[8], which highlights what it considers to be the main risks for the insurance industry and pension funds, updating the situation with regard to its previous risk table, published in October[9]. In this regard, the most relevant risks revealed by EIOPA in this report are as follows:

a) *Macroeconomic risk*. Inflation continues to be high with the expectation that it will remain so in the coming months. The inflationary pressures encompass a mechanical increase due to previously low price levels during the pandemic and reflect the disruption in the supply chains and the general accommodative fiscal and monetary policies. Besides these, other temporary effects, such as the rise in oil and energy prices, the reversal in January 2021 of the temporary VAT cut in Germany, and the changes in the timing and scope of sales periods, are also contributing factors. Due to all of this, the forecasts for the second half of 2021 have been marginally deteriorating due to supply chain disruptions and concerns over the recent increase in coronavirus infections, leading to high levels of uncertainty and macroeconomic risk.

b) *Credit risk*. This risk remains stable at a medium level due fundamentally to the support measures introduced during the crisis. Risk premiums (CDS) remain low, although the credit quality of insurers' portfolios has deteriorated slightly. A sudden repricing of sovereign risk would adversely affect insurance companies that hold a significant share of sovereign bonds in their portfolios. The results of EIOPA's empirical analysis suggest that, while yield increases have a positive effect on assets over liabilities, an increase in credit spreads has a negative effect; as a reference, EIOPA indicates in its report that a 100-basis-point increase in countries with high sovereign risk is associated with a 7% decline in assets over liabilities. Besides government bond yields, it is noteworthy that the trajectory across the various corporate yields is synchronized, implying that the spreads for corporate bonds also remain relatively contained and without huge variation. In any case, the risk of abrupt repricing of spreads due to higher defaults and liquidity risk for the corporates (e.g., for sectors most affected by the pandemic) remains relevant, particularly if financing conditions tighten and policy measures fade out.

c) *Market risk*. Fiscal and monetary support measures mean that market risk (bond and stock markets) also remains stable at a medium level, but the low interest rate environment persists due to the extension of accommodative monetary policy, which may lead insurers to assume higher risks in pursuit of higher returns.

d) *Cyber risk*. Cyber risk has become one of the most important risks for the insurance industry, but its understanding remains limited, and data collection and cyber risk modeling need to be improved Risks related to digitalization are expected to increase over the coming months. The home working setup is becoming structural for some companies, and the number of cyber attacks has

increased, affecting banks and other types of institutions as well. At the same time, demand for cyber security will grow, providing new business opportunities for insurance companies, and the new technologies being used could enhance the underwriting of operational and cyber risks for digital leaders (although they could also increase the aforementioned risks).

e) *Environmental, Social, and Governance (ESG) risks.* For the first time, EIOPA has included ESG risks in its *Risk Table* for October, rating them at a medium level, with an upward forecast for the next twelve months. EIOPA highlights that the ESG rating of insurance companies is improving. It has been noted that insurers are increasing their investments in green bonds, although they do so at a slower rate than the volume growth of these bonds. Average exposure to assets at risk of climate change by insurance companies in the European Union and their groups has been reduced slightly, which enhances transition risk. However, exposure to flood and storm risks by insurers has increased slightly towards the top of the distribution. Although the catastrophic loss ratio has been reduced (physical risks), it is still not capturing the effect of the floods in the European Union in the summer of 2021.

2.2.2 2021 EIOPA stress test: a persistent pandemic in a low interest rate environment

On December 16, the European Insurance and Pension Authority (EIOPA), in collaboration with the European Systemic Risk Board (ESRB), published the results of the fifth stress test of the insurance sector, which covered 75% of the European Economic Area market[10] contemplating a scenario of prolonged COVID-19 in a context of "low rates for longer."

The analysis scenario identified a set of specific market and insurance disruptions, specifically constructed to reflect EIOPA's and ESRB's current assessment of existing systemic risks to the financial system[11]. These risks stem from the worsening economic outlook, which is reflected in an overall decline in long-term risk-free interest rates from already historically low levels, accompanied by a significant revaluation of risk premiums in a context of weakening country fiscal positions and difficulties for corporate profitability. An additional correction in commercial and residential real estate prices completes the set of market disruptions. Divergent movements in the risk-free interest rate and risk premiums qualify the market scenario as a double whammy, which may generate detrimental effects both on the liability side, through the reduction of discount curves, and on the asset side, through the reduction of the prices of the relevant asset classes held by insurers in their investment portfolios.

The scenario embodies the characteristics of verisimilitude and severity required for a robust stress testing exercise. The set of disruptions is designed to be economically and market consistent and therefore plausible. Although designed to test tail events, the overall probability of the scenario's market disruptions ranges from 0.1% to 0.6%, as the correlation ranges from 0.35 to 0.824. Market disruptions are complemented by a set of insurance-specific disruptions affecting all lines of business that are most exposed to the effects of the pandemic outbreak.

Main results

The outcome of the 2021 exercise does not give a pass or fail grade to the participants, but has the primarily micro-prudential objective of assessing their ability to withstand the adverse conditions described in the stress test scenario. Individual post-stress test positions are finally aggregated to infer the overall resilience of the insurance sector. In addition, the 2021 insurance stress test reinforces the macroprudential dimension of the exercise by complementing the standard *fixed balance sheet* approach with a *contained balance sheet* approach in which participants are allowed to apply reactive management actions in the calculation of their post-stress position. The results of these actions are used to identify possible indirect effects in other markets.

Furthermore, the regular capital and solvency assessment, conducted in accordance with the Solvency II framework, is complemented for the first time by the assessment of participants' liquidity position before and after the crisis over

a 90-day time horizon. The two components are based on a common narrative, scenario, and set of shocks, but are clearly separated in terms of shock application, data collection, evaluation, and dissemination.

In general, the European insurance industry showed adequate resilience during the pandemic crisis and, despite the strong economic implications of the pandemic outbreak, approached the year with a strong level of capitalization that was reflected in a solvency ratio of 217.9%, reported at the end of 2020. The strong solvency ratio exhibited at the end of 2020 was a necessary buffer for participants to adequately absorb the impact of the adverse double whammy scenario that proved to be a severe test for the sector, as summarized below (see Table 2.2.2-a)

Overall, the post-stress solvency ratio decreases under the *fixed balance sheet* approach by 92.1 percentage points, from 217.9% to 125.7%. The aggregate drop is reflected in a downward shift in the distribution of the indicator, resulting in companies reporting values below the regulatory threshold of 100%. The reduction in the solvency ratio is due to a 7.1% increase in the Solvency Capital Requirement and a reduction in eligible shareholders' equity, which decreased by a combined 38.2%. None of the participants reported an asset-over-liabilities ratio of less than 100%; this indicates that even in a severe scenario, the industry is in a position to fulfill its promises to policyholders.

Under the *contained balance sheet* approach, 19 participants chose to apply a set of reactive management actions, such as retaining earnings, de-risking their asset allocation, and increasing capital, which mainly affects their solvency position rather than their balance sheet position. Although only a limited number of participants apply reactive management actions, the solvency ratio improves overall by 13.6 percentage points compared to the *fixed balance sheet* calculation (from 125.7% to 139.3%). Among the 9 participants reporting a post-stress solvency ratio below 100% under the *fixed balance sheet approach,* 7 apply reactive management actions that allow them to report solvency ratios above the regulatory threshold.

Long-term guarantees and transitory measures

In addition, the exercise demonstrates that the handling of long-term guarantees and the transitional measures package remain relevant in both the baseline and adverse scenarios (see Table 2.2.2-b). If the effect of the long-term guarantee and transitional measures is eliminated, the aggregate solvency ratio fell from 173.3% (base) to 47.2% (*fixed balance sheet* approach) and 55.1% (*contained balance sheet*approach). This implies that 31 companies have a solvency ratio above 100% with the *fixed balance sheet* approach and 27 with the *contained balance sheet* approach. Likewise, 8 participants in the *fixed balance sheet* exercise and 7 in the *contained balance sheet* exercise have a ratio of assets to liabilities of less than 100%.

Table 2.2.2-a
Stress test: summary of results

	Value	Fixed Balance Sheet		Contained Balance Sheet	
	Baseline scenario	Value	Δ vs baseline	Value	Δ vs baseline
Solvency ratio	217.9 %	125.7 %	-92.1 pp	139.3 %	-78.6 pp
Solvency Capital Requirement (SCR)	291.1 bn	311.6 bn	7.1 %	300.0 bn	3.1 %
Eligible Own Funds	634.1 bn	391.8 bn	-38.2 %	417.9 bn	-34.1 %
Assets/Liabilities	110.0 %	105.9 %	-4.1 pp	106.2 %	-3.8 pp
Assets - Liabilities	590.2 bn	325.8 bn	-44.8 %	340.8 bn	-42.3 %

Source: EIOPA Insurance Stress Test 2021
*English bn = billion European system = 10^9 euros

While the long-term guarantee measures are a permanent element of the Solvency II regulatory regime, the transitional measures have been introduced temporarily to smooth the transition from Solvency I to Solvency II, and their effect should gradually disappear by 2032. If only transitional measures are eliminated, the solvency ratio is 204.6% in the baseline scenario, falling to 111.0% in the *fixed balance sheet* and 123.8% in the *contained balance sheet*, with 15 and 10 participants reporting a value below 100% in the *fixed* and *contained balance sheet* approach, respectively. Similarly, two participants report a ratio of assets to liabilities without transitional measures of less than 100% in both the *fixed* and *contained balance sheet* approaches.

Overall, the capital component of the exercise confirms that the main vulnerabilities stem from market shocks and, in particular, the impact of the decoupling of the risk-free rate and risk premiums. The European insurance industry, with the exception of a limited number of cases, proves to be able to cope with such severe market developments by implementing reactive management actions. However, the capital component of the exercise also shows that part of the market remains dependent on transitional measures that will be phased out between now and 2032.

Liquidity analysis

Additionally, introduced for the first time in the 2021 stress test exercise, the liquidity component targets the same entities as the capital component. However, in the absence of a commonly adopted framework for the assessment and consolidation of liquidity positions at the group level, participating groups were asked to provide liquidity information for a significant subset of European solo insurance entities within the group consolidation perimeter. Based on the defined threshold of 80% of the group's total assets, 117 individual entities were identified and included in the analysis. As summarized in Table 2.2.2-c, overall, the liquidity position appears to be a less important source of concern for the insurance industry than capital and solvency positions in the post-stress situation. However, the massive fall shock prescribed in the scenario generates a significant outflow that, on balance, cannot be covered by cash holdings alone (negative net liquidity position of 10.1 billion euros).

However, the large amount of liquid assets held by the companies alone can offset the reported outflows of funds. It should be noted that more than 80% of the negative net liquidity position is concentrated in the 15 individual companies, which implemented reactive management measures to restore a positive aggregate net liquidity position under the *contained balance sheet* approach (11.4 billion euros). Reactive management actions applied in the liquidity component consist mainly of liquid asset sales; the sales strategy tends to keep the asset allocation unchanged in the liquidity component compared to the baseline.

Macroprudential aspects

Now, moving on to the macroprudential aspect of the exercise, the focus is on identifying possible herd behavior, such as the aggregate reallocation of insurers' assets caused by the implementation of reactive management actions. In the capital exercise, despite the limited number of groups applying deregulation strategies in their asset allocation (8), a shift from corporate

Table 2.2.2-b
Solvency Ratio with Long-Term Guarantee and Transitional Measures

	Baseline scenario	Balance sheet fixed	Contained Balance
Solvency Ratio with Transitional Measures and LP Guarantees	217.9 %	125.7 %	139.3 %
Solvency ratio excluding transitional measures	204.6 %	111.0 %	123.8 %
Solvency ratio without LP guarantees or transitional measures	173.3 %	47.2 %	55.1 %

Source: EIOPA Insurance Stress Test 2021

Table 2.2.2-c
Net liquidity position and sustainable position

	Value	Fixed Balance Sheet		Contained Balance Sheet	
	Baseline scenario	Value	Δ vs baseline	Value	Δ vs baseline
Net liquidity position (cash+net cash flows)	81.1 bn	-10.1 bn	-112.5 %	11.4 bn	-85.9 %
Sustainability (net cash flows+cash+liquid assets)	2.8 tr	2.2 tr	-538.7 bn	2.2 tr	-525.8 bn

Source: EIOPA Insurance Stress Test 2021
*English bn = billion European system = 10^9 euros
** English tr = trillions European system = 10^12 euros

bonds (-47.4 billion euros) and equities (-4.7 billion euros) towards government bonds (+56.6 billion euros) is observed. Although the amounts are limited overall, they correspond to a significant relative shift between the*fixed balance sheet* and *contained balance sheet* of -15.1% in the corporate bond portfolio, -16.8% in the equity portfolio, and 13.9% in the sovereign bond portfolio. Thus, the footprint in the fixed income market can potentially materialize in case more insurance companies apply the same behavior in asset reallocation.

Both EIOPA and the competent national authorities will conduct further analysis of the results of this test to gain a deeper understanding of the risks and vulnerabilities of the sector. Subsequently, EIOPA will assess the need to issue recommendations on the relevant aspects where risks have been identified. Although improvements have been made, EIOPA expects participants to use the lessons learned to build their capacity to produce high-quality data and further improve their corresponding risk management capabilities, and the competent national authorities are expected to oversee and promote these improvements.

Appendix: macroeconomic forecasts

Table A-1
Baseline and Stressed Scenarios: Gross Domestic Product (GDP)
(annual growth, %)

	Baseline Scenario (BS)					
	2018	2019	2020	2021(e)	2022(f)	2023(f)
United States	2.9	2.3	-3.4	5.6	4.0	2.5
Eurozone	1.8	1.6	-6.5	5.1	3.9	2.7
Germany	1.1	1.1	-4.9	2.5	3.9	2.9
France	1.8	1.8	-8.0	6.3	3.7	2.2
Italy	0.8	0.4	-9.0	6.3	4.4	2.5
Spain	2.3	2.1	-10.8	4.9	5.5	4.3
United Kingdom	1.7	1.7	-9.4	7.0	4.4	2.8
Japan	0.6	0.0	-4.7	1.8	3.2	1.7
Emerging markets	4.5	3.7	-2.1	6.3	4.8	4.6
Latin America[1]	1.2	0.2	-7.0	6.3	2.1	2.3
Mexico	2.2	-0.2	-8.4	5.2	2.6	2.7
Brazil	1.7	1.2	-4.2	4.6	0.5	1.9
Argentina	-2.6	-2.0	-9.9	9.3	2.9	1.5
Emerging markets, Europe[2]	3.4	2.5	-2.0	6.0	3.6	2.9
Turkey	3.0	0.9	1.8	10.0	2.8	2.8
Asia-Pacific[3]	6.4	5.4	-0.9	7.1	6.2	5.7
China	6.7	6.0	2.3	8.1	5.0	5.5
Indonesia	5.2	5.0	-2.1	3.7	5.8	6.4
Philippines	6.3	6.1	-9.6	4.6	6.5	7.6
Global	3.6	2.8	-3.1	5.8	4.8	3.6

	Stressed Scenario (SS)					
	2018	2019	2020	2021(e)	2022(f)	2023(f)
United States	2.9	2.3	-3.4	5.6	-0.3	2.1
Eurozone	1.8	1.6	-6.5	5.1	0.5	2.0
Germany	1.1	1.1	-4.9	2.5	0.3	2.0
France	1.8	1.8	-8.0	6.3	0.3	1.0
Italy	0.8	0.4	-9.0	6.3	0.9	2.0
Spain	2.3	2.1	-10.8	4.9	2.3	3.0
United Kingdom	1.7	1.7	-9.4	7.0	1.5	1.9
Japan	0.6	0.0	-4.7	1.8	-0.1	1.1
Emerging markets	4.5	3.7	-2.1	6.3	2.5	3.5
Latin America[1]	1.2	0.2	-7.0	6.3	1.8	1.9
Mexico	2.2	-0.2	-8.4	5.2	-1.8	2.3
Brazil	1.7	1.2	-4.2	4.6	-2.6	1.2
Argentina	-2.6	-2.0	-9.9	9.3	-1.3	0.7
Emerging markets, Europe[2]	3.4	2.5	-2.0	6.0	1.1	2.3
Turkey	3.0	0.9	1.8	10.0	-1.2	1.6
Asia-Pacific[3]	6.4	5.4	-0.9	7.1	4.3	3.5
China	6.7	6.0	2.3	8.1	2.4	4.5
Indonesia	5.2	5.0	-2.1	3.7	2.4	5.2
Philippines	6.3	6.1	-9.6	4.6	2.8	6.6
Global	3.6	2.8	-3.1	5.8	4.0	2.6

Source: MAPFRE Economics (using data from national statistical centers and IMF)

[1]Argentina, Brazil, Chile, Colombia, Mexico, Peru, and Venezuela; [2]Russia, Turkey, Commonwealth of Independent States (CIS) and Central Europe; [3]Association of Southeast Asian Nations (ASEAN)
Forecast end date: January 17, 2022

Table A-2
Baseline and stressed scenarios: inflation
(last quarter, %)

	Baseline Scenario (BS)					
	2018	2019	2020	2021(e)	2022(f)	2023(f)
United States	1.9	2.3	1.4	6.7	2.4	2.1
Eurozone	1.9	1.0	-0.3	4.4	1.1	1.3
Germany	1.6	1.5	-0.2	4.9	1.1	1.7
France	2.1	1.3	0.5	2.0	1.6	1.7
Italy	1.1	0.5	-0.2	3.5	1.3	0.4
Spain	1.2	0.8	-0.5	5.9	1.1	1.5
United Kingdom	2.0	1.3	0.8	4.8	2.6	1.7
Japan	0.9	0.5	-0.9	0.6	0.1	0.2
Emerging markets	4.9	5.1	5.1	5.5	4.9	4.3
Latin America[1]	6.6	7.7	6.4	9.3	7.8	6.0
Mexico	4.8	2.8	3.2	7.5	3.8	3.7
Brazil	3.7	4.3	4.5	9.8	5.3	3.3
Argentina	47.4	52.2	36.4	51.2	44.7	31.5
Emerging markets, Europe[2]	6.4	6.6	5.4	8.4	7.1	6.2
Turkey	20.3	11.8	14.6	36.1	31.6	13.1
Asia-Pacific[3]	2.7	3.3	3.1	2.3	2.7	2.7
China	2.2	4.3	0.1	1.9	2.7	2.4
Indonesia	3.3	2.7	1.6	1.8	3.9	3.0
Philippines	5.9	1.5	3.1	4.2	3.1	3.0
Global	3.6	3.5	3.2	4.4	3.8	3.3

	Stressed Scenario (SS)					
	2018	2019	2020	2021(e)	2022(f)	2023(f)
United States	1.9	2.3	1.4	6.7	3.3	2.3
Eurozone	1.9	1.0	-0.3	4.4	2.2	1.5
Germany	1.6	1.5	-0.2	4.9	2.2	1.9
France	2.1	1.3	0.5	2.0	2.1	2.8
Italy	1.1	0.5	-0.2	3.5	2.2	-0.2
Spain	1.2	0.8	-0.5	5.9	2.3	1.7
United Kingdom	2.0	1.3	0.8	4.8	3.7	2.7
Japan	0.9	0.5	-0.9	0.6	0.1	-0.2
Emerging markets	4.9	5.1	5.1	5.5	5.3	4.4
Latin America[1]	6.6	7.7	6.4	9.3	9.0	7.0
Mexico	4.8	2.8	3.2	7.5	5.0	3.6
Brazil	3.7	4.3	4.5	9.8	7.1	3.5
Argentina	47.4	52.2	36.4	51.2	48.2	30.0
Emerging markets, Europe[2]	6.4	6.6	5.4	8.4	7.5	6.6
Turkey	20.3	11.8	14.6	36.1	34.8	12.5
Asia-Pacific[3]	2.7	3.3	3.1	2.3	3.0	3.0
China	2.2	4.3	0.1	1.9	3.8	2.8
Indonesia	3.3	2.7	1.6	1.8	6.4	2.9
Philippines	5.9	1.5	3.1	4.2	5.3	2.5
Global	3.6	3.5	3.2	4.4	4.0	3.5

Source: MAPFRE Economics (using data from national statistical centers and IMF)

[1]Argentina, Brazil, Chile, Colombia, Mexico, Peru, and Venezuela; [2]Russia, Turkey, Commonwealth of Independent States (CIS) and Central Europe; [3]Association of Southeast Asian Nations (ASEAN)
Forecast end date: January 17, 2022

Table A-3
Baseline and stressed scenarios: 10-year government bond yield
(end of period, %)

	Baseline Scenario (BS)					
	2018	2019	2020	2021(e)	2022(f)	2023(f)
United States	2.69	1.92	0.93	1.52	2.32	2.53
Eurozone	1.17	0.32	-0.19	0.32	0.73	1.14

	Stressed scenario (SS)					
	2018	2019	2020	2021(e)	2022(f)	2023(f)
United States	2.69	1.92	0.93	1.52	2.78	3.00
Eurozone	1.17	0.32	-0.19	0.32	2.02	2.14

Source: MAPFRE Economics (using data from national statistical centers and IMF)
Forecast end date: January 17, 2022

Table A-4
Baseline and stressed scenarios: exchange rates
(end of period, %)

	Baseline Scenario (BS)					
	2018	2019	2020	2021(e)	2022(f)	2023(f)
USD-EUR	0.87	0.89	0.81	0.88	0.85	0.83
EUR-USD	1.15	1.12	1.23	1.13	1.18	1.20
GBP-USD	1.28	1.32	1.36	1.35	1.42	1.43
USD-JPY	111.00	109.00	104.00	115.00	112.00	109.00
USD-CNY	6.88	6.99	6.52	6.35	6.35	6.33

	Stressed Scenario (SS)					
	2018	2019	2020	2021(e)	2022(f)	2023(f)
USD-EUR	0.87	0.89	0.81	0.88	0.88	0.85
EUR-USD	1.15	1.12	1.23	1.13	1.14	1.18
GBP-USD	1.28	1.32	1.36	1.35	1.37	1.40
USD-JPY	111.00	109.00	104.00	115.00	109.00	107.00
USD-CNY	6.88	6.99	6.52	6.35	6.45	6.38

Source: MAPFRE Economics (using data from national statistical centers and IMF)
Forecast end date: January 17, 2022

Table A-5
Baseline and stressed scenarios: official benchmark interest rate
(end of period, %)

	Baseline Scenario (BS)					
	2018	2019	2020	2021(e)	2022(f)	2023(f)
United States	2.50	1.75	0.25	0.25	1.00	1.50
Eurozone	0.00	0.00	0.00	0.00	0.00	0.00
China	3.30	3.25	2.95	3.00	3.00	3.00

	Stressed Scenario (SS)					
	2018	2019	2020	2021(e)	2022(f)	2023(f)
United States	2.50	1.75	0.25	0.25	0.83	0.68
Eurozone	0.00	0.00	0.00	0.00	0.00	0.00
China	3.30	3.25	2.95	3.00	2.68	2.74

Source: MAPFRE Economics (using data from national statistical centers and IMF)
Forecast end date: January 17, 2022

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