Fundación MAPFRE

2023 ECONOMIC AND INDUSTRY OUTLOOK: SECOND-QUARTER PERSPECTIVES

MAPFRE Economics

2023 Economic and Industry Outlook: Second-Quarter Perspectives

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Economic outlook

In a context in which the world appears to have lost its long-term growth capacity, the prospects for the global economy in 2023 and 2024 have nevertheless improved, as of early 2023, compared to what was anticipated in our report in the previous quarter, based on the stronger performance and contribution of all the world's economic regions. Thus, the risk of recession emanating from a large part of the developed economies (mainly the Eurozone) has eased, underpinning the foundations for growth that, in general terms, should be better than expected thanks to the acceleration of activity in the short term.

Despite the moderate optimism, the risks of a potential "*hard landing*" considered throughout 2022 cannot be ignored. These risks have been further amplified by the recent indications of financial instability in the banking sector on both sides of the Atlantic. With this, the cyclical momentum is expected to continue in the *stagflationary* phase, with a fragile pace of activity and below potential, accompanied by a visibly more punitive monetary policy on the demand side. Meanwhile, inflation is expected to remain above the targets set by the main central banks, albeit with a downward dynamic that could show some volatility due to the comparison with the previous year in some components, such as energy or food.

In terms of *positive supply catalysts*, supply chains have continued to normalize, supported by the moderation in the prices of raw materials (mainly energy), the dynamism of the services sector (which is helping to restore pre-pandemic consumption patterns) and the reopening of China, whose reactivation phase continues to support a broader recovery, given its strong presence in the global production mechanism. On the other hand, geopolitical tensions have continued to frustrate the flow of global trade, crystallizing the protectionist current and *multipolar fragmentation*, mainly around strategic sectors such as semi-conductors, certain scarce basic inputs characterized by high concentration and dependence, as well as oil. As for *demand factors*, the optimism is mainly due to the employment situation, whose dynamism continues to surprise on the upside. In the labor market, in the context of frictional unemployment, a trend of workers job hopping (probably to receive a salary bump) has been observed. In periods of high inflation such as the current one, this situation responds to changes in economic activity (as reflected by the Phillips curve), something that did not occur in periods of very low inflation.

However, the economy's increased dynamism has slowed down the inflationary process, and while the broad reading points to the positive effects of supply-side improvement, the underlying reading still reflects the impact of the upturn in demand and the lagged momentum from the rotation towards the services sector. Thus, there is confirmation that inflation seems to have peaked in both the main emerging economies and developed economies, but its reduction to central banks' target levels should take longer than previously anticipated.

This environment has recently been compounded by turbulence in the financial sector in the United States and Europe. Although the initial *shock* had a considerable impact, with falls in the valuations of all risk assets, the news flow has been stabilizing, hand in hand with the action of financial regulators. This crisis of confidence, coupled with pressures on deposits in competition with alternatives in short-term, high-quality fixed income and money market products, raises the prospect of further tightening in credit conditions, already in themselves strained by the cyclical timing of monetary policy as a more cautious view on risk-taking spreads. Consequently, a credit slowdown (or even a credit crunch) is foreseeable, with effects yet to be determined in the real and financial sectors. In any case, they will require greater efforts to manage liquidity in a fragile context.

With regard to monetary policy, the main central banks have continued moving forward with the process of tightening and subsequent normalization, both on the balance sheet and through interest rates. Up to this point, that effort has pushed interest rates into tightening territory at a historically fast pace. However, the upcoming hikes are expected to be rather marginal, allowing for an eventual acceleration of activity and for concerns over price stability to shift to a focus on financial stability.

Finally, the geopolitical landscape is doing little to unburden the current risk map. Several elements combine to shape this environment: tensions building around the war in Ukraine; the deterioration of multilateral relations; the Organization of Petroleum Exporting Countries' action to push oil prices higher; the emerging search for alternatives to dethrone the dollar as the world's reserve currency; and the effect of other bilateral and multilateral agreements such as the BRIICSS (which includes India and Saudi Arabia), the RIC Alliance (Russia, Iran, China) and the yuan agreement between China and Saudi Arabia.

Thus, from the forecast point of view, the *baseline scenario* considered in this report shows an upward scenario for the global economy (+2.8% and +3.0% in 2023 and 2024), while in terms of prices, average inflation of 7.0% and 4.9% is anticipated in 2023 and 2024, respectively. The *stressed scenario* (of an alternative and more pessimistic nature) forecasts global economic growth of 2.0% and 2.3% in 2023 and 2024, and average inflation of around 7.4% and 5.4% for each of these years.

Industry outlook

Revised economic growth estimates for 2023 point to a less pronounced global slowdown than initially expected, painting a more benign picture for the insurance business this year. Inflation data is beginning to show some signs of improvement, although it remains at high levels, especially core inflation. Insurers' profitability will therefore remain under pressure from rising claims costs and other operating expenses.

According to the latest published data and forecasts, inflation continues to moderate—albeit with a certain lack of synchrony among the different countries—as the tightening of restrictive monetary policies implemented by central banks practically worldwide, both in developed and emerging markets (with some important exceptions, such as Japan and China), takes effect. This way, the effects of interest rate hikes and the credit crunch are being passed on to the real economy in the form of lower economic growth, which may become more evident in the coming months of this year in a landing that is nonetheless expected to be relatively soft. This dynamic may be transferred to the insurance business in the form of moderations in the growth of its business volume.

The automotive sector is showing clear signs of improvement following the normalization of the supply chain problems, so the outlook for auto insurance business and profitability (which is benefiting from some pent-up demand) has improved. However, the tightening of conditions for financing new vehicle purchases may weigh negatively in the coming months. On the other hand, the high interest rate environment resulting from restrictive monetary policies will continue providing an additional stimulus to the savings-linked Life insurance business, although the inversion of interest rate curves in many markets complicates the management of products with longer-term interest rate guarantees.

Finally, it should be noted that financial markets had a strong start to the year despite the turbulence from the problems in the banking sector in the United States and Europe. This increased uncertainty and somewhat weakened investor confidence, although the decisive intervention and messages from central banks have helped to reassure the markets. Nevertheless, there remains some caution that the accelerated interest rate hikes being implemented could lead to additional financial accidents. After this situation, it is estimated that central banks are reaching the ceiling in terms of interest rate hikes, with the possibility of some additional hikes by the ones that began the monetary tightening process later, with inflation levels that remain well above their targets. It is therefore foreseeable that they will maintain a restrictive monetary policy until seeing clear signs that inflation is under control. This interest rate environment, together with the stronger performance of equity indexes (after the falls experienced in the previous year), could be favorable to Life insurance products in which the policyholder assumes the investment risk. These products can also take advantage of the higher returns offered by fixed income in the product mix launched on the market.

1. Economic outlook

1.1 The world economic outlook

1.1.1 Moderate optimism with warnings of financial instability

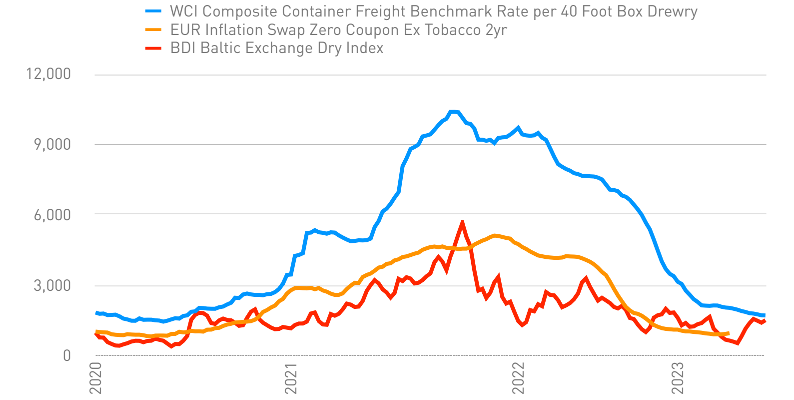
In a context in which the world has clearly lost its long-term growth capacity[1], it is nevertheless noticeable in the early stages of 2023 that the world economic outlook has improved for 2023 and 2024 compared to what was anticipated in our *2023 Economic and Industry Outlook*[2], thanks to the stronger performance and contribution of all the world's economic regions[3]. As a result, the recession risk emanating from a large part of the developed economies (mainly the Eurozone) has eased, underpinning the foundations for growth that, in general terms, should be better than expected thanks to the acceleration of activity in the short term. Despite this, and given the context of heightened uncertainty, this moderate optimism remains insufficient to dismiss the risks of a "*hard landing*" seen over the course of 2022, compounded by recent signs of financial instability coming from the banking sector on both sides of the Atlantic. With this, the cyclical momentum is expected to continue in the *stagflationary* phase, with a fragile pace of activity and below potential, accompanied by a visibly more punitive monetary policy on the demand side. Meanwhile, inflation is expected to remain above the targets set by the main central banks, albeit with a downward dynamic that could show some volatility due to the comparison with the previous year in some components, such as energy or food.

In terms of *positive supply catalysts,* supply chains have continued on the path of normalization, supported by: (i) moderation in the prices of raw materials, mainly energy, (ii) dynamism of the services sector, which continues to contribute to the return to pre-pandemic consumption patterns, and (iii) to a greater extent, the reopening of China, whose reactivation phase continues to progress and consolidate the foundations of a broader recovery, given its strong presence in the global production mechanism. On the other hand, geopolitical tensions have continued to hinder the complete fluidity of global trade, crystallizing the protectionist current and *multipolar fragmentation*, mainly in strategic sectors such as semiconductors or certain scarce basic inputs with high concentration and dependence. Added to this dynamic is the latest decision by the Organization of the Petroleum Exporting Countries (OPEC) to reduce oil production by 2,000,000 b/d. This will mean *additional constraints* for supply chains and put *added pressure* on price stability in both Europe, given the climate of war and its precarious energy stability, and the United States, whose strategic petroleum reserves (SPR) continue to act as a shock absorber.

With regard to *demand factors*, optimism is mainly due to the labor market, whose dynamism continues to surprise on the upside, with unemployment rates below the NAIRU[4] (*natural rate*) and the unfilled vacancy ratio in permanent disequilibrium. The labor market situation, in the context of frictional unemployment, reveals two key dynamics: (i) job-hopping by workers, probably to take advantage of salary bumps (which explains, together with shortage of skilled labor, why the number of vacancies has not been significantly reduced)[5], and (ii) that in periods of high inflation like the current one, this situation responds to changes in the economy (as shown by the slope of the Phillips curve[6]), something not observed in periods when inflation was very low. This helps us to anticipate how monetary policy will behave in the near future, now that the price and job environment is the polar opposite of what existed until 2020. Therefore, it is possible to anticipate greater monetary activism via interest rates than has been experienced over the last twenty years.

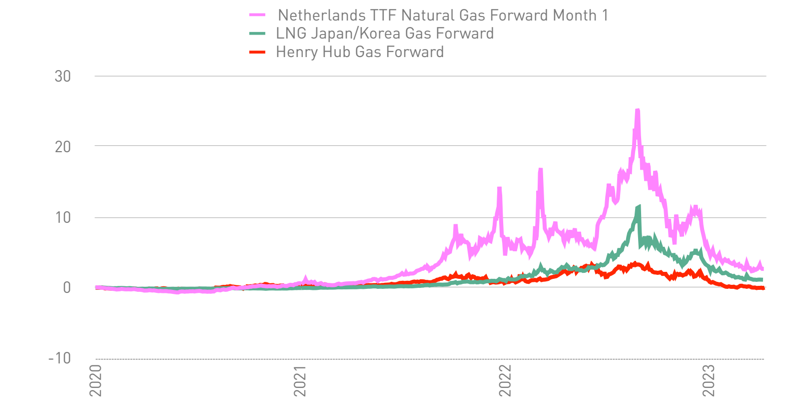
This environment, coupled with the savings generated during the pandemic and not yet consumed, means that both the loss of purchasing power of real wages and the depressed level of consumer confidence (reflected across different surveys) are partially offset by a higher demand base in aggregate terms and the additional boost from lagging wage inflation. At this point, it is worth noting that, although *a priori* the environment is still insufficient to cause large second-round effects, it does have the capacity to be transmitted to prices for a longer period (see Charts 1.1.1-a to 1.1.1-f).

Chart 1.1.1-a
Global: bottlenecks



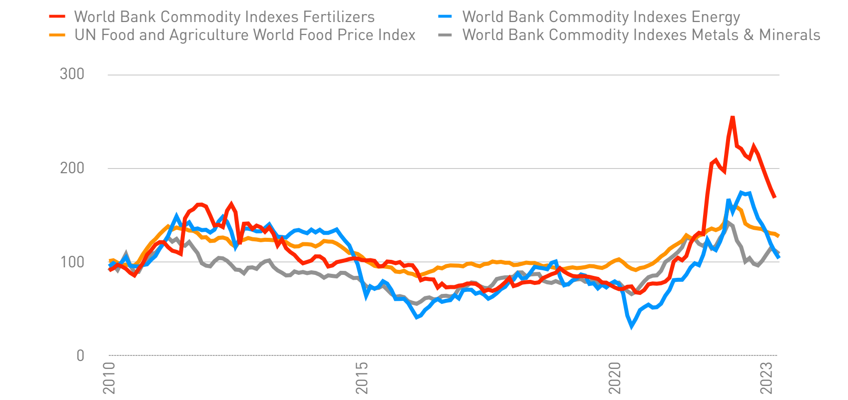
Source: MAPFRE Economics (with Bloomberg and Haver data)

Chart 1.1.1-b
Global: gas prices



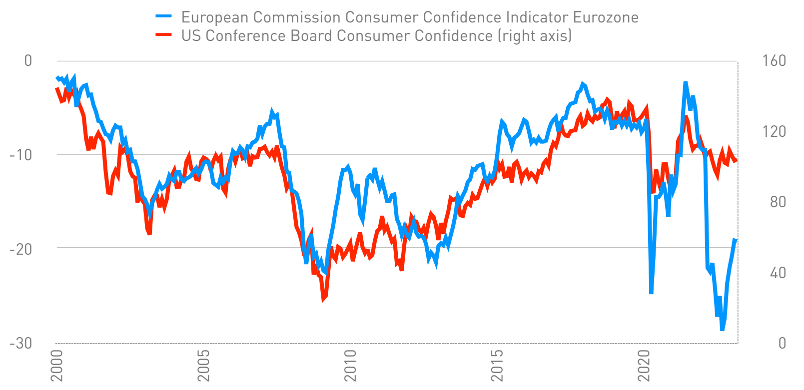
Source: MAPFRE Economics (with Bloomberg and Haver data)

Chart 1.1.1-c
Global: raw materials price index



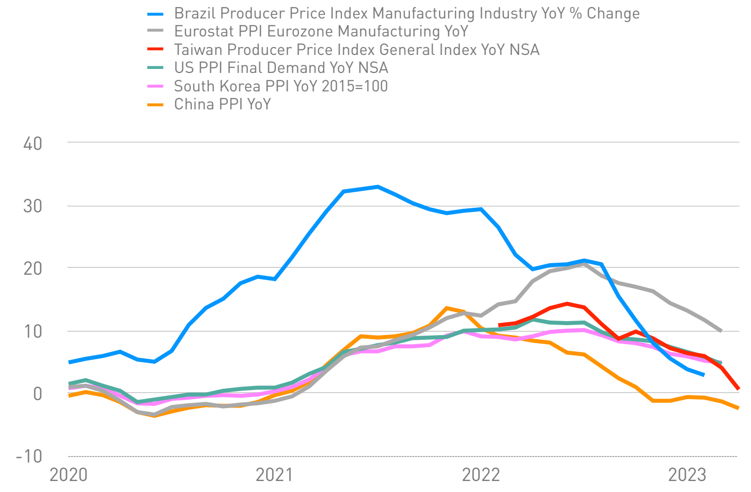
Source: MAPFRE Economics (with Bloomberg and Haver data)

Chart 1.1.1-d
United States and Eurozone: consumer confidence



Source: MAPFRE Economics (with Bloomberg and Haver data)

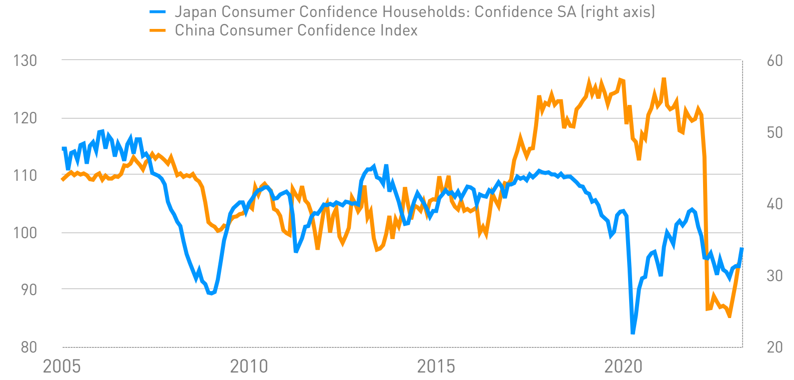
Chart 1.1.1-e
Selected economies: producer prices



Source: MAPFRE Economics (with Bloomberg and Haver data)

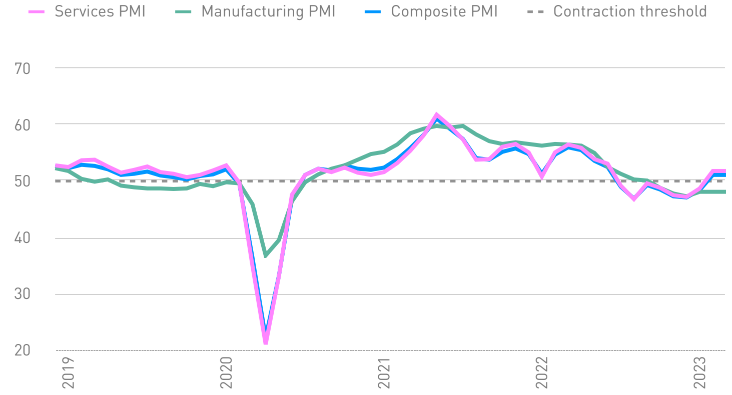
Consequently, the increased dynamism in the economy (see Charts 1.1.1-g and 1.1.1-h) has slowed down the inflationary process, and while the broad reading points to the positive effects of supply-side improvement, the underlying reading continues to show the impact of the upturn in demand and lagged momentum from the rotation towards the services sector. Given this scenario, we can confirm that inflation seems to have peaked in both the main emerging economies and developed economies, but it should take longer than previously anticipated to fall to central banks' target levels. Thus, although the direction of inflationary correction remains downward, its pace will remain linked to both *exogenous* factors (tense geopol-

Chart 1.1.1-f
Japan and China: consumer confidence



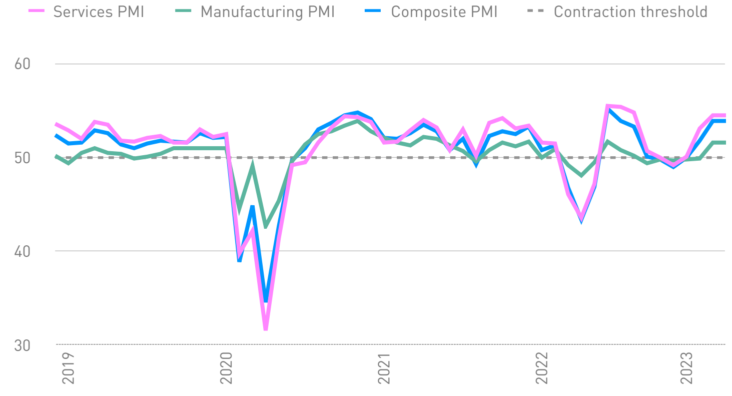
Source: MAPFRE Economics (with Bloomberg and Haver data)

Chart 1.1.1-g
Developed markets: PMIs



Source: MAPFRE Economics (based on Bloomberg data)

Chart 1.1.1-h
Emerging markets: PMIs



Source: MAPFRE Economics (based on Bloomberg data)

itics, escalation of the armed conflict in Ukraine or the effect of protectionist policies) and *endogenous* factors (energy dependence, labor market flexibility, fiscal policy stance).

This situation was recently compounded by turbulence in the financial sector (see Box 1.1.1-a). In the United States, there was an episode of financial stress produced by the withdrawal of deposits from certain banks (regional and with deposits dominated by tech companies) linked to concerns over asset-liability mismatch in this area of the financial sector. In Europe, meanwhile, banking stress led to the takeover of Credit Suisse by UBS, with an emergency ordinance removing the seniority of AT1 (Additional Tier 1) bonds, thus raising the cost of capital across the board in the banking sector.

Box 1.1.1-a
Financial instability

Financial instability in the United States

March 10 was marked by a series of liquidity problems at several U.S. banks, notably Silicon Valley Bank (SVB) and Signature Bank. Furthermore, the implications of this situation were passed on to a broader base, both within the banking sector and in financial markets in general. The origin of the problem lies in traditional sources of risk for banks, where assets that back liabilities are insufficient, or do not have sufficient liquidity, hindering normal term intermediation operations due to liquidity problems that can lead to solvency problems.

While the withdrawal of demand deposits and the inability to transform (make liquid) the available assets is the normal dynamic of so-called *runs on banks* (although the term does not fully apply to this case due to its nature), this time the balance sheet mismatch was aggravated by two additional factors. The first, liabilities consisting mainly of technology company deposits with ample cash availability needs (given insufficient cash flows of their own), and the second, assets consisting of Treasury bonds with large accumulated valuation losses as a result of the sharp rise in interest rates through 2022. The risk, therefore, was triggered by the need to liquidate bonds at a loss to meet liquidity needs and, consequently, having to realize latent portfolio losses given their aging accounting. Thus, the recognition of losses became effective, resulting in insolvency.

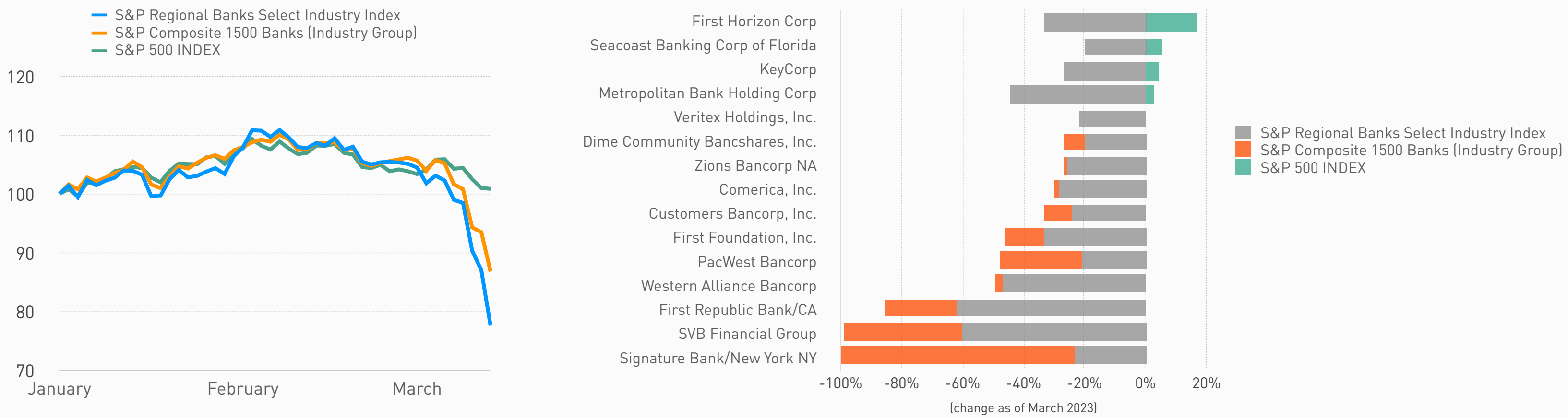
Recognizing that these unrealized losses are a fact shared by other banks within the U.S. financial system, the investor confidence channel deteriorated, prompting financial regulators in the U.S. to take action over the weekend. First, through Treasury Secretary Janet Yellen, who instructed the Federal Deposit Insurance Corporation (FDIC) to compensate all depositors, going beyond the 250,000-dollar level, and then through the Federal Reserve, with the activation of additional liquidity lines to repo with the Bank Term Funding Program (BTFP). This program is unique in that the assets qualifying for these loans are valued at par, rather than at market price, thus opening the window for banks to extend credit to offset unrealized losses on their books for securities carried to maturity.

Over the next month, regional financial institutions reeled under the wave of simmering panic, especially First Republic Bank, which received a 30-billion-dollar rescue package from a deal among 11 major U.S. banks. Even so, this has not been enough to alleviate solvency problems, nor has it prevented a downward revision of its credit rating. In addition, Signature Bank was acquired by Flagstar Bank, and SVB by First Citizens BancShares. The latter carried out the operation with the support of the FDIC, which agreed to establish a line of credit to ensure the entity's liquidity and share losses in the face of the threat of potential credit losses.

Box 1.1.1-a (continued)
Financial instability

The immediate effect of the banks' liquidity problem caused risk sentiment to deteriorate across the board, with volatility picking up and flows returning to safety in high-quality fixed income and traditional safe haven assets, such as gold/silver. The most prominent pressure was felt in the financial sector, especially regional banks, in a classic market reaction that encompassed all banks with potential risk similarities (see Chart A). It is important to note that while the initial reaction during the Monday session following the event was a generalized revaluation, the initial inertia has been fading as the U.S. authorities provided confidence to the market and doubts about the systemic potential of the event were dispelled, at least broadly.

Chart A.
United States: banking sector and regional banking sector, initial shock and subsequent performance, 2023



Source: MAPFRE Economics (based on Bloomberg data)

Box 1.1.1-a (continued)
Financial instability

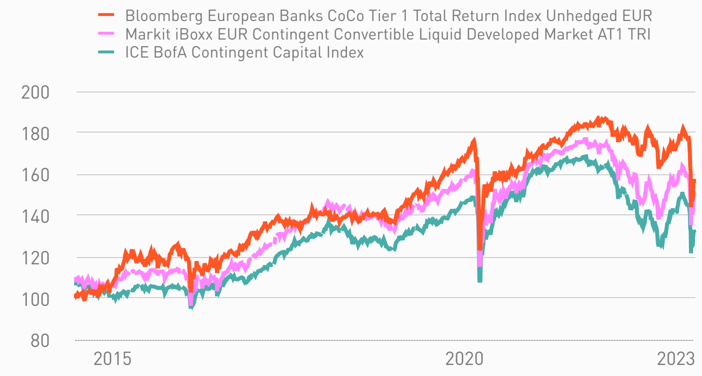
Financial instability in Europe

The repercussions of SVB's collapse have been echoed in Europe, where financial instability has also shaken the major banks of the old continent. The main player was the Swiss entity Credit Suisse, which, after failed attempts to increase available capital, and after some time of dragging restructuring processes and accumulated losses on its balance sheet, was forced by the Swiss supervisory body, FINMA, to be acquired by its largest competitor, UBS, for an amount of 3.24 billion dollars on March 19. The agreement, which did not require shareholder approval because it was classified as a financial emergency, included the support of the Swiss government, which will provide the institution with liquidity assistance (108 billion dollars) and a partial government guarantee in case of losses. This complex restructuring, which has been coupled with a downgrade of UBS's credit *ratings*, will be accompanied by a process of asset sales and significant employee downsizing.

As for the rest of the sector, other banks have suffered financial stress as a result of the uncertainty generated, particularly Deutsche Bank, which saw its investors' confidence eroded following a spike in the price of its CDS. However, following the normalization of the situation and the acquisition of SVB by First Citizens BancShares, valuations have recovered much of the lost ground.

AT1 bonds (CoCos), which cover a 250-billion-dollar market in Europe, have been the subject of controversy and fluctuations in the financial environment following Credit Suisse's problems. These instruments were established as an additional capital mechanism to absorb losses under the activation of a series of contingencies (*triggers*). However, following Credit Suisse's problems and subsequent rescue, FINMA announced that CoCo bondholders would not be compensated, while the shareholders would receive compensation (0.76 Swiss francs per share), thus altering the priority orthodoxy, which puts these bondholders first in the event of insolvency. FINMA argued that, in case of a "feasibility event" such as the one in which

Chart B.
Europe: AT1 aggregates



Source: MAPFRE Economics (based on Bloomberg data)

Box 1.1.1-a (continued)
Financial instability

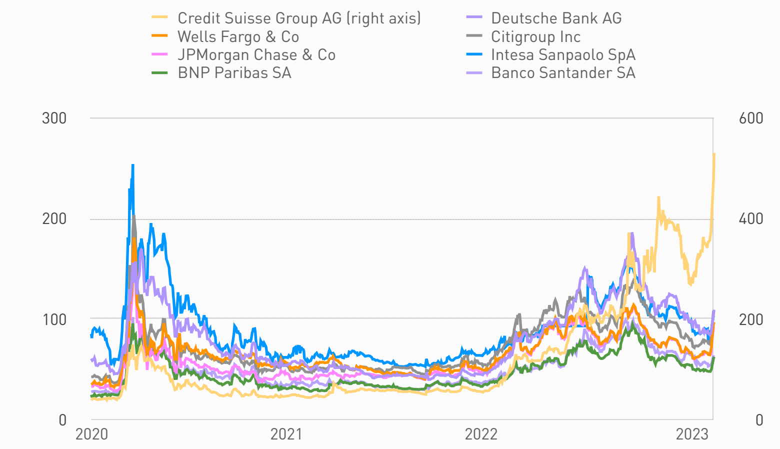
government intervention was necessary, AT1 instruments are derecognized, having recently reaffirmed its position.

This has been causing some fear in the CoCos market (see Chart B), despite interventions by both the European Central Bank (ECB) and the Bank of England, assuring their commitment to the functioning of these instruments and guaranteeing that the priority of AT1 investors will be maintained in their respective jurisdictions. It is currently being assessed whether the legal basis on which FINMA relies can be challenged.

General rating

Both the bank bailout that took place in the United States and the Credit Suisse intervention in Europe came as a mixed warning supported by a combination of signals. On one hand, there are the *retrospective signals*, that is, the consequences of the 2008 banking crisis and the conviction that the impact on the monetary policy system has some lag and therefore its full effects are yet to materialize. And on the other, the *prospective signals*, in that the monetary cycle remains on track, with the prospect of further interest rate hikes and the forecast that liquidity, in general terms, will continue to be drained from the system through ongoing balance sheet reduction. Regarding the health of the financial system, although certain signs of stress have emerged (see Charts C and D), the data seem to indicate that it is in a better starting position than in the previous crisis (2008), with healthier balance sheets, more extensive capitalization and the evolution of a preventive regulation that guarantees adequate risk assumption, complemented by the implementation of adequate solvency requirements and standards.

Chart C.
United States: systemic bank CDS

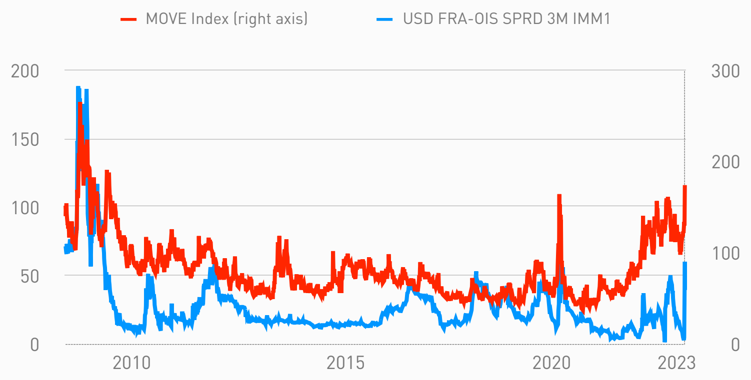


Source: MAPFRE Economics (based on Bloomberg data)

On the other hand, the risk profile and liquidation operations of these types of banks in the United States, which seek to mitigate/avoid the risk of contagion, have more agile intervention mechanisms, a historically longer frequency dynamic and more extensive intervention experience than in the case of Europe (see Chart E). The particularities of these mechanisms in Europe focus on: (i) the financial system's access to banking services; (ii) the concentration after the debt crisis; and (iii) mitigation measures focused on the *resolution* of companies,

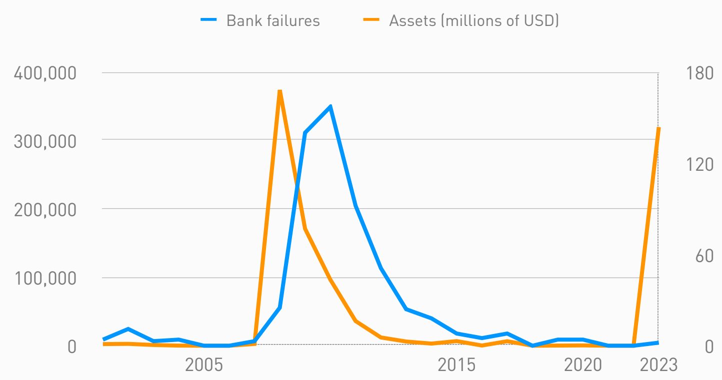
Box 1.1.1-a (continued)
Financial instability

Chart D.
United States: volatility and credit costs



Source: MAPFRE Economics (based on Bloomberg data)

Chart E.
United States: bank interventions



Source: MAPFRE Economics (based on FDIC data)

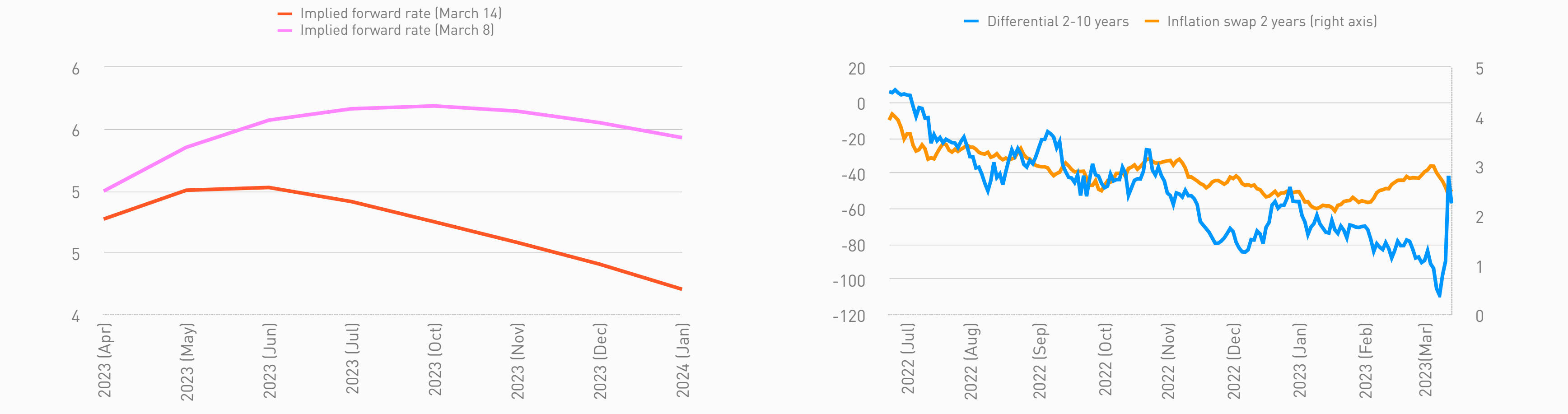
which do not necessarily *fail*, through the figures created in the last decade (such as the Unique Resolution Mechanism, the Unique Resolution Board and the Fund for Orderly Bank Restructuring).

Regarding the implications of the ongoing U.S. monetary cycle, first, market expectations for the terminal rate fell to 5.0%, while completion of hikes is now anticipated in June (down from 5.75% in September). This was accompanied by a sharp reversal of the inversion of the interest rate curve, driven by the rebound of the 2-year Treasury and a drop in inflation expectations (see Chart F).

While financial uncertainty has led to abrupt market movements as well as reassessment of the monetary policy prospects, the forward-looking view offered in our report *2023 Economic and Industry Outlook*, which anticipated the transition to a moderate stance given the accumulated warning signs of an eventual financial accident, among other risks, is strengthened. Thus, while the Fed's next meeting in early May is anticipated to be particularly relevant in terms of the next move, the forecast continues to be for a tight monetary path that considers an additional increase of 25 basis points.

Box 1.1.1-a (continued)
Financial instability

Chart F.
United States: risk-free curves

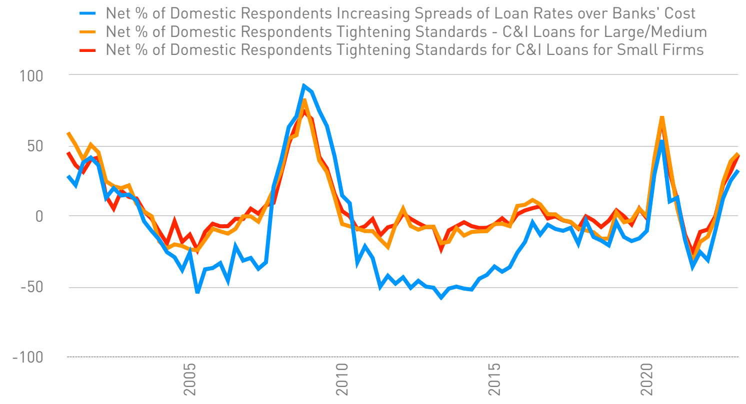


Source: MAPFRE Economics (based on Bloomberg data)

As for the ECB, it continues to advocate gradual interest rate hikes to combat inflation (+25 basis points in May and June).

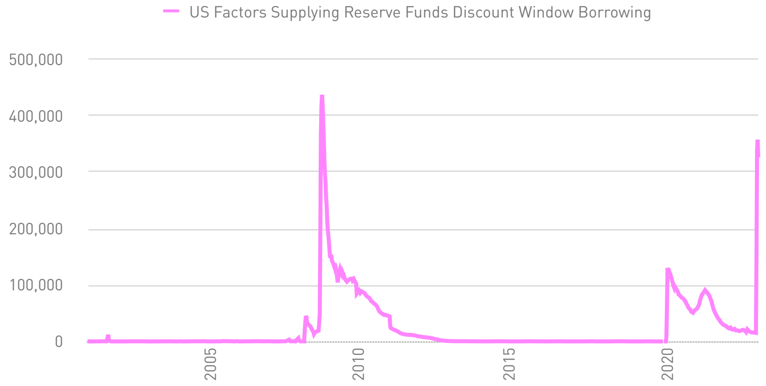
This view of the future monetary stance is supported by several elements: (i) financial conditions that were somewhat decoupled from reality, driven by premature optimism; (ii) the "pain" to come (the inevitable effects of tight monetary policy) had already been forewarned; (iii) March inflation (5.0% and 5.6% core inflation in the United States, compared to 6.9% and 5.7% in the Eurozone) is evidence of the underlying reasons to continue monetary tightening; and (iv) the combination of lower liquidity and normal risk-free interest rates brings the importance of fundamentals back into the analysis and is also a positive mechanism for the correct assessment of risks.

Chart 1.1.1-i
United States: credit standards



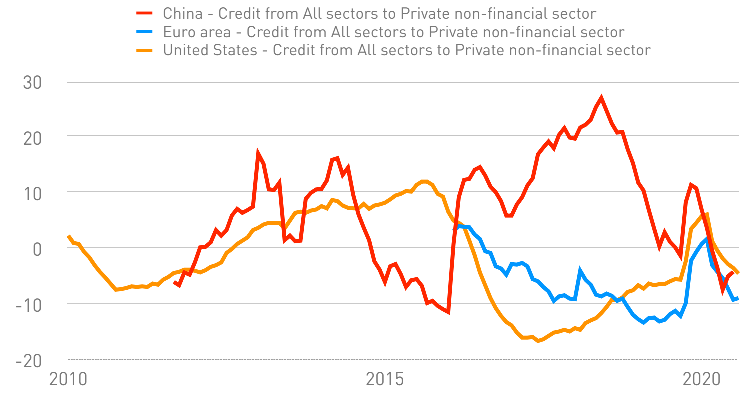
Source: MAPFRE Economics (based on data from Bloomberg, Haver, Federal Reserve)

Chart 1.1.1-j
United States: Federal Reserve discount window



Source: MAPFRE Economics (based on Federal Reserve data)

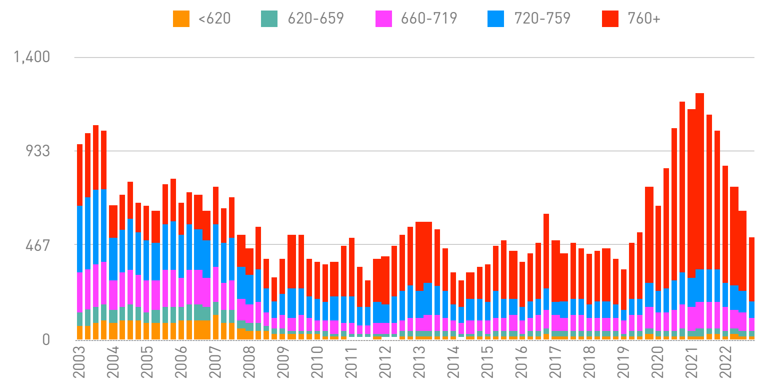
Chart 1.1.1-k
Selected countries: credit gap



Source: MAPFRE Economics (based on BIS data)

Although the initial *shock* had a considerable impact, with falls in the valuations of all risk assets, the news flow has been stabilizing. This has been thanks to the regulators in both the Eurozone and the United Kingdom, offering guarantees on the maintenance of the capital structure in the absorption of losses, and in the United States, with the rapid intervention of the Federal Deposit Insurance Corporation (FDIC) to guarantee deposits, and the Federal Reserve, with the reactivation of the Bank Term Funding Program (BTFP). This crisis of confidence, coupled with constant pressure on deposits in competition with alternatives in short-term, high-quality fixed income and money market products, raises the prospect of further tightening in credit conditions, already in themselves strained by the cyclical timing of monetary policy, as a more cautious view on risk-taking spreads. Consequently, a credit slowdown (or even a

Chart 1.1.1-l
United States: mortgage loan generation by credit scores

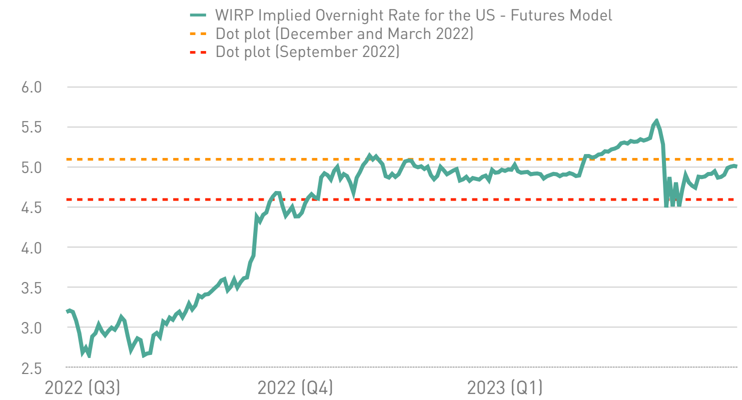


Source: MAPFRE Economics (with Bloomberg and Haver data)

credit crunch) is foreseeable, with effects yet to be determined in the real and financial sectors. In any case, they will require greater efforts to manage liquidity in a fragile context. This situation raises the likelihood and severity of a possible recession if, as noted in our previous reports, such a financial setback shifts us from a liquidity crisis to a solvency crisis of the system, households, companies and financial institutions (see Charts 1.1.1-i to 1.1.1-l).

With regard to monetary policy (see Box 1.1.1-b), the main central banks have continued to move forward with the process of tightening and subsequent normalization, both on the balance sheet and through interest rates, in an effort to slow down the credit cycle that channels into lower demand, via tighter access standards, and thus control inflation. To date, that effort has pushed interest rates into tightening territory at a historically fast pace. However, the upcoming hikes are expected to be rather marginal, allowing for an eventual acceleration of activity and for concerns over price stability to shift to a focus on financial stability. This process would be based on the following arguments: (i) the effects of monetary policy are transmitted with a lag, which is proportional to the efficiency of the financial system's operation; (ii) the effects of monetary policy on the correction of bank credit were already being felt before the episode of financial volatility, which intensified it; and (iii) interest rates, which are already considered close to their *terminal rate*, and the normalization of the balance sheet are moderating inflation, allowing real rates to enter positive territory and thus creating the conditions for a timid recovery of private investment and a disincentive to expand fiscal policy further. This effect is beginning to be seen in some mature markets, although it is clearly noticeable in

Chart 1.1.1-m
United States: Federal Reserve's terminal interest rate forecast



Source: MAPFRE Economics (with Bloomberg and Haver data)

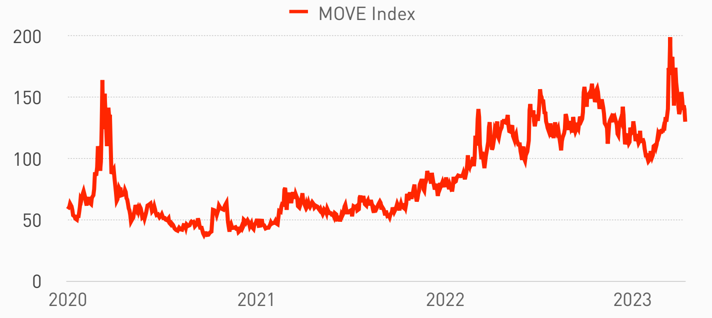
Box 1.1.1-b
Monetary policy update

European Central Bank

In its meeting of March 16, the European Central Bank (ECB) reaffirmed its commitment to monetary normalization by raising benchmark interest rates an additional 50 basis points (bps), placing the range of interest rates on principal financing operations, marginal lending rates and the deposit facility at 3.50%, 3.75% and 3.00 %, respectively. With respect to the asset purchase program, the ECB held firm to the roadmap of reducing the trend of securities acquired through the asset purchase program (APP) at an average pace of 15 billion euros through June. Regarding assets acquired under the Pandemic Emergency Purchase Program (PEPP), it did not offer additional guidance, and is expected to maintain the flexible reinvestment policy until 2024. Finally, with regard to the special liquidity facilities known as TLTROs, despite not introducing anything new, the ECB opened the possibility of relaxing the early repayment terms, along with the use of exchange lines with other central banks or the monetary policy's Transmission Protection Instrument (TPI), reaffirming the separation of available tools to achieve both price stability and financial stability.

The macroeconomic plan presented new outlooks, although it did not consider the most recent events in Switzerland's banking system, with upward economic growth outlooks of 1.0% for 2023 (from the previous 0.5%) and 1.6% for both 2024 and 2025 (versus the previous 1.9% and 1.8%). Inflation is expected to remain high in 2023, with an average rate of 5.3% until the end of the year, 2.9% in 2024 and 2.1% in 2025 (2 to 3 tenths below the December forecasts), along with a moderation of energy prices and a slight appreciation of the euro. In contrast, core inflation is anticipated, with more prolonged persistence, alongside inflation in the services sector and wage compensation (above the historical average). To summarize, as expected, the most optimistic forecast update in relation the growth of economic activity, while offering concerns (perhaps more moderate, but latent) due to inflation in the medium term, they justify the more immediate decision to increase interest rates. At the same time, there are perceived concerns about the health of the financial system, which could blur the roadmap, with the ECB refraining from forecasting future decisions for the time being, under a data-dependent approach going forward. Considering that recent volatility events in the bond markets have exceeded those observed during the COVID-19 crisis (see Chart A), it has also recognized the

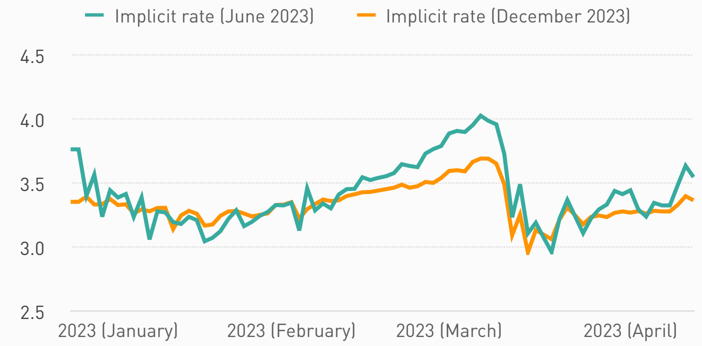
Chart A.
Bond volatility



Source: MAPFRE Economics (based on Bloomberg data)

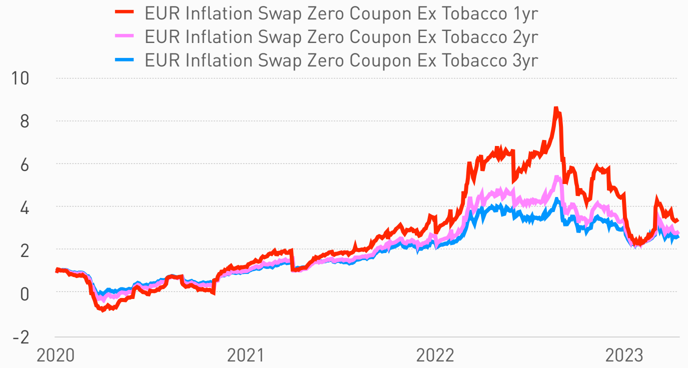
Box 1.1.1-b (continued)
Monetary policy update

Chart B.
Implicit interest rates



Source: MAPFRE Economics (based on ECB data)

Chart C.
Inflation swaps



Source: MAPFRE Economics (based on Bloomberg data)

possibility that any financing stress could be addressed separately (doing everything necessary to combat inflation), using other available tools.

Assessment

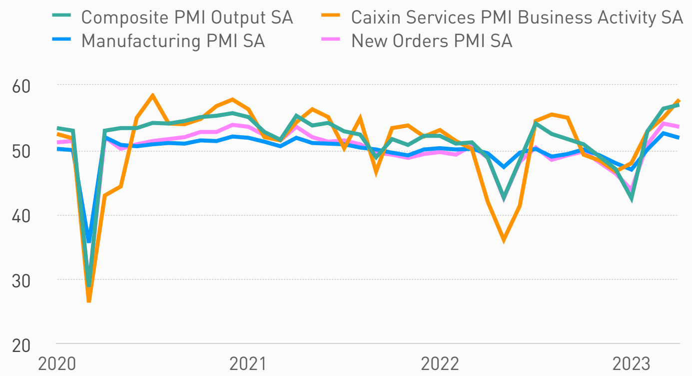
The ECB meeting was marked by turbulence on the financial channel, the confluence of news from the preceding days (the Silicon Valley Bank case before Credit Suisse later in the week), represented by volatility not only in the usual risk assets, but also in the deeper dynamics of expectations, with inflation *swaps* moderating, yield curves steepening again and an abrupt repricing in the scope of the monetary cycle (see Chart B).

In contrast, economic stability has shown a more positive pattern than anticipated in terms of economic performance, and, although persistent in the area of price pressures, there is a stronger sense that the worst is behind us and there is room for positive surprises, while (i) the base effect from March to June will reverse a large part of the energy and raw materials *shock*, (ii) China's industrial production during the first part of the year has been stronger than expected, without transferring tensions to input prices, and (iii) the lag of monetary policy is beginning to show the first consequences of tightening (see Charts C to E).

All in all, the ECB is positioned in a *mixed posture*, with the dichotomy that, on one hand, it is still too early to stop monetary normal-

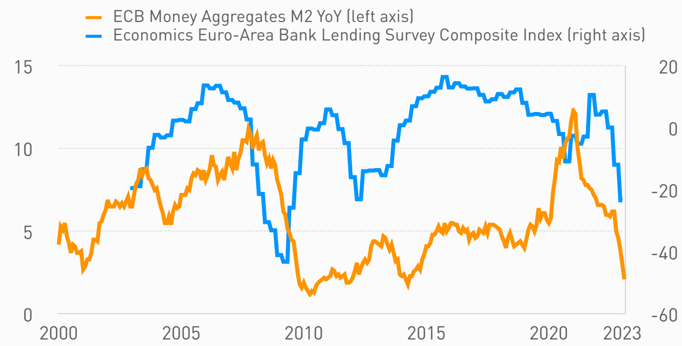
Box 1.1.1-b (continued)
Monetary policy update

Chart D.
China: economic activity levels



Source: MAPFRE Economics (based on Bloomberg data)

Chart E.
Eurozone: financial conditions



Source: MAPFRE Economics (based on Haver and Bloomberg data)

ization, and on the other, that there are enough lights flashing in the financial sector to continue with the roadmap originally set out in December. To summarize, a certain ambiguity is expected in the short term (doing everything necessary to combat inflation, that is, with the will to slow the pace of rate increases to 25 bps, but continuing to raise them at the coming meetings) and a dependence on data for future decisions (reaction capacity, without specifying instruments, a drop in interest rates of instruments becoming less probable), although below the broadest oversight threshold that covers concerns about financial stability.

Federal Reserve

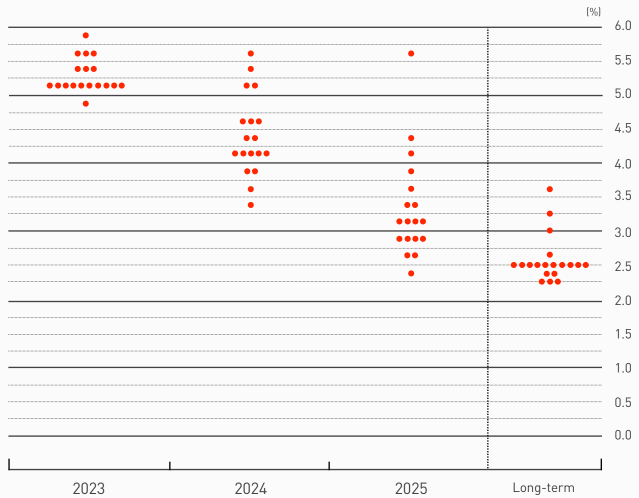
In the March meeting, the United States Federal Reserve again unanimously increased benchmark interest rates by 25 bps, pacing them in the official range of 4.75-5.00%. Along with this decision, the Federal Reserve provided a new benchmark that could be seen as the *terminal rate*, through the dot plot (see Chart F), in line with the position offered last December (range 5.00-5.25%).

However, this view is subject to somewhat more moderate forward guidance where, while reaffirming that future additional rate hikes remain appropriate, some caution was raised about incoming in-

Box 1.1.1-b (continued)
Monetary policy update

formation (the possibility of a pause, but not a cut until at least 2024) in light of the most recent financial instability events that began in early March. Their impact on credit conditions could mean additional monetary tightening, albeit in a more stable situation (after Treasury Secretary J. Yellen's reluctance to insure all bank deposits not originally covered by the FDIC).

Chart F.
United States: Federal Reserve dot plot



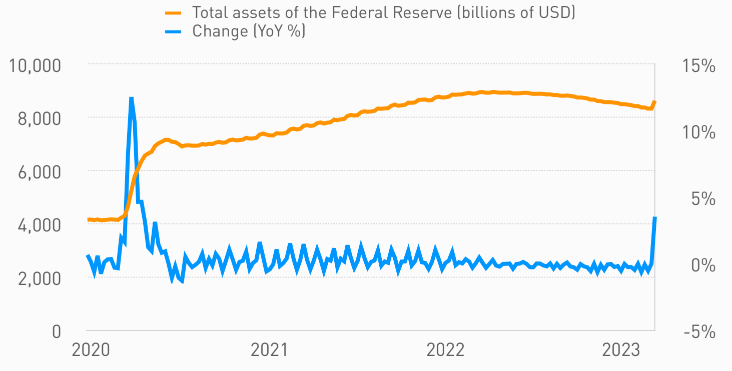
Source: MAPFRE Economics (based on Federal Reserve data)

On the balance sheet side, the Federal Reserve maintained the process of reducing asset holdings, considering both the current pace and the composition of sales, of both Treasury bonds and mortgage-backed assets (MBS), adequate, but differentiating them from the operation of recently resumed reverse repo tools (ON RRP) (BFTD's). While this is similar to injecting liquidity into the system (see Chart G), the former are treated as conventional mechanisms, at a maximum term of 1 year, which seek to buffer one-off liquidity tensions as opposed to the non-conventional QE measures of open purchases from the secondary debt securities market with a long-term time horizon.

Regarding the macroeconomic plan, the estimates show little change. Expected economic activity in the United States was revised slightly down in 2023 and 2024, to 0.4% and 1.2%, respectively (versus the previous 0.5% and 1.6%). On the inflation side, they maintained a moderate downward path on the outlook horizon, although more persistent in the short term, which raises both the expected PCE to 3.2% in 2023 (versus the previous 3.1%), and the measure of core inflation (3.6% versus 2.5% in December), and a return pathway toward the objective of 2% that will not be reached until the long term. In employment terms, and as the labor market continued to show a substantial imbalance in terms of vacancies per employee and the unemployment rate has remained at historical

Box 1.1.1-b (continued)
Monetary policy update

Chart G.
United States: total Federal Reserve assets



Source: MAPFRE Economics (with Haver data)

lows to date, the rebound in unemployment is expected to increase more gradually until it reaches 4.6% in 2024.

In view of the foregoing, and in contrast to the most recent harder-line observations offered during the Congressional and Senate sessions, Jerome Powell offered a more conservative view of the future economic situation. This, combined with the recent developments in the financial markets and the lagging, still-uncertain leverage effect of monetary tightening, is sufficient to suggest that the tighter monetary cycle could be nearing its peak. An additional 25 bps hike is possible due to price dynamics, but weighted (as necessary) toward the scenario of a pause due to financial instability.

Assessment

As the U.S. economy has been moving in a more positive direction than expected, inflation figures have been reflecting and capturing this improvement in the form of stronger price pressures, longer-term inflation reversal, and consequently, a renewed concern that its persistence contains increasingly long-lasting components that permeate into core inflation and feed back into the still latent structural factors. However, looking forward, it is worth noting that the risk of a further acceleration in inflation should lose traction over the coming months (in the broad CPI metric) in the first instance. The main reason for this is the base effects of current energy and other input prices, and secondly, a gradual fading of pressures in the housing and services sector, together with concerns about aggregate demand as lagging monetary policy puts additional pressure on consumption via tighter credit standards (see Chart H).

On the other hand, signs of financial stress originating in the banking system have convincingly emerged as a counterweight to this optimism, raising concerns about the health of the banking sector, a priori healthy in aggregate terms, the outcome of which could lead either to an additional credit crunch through this channel (negatively amplifying the transmission of monetary policy), or to a scenario of broader contagion and dysfunctions in the deeper transmission channels. This would include its less monitored *shadow banking* ramifications, leading to the materialization of a non-linear scenario of financial crisis.

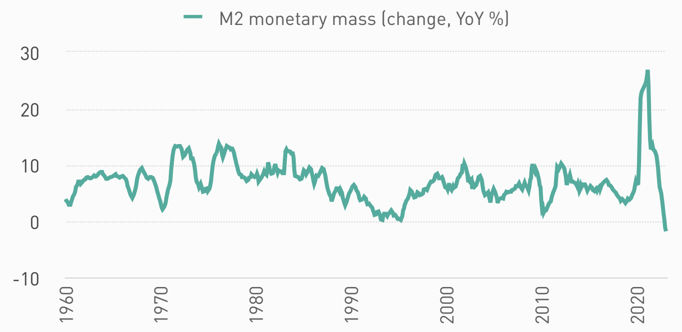
Box 1.1.1-b (continued)
Monetary policy update

Given this circumstance, the Federal Reserve has provided a certain stability to the markets in relation to the direction of monetary policy (see Chart I), which will remain tight until inflation eases, while agreeing to ease policy at a more flexible pace, with the option of both additional hikes and a finally lower *terminal rate*. This provides some room to maneuver given the uncertain development of the most recent events on both fronts, both *economic* (the rebound in growth is expected to be temporary, resulting in lower annual growth) and *financial* (tail risks have a more worrisome slope).

In this sense, and added to the activation of conventional tools to maintain financial stability, in the short term the Federal Reserve's stance could be interpreted as an act of truce or greater understanding of the markets, by factoring in the health of the banking system and the implicit increase in the risk of recession, while reaffirming the intention to slow down demand and eventually inflation.

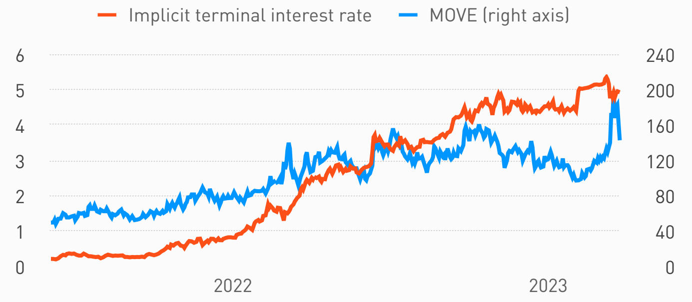
As a result, and as we maintained in our *2023 Economic and Industry Outlook*, those opposing effects will have to rebalance toward lower economic growth and lower inflation, and toward a greater relevance of the risk to financial stability as the lagging effect of the monetary policy places additional pressures on both sides of the equation. Thus, the option of a pause would be considered the most appropriate adjustment measure at the coming meetings.

Chart H.
United States: M2 monetary mass (change, YoY %)



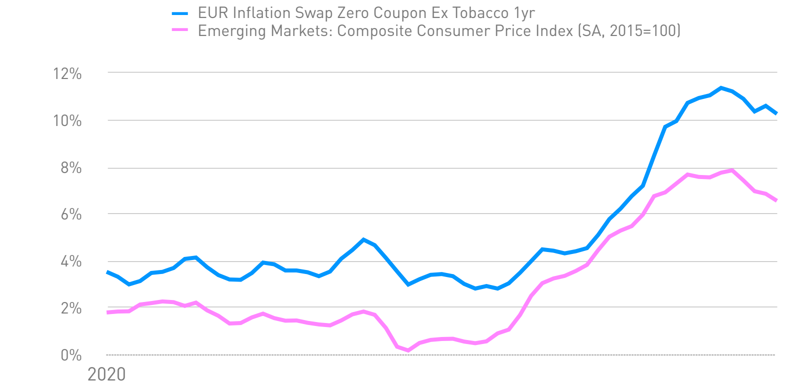
Source: MAPFRE Economics (with Haver data)

Chart I.
United States: implicit terminal rate and volatility



Source: MAPFRE Economics (based on Bloomberg data)

Chart 1.1.1-n
Developed and emerging markets: inflation prices



Source: MAPFRE Economics (with Bloomberg and Haver data)

emerging markets, which are further ahead in the monetary cycle (see Charts 1.1.1-m and 1.1.1-n).

Finally, the geopolitical landscape is doing little to unburden the current risk map. Several elements combine to shape this environment: (i) tensions building around the war in Ukraine, due to both the escalation of military equipment and the consequences of the recent expansion in NATO membership; (ii) the deterioration of multilateral relations, especially between China and the United States, the resetting of European relations in response to the Inflation Reduction Act, and China's neutrality via the paralysis of the Comprehensive Agreement on Investment (CAI); (iii) the Organization of Petroleum Exporting Countries' (OPEC) action to push oil prices higher; (iv) the emerging search for alternatives to dethrone the dollar as the world's reserve currency; and (v) the effect of other bilateral and multilateral agreements, such as the BRIICSS (which includes India and Saudi Arabia), the RIC Alliance (Russia, Iran, China), and the yuan agreement between China and Saudi Arabia.

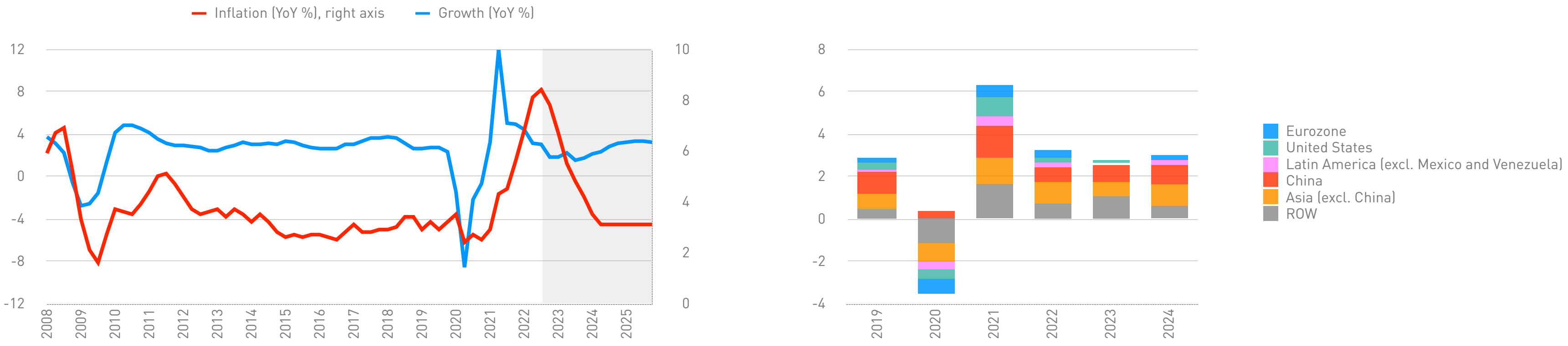
1.1.2 Regional perspective and dynamics

Overall environment

In the updated forecast in this report, global growth prospects have been revised upward in 2023 to 2.8%, compared to 2.0% in our previous report (with a better overall contribution from all economic regions), and to a lesser extent, in 2024 to 3.0%, versus 2.7% previously[7]. This is evidence of a temporary acceleration of growth in the short term, although it cannot be ignored that overall growth will remain below potential, despite the fact that the latter has probably declined over the last three years.

Regarding prices, average inflation for 2023 and 2024 is expected to reach 7.0% and 4.9%, respectively. Even if the rebound in activity makes it more difficult to slow the pace of price increases (not so in the underlying basket, which will delay the adjustment due to already permeated effects), the forecast is based on the fact that wage pressures will remain insufficient to trigger second-round effects. However, there is still a perception of a loss of economic strength throughout the year (partly anticipated during the first half) due to the marked slowdown in demand, a response to the late effects of monetary tightening initiated in 2022, the restriction of credit access and a fiscal policy that will remain in a more neutral space (see Chart 1.1.2-a).

Chart 1.1.2-a
Global: growth and inflation outlook and contribution by region

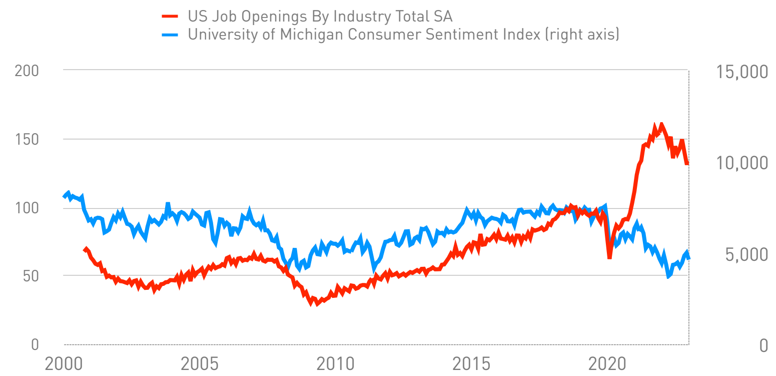


Source: MAPFRE Economics

United States

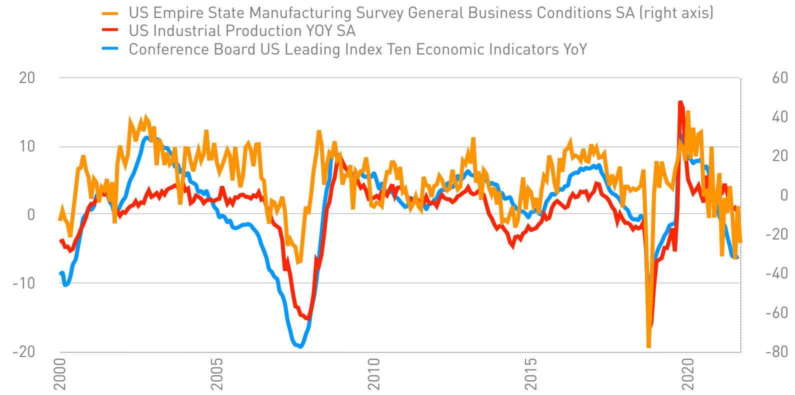
In the United States, economic resilience remains strong, supported by expanding consumer spending data, albeit with a more recent loss of momentum, a tight labor market and wage increases that are trying to catch up with inflation. However, the inertia is still forecast to end in the second half of the year. The country should face a short and not very deep recession at the end of 2023, while maintaining annual growth of 1.0% that should be reduced to 0.7% in 2024 (compared to 0.1% and 0.9% previously). Short-term risks still include the lagged effect of monetary policy (which has yet to fully impact the economy), the eventual need for additional tightening to control inflation that has not been properly signaled, and the risk of exacerbating the ongoing credit slowdown following the recent events in the regional banking sector. In this sense, and al-

Chart 1.1.2-b
United States: consumer confidence and job openings



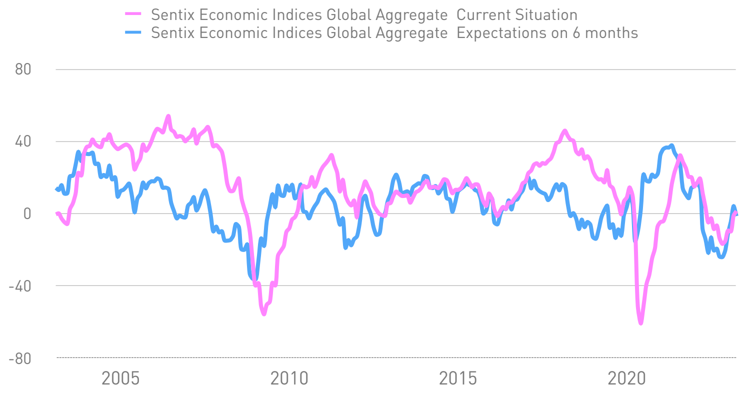
Source: MAPFRE Economics (with Bloomberg and Haver data)

Chart 1.1.2-c
United States: leading indicators and industrial production



Source: MAPFRE Economics (with Bloomberg and Haver data)

Chart 1.1.2-d
Eurozone: Sentix index



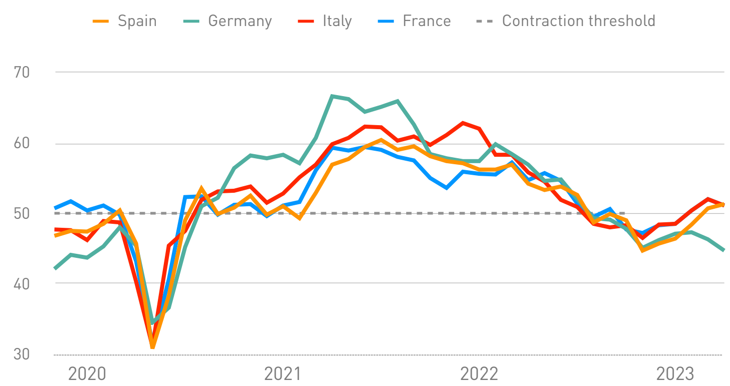
Source: MAPFRE Economics (based on Bloomberg data)

though the probabilities of a financial accident finally materialized last March, the risk of a larger event leading to a hard landing remains high (see Charts 1.1.2-b and 1.1-2-c).

Eurozone

Regarding the Eurozone, the improved forecast has reduced the recessionary outlook for the year, with the region's GDP growth estimated to reach 0.6% in 2023 and 1.3% in 2024 (compared to -0.1% and 1.6% previously), thus breaking with the inertia of downward revisions. This improvement is based on a less pronounced technical recession in Germany (supported by a milder climate, energy efficiency measures, solid fiscal support and energy price containment), with dynamics spreading to oil- and gas-intensive manufacturing countries. At the same time, the recovery of the services sec-

Chart 1.1.3-e
Eurozone: Manufacturing PMIs



Source: MAPFRE Economics (based on Bloomberg data)

tor continues to accelerate, supported by the demand for tourism services and by a labor market that is holding up better than expected. Despite the financial turbulence, additional efforts by the European Central Bank to achieve a *terminal rate*, more uncertain than on the other side of the Atlantic, are to be expected, along with less contained inflation that is expected to remain above target (4.8% in 2023 and 1.1% in 2024) and more dependent on the evolution of geopolitical events (see Charts 1.1.2-d and 1.1.2-e).

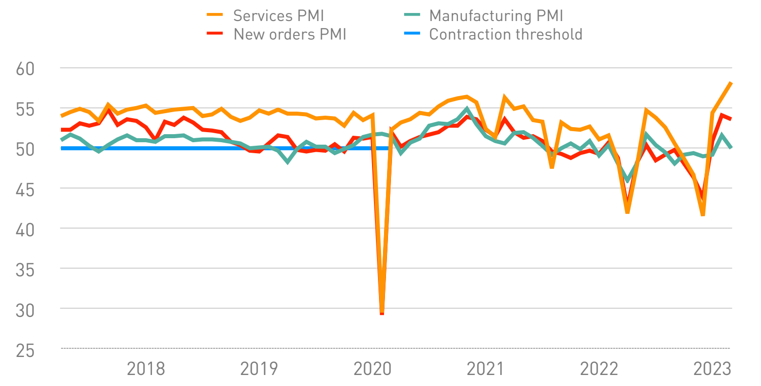
China and Asia Pacific

Regarding the Chinese economy, the international reopening process continues to progress positively, eliminating initial fears of a partial reopening. With this, both activity and production indicators as well as domestic consumption (visible improvement in retail sales and mobility indicators) allow an upward revision in the economic growth forecast for 2023 with the potential to extend to 2024. This effect, coupled with an expansionary economic policy (consumer inflation remains moderate, and producer price indexes are still negative), has increased China's contribution to global growth (around one-third of the total in 2023), thus restoring its role as a supply-side shock absorber (see Charts 1.1.2-f and 1.1.2-g). As for the rest of Asia, the continent is expected to continue acting as a counterweight to the developed economies, thanks to still-positive external demand that allows production levels to remain high, inflation that remains contained and the reopening of China, which is likely to generate positive synergies.

Chart 1.1.2-f
China: mobility

Source: MAPFRE Economics (based on Bloomberg data)

Chart 1.1.3-g
China: PMIs

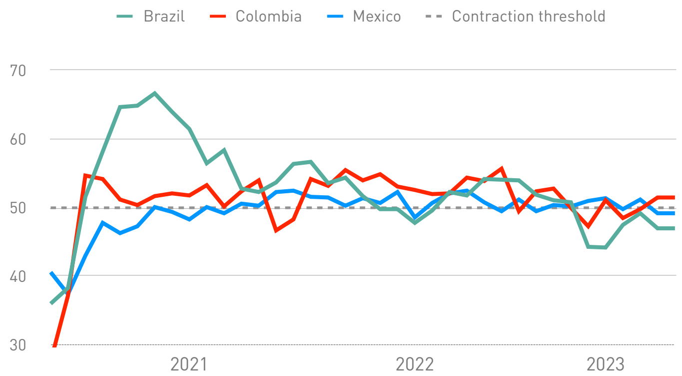


Source: MAPFRE Economics (based on Bloomberg data)

Latin America

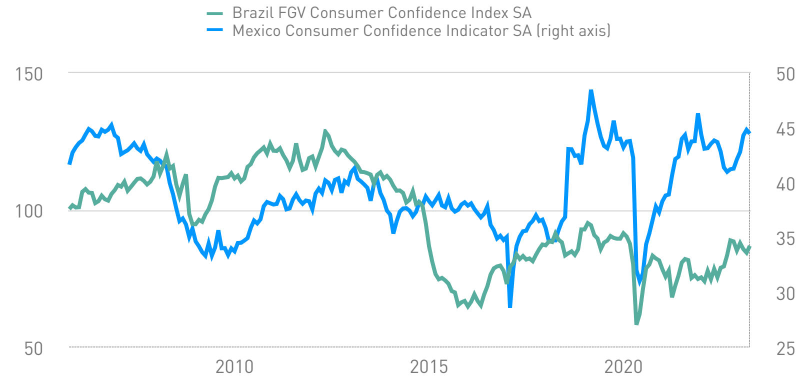
Finally, the outlook for Latin America remains unchanged. Despite the effect of the Federal Reserve's interest rate hikes, the cyclical slowdown induced by pre-emptive monetary tightening, a calendar full of political events and recent pockets of financial instability in the United States and Europe, economic growth in the region continues to hold up. This is supported by a weaker dollar, inflation that is losing momentum and putting real interest rates in positive territory (generating maneuvering room), a more benign loss of external dynamism than anticipated, and a stronger recovery in China. However, while the overall picture looks resilient, the region continues to show a rather heterogeneous dynamic at the country level, in line with the previous recovery. Expectations are positive in 2023 (growth ahead of 2024) for Brazil (underpinned by the prospect of

Chart 1.1.2-h
Brazil, Mexico and Colombia: Manufacturing PMIs



Source: MAPFRE Economics (based on Bloomberg data)

Chart 1.1.2-i
Brazil and Mexico: consumer confidence



Source: MAPFRE Economics (based on Bloomberg data)

fiscal support through the negotiation of a new spending cap, the resilience of external demand and falling inflation, which could loosen monetary policy) and somewhat more modest for Mexico (driven by the external macroeconomic improvement, especially in the United States, strong performance of domestic demand, as well as positive inflow of investments). On the opposite side, downward revisions in 2023 affect Peru (a loss of dynamism weighed down by social unrest) and Colombia (lower consumption, higher interest rates and a stagnant inflation rate). At the same time, the outlook continues to show tacit vulnerabilities in Argentina and Chile, where an economic contraction continues to be projected for 2023 (see Charts 1.1.2-h and 1.1.2-i).

All in all, the global outlook has received a moderate boost after a milder-than-anticipated start to the year, the consolidation of

China's reopening and its co-benefits, an improved economic outlook in the United States, as well as uncertainties (such as the tail risks of 2022) that have been at least partially cleared up. This is happening, however, in a context where global potential growth has fallen below 3%. At the same time, new fragilities in the financial system are emerging as a reminder that the effects of monetary overreaction may be yet to come. Likewise, and despite the fact that so far, it seems that the worst is in the rearview mirror, inflation's downward pressure and rate of decline have been reduced, leaving the main central banks with the complex dilemma of being caught between the pursuit of price stability and financial stability. This dichotomy may transition from a relatively benign baseline scenario to a relatively smooth risk scenario, with the effects of monetary policy leading to a harder landing.

1.1.3 Scenarios and forecasts

Baseline scenario

The *baseline scenario* envisaged in this report considers a broad-based rebound in economic activity that generates a rise in GDP growth forecasts in 2023 and, to a lesser extent, in 2024. At the same time, the scenario foresees inflation continuing to moderate at an appropriate pace in 2023 and more sharply, to approach the central banks' target band, in 2024. This boost to economic growth is underpinned by several elements: (i) weaker-than-anticipated growth in the Eurozone, which manages to avoid recession in the annual calculation; (ii) a positive dynamic in the United States that will continue until at least the first half of the year; and (iii) China gaining ground with its reopening process, consolidating the return to potential growth. Thus, in aggregate terms, emerging economies suffer less deterioration in the face of a more benign external demand environment. The downside of this rebound lies in the anticipation of lower activity heading into 2024, as a result of the effects of monetary policy becoming more acute from the second half of 2023 onwards, with confidence channels deteriorating along with access to credit. Therefore, the *baseline scenario* foresees a path of progressive loss of dynamism starting in the second half of the year, with higher growth than previously proposed, but still below potential growth.

In terms of inflation, the higher activity results in a price increase dynamic that, while continuing to move downward, is expected to do so at a slower pace in the first half of the year, leading to a less flexible core inflation dynamic. In this scenario, high inflation is still anticipated, mainly in 2023, which contains a slightly upward revision with respect to the previous edition of this report, although less intense than that proposed on the supply side. The *baseline scenario* is thus an economic outlook that remains in a state of *stagflation*, but with a more positive tilt, as supply problems seem to be shifting to the demand side.

In terms of economic policy, fiscal policy is expected to continue to lose relevance on its way to neutral territory, while still registering high deficits throughout the forecast horizon. On the monetary policy side, *terminal rates* would peak in May and July 2023, with an additional 25 basis points for the U.S. Federal Reserve and 50 basis points for the ECB. These increases would be followed by a longer pause in the process amid a positive real interest rate environment (until the last quarter of 2023 and first quarter of 2024), after which a staircase decline towards the natural interest rate is forecast. In the emerging markets, and due to the fact that inflation reduction is modeled with a less steep decline and fiscal policy is expected to be more active, the peak of monetary policy is also delayed to the third quarter of 2023.

On the geopolitical front, the war in Ukraine and sanctions on Russia are sustained throughout the forecast horizon (being one of the catalysts for the risk of a *stressed scenario*), together with the multipolar trend, increased fragmentation and reduced dynamism of global trade. Therefore, we have modeled an oil price slightly above the current *spot price* in both 2023 and 2024 (USD/bbl 85 and 81, respectively), although finding a long-term floor in the range of USD/bbl 75-80, as well as a more benign gas price behavior, but subject to higher volatility (mainly due to the Title Transfer Facility, TTF). On the other hand, medium and long-term interest rates infer a similar behavior to monetary policy rates, confirming an interest rate curve that should recover a positive slope as of 2024. Finally, with regard to currencies, the U.S. dollar is expected to come under less pressure, in general terms, as the Federal Reserve's monetary policy leaves behind its peak cycle and inflation cools down, relieving the accumulated pressure on raw materials and emerging currencies. In the case of the Eurozone, with the easing of imported inflation and a later termination of the monetary cycle, the exchange rate would average around 1.08 EUR/USD in 2023, and above 1.10 EUR/USD in 2024, converging in the long term towards the 1.15-1.20 range.

Stressed scenario

The alternative scenario (*stressed scenario*), on the other hand, proposes a growth path that diverges from that of the baseline scenario, placing global growth in 2023 at around 2%. The catalyst for this performance is a resurgence of short-term inflation, driven by a new supply-demand imbalance that is more extended than anticipated, and sufficient to lead to a more punitive and previously undiscounted tightening of financial conditions, which would persist through 2023 and part of 2024. In reaction to the impulse, the credit cycle would enter into contraction, with a correction in the price of risky assets and an accelerated transition to a framework of economic activity that is tilted to the downside.

The shock modeled by the *stressed scenario* maintains inflation rates that raise the annual average by 0.5 percentage points on an aggregate and sustained basis. However, the impact is centered on developed markets, where the shock lasts the longest, as opposed to the rise in emerging economies, which face a more transitory process. As a result, the monetary policy of the major central banks is raising the range of *terminal rates* more aggressively (100 basis points), while accelerating the pace of balance sheet reduction to prevent a change in inflation expectations. Fiscal policy, on the other hand, remains inactive, without resuming the buffering role of previous *shocks*, thus avoiding fiscal dominance events that exacerbate the change in financial conditions.

The transfer to the financial markets establishes an environment of high implied volatility (40 points, in terms of the VIX), with the equity markets declining more than 15%, a deepening of inversion in the interest rate curves (led by the rebound in the short tranches that is not transferred to the rest of the curve), the widening of credit spreads and corrections in the real estate market of more than 10%. In terms of currencies, the U.S. dollar would recover strength against the other currencies (although its exchange rate remains above parity against the euro), being more abrupt in emerging currencies, especially those with structural vulnerabilities.

Finally, in terms of economic activity, the second-order effects of the *shock* forecast in the *stressed scenario* erode both the balance sheets of economic agents and their purchasing power, which deteriorates more profoundly (no fiscal shield or revaluation of wages is modeled). This leads to weaker demand that feels the effects of the monetary policy lag more abruptly, having a more prolonged impact by spreading to consumption and credit during part of 2024.

1.1.4 Risk assessment

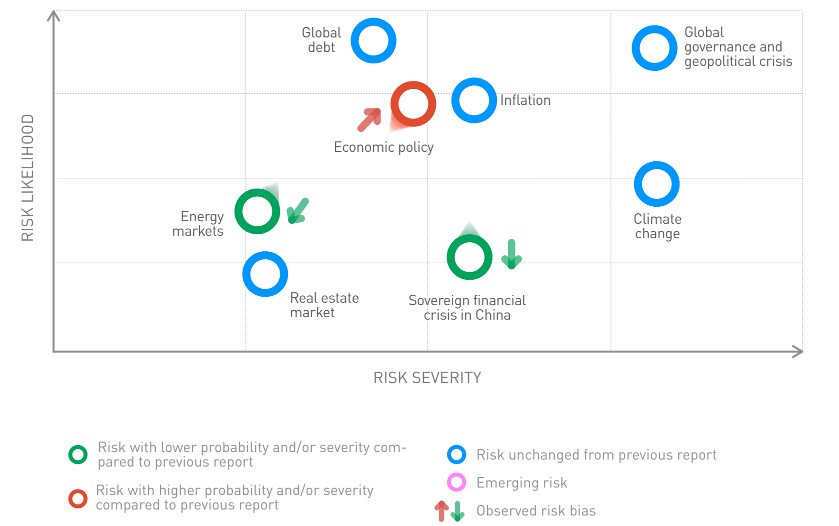
Regarding the outlook for the remainder of 2023, it is necessary to highlight a set of possible additional triggers for the global economy, illustrated in the risk map presented in Chart 1.1.4.

Global governance and geopolitical crisis

The global geopolitical situation in the first quarter of the year has consolidated some relevant dynamics that are likely to define its evolution in the current decade. First of all, a pragmatic solution to the crisis in Ukraine has yet to be found, even under the Chinese peace plan. In this context, the war continues. The United States has announced a 2.6-billion-dollar aid package, and Finland has cleared the final hurdle to NATO membership, with the Turkish Parliament unanimously ratifying its accession, making Finland an official member. Sweden is also expected to join NATO this summer, but efforts by Poland and the Baltic countries to accelerate Ukraine's accession have been met with reluctance by the United States, Germany and Hungary. This development of events seems to have eliminated any hint of coordinated peacemaking, as was initially being promoted with China at the forefront. Furthermore, Belarusian President Aleksandr Lukashenko confirmed reports that Russian nuclear weapons could be on their way to Minsk, raising concerns about the situation in the region.

Meanwhile, tensions between Taiwan and China have increased. Taiwanese President Tsai Ing-wen's recent visit to the U.S. Congress emphasized the need for military training in the event of a Chinese attack. This added a new twist to the U.S.-China tensions, fueled by 19 billion dollars in support for weapons procurement, including HIMARS, F-16s, Javelins, Stingers and Harpoons, which has drawn condemnation from China.

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



Source: MAPFRE Economics

As for Europe, the region is in the midst of a leadership and relationship reset affecting several fronts. On the one hand, the relationship with the United States in response to the Inflation Reduction Act (IRA). On the other, the war in Ukraine, with the escalation of military equipment in the intervention, Russia's rejection of the recent NATO expansion and the review of further sanctions. And, finally, the timid rapprochement with China, which could lead to a halt in the Comprehensive Agreement on Investment (CAI), excluded from the most recent talks.

Meanwhile, the situation in the Middle East has two complementary readings. On the one hand, Israel's extensive internal and external tensions highlight the fragility of its position in the region and the absence of its main supporter, the United States. On the other, China is gradually emerging to fill the gap left by the United States in the region. In this regard, in a surprising move, China brokered a deal between Iran and Saudi Arabia, causing concern among U.S. national security experts.

The issue of cybersecurity, meanwhile, remains a major global concern. Anxiety has continued to grow over suspicions that North Korea is attempting a SolarWinds-style cyberattack[8]. However, information in this regard remains limited and partial.

Finally, new among the long-term geopolitical risks is the emergence of artificial intelligence (AI). This topic has gained exponential relevance with its deployment and widespread adoption in various fields, such as economics, security and defense. AI raises significant challenges about data security and privacy, ethics in its use, and biases and competition for technological supremacy between countries. AI also has implications for labor and society, which may have an impact on global stability and equality. There are now many voices calling for a halt, at least temporarily, to AI training to avoid potential risks. In this regard, Italy has banned the highly regarded ChatGPT, an AI language model developed by OpenAI, on the basis of the General Data Protection Regulation (GDPR), which could have implications for the future of AI in Europe. Also, EU consumer groups are demanding an investigation into ChatGPT and whether the GDPR is being used to regulate AI, which could set a precedent for data protection rules to apply to AI, thereby affecting tech giants such as Google, Microsoft and Meta. The United States, for its part, is considering measures to address potential foreign technological threats through AI, with the introduction of the RESTRICT Act. This law would give the U.S. government the ability to take a variety of measures, from transparency rules to bans, if a threat to national security is identified. The first use case in this mechanism is the analysis of TikTok's influence in the country.

Global debt

At the close of 2022, global debt decreased by 4 trillion dollars to around 300 trillion dollars; in relation to gross domestic product (GDP), the figure reached 337.3%, around 25 percentage points (pp) below its 2021 peak. Compared to 2021, in developed markets, the decrease in relation to GDP was 20 pp, led by governments (-10 pp) and financial companies (-5 pp), compared to -3 pp and -2 pp for non-financial companies and households, respectively. In the case of emerging markets, however, the debt-to-GDP ratio increased by 1.9 pp, largely due to higher indebtedness of non-financial companies (1.9 pp), and to a lesser extent, governments (0.7 pp), as well as to higher borrowing costs and the accumulated depreciation of currencies against the dollar. In the case of China, the debt ratio reached a new all-time high of 346.3% of GDP. Contributions to the increase in this ratio continue to be recorded in all sectors and especially in non-financial companies and government (6.6 pp and 4.8 pp, respectively), largely due to the financing needs during the long period of restrictions due to COVID-19 and the country's economic slowdown.

Despite the reduction in debt *stock* recorded throughout 2022, global debt remained above pre-pandemic levels. This was due to the continuation of the economic expansion, the high inflation environment (as a dilution effect), the more prudent dynamic of agents given the high uncertainty, the change in the monetary cycle characterized by higher rates and the unwinding of the balance sheets of the main central banks. While the dynamics are expected to remain positive, recent events in the bond markets show the increased sensitivity of investors to deteriorating fundamentals, prioritizing stability paths that are feasible and sustainable over time. Likewise, the need to recover a new margin for action in the face of counter-cyclical needs is an additional incentive to maintain the consolidation path.

Economic policy

The dichotomy between price stability and financial stability is becoming increasingly evident, especially as monetary policy tightening approaches its peak, price stability consolidates the signs of remission in inflation, and the effects of monetary policy, although lagged, activate fragilities in the financial system. Generally speaking, and assuming that positive real interest rates will gain ground across the board in the coming months, the possibility of additional tightening is unlikely, and caution is expected to prevail, sustaining current financial conditions for some time.

However, risks are skewed both to the upside (higher inflation in the near term leading to an unanticipated tightening of financial conditions) and to the downside (a tilt of activity towards a less benign macroeconomic scenario or a broader financial accident). In both cases, delays associated with monetary policy add some impatience about how smoothly it is transmitted and how certain its impact is in the different channels. This is because its influence on demand has been less successful (proven from activity and employment data), and its consequences on the credit cycle may respond in a non-linear fashion and quickly spill over to the real economy via additional tightening of financial conditions triggering a *hard landing*. All of this is reflected in a yield curve that remains deeply inverted, as well as in a combined volatility in both the *terminal rates* at the short end of the curve and in the middle and long parts, which determine how the momentum towards any of the proposed scenarios could be catalyzed relatively smoothly.

Sovereign financial crisis in China

As the reopening of the Chinese economy continues to gain traction, economic growth is expected to accelerate thanks to consumer spending, led by a rebound in services (mainly COVID-19 sensitive) and supported by savings accumulated during the prolonged period of restrictions. It will also be underpinned by the continued positive momentum in industrial production, favored by a more coal and Russian oil-intensive energy *mix*, counterbalancing the effects of accelerating domestic activity and allowing inflation rates to remain within range. As a result, the central bank's monetary policy could remain accommodative and focused on the recovery of economic activity, in line with the latest decisions to cut the reserve requirement ratio and liquidity injections, which could be a positive catalyst for future portfolio inflows, favoring the local currency. Finally, with regard to the real estate market, while the downward cycle and uncertainty continue, early signs of stabilization in transactions, prices and climate indicators are beginning to reflect the continued housing easing measures undertaken by the government, although for the time being they remain precarious in terms of eliminating the associated tail risk.

Climate change

The effects of climate change continue to be felt around the world, materializing in the form of both *losses* (2022 was the second consecutive year in which insured damages exceeded the 100-billion-dollar mark) and *uncertainty* through different channels (evolution, mitigation and transition, among others), involving micro and macroprudential regulators. This puts the stability of the financial sector itself at risk both *directly* (chains of events through which climate risk factors affect exposures and counterparties) and *indirectly* (valuation effects on financial assets, underlying assets and hedges).

Inflation

The most recent data continue to show inflation moderating across the board, driven mainly by falling energy and other raw material prices, moderating housing prices, contained goods prices and the baseline effect. In contrast, the buoyancy of prices in the services sector is still on the rise. While this moderation is positive, showing that the worst appears to be behind us, underlying readings continue to reflect more inflexible dynamics.

Despite this, inflation rates remain above central bank targets, subject to some volatility (the more volatile components are currently a greater counterbalance), and risks remain linked to the current uncertainty. It should be emphasized that upward biases remain anchored in: (i) the development of geopolitical events, the uncertain energy outlook and the energy transition; (ii) the performance of raw material prices in view of China's reopening (following the latest consumer and producer price data, there is a possibility of further stimulus to accelerate the start-up of the economy); (iii) second-round effects, mainly in the United States and to a lesser extent in Europe, given the resilience of the latest economic data and labor market tensions; (iv) a moderating fiscal policy, but still with large budgetary deficits; and (v) the correct transmission of a monetary policy whose impact has yet to be entirely felt.

Real estate market

The outlook for the real estate market continues to deteriorate as monetary policy shifts towards interest rates already in tightening territory. This is weakening both credit demand on the consumer side and risk appetite on the investor side, leading to a rebalancing of tighter valuations that has been consolidating since late 2022[9]. Correction in most of the developed economies is noteworthy, with Canada, Australia, Switzerland, the United States and the United Kingdom, among others, leading the adjustment in prices.

Although the correction is expected to be moderate, due to limited supply and a tighter risk policy (both the initial overvaluation level in some markets and the impact on the loss of purchasing power and reduced access to credit), it will continue to signal a more constrained balance point. In turn, while normalization in the residential real estate sector should be constrained by these dynamics, the commercial real estate sector faces more prolonged headwinds (increased telework, e-commerce, below-trend transactions and pre-COVID-19 dynamics not yet restored). Meanwhile, and given the recent turbulence in the banking sector, the risk of an additional impact on credit dynamics with a more pronounced tightening is evident as an additional vulnerability that could amplify the ongoing correction.

Energy markets

Since the beginning of 2023, energy markets have continued to release the tension accumulated in the wake of the geopolitical *shock*, despite its persistence over time. The factors behind this normalization are based on lower global demand, mainly in developed economies, due especially to the phenomenon of high winter temperatures in Europe, which, together with support policies, energy efficiency plans and the diversification of supply sources, made it possible to sustain gas storage levels above the historical average. In Asia, on the other hand, flows from Russia have continued to favor the region and particularly India (favored by refining operations and exports to Europe) and China, whose reopening has continued to progress positively, although without pressure on input prices and supported by imports from Russia (2 million b/d in February), the accumulation of inventories, still-low industrial activity and the incomplete recovery of mobility and consumption.

Despite this, tail risks are likely to persist over time in a structural sense, linked to the ongoing energy transition, the need to safeguard security of supply and the race for leadership in the new industry. This competition, manifested through U.S. "green protectionism" under the Inflation Reduction Act (IRA), the European Green Deal and China's tight control over the production of many strategic inputs, will continue to generate additional tensions to those already latent in traditional energy markets affected by supply shortages, low investment and production subject to an increasingly adverse geopolitical framework. Meanwhile, and following the recent OPEC decisions, the durability of the decline in inflation may be questioned if oil-producing countries are determined to sustain high oil prices, thus prolonging the tension in energy markets.

1.2 Forecasts and risk assessments in selected economies

1.2.1 United States

Commercial real estate and credit crunch: two areas to keep an eye on.

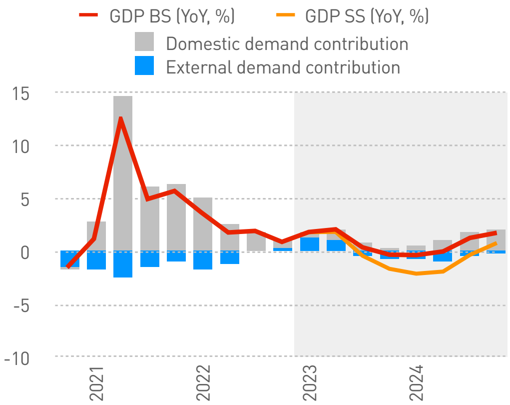
United States

- Economic activity is being sustained as households are spending the savings generated during the pandemic.
- Commercial and residential real estate will struggle with higher interest rates.
- Credit crunch will be a relevant effect of monetary tightening.
- The growth forecast for the U.S. economy has been adjusted to 1.0% in 2023 and 0.7% in 2024.

The U.S. economy grew by 2.1% in 2022, rising 0.9% YoY in the last quarter of the year, which is evidence of a visible slowdown. Consumption has started to lose dynamism, growing 1.8% YoY in the fourth quarter of 2022, marking two quarters with quarter-on-quarter contractions. Investment is also slowing, at +0.7% YoY, and will tend to lose momentum as financing costs rise and credit conditions tighten. Exports grew by 7.2% YoY and imports by 8.2% YoY. Thus, the balance of trade has deteriorated sharply since 2020, as has the current account balance, which has reached a deficit of -3.7% in 2022.

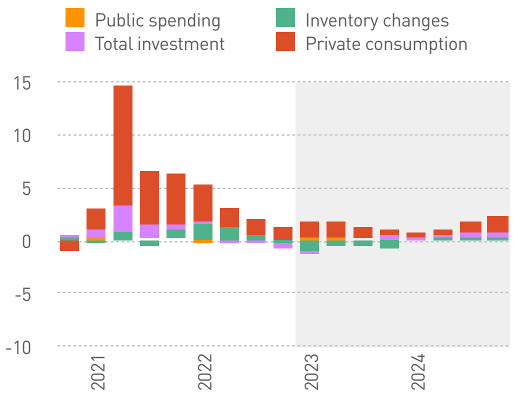
Unemployment rebounded two tenths in February to 3.6%, a fact that is in line with the frequent news of layoffs, starting in the technology sector but spreading to more sectors. The *Conference Board's*

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

	2018	2019	2020	2021	2022	Baseline (BS) 2023(f)	Baseline (BS) 2024(f)	Stressed (SS) 2023(f)	Stressed (SS) 2024(f)
GDP (% YoY)	2.9	2.3	-2.8	5.9	2.1	1.0	0.7	0.4	-0.9
Domestic demand contribution	3.3	2.4	-2.7	7.3	2.5	0.7	1.4	0.0	-0.4
External demand contribution	-0.4	-0.1	-0.2	-1.7	-0.6	0.3	-0.6	0.3	-0.4
Private consumption contribution	2.0	1.4	-2.1	5.7	1.9	1.1	0.8	0.7	-0.2
Total investment contribution	1.0	0.6	-0.3	1.2	-0.1	0.1	0.4	-0.1	-0.2
Public spending contribution	0.2	0.5	0.3	0.2	0.0	0.2	0.0	0.2	0.0
Private consumption (% YoY)	2.9	2.0	-3.0	8.3	2.8	1.5	1.1	0.9	-0.2
Public spending (% YoY)	1.2	3.4	2.2	1.3	-0.2	1.4	0.3	1.4	0.3
Total investment (% YoY)	4.7	2.6	-1.2	5.7	-0.5	0.6	2.0	-0.5	-1.2
Exports (% YoY)	2.8	0.5	-13.2	6.1	7.2	-1.2	2.9	-1.7	1.5
Imports (% YoY)	4.2	1.1	-9.0	14.1	8.2	-2.1	4.9	-2.8	2.9
Unemployment rate (%, last quarter)	3.8	3.6	6.8	4.2	3.6	5.0	5.1	5.2	5.7
Inflation (% YoY, average)	2.4	1.8	1.3	4.7	8.0	4.1	2.9	4.6	2.7
Inflation (% YoY, last quarter)	2.2	2.0	1.2	6.8	7.1	3.3	2.6	3.6	1.9
Fiscal balance (% of GDP)	-6.0	-6.6	-14.8	-12.0	-4.5	-5.1	-5.7	-5.3	-6.5
Primary fiscal balance (% of GDP)	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Current account balance (% of GDP)	-2.1	-2.1	-2.9	-3.6	-3.7	-3.3	-3.6	-3.2	-3.3
Official interest rate (end of period)	2.50	1.75	0.25	0.25	4.50	4.75	2.50	6.50	2.50
3-month interest rate (end of period)	2.81	1.91	0.24	0.21	4.77	5.60	2.68	6.77	2.41
10-year interest rate (end of period)	2.69	1.92	0.93	1.52	3.88	3.31	2.70	3.96	2.85
Exchange rate vs. U.S. 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)	1.15	1.12	1.23	1.13	1.07	1.08	1.11	1.07	1.10
Private lending (% YoY, average)	4.7	5.0	6.3	14.8	1.7	-3.1	3.6	-4.4	1.3
Household lending (% YoY, average)	3.5	3.0	3.4	6.5	6.9	3.4	5.9	2.9	4.2
P.S. non-financial lending (% YoY, average)	9.1	6.6	8.8	3.2	9.4	5.1	2.8	5.1	2.7
P.S. financial lending (% YoY, average)	1.9	2.4	6.8	4.3	10.0	4.5	1.3	4.5	1.1
Savings rate (% pers. disp. income, avg.)	7.6	8.8	16.8	11.9	3.7	3.9	4.4	4.1	5.6

Source: MAPFRE Economics (based on Federal Reserve data)
Forecast end date: April 10, 2023.

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index of leading indicators continued to worsen and stood at -6.5 in February, with significant declines in new building permits, stock markets and a small drop (-1.9%) in hours worked. The consumer confidence indicator relating to expectations has improved slightly, from 70.4 points in February to 73.0 in March, although it is well below 2018–2019 levels. In the residential real estate market, house prices entered negative territory in February, dropping 0.2%. Also, mortgage rates have risen from 3% in 2021 to over 6%. Commercial real estate will also suffer due to higher refinancing costs and lower demand for space, at a time when telecommuting has gained some traction in the wake of forced lockdowns.

As for the outlook for future activity, the March purchasing managers' indexes (PMIs) improved slightly. Thus, the composite PMI stands at 52.3 points, the manufacturing PMI at 49.2 and the services PMI at 53.8. The explanation for these late improvements in the cycle can be found in the lagged effects of the long period of monetary and fiscal expansions, which continue to impact consumption, employment (still at record highs) and prices.

Amid this general environment, the U.S. economy is expected to grow by 1.0% in 2023 and enter a recession in the first quarter of 2024 (see Table 1.2.1 and Charts 1.2.1-a and 1.2.1-b). In fact, the slowdown is beginning to be noticed in many sectors. Consumption has not slowed further because households are still using their creditworthiness and savings accumulated during the pandemic. However, tighter financing conditions will manifest in the coming quarters in consumption levels (the effect sought by the central bank to contain inflation). Thus, looking ahead to 2024, growth is expected to be even lower than this year, at 0.7%, with the slowdown in credit being one of the main factors.

In terms of inflation, the CPI stood at 5.0% in March, with core inflation rising by one tenth of a percentage point to 5.6%. By components, food prices rose 8.4% for households and 8.8% for restaurants. Automotive fuels are down substantially, by 17.3%, while electricity is up 10.2% and household gas is up 5.53%. At its March meeting, the Federal Reserve raised interest rates 25 basis points (bps) to 5.00%. It was an obligatory increase after the crisis unleashed in the regional banks, which raised fears about the health of the entire sector. That rise met market expectations, which had been adjusting downward sharply in the previous days. A halt in interest rate hikes would have raised further suspicions about the health of the banking sector, while a further rise would also have generated high stress in the financial markets. Thus, the Federal Reserve maintains its stance of continuing to fight inflation, and to that end, notes that "some additional policy firming may be appropriate." Furthermore, it will continue to reduce its holdings of Treasury and debt securities as well as mortgage-backed securities. On the other hand, with regard to the banking crisis, although the Silicon Valley Bank case had certain peculiarities due to risk management failures, unrealized losses on bonds are common to more banks. In this regard, the deposit guarantee fund, the Federal Deposit Insurance Corporation (FDIC), has revealed in its statistics that banks have 620 billion dollars of unrealized losses on their books.

The risks to the U.S. economy now center on concerns about the banking sector, although the Federal Reserve and the Treasury have already pledged to provide the necessary liquidity to the banking sector. However, monetary tightening, by its own transmission mechanism, will be reflected in a restriction of bank credit, and this, in turn, in an economic slowdown. In the event that the banking crisis worsens again, the Federal Reserve will have to choose between fighting inflation and new liquidity injections, a difficult dilemma to solve. On the other hand, at the geopolitical level, a number of countries, led by the BRICS (Brazil, Russia, India, China, South Africa), are considering beginning to trade internationally in their own currencies, to the detriment of the dollar. Moreover, China, the largest foreign holder of U.S. bonds, has been reducing its holdings of these financial instruments for 8 years, having reduced its *stock* by 30%.

1.2.2 Eurozone

A delicate balance between tight financial conditions and systemic risk.

The Eurozone grew by 3.5% in 2022, decelerating in the fourth quarter (0.0% QoQ and 1.8% YoY), which was particularly noticeable in private consumption (-0.9% QoQ and 1.2% YoY). On the other hand, investment (3.7% YoY) and exports (7.2% YoY) performed more favorably. For the first two quarters of 2023, the outlook has become more positive than what was predicted a few months ago, as some indicators are improving due to the visible drop in energy costs and the moderate normalization of production chains. While these improvements point to a recession being avoided, the recent volatility in the markets, coupled with the tightening effect of lagged financial conditions, means that optimism is still contained by a margin of uncertainty.

Eurozone

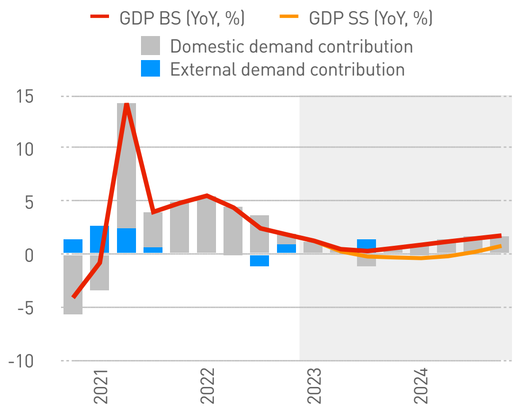
- **Tighter financial conditions will reduce supply levels.**
- **The European Central Bank argues that it has sufficient tools to resolve the dilemma between tight financial conditions and systemic risk.**
- **The outlook is better than a few months ago due to lower energy prices.**
- **The Eurozone growth forecast has been adjusted to 0.6% in 2023 and 1.3% in 2024.**

The March PMI surveys indicate an improvement in the composite (54.1 points) and services (55.6) indicators, but a worsening in manufacturing (47.1), while consumer confidence remains negative at -19.2 points. The industry survey also worsens (by 0.5 points) due to decreases in total orders and export orders. Retail sales are in contraction, down 3.5% YoY (March) and 0.8% MoM. The dynamism of industrial production is maintained, but there are several subgroups in contraction: energy sector (-7.6%), intermediate goods (-5.3%) and durable goods (-0.6%). Automobile sales are trying to recover ground (+11.6%) after a year and a half of bottlenecks in the production lines and accumulated demand from this period.

The historic trade deficit continued in January, exceeding -329 billion euros, and has no signs of being resolved as long as the energy problem remains unresolved. Europe is also concerned about the new U.S. plan, the Inflation Reduction Act, which provides for economic support for its companies. This could make European companies less competitive at a time when energy costs are already a concern. The current account balance stands at -0.7% of GDP.

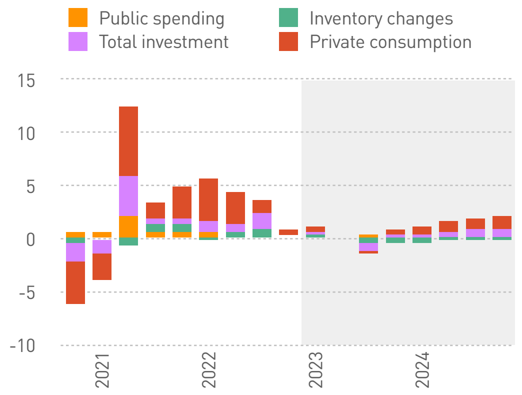
In general, the outlook for recession has receded thanks to the improvement of indicators in recent months. As a result, growth of 0.6% is forecast for 2023 and 1.3% for 2024 (see Table 1.2.2 and Charts 1.2.2-a and 1.2.2-b). However, these forecasts may vary due to the existence of many uncertainties, especially with regard to the recent tensions in the financial sector and bond markets, which after a period of acting as a safe haven sector are once again seeing sovereign bond yields rise.

Chart 1.2.2-a
Eurozone: GDP breakdown and forecasts



Source: MAPFRE Economics (based on ECB data)

Chart 1.2.2-b
Eurozone: domestic demand breakdown and forecasts



Source: MAPFRE Economics (based on ECB data)

Table 1.2.2
Eurozone: main macroeconomic aggregates

						Baseline (BS)		Stressed (SS)	
	2018	2019	2020	2021	2022	2023(f)	2024(f)	2023(f)	2024(f)
GDP (% YoY)	1.8	1.6	-6.3	5.3	3.5	0.6	1.3	0.2	0.1
Domestic demand contribution	1.7	2.4	-5.7	4.0	3.6	0.2	1.4	-0.2	0.1
External demand contribution	0.0	-0.8	-0.5	1.3	-0.1	0.5	0.0	0.5	0.0
Private consumption contribution	0.8	0.7	-4.2	1.9	2.2	0.2	1.0	0.0	0.5
Total investment contribution	0.6	1.4	-1.4	0.9	0.8	-0.1	0.5	-0.3	-0.1
Public spending contribution	0.2	0.4	0.2	0.9	0.2	0.2	0.1	0.2	0.1
Private consumption (% YoY)	1.5	1.4	-7.8	3.7	4.3	0.3	1.9	0.0	0.9
Public spending (% YoY)	1.0	1.7	1.0	4.3	1.1	1.1	0.7	1.1	0.7
Total investment (% YoY)	3.2	6.7	-6.4	3.9	3.8	-0.4	2.4	-1.4	-0.3
Exports (% YoY)	3.6	2.9	-9.2	10.5	7.2	2.0	3.1	1.6	1.8
Imports (% YoY)	3.8	4.9	-8.7	8.3	8.0	1.1	3.4	0.7	2.0
Unemployment rate (%, last quarter)	7.9	7.5	8.3	7.1	6.7	6.9	6.9	7.1	7.5
Inflation (% YoY, average)	1.8	1.2	0.3	2.6	8.4	4.8	1.1	5.2	1.7
Inflation (% YoY, last quarter)	1.9	1.0	-0.3	4.6	10.0	1.7	1.1	2.3	1.2
Fiscal balance (% of GDP)	-0.4	-0.6	-7.0	-5.1	-3.1	-3.6	-2.7	-3.8	-3.4
Primary fiscal balance (% of GDP)	1.4	1.0	-5.5	-3.3	-1.4	-2.0	-1.2	-2.2	-1.8
Current account balance (% of GDP)	2.9	2.4	1.6	2.3	-0.8	1.3	1.4	1.2	1.5
Official interest rate (end of period)	0.00	0.00	0.00	0.00	2.50	4.00	2.50	4.25	2.50
3-month interest rate (end of period)	-0.31	-0.38	-0.55	-0.57	2.13	3.88	1.88	4.88	1.88
10-year interest rate (end of period)	1.17	0.32	-0.19	0.32	3.39	2.97	2.62	3.61	2.75
Exchange rate vs. U.S. dollar (end of period)	1.15	1.12	1.23	1.13	1.07	1.08	1.11	1.07	1.10
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)	2.4	3.4	3.0	3.9	4.0	2.9	5.0	2.4	2.7
P.S. non-financial lending (% YoY, average)	2.3	2.7	3.2	3.0	6.5	5.4	3.5	5.2	2.6
P.S. financial lending (% YoY, average)	-0.4	2.1	-1.1	0.0	7.9	2.9	1.2	2.9	1.0
Savings rate (% pers. disp. income, avg.)	12.5	13.2	19.8	17.9	13.7	13.8	13.6	13.8	14.3

Source: MAPFRE Economics (based on ECB data)
Forecast end date: April 10, 2023.

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Inflation, on the other hand, stood at 6.9% YoY in March, easing due to base effects and lower energy costs. Likewise, core inflation remains stubbornly entrenched and reached 5.7% YoY. Food prices increased by 17%, and in some countries in the region, the figure approached 20%. Fuels have moderated their climb and are now 3.3% higher than last year. Car prices are 8% more expensive, flight prices 23% and hotel prices 10%.

The European Central Bank (ECB), at its March meeting, raised rates by 50 bps, according to the pre-established script, leaving the main refinancing rate at 3.50% and the deposit rate at 3.00%, despite the stress in the financial system in the previous days. The ECB Governing Council considers it necessary to continue raising interest rates in order to bring inflation back to the 2% target, but did not commit itself to future rate hikes, a decision that will depend on future data. The ECB is monitoring tensions in financial markets and will respond as necessary to ensure price and financial stability. Asked about the dilemma of tackling one or the other, because of the stress that interest rate hikes are generating, the ECB indicated that it has the necessary tools to provide the necessary liquidity support and preserve a smooth transmission of monetary policy.

Thus, the ECB is expected to be within 50 bps of the *terminal rate*, making two 25 bps hikes in May and June, to bring the *terminal rate* to 4.00% (main refinancing operations). However, at the economic level, this desired smooth transmission of monetary policy acts with a lag in the revisions of variable-rate loans, which take a year to be fully revised. Therefore, the impact on the economy will not be seen for some time. In any case, it is possible that the tightening of financial conditions could have the undesired effect of restricting supply, thus aggravating the problem that is being tackled: inflation.

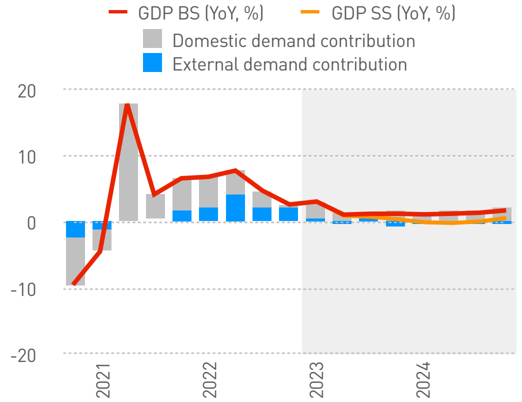
In summary, the outlook for activity in the Eurozone has improved, but risks have not, as stress in the financial sector is not only related to the specific management of certain banks' exposures. Over the past 20 years, central banks have accustomed economic agents to low interest rates, and the transition to a different paradigm may have occurred too quickly. On the other hand, the energy problem has not been completely solved, and companies will have to deal with higher costs in addition to higher financing costs. Inflation may benefit from positive base effects, but as is being observed in core inflation, price revisions by businesses are already widespread. At the geopolitical level, there is no perceived improvement in the sense of seeking peace in Ukraine, but rather both sides are betting on victory as the only way out. The West does not seem interested in China's proposal to mediate in the conflict, since it no longer sees China as a neutral participant.

1.2.3 Spain

Better prospects than a few months ago, albeit with economic activity slowing down.

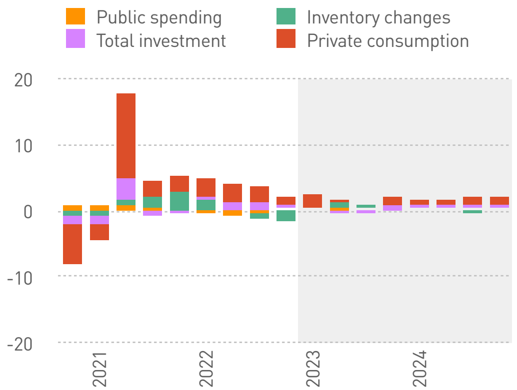
Economic performance in Spain is comparatively better than in other European countries. In 2022, the Spanish economy grew by 5.5% for the year as a whole. In the fourth quarter, GDP dynamism showed some weakening (0.2% QoQ and 2.6% YoY) due to the tightening of financial conditions for individuals and companies. Private consumption contracted by 1.8% QoQ, although not in automobile purchases, which continue to recover following the supply shortage crisis (semiconductors). Public consumption (+1.9% QoQ) evolved in line with expectations and with the increase in fiscal support. Ex-

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)	
	2018	2019	2020	2021	2022	2023(f)	2024(f)	2023(f)	2024(f)
GDP (% YoY)	2.3	2.0	-11.3	5.5	5.5	1.7	1.4	1.3	0.1
Domestic demand contribution	2.9	1.6	-9.1	5.2	2.9	1.6	1.7	1.2	0.2
External demand contribution	-0.6	0.4	-2.3	0.3	2.6	0.1	-0.3	0.1	-0.1
Private consumption contribution	1.0	0.6	-7.0	3.4	2.4	0.9	1.0	0.7	0.2
Total investment contribution	1.2	0.9	-1.9	0.2	0.8	0.0	0.6	-0.2	0.0
Public spending contribution	0.4	0.4	0.7	0.6	-0.2	0.4	0.3	0.4	0.3
Private consumption (% YoY)	1.7	1.1	-12.2	6.0	4.3	1.6	1.8	1.2	0.4
Public spending (% YoY)	2.3	1.9	3.5	2.9	-0.9	1.9	1.5	1.9	1.5
Total investment (% YoY)	6.3	4.5	-9.7	0.9	4.3	-0.2	3.0	-1.1	-0.1
Exports (% YoY)	1.7	2.2	-19.9	14.4	14.9	2.3	1.5	2.0	0.4
Imports (% YoY)	3.9	1.3	-14.9	13.9	7.7	2.2	2.5	1.8	0.7
Unemployment rate (%, last quarter)	14.5	13.8	16.1	13.3	12.9	13.1	13.0	13.4	14.0
Inflation (% YoY, average)	1.7	0.7	-0.3	3.1	8.4	3.7	2.5	4.0	1.7
Inflation (% YoY, last quarter)	1.7	0.4	-0.7	5.8	6.6	3.8	2.1	4.2	0.8
Fiscal balance (% of GDP)	-2.6	-3.1	-10.1	-6.9	-4.0	-4.6	-3.8	-4.8	-4.5
Primary fiscal balance (% of GDP)	-0.2	-0.8	-7.9	-4.7	-1.7	-2.1	-1.2	-2.2	-1.8
Current account balance (% of GDP)	1.9	2.1	0.6	0.9	0.8	1.3	1.3	1.1	1.7
Official interest rate (end of period)	0.00	0.00	0.00	0.00	2.50	4.00	2.50	4.25	2.50
3-month interest rate (end of period)	-0.31	-0.38	-0.55	-0.57	2.13	3.88	1.88	4.88	1.88
10-year interest rate (end of period)	1.42	0.47	0.06	0.60	3.66	3.39	3.09	4.08	3.32
Exchange rate vs. U.S. dollar (end of period)	1.15	1.12	1.23	1.13	1.07	1.08	1.11	1.07	1.10
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)	-0.3	-0.2	-1.0	0.1	1.0	2.5	2.5	2.0	0.3
P.S. non-financial lending (% YoY, average)	-1.9	0.0	2.0	3.5	2.2	2.3	3.0	1.6	-1.0
P.S. financial lending (% YoY, average)	6.5	6.5	3.2	-1.0	-10.1	2.1	1.9	2.1	1.6
Savings rate (% pers. disp. income, avg.)	5.6	8.2	17.8	13.8	6.2	5.3	5.8	5.4	6.7

Source: MAPFRE Economics (based on INE data)
Forecast end date: April 10, 2023.

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Spain

- **Spain is doing comparatively better than other European economies.**
- **The growth forecast for 2023 improves to 1.7%.**
- **Consumption slowed in the last quarter of 2022 and is impacted by the rising cost of living.**
- **It will be difficult for inflation to continue falling, as evidenced by the behavior of the core inflation rate.**
- **The international banking sector event will accelerate the transmission of tight monetary policy.**

ports and imports, on the other hand, both decreased, reflecting both external and domestic demand, but the outlook for the coming quarters is for a moderate improvement.

As for leading indicators, the March Purchasing Managers' Indexes (PMIs) are all in expansion territory, with the composite at 58.2, manufacturing at 51.3 and services at 59.4 points. The consumer confidence indicator remains negative (-22.1) due to the loss of purchasing power of wages and the tightening of financing conditions. The European Commission's economic sentiment indicator (99.5) is below 2019 levels, and the retail sector survey (1.4) reveals some apathy, as expected, while retail sales are holding up (+5.5% YoY in January).

Thus, the outlook for the Spanish economy has improved slightly in recent months, thanks to the moderation of energy costs and the normalization of production chains. Thus, the forecast is for GDP growth of 1.7% in 2023, with no contraction in any quarter, driven by a recovery in net exports and a reasonable performance of consumption given the circumstances of inflation and high financial costs. However, with the rise in Euribor, households with mortgages will see their disposable income decrease (see Table 1.2.3 and Charts 1.2.3-a and 1.2.3-b).

Inflation reached 3.3% in March, a desired decline, although the price increase is in addition to the 8.5% of the same period of the previous year. Core inflation remains persistently on the rise, at 7.5%, as a result of economic agents eventually having to pass on the higher costs of their inputs to finished products. Food is up 16.5% (March), while household energy supplies are down (-16.2%). With regard to future inflation, companies are moderating wage increases (with the exception of the minimum wage), while pensions have kept pace with the CPI. Inflation, while benefiting from base effects, will not experience a more definitive easing until the energy problem is resolved, while higher financial costs will also eventually feed through to the prices of goods and services.

As for the risks to the Spanish economy, the recent episode in the banking sector has been somewhat calmed by the ECB's intentions to use the necessary tools to avoid liquidity tensions while maintaining its commitment to fight inflation. Markets are now pricing in a lower terminal level of central bank interest rates: 3.6%, the ECB's deposit rate as of April 14, versus 3.80% at the beginning of March. What seems clear is that the banks themselves will monitor their liquidity levels more closely, resulting in tighter credit conditions, which is ultimately what the ECB intends with the transmission of a tighter monetary policy. With respect to activity levels, the outlook is better than a few months ago, and in the absence of any disruptive event, growth will continue, albeit moderated by the loss of purchasing power and an external context that is also slowing down.

1.2.4 Germany

More positive outlook for activity, though problems persist.

Germany

- **Inflation in Germany remains very high and will struggle to come down.**
- **Growth will continue to slow until the energy problem is solved.**
- **The growth forecast has been adjusted: growth should be flat in 2023 and 1.3% in 2024.**
- **The emergence of risks in the international banking system raises new doubts.**

German GDP ended 2022 with growth of 1.9%, taking advantage of the fact that the first three quarters still maintained good growth momentum. In the fourth quarter, there was a quarterly contraction of 0.4% QoQ, although in year-on-year terms it was still +0.9% YoY. Consumption contracted in Q4 2022 (-1.0% QoQ), as did investment, -2.5% QoQ, exports, -1.0% QoQ, and imports, -1.3% QoQ, reflecting that the economy is in the slowdown phase that had been anticipated.

The Purchasing Managers' Indexes (PMIs) for March improved, with composite and services PMIs at 52.6 and 53.9 points, respectively, while the manufacturing PMI worsened to 44.4 points. The construction index fell to 42.9 from 48.6 in February, pointing to another month of contraction. Factory orders, an indicator compiled by the central bank, are 11% below the previous year, with the chemical and metallurgical sectors being the hardest hit (20% below the previous year), while the automotive and electronics sectors show the smallest declines.

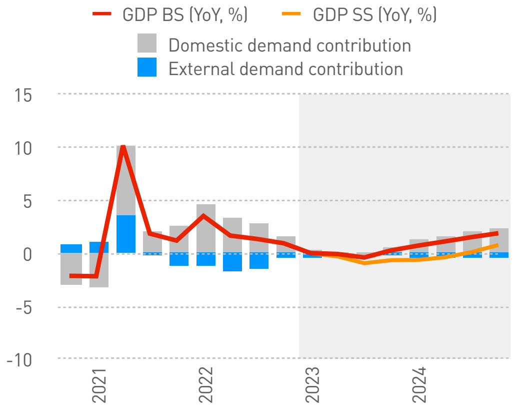
Consumer confidence is low (-30.5 in March) but has improved from -42.8 in October, with very negative income expectations due to the loss of real purchasing power, a factor that is reflected in economic expectations and purchase intentions. Retail sales (-1.3% in February) are contracting in virtually all items, especially those most affected by inflation (food, -10%, household goods -8%, online shopping -8%, shopping malls, -10%).

Thus, a continuation of the slowdown is expected for the coming quarters, especially in consumption, due to the loss of purchasing power and tighter financial conditions. GDP is expected to contract in the second and third quarters, albeit less than expected a few months ago, resulting in a short and shallow recession. The ZEW investor survey of expectations fell to 13 points in March from 28.1 in February.

Overall, the outlook for 2023 has improved marginally, with the economy now expected to contract only in the second and third quarters, thus compatible with a short recession, and ensuring a year with no decline. Thus, German GDP growth is forecast to be zero, at 0% versus -0.9% in our previous report. This is due to lower-than-expected energy costs, which in turn stem from an expected global slowdown (see Table 1.2.4 and Charts 1.2.4-a and 1.2.4-b).

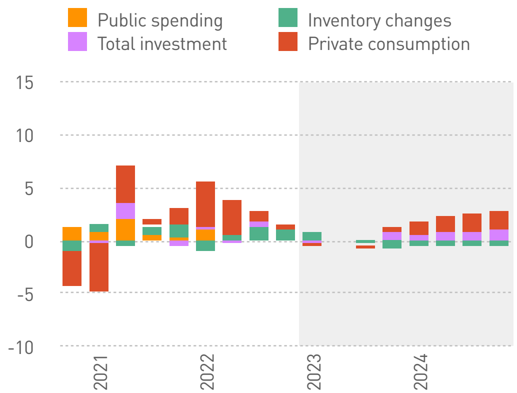
Inflation, meanwhile, remained high at 7.4% (provisional) in March, with harmonized inflation (the one that allows comparison between European countries) at 7.8%. By categories, food is up 22.3% (provisional data for March), while in the other items (Feb-

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

	2018	2019	2020	2021	2022	Baseline (BS) 2023(f)	Baseline (BS) 2024(f)	Stressed (SS) 2023(f)	Stressed (SS) 2024(f)
GDP (% YoY)	1.0	1.1	-4.1	2.6	1.9	0.0	1.3	-0.5	0.0
Domestic demand contribution	1.6	1.7	-3.1	1.9	3.0	0.0	1.8	-0.4	0.5
External demand contribution	-0.5	-0.6	-1.0	0.7	-1.2	-0.1	-0.5	-0.1	-0.5
Private consumption contribution	0.8	0.9	-3.1	0.2	2.2	0.0	1.6	-0.1	1.1
Total investment contribution	0.7	0.4	-0.6	0.2	0.1	0.1	0.7	-0.1	0.2
Public spending contribution	0.2	0.5	0.8	0.8	0.3	0.0	0.0	0.0	0.0
Private consumption (% YoY)	1.5	1.7	-5.9	0.4	4.4	0.0	3.1	-0.3	2.1
Public spending (% YoY)	0.8	2.6	4.0	3.8	1.2	0.2	0.1	0.2	0.1
Total investment (% YoY)	3.4	2.0	-3.0	1.0	0.6	0.5	3.6	-0.7	0.8
Exports (% YoY)	2.4	1.3	-10.1	9.5	3.0	1.5	2.8	1.2	1.4
Imports (% YoY)	4.1	2.9	-9.1	8.9	6.1	1.9	4.1	1.4	2.7
Unemployment rate (%, last quarter)	5.0	5.0	6.1	5.3	5.5	5.3	5.1	5.5	5.8
Inflation (% YoY, average)	1.8	1.4	0.6	3.0	6.9	5.4	1.8	5.5	2.0
Inflation (% YoY, last quarter)	2.0	1.2	-0.1	4.7	8.7	2.0	2.3	2.1	-0.2
Fiscal balance (% of GDP)	1.9	1.5	-4.3	-3.7	-2.6	-3.2	-2.0	-3.3	-2.7
Primary fiscal balance (% of GDP)	2.8	2.3	-3.7	-3.1	-2.1	-2.5	-1.3	-2.6	-1.9
Current account balance (% of GDP)	8.1	7.7	6.9	7.4	3.8	5.2	4.7	5.2	4.8
Official interest rate (end of period)	0.00	0.00	0.00	0.00	2.50	4.00	2.50	4.25	2.50
3-month interest rate (end of period)	-0.31	-0.38	-0.55	-0.57	2.13	3.88	1.88	4.88	1.88
10-year interest rate (end of period)	0.25	-0.19	-0.58	-0.18	2.57	2.30	2.01	2.85	2.05
Exchange rate vs. U.S. dollar (end of period)	1.15	1.12	1.23	1.13	1.07	1.08	1.11	1.07	1.10
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)	2.4	4.6	4.3	5.1	4.9	5.5	9.3	4.7	5.7
P.S. non-financial lending (% YoY, average)	9.9	4.6	4.4	2.7	7.7	5.8	3.4	5.8	3.2
P.S. financial lending (% YoY, average)	1.9	11.6	10.2	8.5	13.8	1.8	1.6	1.7	1.2
Savings rate (% pers. disp. income, avg.)	11.2	10.7	16.6	15.3	11.5	11.4	11.4	11.5	11.9

Source: MAPFRE Economics (based on DESTATIS data)
Forecast end date: April 10, 2023.

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ruary data), fuels for private use moderated to 3.3%, while gas is 52.5% higher YoY, electricity is up 23.1% and flights are up 24%. These latest data, as in the Eurozone as a whole, are surprising because they did not fall further, when they were expected to decline due to the base effect. This means that economic agents, companies and workers have already started to reflect the higher costs in prices and wage demands, which makes it difficult for inflation to come down.

Germany's economy suffers from high inflation, high energy costs that make its industry uncompetitive and tightening financial conditions. Wages are losing purchasing power, and this is reflected in retail sales. Expectations of moderating inflation are fading, as high energy costs persist over time and inflation begins to have second-round effects (rising wages and generalized price increases in products).

For Germany, a highly industrialized country, higher energy costs over time are very negative for the competitiveness of its industries. In fact, the current account balance of the entire European Union is highly dependent on the volume of net exports from Germany, so an urgent resolution to high energy costs is key for the entire region.

More recently, financial stability risks have surfaced due to the aggressive cycle of interest rate hikes, with central banks trying to reassure markets that there are sufficient instruments to sustain liquidity levels in the banking system. Doubts about the banking sector have resulted in a renewed appetite for government bonds, which serve as a refuge amid doubts about the banking sector.

1.2.5 Italy

**Economic indicators are improving,
but interest rate hikes are increasing financial risk.**

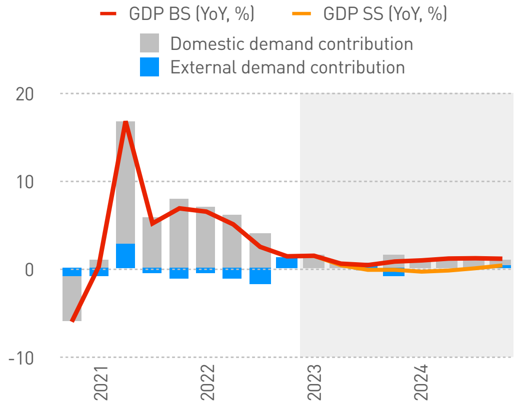
Italy

- Indicators suggest that Italy's economy will be able to escape the recession.
- The GDP growth forecast has been raised to 0.8% for 2023.
- Industrial production has improved slightly and energy costs are down, although medium-term concerns remain.
- The looming crisis in the banking sector is a new factor to be taken into account.

Italian GDP grew by 3.8% in 2022 (+1.4% YoY in Q4), defying forecasts for a sharper slowdown. In the last quarter of 2022, consumption showed signs of weakness in the face of the gradual loss of household purchasing power caused by rising prices (+1.6% YoY and -1.6% QoQ), to the extent that wages have risen by 1.5%, while inflation was close to 12% at the end of the year. Investment grew by 2.0% QoQ, exports were up 2.6% QoQ, while imports decreased by 1.7% QoQ, basically due to the easing of energy costs.

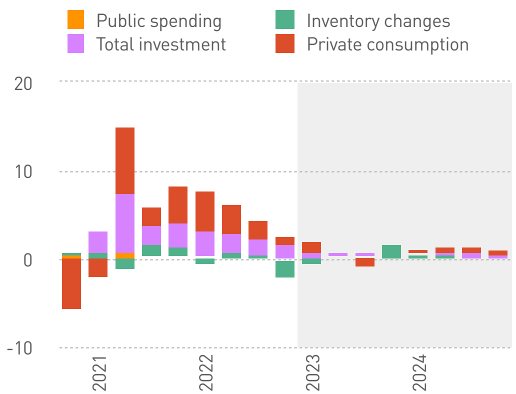
Industrial production, meanwhile, started the year well (+1.4% YoY in January) after a volatile 2022. Retail sales also improved in January (+0.7% YoY), improving in all items except apparel and *online* sales (both with slight declines). Consumer confidence improved in February to 104 points, while the March Purchasing Managers' Indexes (PMIs) also improved, with the composite at 55.2 points, manufacturing at 51.1 and services at 55.7, while construction worsened to 47.4 points.

Chart 1.2.5-a
Italy: GDP breakdown and forecasts



Source: MAPFRE Economics (based on ISTAT data)

Chart 1.2.5-b
Italy: domestic demand breakdown and forecasts



Source: MAPFRE Economics (based on ISTAT data)

Table 1.2.5
Italy: main macroeconomic aggregates

						Baseline (BS)		Stressed (SS)	
	2018	2019	2020	2021	2022	2023(f)	2024(f)	2023(f)	2024(f)
GDP (% YoY)	0.8	0.5	-9.0	7.0	3.8	0.8	1.1	0.4	0.0
Domestic demand contribution	1.1	-0.3	-8.2	7.0	4.3	0.8	1.0	0.4	-0.3
External demand contribution	-0.3	0.7	-0.9	0.0	-0.5	0.0	0.1	0.0	0.3
Private consumption contribution	0.6	0.1	-6.3	2.8	2.7	0.1	0.5	-0.1	-0.1
Total investment contribution	0.5	0.2	-1.5	3.4	2.0	0.3	0.4	0.1	-0.2
Public spending contribution	0.0	-0.1	0.0	0.3	0.0	0.2	-0.1	0.2	-0.1
Private consumption (% YoY)	1.0	0.2	-10.4	4.7	4.6	0.2	0.9	-0.2	-0.2
Public spending (% YoY)	0.1	-0.6	0.0	1.5	0.0	1.0	-0.4	1.0	-0.4
Total investment (% YoY)	2.8	1.2	-8.0	18.6	9.7	1.5	1.7	0.5	-1.1
Exports (% YoY)	1.6	1.8	-14.3	14.1	10.2	1.4	3.4	1.0	2.1
Imports (% YoY)	2.8	-0.5	-12.7	15.3	12.5	1.4	3.2	1.0	1.4
Unemployment rate (%, last quarter)	10.5	9.7	9.8	9.0	7.8	8.2	8.4	8.3	8.9
Inflation (% YoY, average)	1.1	0.6	-0.1	1.9	8.2	5.8	1.7	6.3	0.7
Inflation (% YoY, last quarter)	1.4	0.3	-0.2	3.5	11.7	0.7	2.3	1.3	0.2
Fiscal balance (% of GDP)	-2.2	-1.5	-9.7	-9.0	-8.0	-4.7	-3.0	-4.9	-3.7
Primary fiscal balance (% of GDP)	1.4	1.9	-6.2	-5.4	-3.6	0.0	1.8	-0.1	1.3
Current account balance (% of GDP)	2.6	3.4	3.8	3.0	-0.7	-0.1	-0.4	-0.4	-0.4
Official interest rate (end of period)	0.00	0.00	0.00	0.00	2.50	4.00	2.50	4.25	2.50
3-month interest rate (end of period)	-0.31	-0.38	-0.55	-0.57	2.13	3.88	1.88	4.88	1.88
10-year interest rate (end of period)	2.77	1.43	0.52	1.19	4.72	4.20	3.89	4.86	3.99
Exchange rate vs. U.S. dollar (end of period)	1.15	1.12	1.23	1.13	1.07	1.08	1.11	1.07	1.10
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)	1.8	2.2	1.2	3.0	3.4	1.7	2.9	1.3	1.0
P.S. non-financial lending (% YoY, average)	-0.5	-0.7	3.3	0.1	2.0	2.3	3.4	1.6	-0.6
P.S. financial lending (% YoY, average)	25.1	-5.8	-10.3	22.7	-5.0	-0.1	2.2	-0.5	0.8
Savings rate (% pers. disp. income, avg.)	9.6	9.5	17.0	14.4	9.6	8.7	9.3	8.7	10.3

Source: MAPFRE Economics (based on ISTAT data)
Forecast end date: April 10, 2023.

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In 2023, despite this improvement in the indicators, expectations should moderate, as the impact of interest rate hikes is delayed somewhat. It also remains to be confirmed whether the turbulence of recent weeks in the banking sector will eventually affect any major Italian bank. Under these premises, as illustrated in Table 1.2.5 and Charts 1.2.5-a and 1.2.5-b, the growth forecast for Italy's economy for 2023 has been upgraded to 0.8%, and this trend should continue in 2024, albeit at still low rates (1.1%).

On the other hand, inflation finally dropped to 7.7% in March (provisional), and harmonized inflation stood at 8.2%, with core inflation, however, rising by one tenth of a percentage point to 6.4%. By main items, food rose by 13.2%, housing and household energy by 15.1%, while transportation moderated and only rose by 2.6%.

In terms of risks, the health of the banking sector will be a factor to keep an eye on. Government bond yields have fallen, as they function as a safe haven for money fleeing equities, benefiting government funding costs in the medium term; however, if current levels (4.2%) continue for much longer, renewals will gradually be affected. However, if the ECB continues to raise rates, long-term yields will eventually come under upward pressure as well. In the medium term, higher energy costs will continue to affect the competitiveness of European industries, and Italy is a country with a high industrial component.

1.2.6 United Kingdom

Recession will persist through 2023.

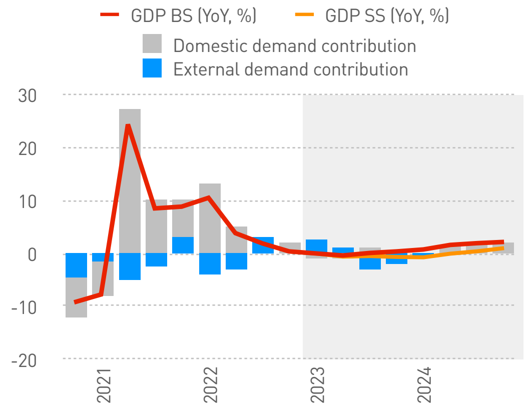
United Kingdom

- **Economic activity could remain stagnant in 2023 and recover only in 2024.**
- **Inflation may not come down as quickly as desirable given the persistence of the energy problem.**
- **Consumption will be affected by the rising cost of living.**
- **The Bank of England will have to weigh the trade-off between combating inflation and risks to financial stability.**

The UK grew by 4.0% in 2022, but ended the year in clear deceleration, with GDP growth of 0.0% QoQ and 0.4% YoY in the last quarter of the year. This is a slowdown that anticipates a bad start to 2023. In Q4 2022, private consumption grew by 1.4% YoY, and government consumption fell 0.6% YoY. Investment grew by 7.8% YoY, exports by 6.4% YoY and imports by 5.9% YoY, while January retail sales fell by 5.1% YoY (+0.5% MoM). The March Purchasing Managers' Indexes (PMIs) point to relative improvement, except for manufacturing, which is in the contraction zone, with the composite at 52.2 points, services at 52.9, construction at 50.7 and manufacturing at 47.9. Likewise, consumer confidence (GFK) barely increased, standing at -36 points in March.

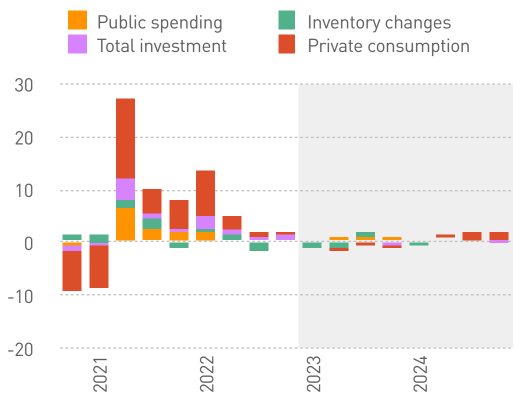
In this context, a recession is anticipated for 2023, with GDP contractions from the beginning of the year, due to declines in consumption and government spending restraint, which would leave GDP growth flat (0.0%) for the full year. Many uncertainties persist for 2024, espe-

Chart 1.2.6-a
United Kingdom: GDP breakdown and forecasts



Source: MAPFRE Economics (based on data from the Office for National Statistics)

Chart 1.2.6-b
United Kingdom: domestic demand breakdown and forecasts



Source: MAPFRE Economics (based on data from the Office for National Statistics)

Table 1.2.6
United Kingdom: main macroeconomic aggregates

						Baseline (BS)		Stressed (SS)	
	2018	2019	2020	2021	2022	2023(f)	2024(f)	2023(f)	2024(f)
GDP (% YoY)	1.7	1.6	-11.0	7.6	4.0	0.0	1.6	-0.4	0.2
Domestic demand contribution	0.8	1.8	-11.9	8.4	5.0	-0.2	1.5	-0.8	-0.3
External demand contribution	-0.1	-0.3	1.5	-1.2	-0.8	-0.4	-0.1	-0.3	0.2
Private consumption contribution	1.3	0.6	-8.0	3.8	3.2	-0.5	1.0	-0.8	-0.2
Total investment contribution	0.0	0.3	-1.9	1.1	1.4	-0.2	0.1	-0.4	-0.4
Public spending contribution	0.1	0.8	-1.4	2.5	0.4	0.7	0.4	0.7	0.4
Private consumption (% YoY)	2.1	1.0	-12.9	6.3	5.3	-0.8	1.6	-1.3	-0.3
Public spending (% YoY)	0.3	4.1	-7.3	12.5	1.9	3.6	1.7	3.6	1.7
Total investment (% YoY)	-0.2	1.9	-10.5	6.1	7.7	-0.8	0.8	-1.9	-2.1
Exports (% YoY)	3.1	1.7	-12.1	2.2	10.3	-2.6	3.3	-2.8	2.3
Imports (% YoY)	3.3	2.6	-16.0	6.2	12.6	-1.4	3.4	-1.8	1.5
Unemployment rate (%, last quarter)	4.0	3.8	5.2	4.0	3.7	4.2	4.0	4.5	4.8
Inflation (% YoY, average)	2.5	1.8	0.9	2.6	9.1	5.9	2.6	6.3	2.9
Inflation (% YoY, last quarter)	2.3	1.4	0.6	4.9	10.8	2.6	2.4	3.3	2.1
Fiscal balance (% of GDP)	-2.2	-2.5	-13.1	-8.0	-5.3	-6.0	-4.7	-6.1	-5.6
Primary fiscal balance (% of GDP)	0.5	-0.1	-11.0	-5.2	-0.5	-1.4	-0.7	-1.4	-1.4
Current account balance (% of GDP)	-4.1	-2.8	-3.2	-1.5	-4.8	-3.9	-3.6	-4.0	-3.3
Official interest rate (end of period)	0.75	0.75	0.00	0.25	3.50	4.50	3.25	5.00	3.25
3-month interest rate (end of period)	0.91	0.79	0.03	0.26	3.87	4.43	3.50	5.24	3.47
10-year interest rate (end of period)	1.27	0.83	0.20	0.97	3.67	3.32	3.08	3.89	3.07
Exchange rate vs. U.S. dollar (end of period)	1.28	1.32	1.36	1.35	1.20	1.23	1.26	1.20	1.24
Exchange rate vs. euro (end of period)	1.11	1.18	1.11	1.19	1.13	1.14	1.13	1.13	1.13
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)	2.8	2.0	2.3	3.3	3.6	3.4	3.4	3.3	2.8
P.S. non-financial lending (% YoY, average)	2.1	1.2	9.4	1.2	1.8	3.9	2.8	3.8	2.7
P.S. financial lending (% YoY, average)	9.4	2.0	12.1	-1.3	14.5	7.8	3.9	7.8	3.8
Savings rate (% pers. disp. income, avg.)	5.1	5.4	15.9	12.6	7.9	7.2	6.3	7.2	7.4

Source: MAPFRE Economics (based on data from the Office for National Statistics)
Forecast end date: April 10, 2023.

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cially with regard to the evolution of the cost of living, energy and its reflection in food, and in general, in the entire shopping basket. Despite this, a return to growth is anticipated with economic growth of around 1.6% (see Table 1.2.6 and Charts 1.2.6-a and 1.2.6-b).

Inflation in February reached 10.4%, with core inflation at 6.2%. Food is up 18.2%, household supplies have increased 11.8%, transportation is up 3.1% (moderating from 3.4%), and hotels and restaurants have risen 12.1%, the highest rate since July 1991. Inflation is expected to continue to ease in the coming quarters. However, as in other countries, second-round effects (wage increases) and continued high energy costs are making it difficult for it to come down as fast as anticipated. Inflation of around 10% in recent months, with 17% in food, is taking its toll on the purchasing power of families. In addition, in the case of the United Kingdom, a shortage factor is also affecting some food products due to energy costs, fertilizer costs and logistical difficulties related to Brexit.

The Bank of England, at its meeting in March, raised interest rates by 25 bps to 4.25%. However, given the risks to the financial system seen in the U.S. regional banks, and also observed in the United Kingdom in the case of the pension system, it is foreseeable that the central bank will now weigh between fighting inflation and safeguarding the stability of the financial system. Thus, implied interest rates in the futures market have been adjusted downwards, considering a maximum rate of 4.685% versus 4.75% a month ago.

Recession in 2023 in the UK is widely expected. All eyes are now on the risks that interest rate hikes may pose to the stability of the financial system. It should be recalled that, in 2022, the United Kingdom already had an episode of stress that led to the resignation of Prime Minister Liz Truss. High energy costs and continued high inflation for a long period will continue to weigh on economic performance. Legislative elections will not be until 2024, and the Conservatives have a difficult year ahead as they attempt to recover the wide disadvantage in voting intentions with respect to the Labour Party.

1.2.7 Japan

Fragile economic growth and currency devaluation trend.

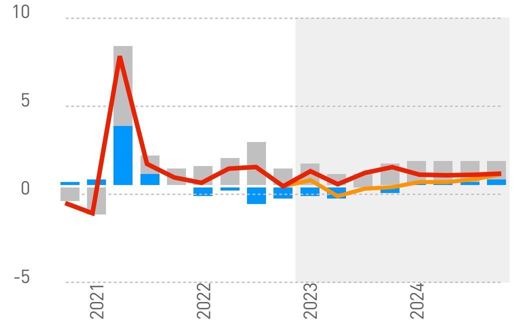
Japan's economy grew by 1.0% in 2022, rising 0.2% QoQ in the fourth quarter, less than expected, with private consumption increasing by only 0.3% QoQ and investment declining by 0.5%. Thus, the economy is growing weakly, and the energy crisis is being passed on to inflation which, in turn, will aggravate the problem. The price of energy is a very negative factor for a country as dependent on energy imports as Japan. The terms of trade are worsening, with import prices rising 15%, while export prices are up 9%. The current account surplus is reduced to 2% of GDP from pre-pandemic levels of 4% due to higher import costs.

Japan

- The outlook for weak economic growth continues.
- Consumer confidence reverses and turns downward.
- Balance of trade remains positive, though trade terms worsen.
- The Bank of Japan widens the range of fluctuation of the 10-year bond rate, which makes it easier to keep it low.

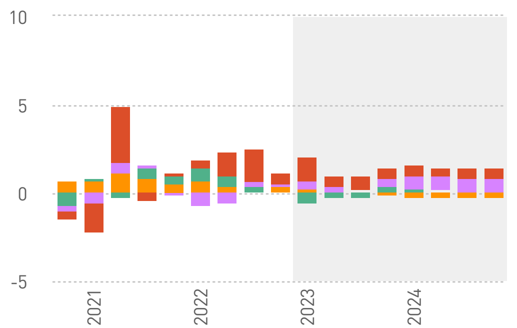
Retail sales in February surprised positively (+6.6% YoY). Household confidence in March also improved slightly to 33.9, from 31.9 points

Chart 1.2.7-a
Japan: GDP breakdown and forecasts



Source: MAPFRE Economics (based on Statistics Bureau data)

Chart 1.2.7-b
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)	
	2018	2019	2020	2021	2022	2023(f)	2024(f)	2023(f)	2024(f)
GDP (% YoY)	0.6	-0.4	-4.3	2.2	1.0	1.1	1.1	0.3	0.8
Domestic demand contribution	0.6	0.1	-3.5	1.2	1.6	1.0	1.2	0.8	0.6
External demand contribution	0.0	-0.5	-0.9	1.1	-0.6	-0.3	0.3	-0.4	0.2
Private consumption contribution	0.1	-0.3	-2.6	0.2	1.1	0.8	0.5	0.8	0.3
Total investment contribution	0.1	0.1	-0.9	0.0	-0.3	0.3	0.7	0.2	0.4
Public spending contribution	0.2	0.4	0.5	0.7	0.3	0.0	-0.2	0.0	-0.2
Private consumption (% YoY)	0.2	-0.6	-4.7	0.4	2.0	1.5	1.0	1.4	0.6
Public spending (% YoY)	1.0	1.9	2.4	3.5	1.5	0.1	-1.1	0.1	-1.1
Total investment (% YoY)	0.6	0.5	-3.7	0.1	-1.0	1.3	3.0	0.8	1.6
Exports (% YoY)	3.8	-1.4	-11.7	11.9	4.9	0.9	3.0	0.2	1.7
Imports (% YoY)	3.8	1.1	-6.8	5.0	7.9	2.6	1.4	2.4	0.4
Unemployment rate (%, last quarter)	2.4	2.3	3.0	2.7	2.5	2.4	2.2	2.5	2.5
Inflation (% YoY, average)	1.0	0.5	0.0	-0.2	2.5	1.5	0.8	2.3	1.5
Inflation (% YoY, last quarter)	0.9	0.5	-0.9	0.5	3.9	-0.1	0.7	0.8	1.2
Fiscal balance (% of GDP)	-2.5	-3.0	-8.9	-5.4	-6.7	-5.9	-3.6	-5.9	-3.9
Primary fiscal balance (% of GDP)	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Current account balance (% of GDP)	3.5	3.4	2.9	3.9	2.0	2.3	2.6	2.2	2.7
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)	0.07	0.07	0.08	0.07	0.06	0.14	0.14	0.12	0.12
10-year interest rate (end of period)	0.01	-0.02	0.04	0.09	0.45	0.72	0.54	0.86	0.59
Exchange rate vs. U.S. dollar (end of period)	110.83	109.12	103.54	115.00	132.65	134.37	126.41	131.83	125.49
Exchange rate vs. euro (end of period)	126.90	122.59	127.05	130.25	141.48	145.19	139.94	140.46	138.06
Private lending (% YoY, average)	2.6	1.8	5.2	3.1	2.1	2.0	0.0	1.8	-0.9
Household lending (% YoY, average)	2.5	2.2	3.1	3.6	1.5	0.3	0.0	0.0	-1.2
P.S. non-financial lending (% YoY, average)	2.4	3.6	7.9	3.2	2.0	0.1	-0.6	0.1	-0.7
P.S. financial lending (% YoY, average)	6.3	2.9	17.1	7.3	8.8	1.0	0.9	1.1	1.0
Savings rate (% pers. disp. income, avg.)	1.8	3.2	12.1	8.7	2.2	0.1	0.1	0.1	0.3

Source: MAPFRE Economics (based on Statistics Bureau data)
Forecast end date: April 10, 2023.

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previously. The index of leading indicators rebounded slightly to 97.7 points in February. Similarly, the Purchasing Managers' Indexes (PMIs) for March improved, with the composite, manufacturing and services PMIs standing at 51.9, 49.2 and 55.0 points, respectively. Thus, a weaker first half of the year is expected, which will gradually recover in the second half of 2023 as energy cost issues are resolved and inflation moderates. Thus, the estimate for Japanese GDP growth stands at 1.1% in 2023 and 2024 (see Table 1.2.7 and Charts 1.2.7-a and 1.2.7-b).

Inflation, meanwhile, is taking off, reaching 3.3% in February, the highest since the early 1980s, with core inflation at 3.1%. In this context, the Bank of Japan, at its March meeting, maintained interest rates at -0.10%. This was the last meeting of Governor Haruhiko Kuroda, and the April meeting will be the first meeting of the new governor, Kazuo Ueda, so it was decided at this meeting not to touch this policy to leave room for the new governor. The central bank will continue to buy as many bonds as necessary (no limit has been set) to further control the interest rate curve and thus keep the yield on the 10-year bond close to zero, although its high fluctuation range has been extended in December last year to 0.50%. The Bank of Japan will also continue to buy ETFs (*exchange-traded funds*) and real estate funds up to 12 trillion yen and 180 trillion yen, respectively. The yield on the 10-year bond rose 15 bps, from 0.25% to 0.40%, the stock market fell 2.5%, and the currency appreciated 3.4%. The central bank also set targets for commercial paper and corporate bonds in the portfolio at 2 trillion and 3 trillion yen, respectively. This monetary policy is the loosest among developed countries, in a context of high risk, with inflation rising rapidly, but it reflects the fact that the Japanese central bank has run out of alternatives given the risk to the exchange rate.

The main short-term risk for the Japanese economy is pressure on the exchange rate given the counter-cyclical monetary policy and the huge monetary expansion of the last 15 years. The central bank's balance sheet reaches 130% of GDP, and the market is wondering what will happen when the Bank of Japan stops injecting so much money into the system. Economically, inflation is rising, at 3.3%, in a country that was always at risk of deflation due to its population pyramid. Additional risks include continued high raw material costs, aggravated by a weak yen, and a slowdown in consumption in its export destination countries.

1.2.8 Turkey

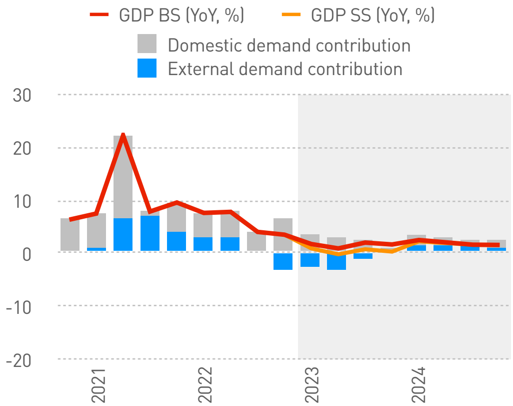
A balanced current account, the key to stability.

Turkey

- **Tourism and foreign investment help reduce imbalances.**
- **Weaker economic activity is expected in 2023 compared to 2022.**
- **Inflation is partly receding, although it will be difficult to bring it down as long as the energy issue and an unorthodox monetary policy persist.**
- **The central bank lowered interest rates to 8.5% in February.**
- **Importance of macroeconomic stability in the run-up to the June elections.**

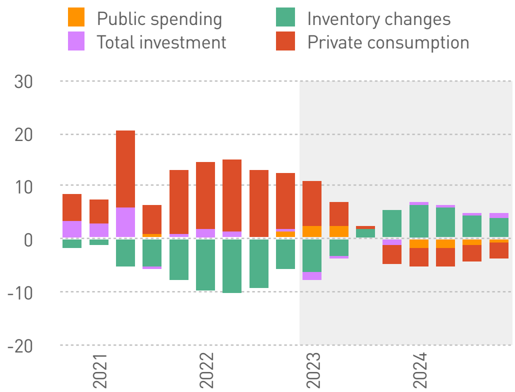
The Turkish economy grew by 5.6% in 2022, rising 3.5% in the fourth quarter. Turkey's economy has entered a slowdown that will lead to weaker growth in 2023. Consumption has been strong all year, growing by 18.2%, and exports have also performed well, with growth of 10.2%. At the level of indicators that provide guidance on activity for the coming months, the manufacturing PMI for March came in at 50.9 points, only marginally positive with respect to the contraction threshold. Retail sales are estimated to have decreased by 3.6% in March, and consumer confidence moderated slightly to 80.1 points.

Chart 1.2.8-a
Turkey: GDP breakdown and forecasts



Source: MAPFRE Economics (based on TURKSTAT data)

Chart 1.2.8-b
Turkey: domestic demand breakdown and forecasts



Source: MAPFRE Economics (based on TURKSTAT data)

Table 1.2.8
Turkey: main macroeconomic aggregates

						Baseline (BS)		Stressed (SS)	
	2018	2019	2020	2021	2022	2023(f)	2024(f)	2023(f)	2024(f)
GDP (% YoY)	3.0	0.8	1.9	11.4	5.6	1.6	2.0	0.5	1.8
Domestic demand contribution	-0.6	-1.4	7.0	6.6	5.0	2.3	1.4	2.0	0.8
External demand contribution	3.6	2.2	-5.0	4.8	0.6	-1.5	1.3	-1.6	1.1
Private consumption contribution	0.3	0.9	1.9	9.1	12.1	2.1	-3.2	1.9	-3.6
Total investment contribution	-0.1	-3.6	1.8	1.9	0.7	-0.9	0.6	-0.9	0.4
Public spending contribution	0.9	0.5	0.4	0.4	0.7	1.3	-1.1	1.3	-1.1
Private consumption (% YoY)	0.6	1.5	3.3	15.3	19.6	3.0	-4.5	2.7	-5.0
Public spending (% YoY)	6.5	3.8	2.5	2.6	5.2	9.8	-7.6	9.8	-7.6
Total investment (% YoY)	-0.2	-12.5	7.4	7.4	2.8	-3.5	2.5	-3.8	1.5
Exports (% YoY)	8.8	4.2	-14.4	24.9	9.1	-0.8	4.2	-0.8	3.3
Imports (% YoY)	-6.2	-5.0	6.7	2.4	7.9	6.4	-1.3	6.8	-1.2
Unemployment rate (%, last quarter)	12.3	13.3	12.9	11.0	10.1	10.5	10.3	10.6	10.5
Inflation (% YoY, average)	16.3	15.2	12.3	19.6	72.3	44.1	26.1	45.1	25.6
Inflation (% YoY, last quarter)	22.4	10.3	13.5	25.8	77.4	38.6	22.8	39.2	21.2
Fiscal balance (% of GDP)	-1.9	-2.9	-3.5	-2.7	-0.9	-4.9	-3.1	-4.8	-3.2
Primary fiscal balance (% of GDP)	0.0	-0.6	-0.8	-0.2	1.2	-3.5	-1.9	-3.4	-2.0
Current account balance (% of GDP)	-2.6	1.4	-4.4	-0.9	-5.5	-3.7	-2.3	-4.1	-2.7
Official interest rate (end of period)	24.00	11.50	17.00	14.00	9.00	8.50	8.50	8.75	8.50
3-month interest rate (end of period)	24.07	10.35	17.25	16.32	10.35	9.23	9.29	10.10	9.43
10-year interest rate (end of period)	16.53	11.95	12.51	22.99	9.50	11.49	11.51	11.73	11.57
Exchange rate vs. U.S. dollar (end of period)	5.29	5.95	7.44	13.32	18.69	20.13	20.81	21.01	21.34
Exchange rate vs. euro (end of period)	6.06	6.68	9.11	15.23	19.96	21.75	23.03	22.39	23.47
Private lending (% YoY, average)	20.2	8.4	30.1	23.9	54.8	42.5	18.4	43.2	18.3
Household lending (% YoY, average)	9.8	3.3	41.8	20.3	29.3	25.9	10.2	25.6	9.7
P.S. non-financial lending (% YoY, average)	18.2	5.5	29.0	23.2	56.3	33.7	27.9	33.1	25.8
P.S. financial lending (% YoY, average)	25.1	18.3	21.2	31.5	105.5	46.6	26.3	46.3	25.5
Savings rate (% pers. disp. income, avg.)	32.0	30.4	20.9	22.7	9.8	10.0	10.8	9.9	11.1

Source: MAPFRE Economics (based on TURKSTAT data)
Forecast end date: April 10, 2023.

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In this context, growth of 1.6% is forecast for 2023, which will imply a significant deceleration from the 5.6% of 2022, based on a significant slowdown in consumption, investment and exports (see Table 1.2.8 and Charts 1.2.8-a and 1.2.8-b).

Meanwhile, inflation in Turkey continues to moderate and stood at 50.5% in March, coming from a high of 85.5% in October, with food prices rising 68%, housing prices 56%, restaurants and hotels 70.7%, and transportation prices moderating to 28.7%. Core inflation (47.4%) and producer prices (62.5%) show that inflation will still remain at high levels for some time. Against this backdrop, the Turkish lira, with an exchange rate approaching 19.30 TRY/USD and 21.0 TRY/EUR, is expected to depreciate further.

The Central Bank of Turkey maintained interest rates (1-week Repo) in March at the level of 8.50%. The central bank's committee believes that the current monetary policy stance is adequate to support the recovery from the effects of the earthquake, with the objective of achieving price stability and financial stability. The central bank has indicated that it will continue to use all available instruments until indicators point to a permanent fall in inflation and the medium-term target of 5% is reached. In this regard, it pointed out that it will implement a strategy of "*liralization*" in order to create an institutional basis for permanent and sustainable price stability, which, in turn, will promote macroeconomic stability and financial stability.

The impact of the earthquake on production, consumption, employment and expectations is being assessed by the authorities. Although the earthquake is expected to affect economic activity in the short term, it is not expected to have a permanent negative impact on the Turkish economy in the medium term. Tourism revenue continues to make a stronger-than-expected contribution to the current account balance in 2023. On the other hand, domestic consumption demand, the high level of energy prices and the weak economic activity of the main trading partners mean that current account balance risks remain. Achieving a balanced current account is important for price stability.

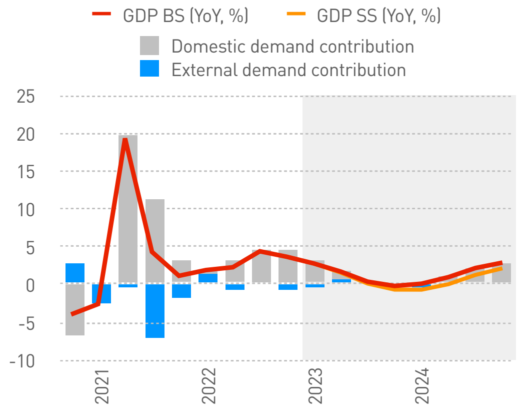
Turkey will hold presidential and parliamentary elections on June 18, and President Recep Tayyip Erdoğan is eligible for another 5-year term. Some fiscal easing is expected in the second quarter in anticipation of the elections. Despite all the macroeconomic imbalances, including the current account deficit and skyrocketing inflation, it is foreseeable that, should Erdoğan remain in office, Turkey will maintain the support of its regional partners (Russia, Saudi Arabia and Qatar) in the areas of investment, international trade and foreign policy.

1.2.9 Mexico

Loss of economic dynamism in 2023, which will be accentuated if a recession occurs in the United States.

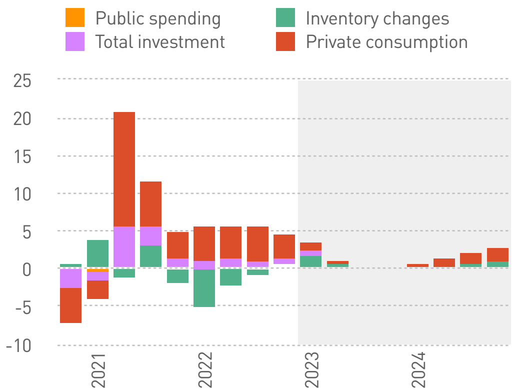
Mexico's economy grew 3.1% in 2022 and 3.7% in the fourth quarter of the year. Private consumption increased 6.0% YoY, investment 5.0% YoY and exports 8.7% YoY. Growth has met expectations, to the extent that 3.0% was anticipated in our report a year ago. Industrial production continues to increase (+3.0%), with good data in the computer, automotive manufacturing and construction segments. Retail sales, on the other hand, continued to grow (+2.5% in December), but food sales fell (-3.6%), mainly due to the effect of inflation.

Chart 1.2.9-a
Mexico: GDP breakdown and forecasts



Source: MAPFRE Economics (based on INEGI data)

Chart 1.2.9-b
Mexico: domestic demand breakdown and forecasts



Source: MAPFRE Economics (based on INEGI data)

Table 1.2.9
Mexico: main macroeconomic aggregates

						Baseline (BS)		Stressed (SS)	
	2018	2019	2020	2021	2022	2023(f)	2024(f)	2023(f)	2024(f)
GDP (% YoY)	2.2	-0.2	-8.2	4.9	3.1	1.2	1.5	0.9	0.7
Domestic demand contribution	2.4	-1.0	-10.8	8.0	3.2	1.1	1.5	0.9	0.8
External demand contribution	-0.2	0.8	2.6	-3.0	-0.1	0.1	0.0	0.1	-0.1
Private consumption contribution	1.7	0.2	-7.1	5.1	4.1	0.3	1.0	0.1	0.6
Total investment contribution	0.2	-1.0	-3.4	1.8	0.9	0.3	0.1	0.2	-0.2
Public spending contribution	0.3	-0.2	0.0	-0.1	0.2	0.3	0.2	0.3	0.2
Private consumption (% YoY)	2.6	0.4	-10.5	7.7	6.0	0.4	1.4	0.2	0.9
Public spending (% YoY)	2.9	-1.8	-0.3	-0.6	1.4	2.4	2.0	2.4	2.0
Total investment (% YoY)	0.8	-4.7	-17.8	10.5	5.1	1.4	0.4	0.9	-1.1
Exports (% YoY)	5.9	1.5	-7.1	6.9	8.8	-1.9	3.8	-2.5	1.9
Imports (% YoY)	6.4	-0.7	-14.1	16.1	9.0	-2.0	3.7	-2.6	2.1
Unemployment rate (%, last quarter)	3.3	3.4	4.5	3.7	3.0	3.5	3.8	3.6	4.1
Inflation (% YoY, average)	4.9	3.6	3.4	5.7	7.9	5.6	3.7	5.9	3.8
Inflation (% YoY, last quarter)	4.8	2.9	3.5	7.0	8.0	4.3	3.5	4.8	3.2
Fiscal balance (% of GDP)	-2.0	-1.7	-2.8	-3.0	-3.4	-3.2	-3.0	-3.2	-3.1
Primary fiscal balance (% of GDP)	0.6	1.1	0.1	-0.3	-0.5	-0.2	0.0	-0.2	-0.1
Current account balance (% of GDP)	-2.1	-0.4	2.1	-0.6	-0.9	-0.8	-0.4	-0.9	-0.5
Official interest rate (end of period)	8.25	7.25	4.25	5.50	10.50	10.75	7.50	10.25	6.25
3-month interest rate (end of period)	8.63	7.45	4.47	5.86	10.97	10.25	6.27	10.50	6.38
10-year interest rate (end of period)	8.70	6.84	5.23	7.57	9.02	8.16	7.26	8.36	7.01
Exchange rate vs. U.S. dollar (end of period)	19.65	18.93	19.88	20.50	19.49	20.05	20.80	20.39	21.04
Exchange rate vs. euro (end of period)	22.50	21.26	24.40	23.22	20.79	21.66	23.03	21.72	23.15
Private lending (% YoY, average)	10.4	8.9	5.2	-1.0	7.5	8.1	5.6	8.0	4.6
Household lending (% YoY, average)	8.4	6.2	1.6	4.4	9.1	5.3	6.5	5.1	6.2
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)	-0.8	6.2	3.7	18.3	8.7	12.3	11.6	12.3	11.0
Savings rate (% pers. disp. income, avg.)	12.3	16.4	21.9	23.1	22.9	17.3	17.1	17.3	17.1

Source: MAPFRE Economics (based on INEGI data)
Forecast end date: April 10, 2023.

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Mexico

- **Inflation is coming down, but slower than anticipated.**
- **The greatest risk to economic activity is an eventual recession in the United States.**
- **Mexico's economy could benefit from the relocation of the production chains of U.S. multinationals.**
- **GDP growth forecast has been adjusted to 1.2% for 2023 and 1.5% for 2024.**

With respect to expectations, factory orders point to increased activity, with the index standing at 53.4 in February, while business confidence is also up marginally to 52.0. The manufacturing purchasing managers' index (PMI) for March remains at 51.0 points. Likewise, automobile production has improved in January and February, with a medium-term trend of recovery. Thus, Mexican GDP growth is expected to be 1.2% in 2023 and 1.5% in 2024 (see Table 1.2.9 and Charts 1.2.9-a and 1.2.9-b).

Inflation, meanwhile, stood at 6.9% in March, on a downward trajectory since the September 2022 peak, although still facing challenges to return to the monetary authorities' target band. This is particularly reflected in the behavior of core inflation, which remains high at 8.1%. Food is up 14%, hotels and restaurants 12.4%, services 10.4%, and energy 3.2% (managed prices, +5.6%). Thus, inflation is expected to remain high, with an average of 5.6% in 2023.

At its March meeting, the Bank of Mexico raised official interest rates by 25 bps to 11.25%. In the face of a more-complex-than-expected disinflation process, no immediate cuts are expected, although, with very positive real rates, the central bank has room to begin cuts in the second part of 2023, at the pace of the U.S. Federal Reserve. Due to the issue of exchange rate stability, the path is unlikely to diverge significantly from that of the Federal Reserve.

Among the main short-term risks to Mexico's economy is a possible recession in the United States, which would spill over to Mexico through its exports, both in the automotive sector and in the construction materials sector. The disinflation process is costing more than expected, and restrictive monetary policy will continue to affect financing costs, consumption and investment. On the positive side, there is the so-called "*nearshoring*," which consists of relocating production chains that, due to the Mexican economy's integration with that of North America, could benefit the country by bringing production lines from Southeast Asia closer to home.

1.2.10 Brazil

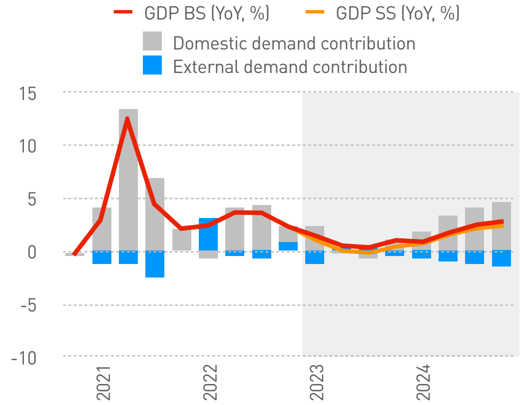
Activity begins to slow down, pointing to lower growth in 2023.

Brazil

- **Brazilian GDP in the last quarter of 2022 slowed visibly, and a more complex 2023 is expected.**
- **Economic growth is forecast at 0.8% in 2023 and 2.0% in 2024.**
- **Brazil was the first country to raise interest rates, although inflation behavior may complicate the eventual reduction of interest rates.**
- **For the time being, financial conditions remain tight, and credit risks are increasing.**

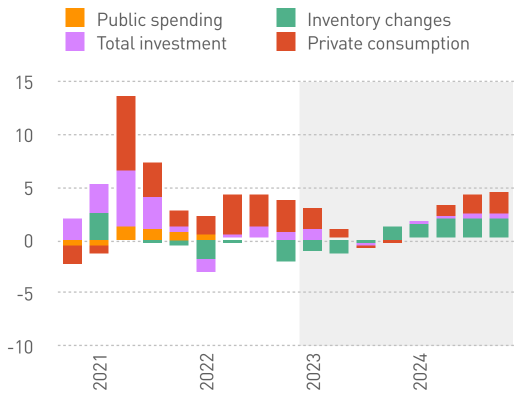
Brazil's economy grew by 3.0% in 2022, far exceeding the estimates at the beginning of the year. This was due to better-than-anticipated private consumption, net exports and investment performance. However, the fourth quarter of 2022 saw a decline of 0.2% QoQ, (+1.9% YoY), giving the first indications that the start of 2023 is going to be difficult. Brazil was one of the first countries to raise interest rates, so naturally it should be the first to observe the slowdown caused by the restrictive monetary policy.

Chart 1.2.10-a
Brazil: GDP breakdown and forecasts



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

Chart 1.2.10-b
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

	2018	2019	2020	2021	2022	Baseline (BS) 2023(f)	Baseline (BS) 2024(f)	Stressed (SS) 2023(f)	Stressed (SS) 2024(f)
GDP (% YoY)	1.7	1.2	-3.6	5.3	3.0	0.8	2.0	0.3	1.7
Domestic demand contribution	2.4	1.8	-4.9	6.5	2.3	0.6	3.5	0.4	3.1
External demand contribution	-0.7	-0.6	1.4	-1.2	0.7	-0.1	-1.1	-0.1	-1.1
Private consumption contribution	1.6	1.8	-3.2	2.6	2.9	0.6	1.3	0.5	1.0
Total investment contribution	0.8	0.7	-0.3	2.9	0.2	0.2	0.3	0.1	0.2
Public spending contribution	0.1	-0.1	-0.6	0.6	0.3	0.1	0.2	0.1	0.2
Private consumption (% YoY)	2.4	2.6	-4.6	3.7	4.3	0.9	1.8	0.7	1.5
Public spending (% YoY)	0.8	-0.5	-3.7	3.5	1.5	0.4	1.3	0.4	1.3
Total investment (% YoY)	5.2	4.0	-1.7	16.6	0.8	1.0	1.7	0.7	1.1
Exports (% YoY)	3.4	-2.5	-2.7	6.4	6.0	0.7	3.9	0.5	3.0
Imports (% YoY)	7.0	1.3	-9.9	12.6	1.3	1.4	9.4	0.9	8.8
Unemployment rate (%, last quarter)	11.7	11.1	14.2	11.1	7.9	8.2	8.3	8.2	8.4
Inflation (% YoY, average)	3.7	3.7	3.2	8.3	9.3	5.1	4.1	5.4	4.3
Inflation (% YoY, last quarter)	4.1	3.4	4.3	10.5	6.1	5.3	3.9	6.0	3.5
Fiscal balance (% of GDP)	-7.0	-5.8	-13.3	-4.3	-4.6	-9.0	-7.8	-8.9	-7.9
Primary fiscal balance (% of GDP)	-1.5	-0.8	-9.2	0.7	1.3	-1.9	-0.8	-1.9	-0.9
Current account balance (% of GDP)	-2.8	-3.6	-1.9	-2.8	-2.9	-3.4	-4.1	-3.2	-4.0
Official interest rate (end of period)	6.50	4.50	2.00	9.25	13.75	12.25	8.25	12.50	8.50
3-month interest rate (end of period)	6.40	4.40	1.90	9.15	13.65	12.15	8.03	12.53	8.34
10-year interest rate (end of period)	9.24	6.81	6.98	10.31	12.76	12.08	11.38	12.23	11.13
Exchange rate vs. U.S. dollar (end of period)	3.87	4.03	5.20	5.58	5.22	5.40	5.42	5.53	5.50
Exchange rate vs. euro (end of period)	4.44	4.53	6.38	6.32	5.56	5.84	6.00	5.89	6.05
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)	7.0	10.8	10.1	17.7	20.3	11.3	9.4	11.2	9.6
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 (% pers. disp. income, avg.)	16.4	15.8	19.0	22.2	20.2	18.6	17.7	18.5	17.7

Source: MAPFRE Economics (based on data from the Brazilian Institute of Geography and Statistics (IBGE))
Forecast end date: April 10, 2023.

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Industrial production in Brazil rose by 0.3% in January, corroborating a cooling outlook for activity. Consumer confidence has rebounded from 2020–21, but is not at 2018–19 levels. Purchasing managers' surveys (PMIs) have improved, with the composite at 50.7 points, and services at 51.8, but manufacturing worsening to 47.0. The reopening of China and a good agricultural season will provide some support to the performance of the Brazilian economy, although counterbalanced by slowing private and public consumption. The Brazilian government has reinstated fuel taxes and introduced a 9% tax on oil exports. It is also preparing a series of tax increases as part of the fiscal consolidation effort. In this context, weaker economic growth is expected, which would stand at 0.8% for 2023 and 2.0% for 2024 (see Table 1.2.10 and Charts 1.2.10-a and 1.2.10-b).

Meanwhile, inflation has been moderating since April last year and stood at 4.65% in March, although the downward momentum is losing steam. The items with the highest price increases are food (+11.1%), clothing (+16.5%) and health (+11.2%), while fuels pushed down the CPI (-22.4%). Our HICP inflation expectations for the next 12 months are at 5.1%.

The Central Bank of Brazil, at its March meeting, maintained the SELIC interest rate at 13.75%. The central bank considers that there are risks in both directions and that macroeconomic projections have more uncertainty than usual. Its objective is to bring inflation back to target by stabilizing prices, smoothing fluctuations in the level of economic activity and promoting full employment. In its statements, the government, which is tightening fiscal policy, hints that it would like the central bank to begin loosening monetary policy. However, it is foreseeable that short-term interest rate cuts will only materialize if the economy experiences a significant slowdown.

With respect to short-term risks to the economy, they include: inflationary pressures that are still observed globally; the prices of raw materials exported by Brazil, which could sustain a drop; the possibility of the global economy experiencing a more marked slowdown than is currently expected; and the reinstatement of taxes that had been reduced during lockdown. The rise in interest rates worldwide, not only in Brazil, and their maintenance at high levels will affect the financing costs of all economic agents, with implications for the activity or even the solvency of certain agents.

1.2.11 Argentina

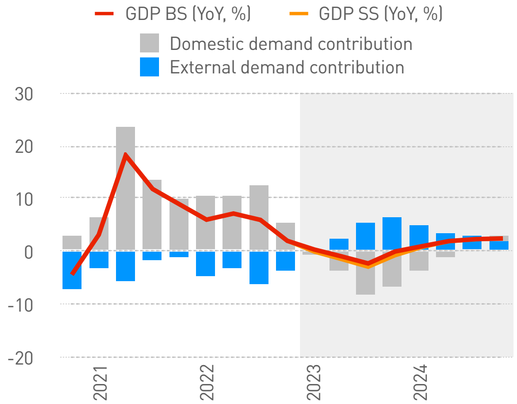
Recession in 2023 aggravated by drought in the agricultural sector.

Argentina's economy grew by 5.3% in 2022 (+1.4% YoY in the fourth quarter of the year). Private consumption increased by 5.1% in the fourth quarter, investment by 0.1%, exports by 8.6%, and imports by 1.0%. This growth should be analyzed in terms of recovery after several years in negative territory, and in a context that remains challenging: high inflation, currency depreciation, fiscal deficit and with assistance from the International Monetary Fund (IMF). 2023 will continue to be difficult for the

Argentina

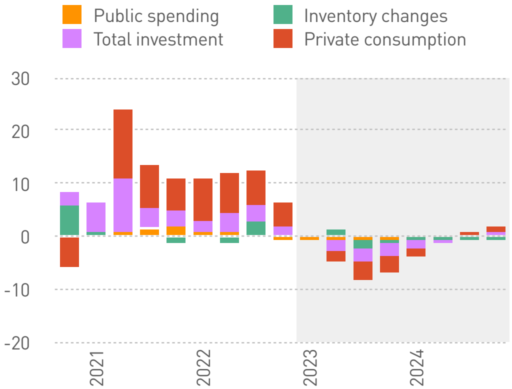
- Drought in the countryside subtracts about 2.1 percentage points from GDP, which is estimated to contract by 0.7% in 2023.
- Inflation is anchored at levels close to 100%.
- The unstoppable depreciation of the currency is the result of a constant increase in the money supply.
- There will be elections in October: a difficult challenge for the next administration.

Chart 1.2.11-a
Argentina: GDP breakdown and forecasts



Source: MAPFRE Economics (based on INDEC data)

Chart 1.2.11-b
Argentina: domestic demand breakdown and forecasts



Source: MAPFRE Economics (based on INDEC data)

Table 1.2.11
Argentina: main macroeconomic aggregates

						Baseline (BS)		Stressed (SS)	
	2018	2019	2020	2021	2022	2023 (f)	2024 (f)	2023 (f)	2024 (f)
GDP (% YoY)	-2.6	-2.0	-9.9	10.4	5.3	-0.7	1.9	-1.3	1.8
Domestic demand contribution	-4.1	-9.5	-10.3	13.3	9.7	-4.8	-1.0	-5.2	-1.3
External demand contribution	1.5	7.5	0.3	-2.9	-4.4	3.7	3.2	3.8	3.2
Private consumption contribution	-1.7	-4.6	-9.8	6.8	6.7	-2.1	0.2	-2.3	0.0
Total investment contribution	-1.2	-3.2	-2.2	5.6	2.6	-1.8	-0.6	-1.9	-0.7
Public spending contribution	-0.3	-0.9	-0.2	1.0	0.2	-0.7	0.0	-0.7	0.0
Private consumption (% YoY)	-2.2	-6.1	-13.7	10.0	9.8	-2.9	0.3	-3.3	0.0
Public spending (% YoY)	-1.9	-6.4	-1.9	7.1	1.3	-5.4	-0.2	-5.4	-0.2
Total investment (% YoY)	-5.7	-16.0	-13.0	33.4	12.9	-8.4	-2.8	-8.8	-3.3
Exports (% YoY)	0.6	9.8	-17.7	9.2	2.3	0.0	8.2	0.0	7.2
Imports (% YoY)	-4.5	-18.7	-18.5	22.0	20.3	-13.4	-6.4	-13.9	-7.1
Unemployment rate (%, last quarter)	9.1	8.9	11.0	7.0	7.0	8.4	7.4	8.5	7.6
Inflation (% YoY, average)	34.3	53.5	42.0	48.4	72.4	100.7	85.4	102.6	85.8
Inflation (% YoY, last quarter)	47.4	52.2	36.4	51.4	91.8	99.1	77.2	102.0	76.1
Fiscal balance (% of GDP)	-4.9	-3.8	-8.4	-3.6	-3.8	-3.0	-1.1	-3.0	-1.2
Primary fiscal balance (% of GDP)	-2.3	-0.4	-6.4	-2.1	-2.0	-1.7	-0.1	-1.7	-0.2
Current account balance (% of GDP)	-4.9	-0.8	0.8	1.4	-0.7	1.0	1.6	1.1	1.7
Official interest rate (end of period)	59.25	55.00	38.00	38.00	75.00	75.00	75.00	75.00	75.00
3-month interest rate (end of period)	56.76	45.13	29.55	31.49	67.61	73.00	72.96	73.33	73.35
10-year interest rate (end of period)	16.85	30.24	21.68	25.52	34.40	33.71	31.36	33.81	31.48
Exchange rate vs. U.S. dollar (end of period)	37.70	59.89	84.15	102.72	177.15	352.73	561.19	373.64	579.21
Exchange rate vs. euro (end of period)	43.17	67.28	103.26	116.34	188.95	381.15	621.25	398.24	637.27
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)	52.3	15.3	22.9	34.6	60.4	50.7	67.1	50.4	67.3
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 (% 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: April 10, 2023.

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Argentina's economy, with inflation expected to be above 102%, according to the central bank's expectations survey. At the same time, its currency will continue to depreciate as a result of the growth of the monetary base due to the inflow of money from multilateral organizations (IMF and Inter-American Development Bank).

Likewise, consumer confidence remains low, although it rebounded 5.6% (38.2 points) in March. Car sales also rallied (+23% YoY) but have been at low levels since 2019, with the industry selling half as many cars as were sold in 2018. Industrial production contracted 1.4% in February, and the leading indicator (Torcuato Di Tella University Leading Index) was stagnant in February (+0.0%).

Within this framework, the GDP growth forecast for 2023 is for a contraction of 0.7% (after growing by 5.3% in 2022), and to return to growth, albeit mildly in 2024, by 1.9% (see Table 1.2.11 and Charts 1.2.11-a and 1.2.11-b). The drought in the agricultural sector alone is estimated to be responsible for at least 2.1 percentage points less GDP, affecting the population's income and the government's tax revenues. This sector is also important in obtaining the foreign currency necessary for the proper functioning of the rest of the economy.

Inflation stood at 102.5% in February and shows no signs of cooling down, with core inflation at 100.4%, and the expectation is that it will remain high throughout 2023, close to 100%. Price increases are occurring in all segments: food, clothing, transportation, restaurants, goods and services. It is difficult to cool down prices when the money supply (M2) continues to grow at around 70% per year. The 28-day LELIQ stood unchanged at 75%. The other reference rate is the BADLAR rate for private banks, which stands at 69.75%. The Argentine peso will continue to depreciate due to the increase in money supply and injections of money in the form of outside assistance. As of the date of this report, the currency was already above 215 ARS/USD, with an almost exponential depreciation trend.

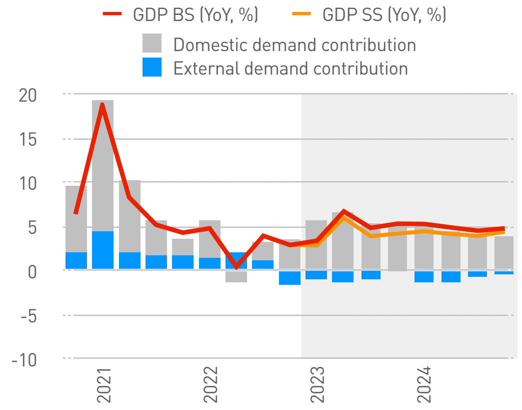
Argentina will hold general elections in October 2023, with two main coalitions competing: "Frente de Todos" (Everyone's Front) and "Juntos por el Cambio" (Together for Change). The government, in the recessionary environment of 2023, may again face difficulties in raising domestic financing, especially important because tax revenues may be reduced as a result of lower agricultural and industrial production. Inflation is expected to remain high, and the currency is expected to continue to depreciate, with a challenging medium-term outlook. Bringing the economy back to a lower inflation rate, currency stability and consolidation of growth and state accounts will be important challenges for the next administration.

1.2.12 China

Growth has resumed, albeit at lower levels than in the past.

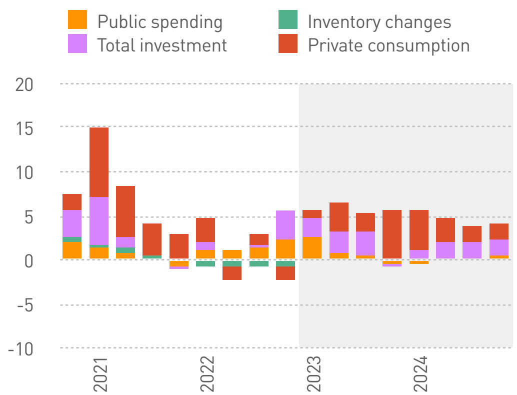
The Chinese economy ended 2022 with total growth of 3.0% (2.9% YoY in the last quarter of the year), with declines in private consumption in the second and fourth quarters due to further lockdowns in the country. Exports (0% YoY) and imports (-4.5% YoY) have also been affected by the inability of factories to work at full capacity and consumers to go about their normal lives. Government consumption was the only item that went against the trend (+9.0% YoY). A return to normality is expected in 2023, with a strong boost to consumption due to pent-up demand and accumulated savings, while inflation is well under control (2.1% in January).

Chart 1.2.12-a
China: GDP breakdown and forecasts



Source: MAPFRE Economics (based on BoPRC data)

Chart 1.2.12-b
China: domestic demand breakdown and forecasts



Source: MAPFRE Economics (based on BoPRC data)

Table 1.2.12
China: main macroeconomic aggregates

	2018	2019	2020	2021	2022	Baseline (BS) 2023(f)	Baseline (BS) 2024(f)	Stressed (SS) 2023(f)	Stressed (SS) 2024(f)
GDP (% YoY)	6.7	6.0	2.2	8.5	3.0	5.1	4.9	4.2	4.2
Domestic demand contribution	7.3	5.3	1.6	6.6	2.2	5.6	4.4	5.2	3.9
External demand contribution	-0.3	0.6	0.7	2.3	0.7	-0.8	-0.8	-0.8	-0.9
Private consumption contribution	3.2	2.5	-1.0	4.6	0.0	3.1	2.7	3.1	2.5
Total investment contribution	3.1	2.2	1.3	1.3	1.3	1.6	1.7	1.4	1.3
Public spending contribution	1.2	1.1	0.8	0.3	1.4	0.9	0.0	0.9	0.0
Private consumption (% YoY)	8.1	6.3	-2.4	12.1	0.1	8.2	6.7	8.0	6.4
Public spending (% YoY)	7.1	6.6	4.6	1.6	9.0	5.1	0.1	5.1	0.1
Total investment (% YoY)	7.3	5.1	3.1	3.2	3.2	4.1	4.1	3.4	3.3
Exports (% YoY)	4.4	2.3	1.7	18.2	-0.3	-1.7	2.5	-2.1	1.1
Imports (% YoY)	6.5	-0.7	-2.2	6.6	-4.6	3.1	9.0	2.6	7.8
Unemployment rate (%, last quarter)	2.9	3.1	3.5	3.3	3.6	3.5	3.4	3.6	3.6
Inflation (% YoY, average)	2.1	2.9	2.5	0.9	2.0	2.3	2.3	2.7	2.5
Inflation (% YoY, last quarter)	2.2	4.3	0.1	1.8	1.8	2.8	2.4	3.4	2.1
Fiscal balance (% of GDP)	-4.7	-5.6	-7.6	-5.1	-7.4	-6.8	-6.3	-6.9	-6.6
Primary fiscal balance (% of GDP)	-1.5	-2.2	-3.7	-1.5	-3.6	-2.8	-2.2	-2.9	-2.5
Current account balance (% of GDP)	0.2	0.7	1.7	1.8	2.3	1.6	0.2	1.5	0.2
Official interest rate (end of period)	3.25	3.25	3.00	3.00	2.75	2.75	3.00	2.75	3.00
3-month interest rate (end of period)	3.35	3.02	2.76	2.50	2.42	2.45	2.53	2.44	2.53
10-year interest rate (end of period)	3.23	3.14	3.14	2.78	2.84	3.18	3.67	3.26	3.59
Exchange rate vs. U.S. dollar (end of period)	6.88	6.99	6.52	6.35	6.90	6.85	6.48	6.91	6.51
Exchange rate vs. euro (end of period)	7.87	7.85	8.00	7.19	7.36	7.41	7.17	7.36	7.16
Private lending (% YoY, average)	12.9	13.1	13.1	12.3	11.1	11.3	9.0	10.5	9.6
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 (% pers. disp. income, avg.)	28.8	29.0	32.9	30.5	32.3	30.3	29.4	30.2	29.5

Source: MAPFRE Economics (based on BoPRC data)
Forecast end date: April 10, 2023.

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China

- **China's economy is forecast to be able to grow by 5.1% in 2023, but still with internal and external weaknesses.**
- **There has been a recovery in consumption and manufacturing.**
- **Chinese exports, however, will depend on weaknesses in the destination countries.**
- **The central bank has room to maintain an accommodative monetary policy because inflation is not tightening, except for a spike in food prices.**

Purchasing managers' indexes (PMIs) for March came out very positive, with the composite at 57.0, manufacturing at 51.9 and non-manufacturing at 58.2 points, while auto sales rebounded in March, up 15.3%. Consumer confidence is recovering, with the end of lockdowns in December (88.3), and confidence in the real estate sector has stabilized (94.4 in December), after the government enacted measures to stabilize the sector. Thus, Chinese GDP growth is forecast at 5.1% in 2023 and 4.9% in 2024, if the economy manages to navigate the choppy waters in its financial and real estate sectors and avoid further lockdowns (see Table 1.2.12 and Charts 1.2.12-a and 1.2.12-b).

Inflation, meanwhile, remained low at only 0.7% YoY in March (-0.3% QoQ). Likewise, producer prices (PPI) fell by 2.5%, while food inflation eased 2.4%. Recent data suggest a mixed performance: services are recovering from the effect of lockdowns, while manufacturing is weaker but gaining traction, with exports growing by 14.8% in March, the first advance in half a year.

Monetary policy remains stable, and the central bank has more leeway because there is not as much price tension as in the West. The level of reserves required from banks has been stable since November, at 11.00%, and the 7-day Reverse Repo rate is at 2.09%, the deposit rate is at 1.50% and the 5-year lending rate is at 4.30%.

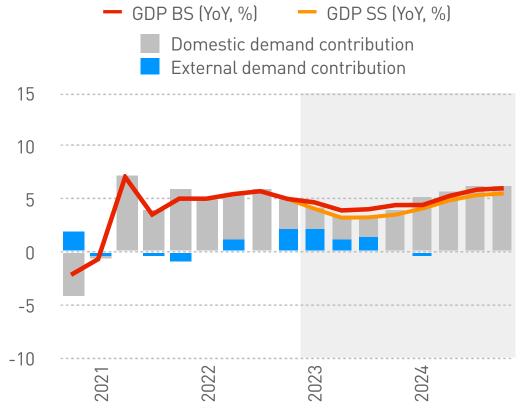
Growth has resumed, but China has many uncertainties to manage. The first is geopolitical, amid growing tensions with the United States over the Taiwan issue, but it is not the only one. The *Belt & Road* infrastructure project aims to connect the "Chinese factory" with the rest of the world and reduce dependence on the United States as a market. Furthermore, relations with Saudi Arabia are improving, with the creation of long-term oil supply commitments. On the other hand, China's offer of mediation in favor of Russia regarding the conflict in Ukraine was also immediately rejected by the United States. Similarly, on the economic front, China continues to face risks linked to the real estate sector, which, if not well managed, could affect the financial sector.

1.2.13 Indonesia

Growth will moderate in 2023 before picking up again in 2024.

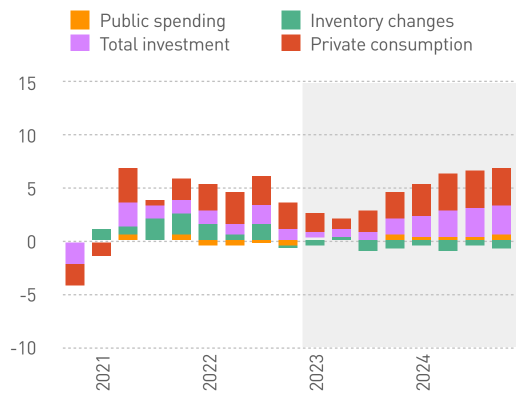
Indonesia's economy ended the year with average growth of 5.3%, recovering the growth rate observed before the pandemic. Over the year, consumption grew by 4.9% YoY and in-

Chart 1.2.13-a
Indonesia: GDP breakdown and forecasts



Source: MAPFRE Economics (based on BPS data)

Chart 1.2.13-b
Indonesia: domestic demand breakdown and forecasts



Source: MAPFRE Economics (based on BPS data)

Table 1.2.13
Indonesia: main macroeconomic aggregates

	2018	2019	2020	2021	2022	Baseline (BS) 2023(f)	Baseline (BS) 2024(f)	Stressed (SS) 2023(f)	Stressed (SS) 2024(f)
GDP (% YoY)	5.2	5.0	-2.1	3.7	5.3	4.3	5.4	3.5	5.0
Domestic demand contribution	6.2	3.6	-3.6	4.1	4.5	2.5	5.8	2.4	5.2
External demand contribution	-1.0	1.4	1.5	-0.4	0.8	1.1	-0.2	1.1	-0.3
Private consumption contribution	2.8	2.9	-1.5	1.1	2.7	1.8	3.5	1.7	3.3
Total investment contribution	2.2	1.5	-1.6	1.2	1.2	0.9	2.5	0.8	2.1
Public spending contribution	0.4	0.3	0.2	0.3	-0.4	0.3	0.4	0.3	0.5
Private consumption (% YoY)	5.1	5.2	-2.7	2.0	4.9	3.3	6.4	3.2	6.1
Public spending (% YoY)	4.8	3.3	2.1	4.2	-4.5	3.7	5.8	3.8	6.0
Total investment (% YoY)	6.7	4.5	-5.0	3.8	3.9	2.9	7.9	2.6	6.6
Exports (% YoY)	6.5	-0.5	-8.4	18.0	16.3	1.4	3.1	1.1	2.0
Imports (% YoY)	12.1	-7.1	-17.6	24.9	14.7	-3.8	4.8	-4.1	3.9
Unemployment rate (%, last quarter)	5.1	5.1	6.7	6.2	5.6	5.4	5.1	5.5	5.4
Inflation (% YoY, average)	3.3	2.8	2.0	1.6	4.2	4.0	2.1	4.2	2.2
Inflation (% YoY, last quarter)	3.3	2.7	1.6	1.8	5.5	2.9	2.5	3.3	2.2
Fiscal balance (% of GDP)	-1.7	-2.2	-6.2	-4.6	-2.4	-3.2	-3.1	-3.2	-3.2
Primary fiscal balance (% of GDP)	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Current account balance (% of GDP)	-2.9	-2.7	-0.4	0.3	1.0	0.6	0.2	0.5	0.2
Official interest rate (end of period)	6.00	5.00	3.75	3.50	5.50	5.75	5.00	5.75	5.00
3-month interest rate (end of period)	7.70	5.51	4.06	3.75	6.62	6.66	5.86	6.99	5.90
10-year interest rate (end of period)	7.98	7.10	6.10	6.38	6.93	6.75	6.69	6.98	6.62
Exchange rate vs. U.S. dollar (end of period)	14,380	13,883	14,050	14,253	15,568	15,431	14,516	15,600	14,605
Exchange rate vs. euro (end of period)	16,465	15,596	17,241	16,143	16,605	16,674	16,070	16,622	16,067
Private lending (% YoY, average)	10.8	8.8	1.4	1.0	9.6	7.8	9.3	8.0	9.3
Household lending (% YoY, average)	10.2	7.9	2.1	2.2	7.8	8.1	5.0	7.9	4.8
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)	5.6	-3.0	-6.0	-12.6	14.4	22.7	16.5	22.7	16.1
Savings rate (% pers. disp. income, avg.)	24.0	22.8	21.4	25.7	29.2	27.6	25.7	27.6	25.7

Source: MAPFRE Economics (based on BPS data)
Forecast end date: April 10, 2023.

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vestment by 3.9%, while government consumption fell by 4.5%. Exports grew by 16.3%, stronger in the first half of the year, and imports grew by 14.7%. The Indonesian rupiah weakened in the second half of the year to IDR15,500/USD levels, coinciding with the strengthening of the dollar.

Indonesia

- Consumption will moderate in 2023 due to inflation, and exports will fall due to the base effect and external conditions.
- GDP is forecast to grow 4.3% in 2023 and 5.4% in 2024.
- Indonesia's economy is struggling to lower inflation levels.
- Currency stability and inflation control are central bank priorities.

The purchasing managers' index (manufacturing PMI) for March came in at 51.9 points, an improvement that has been ongoing for 19 months in a row, on the back of reduced supply difficulties and improved delivery times. Meanwhile, retail sales fell in January (-0.7%), while auto sales, after a drop in mid-2022, are still recovering (+7.4%), and auto manufacturing has eased a bit, although it is near peak levels.

For the coming quarters, economic activity levels are expected to weaken, as fuel subsidies will no longer be available and due to the effect of inflation. Thus, consumption is expected to weaken in the first half of the year, and this will also be seen in government consumption in its effort to control the deficit. Exports will also moderate comparatively after a year of recovery in 2022, and in 2023, a high base effect coincides with a global slowdown. Thus, the forecast for economic growth in Indonesia stands at 4.3% for 2023, a slowdown from 2022, with a return to trend at 5.4% for 2024 (see Table 1.2.13 and Charts 1.2.13-a and 1.2.13-b).

Inflation stood at 5.0% in March, slightly moderating and with mixed effects: upward due to the withdrawal of the fuel subsidy and downward for food. Core inflation fell to 2.9%, and producer prices rose by 5.4%. In terms of trend, average inflation in 2023 is expected to be around 4.0% due to second-round effects.

The Central Bank of Indonesia held interest rates at 5.75% at its March meeting. If inflation stabilizes at around 3.5% in 2023, it will be within the target range of 2–4%. The body believes that core inflation is still likely to have risen through the first quarter of 2023 but expects it to remain below 4.0%. This restrictive monetary policy, together with interventions in the foreign exchange market, is aimed at stabilizing the currency.

Risks to the Indonesian economy could come from a global economic slowdown, affecting palm oil and coal prices, its main exports. The current account balance is positive, above 1%, thanks to strong exports. The exchange rate weakened in the last quarter of 2022, coinciding with the strengthening of the dollar, but has recently stabilized around IDR 15,200/USD. Rising interest rates on external dollar debt is a challenge for all emerging countries to roll over such debt issues, and instability in international funding markets would be a challenge for Indonesia.

1.2.14 Philippines

The highest growth in the region, although inflation is not yet under control.

> **Philippines**
>
> - Inflation is not under control and still appears to be accelerating.
> - The central bank should continue to tighten financial conditions to avoid second-round effects.
> - GDP grew by 7.6% in 2022 and is expected to moderate to 5.0% in 2023.
> - The current account deficit in the balance of payments has increased to -5.8%.

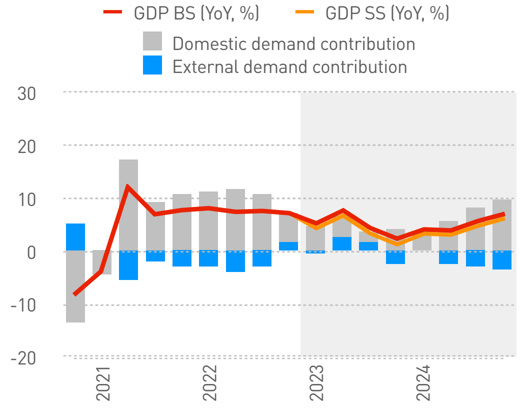
The Philippine economy grew by 7.6% in 2022, the highest growth among Southeast Asian countries and highest rate since 1976. Private consumption increased by 8.3% YoY, government consumption by 5.0% YoY, and investment by 10.4%. Exports also showed excellent performance (+10.7%), but imports grew even more (+13.1%). Thus, the current account balance is strongly negative (-5.8% in the third quarter of 2022).

In terms of leading indicators of activity, the PMI manufacturing index stabilized in March at 52.5 points. Industrial production rose 15.4% in February, with the automotive sector showing signs of having overcome the semiconductor crisis. Against this backdrop, the Philippine economy is expected to slow down in 2023 from record highs in 2022, mainly due to inflationary pressures and tighter financial conditions. Thus, GDP growth is expected to be around 5.0% in 2023 and 5.2% in 2024, with a slowdown across all GDP components and especially consumption and exports (see Table 1.2.14 and Charts 1.2.14-a and 1.2.14-b).

Inflation, on the other hand, reached 7.7% in March (-0.2% MoM), already in a deceleration phase, but with core inflation at 8.0%. With the monetary base increasing significantly by the end of 2022, inflation should remain high. By categories, food rose by 9.5%, while housing and household supplies rose by 7.5%. The Central Bank of the Philippines raised interest rates by 25 bps to 6.25% (*Overnight Repo*) in March. Risks to inflation remain high, and the bank expects it to remain outside the 2–4% target range and stand at 6.1% in 2023, falling to 3.1% in 2024. These forecasts were adjusted upward due to the strength of consumption and broadening price pressures, especially in services. The central bank sees the need to take preventive measures to control second-round effects, i.e., wage increases that continue to fuel inflation.

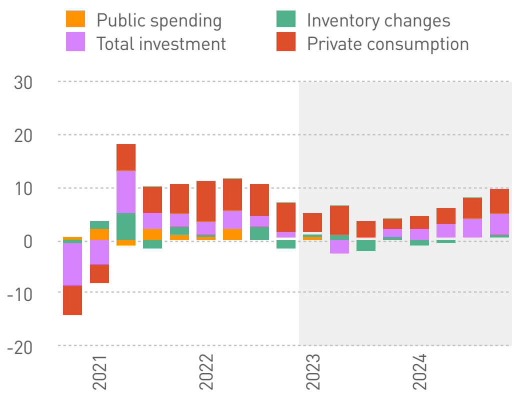
As for near-term risks to the Philippine economy, the main one is inflation, which appears to be accelerating for now. Rising imported prices, especially energy, are widening the current account deficit, which reached 5.8% in the third quarter of 2022. The terms of trade have been worsening for years, with the price of exports growing less than those of imports. On the positive side, we must acknowledge the sustained high economic growth of the Philippine economy, even if it will show some slowdown in 2023.

Chart 1.2.14-a
Philippines: GDP breakdown and forecasts



Source: MAPFRE Economics (based on PSA data)

Chart 1.2.14-b
Philippines: domestic demand breakdown and forecasts



Source: MAPFRE Economics (based on PSA data)

Table 1.2.14
Philippines: main macroeconomic aggregates

	2018	2019	2020	2021	2022	Baseline (BS) 2023(f)	Baseline (BS) 2024(f)	Stressed (SS) 2023(f)	Stressed (SS) 2024(f)
GDP (% YoY)	6.3	6.1	-9.5	5.7	7.6	5.0	5.2	3.9	4.4
Domestic demand contribution	8.6	6.3	-13.5	8.1	9.6	3.8	6.8	3.7	6.6
External demand contribution	-2.3	-0.2	4.0	-2.4	-2.0	0.2	-2.1	0.2	-2.2
Private consumption contribution	4.2	4.3	-5.8	3.1	6.1	3.6	3.4	3.5	3.3
Total investment contribution	3.3	1.1	-7.3	2.1	2.3	-0.1	3.1	-0.1	3.0
Public spending contribution	1.5	1.1	1.3	1.1	0.8	0.3	0.3	0.3	0.3
Private consumption (% YoY)	5.8	5.9	-8.0	4.2	8.3	4.9	4.7	4.8	4.5
Public spending (% YoY)	13.4	9.1	10.5	7.1	5.0	1.9	2.3	1.9	2.3
Total investment (% YoY)	12.9	3.9	-27.3	9.9	10.4	-0.3	14.2	-0.4	13.7
Exports (% YoY)	11.8	2.6	-16.1	8.0	10.7	-1.7	5.4	-1.9	4.4
Imports (% YoY)	14.6	2.3	-21.6	13.0	13.1	-1.7	9.5	-1.8	9.1
Unemployment rate (%, last quarter)	5.1	4.6	8.7	6.8	4.3	4.7	4.6	4.7	4.8
Inflation (% YoY, average)	5.3	2.4	2.4	3.9	5.8	5.5	2.9	5.9	3.3
Inflation (% YoY, last quarter)	6.1	1.4	2.9	3.6	7.9	2.7	3.2	3.3	3.1
Fiscal balance (% of GDP)	-3.1	-3.4	-7.6	-8.6	-7.3	-6.5	-5.7	-6.5	-5.7
Primary fiscal balance (% of GDP)	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Current account balance (% of GDP)	-2.6	-0.8	3.2	-1.5	-4.8	-2.8	-2.8	-3.1	-2.8
Official interest rate (end of period)	4.75	4.00	2.00	2.00	5.50	6.00	5.00	6.25	4.00
3-month interest rate (end of period)	5.03	3.97	2.00	1.81	5.50	6.37	4.94	6.69	5.00
10-year interest rate (end of period)	7.05	4.44	2.97	4.72	6.91	6.05	5.76	6.19	5.68
Exchange rate vs. U.S. dollar (end of period)	52.72	50.74	48.04	50.27	56.12	55.46	53.20	56.10	53.61
Exchange rate vs. euro (end of period)	60.37	57.01	58.94	56.93	59.86	59.93	58.89	59.78	58.97
Private lending (% YoY, average)	16.8	9.5	4.0	0.9	8.3	6.1	8.1	6.4	8.1
Household lending (% YoY, average)	14.3	12.8	11.2	-2.1	7.7	11.6	10.5	11.4	10.2
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)	10.3	6.9	-7.9	8.2	13.4	11.8	7.0	11.7	7.0
Savings rate (% pers. disp. income, avg.)	6.4	5.0	3.4	-0.4	-2.7	-1.5	2.0	-1.6	2.1

Source: MAPFRE Economics (based on PSA data)
Forecast end date: April 10, 2023.

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2. Industry outlook

2.1 The economic environment and its impact on insurance demand

2.1.1 Global markets

The revised estimates for economic growth in 2023 point to a global slowdown that is less pronounced than initially forecast in our previous report, with global growth likely to reach around 2.8% (3.4% in 2022). This is due to the reopening of China, the normalization of supply chains and a moderation in energy prices, which consequently paints a more benign picture for insurance demand this year. Inflation is beginning to show some signs of improvement but remains high, especially core inflation. Insurers' profitability will therefore remain under pressure from rising claims costs and other operating expenses as long as this situation persists.

According to the latest published data and forecasts, inflation continues to moderate—albeit with a certain lack of synchrony among the different countries—as the tightening of restrictive monetary policies implemented by central banks practically worldwide, both in developed and emerging markets (with some important exceptions, such as Japan and China), takes effect. This way, the effects of interest rate hikes and the credit crunch are being passed on to the real economy in the form of lower economic growth, which may become more evident in the coming months of this year in a landing that is nonetheless expected to be relatively soft.

The automotive sector is showing clear signs of improvement due to the normalization of the supply chain problems, so the outlook for auto insurance business and profitability (which is benefiting from some pent-up demand) has improved. However, the tightening of conditions for financing new vehicle purchases may weigh on the business in the coming months. Meanwhile, the high interest rate environment resulting from tight monetary policies will continue to be an additional stimulus for the savings-linked Life insurance business, while lower inflation, good exchange rate performance in certain markets (such as Brazil and Mexico), and high interest rates may help to improve the profitability of the insurance industry in 2023 after the challenging year experienced in 2022.

Finally, it should be noted that financial markets have had a good start to the year, despite the turbulence caused by the problems of some small and medium-sized banks in the United States and Credit Suisse in Europe. This has heightened uncertainty and generated some fragility in investor confidence, although the decisive intervention and messages from central banks have helped to reassure markets. However, there remains some uncertainty that accelerated interest rate hikes being implemented may cause some additional financial accidents. After this situation, it is estimated that central banks are reaching the ceiling in terms of interest rate hikes, with the possibility of some additional hikes by the ones that began the monetary tightening process later, with inflation levels that remain well above their objectives. They will therefore maintain a restrictive monetary policy until there are clear signs that inflation is under control. Likewise, the improved performance of equity indexes (after the falls experienced in the previous year) could be favorable to Life insurance products in which the policyholder assumes the investment risk. These products can also take advantage of the higher returns offered by fixed income in the product mix launched in the market.

2.1.2 Eurozone

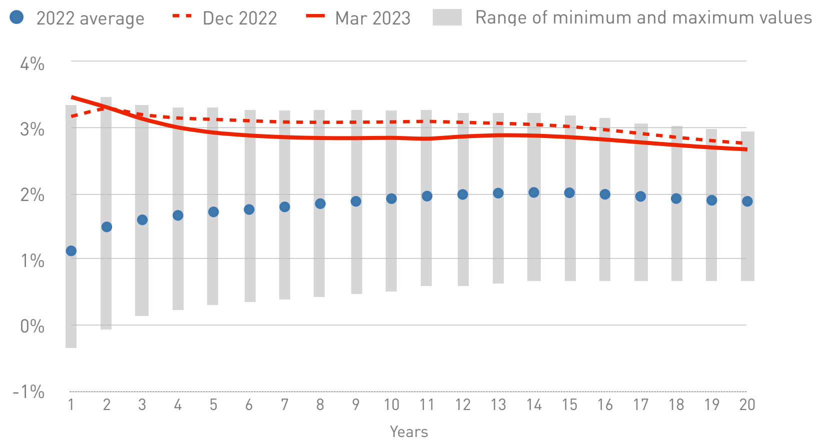
The estimate for economic growth in 2023 for the Eurozone is around 0.6% (3.5% in 2022), once again improving on the forecasts made during the previous year, which pointed to a slight recession. Moderation in energy prices and the Chinese economy's rapid emergence from lockdown have improved the economic outlook for this year. However, this outlook assumes that economic activity in the Eurozone will remain at modest levels as the effects of the tightening of financing conditions and credit restrictions are passed on to the real economy. This may complicate the outlook for the insurance industry as they materialize and as long as the European Central Bank (ECB) decides to maintain a restrictive monetary policy in its fight against inflation. For the time being, the normalization of supply chains and energy prices have boosted production in the automotive sector, increasing new vehicle registrations with a positive effect on the auto insurance segment. Meanwhile, interest rate hikes have revived traditional Life savings and annuity insurance, which, after a decade of a low interest rate environment, had virtually disappeared from the market. At the same time, the improvement in the financial performance of investment portfolios, falling inflation and the revision of rates in 2023 to offset higher claims costs and other operating expenses may help to improve the profitability of the insurance industry, which remains under some pressure from rising prices.

The ECB has continued to tighten its monetary policy with two new rate hikes of 50 basis points each in February and March, leaving interest rates at 3.5% for the main refinancing operations and 3% for the deposit facility, and pointing to the possibility of further, more moderate rate hikes for the next meetings. This will depend on inflation, which, despite beginning to moderate, remains at high levels for the Eurozone as a whole, standing at 6.9% in March (8.5% in February), compared to an average annual inflation rate of 8.4% for 2022. On the other hand, the ECB's quantitative easing program began in March, reducing its bond holdings by 15 billion euros per month for four months, without altering its roadmap despite the turbulence in the banking sector. However, it has made it clear that if necessary, it will use the means at its disposal to stabilize the financial system. This message helped to lower the tension in the risk premiums of peripheral countries' sovereign bonds, which had begun to rebound significantly.

An analysis of the March risk-free yield curves compared to those of December of last year, produced by the European Insurance and

Pensions Authority (EIOPA)[10], shows a rise in interest rates in the short end of the curve and a fall in all the tranches with maturities of over two years (which are below the December rates). This has led to a significant inversion of the risk-free yield curve, affecting practically all of its tranches, especially maturities up to five years (see Chart 2.1.2). Rises in risk-free interest rates continue to paint a favorable picture for the Life savings business, although the inversion of the yield curve complicates the management of this business, which has to adapt to a new environment in which the term premium is negative. This climate is more suitable for products with shorter durations and periodic renewals and more complex for longer-term products such as traditional annuities. Meanwhile, the Euro Stoxx 50 index has risen by 11.9% so far this year, up to the end of March. In the U.S. market, the S&P500 has climbed 7.5%, and Nasdaq Composite has risen to an even greater extent, by 17.7%. This improved performance of indexes (after the falls experienced last year) could be favorable to Life insurance products in which the policyholder assumes the investment risk. These products can also take advantage of the higher returns offered by fixed income in the product mix launched in the market.

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



Source: MAPFRE Economics (based on EIOPA data)

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2.1.3 Germany

Forecasts indicate that the German economy will have no real growth in 2023 (1.9% in 2022). Nevertheless, this is an improvement on estimates of German GDP growth that, in previous quarters, pointed to a recession. This new outlook is supported by the moderation observed in energy prices and the rapid normalization of supply chains, which have improved the economic outlook for this year. In any case, this is a situation of stagnation in the German economy, which is strongly influenced by weak demand as a result of the tightening of financing conditions. Inflation levels remain high (8.7% and 7.4% in February and March, respectively; with the average for 2022 closing at 6.9%). This continues to paint a complicated picture for the business development and profitability of the insurance industry in the Non-Life segment (as a result of high inflation), a situation that could improve in 2024 with economic growth estimated at around 1.3% and inflation expected to fall (1.8%).

On the other hand, the German sovereign bond yield, which had experienced a strong rebound in December following the tightening of monetary policy by the ECB, has continued to advance in its short tranches with the last two interest rate hikes in 2023. However, at the end of March, the longest parts of the curve have barely moved compared to December, so the yield curve has increased its negative slope. This interest rate situation continues to provide a favorable environment for Life savings business with guaranteed interest rates with shorter terms and periodic renewals, and a more complex one for products with guaranteed interest rates of longer terms, as well as for traditional annuities by virtue of the inversion of the risk-free yield curve. The German DAX, meanwhile, remains volatile but has recovered with a revaluation of 11.1% in the first quarter of the year, following a 12.3% drop in 2022, remaining close to its all-time highs. This improved performance of equities (after the falls experienced in the previous year) may favor the development of Life insurance products in which the policyholder assumes the investment risk. These products can also take advantage of the higher returns offered by fixed income in the product mix offered in the market.

2.1.4 Italy

The forecast for Italy's economy in 2023 is for a slowdown in GDP growth to 0.8% (3.8% in 2022), but without going into recession. This represents an upward revision of the growth estimate for this year compared to that considered in our previous report, based on economic indicators that continue to surprise positively. However, the economic environment is weak as a result of the tightening of financial conditions for households and companies, with an inflation level that, while beginning to moderate, remains high (9.1% and 7.7% in February and March, compared to an average inflation rate of 8.2% in 2022). This economic situation paints a still complex picture for the development and profitability of the insurance industry, especially for the Non-Life segment.

On the other hand, the risk premium of Italian sovereign debt has been affected by the turbulence in the banking sector on both sides of the Atlantic. This significantly stressed the risk premium of the Italian sovereign bond, although it was later reduced after the ECB's message. In any case, the yield on the ten-year bond has remained above 4%, and the sovereign debt yield curve continues to show a steep positive slope. This environment of higher interest rates and a yield curve that makes it possible to offer returns on medium and long-term products that are significantly higher than short-term rates (term premium) continues to paint a good picture for traditional Life savings and annuity products. On the other hand, equity markets, although still volatile, rallied in the first quarter of the year, and the FTSE MIB in particular rose by 12.2% in the first quarter of the year. The stronger performance of equities (after the falls observed in 2022) may help the development of Life insurance products in which the policyholder assumes the investment risk, which are widespread in the Italian market. Such products may also benefit, as in other European markets, from the higher returns offered by fixed income.

2.1.5 Spain

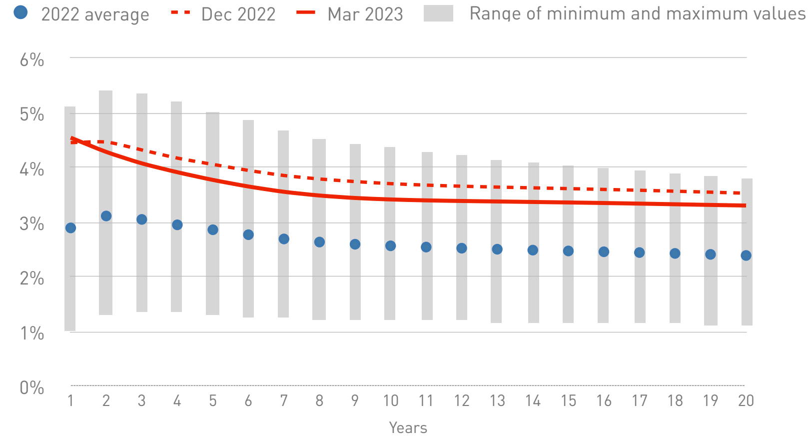
Economic growth expectations for the Spanish economy in 2023 have improved compared to what was considered in our report in the previous quarter, standing at 1.7% (5.5% in 2022). This would see the country surpass its pre-pandemic production level this year. The moderation of energy prices and the normalization of problems in supply chains are helping certain sectors of the economy, such as the automotive sector, by improving exports and new vehicle registrations, which is helping the auto insurance business to recover. However, this is still an environment of weak economic activity as a result of the tightening of financial conditions for households and companies, which will continue until inflation shows clear signs of moderating in the Eurozone as a whole. Nevertheless, Spain is already seeing signs of a more evident moderation, with year-on-year inflation coming in at 6% and 3.3% in February and March, respectively, well below the average inflation rate of 8.4% in 2022. This environment paints a picture of moderate growth for the insurance business and a better outlook for its profitability (essentially due to lower inflation). The forecast for 2024 is for the Spanish economy to continue to slow down, with estimated growth of 1.4%, as the effects of the tightening of financing conditions are passed on to the real economy, which may also have an impact on growth in the insurance industry.

2.1.6 United Kingdom

The forecast for the UK economy in 2023 anticipates GDP stagnation (4.0% in 2022), a situation that could improve in 2024 with estimated growth of 1.6%. This represents a significant slowdown in the country's economy, despite the fact that the revised forecasts with respect to those of the previous quarter imply an improvement (since a recession had been anticipated), once the problems in supply chains and the spike in energy prices were overcome. In any case, the outlook remains complex for the development of the UK insurance market, especially for the Non-Life segment, in an environment of high inflation that shows no signs of improvement (10.1% and 10.4% in January and February, respectively, compared to an average inflation of 9.1% in 2022). This continues to erode household disposable income and the profitability of the insurance industry, keeping pressure on insurance prices high.

With respect to the environment for savings-linked Life insurance and traditional annuities, in view of the poor inflation data, the Bank of England increased interest rates again at its February and March meetings by 50 and 25 basis points, respectively, leaving them at 4.25%. EIOPA's risk-free yield curves at the end of March (see Chart 2.1.6) show a slight upturn in one-year rates and a decline in risk-free interest rates in all tranches of the curve compared to December, with the curve gaining negative slope. This is a complex interest rate environment for insurers to manage. The high level of short-term interest rates continues to be favorable for the marketing of Life savings insurance products with guaranteed rates for short durations and rate reviews at each renewal. Meanwhile, it is

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



Source: MAPFRE Economics (based on EIOPA data)

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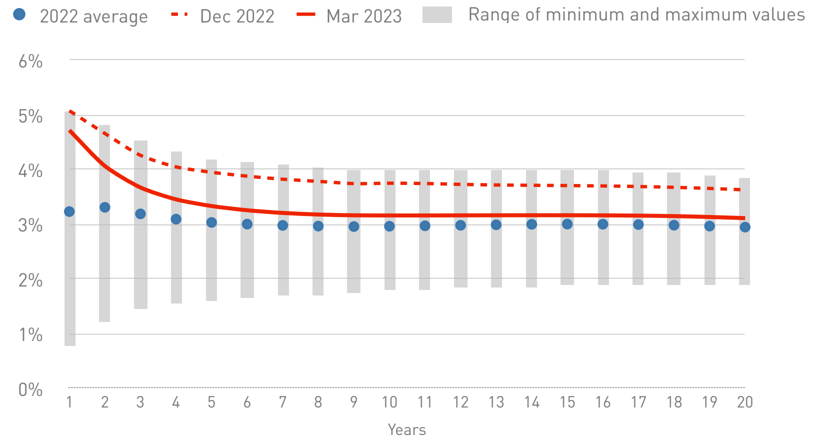
less favorable for the marketing of annuities with guaranteed interest rates, in an environment of negative real interest rates and a curve that has a negative slope affecting all tranches. With regard to equities, the FTSE 100 continues to be exposed to high volatility, closing the first quarter with a slight increase of 1%. This, together with the good performance of the main international equity indexes in the quarter, continues to favor the marketing of Life insurance policies in which the policyholder assumes the investment risk, which are deeply rooted in this market, with products that can also leverage the higher returns of fixed income.

2.1.7 United States

The economic growth forecast for the United States in 2023 is around 1.0% (2.1% in 2022), which represents a significant slowdown year-on-year, despite the improvement in expectations for this year compared to our report from the previous quarter. However, forecasts for next year have been downgraded, with estimated growth in 2024 of 0.7% as a result of the tightening of financing conditions, with interest rates at levels not seen in the last 15 years and the possibility of a credit crunch (especially in view of the liquidity problems that have affected medium and small banks in the country after the bankruptcies in March). Inflation continues to show signs of easing (6% and 5% in February and March, respectively, compared to an average inflation rate of 8.0% in 2022), and the labor market continues to show signs of strength. This may help to maintain moderate growth for the insurance business and improve its profitability, which in the previous year was negatively affected by the strong and unexpected upturn in inflation. Rising interest rates are also helping to improve the outlook for the future profitability of its investment portfolios.

The U.S. Federal Reserve has raised interest rates again, with two additional rate hikes in 2023 of 25 basis points each at the February and March meetings, leaving them in a range between 4.75% and 5%. It is expected that some additional 25 basis points could still be seen, although uncertainty in this regard has increased due to the problems encountered in some small and medium-sized banks in this country. The Federal Reserve has maintained its stance that it will continue to pursue tight monetary policy until there are strong indications that inflation is under control at levels close to its 2% target, with data continuing to improve but still falling short of that target. The March market risk-free yield curve produced by EIOPA (see Chart 2.1.7) shows a fall in interest rates in all tranches of the

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



Source: MAPFRE Economics (based on EIOPA data)

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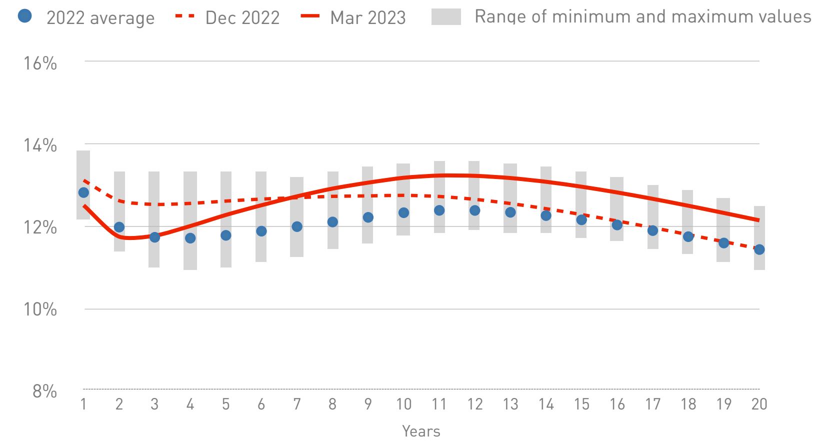
curve, moving away from the highs reached in 2022. This is a practically parallel displacement, so that the curve continues to display a negative slope that affects all its tranches, although more markedly in its middle section. Thus, the high levels of risk-free interest rates continue to paint a favorable picture for the Life savings business, but the inversion of the yield curve complicates the management of this business, which has to adapt to a new environment in which short-term rates are higher than long-term rates (negative term premium). This could be favorable for products with shorter durations and periodic renewals, but more complex for products with longer durations as well as for traditional annuities.

Meanwhile, the S&P500 index had rallied 7.5% by the end of March and the Nasdaq Composite 17.7%. This partial recovery of equity indexes may help the development of Life insurance products in which the policyholder assumes the investment risk, very common in the U.S. market, which can also take advantage of the higher returns offered by fixed income in the product mix.

2.1.8 Brazil

The economic growth estimate for the Brazilian economy in 2023 stands at 0.8% (3.0% in 2022), a slight downgrade in the growth forecast for this year compared to our previous report. The tightening of financial conditions due to the restrictive monetary policy implemented by the Central Bank of Brazil is being passed on to the real economy, with inflation continuing to moderate but still above the target range. This may lead to a slowdown in the insurance market, mainly in the Non-Life segment, although the normalization of supply chains and energy prices has boosted production in the automobile sector in Brazil as well, increasing production and

Chart 2.1.8
Brazil: risk-free yield curve
(%)



Source: MAPFRE Economics (based on EIOPA data)

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new vehicle registrations, with a positive effect on the auto insurance segment. On the other hand, the profitability of insurance companies may improve due to moderating inflation (5.6% and 4.65% in February and March, respectively, compared to average inflation of 9.3% in 2022). Furthermore, economic forecasts continue to point to an improvement in 2024, with estimated economic growth of around 2.0%.

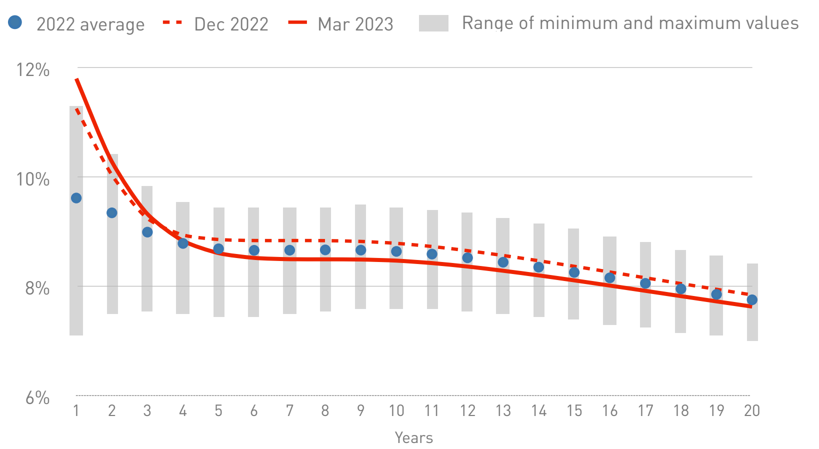
With regard to the interest rate environment, of great relevance for the insurance business due to the extensive development of Life savings insurance in the Brazilian market, it should be noted that the central bank once again decided to maintain interest rates at 13.75% at its February and March meetings (for the fifth consecutive time) with inflation continuing to fall, albeit more moderately and still above its target range. This environment of positive real interest rates continues to be favorable for the development of the Life savings and annuities business, with interest rates offering returns significantly higher than the latest inflation data. EIOPA's risk-free yield curves at the end of March (see Chart 2.1.8) show a fall in the short and medium tranches of the curve to maturities of less than seven years, with a slight negative slope in the first tranches. This continues to favor the development of products backed by sovereign bonds with short maturities, very common in this market (VGBL and PGBL), and even the possibility of entering longer-term bonds becomes more attractive, taking advantage of the increase in interest rates in the longer tranches, which remain above short-term rates (positive term premium in the long tranches).

2.1.9 Mexico

Although economic dynamics remain weak, in the case of Mexico, GDP growth expectations for 2023 are slightly better than in our previous report, estimated at around 1.2% (3.1% in 2022). Even in an environment of economic fragility, activity levels could improve by 2024, when GDP growth could be around 1.5%. Mexico's economy continues to be affected by high interest rates, which were raised again at recent meetings of the Bank of Mexico, maintaining a restrictive monetary policy as long as inflation does not show clear signs of returning to its target range. This may lead to a slowdown in the insurance market, mainly in the Non-Life segment, although (as has occurred in other countries), the normalization of supply chains and energy prices have boosted production in the automobile sector, improving exports and new vehicle registrations, with the positive effect this has had on the auto insurance segment. Meanwhile, the moderation of inflation (6.85% in March, compared to an average inflation rate of 7.9% in 2022) and the higher profitability of investment portfolios could help to improve the performance of the insurance industry this year.

Regarding the interest rate environment, the Bank of Mexico decided to apply two additional hikes in the monetary policy reference rate in February and March of 50 and 25 basis points, respectively, leaving it at 11.25%. Thus, the risk-free yield curves produced by

Chart 2.1.9
Mexico: risk-free yield curve
(%)



Source: MAPFRE Economics (based on EIOPA data)

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EIOPA (see Chart 2.1.9) show a slight rise in the shorter tranches of the curve with maturities up to four years, significantly inverted in these tranches, as well as a slight fall and a flatter curve in the longer tranches. Therefore, this interest rate environment remains appropriate for the development of Life savings insurance, which can offer a remuneration significantly higher than the latest inflation data. The inversion of the interest rate curve continues to be favorable for the launch of savings products with shorter-term rate guarantees and periodic reviews of guaranteed rates.

2.1.10 Argentina

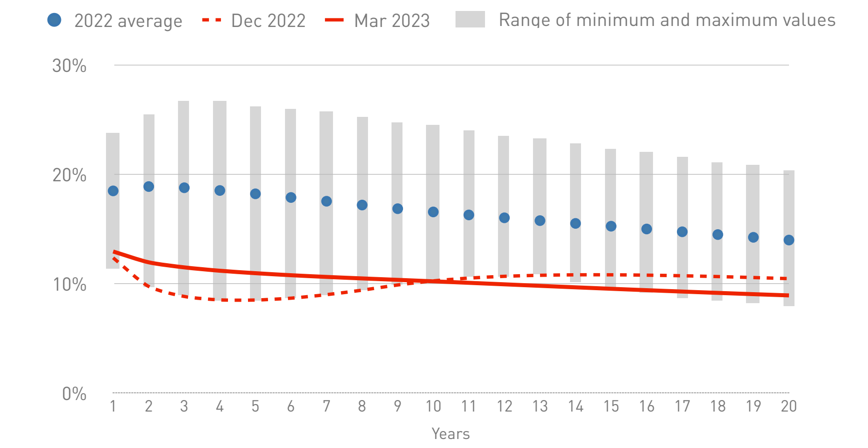
In Argentina, economic expectations for 2023 have worsened in relation to the previous quarter's forecasts, anticipating a recession with a GDP decline of around 0.7% (+5.3% in 2022), following the severe droughts being experienced in the region. Likewise, inflation remains at extremely high levels (102.5% in February, compared to an average inflation rate of 72.4% for 2022), and the exchange rate against the dollar continues to depreciate. This economic context continues to paint a very complex picture for the business and profitability of the insurance industry. Estimates indicate that Argentina's economy could return to growth of around 1.9% in 2024, which would improve the environment for insurance activity next year.

At its March meeting, the central bank decided to increase the benchmark interest rate by three percentage points, to 78%, in view of the spike in inflation, which reached triple digits. All this is in an environment of real interest rates that continue to move further into negative territory. The outlook for Life insurance linked to savings therefore remains very complex, as there are no financial assets on the market with sufficient security and returns to support products that can offset the loss of purchasing power caused by such high inflation.

2.1.11 Turkey

The forecast for Turkey's economy for 2023 are maintained, with estimated growth of 1.6% (5.6% in 2022), implying an economic slowdown that could be improving towards next year, with estimated growth of around 2.0% in 2024. Inflation, on the other hand, remains very high, although it seems to be showing some signs of relative moderation (55.18% and 50.51% in February and March, respect-

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



Source: MAPFRE Economics (based on EIOPA data)

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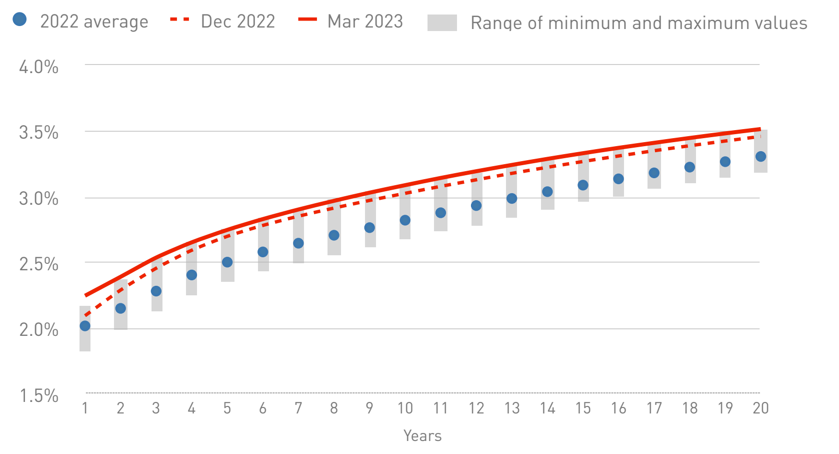
ively, compared to average inflation of 72.3% in 2022). The Turkish central bank has decided to continue to pursue an unorthodox monetary policy and cut interest rates to 8.5% at its February meeting, keeping them at that level for the March meeting. The expected economic slowdown points to a moderate growth outlook for the insurance industry, and better inflation data could help to improve its profitability, although these are still very high levels that maintain upward pressure on insurance prices.

The savings-linked Life insurance business will continue to be weighed down by the effect of monetary policy in an environment of high inflation, which continues to generate a situation of negative real interest rates, although the gap between inflation and nominal interest rates has narrowed in recent months. The EIOPA curves (see Chart 2.1.11) show a rise in the market risk-free interest rates in the short and medium tranches of the curve and a fall in the long tranches, with a curve with a negative slope in all tranches that is still far from being able to compensate for the loss of purchasing power due to high inflation. The outlook therefore remains very complex for the insurance business.

2.1.12 China

Following the reopening process, expectations in 2023 for China's economy improve from our previous quarter's forecast, anticipating real GDP growth of around 5.1% (3.0% in 2022). This rise in expectations is supported by the rapid reopening of the economy after the long period of lockdown, accommodative monetary policy and moderating energy prices, a situation that should carry over to 2024, when economic growth is expected to be around 4.9%. This is a context of economic activity for the next two years that will favor the development of the insurance industry in all its lines of business.

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



Source: MAPFRE Economics (based on EIOPA data)

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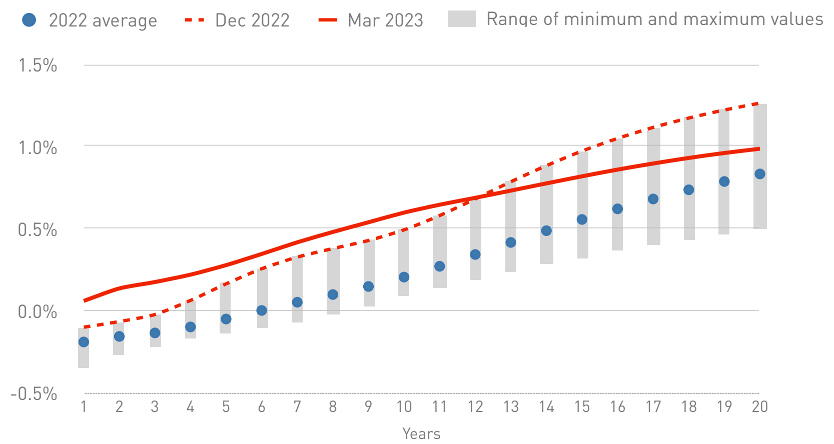
On the other hand, the interest rate environment remains very favorable for Life savings insurance. Inflation in China had been picking up again, standing at 2.1% in January, but fell back down in February to 1.0% and in March to 0.7% (average inflation for 2022 was 2.0%). This has allowed the central bank to continue to apply an accommodative monetary policy, leaving interest rates at 3.65% at its February and March meetings. The EIOPA curves (see Chart 2.1.12) show a slight rise in market risk-free interest rates, which are around the maximum values of 2022, and even higher in the shorter tranches of the curve. Long-term rates, on the other hand, are significantly above short-term rates, offering a positive term premium, an environment that continues to be highly favorable for the Life savings and annuities business, with a curve that makes it possible to offer guaranteed medium and long-term rates that are higher than short-term rates, above inflation.

2.1.13 Japan

In Japan, economic expectations for 2023 remain unchanged, anticipating GDP growth of around 1.1% (1.0% in 2022). This is moderate yet sustained growth, in line with the performance of the Japanese economy prior to the pandemic, which may help the insurance industry to maintain similarly moderate growth rates in a context in which consumer confidence has recovered after the lower-than-expected economic growth of 2022.

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



Source: MAPFRE Economics (based on EIOPA data)

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As for the Life insurance segment, the Bank of Japan has decided not to alter its ultra-accommodative monetary policy. In this regard, at its March meeting, it left short-term interest rates at -0.1% and the ten-year sovereign bond at around 0%, despite inflation that continued to rise (4.3% and 3.3% in January and February, respectively, far from its 2% target). The market risk-free yield curves produced by EIOPA (see Chart 2.1.13) continue to show disturbances in a rate curve that has lost part of the slope it had gained in the previous quarter; nevertheless, it presents positive values in all its tranches. The curve thus offers a positive term premium, with yields, albeit below inflation, to which the Japanese market is not accustomed, which complicates the management of this business.

2.1.14 Philippines

In the Philippines, economic expectations for 2023 anticipate GDP growth of 5.0% (7.6% in 2022). This represents a slight upward revision, driven mainly by the moderation in energy prices, which continues to paint a favorable picture for the development of the insurance business. Meanwhile, inflation remains high at 7.6% in March (average inflation for 2022 was 5.8%), which continues to put pressure on profitability and insurance prices by increasing the cost of claims and other operating expenses.

Regarding the savings-linked Life insurance segment, the central bank of the Philippines continues to tighten its monetary policy and raised the benchmark rate again at its March meeting to 6.25%. The yield on the two-year sovereign bond stood at 5.8% at the end of March, while the ten-year sovereign bond was at 6.25%. This makes the interest rate environment more complex for the marketing of traditional Life savings and annuity products, with a flatter curve and interest rates that do not compensate for the loss of purchasing power as a result of inflation, entering a situation of negative real interest rates.

2.1.15 Reinsurance

According to the latest estimates,[11] natural disasters caused global economic losses in 2022 of 275 billion dollars, of which 125 billion dollars had insurance coverage, representing about 45% of the total. This result continued a streak of higher overall insured losses since 2017, following a benign period from 2012 to 2016 and reaffirming an average annual growth rate of 5% to 7% in losses in force since 1992. The growth in the severity of losses, due to the increase in property exposures and values at risk, continued urban expansion, economic growth and a context of intensifying hazards due to the effects of climate change, makes it likely that this trend will continue.

2.2 Regulatory and supervisory trends

Sustainability disclosure requirements in the financial services sector in the European Union

On April 12, the *Joint Committee* of the European Supervisory Authorities (EBA, ESMA and EIOPA) published a public consultation to revise the technical standards set out in Commission Delegated Regulation (EU) 2022/1288 of April 6, 2022, supplementing Regulation (EU) 2019/2088 on sustainability-related disclosures in the financial services sector (SFDR). Said publication was prepared in compliance with the mandate received from the European Commission. Guiding principles for the amendments including reducing the risk of "false certainty" and possible "greenwashing," and requiring well-founded evidence that investments comply with the safeguards and that implementation and enforcement efforts are being carried out. However, according to this mandate, the amendments must be carefully calibrated so that the disclosure of information based on these indicators is proportionate and feasible for financial market participants.

The changes proposed by the *Joint Committee* include expanding the list of indicators to disclose the main adverse impacts of investment decisions on the environment and society, refining the content of other adverse impact indicators and their respective definitions, applicable methodologies and calculation formulas, as well as adding information on products in relation to greenhouse gas emission reduction targets, including interim targets and milestones and actions pursued, among other aspects. Comments on this consultation should be submitted by July 4, 2023[12].

Tables: macroeconomic forecast scenarios

Table A-1
Baseline and stressed scenarios: gross domestic product
(annual growth, %)

	Baseline Scenario (BS)						Stressed Scenario (SS)					
	2019	2020	2021	2022	2023(f)	2024(f)	2019	2020	2021	2022	2023(f)	2024(f)
United States	2.3	-2.8	5.9	2.1	1.0	0.7	2.3	-2.8	5.9	2.1	0.4	-0.9
Eurozone	1.6	-6.3	5.3	3.5	0.6	1.3	1.6	-6.3	5.3	3.5	0.2	0.1
Germany	1.1	-4.1	2.6	1.9	0.0	1.3	1.1	-4.1	2.6	1.9	-0.5	0.0
France	1.9	-7.9	6.8	2.6	0.5	1.1	1.9	-7.9	6.8	2.6	0.1	-0.2
Italy	0.5	-9.0	7.0	3.8	0.8	1.1	0.5	-9.0	7.0	3.8	0.4	0.0
Spain	2.0	-11.3	5.5	5.5	1.7	1.4	2.0	-11.3	5.5	5.5	1.3	0.1
United Kingdom	1.6	-11.0	7.6	4.0	0.0	1.6	1.6	-11.0	7.6	4.0	-0.4	0.2
Japan	-0.4	-4.3	2.2	1.0	1.1	1.1	-0.4	-4.3	2.2	1.0	0.3	0.8
Emerging markets	3.6	-1.8	6.9	4.0	3.9	4.2	3.6	-1.8	6.9	4.0	3.3	4.0
Latin America	0.2	-6.8	7.0	4.0	1.6	2.2	0.2	-6.8	7.0	4.0	1.0	1.8
Mexico	-0.2	-8.2	4.9	3.1	1.2	1.5	-0.2	-8.2	4.9	3.1	0.9	0.7
Brazil	1.2	-3.6	5.3	3.0	0.8	2.0	1.2	-3.6	5.3	3.0	0.3	1.7
Argentina	-2.0	-9.9	10.4	5.3	-0.7	1.9	-2.0	-9.9	10.4	5.3	-1.3	1.8
Colombia	3.2	-7.3	11.0	7.5	1.0	1.9	3.2	-7.3	11.0	7.5	-1.0	1.6
Chile	0.7	-6.2	11.9	2.8	-0.8	1.9	0.7	-6.2	11.9	2.8	-1.0	1.5
Peru	2.3	-11.0	13.6	2.7	2.1	2.8	2.3	-11.0	13.6	2.7	1.9	2.5
Emerging markets, Europe[1]	2.5	-1.6	7.3	0.8	1.2	2.5	2.5	-1.6	7.3	0.8	1.0	2.1
Turkey	0.8	1.9	11.4	5.6	1.6	2.0	0.8	1.9	11.4	5.6	0.5	1.8
Asia Pacific	5.9	1.6	8.0	3.3	5.0	4.9	5.9	1.6	8.0	3.3	4.2	4.3
China	6.0	2.2	8.5	3.0	5.1	4.9	6.0	2.2	8.5	3.0	4.2	4.2
Indonesia	5.0	-2.1	3.7	5.3	4.3	5.4	5.0	-2.1	3.7	5.3	3.5	5.0
Philippines	6.1	-9.5	5.7	7.6	5.0	5.2	6.1	-9.5	5.7	7.6	3.9	4.4
Global	2.8	-2.8	6.3	3.4	2.8	3.0	2.8	-2.8	6.3	3.4	2.0	2.3

Source: MAPFRE Economics

[1]Eastern Europe
Forecast end date: April 10, 2023.

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Table A-2
Baseline and stressed scenarios: inflation
(% y/y, average)

	Baseline Scenario (BS)						Stressed Scenario (SS)					
	2019	2020	2021	2022	2023(f)	2024(f)	2019	2020	2021	2022	2023(f)	2024(f)
United States	1.8	1.3	4.7	8.0	4.1	2.9	1.8	1.3	4.7	8.0	4.6	2.7
Eurozone	1.2	0.3	2.6	8.4	4.8	1.1	1.2	0.3	2.6	8.4	5.2	1.7
Germany	1.4	0.6	3.0	6.9	5.4	1.8	1.4	0.6	3.0	6.9	5.5	2.0
France	1.1	0.5	1.6	5.2	4.9	2.2	1.1	0.5	1.6	5.2	5.5	2.6
Italy	0.6	-0.1	1.9	8.2	5.8	1.7	0.6	-0.1	1.9	8.2	6.3	0.7
Spain	0.7	-0.3	3.1	8.4	3.7	2.5	0.7	-0.3	3.1	8.4	4.0	1.7
United Kingdom	1.8	0.9	2.6	9.1	5.9	2.6	1.8	0.9	2.6	9.1	6.3	2.9
Japan	0.5	0.0	-0.2	2.5	1.5	0.8	0.5	0.0	-0.2	2.5	2.3	1.5
Emerging markets	5.1	5.2	5.9	9.8	8.6	6.5	5.1	5.2	5.9	9.8	9.2	7.1
Latin America	7.7	6.3	11.6	14.7	13.3	9.0	7.7	6.3	11.6	14.7	13.7	9.4
Mexico	3.6	3.4	5.7	7.9	5.6	3.7	3.6	3.4	5.7	7.9	5.9	3.8
Brazil	3.7	3.2	8.3	9.3	5.1	4.1	3.7	3.2	8.3	9.3	5.4	4.3
Argentina	53.5	42.0	48.4	72.4	100.7	85.4	53.5	42.0	48.4	72.4	102.6	85.8
Colombia	3.5	2.5	3.5	10.2	11.3	5.3	3.5	2.5	3.5	10.2	12.1	5.6
Chile	2.3	3.0	4.5	11.6	7.9	3.3	2.3	3.0	4.5	11.6	8.2	3.0
Peru	2.1	1.8	4.0	7.9	6.0	3.3	2.1	1.8	4.0	7.9	6.3	3.5
Emerging markets, Europe[1]	6.7	5.4	9.6	27.9	19.7	13.2	6.7	5.4	9.6	27.9	20.3	13.9
Turkey	15.2	12.3	19.6	72.3	44.1	26.1	15.2	12.3	19.6	72.3	45.1	25.6
Asia Pacific	2.9	2.5	1.0	2.2	2.5	2.3	2.9	2.5	1.0	2.2	2.9	2.3
China	2.9	2.5	0.9	2.0	2.3	2.3	2.9	2.5	0.9	2.0	2.7	2.5
Indonesia	2.8	2.0	1.6	4.2	4.0	2.1	2.8	2.0	1.6	4.2	4.2	2.2
Philippines	2.4	2.4	3.9	5.8	5.5	2.9	2.4	2.4	3.9	5.8	5.9	3.3
Global	3.5	3.2	4.7	8.7	7.0	4.9	3.5	3.2	4.7	8.7	7.4	5.4

Source: MAPFRE Economics

[1]Eastern Europe
Forecast end date: April 10, 2023.

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

	Baseline Scenario (BS)						Stressed Scenario (SS)					
	2019	2020	2021	2022	2023(f)	2024(f)	2019	2020	2021	2022	2023(f)	2024(f)
United States	1.92	0.93	1.52	3.88	3.31	2.70	1.92	0.93	1.52	3.88	3.96	2.85
Eurozone	0.32	-0.19	0.32	3.39	2.97	2.62	0.32	-0.19	0.32	3.39	3.61	2.75

Source: MAPFRE Economics
Forecast end date: April 10, 2023.

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

	Baseline Scenario (BS)						Stressed Scenario (SS)					
	2019	2020	2021	2022	2023(f)	2024(f)	2019	2020	2021	2022	2023(f)	2024(f)
USD-EUR	0.89	0.81	0.88	0.94	0.93	0.90	0.89	0.81	0.88	0.94	0.94	0.91
EUR-USD	1.12	1.23	1.13	1.07	1.08	1.11	1.12	1.23	1.13	1.07	1.07	1.10
GBP-USD	1.32	1.36	1.35	1.20	1.23	1.26	1.32	1.36	1.35	1.20	1.20	1.24
USD-JPY	109.12	103.54	115.00	132.65	134.37	126.41	109.12	103.54	115.00	132.65	131.83	125.49
USD-CNY	6.99	6.52	6.35	6.90	6.85	6.48	6.99	6.52	6.35	6.90	6.91	6.51

Source: MAPFRE Economics
Forecast end date: April 10, 2023.

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

	Baseline Scenario (BS)						Stressed Scenario (SS)					
	2019	2020	2021	2022	2023(f)	2024(f)	2019	2020	2021	2022	2023(f)	2024(f)
United States	1.75	0.25	0.25	4.50	4.75	2.50	1.75	0.25	0.25	4.50	6.50	2.50
Eurozone	0.00	0.00	0.00	2.50	4.00	2.50	0.00	0.00	0.00	2.50	4.25	2.50
China	3.25	3.00	3.00	2.75	2.75	3.00	3.25	3.00	3.00	2.75	2.75	3.00

Source: MAPFRE Economics
Forecast end date: April 10, 2023.

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References

1/ Global potential GDP growth has been revised by the International Monetary Fund below 3% in its latest *World Economic Outlook* from spring 2023.

2/ See: MAPFRE Economics (2023), *2023 Economic and Industry Outlook*, Madrid, Fundación MAPFRE.

3/ Basically, compared to our previous report, the outlook for the U.S. economy (+90 basis points, bps), the Eurozone (+70 bps), China (+30 bps), the rest of Emerging Asia (+20 bps), Emerging Europe (+110 bps) and Latin America (+20 bps) has improved.

4/ NAIRU is the *Non-Accelerating Inflation Rate of Unemployment*.

5/ From the Beveridge curve perspective (which shows the relationship between unemployment and the rate of job openings), the tightness of the current labor market would indicate a *skills gap,* with an unbalanced job-to-job transition instead of unemployment to job openings, which continues to cause the empirically negative relationship between the two variables to flatten out, i.e., to show lower elasticity.

6/ The Phillips curve establishes an inverse relationship between the inflation behavior and unemployment levels in an economy.

7/ See: MAPFRE Economics (2023), *2023 Economic and Industry Outlook*, *op. cit*.

8/ In this case, hackers used a method known as "supply chain attack" to insert malicious code into the company's systems. This type of supply chain attack operates by targeting a third party with access to an organization's systems rather than attempting to access networks directly.

9/ See: MAPFRE Economics (2023), *Real Estate Markets and the Insurance Sector*, Madrid, Fundación MAPFRE.

10/ These risk-free interest rate charts produced by EIOPA show the minimum, average and maximum levels reached in 2022 as well as the level of the last published curves corresponding to the months of December 2022 and March 2023. This information can also be viewed for other months and currencies in the interactive charts prepared by MAPFRE Economics, at https://app.klipfolio.com/published/29577612d0ba9ff3681af85b8ee8a998/curvas-eiopa

11/ Swiss Re Institute (2023). *Natural catastrophes and inflation in 2022: a perfect storm*. Sigma 1/2023, on: https://www.swissre.com/institute/research/sigma-research/sigma-2023-01.html

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