



Fundación **MAPFRE**

2023 ECONOMIC AND
INDUSTRY OUTLOOK:
FOURTH-QUARTER
PERSPECTIVES

MAPFRE Economics

**2023 Economic and
Industry Outlook:
Fourth-Quarter
Perspectives**

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Executive summary

2023 Economic and Industry Outlook: Fourth-Quarter Perspectives

Economic outlook

The buffers of economic growth remain, on one hand, private consumption, driven by both the remaining cumulative savings and the general strength of employment, and on the other, broad sources of fiscal support. In terms of inflation, the downward trajectory of prices has continued to consolidate alongside the normalization of supply chains, the base effects of energy prices, and some movement toward a broader slowdown in the components of the basic market basket. Thus, the global cycle of monetary tightening has shifted toward a more balanced situation between activity level and price dynamics, although subject to an ever more challenging and tense geopolitical environment.

Looking to the future, manufacturing is expected to remain depressed, with industrial activity still far from stabilizing. Meanwhile, services point to a loss of momentum, approaching greater synchrony with manufacturing and showing less capacity to transfer cost increases to the end customer. Meanwhile, consumption is expected to moderate progressively, generally reinforcing the idea that the effects of mone-

tary policy are beginning to have an impact with their main pillars. First, accumulated savings are considered practically exhausted in most economies, providing little maneuvering room. Second, and although the link between production and job growth appears weaker in this cycle due to the relative scarcity of labor, the labor supply is expected to balance out in the future. Finally, the drive fiscal policy had been providing will begin to decline in 2024, in sync with the monetary tightening cycle.

Inflation is expected to continue to fall, and oil prices should have more of an impact on demand (by depressing consumption) than on prices, thus controlling sustained price increases. Likewise, inflation dynamics present a series of divergences that make it difficult to generalize uniform behavior, or to establish a single formula to combat inflation (with both fiscal and monetary tools). Within this framework, with regard to monetary policy, the resolve to reach a cyclical peak is still unclear and inconclusive, given the uncertainty surrounding the aforementioned variables, in addition to the potential energy crisis that could result from an escalation of the conflict in the Middle East.

This scenario is compounded by a series of growing regional divergences, different cyclical moments, and different ways of applying the economic tools at hand, thus exposing a vulnerability gap and very un-

equal margins for action. Moreover, the bottom line remains subject to great uncertainty, with resilience running out of footholds, risks on the inflation side both inside and outside of the macroeconomic variables themselves, and doubts as to the space and effectiveness of monetary policy.

Industry outlook

Global growth estimates point to economic slowdown in which the mechanisms for transmission of monetary policy to the real economy are beginning to show stronger effects, with a credit crunch, weaker labor markets, and clear signs of moderating inflation. This poses a scenario for insurance of lower growth in business volume, which will affect its more cyclical and credit-linked lines of business, such as Motors and Life insurance. Still, profitability is expected to improve as insurance premiums are revised upwards to adjust for inflation, cost growth eases, and financial income continues to be supported by interest rate increases.

Higher interest rates are encouraging the growth of the Life insurance business linked to savings. Messages from major central banks suggest that the rate hike cycle may be over, but the ongoing conflict in the Middle East has reintroduced uncertainty about price dynamics, which could lead central banks to step up the battle against inflation if there is another spike in energy prices. Some central banks that began the monetary tightening process earlier, as in Brazil, have already started to lower their benchmark interest rate, and in other cases, like Mexico, interest rates are being held at the levels reached in prior months as inflation eases. This environment of high positive real interest rates for an extended period of time will continue to support the development of the Life savings and annuities business, although the expected eco-

nomical slowdown may result in lower growth than some markets have experienced in recent months.

In terms of financial markets, the rebound in yields on longer-duration sovereign and corporate bonds has once again led to downward corrections in their valuations, adding to the correction already carried over from the previous year due to the tightening of monetary policy. Meanwhile, equities have also suffered corrections, losing most of the gains obtained in the first half of the year. These latest corrections, together with the increase in volatility, introduce some uncertainty that may affect the development of Life Insurance products in which the policyholder assumes the investment risk. However, opportunities are arising to sell new issues that broaden the composition of the reference assets, achieving a higher weight of fixed income in the combination of products offered in the market.

Meanwhile, corrections in the financial markets could affect the solvency ratios of the insurance industry. Nevertheless, the high level of capitalization and the risk management framework, specifically of insurance companies in the European Union, allow these corrections to be absorbed thanks to the industry's high solvency ratios, as underscored by the latest financial stability reports of the European supervisory authorities. In any case, these reports warn that the impact of sharp increases in official interest rates and potential surges in risk premiums, as well as a potential spike in credit risk, among other factors, on financial institutions and market participants should be closely monitored and considered in risk management.

1. Economic outlook

1.1 The world economic outlook

1.1.1 World economic environment in a context of geopolitical adjustment

Over the last quarter, the global economic environment remained dominated by a dynamic of falling inflation and more widespread resilience in economic activity than initially expected. This has shaped a more balanced scenario between activity and prices for the remainder of 2023, to the detriment of 2024, with fewer options for a further inflationary rebound and a greater likelihood of weaker economic growth and fewer footholds. This overall picture suggests that the inflation problem is getting smaller in the rear-view mirror, while positive real interest rates are becoming more prevalent, extending across the entire yield curve and allowing the major central banks to convey the feeling that monetary policy has also reached, or is close to reaching, its peak. While this is the general outlook, disparities across economies and regions are widening amid a challenging geopolitical scenario shaped by the Hamas attack on Israel, carrying the risk of a broader Middle East backlash, while supply-side shocks could pose a new macroeconomic challenge globally.

In terms of the dynamics of economic activity, growth is still being buffered by, on the one hand, private consumption, driven by both remaining cumulative savings and the general strength of employment, and on the other, broad sources of fiscal support. Both variables have probably been undervalued throughout the year. This has been reflected in private consumption, in terms of spending capacity by income quintile (regarding accumulated savings) and the insensitivity of labor markets to global monetary tightening. In the case of fiscal support sources, this has been observed in the capacity and expansion of government spending packages, a relevant pillar in developed economies, whose unsustainability is now starting to be reflected both in new issues and term premiums.

On the inflation side, prices have continued to consolidate a downward trajectory alongside the normalization of the supply chain, the base effects of energy prices, and some movement toward a broader slowdown in the components of the basic market basket. However, the pace of inflation has not yet slowed to the desired level in terms of both the current and expected rate, both exceeding the target set by the various central banks and suggesting that economic policy must continue to provide a counterweight to a multitude of cyclical factors and varying degrees of sensitivity to interest rates. It must also counteract structural factors that emerged in the wake of the pandemic, such as the

energy transition, de-globalization, relative labor shortages, resource protectionism, and the increased role of fiscal policy.

At this point, the dichotomy between economic activity and prices that marked the start of the cycle of global monetary tightening has shifted, now showing a greater balance between the two variables. However, this is subject to an increasingly challenging and tense environment on the geopolitical side. In terms of activity, both the high levels of tightening achieved and uncertainty surrounding the effective impact of the lags suggest that the probability of a demand shock remains high. Meanwhile, on the inflation side, while the trend to date has been positive, there is a risk of an additional obstacle from the spike in energy prices amid the ongoing conflict in the Middle East. This suggests that the risk of doing too little remains, and with it, that the current monetary cycle cannot be deemed close to completion.

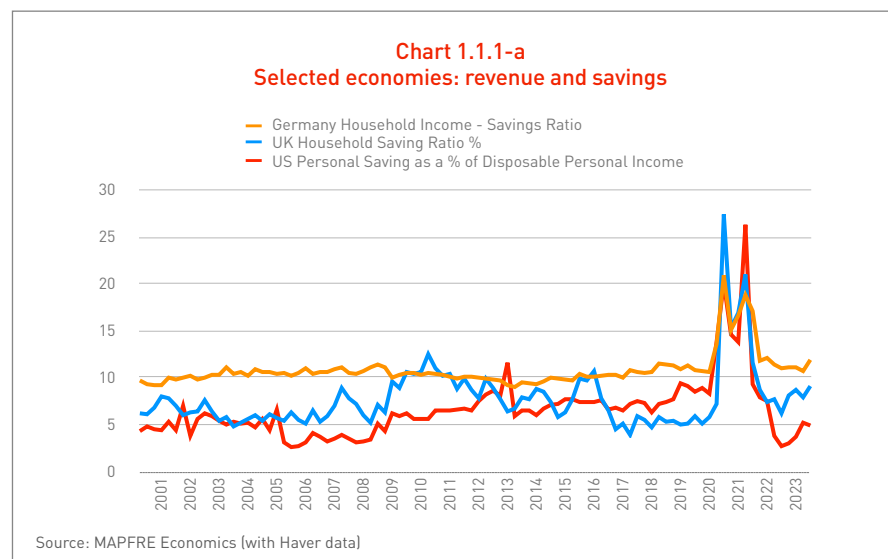
Catalysts: from stagnation to exhaustion

Focusing again on economic activity, and in light of the latest available indicators, manufacturing is expected to remain broadly depressed, with industrial activity far from stabilizing and with less capacity to pass on cost increases to the end customer (especially in the Eurozone, burdened by energy dependence). The most recent dynamics for services point to a decline, and the underlying idea is still a loss of momentum toward greater synchrony with manufacturing. In general, consumption is expected to moderate progressively, generally reinforcing the idea that monetary policy is beginning to take effect with its three main pillars, leading to a more somber phase.

First, accumulated savings are considered virtually exhausted in most economies, or at least provide little room to maneuver at the current

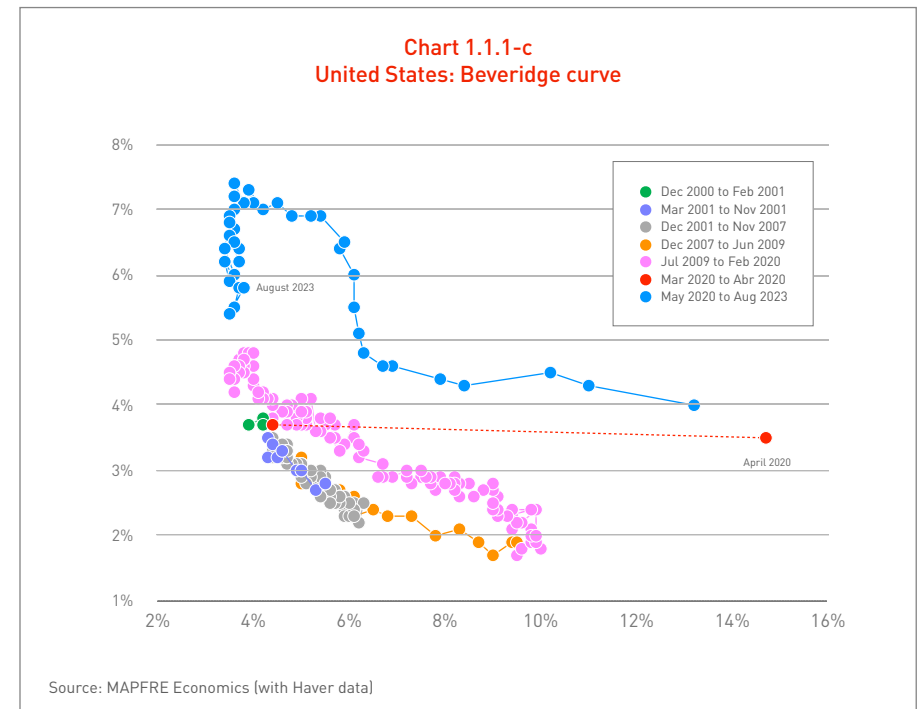
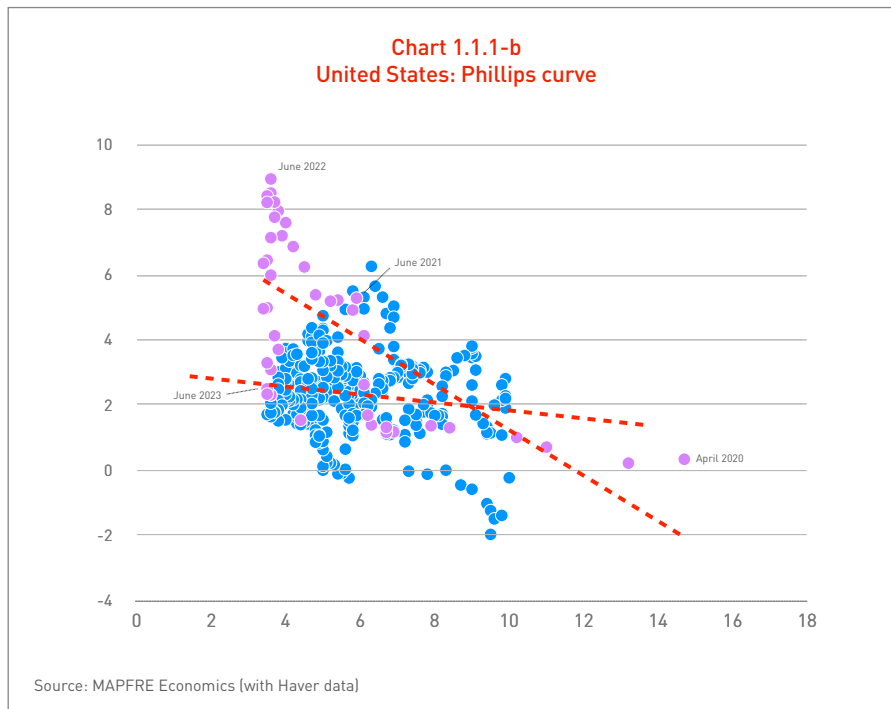
cyclical moment (mainly in the United States, given the resumption of student loan repayments), presenting an obstacle to offset the ongoing loss of purchasing power. While this is the most recent dynamic, the trend may be reversed in certain income quintiles, giving rise to a new stage of accumulation under the precautionary savings hypothesis (see Chart 1.1.1-a).

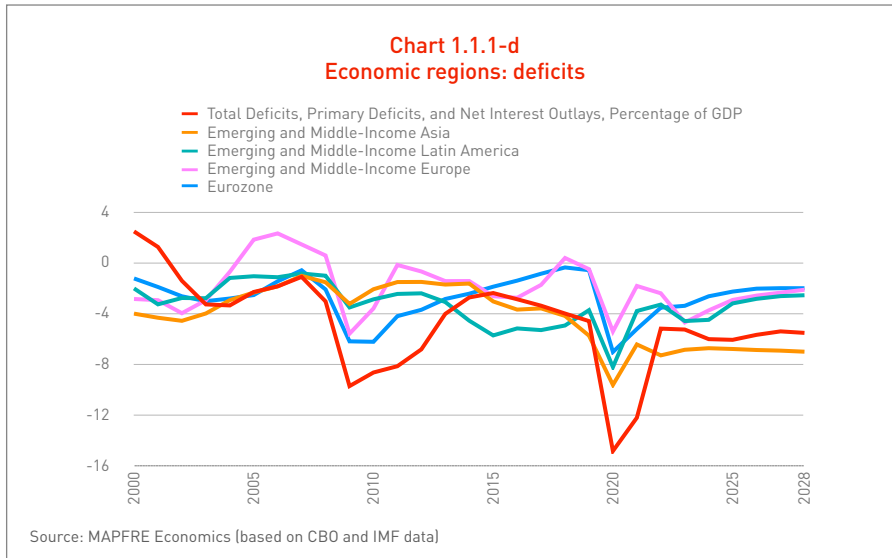
Second, and simultaneously, although the link between production and job growth appears weaker in this cycle due to labor remaining scarce, the labor supply is expected to balance out in the future. This could happen along with clearer signs of economic cooling, and it will continue to balance out with demand towards a balance point with higher wages, although not enough to fuel second-round effects, thus closing the current gap and attenuating imbalances from both a Phillips curve and Beveridge curve perspective (see Charts 1.1.1-b and 1.1.1-c).



And third, fiscal policy starts to fall back in 2024. Until now, a large part of consumer resistance has resided in the protections offered by the various stimuli of fiscal policy, both during the pandemic and in the aftermath of the war in Ukraine. However, counter-cyclical measures have increasingly come up against the monetary tightening cycle. Such is the dichotomy today that the long side of the interest rate curve is no longer controlled in part by central banks (expected short-term rates have already been transmitted across the curve, as shown by the flattening so far this year), and now the main driver of rising long-term yields depends on the degree of government fiscal discipline as perceived by the markets (see Chart 1.1.1-d).

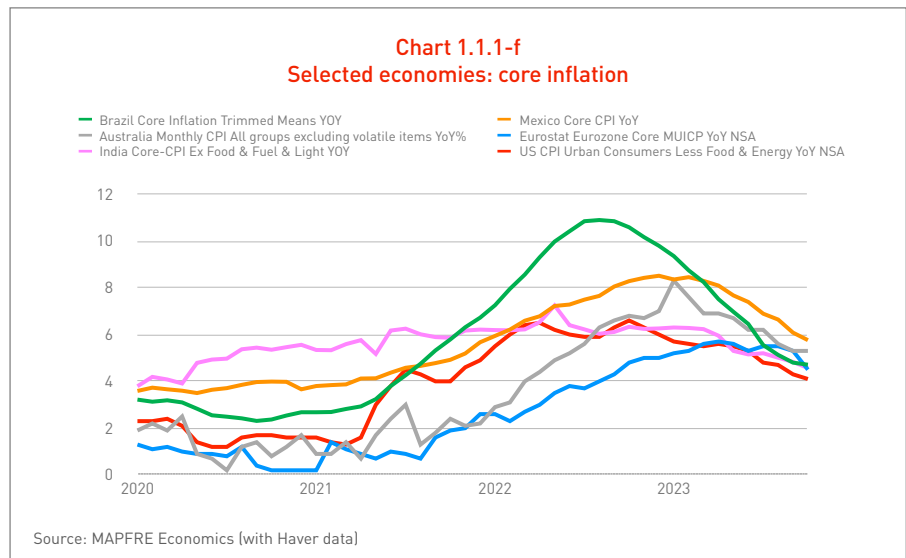
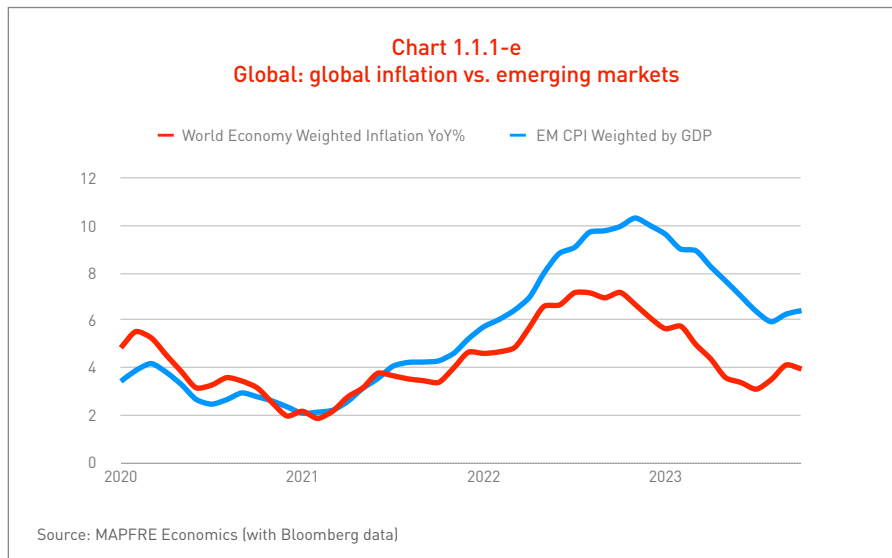
Inflation is expected to continue to fall, and oil prices should have more of an impact on demand (by depressing consumption) than on prices, thus controlling sustained price increases. To date, the prices of durable goods affected by the normalization of supply chains and energy prices have been the main drivers of the inflation reduction process, also aided by the base effect of the first half of the year, as well as other components with lower weights in the indexes. However, the prices of services, housing, and food have shown resistance, demonstrating that, while the trend is favorable, it still isn't enough in terms of levels and scope (along with vulnerability to new supply shocks) to bring the inflationary episode to an end. At the same time,





the fiscal umbrella remains in force in some economies without a clear picture of the situation on the demand side, and may distort price signals by delaying the potential upward effects of its withdrawal on current inflation (see Charts 1.1.1-e and 1.1.1-f).

On the positive side, the tailwinds for raw materials continue, given the Chinese economy's weak response to the most recent stimulus, as well as the general weakness in global demand, factors that could continue to provide additional deflationary impetus through the manufacturing sector (see Chart 1.1.1-g). In terms of short-term risks, and while the potential oil shock on the supply side revives the growth-inflation dilemma, none of the recent military conflicts involving Israel have had a lasting impact on oil prices. Therefore, the baseline scenario continues to present a more balanced outlook, with supply factors normalizing and de-

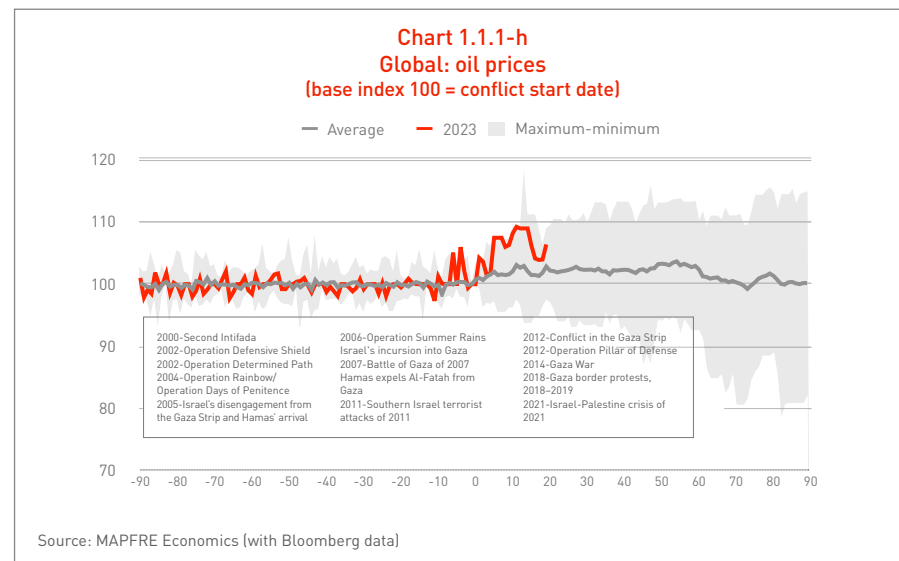
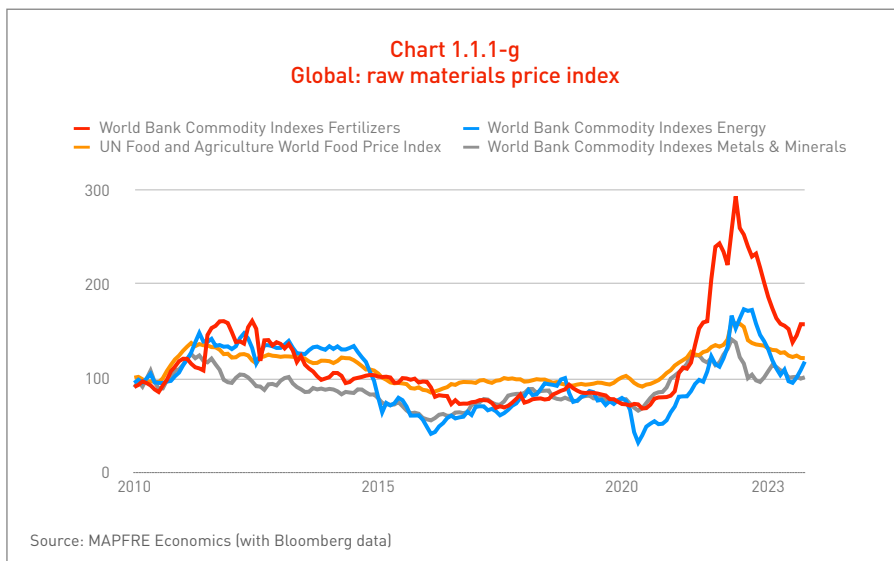


mand factors declining, and with hopes for a soft landing as the even more likely scenario (see Chart 1.1.1-h).

In terms of monetary policy, the resolve to reach a cyclical peak is still unclear and inconclusive, given the uncertainty surrounding the aforementioned variables, in addition to the potential energy crisis that could arise from an escalation of the conflict in the Middle East (see Charts 1.1.1-i and 1.1.1-j). While the European Central Bank (ECB) seems the least likely to continue a path of monetary tightening, as the European economy is weaker than that of the U.S., the Federal Reserve's domain, its attention is beginning to shift to other factors. Thus, the discussion seems to be veering from the height of the peak to: (i) the duration of the real interest rate environment, with rates continuing to rise under a gradual reduction in inflation; (ii) balance-sheet policies, which should remain measurable and

predictable; and (iii) to some extent, the credit cycle and materialization of lagged effects of the cumulative adjustment (see Box 1.1.1).

Thus, the bottom line is still subject to high uncertainty, with resilience running out of support points, inflation risks both connected and unconnected to macroeconomic variables, financial risks, both latent (in the United States, they remain covered by the Bank Term Funding Program) and emerging on the fiscal side, and persistent doubts as to the space and effectiveness of monetary policy. As a result, the odds of returning to a path of controllable inflation and predictable growth are set against a more chaotic version, dominated by geopolitics and a new multipolar order that ultimately looks much less predictable and likely (see Chart 1.1.1-k).



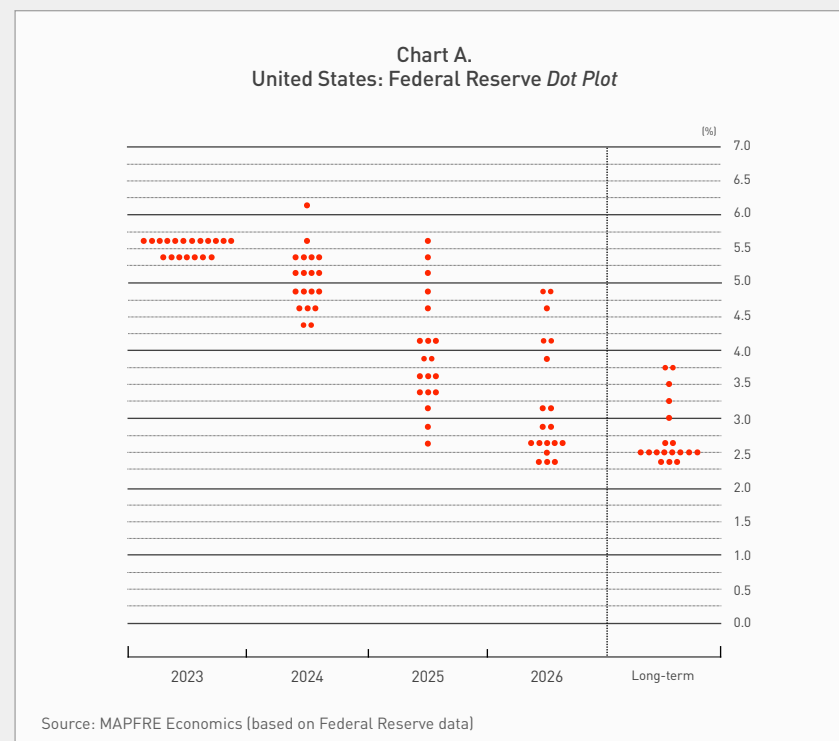
Box 1.1.1 Monetary policy update

Federal Reserve

At its September meeting, the Federal Reserve decided to hold interest rates steady, keeping them within the 5.25%-5.50% range, in line with expectations. Similarly, and as expected, it made no changes to the balance sheet reduction program in progress. The decision was accompanied by an updated dot plot representing the interest rate expectations of members of the Federal Open Market Committee (FOMC). While maintaining the most recent 2023 forecast with a further 25-basis-point (bps) increase for the final stretch of the year, it suggests a significant change in the restrictive bias between 2024 and 2025, with 50 bps less of cuts than agreed in June. This would place interest rates at 5.125% and 3.875% in those years (see Chart A).

Regarding macroeconomic forecasts, in terms of activity, these were revised significantly upwards, with anticipated growth in 2023 increasing from 1.0% to 2.1%, and in 2024 to 1.5% (previously 1.1%). In the same vein, the unemployment rate forecast was revised downwards, to 3.8% in 2023 and 4.1% in 2024–2025 (from 4.1% and 4.5% previously). Headline inflation was adjusted slightly upwards by an additional one tenth in 2023 and 2025, to 3.3% and 2.2%, respectively. Meanwhile, core inflation was cut by two tenths for 2023, to 3.7%, and for 2025 it was increased by one tenth, to 2.3% (without changes in either reading for 2024).

It should be noted that the primary focus, rather than the updated macroeconomic forecast, was the rigidity of interest rates in the medium term and consideration of a neutral interest rate now estimated to be higher. With this narrative, the Federal Reserve is reinforcing its main message of



higher interest rates for a longer period of time, although with the first component outlining the first moderation biases which are not necessarily much higher.

Box 1.1.1 (continued) Monetary policy update

Assessment

Taking note of the forecasts for the U.S. economy, the revised growth and employment data are positive enough to push activity to a higher level upon landing, although unequivocally below its potential. So much so that the revision proposed for 2023 has been partially extended to 2024. This marked revision, while suggesting a better outlook, also has a lower starting point (the 2023 forecast has remained low, without being revised throughout the year) while continuing to imply a slowdown in the future.

Meanwhile, and unlike on previous occasions, when stronger activity was accompanied by greater price pressure, the inflation forecasts were also combined with positive news, with forecasts pointing to a slightly more promising deceleration, particularly in headline inflation. In this regard, it seems more like an update than a new forecast, incorporating the latest data since the last meeting and taking a closer look at how recent events (the United Auto Workers' salary demands, rise in oil, and new tensions over costs in the House of Representatives) have impacted prices. All of this, as in Europe and other Western regions, is subject to a geopolitical framework that continues to skew risks downwards.

Thus, this convergence of factors has resulted in a forecast of higher interest rates for a longer period of time, albeit with a stronger emphasis on the time factor than the suitability of the next 25 bps. In this regard, Fed chair Jerome Powell suggested that the neutral interest rate may be higher than anticipated, which would mean keeping real interest rates positive in the short and medium term until reaching a new balance point. This conclusion is again reflected in the gap between the Federal Open Market Committee

(FOMC) members' expectations and those of the market (see Chart B, which shows how SOFR contracts continue to imply around 75 bps of rate cuts in both 2024 and 2025).

Thus, in general, the positive view emerging on the growth side throughout the year has been quantified in a forecast that now includes the latest dynamics. However, the narrative shaping the forecast eliminates the option of a soft landing. Similarly, the dichotomy between economic activity and price dynamics seems more balanced on the inflation side, responding less intensely to increases in activity, although still far from being considered under control.

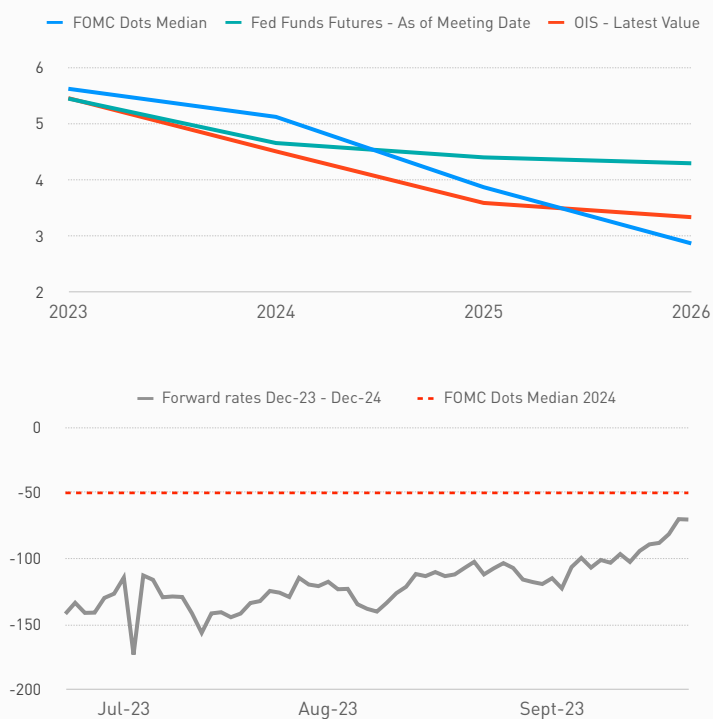
Despite this update, the timeline for the short and medium term will remain marked by the slowdown of the U.S. economy now underway, together with reduced price pressure. However, prices will be subject to an environment of positive real interest rates, serving as a reminder that inflation remains well above the 2% target, and whose permanence will be the new focus of attention. At the same time, and harking back to the pause implemented in 2007, under Ben S. Bernanke's mandate, at levels similar to the current ones (in an attempt to steer the economy towards a soft landing), imposing restrictive interest rates for a long period of time usually increases the likelihood of a financial accident on a cumulative basis.

European Central Bank

Meanwhile, during its October meeting, and for the first time since the start of the monetary tightening cycle, the European Central Bank (ECB) decided not to raise its three official interest rates by 25 base points (bps), thus

Box 1.1.1 (continued)
Monetary policy update

Chart B.
United States: Fed funds futures vs dot plot



Source: MAPFRE Economics (with Bloomberg data)

keeping the marginal lending facility at 4.75%, the main financing rate at 4.50%, and the deposit facility at 4%. On the balance-sheet side, the ECB offered no updates; therefore it is expected to hold the line of balance re-duction, at an average pace of €15 billion from the Asset Purchase Pro-gramme (APP), and to maintain reinvestment of payments from the Pan-demic Emergency Purchase Programme (PEPP) until at least 2024. Nor was any additional guidance presented on the Targeted Longer-term Refinanc-ing Operations (TLTROs).

Given the lack of supportive macroeconomic forecasts or any wider range of new data since the last meeting, the ECB's Governing Council opted to maintain its September position and apply a dependent, moderate, and to a certain extent, ambiguous approach in terms of not just the *terminal interest rate* but also its duration. As for its narrative, it warned of economic activity being weakened from the demand side, but supported by the strength of the labor market, while calling for the need for progress on the moderation of public deficits and towards structural reforms. Regarding inflation, the tone was positive, given the CPI's pronounced reduction in September, but with continued prudence on account of a downward-biased risk assessment and the recent geopolitical uncertainty.

Assessment

In general terms, the Eurozone's headwinds have grown stronger, offering a weaker outlook and seemingly exhausted appetite for further interest rate hikes. Despite that, the shadows cast by oil and the currently uncertain geopolitical chessboard defy all forecasts, which will remain inconclusive. Internally, the latest purchasing managers' index (PMI) data for October (see Chart C) shows an accelerated decline since the start of the fourth quarter,

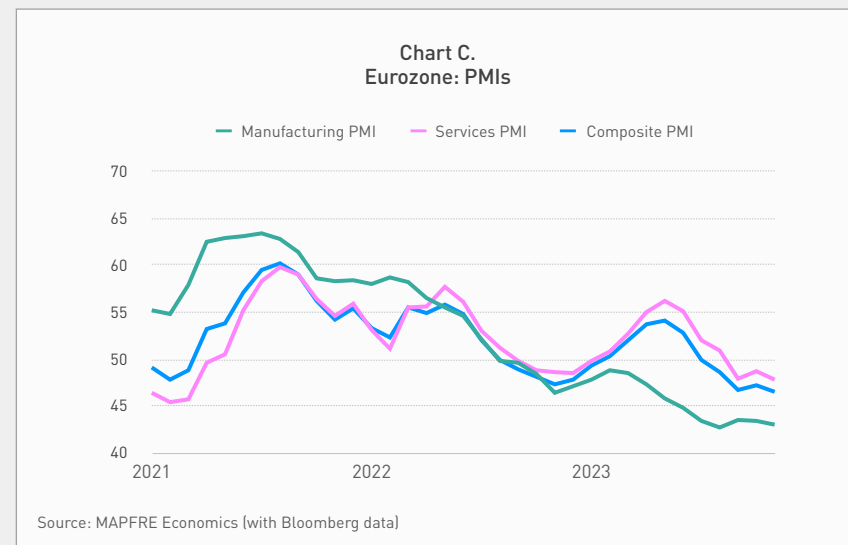
Box 1.1.1 (continued)
Monetary policy update

in terms of both demand (for products and services) and employment (first labor market weakness since early 2021). On the price side, a certain upward pressure at origin is observed, though lower final movement, indicating that the drop in prices is continuing for goods (mainly industrial) and that the reduction in services is flattening off, strengthening the idea that the latter's inflation may have peaked.

Externally, no support for economic revitalization from China seems to be in sight for the short term, despite the new incentives (an additional 1 billion yuan, which implies exceeding the self-imposed 3% annual deficit limits). Also, in spite of the more recent positive data (GDP, industrial production, and retail sales growing between 4.5% and 5.5%), the internal challenges will continue to burden the economy in the medium term. More broadly speaking, trade relations with the rest of the world, according to SWIFT data (see Chart D), also indicate that, besides the above-mentioned cyclical weakening (exporter fragility), the structural energy problems remain (loss of purchasing power as importer).

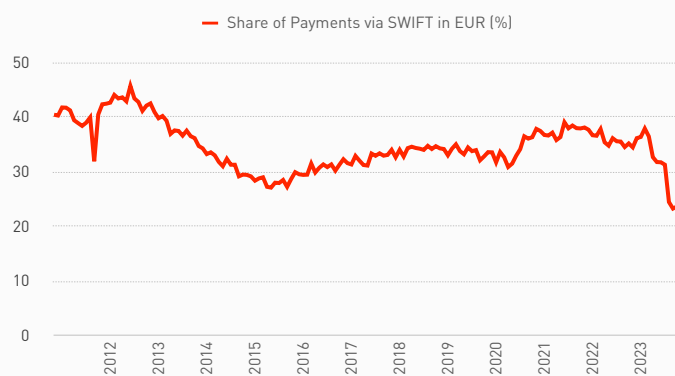
As for the credit cycle, the latest survey on the ECB's bank loans from the third quarter confirmed the previous trend by revealing a further tightening of financial conditions, a sign that the transmission mechanism is certainly working and that the restriction should remain significant in the coming months. On the positive side, the channels continue to work in unison, and the risk of fragmented transmission remains remote (see Chart E).

Inflation continued to fall in September, down to 4.3%, compared to 5.2% in August, thanks not just to lower inflation of services (down by 9 decimal points) but also to the contribution from energy (down by 1.4 points), whereas food prices continued to rise, though at a slower pace (1 monthly decimal point). Core inflation, for its part, also dropped to 4.5% (compared to 5.3% in August), reflecting a favorable month-on-month slowdown. This contrasted with the latest salary negotiations (the German labor union Ver.di proposed



Box 1.1.1 (continued)
Monetary policy update

Chart D.
Eurozone: SWIFT system payments in euros

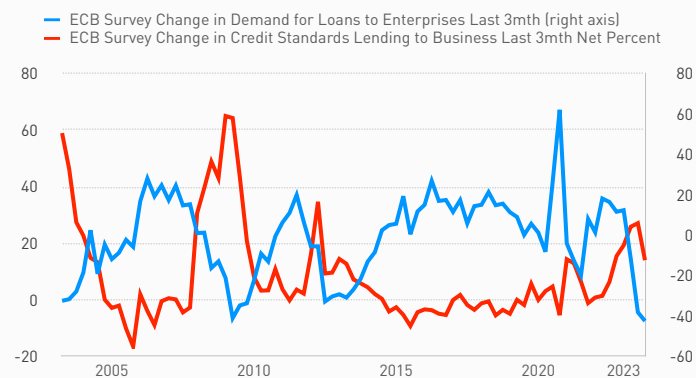


Source: MAPFRE Economics (with Bloomberg data)

raises of 10.5%), while the average growth of salaries continued to show a strong dynamic (around 5.5% year on year). Events in the Middle East have in turn been casting a shadow on the outlook, as oil prices and energy have the potential to transmit new tensions to the Eurozone's energy deficit (see Chart F).

As for fiscal stance, the draft budget plans recently presented in Brussels point to very moderate fiscal consolidation. This dynamic would not be favorable to the ECB in meeting its targets, as it is an expense which, on the

Chart E.
Eurozone: bank surveys

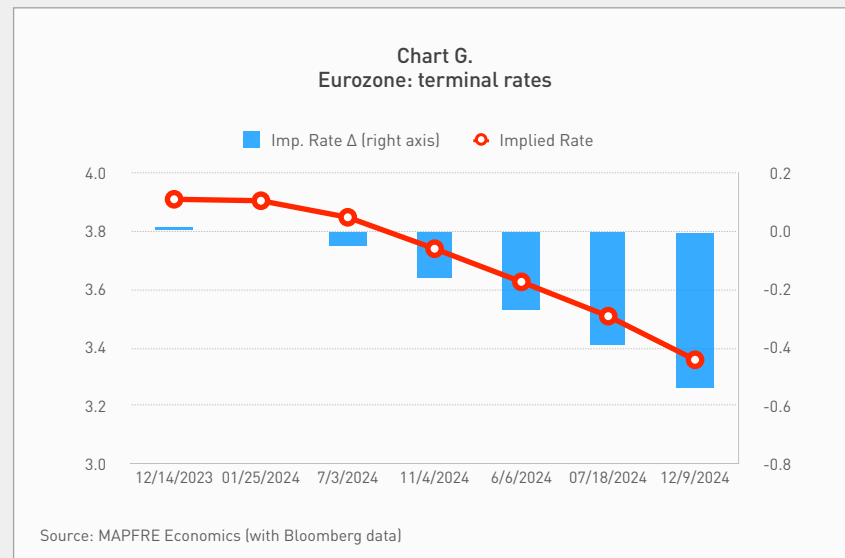
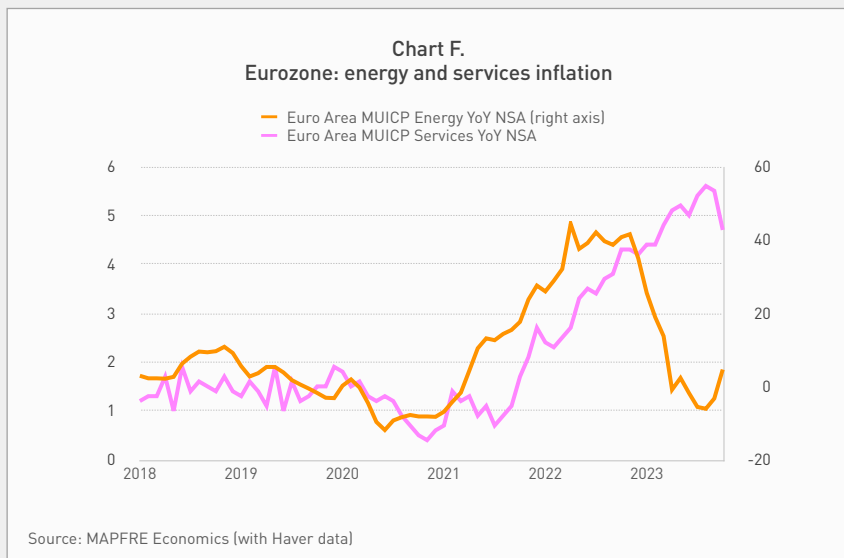


Source: MAPFRE Economics (with Haver data)

one hand, does not help to control inflation in the short term, and on the other, may lead to the loss of eligibility for the Anti-Fragmentation Mechanism (TPI). These concerns may start to appear in the differentials sooner rather than later.

In short, monetary policy is keeping its distance from the most recent events and awaiting new data to reveal the best path towards restoring the balance between activity and prices (see Chart G). Those scales seem to be tipping more and more towards the end of the monetary cycle, given the

**Box 1.1.1 (continued)
Monetary policy update**



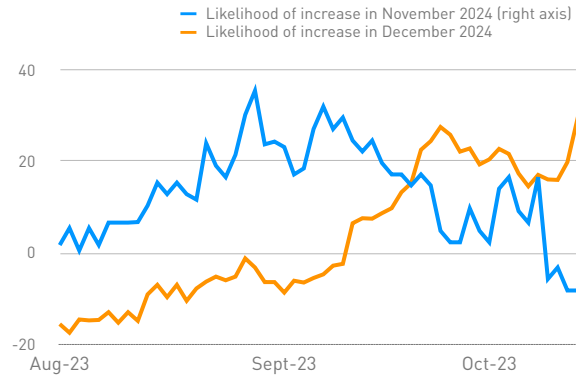
weakness of the cyclical period (a reason to hurry along progress on structural reforms). Even so, a risk scenario cannot be ruled out yet, given not just internal factors (labor resilience and deficit support) but also external factors (complex geopolitics).

1.1.2 Regional perspectives and dynamics

In the previous version of this report¹, our updated forecasts still predicted a slight upward revision of growth in 2023 and downturn in 2024,

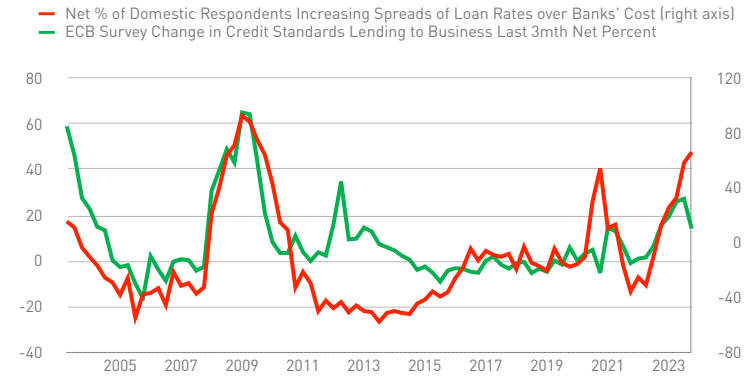
of two decimal points in the former and one decimal point in the latter year. As illustrated in Chart 1.1.2-a, this would imply a global GDP increase of 2.9% and 2.2%, respectively (see Tables A-1 and A-2 in the Appendix of this report). With respect to inflation, the changes are

Chart 1.1.1-i
United States: expected interest rates



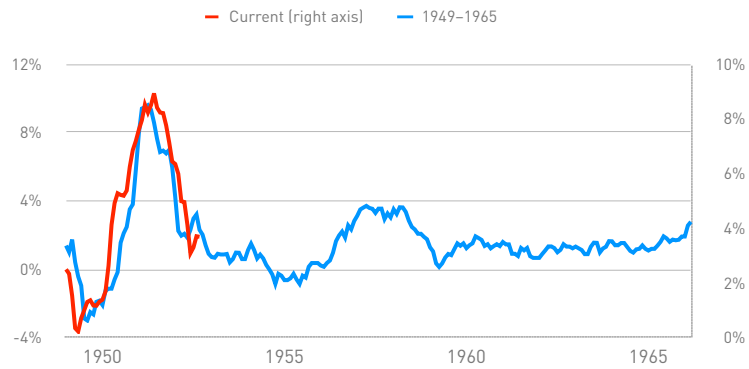
Source: MAPFRE Economics (with Bloomberg data)

Chart 1.1.1-j
United States: credit indicators

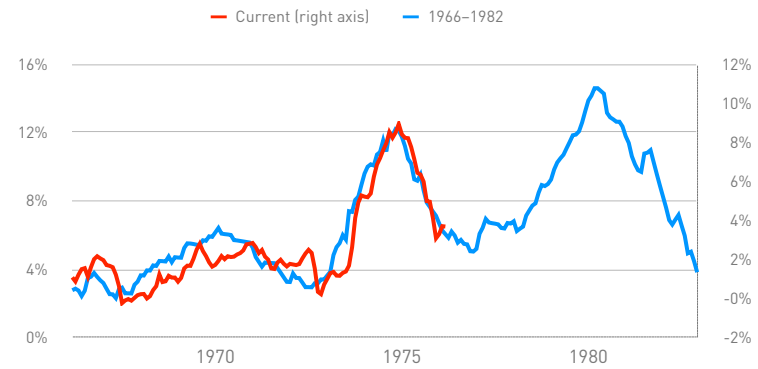


Source: MAPFRE Economics (with Bloomberg data)

Chart 1.1.1-k
United States: inflation cycles



Source: MAPFRE Economics (based on Federal Reserve data)



more pronounced, with more benign average inflation in 2023 (6.6% vs. 7.0% in our previous report), followed by a trend towards greater persistence in 2024 (6.1% vs. 4.9% previously).

Divergent trends in contributions to growth and inflation, which mainly reflected the different cyclical moments in developed and emerging economies, are also starting to appear within the groups themselves. Gaps are especially evident within the group of developed economies, with the United States performing better to the detriment of the European Union, whose weaknesses are becoming entrenched. This is also the case among the emerging markets, given both the weakness of China, which has not yet managed to sustain a convincing recovery, and the latent vulnerabilities in certain countries, mainly in Latin America and the EMEA region (see Charts 1.1.2-b and 1.1.2-c)

Likewise, inflation dynamics present a series of divergences that make it difficult to identify uniform behavior or establish a single formula to combat it (with both fiscal and monetary tools). In the case of developed countries, inflation in the United States registered its third consecutive monthly spike, with housing and services not yet returning to the desirable target, and there may still be secondary pressures on demand. Meanwhile, inflation in the Eurozone shows more widespread weakness and greater obstacles in reaching the consumer due to the energy component. Therefore, it is subject to more volatility, as exposure to supply factors (currently stemming from the crisis in the Middle East) has not been reduced. In the emerging markets, Asia continues to show more moderate inflation rates, with China entering deflationary territory. Finally, in Latin America, while there have been recent spikes in inflation, these are due more to idiosyncratic factors and should not alter the underlying assumption.

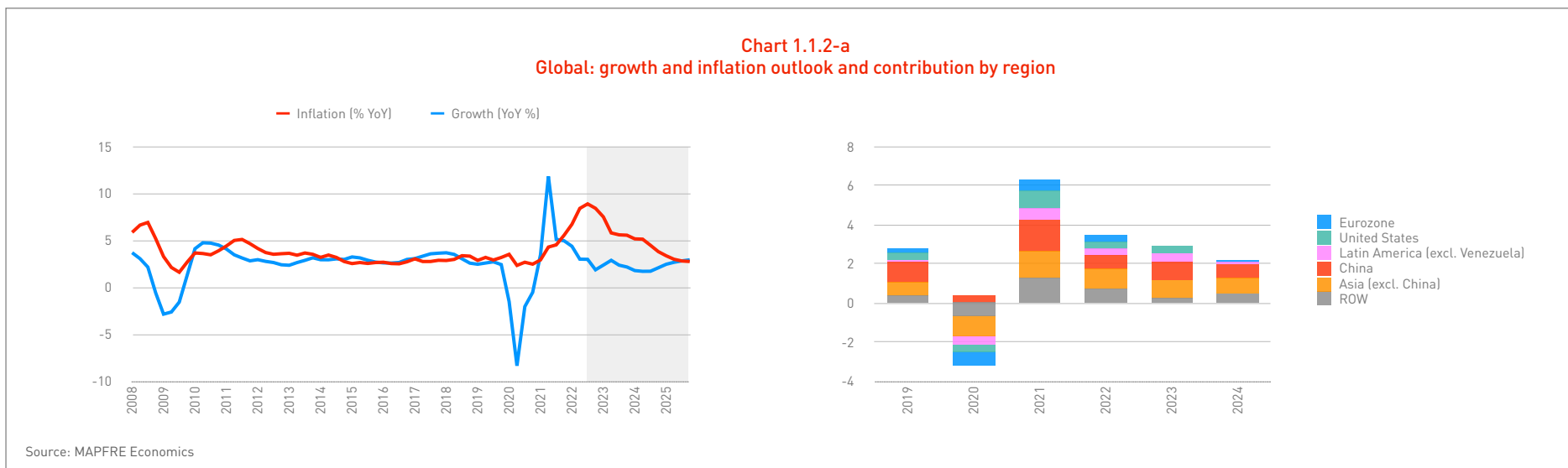
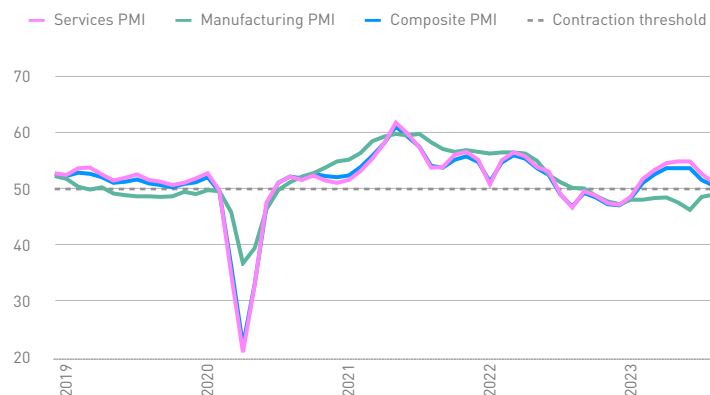
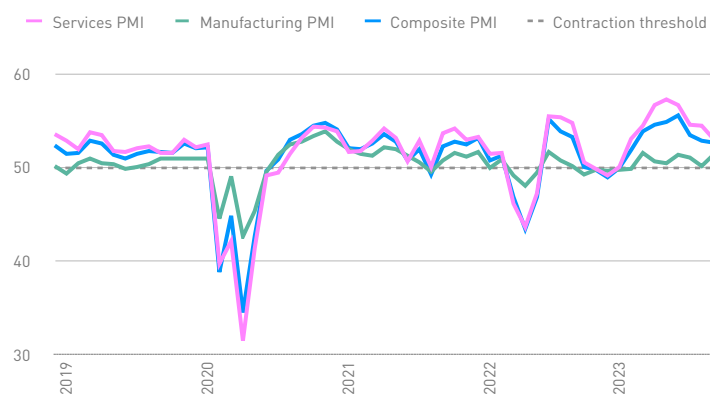


Chart 1.1.2-b
Developed markets: PMIs



Source: MAPFRE Economics (with Bloomberg data)

Chart 1.1.2-c
Emerging markets: PMIs



Source: MAPFRE Economics (with Bloomberg data)

This scenario contextualizes the disparity of monetary policies applied around the world, the accuracy of which is yet to be determined. In developed economies, a rapid increase in interest rates has been the chosen path (partly due to the fact that inflation was initially thought to be transient), followed by a maximum point of monetary restriction for an extended period of time, with the transition point looming in the final stretch of the year. In contrast, and unlike in previous cycles, emerging economies reacted sooner, which has allowed them to reach a more pronounced tightening moment, with very positive real interest rates and greater exchange rate stability. This path, a priori, seems to have enabled both a better anchoring of inflation expectations and greater stability in terms of flows, versus the disorderly capital outflows of previous episodes. At the same time, now that they have recovered maneuvering room, their central banks can be the first to move towards some monetary easing. Developed economies, on the other hand, have been moving in a less aggressive direction, which entails greater risks both in terms of credibility, by relying on a more symmetrical balance between growth and inflation, and in terms of calibration, by maintaining a below-trend pace of activity and more flexible inflation targets over time. This has permitted a certain de-anchoring of expectations, combined with a less orthodox demand control process (based on signals marked by the Taylor Rule, which currently indicate easing), and which, combined with a string of external factors (unconventional supply shocks in the monetary policy manuals), may reveal a time lag or undesired mismatch between "too much tightening" and "too little tightening" (see Chart 1.1.2-d).

In short, 2023 looks more balanced thanks to more durable points of support on the activity side and inflation continuing to move in a positive direction, while central banks are in the process of maturing the monetary policy cycle amid the ongoing dichotomy between the conse-

quences of taking too much and too little action (see Charts 1.1.2-e and 1.1.2-f). Thus, much of the lag is yet to permeate the economy, and the pillars of support are disappearing, so the fight against inflation could focus on duration as the determining aspect of the adjustment factor. On the other hand, the consequences of not having acted sufficiently or forcefully enough continue in the light of structural factors, amplified by the recent geopolitical shock in the Middle East and fears of another supply shock in oil prices that would slow down the expected disinflation path and reactivate fiscal protection tools.

So, looking toward 2024, the forecast continues to point to a stagflationary dynamic, with growth slowing, monetary policy supporting the tightening of financial conditions, and inflation entering a more prolonged and sustainable moderation phase, although still far from tar-

get levels. This scenario is compounded by a series of growing regional divergences, different cyclical moments, and different ways of applying the economic tools at hand, thus exposing a vulnerability gap and very unequal margins for action. All this, in the face of the persistent or transitory uncertainty of a geopolitical situation that is casting a shadow over the outcome of the possible scenarios.

1.1.3 Scenarios and forecasts

Baseline scenario

For the purpose of the *baseline scenario* considered in this report, for the rest of 2023 and the beginning of 2024, growth will remain below potential, with a cyclical slowdown later than that proposed in prior

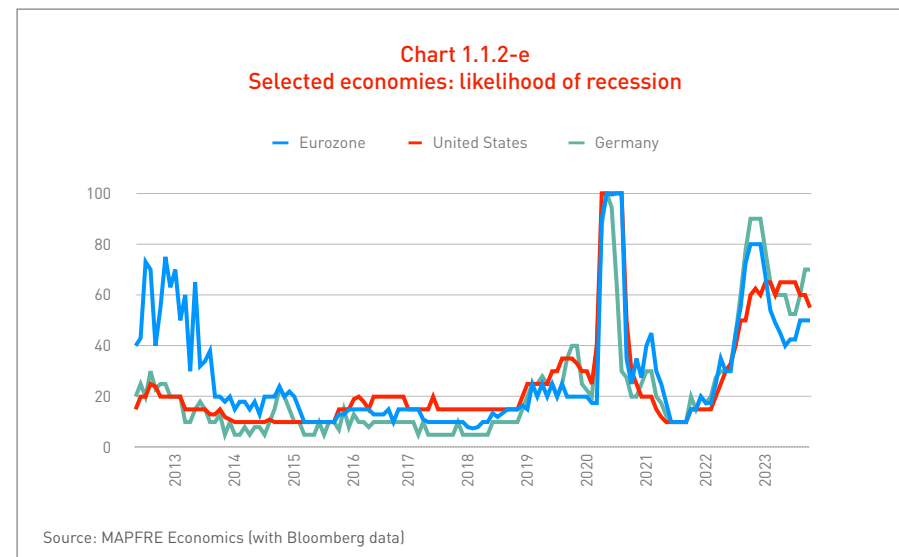
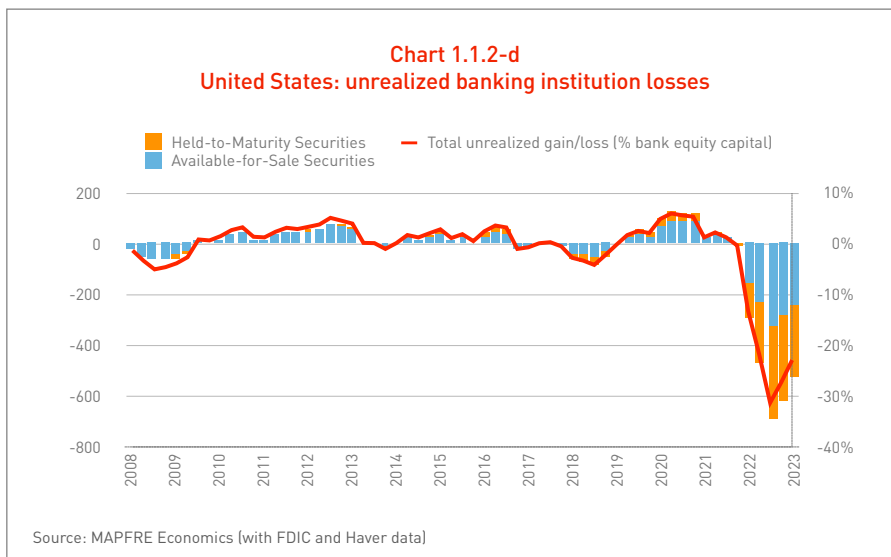


Chart 1.1.2-f
Selected economies: manufacturing PMIs

	6/30/2022	7/31/2022	8/31/2022	9/30/2022	10/31/2022	11/30/2022	12/31/2022	1/31/2023	2/28/2023	3/31/2023	4/30/2023	5/31/2023	6/30/2023	7/31/2023	8/31/2023	9/30/2023
Austria	51.2	51.7	48.8	48.8	46.6	46.6	47.3	48.4	47.1	44.7	42.0	39.7	39.0	38.8	40.6	41.7
Brazil	54.1	54.0	51.9	51.1	50.8	44.3	44.2	47.5	49.2	47.0	44.3	47.1	46.6	47.8	50.1	49.0
Canada	54.6	52.5	48.7	49.8	48.8	49.6	49.2	51.0	52.4	48.6	50.2	49.0	48.8	49.6	48.0	47.5
China	51.7	50.4	49.5	48.1	49.2	49.4	49.0	49.2	51.6	50.0	49.5	50.9	50.5	49.2	51.0	50.6
Czech Republic	49.0	46.8	46.8	44.7	41.7	41.6	42.6	44.6	44.3	44.3	42.8	42.8	40.8	41.4	42.9	41.7
Developed markets	52.5	51.2	50.2	50.1	48.8	47.8	47.3	48.1	48.1	48.4	48.5	47.6	46.3	47.1	46.8	47.4
Emerging markets	51.7	50.8	50.2	49.3	49.8	47.7	49.8	49.9	51.6	50.7	50.5	51.4	51.1	50.2	51.4	50.9
European Union	51.6	49.3	49.1	48.1	46.1	46.7	47.5	48.6	48.3	47.3	45.8	44.9	43.4	42.7	43.4	43.4
Eurozone	52.1	49.8	49.6	48.4	46.4	47.1	47.8	48.8	48.5	47.3	45.8	44.8	43.4	42.7	43.5	43.4
France	51.4	49.5	50.6	47.7	47.2	48.3	49.2	50.5	47.4	47.3	45.6	45.7	46.0	45.1	46.0	44.2
Germany	52.0	49.3	49.1	47.8	45.1	46.2	47.1	47.3	46.3	44.7	44.5	43.2	40.6	38.8	39.1	39.6
Greece	51.1	49.1	48.8	49.7	48.1	48.4	47.2	49.2	51.7	52.8	52.4	51.5	51.8	53.5	52.9	50.3
India	53.9	56.4	56.2	55.1	55.3	55.7	57.8	55.4	55.3	56.4	57.2	58.7	57.8	57.7	58.6	57.5
Indonesia	50.2	51.3	51.7	53.7	51.8	50.3	50.9	51.3	51.2	51.9	52.7	50.3	52.5	53.3	53.9	52.3
Ireland	53.1	51.8	51.1	51.5	51.4	48.7	48.7	50.1	51.3	49.7	48.6	47.5	47.3	47.0	50.8	49.6
Italy	50.9	48.5	48.0	48.3	46.5	48.4	48.5	50.4	52.0	51.1	46.8	45.9	43.8	44.5	45.4	46.8
Japan	52.7	52.1	51.5	50.8	50.7	49.0	48.9	48.9	47.7	49.2	49.5	50.6	49.8	49.6	49.6	48.5
Mexico	52.2	48.5	48.5	50.3	50.3	50.6	51.3	48.9	51.0	51.0	51.1	50.5	50.9	53.2	51.2	49.8
Netherlands	55.9	54.5	52.6	49.0	47.9	46.0	48.6	49.6	48.7	46.4	44.9	44.2	43.8	45.3	45.9	43.6
Poland	44.4	42.1	40.9	43.0	42.0	43.4	45.6	47.5	48.5	48.3	46.6	47.0	45.1	43.5	43.1	43.9
Russia	50.9	50.3	51.7	52.0	50.7	53.2	53.0	52.6	53.6	53.2	52.6	53.5	52.6	52.1	52.7	54.5
South Korea	51.3	49.8	47.6	47.3	48.2	49.0	48.2	48.5	48.5	47.6	48.1	48.4	47.8	49.4	48.9	49.9
Spain	52.6	48.7	49.9	49.0	44.7	45.7	46.4	48.4	50.7	51.3	49.0	48.4	48.0	47.8	46.5	47.7
Taiwan	49.8	44.6	42.7	42.2	41.5	41.6	44.6	44.3	49.0	48.6	47.1	44.3	44.8	44.1	44.3	46.4
Turkey	48.1	46.9	47.4	46.9	46.4	45.7	48.1	50.1	50.1	50.9	51.5	51.5	51.5	49.9	49.0	49.6
United Kingdom	52.8	52.1	47.3	48.4	46.2	46.5	45.3	47.0	49.3	47.9	47.8	47.1	46.5	45.3	43.0	44.3
United States	52.7	52.2	51.5	52.0	50.4	47.7	46.2	46.9	47.3	49.2	50.2	48.4	46.3	49.0	47.9	49.8
Vietnam	54	51.2	52.7	52.5	50.6	47.4	46.4	47.4	51.2	47.7	46.7	45.3	46.2	48.7	50.5	49.7
Global	52.2	51.1	50.3	49.8	49.4	48.8	48.7	49.1	49.9	49.6	49.6	49.6	48.8	48.6	49	49.1

Source: MAPFRE Economics (with Bloomberg data)

reports, and more abrupt coming into the next year. Projected inflation also has a later gradual return, but subject to more sustainable rates that permit the gradual recovery of real wages. Despite this, the exhaustion of the main pillars of support for demand will continue to have a negative impact, while limiting the catalysts of inflation.

As a result, monetary policy would remain at the current levels, at least until the second half of 2024 in developed countries, while continuing to gradually relax in emerging countries, always considering the internal dynamics of the balance between economic activity and prices. More specifically, both the Federal Reserve and ECB would maintain their current interest rates, at least during the first half of 2024, after which the first decreases would begin, but maintaining positive real interest rates for a prolonged period.

Given the new global environment, oil price forecasts are modified, going up to 87 dollars/barrel on average and starting Q4 at a peak of 101 dollars/barrel until the end of the year. Meanwhile, a higher long-term path is projected, with an average above 90 dollars/barrel in 2024 and a later convergence and normalization in the medium term. This assumption results in a more pronounced period of stagflation in 2024, but with stronger implications on activity than on price dynamics. Gas prices also move upwards, but with a more contained shock and an earlier recovery to pre-conflict levels.

Stressed scenario

The *stressed scenario* (risk scenario) considered for the purposes of this report assumes a more pronounced and sustained oil price shock during most of 2024, due to a worsening of tensions in the Middle East. This supply shock results in a more rigorous stagflation outlook, with

implications on both the economic activity side and price dynamics side. More specifically, while the effects are practically null for the rest of 2023, the erosion of activity causes growth to fall by three tenths in 2024. As for inflation, the impact adds two tenths to the annual average in 2024, and seven tenths to 2024 (around one percentage point in a 12-month period). The oil price shock assumes prices of 15 dollars/barrel between late Q4 and early Q1 2024, as a peak, and price stagnation in the vicinity of 100 dollars/barrel for the remainder of the projection horizon.

In this stressed scenario, fiscal policy remains in neutral territory, without new fiscal protection policies being activated, although subject to an environment of stricter financial conditions. Monetary policy remains in a tightening environment for a longer period of time, with the Federal Reserve, but not the ECB, further raising interest rates and delaying the monetary easing phase until late 2024 and early 2025. No additional tightening is included in the case of emerging-market monetary policies, but they do subscribe to a more protracted easing process that is postponed by one quarter.

The change in conditions leads to implied volatility that would raise the VIX to levels over 40, with the annual average close to 35. The inference results in a correction of risk assets, with global equities contracting by 20% in their aggregate index, fixed income starting from a 10% correction in the 10-year duration, and the dollar regaining strength against other currencies (1.05 against the EUR). The dollar continues to appreciate in the short and medium term (1.07 in 2024 and 1.1 in 2025), thereby amplifying the effect of the withdrawal of liquidity and a flight-to-quality that affects emerging currencies, which face outflows similar to previous shocks, but far more selectively (see

Box 1.1.3-a Emerging exchange rate volatility

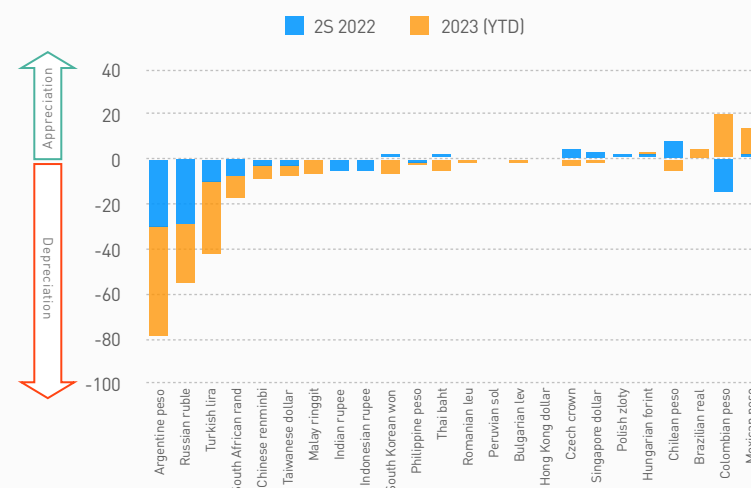
Emerging exchange rate volatility

Over the past year, economic recovery has continued its course, overcoming the initial shock produced by the Russian invasion of Ukraine, the tightening of global financial conditions in response to higher and more persistent inflation than desirable, the resulting turbulence in the U.S. (and to a lesser extent, European) banking sector, as well as the consolidation of a trend towards a multipolar order whose frictions reverberate in supply chains and raw material prices. In this environment, most emerging markets have benefited from more resilient growth than anticipated, tighter inflation control than in previous cycles, and the relative absence of relevant catalysts leading to abrupt capital outflows.

In terms of inflationary dynamics, and in contrast to what happened at the beginning of the price escalation, the emerging world's dependence on raw materials and proximity to the first stages of production provided the first signs of a slowdown in prices (particularly in the case of China). These dynamics lost intensity in anticipation of the more erratic behavior of some developed regions, signaling a horizon of monetary and fiscal policies with a shorter road ahead through 2023. In terms of exchange rates, both monetary and fiscal tightening have generated lower depreciation pressures on exchange rates compared to previous cycles, accompanied by well-anchored inflation expectations and a more disciplined and positive interest rate environment in real terms.

From the perspective of investment flows, given the lower inflows from exports due to weakening global trade (in addition to the strong dollar), a less favorable appetite for risk due to access to positive real rates in safer mar-

Chart A.
Select emerging markets:
change in local currency value vs. USD
[% , H2 2022 vs. 2023 YTD]



Source: MAPFRE Economics (with Bloomberg data)

Box 1.1.3-a (continued)
Emerging exchange rate volatility

kets, and the vulnerability exposed in previous shocks, emerging economies can be expected to receive fewer and more selective flows in the future. In terms of monetary policy, although financial conditions have already begun to ease in certain countries, this is still in the initial stage. There is observable caution due to the risk outlook that has yet to dissipate, the history of inflation in previous cycles, and developed markets' reluctance to sustain higher rates for a longer period, recovering credibility at the cost of limiting local maneuvering room. This is mainly the case in Asia, given the lower degree of restriction achieved.

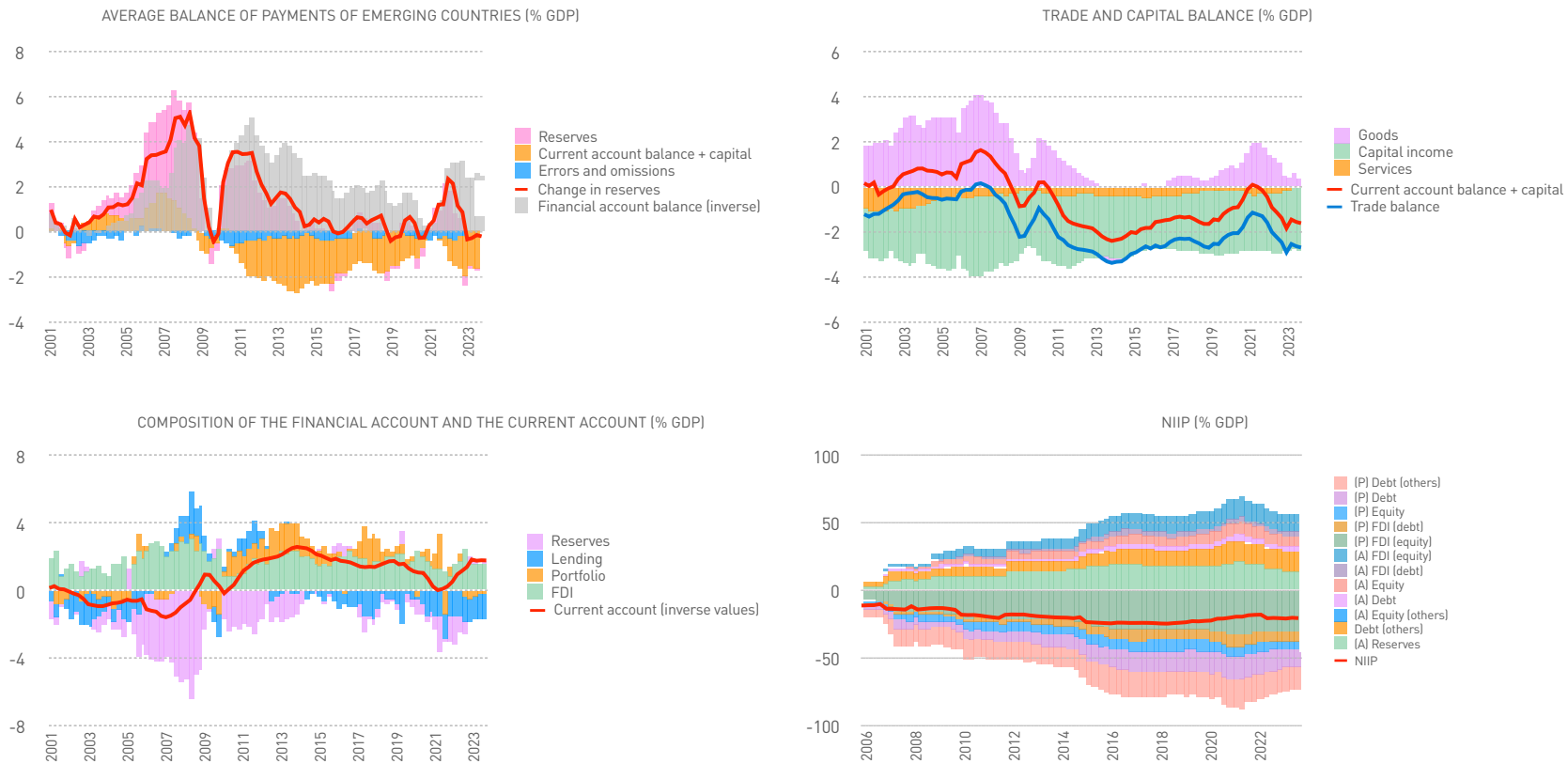
In line with the information presented in Chart A, most emerging currencies depreciated in the first half of 2023, with the exception of those of Mexico, Colombia, and Brazil, which performed in the opposite direction. This trend continues the momentum experienced in the second half of 2022, coinciding with the drop in portfolio flows exacerbated after the onset of the Russian invasion of Ukraine and global economic fragmentation compounded by geopolitical conflicts and protectionist measures.

In emerging countries (see Chart B), the average current account had a deficit close to zero at the end of 2020, remained at that level until the close of Q1 2022, and then rose to 2% by the end of Q2 2023. This was mainly due to the deficit in the primary income account and slower momentum of the trade surplus, which has been shrinking since Q2 2022 (local peak) to a level close to zero as of June 2023. On average, emerging markets accumulated some reserves until mid-2022, albeit without increasing liabilities, which helped to contain liquidity risk. However, since that date, reserves have been lost, albeit at a slow pace. As a result, the exchange rate appreciated until mid-2022 and has since depreciated.

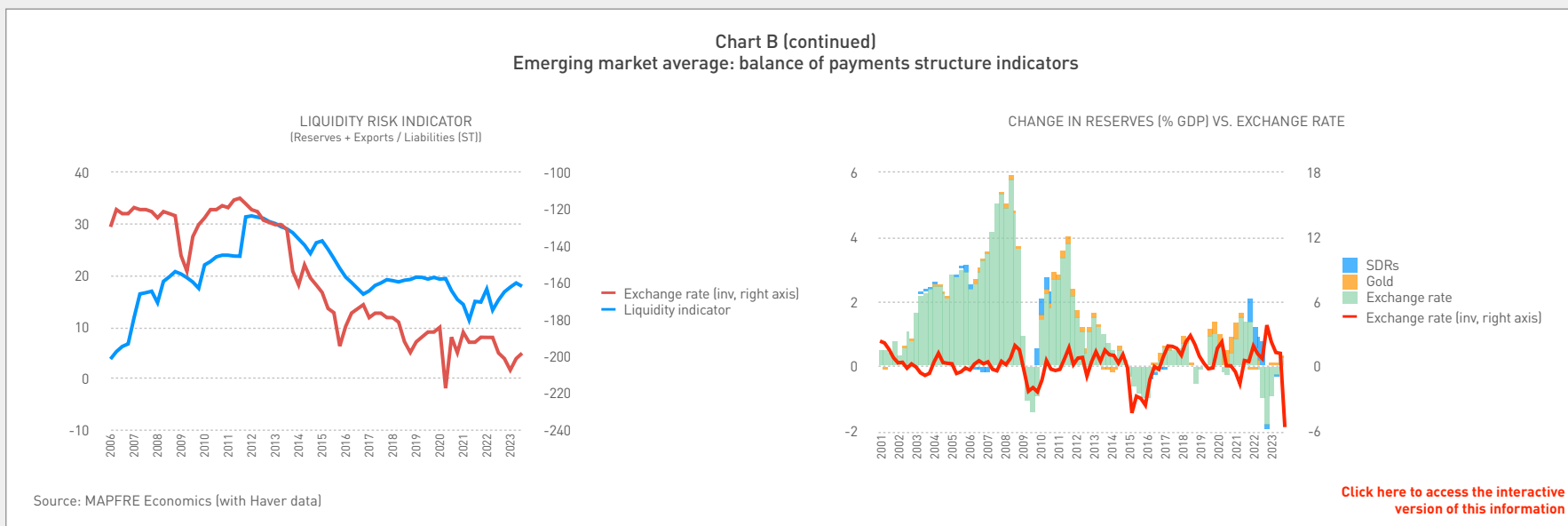
As a general conclusion, certain emerging economies are likely to benefit from both capital outflows from China and the weaker institutional performance of the CEMEA (Central Europe, Middle East and Africa) region; a window that, with the conflict in Ukraine and in the absence of negative catalysts, could prevent abrupt capital outflows to some extent in the future. Meanwhile, the slowdown in economic activity forecast for 2023 is expected to remain heterogeneous, a result of both inflation dynamics (still permanent in certain economies and under greater control by their central banks) and the production mix. Meanwhile, the advent of a new multipolar world order, with segmented supply and trade chains, reveals the rise of certain players that stand to benefit from nearshoring and the fragilities of other economies with a traditional importing bias, as well as the reality of emerging countries with latent structural vulnerabilities. This will widen the gap and open the door to an increasingly selective emerging path of depreciation.

Box 1.1.3-a (continued)
Emerging exchange rate volatility

Chart B.
Emerging market average: balance of payments structure indicators



Box 1.1.3-a (continued)
Emerging exchange rate volatility



Boxes 1.1.3-a and 1.1.3-b). Finally, credit spreads widen in the range of 100 to 200 basis points, depending on the credit quality scale.

1.1.4 Risk assessment

Regarding the outlook for the remainder of 2023, in terms of risk, a set of possible additional triggers for the global economy must be underscored, as illustrated on the risk map presented in Chart 1.1.4.

Energy markets

War tensions in the Middle East, together with production cuts by the Organization of the Petroleum Exporting Countries (OPEC), have caused oil prices to jump back towards 90 dollars/bl. The price of natural gas, meanwhile, also rose 20% to €50/MWh last month, although this is far from the peak of 2022, when it reached €292/MWh. Sustained higher prices would also have repercussions on the

Box 1.1.3-b
Emerging vulnerability analysis:
evolution of the Emerging Risk Index (ERI)

Emerging vulnerability analysis

By studying the structural vulnerabilities of a number of markets, the Emerging Risk Index (ERI) offers a forward-looking approach (see Table A). In line with this measurement (presented in previous versions of this report), we observe how the positive divergence seen in countries with a surplus in their trade accounts, driven by the cyclical momentum of manufactured goods and favorable rebound in raw materials, has been adapting restrictive monetary policies domestically and formulating fiscal measures that are more sensitive to the financing of the financial account.

In this context, the volatility analysis in emerging markets allows for the analysis of different volatility categories (see Charts A to F). A first group of emerging countries, which has been closing the gap opened in 2022 and consolidating the cyclical change towards a slowdown in activity and prices in line with the most advanced countercyclical policies, shows deterioration in short-term indicators. However, it presents greater momentum than expected, both by relying in advance on still-positive foreign demand and by allowing a more predictable adjustment of domestic consumption, thus generating a more stable environment for portfolio investment flows and the basis for a less volatile exchange rate dynamic. This environment has allowed for a resurgence of the carry trade (a strategy employed in the foreign exchange market whereby an investor sells a certain currency with a relatively low interest rate and buys a different one with a higher interest rate) for much of 2023, although its most recent extension demonstrates some cyclical exhaustion as interest rates reach terminal levels.

Conversely, emerging countries with more volatile financing needs and less predictable fiscal sustainability paths have experienced a deeper reduction of economic activity, less effective inflation control, and a greater accumulation of tacit imbalances with implications in terms of potential, although external adjustment and other fundamentals have been less exposed than in the past. In this case, such divergences are reflected in less anchored price expectations due to the association not only with the trade channel but also with the financial channel, showing greater price inefficiencies, fluctuating future expectations, and a monetary policy that is more reactive to the tightening cycle of developed economies. In this group of countries, capital flows continue to exhibit erratic and unstable momentum, making cross interest rate transactions more difficult in view of the risks associated with exchange rate fluctuations.

The last block includes emerging countries with the greatest imbalances derived from structural and idiosyncratic factors, such as the use of foreign debt as a mechanism to cover the succession of current deficits, debt in foreign currency, frequent capital flight in view of exchange rate instability, and high micro-finance risk premiums in the absence of macroprudential measures. Domestically, inflation dynamics remain high, amplifying the sources of foreign contagion, and a mix of low reserve levels to stabilize exchange rates and unorthodox monetary policies focused on supporting demand-side growth and sustaining fiscal deficits exacerbate imbalances and perpetuate vulnerabilities.

Box 1.1.3-b (continued)
Emerging vulnerability analysis:
evolution of the Emerging Risk Index (ERI)

Table A.
Selected markets: risk profiles and Emerging Risk Index (ERI) estimation

	Thresholds		Emerging markets									
	Emerging markets	Developed	Argentina	Brazil	China	Colombia	Philippines	Indonesia	Mexico	Peru	Russia	Turkey
2030 potential GDP growth	3	1.5										
Potential inflation	10	2										
EMBI	8%											
CDS	20%	10%									N/A*	
CA % GDP	1	1										
NIIP % GDP	-40	-40										
External Debt CB ST % GDP	4%	4%										
External Debt CB LT % GDP	1%	1%										
External Debt Governments ST % GDP	2%	2%										
External Debt Governments LT % GDP	34%	34%										
External Debt Corporate ST % GDP	8%	8%										
External Debt Corporate LT % GDP	27%	27%										
External Debt Banks ST % GDP	12%	12%										
External Debt Banks LT % GDP	12%	12%										
External Debt Total % GDP	30%	30%										
External Debt Total ST % GDP	6%	6%										
External Debt Total LT % GDP	24%	24%										
Total Lending to Non-Financial Sector	20	90										
Lending to Government	20	90										
Lending to Households	20	90										
Lending to Non-Financial Corporations	20	90										
Lending to Non-Financial Private Sector	20	90										
Leverage	10	8										
LC GDP Growth (Nominal)	3	1.5										
NPL	7	7										
CPI	3	1.5										
CB Rate (benchmark interest rate)	6	3										
Money supply/Reserves	3	6										
External debt/Exports	1	3										
ERI 2022			85.96	33.75	60.47	40.72	11.11	23.55	24.74	1616	27.63	61.07
ERI 2021			71.61	37.54	56.96	42.86	11.50	26.13	30.04	13.33	30.04	67.04
Change vs. 2021			14.4	-3.8	3.5	-2.1	-0.4	-2.6	-5.3	2.8	-2.4	-6.0

Source: MAPFRE Economics (estimates based on data from OEF, Haver, IMF, BIS, Bloomberg and World Bank)

* Russia: Equivalent CDS not available.
 Russia: it was excluded from the EMBI index in 2022 by JP Morgan.
 Russia: external debt data to 2021

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Box 1.1.3-b (continued)
Emerging vulnerability analysis:
evolution of the Emerging Risk Index (ERI)

Chart A.
Argentina: ERI vs. EMBI

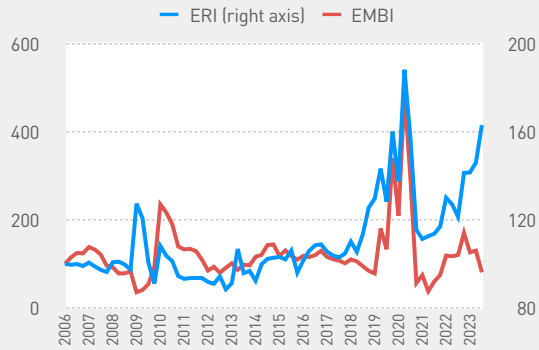


Chart B.
Peru: ERI vs. EMBI

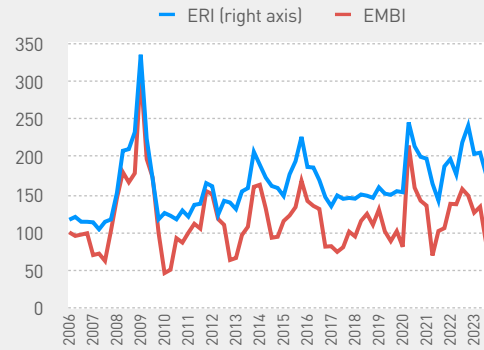


Chart C.
Indonesia: ERI vs. EMBI

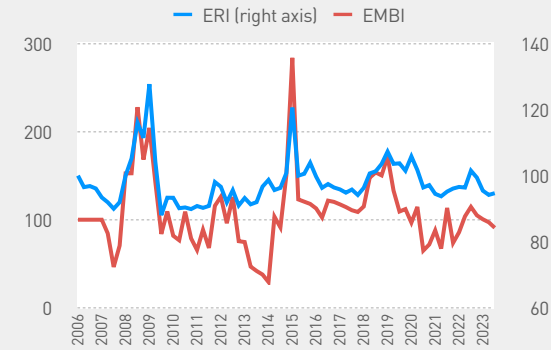


Chart D.
Turkey: ERI vs. EMBI

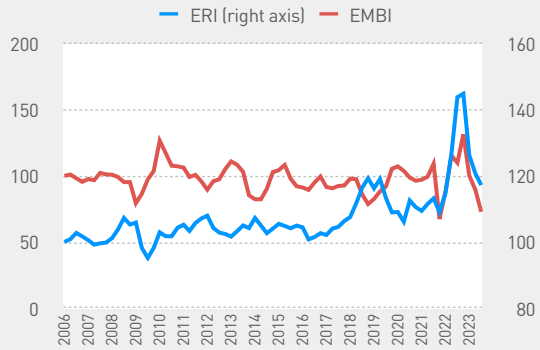


Chart E.
Brazil: ERI vs. EMBI

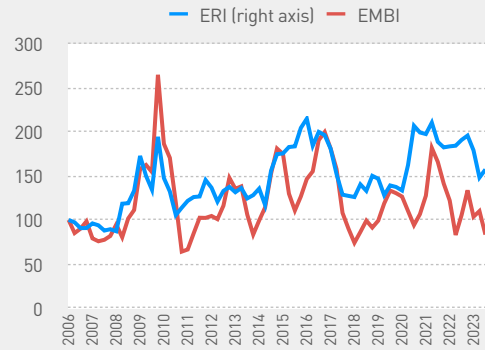
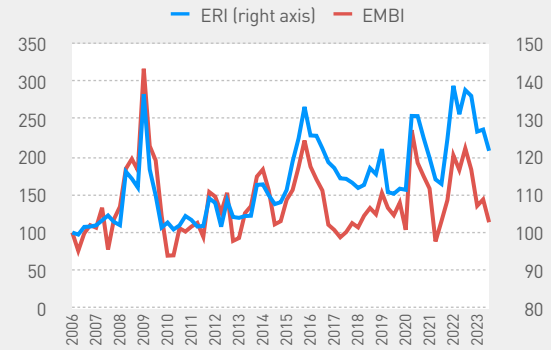


Chart F.
Colombia: ERI vs. EMBI



Source: MAPFRE Economics (own estimates and data from OEF, Haver)

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inflation dynamic through a new supply shock. The resolution of geopolitical conflicts, along with less punishing policies toward fossil fuels, would now be determining factors in the moderation of growth in energy prices, thus combating inflation in the short term.

Inflation

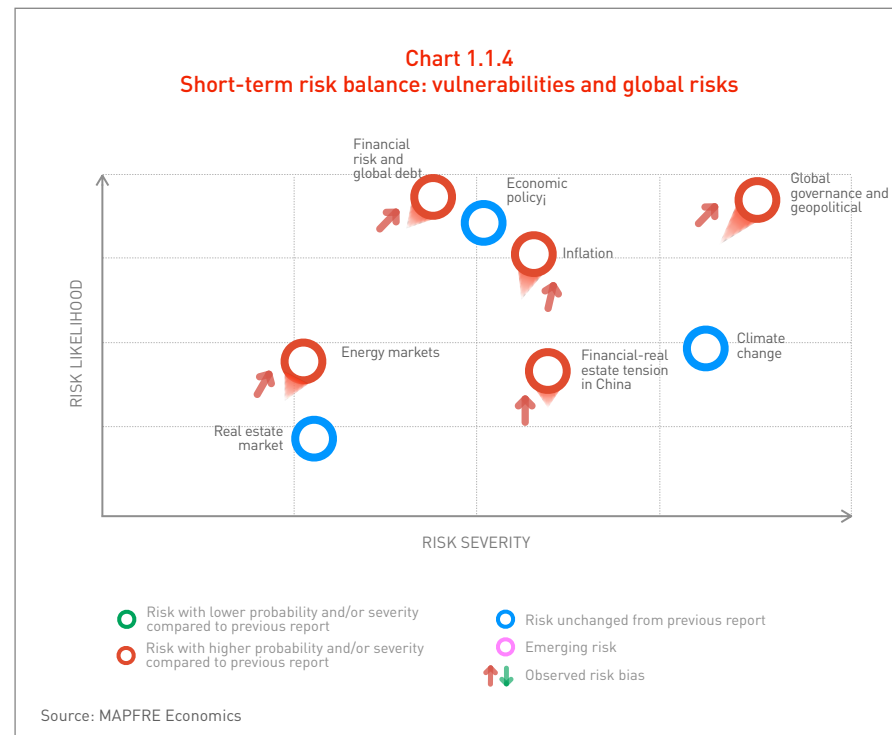
Over the last few months, inflation data has been moderating downwards, mainly producer prices and core inflation, although in some countries this path is interrupted by the effect of the energy price component. Looking to the next quarters, inflation is expected to continue to moderate as a result of restrictive monetary policy, but counterbalanced by a possible jump in energy prices and the effects of ongoing wage renegotiations.

Financial risk and global debt

At the end of Q2 2023, global aggregate debt reached 307.1 trillion dollars, which is almost 336% of global GDP, up 0.9 trillion dollars quarter-on-quarter and 9.9 trillion dollars year-on-year. This increase is mainly in government and financial sector debt, while household and non-financial corporate debt has declined slightly over the last two years.

Interest rate hikes by central banks around the world have affected, firstly, the rates of the short end of the curve (generating an inversion of the yield curve, mainly in the United States), while also influencing the behavior of long-term interest rates in the market. The balance-sheet reduction policies of central banks have favored the rise in long-term interest rates, as bonds must find replacement demand in the market. More recently, with the outbreak of conflict in the Middle East,

the market began to discount possible scenarios of higher energy costs and thus more persistent inflation and higher interest rates (short and long-term) for a longer period. This will affect debt service costs of both governments and the private sector, which will have a gradual impact on the pace of renewals. Hence, the urgency to get inflation expectations back on track, and therefore, the promises of a restrictive monetary policy for a longer period of time. However, considering current global debt levels, the risks of a potential financial crash are increasing; central banks will have to weigh this factor in order to find a bal-



ance between monetary restraint to contain inflation and the necessary financial stability.

Economic policy

In the area of economic policy, there are two main vectors to take into consideration. On the one hand, there is the fight against inflation by central banks, and on the other, government stimulus policies in an effort to achieve the much-desired *soft landing*. In recent months, inflation has shown a general tendency to moderate, revealing that monetary policy transmission is finally working as intended, reducing credit availability and tightening financing conditions. Applicants' borrowing capacity has dropped in the real estate market, and therefore, so has lending. This is also being observed in the construction sector in several countries where activity is visibly declining, as is the case in Germany. On the other side are governments with stimulus policies, like the Inflation Reduction Act in the United States and the Recovery and Resilience Fund and RePowerEU in the Eurozone. These aid and investment programs have been partially cushioning the credit crunch and sustaining activity. At the moment, there appears to be a balance between these two forces, which, in the absence of some financial accident, seems likely to avoid recessions in both the United States and the Eurozone, although not in the case of Germany.

Financial and real estate tension in China

In China, economic growth is being maintained thanks to the performance of some industrial sectors, such as automobile production, a sector that has overtaken Germany and Japan in production. Meanwhile, the central bank has also been relaxing monetary policy through

different levers, with the aim of maintaining the flow of credit to the economy. At the end of October, the central government unexpectedly announced fiscal support in the amount of 1 trillion yuan; this support involves increasing the deficit from 3.0% to 3.8% of GDP. This fiscal support is aimed at, among other things, supporting some regional governments that are in a stressed financial situation. There is also stress in the real estate market, with well-known troubles of the large developers, notably Country Garden, which entered into default in October.

Real estate market

The rise in interest rates and tightening of access to financing continue to weaken the appetite for the real estate sector. For now, prices are adjusting very moderately, and in some cases, remain without significant changes. However, the transmission of monetary policy, which is starting to gain traction, is starting to be felt in new construction: Germany (-30%), France (-24%), United States (-30% in residential construction and -7% on the aggregate). Thus, in the coming months, adjustments may start to be seen in real estate prices, although this market does not have much downward flexibility, and the effect usually results in a decrease in the number of transactions. In the United States, in particular, there is stress in the commercial real estate sector (offices and trade), with office occupation rates dropping, aggravated by the trend toward remote work.

Climate change

The vulnerabilities associated with climate change (increase in the frequency and severity of cyclones, hurricanes, and floods, among other

weather phenomena) are mainly reflected in extreme climatological events that affect food prices and the cost of construction materials. Society will have to accelerate investment in energy transition, but in the process, there is a risk of discontinuing access to moderately priced energy, with the resulting impact on competition, productivity, and economic activity levels.

Global governance and geopolitical environment

The context of social unrest and warmongering has reached its highest level in decades this quarter. The Middle East crisis generated in early October led to institutional movement in favor of Israel, which contrasts with a partisan reading, popular in Europe and less so in the United States. The ideological differences and partisanship provoked by the conflict have been aggravated by the start of Phase II of Israel's ground campaign. Thus, there is a real risk that the conflict will extend to the region and provoke a crisis in the Middle East similar to that of the 1970s with the Yom Kippur War. However, for now the markets have not echoed this situation. The gold/copper ratio, a measurement of risk aversion, is at its historic average at the moment. The United States' unconditional support of Israel has raised doubts as to the sustainability of simultaneous *full* support to Ukraine. The reordering of the priorities of a Democratic Congress, or the reinforcement of the United States' vision, would reduce the contribution to the Ukrainian cause, so that the crisis there would have a more certain and more immediate end in time.

With respect to the Ukraine-Russia conflict, two elements are at play, despite the fact that the war has stalled tactically. The first is the potential new Polish government of Donald Tusk, and the second, the

progress of conversations to define what the post-war situation would be like (which was discussed at the international meeting in Malta on October 27-28). Although Russia did not participate in that meeting, the increase in participants and reduction in the number of countries that have so far not taken a position offers some hope for Ukraine. Raw materials and gas remain in relatively moderate territory, although with episodes of volatility. The base effect of the situation last year helps, as does the reduced industrial demand and global consumption that are keeping prices relatively stable. All in all, the conflict in Ukraine is not likely to be resolved without a winner being declared.

In addition to these global hotspots of conflict, Europe is influenced by the situation in the Sahel. This is not only because the coup d'état in Niger represents the umpteenth overthrow of a democratic government in favor of a military junta, but also because France is increasingly losing specific weight in the region to Russia and China, and because the stockpiling of materials for its atomic energy industry could be jeopardized. The conflict in Nagorno-Karabakh, between Armenia and Azerbaijan, is also on Europe's doorstep. The tension in this situation is limited to the extent that Turkey (pro-Azerbaijan) avoids confronting Russia (pro-Armenia), as the two countries are also meeting and discussing the transit of gas and grain through the Black Sea and the Bosphorus Strait.

1.2 Forecasts and risk assessments in selected economies

1.2.1 United States

Momentum in activity and employment, but with increasing risks.

The U.S. economy grew 2.9% YoY in the third quarter of 2023 (4.9% QoQ annualized and adjusted [SAAR]). This economic performance has undoubtedly come as a surprise, as it reflects the solid performance of private consumption, government consumption, and investments. Despite this, there has been a certain depletion of accumulated household savings, as well as an increase in the use of credit. Exports, in turn, rose 6.2% YoY, while imports rose 5.7% YoY.

The U.S. job market remains strong, with new unemployment requests (initial claims) dropping since June. Furthermore, the Conference Board leading indicators index has stabilized in recent months (-7.8 in September). However, a contraction is observed in credit and in the construction sector, while the manufacturing sector is only marginally in the positive (0.25% YoY). The consumer confidence indicator has also stabilized, although well below the level registered during the 2018–2019 period. As for the future activity surveys, the PMIs (purchasing manager indexes) for October landed as follows: composite at 51.0, manufacturing at 50.0, and services at 50.9 points; only the manufacturing index is in the contraction zone.

Looking ahead to the coming quarters, a credit crunch and cost increase will impact economic activity levels, although it may be offset by the government's stimulus programs (Inflation Reduction Act). In

addition, the rise in interest rates in the credit markets (sovereign and private bonds in all maturities) means tighter credit, which may allow the Federal Reserve to avoid having to further tighten the money market. GDP growth forecasts for the baseline scenario have improved and now stand at 2.3% growth in 2023 and 0.6% in 2024, eventually achieving the much desired yet elusive soft landing (see Table 1.2.1 and Charts 1.2.1-a and 1.2.1-b).

Meanwhile, headline inflation (CPI) has been easing since mid-2022, and core inflation continues to do so (4.1% in September). However, headline inflation has rebounded in the last two months (3.7% in August and September), showing that the final stretch of convergence to the target (2%) will remain difficult to achieve. In fact, second-round effects are already evident, with paralyzed production in some sectors due to rising wage demands. By components, food rose 3.7%, especially in restaurants (6.0%). Automotive fuels were up (2.2%), and this behavior could be aggravated in coming months due to tensions in the Middle East.

The Federal Reserve did not raise interest rates at its September meeting, leaving them at 5.5% (high band), with the last hike of 25 ba-

United States

- As 2023 progresses, performance is better than expected.
- The interest rate and energy shocks will start to be reflected in activity levels.
- The Federal Reserve has paused hikes until it sees how the economy handles monetary policy interest rates of 5.50% and 10-year bonds at 5%.
- Rating agency Fitch downgraded the United States' credit rating to AA+ due to uncontrolled spending.

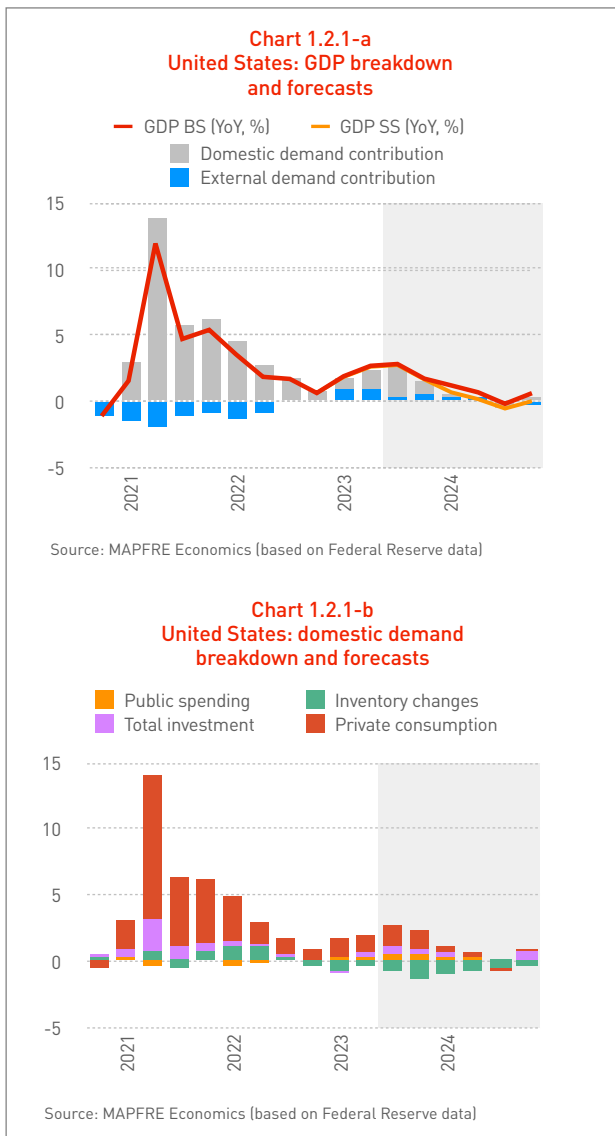


Table 1.2.1
United States: main macroeconomic aggregates

	2018	2019	2020	2021	2022	Baseline (BS)		Stressed (SS)	
						2023 ^(f)	2024 ^(f)	2023 ^(f)	2024 ^(f)
GDP (% YoY)	3.0	2.5	-2.2	5.8	1.9	2.3	0.6	2.2	0.1
Domestic demand contribution	3.2	2.6	-2.0	7.1	2.4	1.3	0.0	1.3	-0.5
External demand contribution	-0.3	-0.1	-0.2	-1.3	-0.5	0.7	0.2	0.7	0.3
Private consumption contribution	1.9	1.4	-1.7	5.6	1.7	1.4	0.2	1.4	-0.1
Total investment contribution	1.1	0.6	-0.2	1.2	0.2	0.3	0.2	0.3	0.2
Public spending contribution	0.2	0.5	0.4	0.0	-0.1	0.4	0.2	0.4	0.2
Private consumption (% YoY)	2.7	2.0	-2.5	8.4	2.5	2.1	0.3	2.0	-0.2
Public spending (% YoY)	1.4	3.9	2.9	0.3	-0.9	2.8	1.4	2.8	1.4
Total investment (% YoY)	5.0	2.9	-1.0	5.3	0.9	1.5	1.1	1.5	0.8
Exports (% YoY)	2.9	0.5	-13.1	6.3	7.0	1.8	0.0	1.8	-0.1
Imports (% YoY)	4.0	1.2	-9.0	14.5	8.6	-3.2	-1.1	-3.3	-2.1
Unemployment rate (% , last quarter)	3.8	3.6	6.8	4.2	3.6	3.9	5.0	3.9	5.1
Inflation (% YoY, average)	2.4	1.8	1.3	4.7	8.0	4.1	2.9	4.5	3.2
Inflation (% YoY, last quarter)	2.2	2.0	1.2	6.8	7.1	3.6	2.2	4.3	2.2
Fiscal balance (% of GDP)	-6.0	-6.6	-14.6	-11.9	-4.5	-7.5	-7.3	-7.5	-7.4
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	-2.8	-3.5	-3.8	-3.1	-2.9	-3.1	-2.5
Official interest rate (end of period)	2.50	1.75	0.25	0.25	4.50	5.50	4.50	5.75	4.75
3-month interest rate (end of period)	2.81	1.91	0.24	0.21	4.77	5.60	4.77	5.62	4.77
10-year interest rate (end of period)	2.69	1.92	0.93	1.52	3.88	4.65	4.07	4.65	5.08
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	1.05	1.07	1.05	1.07
Private lending (% YoY, average)	4.7	5.0	6.3	14.8	2.1	-3.3	1.6	-3.3	2.1
Household lending (% YoY, average)	3.5	3.4	3.3	8.0	7.5	4.1	5.6	4.1	5.6
P.S. non-financial lending (% YoY, average)	9.1	6.0	8.7	4.6	10.8	4.5	2.1	4.5	2.1
P.S. financial lending (% YoY, average)	1.9	2.4	6.8	4.8	9.8	6.0	0.9	6.0	1.2
Savings rate (% pers. disp. income, avg.)	6.4	7.4	15.2	11.2	3.3	5.1	6.5	5.0	6.4

Source: MAPFRE Economics (based on Federal Reserve data)
Forecast end date: October 30, 2023.

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sis points (bps) in July. In recent weeks, given the rising yields of bonds in all tranches and the increase in oil prices due to the Israel conflict, some members of the Federal Reserve have already discussed the possibility of not increasing monetary restriction through an additional hike in interest rates. In this regard, they would first want to look at the effect of previous hikes, as bond yield increases in all tranches amount to monetary tightening. Tighter credit conditions are already being transmitted to economic activity. The Fed would not want to tighten conditions too much, as this has implications for the stability of the financial system, as seen with the bank failures last April.

Risks to economic activity and financial stability are becoming increasingly visible. Although the baseline scenario considered in this report is that of a soft landing, a recession is far from being ruled out. For starters, an inverted interest rate curve has rarely not preceded a recession, although this is possible. Second, an interest rate shock is underway (from 0.25% in 2021 to 5.5% today), and many businesses are not designed to be profitable at this rate level (e.g., rental, office and retail real estate, and also auto financing prices). Additionally, in view of the growing instability in the Middle East and OPEC's production cuts, there could be another energy shock. No less important are the risks in the banking system, especially with unrealized losses on bonds, and the risks of high U.S. government debt. In August, Fitch Ratings downgraded the U.S. sovereign rating from AAA to AA+, based on expected fiscal deterioration over the next three years, a high and growing general government debt burden, and the erosion of governance relative to its AA and AAA-rated peers. Despite this, the political will to channel spending before the 2024 presidential elections is not expected.

1.2.2 Eurozone

The transmission of monetary policy starts to slow down demand.

Eurozone GDP grew by only 0.1% QoQ in Q2 2023 (+0.5% YoY), maintaining the sluggishness in the Q3 estimate at -0.1% QoQ (+0.1% YoY), mainly due to the effect that energy costs have had on inflation and the impact financial costs are having on activity. Domestic demand has grown only 0.6% QoQ, while investment is up 2.1% QoQ, and exports are down 0.7% QoQ. Purchasing managers' indexes (PMIs) are in the contraction range in October, with the manufacturing at 43.0, composite at 46.5, services at 47.8, and construction at 43.6 points. Industrial production dropped 2.2% in July, especially in the energy sector and durable consumer goods, despite jumping slightly in August (0.6% monthly). The industry survey anticipates a contraction in total orders (-18.0) and in export orders (-21.4). Additionally, the leading indicator index has been worsening for months, especially in terms of the (inverted) rate curve component and the drop in construction permits. Consumer confidence remains negative and turned downward again (-17.8). Automobile sales are the sole leader in growth (+24.3%), due to the pent-up demand in recent years and subsidies for the purchase of hybrid and electric vehicles. Thus, the aggregate Eurozone economy has shown some resilience, thanks to the easing of fiscal deficits and the support of the recovery and growth plan and the renewable energy stimulus plan (NextGenEU). In this context, growth of 0.5% is forecast for 2023 and 0.7% for 2024 (see Table 1.2.2 and Charts 1.2.2-a and 1.2.2-b).

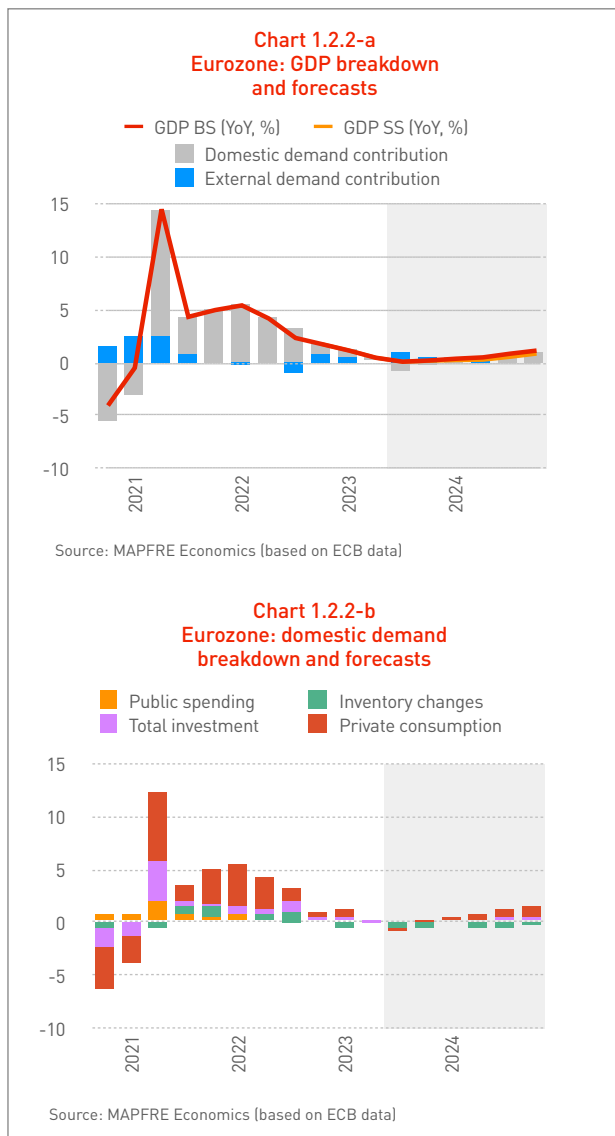


Table 1.2.2
Eurozone: main macroeconomic aggregates

	2018	2019	2020	2021	2022	Baseline (BS)		Stressed (SS)	
						2023 ^(f)	2024 ^(f)	2023 ^(f)	2024 ^(f)
GDP (% YoY)	1.8	1.6	-6.3	5.6	3.4	0.5	0.7	0.5	0.5
Domestic demand contribution	1.7	2.3	-5.7	4.2	3.5	-0.1	0.6	-0.1	0.3
External demand contribution	0.0	-0.7	-0.6	1.4	-0.1	0.5	0.1	0.5	0.1
Private consumption contribution	0.8	0.7	-4.2	2.2	2.2	0.2	0.7	0.2	0.5
Total investment contribution	0.7	1.4	-1.4	0.8	0.6	0.2	0.2	0.1	0.0
Public spending contribution	0.2	0.4	0.2	0.9	0.3	0.0	0.1	0.0	0.1
Private consumption (% YoY)	1.5	1.4	-7.8	4.1	4.3	0.4	1.2	0.4	1.0
Public spending (% YoY)	1.0	1.8	1.1	4.1	1.4	0.0	0.7	0.0	0.7
Total investment (% YoY)	3.2	6.5	-6.5	3.6	2.9	0.7	0.7	0.7	0.2
Exports (% YoY)	3.6	3.2	-9.3	11.0	7.2	0.6	2.2	0.6	2.0
Imports (% YoY)	3.8	5.0	-8.7	8.7	8.1	-0.5	2.2	-0.5	1.9
Unemployment rate (% , last quarter)	7.9	7.5	8.3	7.1	6.7	6.5	6.7	6.5	6.8
Inflation (% YoY, average)	1.8	1.2	0.3	2.6	8.4	5.6	2.5	5.7	3.0
Inflation (% YoY, last quarter)	1.9	1.0	-0.3	4.6	10.0	3.5	1.7	3.7	2.1
Fiscal balance (% of GDP)	-0.4	-0.6	-7.1	-5.3	-3.7	-3.3	-3.0	-3.3	-3.2
Primary fiscal balance (% of GDP)	1.4	1.0	-5.5	-3.9	-1.9	-1.7	-1.2	-1.7	-1.3
Current account balance (% of GDP)	2.9	2.5	1.7	2.8	-0.6	1.7	1.9	1.6	1.4
Official interest rate (end of period)	0.00	0.00	0.00	0.00	2.50	4.50	3.00	4.50	3.25
3-month interest rate (end of period)	-0.31	-0.38	-0.55	-0.57	2.13	4.00	2.30	3.99	2.22
10-year interest rate (end of period)	1.17	0.32	-0.19	0.32	3.39	3.95	3.51	3.95	4.54
Exchange rate vs. U.S. dollar (end of period)	1.15	1.12	1.23	1.13	1.07	1.05	1.07	1.05	1.07
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	2.9	3.9	4.2	1.8	3.2	1.7	3.1
P.S. non-financial lending (% YoY, average)	0.6	1.1	3.1	3.3	5.7	1.3	2.8	1.3	2.6
P.S. financial lending (% YoY, average)	-0.7	2.9	-0.3	0.5	8.4	0.3	1.4	0.3	1.6
Savings rate (% pers. disp. income, avg.)	12.5	13.1	19.7	17.7	13.5	14.5	13.9	14.5	13.7

Source: MAPFRE Economics (based on ECB data)
Forecast end date: October 30, 2023.

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Meanwhile, aggregate inflation stood at 2.9% in the Eurozone in October (compared with 4.3% in September), while the unemployment rate was 4.2% (compared with 4.5% the month before). Producer prices are now climbing again due to the effect of stresses on the energy markets. In addition, food prices slowed to 7.5%, while services moderated to 4.6%.

Meanwhile, energy prices dropped again, some 11.1% (versus -4.6% in September).

At its September meeting, the European Central Bank (ECB) raised interest rates by 25 bps, leaving rates on the main refinancing operations at 4.50% and deposit facility at 4%. The Council still expects inflation to be too high for some time. Thus, ECB experts have revised the projected path of inflation, excluding energy and food, slightly downward to an average of 5.1% in 2023, 2.9% in 2024, and 2.2% in 2025. Past interest rate hikes continue to be passed on strongly to the real economy. Thus, financing conditions have tightened again and are increasingly dampening demand, which is an important factor in bringing inflation back to target. Given the increasing impact of this monetary tightening on domestic demand and the weaker international trade environment, the ECB has significantly lowered its economic growth projections.

Eurozone

- **Financing for the economy is tightening, resulting in lower demand growth.**
- **The Eurozone's leading indicators point to a cooling off of economic activity levels, especially in industry.**
- **Inflation will be controlled by lowering energy prices.**

Risks for the real economy and the financial sector in the Eurozone are on the rise. With financial costs climbing, both in the short term (central bank, Euribor, short-term bonds) and in the long term, and with government bonds increasing yields in the market, the risk of disruptions to financial stability increases. At the activity level, the effective transmission of monetary policy to the availability and cost of credit is increasingly dampening demand. The ECB considers this necessary to stop inflation. However, as inflation also has energy, supply cost, and excessive public spending components, higher financial costs could further feed inflation instead of moderating it. In Europe, the high wage indexing and workers' negotiation power also make price moderation a hard goal to reach. The goal of getting back to cheap energy should be priority number one, but this would mean having to overcome many geopolitical barriers.

1.2.3 Spain

The Spanish economy shows more resilience than other European economies, but a slowdown seems inevitable.

The Spanish economy has proven to be more resilient than other European economies, with 0.3% QoQ growth in Q3 (+1.8% YoY), after a Q2 with 0.5% QoQ growth. These figures are quite good in a context of higher financial costs and a trend toward credit crunch. Household consumption continues to grow (+1.4% QoQ), as well as public spending (+0.6% QoQ), thanks to the fiscal deficit and different funds of the European Union. Investment dropped slightly (-0.4%), still driven by projects associated with the RePowerEU program, although construction is already starting to slow down in view of the decline in mortgages granted (-20% YoY).

Looking to Q4 2023, a continued slowdown is expected as a result of the effective transmission of the ECB's monetary policy, whose goal is to cool activity in order to control inflation. Industrial production dropped 3.6% in August. In addition, retail sales increased 7.0% YoY, but dropped 7.2% from July to August. The end of the tourist season will also contribute to a moderation of growth in the last quarter of the year. The purchasing managers' indexes (PMIs) for September were positive nonetheless, with the exception of manufacturing, which stood at 47.7 points, while services came in at 50.5 and the composite at 50.1 points. The consumer confidence index has worsened to -20.2, and the European Commission's economic sentiment indicator (99.0) is below 2019 levels, while the retail sector survey is positive, but slowing.

Spain

- **The credit crunch and rise in the Euribor will impact the Spanish economy's momentum.**
- **Government financing will gradually become more expensive in upcoming issues.**
- **Inflation may jump due to the rise in oil prices in recent months.**

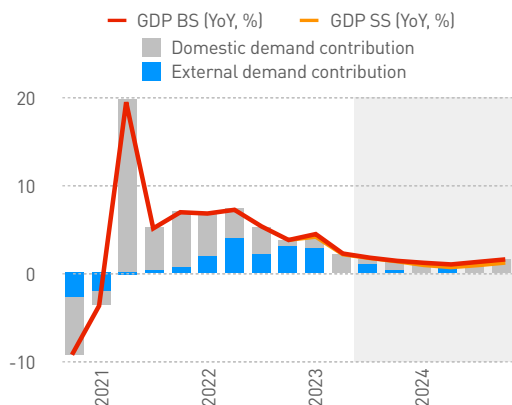
Looking ahead to the coming quarters, growth in the Spanish economy is expected to moderate due to higher financial costs, especially the Euribor, which will be taking disposable income away from households with mortgages, while rents have also risen as the ability to pay mortgages is declining and there is greater demand in the rental market. Furthermore, a decline in exports is expected, because of the slump in target markets and a moderation of tourism. Thus, in line with this con-

text, Spanish GDP growth is expected to reach 2.5% in 2023 and 1.3% in 2024 (see Table 1.2.3 and Charts 1.2.3-a and 1.2.3-b).

Meanwhile, inflation in October remained stable at 3.5%, although it increased monthly (0.3% MoM), with harmonized inflation growing 0.3% MoM, while core inflation stood at 5.2%. Food prices continue to increase by more than 10% (September), while, in general, all items are moderating. The rise in oil prices over the summer months will probably be reflected in end products and interrupt the downward trend in inflation. Temporary aid for agricultural and road transport diesel fuel is scheduled to end in December.

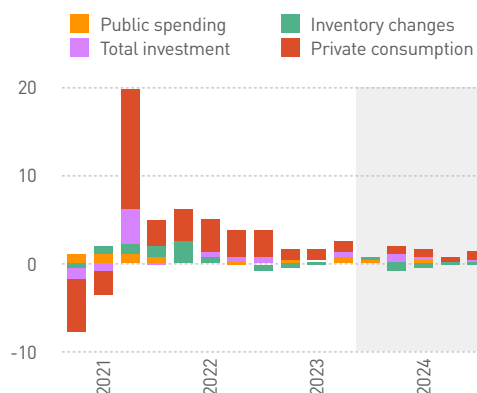
Among the short-term risks facing the Spanish economy is the rise in the Euribor, which will affect households with mortgages, having an impact on the increase in new rental contract prices. Construction will also slow down as a result of the reduction in households' ability to pay mortgages. Real estate prices are more rigid to the downside, but the ECB's policy of "higher interest rates for longer" may change the medium-term outlook. The other expected slowdown channels include tourism-originating countries and export markets. Meanwhile, on the positive side, there are still spending plans for the Recovery and Resilience Fund and the RePowerEU fund for investment in clean energy. In addition, the government continues to run a high fiscal deficit. Thus, the rise in Treasury bond yields will weigh on financing costs at the pace of new issuing.

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

	2018	2019	2020	2021	2022	Baseline (BS)		Stressed (SS)	
						2023 ^(f)	2024 ^(f)	2023 ^(f)	2024 ^(f)
GDP (% YoY)	2.3	2.0	-11.2	6.4	5.8	2.5	1.3	2.4	1.0
Domestic demand contribution	2.9	1.6	-8.9	6.7	3.0	1.4	1.0	1.4	0.7
External demand contribution	-0.6	0.4	-2.3	-0.3	2.8	1.0	0.2	1.0	0.3
Private consumption contribution	1.0	0.6	-7.0	4.0	2.7	0.9	0.8	0.9	0.7
Total investment contribution	1.2	0.9	-1.8	0.6	0.5	0.3	0.2	0.3	0.1
Public spending contribution	0.4	0.4	0.7	0.7	0.0	0.4	0.2	0.4	0.2
Private consumption (% YoY)	1.7	1.1	-12.3	7.1	4.7	1.6	1.5	1.6	1.2
Public spending (% YoY)	2.3	1.9	3.6	3.4	-0.2	2.2	0.9	2.2	0.9
Total investment (% YoY)	6.3	4.5	-9.0	2.8	2.4	1.6	1.2	1.6	0.7
Exports (% YoY)	1.7	2.2	-20.1	13.5	15.2	4.0	2.2	4.0	2.0
Imports (% YoY)	3.9	1.3	-15.0	14.9	7.0	1.5	1.9	1.5	1.5
Unemployment rate (% , last quarter)	14.5	13.8	16.1	13.3	12.9	11.5	11.6	11.5	11.8
Inflation (% YoY, average)	1.7	0.7	-0.3	3.1	8.4	3.5	2.5	3.7	2.8
Inflation (% YoY, last quarter)	1.7	0.4	-0.7	5.8	6.6	3.8	1.8	4.0	2.1
Fiscal balance (% of GDP)	-2.6	-3.1	-10.1	-6.7	-4.7	-3.9	-3.8	-3.9	-4.0
Primary fiscal balance (% of GDP)	-0.2	-0.8	-7.8	-4.6	-2.4	-1.7	-1.3	-1.7	-1.4
Current account balance (% of GDP)	1.9	2.1	0.6	0.8	0.6	3.0	2.7	2.9	2.1
Official interest rate (end of period)	0.00	0.00	0.00	0.00	2.50	4.50	3.00	4.50	3.25
3-month interest rate (end of period)	-0.31	-0.38	-0.55	-0.57	2.13	4.00	2.30	3.99	2.22
10-year interest rate (end of period)	1.42	0.47	0.06	0.60	3.66	4.32	4.17	4.32	5.60
Exchange rate vs. U.S. dollar (end of period)	1.15	1.12	1.23	1.13	1.07	1.05	1.07	1.05	1.07
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	0.5	-2.1	-0.9	-2.1	-1.1
P.S. non-financial lending (% YoY, average)	-1.9	0.0	2.0	3.4	2.2	-1.1	3.2	-1.1	2.7
P.S. financial lending (% YoY, average)	6.5	6.5	3.2	-0.8	-12.1	-1.0	2.5	-1.0	3.3
Savings rate (% pers. disp. income, avg.)	5.6	8.2	17.7	13.8	7.6	11.1	9.1	11.1	9.0

Source: MAPFRE Economics (based on INE data)
Forecast end date: October 30, 2023.

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1.2.4 Germany

The economy stagnated in Q2, and the outlook is complex.

According to the most recent data, the German economy contracted in Q3 2023 (-0.1% QoQ), thus marking four consecutive quarters of poor economic performance data. Moreover, with financial and energy costs on the rise, final consumer demand will be affected. Meanwhile, industrial production is down (-2.0%), and factory orders have also dropped (-10.2%). New construction orders are on a two-year downward trend, while the volume of construction activity is down nearly 20% from 2021 levels, with a 30% drop in residential construction. More expensive financing and energy are taking their toll on industrial activity levels. Uncertainty about future energy prices is influencing industrial planning, and automobile production has fallen by almost half in the last four years, in a relocation movement.

The IFO business confidence index is in the negative, with many sectors expecting significant contractions in business volume. Meanwhile, the construction outlook index (-33) and the expected business development index (-44) show negative data. The PMIs (purchasing managers' indexes) for October were in contraction territory, with the composite

Germany

- The German economy is stalling.
- More expensive financing and energy are taking their toll on industrial activity levels.
- Factory orders have dropped 10%.
- Construction is down 20% and the residential segment 30%.

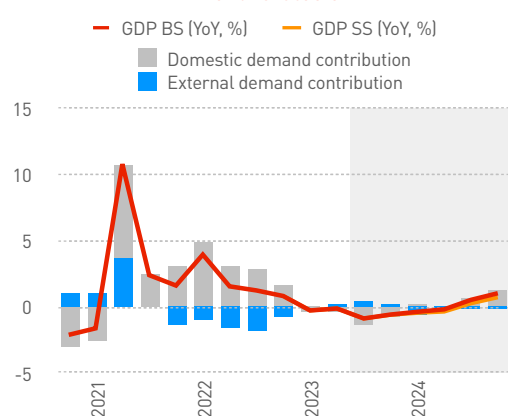
index at 45.8, the services index at 48.0, and the manufacturing index at 40.7 points. Retail sales are dropping in practically all categories (-4.6% in September). Automobile sales, meanwhile, remain strong, increasing 15.6% YoY. Consumer confidence remains at negative levels (-28.1 in September).

A recovery in economic activity levels is not expected for the coming quarters, due to the impact of high interest rates on the economy, with the 1-year Euribor reaching 4.22%, and the oil price shock (Brent 91 dollars/bl). In this context, German GDP growth estimates have been adjusted to a contraction of 0.5% in 2023, with a slight recovery of 0.3% in 2024, considering that the ECB is only expected to lower rates gradually from Q2 2024 onwards (see Table 1.2.4 and Charts 1.2.4-a and 1.2.4-b).

Meanwhile, October inflation stood at 3.8% YoY, a figure that benefits from the year-on-year comparison, but did not fall on a monthly basis (0.0% MoM). Among the main categories, food prices continued to rise (7.7% in September), followed by hotel and restaurant prices (6.6% in September). Harmonized inflation dropped to 3.0%.

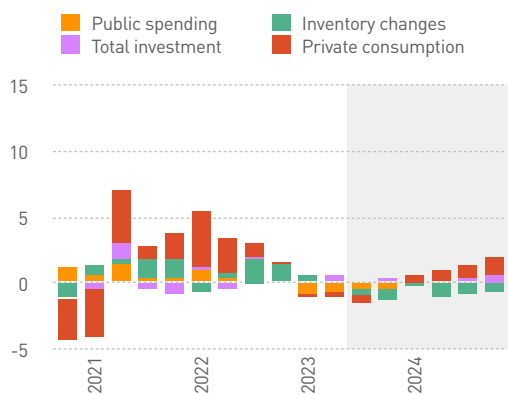
Among the main short-term risks to the German economy is the substantial drop in construction activity, which acts as an early warning sign of what may happen in the real estate sector. Industry also faces higher energy costs, as does activity in general, and inflation will suffer as a result of higher oil and gas prices. In addition, the rise in Euribor will weigh on households and businesses by reducing consumption and investment, as is already being felt in retail sales.

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)		Stressed (SS)	
						2023 ^(f)	2024 ^(f)	2023 ^(f)	2024 ^(f)
GDP (% YoY)	1.0	1.1	-4.2	3.1	1.9	-0.5	0.3	-0.6	0.0
Domestic demand contribution	1.6	1.4	-3.1	2.4	3.1	-0.8	0.5	-0.8	0.3
External demand contribution	-0.5	-0.3	-1.1	0.8	-1.3	0.3	-0.3	0.3	-0.3
Private consumption contribution	0.8	0.9	-3.2	0.8	2.0	-0.2	1.0	-0.2	0.9
Total investment contribution	0.7	0.4	-0.7	-0.1	0.1	0.2	0.3	0.2	0.2
Public spending contribution	0.2	0.5	0.8	0.7	0.3	-0.6	0.0	-0.6	0.0
Private consumption (% YoY)	1.5	1.6	-6.1	1.5	3.9	-0.5	1.8	-0.5	1.7
Public spending (% YoY)	0.8	2.6	4.1	3.1	1.6	-2.6	0.0	-2.6	0.0
Total investment (% YoY)	3.4	1.8	-3.2	-0.3	0.2	0.9	1.4	0.9	1.0
Exports (% YoY)	2.4	2.3	-10.0	9.5	3.5	-0.4	1.7	-0.4	1.4
Imports (% YoY)	4.1	3.4	-8.9	8.8	6.8	-1.0	2.6	-1.0	2.2
Unemployment rate (% , last quarter)	5.0	5.0	6.1	5.3	5.5	5.8	5.6	5.8	5.7
Inflation (% YoY, average)	1.8	1.4	0.5	3.1	6.9	6.0	2.0	6.1	2.5
Inflation (% YoY, last quarter)	2.0	1.2	-0.1	4.7	8.6	3.8	0.8	4.0	0.5
Fiscal balance (% of GDP)	1.9	1.5	-4.3	-3.6	-2.5	-2.6	-1.9	-2.6	-2.1
Primary fiscal balance (% of GDP)	2.8	2.3	-3.7	-3.1	-1.9	-1.8	-0.9	-1.8	-1.1
Current account balance (% of GDP)	8.0	8.4	7.0	7.8	4.3	5.9	5.3	5.9	4.9
Official interest rate (end of period)	0.00	0.00	0.00	0.00	2.50	4.50	3.00	4.50	3.25
3-month interest rate (end of period)	-0.31	-0.38	-0.55	-0.57	2.13	4.00	2.30	3.99	2.22
10-year interest rate (end of period)	0.25	-0.19	-0.58	-0.18	2.57	3.25	2.80	3.25	3.70
Exchange rate vs. U.S. dollar (end of period)	1.15	1.12	1.23	1.13	1.07	1.05	1.07	1.05	1.07
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	5.0	3.2	6.6	3.2	6.4
P.S. non-financial lending (% YoY, average)	9.1	4.7	4.5	3.6	7.7	4.4	3.9	4.4	3.9
P.S. financial lending (% YoY, average)	2.7	10.3	9.7	8.4	9.6	1.6	2.9	1.6	3.1
Savings rate (% pers. disp. income, avg.)	11.2	10.8	16.6	15.0	11.2	11.3	11.2	11.3	11.0

Source: MAPFRE Economics (based on DESTATIS data)
Forecast end date: October 30, 2023.

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1.2.5 Italy

The slowdown in the Italian economy has finally arrived.

After growing more than expected in Q1 2023, in Q2 the economy contracted 0.4% QoQ, while preliminary Q3 figures showed stagnation (0.0% QoQ), avoiding a recession, but reinforcing fears of weakness. Private consumption stagnated, and public spending contracted by 1.6% QoQ. In addition, investment dropped by 1.8% QoQ, while exports (-0.4%

QoQ) are already reflecting the lower demand from abroad. Italy depends heavily on tourism and industrial production, tranches that represent around 20% of GDP and, by their nature, are vulnerable to the global slowdown.

Italian industrial production has been declining for several months, although in August, the decline stopped with 0.2% growth YoY. However, the drop in energy consumption (-4.0% in July and -8.7% on the year) is indicative of a slowdown in progress. Retail sales fell 3.4% in July and an average of 3.0% year-to-date. Consumer confidence (101.6 points) continues to show weakness, and the momentum of previous months has eroded. The September purchasing managers' indexes

Italy

- 2023 GDP growth estimate is revised after a second quarter of contraction.
- Manufacturing and construction PMIs are in contraction territory.
- Budget deficit remains around -8%.
- Additionally, the cost of public debt is on the rise.

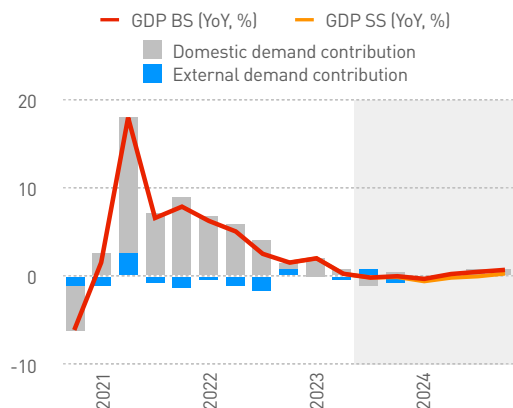
(PMIs) are negative, including services: manufacturing at 46.8, the composite at 49.2, and services at 49.9 points.

For the coming quarters, a slowdown is expected in all components of GDP, including public consumption due to the need to redirect the deficit, which has been very high since 2020. Consumption and investment will suffer due to inflation and the higher costs of financing, and exports due to the foreign context. Thus, due to the slowdown that is becoming apparent, the Italian GDP growth forecast has been adjusted downward to 0.6% for 2023 and 0.4% for 2024 (see Table 1.2.5 and Charts 1.2.5-a and 1.2.5-b).

Meanwhile, inflation continues to fall (1.8% in October compared to 5.3% in September), but the rise in fuel prices in recent months, coupled with wage revisions, will make it unlikely to continue declining at the same pace. With financing costs and wages on the rise, second-round effects for the Italian economy are to be expected. Core inflation stood at 4.5% and harmonized inflation at 1.9%, while producer prices fell 16.1% YoY. By main items, food is up by 6.9%, while transportation is up again by 5.3%, and fuels offer a negative contribution, declining by 17.7%.

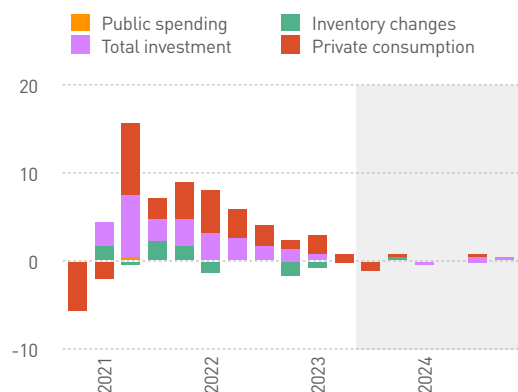
The main short-term risk for the Italian economy remains the government's level of debt, at a time when deficits are still very high (8% of GDP). The Italian Treasury will have to meet funding needs (approximately €15 billion/month) in a context of higher interest rates and the ECB in the process of balance-sheet reduction. The 10-year bond financing cost is approaching 4.8%, the highest in 10 years.

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

	2018	2019	2020	2021	2022	Baseline (BS)		Stressed (SS)	
						2023 ^(f)	2024 ^(f)	2023 ^(f)	2024 ^(f)
GDP (% YoY)	0.8	0.5	-9.0	8.3	3.9	0.6	0.4	0.6	0.0
Domestic demand contribution	1.1	-0.3	-8.2	8.3	4.4	0.7	0.3	0.6	-0.1
External demand contribution	-0.3	0.7	-0.9	0.0	-0.5	-0.1	0.0	-0.1	0.1
Private consumption contribution	0.6	0.1	-6.3	3.1	2.9	0.7	0.1	0.6	-0.2
Total investment contribution	0.5	0.2	-1.5	3.8	2.1	0.1	0.2	0.1	0.1
Public spending contribution	0.0	-0.1	0.0	0.3	0.1	-0.1	-0.1	-0.1	-0.1
Private consumption (% YoY)	1.0	0.2	-10.4	5.3	5.0	1.1	0.2	1.1	-0.3
Public spending (% YoY)	0.1	-0.6	0.1	1.5	0.7	-0.3	-0.3	-0.3	-0.3
Total investment (% YoY)	2.8	1.2	-8.0	20.7	10.1	0.7	1.1	0.6	0.3
Exports (% YoY)	1.5	1.8	-14.3	14.0	10.7	0.4	2.4	0.4	1.9
Imports (% YoY)	2.8	-0.5	-12.7	15.2	13.1	0.7	2.4	0.6	1.7
Unemployment rate (% , last quarter)	10.5	9.7	9.8	9.0	7.9	7.7	8.0	7.7	8.1
Inflation (% YoY, average)	1.1	0.6	-0.1	1.9	8.2	6.0	2.9	6.1	3.6
Inflation (% YoY, last quarter)	1.4	0.3	-0.2	3.5	11.7	2.2	2.6	2.6	3.4
Fiscal balance (% of GDP)	-2.2	-1.5	-9.6	-8.8	-8.0	-5.3	-4.6	-5.4	-4.9
Primary fiscal balance (% of GDP)	1.4	1.9	-6.1	-5.3	-3.7	-1.5	-0.3	-1.5	-0.6
Current account balance (% of GDP)	2.6	3.4	3.8	3.0	-1.2	0.7	0.3	0.6	-0.5
Official interest rate (end of period)	0.00	0.00	0.00	0.00	2.50	4.50	3.00	4.50	3.25
3-month interest rate (end of period)	-0.31	-0.38	-0.55	-0.57	2.13	4.00	2.30	3.99	2.22
10-year interest rate (end of period)	2.77	1.43	0.52	1.19	4.72	5.27	4.94	5.28	6.29
Exchange rate vs. U.S. dollar (end of period)	1.15	1.12	1.23	1.13	1.07	1.05	1.07	1.05	1.07
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	3.5	0.6	1.1	0.5	0.7
P.S. non-financial lending (% YoY, average)	-0.5	-0.6	3.7	0.9	1.9	-1.2	0.3	-1.3	-0.5
P.S. financial lending (% YoY, average)	25.1	-5.8	-10.3	22.7	26.0	7.9	1.9	7.8	1.5
Savings rate (% pers. disp. income, avg.)	9.6	9.5	17.0	15.2	9.5	8.5	9.2	8.5	9.1

Source: MAPFRE Economics (based on ISTAT data)
Forecast end date: October 30, 2023.

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1.2.6 United Kingdom

Inflation and high interest rates are starting to take their toll on economic activity.

The United Kingdom's economy grew by 0.6% YoY (0.2% QoQ) in Q2 2023. Consumption recovered slightly (0.2% YoY), government spending rose a bit (1.3% QoQ), investment improved (4.6% YoY), and exports rose moderately (3.2%). Additionally, unemployment remained low (4.3%), keeping the pressure on wage revisions high. A labor shortage is observed in some sectors, partly the result of post-Brexit immigration restrictions. This situation foreshadows second-round effects on inflation, which could rise again due to the increase in fuel prices. Retail sales fell by 1.4% in August, indicating that households are beginning to restrict their purchases, especially in food, which fell by 4.0%. However, automobile sales continued to grow (24.0%), driven by the pent-up demand in this sector.

United Kingdom

- The Bank of England paused interest rate hikes in September.
- The transmission of tightening monetary policy is starting to be reflected in the observed slowdown of economic activity.
- The pressure on wage negotiations may start to feed inflation.

Purchasing managers' indexes (PMIs) for the UK economy point to a worsening, with all three indexes in the contraction zone. Thus, the composite stands at 48.6 points, services at 49.2, and manufacturing at

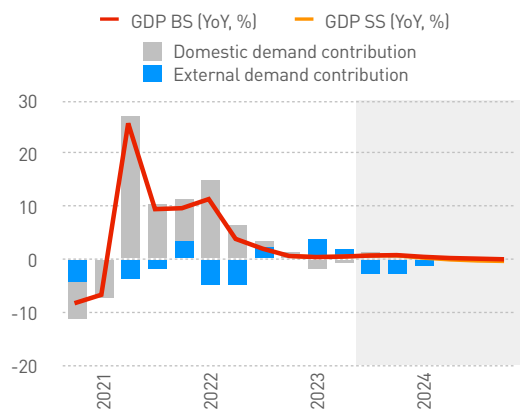
45.2. Consumer confidence (GFK) is recovering, although it remains negative (-21 in September). In this context, around 0.5% GDP growth is expected for 2023 and 0.3% for 2024 (see Table 1.2.6 and Charts 1.2.6-a and 1.2.6-b).

Inflation reached 6.7% in August and September, showing that it is becoming more difficult to reduce, especially given the pressure for higher wages. Core inflation dropped to 6.1%, from 6.2% in August. Food prices continue to accelerate (12.2%), household supplies are moderating (6.9%), while automotive fuels in August and September contributed to the moderation of inflation (-16.4% and -9.7%, respectively), although this easing will not continue in the coming months. Meanwhile, producer prices (supplies) contributed to disinflation (-2.3% in August), while finished products dropped 3.4%.

The Bank of England held interest rates at 5.25% at its September meeting, in line with market expectations. The Committee sees risks around the inflation forecast as skewed upward, albeit to a lesser extent than in May, reflecting the possibility that the second-round effects of external cost shocks on wage and domestic price inflation will take longer to reverse than they did to emerge. The Committee also voted unanimously to reduce the volume of U.K. government debt purchases for monetary policy purposes, financed by central bank reserve issues, by £100 billion over the next twelve months (to a total of £658 billion).

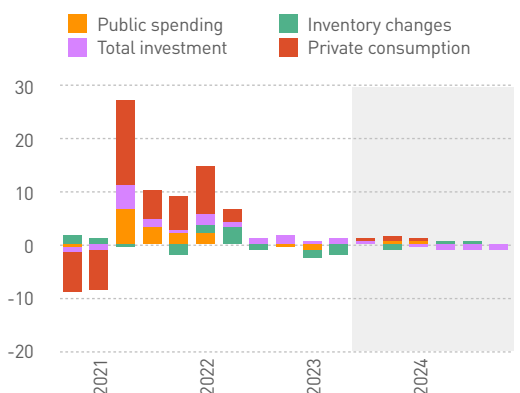
Short-term risks to the UK economy continue to include inflation, due to second-round effects from the pressure of wage revisions, food, and fuel prices. As the pressure is already being felt in household pockets, we may begin to see some lower prices in services. There is also grow-

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

	2018	2019	2020	2021	2022	Baseline (BS)		Stressed (SS)	
						2023 ^(f)	2024 ^(f)	2023 ^(f)	2024 ^(f)
GDP (% YoY)	1.4	1.6	-10.4	8.7	4.3	0.5	0.3	0.4	0.0
Domestic demand contribution	0.5	1.8	-11.4	8.5	5.7	0.1	0.2	0.0	-0.2
External demand contribution	0.0	-0.3	1.7	-0.4	-1.7	0.0	-0.4	0.0	-0.3
Private consumption contribution	1.0	0.7	-8.0	4.5	2.9	0.5	0.1	0.5	-0.1
Total investment contribution	-0.1	0.4	-2.0	1.3	1.4	0.5	-0.7	0.5	-0.8
Public spending contribution	0.1	0.7	-1.5	2.9	0.5	0.1	0.5	0.1	0.5
Private consumption (% YoY)	1.7	1.1	-13.0	7.5	4.9	0.8	0.2	0.8	-0.2
Public spending (% YoY)	0.6	4.0	-7.9	14.9	2.5	0.6	2.3	0.6	2.3
Total investment (% YoY)	-0.5	2.2	-10.8	7.4	7.9	2.8	-3.7	2.7	-4.2
Exports (% YoY)	3.1	2.0	-11.5	4.9	8.6	-0.2	1.5	-0.2	1.4
Imports (% YoY)	3.1	2.7	-16.0	6.1	14.1	-0.2	2.5	-0.2	2.2
Unemployment rate (% , last quarter)	4.0	3.8	5.2	4.0	3.7	4.4	4.8	4.4	4.9
Inflation (% YoY, average)	2.5	1.8	0.9	2.6	9.1	7.4	3.4	7.5	4.0
Inflation (% YoY, last quarter)	2.3	1.4	0.6	4.9	10.8	4.5	2.6	4.9	3.0
Fiscal balance (% of GDP)	-2.2	-2.5	-13.0	-7.9	-4.6	-5.7	-4.2	-5.7	-4.3
Primary fiscal balance (% of GDP)	0.5	0.0	-10.9	-5.0	0.3	-0.6	0.7	-0.6	0.6
Current account balance (% of GDP)	-3.9	-2.7	-2.9	-0.5	-3.3	-2.8	-2.8	-2.9	-3.1
Official interest rate (end of period)	0.75	0.75	0.00	0.25	3.50	5.25	4.75	5.25	5.00
3-month interest rate (end of period)	0.91	0.79	0.03	0.26	3.87	5.41	4.91	5.41	4.91
10-year interest rate (end of period)	1.27	0.83	0.20	0.97	3.67	4.89	4.74	4.88	5.73
Exchange rate vs. U.S. dollar (end of period)	1.28	1.32	1.36	1.35	1.20	1.22	1.24	1.22	1.24
Exchange rate vs. euro (end of period)	1.11	1.18	1.11	1.19	1.13	1.16	1.15	1.16	1.16
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	2.2	2.5	3.3	2.0	2.2	1.6	2.2	1.6
P.S. non-financial lending (% YoY, average)	2.1	1.2	10.2	0.5	1.4	4.2	2.9	4.2	2.9
P.S. financial lending (% YoY, average)	9.5	1.9	11.8	-1.5	10.9	1.2	4.1	1.2	4.3
Savings rate (% pers. disp. income, avg.)	5.3	5.5	16.8	12.5	8.1	8.4	7.6	8.3	7.4

Source: MAPFRE Economics (based on data from the Office for National Statistics)
Forecast end date: October 30, 2023.

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ing evidence of the impact of tight monetary policy on the labor market and on the momentum of the real economy in general. Although the rhetoric is for higher interest rates for longer, the risk remains that too much tightening will cause medium-term damage to the labor market, investment and activity in general.

1.2.7 Japan

Trend toward depreciation of the yen while maintaining a lax monetary policy.

The Japanese economy grew 1.6% YoY (1.2% QoQ) in Q2 2023, with private and public consumption abruptly braking (0.4% YoY and 0.4% YoY, respectively). Residential investment improved (3.5%), while exports rose 3% and imports dropped (-1.7%), maintaining a surplus current account balance typical of an exporting country (2.2% of GDP). Retail sales continue to grow (rising 1.7% YoY in August, 0.5% MoM). Likewise, the leading indicators index has improved with respect to the previous quarter, standing at 108.2 in July. Purchasing managers' indexes (PMIs) dropped in September: the composite at 52.1 points, manufacturing at 48.5, and services at 53.8. Meanwhile, consumer confidence recovered, although it remains negative (-35.9). In this context, the estimate for Japanese GDP growth stands at 1.6% in 2023 and 1.1% in 2024 (see Table 1.2.7 and Charts 1.2.7-a and 1.2.7-b).

Inflation, on the other hand, seems to have stabilized (3.0% national CPI in September, and 2.8% Tokyo CPI September) thanks to lower electricity and gas costs, while fuels have risen again. Food increased 8.8%, putting pressure on the consumer. Meanwhile, pro-

ducer prices rose again (11.4%), especially export prices (15.8%). Core inflation stood at 2.7% in August, at the highest levels of the last 30 years.

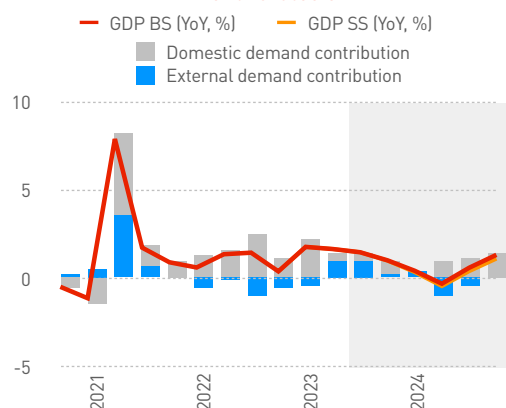
The Bank of Japan held interest rates on deposits negative at -0.10% at its October meeting. With respect to long-term rates, the central bank will continue to buy as many bonds as necessary to continue controlling the interest rate curve, thus maintaining the 10-year bond yield at a higher range than the previous one, raising it to 1.0%. The Bank of Japan will also continue to buy ETFs (exchange-traded funds) and real estate funds up to 12 trillion yen and 180 billion yen, respectively. In addition, the central bank will continue to purchase commercial paper in order to maintain the portfolio at 2 trillion yen, as well as corporate bonds to maintain the portfolio at about 3 trillion yen. This monetary policy is the loosest among developed countries, with M2 money supply expansion of 2.5%.

Short-term risks affecting the outlook for the Japanese economy include: the performance of the yen, impact of interest rate hikes on global financial markets and their influence on financial flows, slowdown in the external environment affecting export performance and industrial production, rising raw material prices, and generalized price increases

Japan

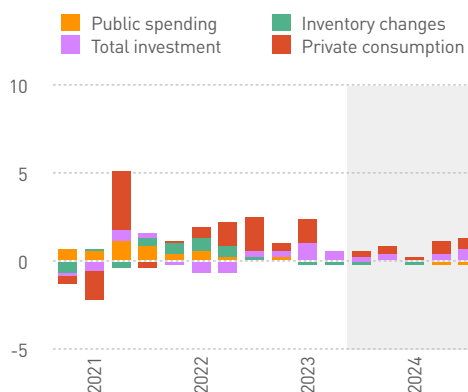
- Inflation in Japan has stabilized despite being at its highest levels in the last 30 years.
- The manufacturing and export sectors have been affected by the global economic slowdown.
- The exchange rate becomes a risk to monitor.

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

	2018	2019	2020	2021	2022	Baseline (BS)		Stressed (SS)	
						2023 ^(f)	2024 ^(f)	2023 ^(f)	2024 ^(f)
GDP (% YoY)	0.6	-0.4	-4.3	2.3	1.0	1.6	1.1	1.5	0.8
Domestic demand contribution	0.6	0.1	-3.4	1.3	1.6	0.9	0.9	0.9	0.7
External demand contribution	0.0	-0.5	-0.9	1.2	-0.5	0.4	-0.2	0.4	-0.2
Private consumption contribution	0.1	-0.3	-2.6	0.2	1.1	0.6	0.5	0.6	0.4
Total investment contribution	0.1	0.1	-0.9	0.1	-0.2	0.4	0.4	0.4	0.3
Public spending contribution	0.2	0.4	0.5	0.7	0.3	0.0	-0.1	0.0	-0.1
Private consumption (% YoY)	0.2	-0.6	-4.7	0.4	2.1	1.1	1.0	1.1	0.8
Public spending (% YoY)	1.0	1.9	2.4	3.5	1.2	0.1	-0.6	0.1	-0.6
Total investment (% YoY)	0.6	0.5	-3.6	0.3	-0.9	1.8	1.6	1.8	1.3
Exports (% YoY)	3.8	-1.4	-11.7	12.0	5.1	0.6	0.4	0.6	0.1
Imports (% YoY)	3.8	1.1	-6.8	5.1	8.0	-1.4	1.6	-1.4	1.3
Unemployment rate (% , last quarter)	2.4	2.3	3.0	2.7	2.5	2.5	2.4	2.5	2.4
Inflation (% YoY, average)	1.0	0.5	0.0	-0.2	2.5	3.0	2.1	3.1	2.4
Inflation (% YoY, last quarter)	0.9	0.5	-0.9	0.5	3.9	2.3	1.0	2.4	1.3
Fiscal balance (% of GDP)	-2.5	-3.0	-9.0	-6.2	-5.7	-5.1	-4.4	-5.1	-4.5
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)	3.5	3.4	2.9	3.9	2.0	3.2	2.7	3.2	2.3
Official interest rate (end of period)	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
3-month interest rate (end of period)	0.07	0.07	0.08	0.07	0.06	0.06	0.06	0.06	0.05
10-year interest rate (end of period)	0.01	-0.02	0.04	0.09	0.45	0.91	0.91	0.91	1.40
Exchange rate vs. U.S. dollar (end of period)	110.83	109.12	103.54	115.00	132.65	151.53	138.61	151.60	138.58
Exchange rate vs. euro (end of period)	126.90	122.59	127.05	130.25	141.48	159.10	148.55	159.08	148.37
Private lending (% YoY, average)	2.6	1.9	5.2	3.2	2.8	3.2	0.1	3.2	0.0
Household lending (% YoY, average)	2.5	2.2	3.2	3.8	1.9	1.5	-0.1	1.5	-0.2
P.S. non-financial lending (% YoY, average)	2.3	3.6	7.9	3.5	2.8	1.4	-2.3	1.4	-2.3
P.S. financial lending (% YoY, average)	6.3	2.9	17.1	7.3	7.5	1.7	0.9	1.7	0.9
Savings rate (% pers. disp. income, avg.)	1.8	3.3	11.4	7.8	5.3	2.7	2.4	2.7	2.3

Source: MAPFRE Economics (based on Statistics Bureau data)
Forecast end date: October 30, 2023.

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in the global environment. The central bank's policy will remain expansionary, when the rest of the world has turned towards restrictive policies, so it will continue to influence the exchange rate's evolution.

1.2.8 Turkey

The central bank seems to return to monetary orthodoxy.

The Turkish GDP grew 3.8% on a non-seasonally adjusted basis (+5.0% when seasonally adjusted) in Q2 2023 (+3.5% QoQ when seasonally adjusted). Consumption remains strong, growing by 15.6%, thanks in part to the still lax financial conditions brought about by the unorthodox monetary policy maintained by the central bank. Investments, both direct and portfolio investment, continue to recover, although they are far from the levels observed in 2010–2015. Meanwhile, exports performed unfavorably in Q2 (-9.0%), but improved in July, while imports grew in line with the strength of consumption (+20.3%).

Turkey

- The central bank appears to have returned to monetary orthodoxy, with interest rates already standing at 30%.
- The economy remains strong for consumption, and real financial conditions are still relatively lax.
- The Turkish lira has temporarily slowed its previous pace of depreciation.

The purchasing managers' index (PMIs) for manufacturing in September stood at 49.6 points, in contraction territory. Retail sales, meanwhile, are very strong, growing by more than 30% in real terms, one of the effects of high inflation. Consumer confidence has rebound-

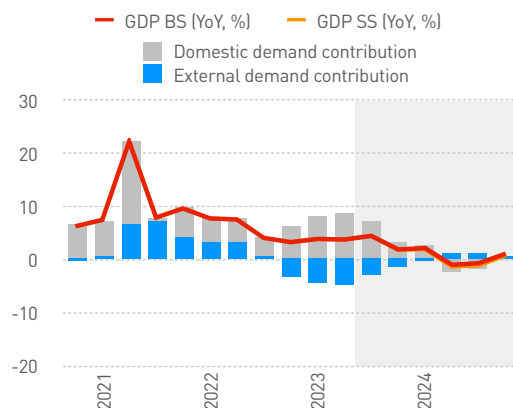
ed (69), but is still below its historical average, and automobile sales remain strong. With Q3 now complete, and with activity indicators available, the GDP growth forecast has been revised upward to 3.7% for 2023 and to 2.0% for 2024 (see Table 1.2.8 and Charts 1.2.8-a and 1.2.8-b).

Inflation in Turkey increased in August and September (59.0% and 61.5%, respectively), interrupting the trend of moderation. By category, food rose 73%, transportation 70%, and lodging, at a seasonal high, nearly 90%. Core inflation climbed to 55%, and producer prices rose 49%. The Turkish lira has reached nearly 27/USD and 29/EUR, and despite the recent, temporary stabilization, it is expected to continue depreciating.

The Central Bank of Turkey raised interest rates in October (Repo at 1 week) 500 basis points to 35%, returning to a more orthodox policy. Even so, real short-term interest rates remain negative. The central bank decided to continue tightening its monetary policy to establish a disinflationary course as soon as possible, anchor inflation expectations, and control the deterioration in pricing behavior. The bank continues to act with different mechanisms to promote an increase in deposits in liras, and therefore strengthen the transmission of the monetary policy. In this regard, the committee will continue to take quantitative tightening and selective credit tightening measures to support the monetary stance.

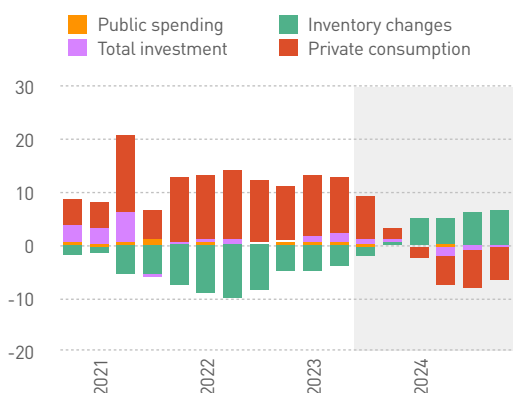
The main short-term risk to the Turkish economy relates to rising energy prices, which started to derail inflation control. However, the improvement in foreign direct investment, together with the improvement in external financing conditions, continued to increase foreign currency reserves. Moreover, the positive impact of tourism on the current ac-

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

	2018	2019	2020	2021	2022	Baseline (BS)		Stressed (SS)	
						2023 ^(f)	2024 ^(f)	2023 ^(f)	2024 ^(f)
GDP (% YoY)	3.0	0.8	1.9	11.4	5.5	3.7	2.0	3.6	1.4
Domestic demand contribution	-0.6	-1.6	7.0	6.6	4.7	6.7	-0.4	6.7	-0.8
External demand contribution	3.6	2.4	-5.2	4.9	0.8	-3.2	0.8	-3.2	0.9
Private consumption contribution	0.4	0.9	1.9	9.2	11.7	7.8	-5.4	7.7	-5.7
Total investment contribution	0.0	-3.6	1.8	1.9	0.3	1.0	-0.7	1.0	-0.9
Public spending contribution	0.8	0.5	0.3	0.4	0.6	0.2	-0.2	0.2	-0.2
Private consumption (% YoY)	0.7	1.5	3.2	15.4	18.9	11.2	-7.2	11.1	-7.6
Public spending (% YoY)	5.9	3.9	2.2	3.0	4.2	1.6	-1.3	1.6	-1.3
Total investment (% YoY)	0.1	-12.5	7.3	7.2	1.3	4.3	-2.9	4.3	-3.6
Exports (% YoY)	9.1	5.3	-14.6	25.1	9.9	-4.2	1.9	-4.2	1.8
Imports (% YoY)	-6.2	-5.0	6.7	2.4	7.9	10.3	-1.5	10.2	-2.2
Unemployment rate (% , last quarter)	12.3	13.3	12.9	11.0	10.1	10.2	10.4	10.2	10.5
Inflation (% YoY, average)	16.3	15.2	12.3	19.6	72.3	50.9	51.6	51.3	63.1
Inflation (% YoY, last quarter)	22.4	10.3	13.5	25.8	77.4	61.2	35.9	62.1	46.9
Fiscal balance (% of GDP)	-1.9	-2.9	-3.5	-2.7	-0.9	-2.5	-3.1	-2.5	-3.1
Primary fiscal balance (% of GDP)	0.0	-0.6	-0.8	-0.2	1.2	0.0	-1.0	0.0	-1.0
Current account balance (% of GDP)	-2.6	1.4	-4.4	-0.9	-5.4	-4.9	-2.9	-5.0	-3.5
Official interest rate (end of period)	24.00	11.50	17.00	14.00	9.00	35.00	35.75	35.00	36.25
3-month interest rate (end of period)	24.07	10.35	17.25	16.32	10.35	36.51	29.67	36.54	30.03
10-year interest rate (end of period)	16.53	11.95	12.51	22.99	9.50	28.66	24.19	28.68	27.35
Exchange rate vs. U.S. dollar (end of period)	5.29	5.95	7.44	13.32	18.69	28.71	30.38	28.71	30.35
Exchange rate vs. euro (end of period)	6.06	6.68	9.11	15.23	19.96	30.15	32.56	30.13	32.49
Private lending (% YoY, average)	20.2	8.4	30.1	23.9	54.8	57.6	19.6	57.6	19.4
Household lending (% YoY, average)	0.1	-2.4	32.1	16.2	25.9	57934.5	46996.6	57926.7	46924.4
P.S. non-financial lending (% YoY, average)	18.2	5.5	29.0	23.2	56.3	119.4	94.7	119.2	93.7
P.S. financial lending (% YoY, average)	25.1	18.3	21.1	31.6	105.5	68.3	43.1	68.2	42.6
Savings rate (% pers. disp. income, avg.)	32.0	30.4	20.9	22.7	10.6	19.1	20.6	19.0	20.3

Source: MAPFRE Economics (based on TURKSTAT data)
Forecast end date: October 30, 2023.

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count and increase in domestic and foreign demand due to the Turkish lira could contribute to price stabilization.

1.2.9 Mexico

The economy is rebounding on strong investment and a strengthened currency.

The Mexican economy grew by 3.6% in the second quarter of the year (0.8% QoQ). Private consumption remained strong, up 4.3% YoY. Investment also showed lots of momentum, with a 21.0% increase, driven in part by the relocation of global production chains (nearshoring). However, exports are declining due to the slowdown of global demand, especially in the United States. Industrial production grew by nearly 5.0%, thanks to construction (mainly infrastructure), automobile manufacturing, and oil production. Likewise, retail sales continue to grow (+5.2% in July), although month-on-month a cooling (+0.2% MoM) is starting to be observed.

Business confidence is high (53.5 points), while consumer confidence also continues to improve and is at a four-year high. The purchasing managers' index (PMI) in September stood at 49.8 points,

Mexico

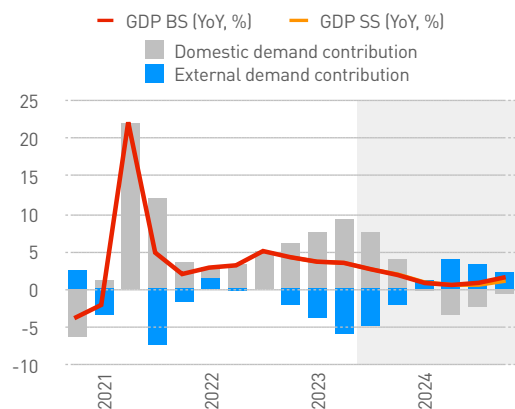
- The GDP growth forecast for 2023 has been revised upward based on strong economic performance so far this year.
- Consumption remains strong, although it should slow down in the remainder of the year.
- The currency has strengthened due to investment flows into the country.

still in contraction territory, and automobile production continues on an upward trend. Thus, given the improved data from the first half of the year and the catalysts of consumption and investment, the Mexican GDP growth forecast has been revised upward to 2.9% for 2023 and 1.8% for 2024 (see Table 1.2.9 and Charts 1.2.9-a and 1.2.9-b).

Meanwhile, inflation has continued to ease, at 4.5% in September, although it is still far from the target range. Core inflation remains high at 6.1%. By major categories, food is up nearly 8.5%, housing has risen 3.6%, fuels are up 2.0%, and the price of flights has increased again (10.0%). Thus, inflation is expected to continue to moderate, but the recent upturn in oil prices added to higher financial costs may alter this trend, making it trickier to reach the central bank's target range.

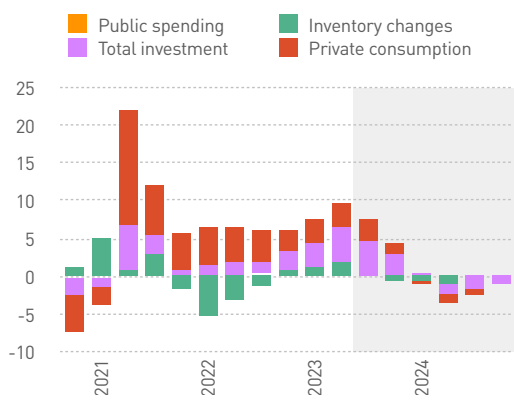
The Bank of Mexico held reference interest rates at 11.25% at its September meeting. As noted above, the disinflation process is still underway, but core inflation remains high, which could cause the central bank to be in no hurry to begin the process of reducing monetary policy interest rates. Meanwhile, given the positive real interest rates (around 7.0%) and the significant flows of foreign direct and portfolio investment into the Mexican economy, the peso underwent a revaluation process that, by the end of August, had brought it close to 17 pesos/dollar. However, this situation could be reversed, at least partially, in the short term, since monetary policy interest rates seem to have reached a ceiling in Mexico, while in the United States there could be yet another increase in the remainder of the year. Meanwhile, recent geopolitical events could alter portfolio investment flows, a situation that has already been observed with a certain decline in the value of the peso against the dollar in September and October.

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

	2018	2019	2020	2021	2022	Baseline (BS)		Stressed (SS)	
						2023 ^(f)	2024 ^(f)	2023 ^(f)	2024 ^(f)
GDP (% YoY)	2.0	-0.3	-8.8	6.1	3.9	2.9	1.8	2.9	1.3
Domestic demand contribution	1.7	-1.2	-11.0	9.2	4.0	7.1	-1.7	7.1	-1.8
External demand contribution	0.2	0.9	2.1	-3.1	-0.1	-4.1	2.7	-4.1	2.7
Private consumption contribution	1.0	0.8	-7.4	5.5	4.2	2.7	-0.4	2.7	-0.5
Total investment contribution	0.1	-1.0	-3.8	1.9	1.8	3.7	-1.0	3.7	-1.0
Public spending contribution	0.3	-0.2	-0.1	-0.1	0.1	0.1	0.1	0.1	0.1
Private consumption (% YoY)	1.4	1.1	-10.8	8.2	6.2	3.8	-0.6	3.8	-0.7
Public spending (% YoY)	3.1	-1.6	-0.7	-0.5	1.3	1.3	1.0	1.3	1.0
Total investment (% YoY)	0.6	-4.4	-17.3	9.3	8.5	17.2	-4.0	17.3	-4.2
Exports (% YoY)	6.5	1.3	-7.2	7.4	9.1	-3.4	4.4	-3.4	3.7
Imports (% YoY)	5.6	-1.0	-12.3	15.4	8.9	6.0	-2.0	6.0	-2.6
Unemployment rate (% , last quarter)	3.3	3.4	4.5	3.7	3.0	3.2	3.8	3.2	3.9
Inflation (% YoY, average)	4.9	3.6	3.4	5.7	7.9	5.6	4.1	5.9	4.2
Inflation (% YoY, last quarter)	4.8	2.9	3.5	7.0	8.0	4.6	3.9	4.7	4.1
Fiscal balance (% of GDP)	-2.0	-1.6	-2.7	-2.9	-3.2	-3.6	-4.7	-3.6	-5.0
Primary fiscal balance (% of GDP)	0.6	1.1	0.1	-0.3	-0.4	-0.4	-1.5	-0.4	-1.7
Current account balance (% of GDP)	-2.1	-0.4	2.0	-0.6	-1.2	-0.6	-0.2	-0.6	-0.4
Official interest rate (end of period)	8.25	7.25	4.25	5.50	10.50	11.25	9.75	11.25	10.25
3-month interest rate (end of period)	8.63	7.45	4.47	5.86	10.97	11.25	7.27	11.27	7.77
10-year interest rate (end of period)	8.70	6.84	5.23	7.57	9.02	10.68	9.00	10.67	10.89
Exchange rate vs. U.S. dollar (end of period)	19.65	18.93	19.88	20.50	19.49	17.57	19.16	17.55	18.96
Exchange rate vs. euro (end of period)	22.50	21.26	24.40	23.22	20.79	18.45	20.53	18.41	20.30
Private lending (% YoY, average)	10.4	8.9	5.2	-1.0	7.4	9.8	4.9	9.9	4.7
Household lending (% YoY, average)	8.4	6.2	1.6	4.4	9.2	9.1	3.7	9.1	3.5
P.S. non-financial lending (% YoY, average)	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
P.S. financial lending (% YoY, average)	-0.8	6.2	3.7	18.3	8.7	3.7	14.5	3.7	14.5
Savings rate (% pers. disp. income, avg.)	6.9	11.4	17.2	18.6	18.7	19.8	17.5	19.8	17.5

Source: MAPFRE Economics (based on INEGI data)
Forecast end date: October 30, 2023.

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The main short-term risk to the Mexican economy is a sharp recession in the United States during Q1 2024, which would spill over to industrial production. Otherwise, the outlook appears to be generally positive, given the high levels of investment due to the nearshoring effect, an expected change in the monetary policy cycle, improving confidence levels, and a strengthened currency against the U.S. dollar that contributes to the disinflationary process.

1.2.10 Brazil

Dynamic growth in 2023, but a slowdown is expected in 2024.

Brazil's economic growth slowed to 3.4% in Q2 2023 (+0.9% QoQ), from the 4.0% registered in the previous quarter. Private consumption grew 3.0%, government spending was up 2.9%, and investment dropped 2.5%, while exports performed well with 12.0% growth. Industrial production in Brazil dropped 1.1% in July, keeping the pace with the slowdown of general economic activity. Investment should decline due to the persistent tightening of conditions for financing to companies. Consumer confidence is improving thanks to inflationary control, although it rose somewhat in August. The PMIs (purchasing managers' indexes) were down in September, with the composite index at 49.0, the services index at 48.7, and the manufacturing index at 49.0 points. The reduced pace of economic activity in Q2, however, does not change the conservative GDP growth forecasts. Strong consumption and exports allow growth to be revised upward to 3.1% in 2023 and 1.5% by 2024 (see Table 1.2.10 and Charts 1.2.10-a and 1.2.10-b).

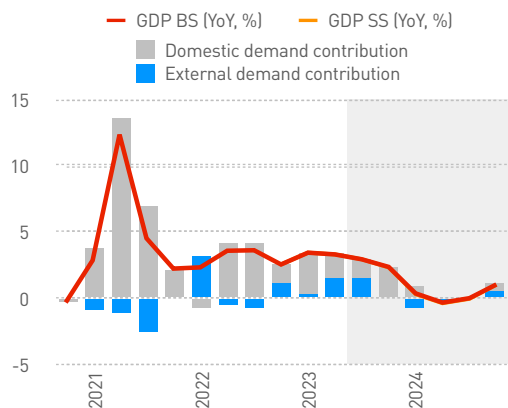
The decline in inflation stagnated in June, rebounding to 4.6% in August and 5.2% in September. Food increased less (1.0%), but pressures remained in categories like clothing (7.5%) and health (9.3%), while fuels reversed the trend and are up again (1.0% in August). At its September meeting, the Central Bank of Brazil cut the SELIC interest rate 50 bps to 12.75%. With this decision, the central bank expects inflation to converge to target over 2024 and 2025, stabilizing prices, smoothing fluctuations in the level of economic activity, and boosting employment. The monetary policy committee believes that continued tight policy (high real interest rates) is necessary to consolidate the disinflation process and to anchor inflation expectations around the target.

In terms of short-term risks to the Brazilian economy, the risk of higher fiscal deficits due to spending pressure on social measures persists. Global inflationary pressures, including oil prices, will prevent further moderation of inflation in the near term. Moreover, from the activity standpoint, the slowdown in the global economy may moderate Brazilian exports, while consumption will remain subdued due to restrictive interest rates.

Brazil

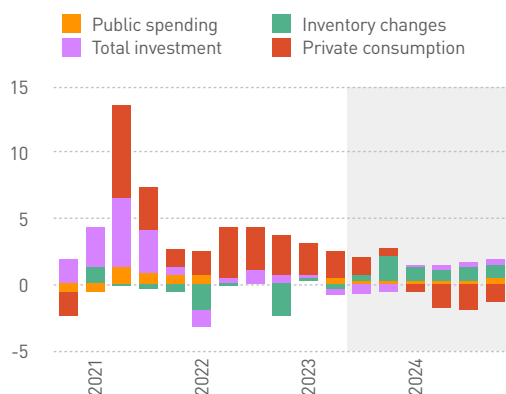
- Inflation has dropped, although further declines may face difficulty.
- The central bank has cut interest rates, but they will remain at still restrictive levels.
- Ongoing restrictive financing conditions and the external environment will lead to a slowdown of economic activity in 2024.

Chart 1.2.10-a
Brazil: GDP breakdown
and forecasts



Source: MAPFRE Economics (based on data from the Instituto Brasileiro de Geografia e Estatística [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 Instituto Brasileiro de Geografia e Estatística [Brazilian Institute of Geography and Statistics, IBGE])

Table 1.2.10
Brazil: main macroeconomic aggregates

	2018	2019	2020	2021	2022	Baseline (BS)		Stressed (SS)	
						2023 ^(f)	2024 ^(f)	2023 ^(f)	2024 ^(f)
GDP (% YoY)	1.7	1.2	-3.6	5.3	3.0	3.1	1.5	3.0	1.0
Domestic demand contribution	2.4	1.8	-4.9	6.4	2.2	2.1	0.3	2.1	0.3
External demand contribution	-0.8	-0.6	1.3	-1.1	0.8	0.9	-0.1	0.9	-0.1
Private consumption contribution	1.6	1.8	-3.4	2.8	2.9	1.7	-1.4	1.7	-1.4
Total investment contribution	0.8	0.7	-0.3	2.9	0.2	-0.4	0.4	-0.4	0.4
Public spending contribution	0.1	-0.1	-0.6	0.6	0.3	0.3	0.4	0.3	0.4
Private consumption (% YoY)	2.4	2.6	-4.9	4.0	4.3	2.4	-2.0	2.4	-2.0
Public spending (% YoY)	0.8	-0.5	-3.7	3.5	1.5	2.0	2.3	2.0	2.3
Total investment (% YoY)	5.2	4.0	-1.7	16.6	0.8	-2.1	2.3	-2.1	2.3
Exports (% YoY)	3.6	-2.5	-2.7	6.5	5.9	5.5	-2.9	5.5	-3.1
Imports (% YoY)	7.7	1.3	-9.4	12.1	0.6	-0.1	-2.2	-0.1	-2.3
Unemployment rate (% , last quarter)	11.7	11.1	14.2	11.1	7.9	8.1	8.3	8.1	8.3
Inflation (% YoY, average)	3.7	3.7	3.2	8.3	9.3	4.7	4.3	4.7	4.5
Inflation (% YoY, last quarter)	4.1	3.4	4.3	10.5	6.1	5.0	4.0	5.2	4.3
Fiscal balance (% of GDP)	-7.0	-5.8	-13.3	-4.3	-4.6	-7.9	-8.5	-7.9	-8.5
Primary fiscal balance (% of GDP)	-1.5	-0.8	-9.2	0.7	1.3	-1.1	-0.6	-1.1	-0.5
Current account balance (% of GDP)	-2.8	-3.6	-1.9	-2.8	-2.8	-1.7	-3.1	-1.6	-2.7
Official interest rate (end of period)	6.50	4.50	2.00	9.25	13.75	11.75	9.50	11.75	9.75
3-month interest rate (end of period)	6.40	4.40	1.90	9.15	13.65	11.66	9.36	11.68	9.55
10-year interest rate (end of period)	9.24	6.81	6.98	10.31	12.76	12.68	12.00	12.68	13.56
Exchange rate vs. U.S. dollar (end of period)	3.87	4.03	5.20	5.58	5.22	5.08	5.19	5.05	5.06
Exchange rate vs. euro (end of period)	4.44	4.53	6.38	6.32	5.56	5.33	5.57	5.30	5.42
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	11.8	8.5	11.8	8.5
P.S. non-financial lending (% YoY, average)	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
P.S. financial lending (% YoY, average)	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Savings rate (% pers. disp. income, avg.)	16.4	15.8	19.0	22.2	20.2	19.0	19.9	19.0	19.8

Source: MAPFRE Economics (based on data from the Brazilian Institute of Geography and Statistics (IBGE))
Forecast end date: October 30, 2023.

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1.2.11 Argentina

Slower growth and rising momentum behind inflation increase the risk of recession in 2024.

The Argentine economy contracted sharply in the second quarter by 4.9% YoY (-2.8% QoQ), after growing by 1.4% YoY (+0.9% QoQ) in the first quarter. Private consumption rose 0.8% YoY, but its seasonally adjusted (s.a.) quarterly contraction was 2.8% YoY. Exports fell by 10.9% YoY (-4.1% QoQ, s.a.) and imports rose by 4.3% YoY. Investment also declined 1.1% YoY. These figures reveal a complex outlook, with inflation on the rise and far from being under control, in a slowing global context and with higher financial costs.

Economic activity in Argentina in 2023 has been affected by the drought, which reduced agricultural production. Government consumption continues to grow, with elections in November, resulting in a fiscal deficit that widened in the second quarter to 4.4% of GDP. Industrial production started to drop in June and July, by 2.4% and 3.9%, respectively, with construction again accelerating its decline (-5.8% in July), while automobile production has been doing well and

Argentina

- The economy contracted in the second quarter.
- Inflation reaches 138% and maintains an upward trend.
- The central bank raises interest rates 15 percentage points and continues the currency devaluation process.
- The risk of a recession in 2024 increases.

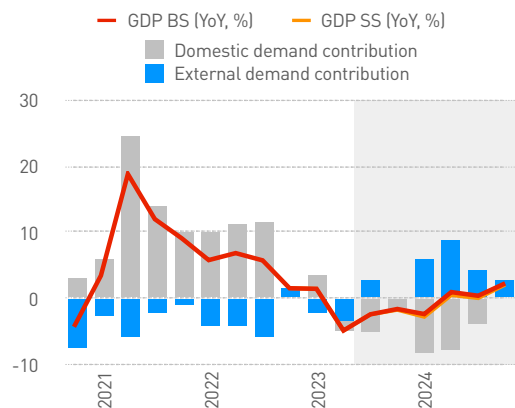
even accelerated (+17.4% YoY in August). In this context, the Argentine GDP growth forecast for 2023 has been revised downward to -2.2%, as poor forecasts for consumption and exports have materialized, while investment is also falling in a context of higher financial costs and economic slowdown. For 2024, growth is forecast at just 0.2% and subject to downside risks (see Table 1.2.11 and Charts 1.2.11-a and 1.2.11-b).

Inflation in Argentina continues to climb (138.3% in August), with core inflation at 140.2%. According to the expectations survey conducted by the central bank in late August, analysts expect inflation to stand at 169% throughout 2023, compared to their estimate of 141% in July. Price increases are occurring in all segments: food, clothing, transportation, restaurants, goods and services. Likewise, the money supply (M2) is growing less, but still continues to grow at 56%.

At its October meeting, the central bank decided to raise the 28-day LELIQ benchmark interest rate by 15 percentage points to 133% (209% effective annual rate). At the same time, the official exchange rate has risen to 350 ARS/USD. The monetary authority has seen fit to readjust interest rates, in line with the recalibration of the official exchange rate. The goal is to anchor exchange rate expectations and minimize the degree of pass-through to prices, seeking positive real returns on investments in local currency and favoring the accumulation of international reserves.

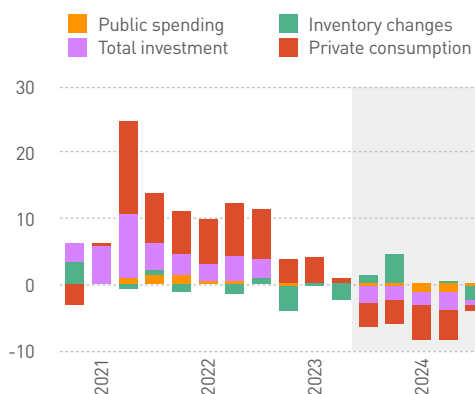
With elections in November, short-term risks for the Argentine economy are on the downside and stem from the difficulty in executing the adjustments the economy requires. The adjustment to the exchange rate is an effort to stabilize the markets and align the official exchange

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

	2018	2019	2020	2021	2022	Baseline (BS)		Stressed (SS)	
						2023 ^(f)	2024 ^(f)	2023 ^(f)	2024 ^(f)
GDP (% YoY)	-2.6	-2.0	-9.9	10.7	5.0	-2.2	0.2	-2.5	-0.4
Domestic demand contribution	-4.1	-9.5	-10.0	13.4	8.1	-1.1	-5.0	-1.1	-5.5
External demand contribution	1.5	7.5	0.1	-2.7	-3.1	-0.8	5.3	-0.8	5.4
Private consumption contribution	-1.7	-4.6	-8.7	7.2	6.7	-0.8	-2.6	-0.8	-2.9
Total investment contribution	-1.2	-3.2	-2.2	5.6	2.2	-1.1	-1.4	-1.1	-1.5
Public spending contribution	-0.3	-0.9	-0.3	0.9	0.3	0.0	-0.6	0.0	-0.6
Private consumption (% YoY)	-2.2	-6.1	-12.2	10.4	9.7	-1.1	-3.5	-1.1	-4.0
Public spending (% YoY)	-1.9	-6.4	-2.0	6.3	1.9	0.1	-4.1	0.1	-4.1
Total investment (% YoY)	-5.7	-16.0	-13.1	33.8	11.1	-5.4	-6.8	-5.4	-7.4
Exports (% YoY)	0.6	9.8	-17.4	8.5	5.8	-5.4	10.0	-5.4	9.7
Imports (% YoY)	-4.5	-18.7	-17.2	20.4	17.9	-1.0	-12.1	-1.0	-12.7
Unemployment rate (% , last quarter)	9.1	8.9	11.0	7.0	6.3	7.7	7.5	7.7	7.6
Inflation (% YoY, average)	34.3	53.5	42.0	48.4	72.4	132.0	157.0	136.0	159.0
Inflation (% YoY, last quarter)	47.4	52.2	36.4	51.4	91.8	162.4	121.2	163.2	122.8
Fiscal balance (% of GDP)	-4.9	-3.8	-8.4	-3.6	-3.8	-4.2	-3.0	-4.2	-3.0
Primary fiscal balance (% of GDP)	-2.3	-0.4	-6.4	-2.1	-2.0	-2.7	-2.2	-2.7	-2.1
Current account balance (% of GDP)	-4.9	-0.8	0.7	1.4	-0.7	-2.6	1.7	-2.6	1.6
Official interest rate (end of period)	59.25	55.00	38.00	38.00	75.00	133.00	97.90	138.00	104.00
3-month interest rate (end of period)	56.76	45.13	29.55	31.49	67.61	116.00	116.02	115.99	116.10
10-year interest rate (end of period)	16.85	30.24	21.68	25.52	34.40	28.99	27.52	28.98	30.55
Exchange rate vs. U.S. dollar (end of period)	37.70	59.89	84.15	102.72	177.15	509.29	1103.53	509.55	1102.48
Exchange rate vs. euro (end of period)	43.17	67.28	103.26	116.34	188.95	534.72	1182.68	534.69	1180.36
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	83.4	52.1	83.4	50.5
P.S. non-financial lending (% YoY, average)	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
P.S. financial lending (% YoY, average)	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Savings rate (% 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: October 30, 2023.

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rate with the unofficial exchange rate. Still, the situation has not stabilized, and with the slowdown underway and inflation unchecked, there are risks of a recession in 2024, with even higher inflation and instability in the currency and funding markets.

1.2.12 China

Deflation in producer prices could anticipate an economic downturn.

China's economy grew by 4.9% in Q3 2023, with consumption increasing by 6.8% and investment expanding by 3.1% (led by infrastructure investment, manufacturing, and a real estate upturn). Some improvement was also seen in foreign trade figures, although the category continued to contract in September. The PMIs (purchasing managers' indexes) in September were only marginally in the positive, with the composite index at 50.7, services at 50.6, on a clearly descending path, and manufacturing in contraction, at 49.5 points.

China

- Chinese exports again gain momentum, but below the level observed in the recent past.
- The authorities are reinforcing stimuli in an attempt to prevent the economy from slowing down.
- Risks of a crisis in the real estate sector, which may have a systemic effect, persist.

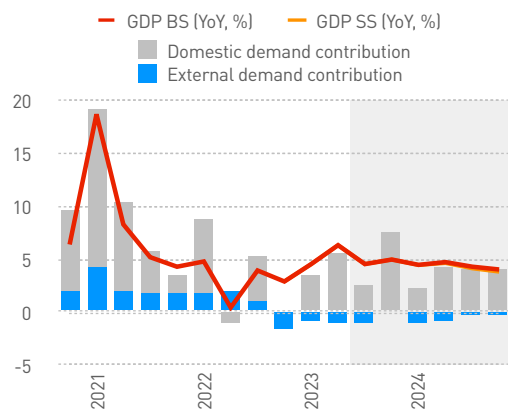
Meanwhile, retail sales rose 4.6%, and consumer confidence is stable, although at depressed levels (86.8). The government has an official growth target for the economy of around 5%. In this context, growth of

5.1% is forecast for this year and 4.4% in 2024, showing an expected slowdown due to the cooling of the market for Chinese exports amid the drop in foreign demand (see Table 1.2.12 and Charts 1.2.12-a and 1.2.12-b).

Inflation stood at 0.0% in September (compared to 0.1% in August), while producer prices are in outright deflation (-2.9% YoY in August). With the global economic slowdown and producer prices declining (-2.9% in August), and with all business supplies dropping in price, the likelihood of deflation is increasing. On the monetary policy front, the central bank is still on an easing path. In September, it decided to lower the reserve ratio required of banks by 25 bps to 10.50%, as a way of stimulating lending activity. The deposit interest rate stands at 1.50% and the reverse repo rate at 1.92%. With low inflation, and even the risk of deflation, this monetary stance seems appropriate.

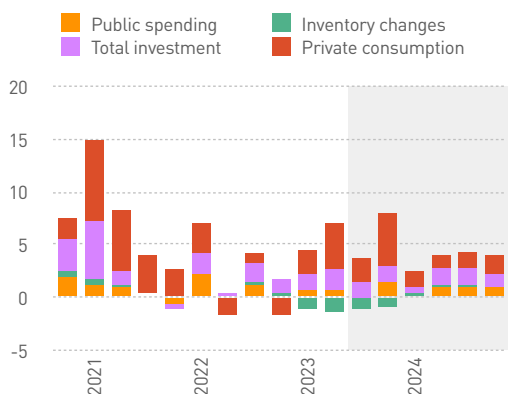
In terms of short-term economic and financial risks, the problem in the real estate sector persists, with the developer Country Garden informing the stock market that it is heading towards insolvency. This situation, which on its own may not be systemic, may be indicative of a broader problem that could become systemic. Meanwhile, the global slowdown is beginning to show in the growth rate of Chinese exports. Thus, with producer prices clearly negative, there is a risk of deflation in China. However, with the financial and real estate sectors in a delicate situation, the government will at least try to make its exports a factor for growth.

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)		Stressed (SS)	
						2023 ^(f)	2024 ^(f)	2023 ^(f)	2024 ^(f)
GDP (% YoY)	6.7	6.0	2.2	8.5	3.0	5.1	4.4	5.1	4.2
Domestic demand contribution	7.3	5.3	1.6	6.6	2.5	4.8	3.7	4.8	3.6
External demand contribution	-0.3	0.6	0.7	2.3	0.7	-0.6	-0.5	-0.6	-0.5
Private consumption contribution	3.2	2.5	-1.0	4.6	0.1	3.5	1.5	3.5	1.5
Total investment contribution	3.1	2.2	1.3	1.3	1.3	1.6	1.2	1.6	1.1
Public spending contribution	1.2	1.1	0.8	0.3	0.9	0.7	0.8	0.7	0.8
Private consumption (% YoY)	8.1	6.3	-2.4	12.1	0.3	9.2	3.8	9.2	3.6
Public spending (% YoY)	7.1	6.6	4.6	1.6	5.7	4.4	4.8	4.4	4.8
Total investment (% YoY)	7.3	5.1	3.1	3.2	3.2	4.0	3.1	4.0	2.8
Exports (% YoY)	4.4	2.3	1.7	18.2	-0.3	3.4	1.7	3.4	1.5
Imports (% YoY)	6.5	-0.7	-2.2	6.7	-4.7	8.4	5.4	8.4	5.0
Unemployment rate (% , last quarter)	2.9	3.1	3.5	3.3	3.6	3.4	3.5	3.4	3.5
Inflation (% YoY, average)	2.1	2.9	2.5	0.9	2.0	0.5	1.9	0.5	2.3
Inflation (% YoY, last quarter)	2.2	4.3	0.1	1.8	1.8	0.7	2.0	0.7	2.4
Fiscal balance (% of GDP)	-4.7	-5.6	-7.6	-5.1	-7.4	-7.3	-7.0	-7.3	-7.0
Primary fiscal balance (% of GDP)	-1.5	-2.2	-3.7	-1.5	-3.7	-3.5	-3.1	-3.5	-3.1
Current account balance (% of GDP)	0.2	0.7	1.7	2.0	2.2	1.4	0.9	1.4	0.8
Official interest rate (end of period)	3.25	3.25	3.00	3.00	2.75	2.50	3.00	2.50	2.75
3-month interest rate (end of period)	3.35	3.02	2.76	2.50	2.42	1.92	1.91	1.92	1.92
10-year interest rate (end of period)	3.23	3.14	3.14	2.78	2.84	3.20	3.17	3.19	4.46
Exchange rate vs. U.S. dollar (end of period)	6.88	6.99	6.52	6.35	6.90	7.30	7.10	7.30	7.10
Exchange rate vs. euro (end of period)	7.87	7.85	8.00	7.19	7.36	7.66	7.61	7.66	7.60
Private lending (% YoY, average)	12.9	13.1	13.1	12.3	11.1	11.1	7.4	11.1	4.6
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	30.2	31.8	28.7	29.7	28.7	29.6

Source: MAPFRE Economics (based on BoPRC data)
Forecast end date: October 30, 2023.

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1.2.13 Indonesia

Inflation is coming under control, but energy costs could reverse the trend.

The Indonesian economy grew 5.2% in the second quarter of the year, with household consumption rising 5.9% and public spending up 10.6%. Investment increased 4.6%, while exports dropped 2.7%, and imports fell 3.1%. However, the trade balance is very positive, thanks to agricultural and mining exports. The purchasing managers' index (PMI) for manufacturing in September stood at 53.3 points, improving from the previous 52.4. Retail sales rose 1.3% in August, and auto sales have stabilized at more than 80,000 units per month. Industrial production is more volatile, but at average levels for the last three years. For the coming quarters, consumption is expected to hold its growth levels, while exports and imports are expected to weaken due to the global slowdown and tightening of financial conditions in many countries. Thus, the forecast for economic growth in Indonesia stands at 5.1% for 2023 and 4.8% for 2024 (see Table 1.2.13 and Charts 1.2.13-a and 1.2.13-b).

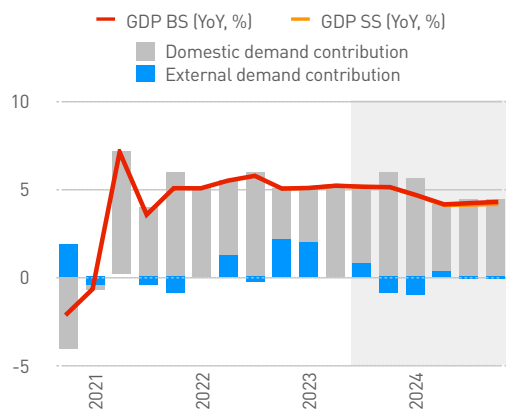
Indonesia

- The Indonesian economy maintains a strong growth pace, above 5%.
- Inflation is moderate, but seems to have bottomed out at 3%.
- The currency and external financing markets constitute the points of greatest risk in the short term for the Indonesian economy.

Meanwhile, inflation accelerated slightly in August to 3.3% from a peak of nearly 6.0% in 2022, maintaining a downward trajectory that put it at 2.2% in September. Producer prices remain somewhat higher, but also on a moderation path (3.7% in August). However, the rise in oil prices in recent months is pushing inflation expectations back up. The Central Bank of Indonesia held monetary policy interest rates at 5.75% at its September meeting. The decision is aimed at keeping inflation within the range of 3.0% \pm 1% in 2023 and 2.5% \pm 1% in 2024. It also aims to reinforce the stability of the rupee in view of the current uncertainty in global financial markets. Meanwhile, the central bank continues to gear accommodative prudential macro policy towards reviving bank lending/financing to businesses through liquidity incentives, with a focus on downstream industry, housing, and tourism.

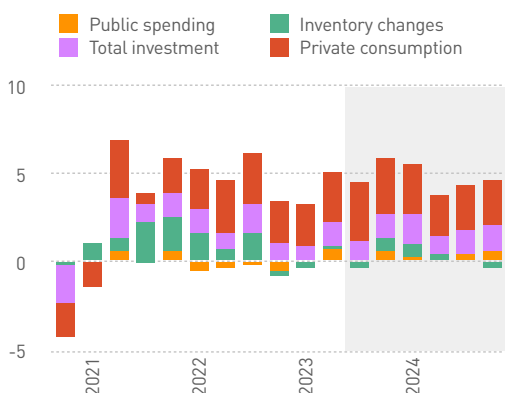
Near-term risks to Indonesia's economy could come from uncertainty in global financial markets, and especially foreign exchange, as the Federal Reserve's monetary policy could generate currency shocks in emerging markets. The current account balance remains positive at close to 0.7% of GDP (although exports are moderating, imports are falling more) and continues the upward trend. The exchange rate has been depreciating since May, standing at around 15,400 IDR/USD. Rising interest rates on external dollar debt is a challenge for all emerging countries when rolling over such debt issues, and instability in international funding markets would be a challenge for Indonesia.

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)		Stressed (SS)	
						2023(f)	2024(f)	2023(f)	2024(f)
GDP (% YoY)	5.2	5.0	-2.1	3.7	5.3	5.1	4.8	5.1	4.3
Domestic demand contribution	6.2	3.6	-3.6	4.1	4.5	4.6	4.5	4.6	4.5
External demand contribution	-1.0	1.4	1.5	-0.4	0.8	0.5	-0.2	0.5	-0.2
Private consumption contribution	2.8	2.9	-1.5	1.1	2.7	3.0	2.6	3.0	2.5
Total investment contribution	2.2	1.5	-1.6	1.2	1.2	1.1	1.4	1.1	1.4
Public spending contribution	0.4	0.3	0.2	0.3	-0.4	0.4	0.3	0.4	0.3
Private consumption (% YoY)	5.1	5.2	-2.7	2.0	4.9	5.5	4.7	5.5	4.6
Public spending (% YoY)	4.8	3.3	2.1	4.2	-4.5	6.0	4.2	6.0	4.5
Total investment (% YoY)	6.7	4.5	-5.0	3.8	3.9	3.6	4.6	3.6	4.5
Exports (% YoY)	6.5	-0.5	-8.4	18.0	16.3	0.2	1.9	0.2	1.7
Imports (% YoY)	12.1	-7.1	-17.6	24.9	14.7	-2.0	3.5	-2.0	3.3
Unemployment rate (% , last quarter)	5.1	5.1	6.7	6.2	5.7	5.7	5.3	5.7	5.3
Inflation (% YoY, average)	3.3	2.8	2.0	1.6	4.2	3.7	2.4	3.7	2.7
Inflation (% YoY, last quarter)	3.3	2.7	1.6	1.8	5.5	2.7	2.3	2.7	2.7
Fiscal balance (% of GDP)	-1.7	-2.2	-6.2	-4.6	-2.4	-1.7	-1.7	-1.7	-1.6
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	-0.2	-1.0	-0.3	-1.5
Official interest rate (end of period)	6.00	5.00	3.75	3.50	5.50	6.00	5.00	6.00	5.25
3-month interest rate (end of period)	7.70	5.51	4.06	3.75	6.62	6.48	5.50	6.49	5.83
10-year interest rate (end of period)	7.98	7.10	6.10	6.38	6.93	7.79	7.75	7.78	8.88
Exchange rate vs. U.S. dollar (end of period)	14,380	13,883	14,050	14,253	15,568	15,650	16,093	15,657	16,030
Exchange rate vs. euro (end of period)	16,465	15,596	17,241	16,143	16,605	16,432	17,247	16,429	17,162
Private lending (% YoY, average)	10.8	8.8	1.4	1.0	9.6	8.1	9.1	8.1	9.3
Household lending (% YoY, average)	10.2	7.9	2.1	2.2	7.8	8.3	5.6	8.3	5.4
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	0.3	-9.0	-12.6	15.3	31.1	12.9	31.1	12.7
Savings rate (% pers. disp. income, avg.)	24.0	22.8	21.4	25.7	29.2	26.9	23.4	26.9	23.3

Source: MAPFRE Economics (based on BPS data)
Forecast end date: October 30, 2023.

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1.2.14 Philippines

Moderating growth with the risk of an upturn in inflation.

Growth of the Philippine economy slowed in the second quarter of 2023 to 4.3% (-0.9% QoQ), from 6.4% in the first quarter of the year. Private consumption rose 5.5% YoY, government consumption contracted 7.1% YoY (in part due to the base-line effect due to 10.9% growth in Q2 2022), and investment did not increase. Moreover, exports accelerated again (+4.1%), but with an emphasis on services (+9.6%), as goods exports remained in contraction territory (-0.9%). Thus, the current account balance has been correcting since 2022, but at the cost of a sharp contraction in imports.

Philippines

- The Philippine economy has slowed in 2023, but still maintains strong growth momentum.
- Unlike exports of goods, exports of services continue to grow.
- Inflation is up, although core inflation continues to ease.

In terms of leading activity indicators, the purchasing managers' index (manufacturing PMI) came in at 50.6 points in September. The future business conditions surveys improved substantially, standing at 53.8, up from 46.4 points (<50 indicates contraction), but the current figures remain depressed (35.5). Meanwhile, industrial production rose 8.5% in August, driven by the automation and electric machinery sectors. Against this backdrop, the Philippine economy is expected to slow down in 2023, from its 7.6% growth in 2022, mainly due to inflationary

pressures and tighter financial conditions. Thus, GDP growth is expected to be around 5.1% in 2023 and 4.9% in 2024, mainly due to the slowdown of consumption and exports (see Table 1.2.14 and Charts 1.2.14-a and 1.2.14-b).

Meanwhile, inflation reached 6.1% in September, again increasing month on month (0.2% MoM) and interrupting the downward trend, while core inflation remains low (5.9%). By categories, food rose 9.7%, and housing and household supplies by 2.4%, while the cost of transportation increased 1.2%. With the M2 money supply stabilizing, as opposed to other regions of the world where it is contracting, inflation should remain relatively high.

The central bank's interest rates were held at 6.25% (Overnight Repo) after its September meeting. Baseline projections for inflation are now somewhat higher than before, but are estimated to land within the range of 2-4% by the end of the year. The central bank also deems it appropriate to maintain its pause amid upside risks to the inflation forecast. Looking ahead, the central bank would be prepared to resume its monetary tightening actions, given upside risks and potential second-round effects that could derail inflation expectations.

As for short-term risks to the Philippine economy, the main risk continues to be inflation, with core inflation easing very slowly. Another risk is the trade deficit, which remains broadly negative despite moderating, with imports falling more than exports. Furthermore, the terms of trade have been worsening for years, with the price of exports growing less than those of imports. On the positive side, the high economic growth of the Philippine economy is a factor of strength, albeit slowing over the next two years.

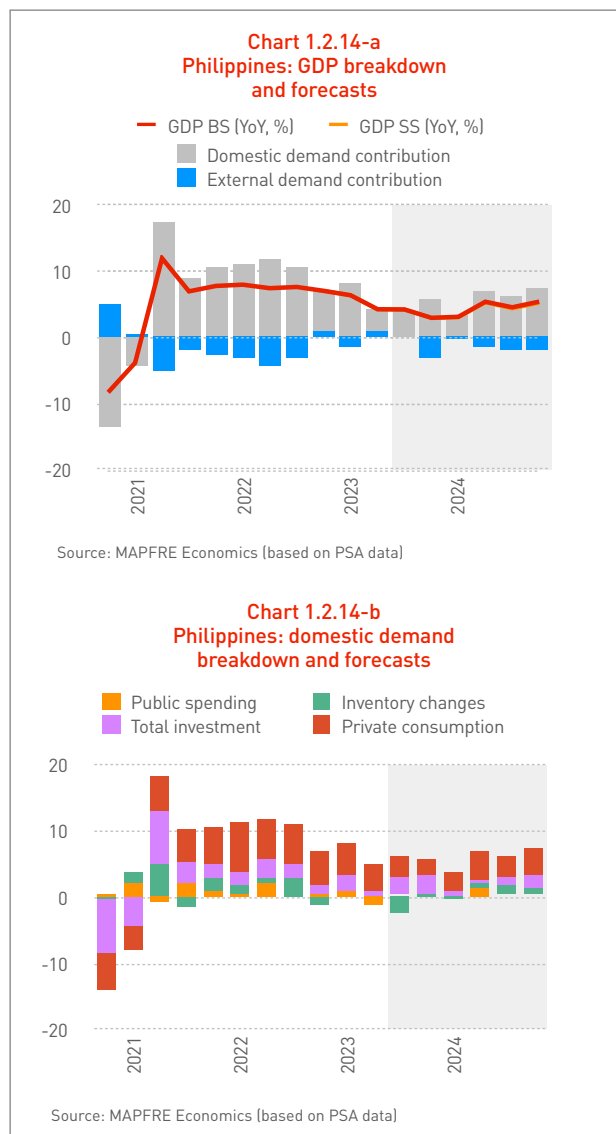


Table 1.2.14
Philippines: main macroeconomic aggregates

	2018	2019	2020	2021	2022	Baseline (BS)		Stressed (SS)	
						2023 ^(f)	2024 ^(f)	2023 ^(f)	2024 ^(f)
GDP (% YoY)	6.3	6.1	-9.5	5.7	7.6	5.1	4.9	5.0	4.6
Domestic demand contribution	8.6	6.3	-13.5	8.0	9.8	5.3	6.1	5.3	5.9
External demand contribution	-2.3	-0.2	4.0	-2.3	-2.2	-0.9	-1.3	-0.9	-1.3
Private consumption contribution	4.2	4.3	-5.8	3.1	6.0	3.6	3.7	3.6	3.5
Total investment contribution	3.3	1.1	-7.3	2.1	2.2	2.2	1.3	2.2	1.2
Public spending contribution	1.5	1.1	1.3	1.1	0.7	0.0	0.6	0.0	0.6
Private consumption (% YoY)	5.8	5.9	-8.0	4.2	8.3	5.0	5.0	5.0	4.8
Public spending (% YoY)	13.4	9.1	10.5	7.2	4.9	0.2	4.0	0.2	4.0
Total investment (% YoY)	12.9	3.9	-27.3	9.8	9.7	9.6	5.3	9.6	5.1
Exports (% YoY)	11.8	2.6	-16.1	8.0	10.9	0.1	3.8	0.1	3.6
Imports (% YoY)	14.6	2.3	-21.6	12.8	13.9	2.3	6.1	2.3	5.9
Unemployment rate (% , last quarter)	5.1	4.6	8.7	6.8	4.3	4.6	4.5	4.6	4.6
Inflation (% YoY, average)	5.3	2.4	2.4	3.9	5.8	5.9	3.2	6.0	3.8
Inflation (% YoY, last quarter)	6.1	1.4	2.9	3.6	7.9	4.1	3.1	4.3	3.7
Fiscal balance (% of GDP)	-3.1	-3.4	-7.6	-8.6	-7.3	-5.9	-5.7	-5.9	-5.8
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	-4.5	-3.5	-3.4	-3.6	-3.9
Official interest rate (end of period)	4.75	4.00	2.00	2.00	5.50	6.25	5.25	6.50	5.75
3-month interest rate (end of period)	5.03	3.97	2.00	1.81	5.50	6.44	5.30	6.45	5.64
10-year interest rate (end of period)	7.05	4.44	2.97	4.72	6.91	7.17	6.80	7.17	7.97
Exchange rate vs. U.S. dollar (end of period)	52.72	50.74	48.04	50.27	56.12	57.50	54.95	57.52	54.78
Exchange rate vs. euro (end of period)	60.37	57.01	58.94	56.93	59.86	60.37	58.90	60.36	58.65
Private lending (% YoY, average)	16.8	9.5	4.0	0.9	8.3	7.5	6.9	7.5	7.0
Household lending (% YoY, average)	14.3	12.8	11.2	-2.1	7.9	13.0	10.8	13.0	10.6
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)	10.3	6.9	-7.9	8.2	13.4	9.7	8.9	9.7	8.8
Savings rate (% pers. disp. income, avg.)	6.4	5.0	3.4	-0.4	-0.9	1.1	3.4	1.0	3.2

Source: MAPFRE Economics (based on PSA data)
Forecast end date: October 30, 2023.

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2. Industry outlook

2.1 The economic environment and its impact on insurance demand

2.1.1 Global markets

As stated in the first part of this report, economic growth estimates for 2023 have been revised upward, but continue to reflect an economic slowdown. Overall growth is forecast to reach 2.9% in 2023 (3.4% in 2022) and 2.2% in 2024, mainly due to the impact of tighter financing conditions for governments, households, and companies on the level of activity. At the same time, the open conflict in the Middle East has reintroduced uncertainty into the global economic environment, among other reasons, due to the upturn in oil prices, which could affect how long central banks will have to maintain a restrictive monetary policy to fight inflation.

This global economic slowdown, in an environment in which the mechanisms of monetary policy transmission to the real economy are working through a credit crunch, weakening labor markets (still strong), and clear signs of moderation in inflation, pose a scenario of lower growth in insurance business volume, affecting more cyclical and credit-linked lines of business, such as Motors and Life insur-

ance. Still, profitability is expected to improve as insurance premiums are revised upwards to adjust for inflation, cost growth eases, and financial income continues to be supported by interest rate increases. Meanwhile, in a structural sense, higher interest rates are encouraging the growth of the savings-linked Life insurance and annuities business.

In terms of financial markets, the rebound in yields on longer-duration sovereign and corporate bonds has once again led to downward corrections in their valuations, adding to the strong correction already carried over from the previous year due to the tightening of monetary policy. Meanwhile, equities have also suffered corrections, losing most of the gains obtained in the first half of the year. Thus, the Euro Stoxx 50 index, which had appreciated by 15.7% in the first half of the year, suffered a significant correction in Q3, leaving the annual revaluation of this index at 5.6% at the October 30 close, which represents a loss of 10.1 percentage points (pp) of the accumulated return for the year. This situation was similar in the U.S. market, where the S&P 500 suffered a decline of 8.6 pp in the last quarter, as of October 30, leaving the annual revaluation at 6.9% and, in the case of the Nasdaq Composite, at 19.7%, with a decline of 10.8 pp.

These latest corrections and increased volatility introduce some uncertainty that could affect the development of Life insurance products in which the policyholder assumes the investment risk. Nevertheless, opportunities are arising to sell new issues, opening up the possibility of broadening the composition of reference assets towards a higher weight of fixed income in the combination of products offered in the market. This follows the strong correction experienced in the bond market and the expectation that interest rates may have little upside left. The foregoing is especially the case after the latest messages from the main central banks, such as the European Central Bank (ECB) and Federal Reserve, based on moderating inflation data. The situation is different for other central banks that started the monetary tightening process earlier. This is the case of Brazil, whose central bank has already begun to lower its benchmark interest rate, although inflation has picked up slightly since the rate cuts implemented, and Mexico, whose central bank is keeping interest rates at the levels reached in previous months until inflation eases.

It is also notable that credit risks are rising, as higher financing costs and inflation continue to impact issuers, with more issuers facing the need to refinance. This is a problem that particularly affects corporate debt, both issued by large companies and by companies with less access to capital markets, such as small and medium-sized companies. It is taking place in an environment in which private equity has become less attractive due to the rise in risk-free interest rates, which is also beginning to have a notable effect on sovereign bonds. So far, high inflation levels have been beneficial to governments because of the dilution effect of the inflationary process on debt levels when measured in relation to the country's GDP, in a context in which interest rate hikes do not immediately equate to higher borrowing costs, as long as there

are no substantial maturities of sovereign debt financed at low rates. However, this refinancing process continues at a steady pace, which, together with the gradual withdrawal of monetary stimuli through central banks' bond purchase programs, is beginning to have an effect on interest rates, not only in their risk-free component, but also the risk premiums of countries with the highest debt levels, which are becoming tighter.

2.1.2 Eurozone

Economic growth forecasts for the Eurozone in 2023 have been revised downward to 0.5% (+3.4% in 2022), representing a significant slowdown, as the effects of interest rate hikes and the credit crunch associated with tighter financing conditions are transmitted to the real economy. These circumstances may be aggravated by the spike in energy prices as a result of the conflict in the Middle East and the continuation of the war in Ukraine. This environment of slower economic growth continues to be a challenge for the more cyclical lines of business in the European insurance industry. However, interest rate hikes will continue to favor Life savings insurance while improving financial returns on investment portfolios. Also, downward inflation and rate revisions applied this year to offset cost increases may help boost insurance companies' profitability, which has been impacted by the inflationary process.

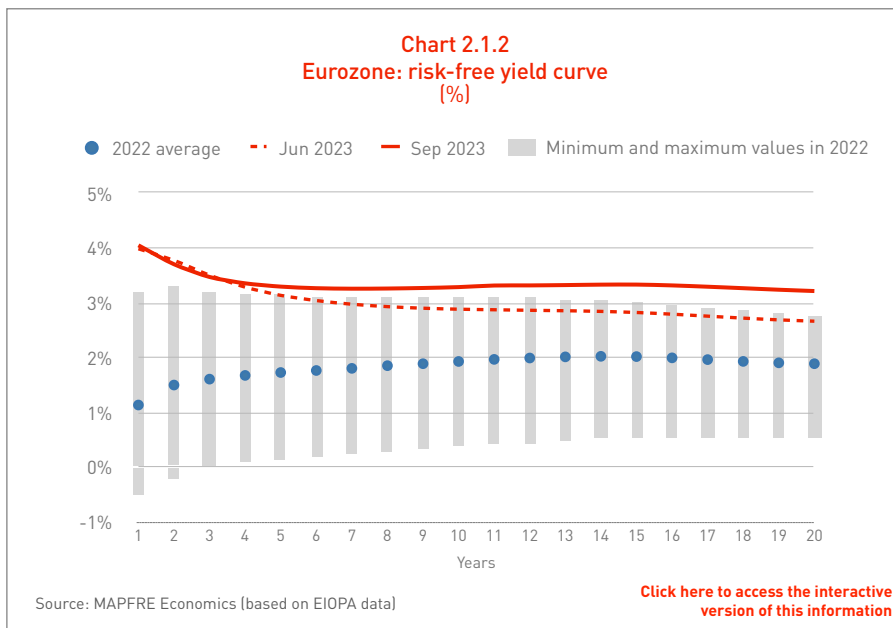
Meanwhile, after 15 months and 10 consecutive interest rate hikes, at its October meeting the ECB decided to hold interest rates at 4.5% for the main refinancing operations and 4.0% for the deposit facility, a significant change from its previous decisions. However, these are the highest levels in more than two decades, with inflation

figures continuing to moderate to 4.3% in September (5.2% in August), compared to average inflation of 8.4% for 2022, still well above the 2% target for the Eurozone as a whole. There is every indication that the monetary policy transmission mechanism is working properly, which is resulting in a credit crunch and a weaker labor market, leading the ECB to pause and wait for more data for future decisions.

At the same time, it continues to gradually downsize its balance sheet, as expected, and the risk premiums of the countries with the highest debt levels have begun to rise. Looking at the risk-free yield curves produced by the European Insurance and Pension Authority (EIOPA) at

the close of September, the stability of interest rates in their shortest tranches (still with a negative slope) and the rise of the slope in the rest of the curve is noticeable. This suggests a scenario in which interest rates could remain high for a longer period of time (see Chart 2.1.2, which shows the minimum, average, and maximum levels reached in 2022, as well as the level of the latest curves published by EIOPA for June and September 2023)².

As this information shows, increases in risk-free interest rates continue to provide an appropriate environment for the Life savings business, improving the outlook for products with longer durations, such as annuities, due to the rise in interest rates in the longer maturity tranches. However, the inversion of the yield curve in the shorter maturities (where the term premium is negative) favors the development of products with shorter durations and periodic renewals. Meanwhile, the corrections in the Euro Stoxx 50 index and other international indexes, together with the drop in the value of fixed income, are creating opportunities for the development of Life insurance products in which the policyholder assumes the investment risk. This opens up the possibility of broadening the composition of the reference assets towards a greater weight of fixed income, following the strong correction experienced in the bond market in 2022 and so far this year, and the expectations that interest rates may have little upside left.



2.1.3 Germany

Germany's economic growth forecast for 2023 has again been revised downward, with a recession deepening the decline in GDP to 0.5% (+1.9% in 2022), a situation that could improve slightly in 2024, when 0.3% growth is expected. This recessionary environment, with a forecast of weaker demand beginning to affect consumption and inflation

that continues to show signs of moderation, but still remains high (6.1% and 4.5% in August and September, respectively, compared to the average of 6.9% for 2022 as a whole), poses challenges for the development of the insurance industry's business and profitability, especially in the Non-Life segment.

Meanwhile, German sovereign bond yields have continued to rebound, both in shorter and longer maturities, although the slope of the sovereign bond yield curve at the end of October was still sharply negative, especially in the one- to eight-year maturity tranche. This interest rate situation continues to provide a favorable environment for Life savings business with guaranteed interest rates with shorter terms and periodic renewals, although a more complex one for products with longer-term guaranteed interest rates and for traditional annuities by virtue of the inversion of the risk-free yield curve. However, in the last few months, the environment has continued to improve for these types of products with guaranteed interest rates with longer terms, with the rate hike in the longest tranches of the curve. The German DAX, which had rallied with a 15.4% revaluation in the first half of the year, has since retreated, leaving the annual revaluation as of October 30 at 5.0%, following a 13.6% drop in 2022. This latest correction, together with increased volatility, introduces some uncertainty that may affect the development of Life insurance products in which the policyholder assumes the investment risk. In particular, it may shift the composition of the reference assets towards a higher weight of fixed income in the combination of products offered in the market.

2.1.4 Italy

The Italian economy is weakening, which has caused its economic growth forecast to be revised downward to 0.6% in 2023 (+3.9% in 2022) and 0.4% in 2024. The tightening of financing conditions due to interest rate hikes and the loss of purchasing power as a result of inflation, which, despite moderating in recent months, remains high (5.4% and 5.3% in August and September, compared to an average inflation of 8.2% in 2022), are beginning to have significant effects on the real economy. This complicates the outlook for the business and profitability of the insurance industry, especially in the Non-Life segment.

On the other hand, the yield on the 10-year sovereign bond has remained slightly below (but very close to) 5%, with a sovereign debt curve at high levels and a slightly positive slope that enables yields on long-term products to be higher than short-term rates (term premium). This situation continues to paint a very favorable picture for traditional Life savings insurance and annuity products. Meanwhile, the main Italian equity index has lost ground, but performed well so far this year (following the declines in 2022). The FTSE MIB, which gained 18.3% in the first half of the year, has since retreated, leaving the 2023 revaluation as of October 30 at 14.3%. The performance of equities, together with the high yields offered by fixed income, may support the development of Life insurance products in which the policyholder assumes the investment risk, which are widespread in the Italian market.

2.1.5 Spain

Economic growth expectations for the Spanish economy in 2023 have been revised upwards to 2.5% (+5.8% in 2022) and downwards in 2024, when growth is expected to slow to 1.3%. This is against a backdrop of tightened financial conditions and greater uncertainty as a result of the conflict in the Middle East and the war in Ukraine. Private consumption is the main driver of growth in the Spanish economy, while investment is showing signs of slowing down. Inflation (which has been easing throughout the year) has rebounded slightly in recent months, reaching 2.6% and 3.5% year-on-year in August and September, respectively, but far from the 8.4% average inflation of 2022 and below the latest data for the Eurozone.

As noted above, the ECB decided to maintain interest rates at its last meeting and continues to slightly reduce the size of its balance sheet. In view of this economic and interest rate environment, the Spanish insurance industry continues to experience notable growth, although it may face a slowdown that would particularly affect the more cyclical businesses linked to credit behavior, such as Motors and Life insurance. However, there is still significant growth in Life savings and annuity insurance and a progressive improvement in profitability prospects due to easing inflation, the adjustment of premiums as policies are renewed, and higher financial income. Along these lines, in the first nine months of 2023, the insurance industry continued to show positive growth above inflation in all the major business segments, and particularly the Life savings business, which grew by 57.8% in premiums through the end of September (€21.2 billion, compared to €13.4 billion in the same period of the previous year). This was the result of interest rate hikes and the delay in compensat-

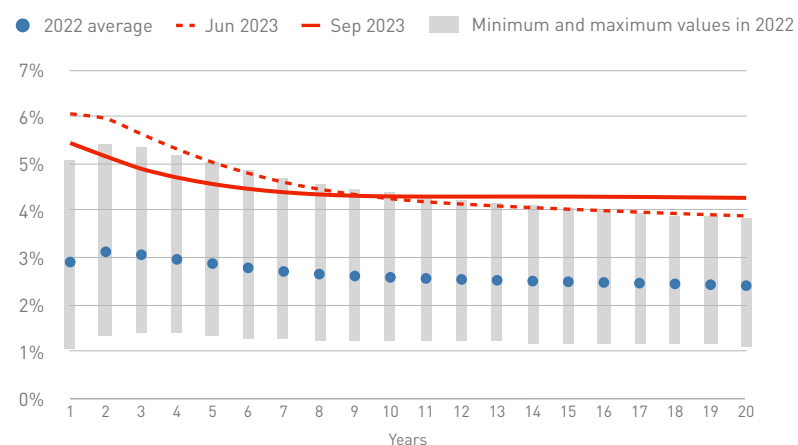
ing bank deposits, which continues to open up business opportunities in terms of attracting savings; however, they may decline as the companies adapt their deposit compensation policies to the new interest rate environment.

2.1.6 United Kingdom

Forecasts for the UK economy continue to point to a low growth scenario, with a 0.5% change in GDP in 2023 (+4.3% in 2022), and 0.3% expected growth in 2024. Inflation is starting to show signs of improvement (6.7% year-on-year in August and September, compared to an average inflation rate of 9.1% in 2022). However, the tightening of financial conditions is creating an environment of weak economic growth, so the outlook remains unfavorable for the development of the UK insurance market, especially for the Non-Life segment.

With respect to savings-linked Life insurance and traditional annuities, the Bank of England notably increased interest rates again at its August meeting by 25 basis points (bps), leaving them at 5.25%, and decided to pause the hikes at its September meeting. This situation was reflected in EIOPA's risk-free yield curves for the end of September (see Chart 2.1.6), which show a slight decline in the curve levels with maturities up to nine years and an increase in the longer maturities, with the curve flattening slightly, yet maintaining a negative slope. Despite the downturn, the high short-term interest rates continue to be favorable for the marketing of Life savings insurance products with guaranteed short-term rates and rate revisions at each renewal, with annuity products with guaranteed interest rates also becoming more attractive. In terms of equities, the FTSE 100 has declined by 2.2% so

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



Source: MAPFRE Economics (based on EIOPA data)

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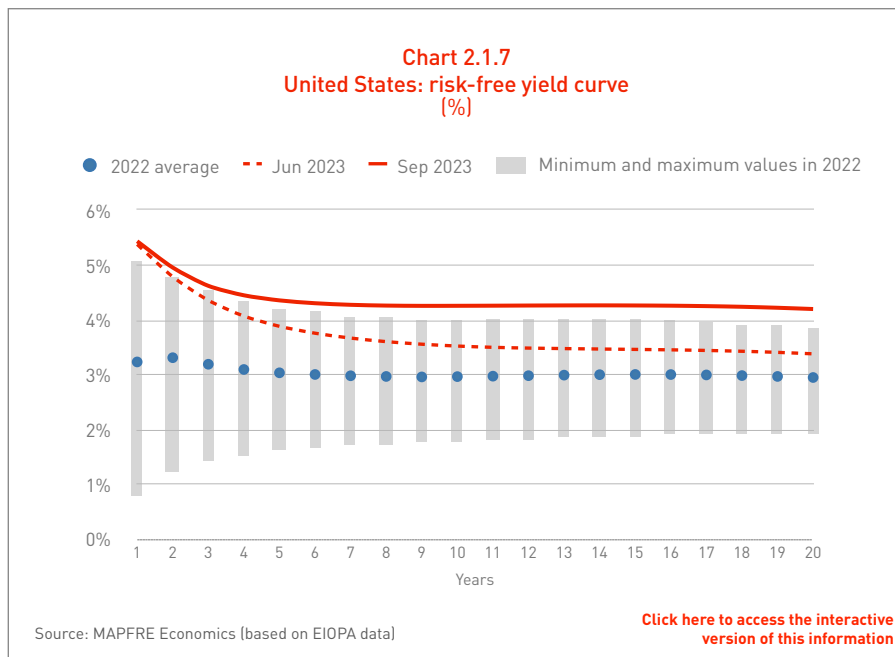
far this year, through October 30. This situation, together with the worse performance and increased volatility of the main international equity indexes in recent months, may affect the performance of Life insurance products in which the policyholder assumes the investment risk in terms of the composition of the reference assets, with a greater weight of fixed income in the combination of products offered in the market.

2.1.7 United States

Economic growth data for the United States in 2023 continues to surprise on the upside, leading to further revisions to full-year estimates,

which anticipate GDP growth of 2.3% (+1.9% in 2022). The pace of growth should slow to 0.6% in 2024 as the effects of tighter financing conditions are passed on to the real economy, which continues to show clear signs of strength, with interest rates at levels not seen in more than a decade. Although inflation has rebounded slightly since June, when it stood at 3% year-on-year, it continues to show signs of easing throughout the year (3.7% in August and September, compared to an average inflation rate of 8.0% in 2022). Overall, the economy, the labor market, and personal consumption remain strong, continuing to support the growth of the insurance business, while lower inflation may help to improve its profitability, aided by repricing as insurance policies mature and significantly higher financial income from high interest rates.

In terms of the environment for savings-linked Life insurance, it is worth noting that the Federal Reserve raised monetary policy interest rates at its July meeting, leaving them in a range between 5.25% and 5.5%, and decided to hold them at that level at its last meeting. As a result, monetary policy will remain tight until there are strong indications that inflation is under control near its 2% target, with data continuing to improve but still far from the goal, and as the economy continues to surprise on the upside. The market risk-free yield curve for June produced by EIOPA (see Chart 2.1.7) shows an increase in levels of all tranches of the curve that are more significant as maturities increase, with the curve flattening slightly, but maintaining a negative slope and offering positive real interest rates (above the latest inflation data) in all tranches. This environment is highly favorable for the marketing of Life savings insurance products with guaranteed rates for short terms and revised rates at each renewal, while products with longer-term interest rate guarantees and life annuities are also gaining appeal.



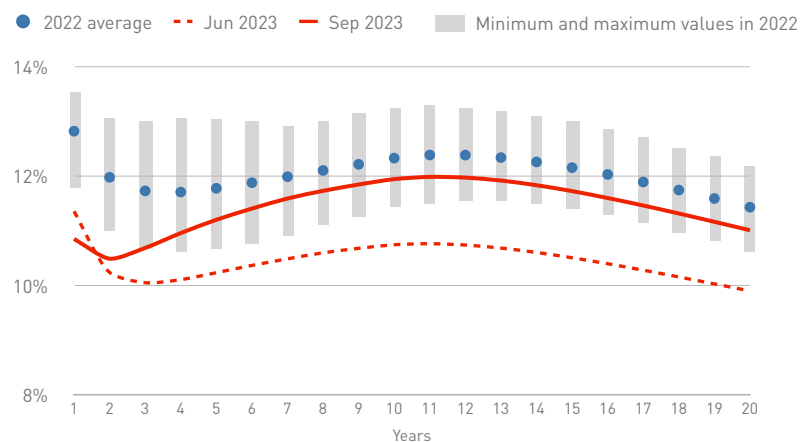
Meanwhile, the S&P 500 index, which had appreciated by 15.5% so far this year through the end of June, has fallen back in recent months, so that the annual appreciation through October 30 stood at 6.9%. The Nasdaq Composite, which had appreciated by 30.5% from January through the end of June, has retreated in recent months, so that the annual appreciation through October 30 reached 19.7%. These recent corrections, together with the increase in volatility, introduce some uncertainty that may affect the development of Life insurance products in which the policyholder assumes the investment risk, and particularly the composition of assets, resulting in a higher weight of fixed income in the combination of products offered in the market, considering the high yield currently offered by fixed income assets.

2.1.8 Brazil

The Brazilian economy continues to exceed expectations, causing GDP growth forecasts for 2023 to be revised upward to 3.1% (+3.0% in 2022), but should begin slowing down over the next year, with estimated economic growth of 1.5%. This will reflect the effects of tightened financing conditions on the real economy, despite the latest cuts in benchmark interest rates implemented by its central bank, and inflation, which had been falling but rebounded in the last quarter. In this context, the insurance market continues to perform well, mainly in the Non-Life segment, with significant growth above inflation in practically all lines of business, although growth is expected to slow down in line with the expected economic downturn. Meanwhile, profitability indicators remain positive, driven by easing inflation and significantly higher financial income due to high interest rates, which are well above the current inflation rate.

The Central Bank of Brazil, which began raising interest rates a year before the Federal Reserve, has already started to reduce monetary policy interest rates, applying two 50 bps cuts each in July and September, to 12.75%, in view of the improvement in inflation data. However, prices have rebounded since June (when inflation fell to 3.16% year-on-year), rising to 4.61% and 5.19% in July and September, respectively (compared to average inflation of 9.3% in 2022). In EIOPA's risk-free yield curves for the end of September (see Chart 2.1.8), we observe a drop in the shorter end of the curve and a rebound in all other maturities, with a positive term premium and positive real interest rates, especially in maturities around 10 years. This still offers a highly favorable environment for the development of the Life savings (VGBL and PGBL) and annuities business, with interest rates continuing to offer notably higher yields than the latest inflation data, although the ex-

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



Source: MAPFRE Economics (based on EIOPA data)

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pected economic slowdown could mean weaker growth in this line of business in the coming quarters.

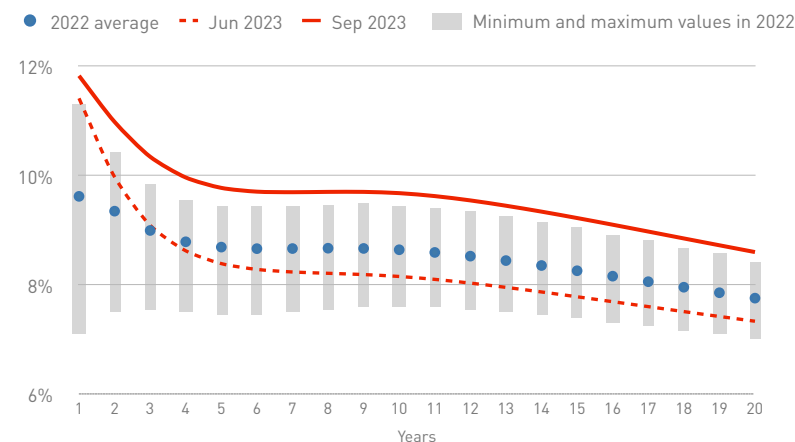
2.1.9 Mexico

As in the case of Brazil, economic growth forecasts for Mexico have been revised upwards to 2.9% for 2023 as a whole (+3.9% in 2022), with a slowdown expected in 2024 to 1.8%. The economy is withstanding the tightening of financing conditions better than anticipated, with high interest rates (11.25%) and inflation that continues to moderate (4.64% and 4.45% in August and September, respectively), moving closer to its target range (between 2% and 4%), although core infla-

tion remains stubbornly high. This economic environment with tightened financing conditions may lead to a slowdown in the insurance market, mainly in the Non-Life segment, as the Life savings and annuities business will benefit from the stimulus of positive real interest rates. Meanwhile, the moderation in price increases and the high profitability of investment portfolios is helping to improve the sector's profitability, still affected by the sharp upturn in inflation over the last two years.

Regarding the interest rate environment, the Bank of Mexico has held the reference monetary policy interest rate at 11.25% since March. In the market risk-free yield curves produced by EIOPA (see Chart 2.1.9),

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



Source: MAPFRE Economics (based on EIOPA data)

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an increase is noticeable across all tranches of the curve, which remains significantly inverted in tranches up to five years, flattening in the middle section. This interest rate environment continues to be appropriate for the development of Life savings insurance with positive real interest rates, which can offer significantly higher remuneration than the latest inflation data. The rise in the yield curve above the highs of 2022 suggests a favorable scenario for launching savings products with shorter term rate guarantees and periodic updates of the guaranteed rates, with products with longer term guarantees and life annuities also gaining appeal due to the high interest rates offered across all sections of the curve.

2.1.10 Argentina

The Argentine economy continues to move towards a recession, leading to a further downward revision of the economic growth outlook for this year, with a 2.2% decline in GDP in 2023 (+5.0% in 2022), while the inflation rate has increased again in recent months (138.3% in September, compared to average inflation of 72.4% in 2022). The economic situation for the coming year points to a slight improvement, and it may emerge from its current recessionary state, with estimated weak growth of 0.2%. This challenging economic context of recession and growing inflation continues to paint a very complex picture for the business and profitability of the insurance industry.

Meanwhile, the Central Bank of Argentina continued to tighten monetary policy in response to the strong rebound in inflation, raising the benchmark interest rate to 133% at its October meeting, in an environment of still negative real interest rates. This rate hike should improve the outlook for savings-linked Life insurance, al-

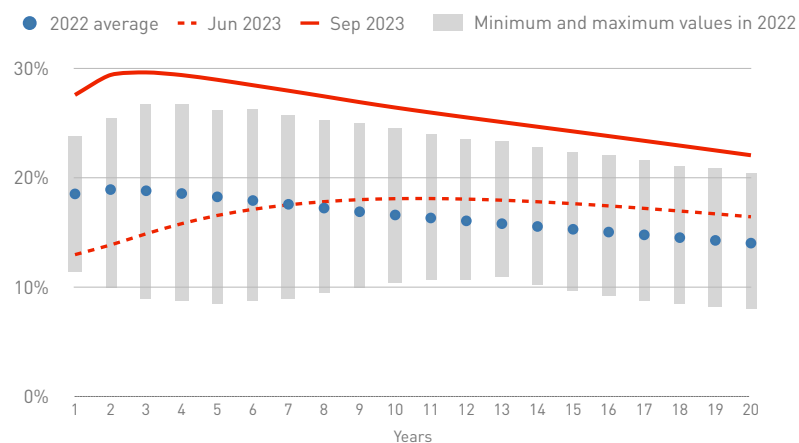
though the situation remains complex. Financial assets that are secure and profitable enough to back products capable of offsetting the erosion of purchasing power caused by inflation are difficult to find in the market.

2.1.11 Turkey

In Turkey, growth forecasts for 2023 have been revised upwards to 3.7% (+5.5% in 2022), with a slowdown expected for next year, when estimated growth would be around 2.0%. Inflation has been picking up since June (when it reached 32.2% year-on-year), rising to 61.5% in September, compared to average inflation of 72.3% in 2022. In response to this upturn, the Turkish central bank continues to tighten its monetary policy at an accelerated pace, raising its benchmark interest rate to 35% at its last meeting in October, its fifth consecutive hike since June. The economic slowdown points to an outlook for moderate growth for the insurance industry in real terms, although the sharp rebound in inflation may erode its profitability.

That said, the latest interest rate hike implemented by the central bank has not been enough to bring real interest rates into positive territory (due to the strong upturn in inflation). In the EIOPA curves (see Chart 2.1.11), a sharp rise in market risk-free interest rates is observed in all sections of the curve, which becomes negatively sloped for maturities of more than three years. Although interest rates have risen, they do not come close to offsetting the loss of purchasing power brought about by high inflation after the last upturn, so the interest rate environment continues to pose a challenge for the development of the Life savings business.

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



Source: MAPFRE Economics (based on EIOPA data)

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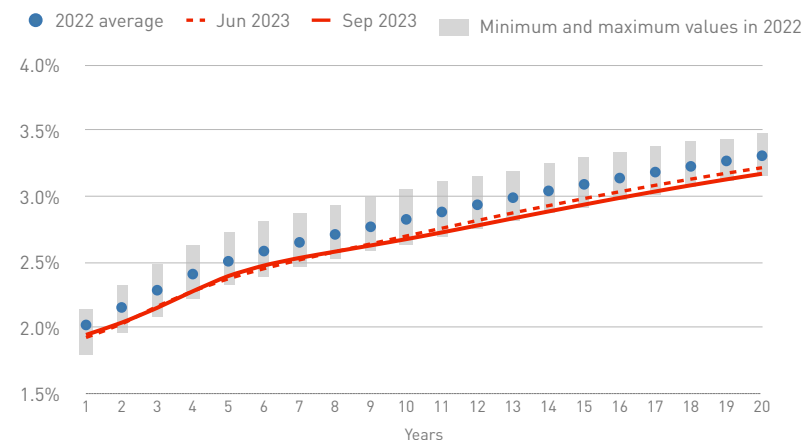
2.1.12 China

Economic growth estimates for China have been revised downward, with real GDP growth forecast at 5.1% (+3.0% in 2022) and a slowdown to around 4.4% by 2024. This continues to provide a suitable growth environment for the insurance business, in an economy supported by an accommodative monetary policy, but with the challenges posed by the real estate market crisis affecting this country.

Meanwhile, inflation in China turned negative in June, at -0.3% year-on-year, and remains very low, at 0% in September (compared to 2.0% average inflation in 2022), allowing the central bank to continue to apply

an accommodative monetary policy. It further reduced interest rates by 10.0 bps to 3.45% at its August meeting, maintaining this level at its September meeting. The EIOPA curves (see Chart 2.1.12) show that market risk-free interest rates have stabilized around the minimum values reached in 2022. Long-term rates, on the other hand, remain significantly above short-term rates, offering a positive term premium, an environment that continues to be 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.

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



Source: MAPFRE Economics (based on EIOPA data)

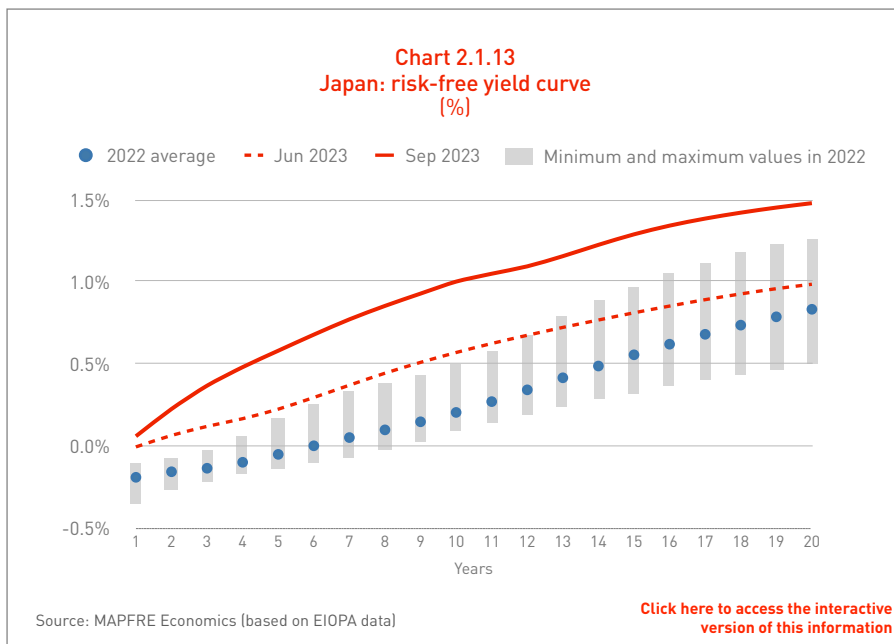
[Click here to access the interactive version of this information](#)

2.1.13 Japan

In Japan, economic growth expectations are improving, with GDP growth expected to be around 1.6% (+1.0% in 2022), and a slowdown forecast for 2024, when the Japanese economy should grow by 1.1%. The acceleration this year creates a favorable environment for the development of the insurance business, although inflation has picked up again and remains relatively high for the Japanese economy, posing an ongoing challenge for its profitability.

In terms of the Life business, the Bank of Japan decided again at its October meeting not to alter its ultra-lax monetary policy, leaving

short-term interest rates at -0.1%. However, it introduced changes to the upper limit of the 10-year rate, raising it to 1.0% due to inflation data of 3.2% and 3.0% in August and September, respectively (above its 2% target). Nevertheless, the risk-free yield curves produced by EIOPA (see Chart 2.1.13) show an upturn in all sections of the market curve, notably above the levels at the end of the previous quarter and the highs reached the previous year, with positive values across all sections and an increase in its positive slope. The curve makes it possible to offer a positive term premium, still below inflation, which suggests a more favorable environment for the development of Life savings insurance and annuities, although expectations that rates might increase continue to paint a complex picture for the management of this business.



2.1.14 Philippines

The economic outlook for the Philippines remains strong, with expected GDP growth of 5.1% in 2023 (+7.6% in 2022), and a slight slowdown in 2024 to 4.9%, which continues to paint a favorable picture for the development of the insurance business. Inflation has been picking up again since July, when it reached 4.7% year-on-year, rising to 6.1% in September, above the 2022 average inflation of 5.8%. If this situation persists, it could cast a shadow on the outlook for the profitability of insurance companies in this market.

Faced with this price spike, the Central Bank of the Philippines, which has been pursuing a tight monetary policy, decided to raise the benchmark rate by 25 bps in October at an extraordinary meeting called for this purpose, to 6.5%. The yield on the two-year sovereign bond has increased and stood at 6.57% on October 26, while the 10-year sovereign bond has also been rising, reaching 7.07%. This makes

the interest rate environment still appropriate for the marketing of traditional Life savings and annuity products, with real interest rates entering positive territory and high levels in an inflation environment that shows clear signs of improvement.

2.2 Regulatory and supervisory trends

Risks and vulnerabilities in the European Union's financial system

In September, the Joint Committee of the European System of Financial Supervision (EBA, ESMA, and EIOPA) released its report on risks and vulnerabilities in the financial system of the European Union (EU)³. In summary, this report highlights that the European economy continues to experience a period of great uncertainty, which poses significant risks to financial stability and requires vigilance from all financial market participants.

Interest rate risk

The end of the low interest rate environment may benefit financial institutions, although during the transition to this new environment, bondholders are exposed to significant risk from interest rate movements involving a decline in the prices of debt securities held on financial companies' balance sheets. In the case of banks, part of this decline in value is recorded in shareholders' equity or in the profit and loss accounts in the case of assets held at market value. Meanwhile, Life insurers and defined benefit pension funds have liabilities that, for the most part, last longer than the debt securities they hold, so rate hikes also ease the burden on liabilities by reducing their valuation, sometimes even more than asset value.

Insurers often hedge their equity positions against interest rate movements through interest rate risk derivatives. However, sudden large movements in interest rates can trigger margin calls, as has recently occurred in the UK, leading to losses in the derivative positions of insurance companies and defined benefit pension funds. However, compared to pension funds in other jurisdictions, companies in the European Economic Area (EEA) operating in derivatives markets, on average, are much better diversified in their government bond holdings and would have had no difficulty meeting these demands, even in the event of such significant upward and downward rate movements.

For debt securities held at amortized cost by EU banks, representing around €1.3 trillion, the decline in value resulting from rising interest rates is not reflected in the banks' income statements. Potential unrealized losses on EU banks' holdings of bonds at amortized cost, calculated as the difference between the book value and fair value of the debt securities at amortized cost, appear to be contained. As of February 2023, aggregate net unrealized losses of €75 billion were estimated for EU banks. In the absence of a liquidity shortfall, these potential losses are not expected to materialize and are therefore, to some extent, benign. Moreover, the report highlights that, as part of their interest rate management, banks actively manage these portfolios.

Meanwhile, high and rising interest rates are expected to support the medium-term profitability of both banks and insurance companies. However, banks may struggle to maintain high yields, and the medium-term prospects for sustained bank profitability are uncertain. The price of deposits is expected to increase as depositors become more sensitive to rate movements and shift from demand deposits to time deposits. Impairment losses could also increase as credit risk increases.

Rising market financing costs could also impact banks' cost base, while they face rising costs through other channels, such as wage inflation, costs required for digital transformation, and potential increased compliance costs. In the medium term, moderating loan growth could also mitigate the impact of wider spreads, so it is important for banks to manage their interest rate risk well.

Liquidity risk

Recent experiences of some mid-sized U.S. banks and Credit Suisse confirm the extent to which banks can be vulnerable to a sudden, rapid outflow of deposits. This situation also shows that liquidity risk control by all financial institutions is especially important now that the period of abundant liquidity is coming to an end. In the banking sector, the report highlights that liquidity positions remain solid, but continue to decline slightly. The liquidity coverage ratio (LCR) decreased from 167.9% in the first quarter of 2022 to 163.7% in the first quarter of 2023. The increase in high-quality liquid assets (HQLA) was offset by higher net outflows. In a context of slightly declining liquidity cushions, it will be important for banks to continue securing comfortable cushions, especially as long as they use these liquidity cushions to partially repay outstanding volumes of central bank financing (TLTRO-3). The RAQ (Risk Assessment Questionnaire) of the banking authority (EBA) indicates that use of current liquidity is and will remain the most common strategy for banks to repay TLTRO-3, ahead of issuing covered bonds and use of short-term financing. On the other hand, banks' financing plans indicate that they expect economic and monetary evolution to continue to reduce their liquidity coverage ratios (LCR) and net stable financing ratios (NSFR) in the future. The events of March have also underscored the implications of the digital age for bank liquidity, as information, as well as deposits, can move very quickly.

In terms of insurers, the report emphasizes that while these companies do not have deposits that could experience a massive withdrawal, the current economic environment could create incentives for policyholders to surrender policies, which could weaken the insurers' liquidity place. According to EIOPA's latest dashboard, surrender rates have increased over time (e.g., in the Life business they increased by 0.4% YoY to 3.8% in Q4 2022). The reasons and theories driving the increase vary and depend on the specifics of each market. The declines may be due to diminished disposable income (due to high inflation) for lower-income individuals, or to the reallocation of investments to more profitable short-term opportunities outside the insurance market for higher-income individuals. In this case, the risks are mitigated by the fact that insurers have large, liquid, and highly rated investment funds. In the fourth quarter of 2022, the liquid asset ratio stood at 45.6%. However, insurance companies could create stress in other markets in the event of large sales of common assets to meet sudden liquidity needs.

In the case of mutual funds, in 2022 fixed income funds faced high liquidity risk due to the high level of redemption requests in some jurisdictions. The situation normalized in the first half of 2023, but some funds reduced the liquidity of their portfolios. Specifically, liquid assets decreased slightly in high-yield bond funds, while portfolio liquidity improved in investment-grade bond funds. Both fund categories reduced cash holdings from 2.8% to 1.9% in the first half of 2023.

Credit risk

Rating agency credit risk indicators for European debt began to show some signs of impairment in the first half of 2023. This was particularly relevant in the case of sovereign bonds due to the downgrades of France, Hungary, the Czech Republic, and Poland, without falling be-

low investment grade in any case. For corporate issuers, downgrades below investment grade grew strongly versus the previous half-year, but remained below historical averages, reaching 0.1% for rated companies (versus 0.03% in the second half of 2022) and 0.13% (versus 0.7%) for investment grade ratings of structured financing. Looking ahead, short-term credit risks remain high, given the possibility of further interest rate hikes as inflation costs continue to be passed on and more issuers need to refinance.

In the case of insurance companies, credit quality is only slightly impaired. The median credit quality of EEA insurers' investments remains constant at around grade 2 (corresponding to an S&P rating between AA and A), amid signs of impairment at the lower end of the distribution. In particular, the 90th percentile increased from 2.6 to 3.0, indicating a decline in credit quality in 2022. Lower-quality bonds could potentially be a risk transmission channel, as they expose insurers to higher credit risk. The median exposure to loans and mortgages remained below 0.5% throughout the year.

In the case of banking companies, although asset quality is stable for the time being, they should be prepared for possible impairment. High and rising interest rates and persistent inflation could negatively affect over-indebted households and businesses and impact debt-servicing capacity. Credit risk is expected to deteriorate in the future in all loan segments, albeit from a good starting point. Some loan portfolios, such as the real estate portfolios of both residential and commercial real estate, are already registering a correction in asset prices. In addition, the slight increase in exposure to the residential market in the first quarter of 2023 compared to the previous quarter may pose risks in light of falling real estate prices and rising interest rates. Other portfolios, such as consumer loans, may also face new challenges. As

asset quality is expected to deteriorate, appropriate provisioning levels and forward-looking provisioning policies remain important for banks, along with the timely recognition of loan losses with related impairments. Many banks also have provisioning supplements, and a significant increase in the cost of risk is not expected, as banks would use these supplements in the event that asset quality impairment materializes.

In this context, the Joint Committee advises the European Supervisory Authorities (EBA, ESMA, and EIOPA), competent national authorities, financial institutions, and market participants to take the following measures:

- The impact on financial institutions and market participants of sharp increases in official interest rates and potential surges in risk premiums should be closely monitored and considered in risk management. In this regard, interest rate hikes have simultaneously affected all sectors, reducing the value of fixed-income assets and negatively impacting insurance companies' profitability. Overall, insurance companies and pension funds remain well capitalized, but their development needs to be monitored. Meanwhile, although rising rates are currently improving banks' net interest income and interest margins, the medium-term implications of a higher interest rate environment could be less favorable. Higher interest rates and the potential rise in risk premiums are expected to further increase funding costs and negatively affect financing conditions at a time when banks are replacing substantial amounts of central bank financing with other funding sources and continue to accumulate or replace loss-absorbing capacity. The use of interest rate derivative contracts should also continue to be closely monitored, although the potential risks are tempered by increasing

levels of central clearing. Although market infrastructures withstood recent spikes in volatility well, the uncertain economic and geopolitical situation could put them to the test and affect both financing and securities issuing, as seen recently during the banking turmoil.

- Financial institutions and supervisors should closely monitor asset quality and loan loss provisions and be prepared for impairment of asset quality in the financial sector, in a context of high macro-economic uncertainty, risk of recession, persistent inflation, volatile energy and raw material prices, and potential interest rate hikes. Higher interest rates and potentially higher risk premiums further affect the ability of highly leveraged borrowers to service their debt, adding to the adverse effects of inflation and the sluggish economic environment on their business. The assets most affected would be real estate loans, unsecured consumer loans, assets that benefited from pandemic-related support measures, and assets in sectors particularly vulnerable to rising inflation, as well as energy and raw material price volatility.
- Recent banking problems in the United States and Switzerland highlight the importance of effective risk management and governance mechanisms for financial companies, particularly in relation to liquidity risk and interest rate risk, after the coronavirus crisis revealed the importance of adequate capital cushions.
- Financial institutions and supervisors should be aware of the impact of inflation risk and monitor it closely. Inflation not only impacts financial companies through its effects on asset quality and valuation, but also through increased expenses and financing costs. Depending on their ability to adjust their premiums in a timely manner, insurance companies could be negatively affected by infla-

tion in claims (particularly those with long tail business). Moreover, inflation is not only relevant from a risk point of view, but can also have an impact on product suitability.

The impact of inflation on the insurance industry

In relation to this last point, on October 5, EIOPA published a specific report on the impact of inflation on the insurance industry⁴, considering the effects that higher-than-expected inflation and interest rates have had so far on the insurance industry, and analyzing potential future risks and vulnerabilities. The report points out that, over the past year, the value of European insurance companies' assets over liabilities has trended downwards, although they remained well capitalized. In terms of technical provisions, inflation has negatively affected Non-Life insurers by increasing the cost of claims and expenses. Although Life insurance companies have been less exposed due to the nominal nature of their liabilities, they may face higher surrender rates as inflation weakens households' ability to save.

A crucial question for insurance companies in the future is to what extent the positive effect of higher interest rates will offset the negative effect of higher inflation. EIOPA's sensitivity analysis points to positive net results for companies with long-term liabilities and negative term gaps, such as Life insurance companies. However, the erosion of the real value of insured capital and higher interest rates could lead to higher surrender rates. Meanwhile, in the short term, claims and expense inflation negatively affects the profitability of Non-Life insurance companies, requiring an increase in technical reserves and gradual adjustments to premiums.

In contrast, Life insurers are less exposed to claims inflation in the short term, but face reduced profits due to higher operating expenses.

Looking ahead, the profitability of the Life business could benefit from reinvestment with higher returns, but insurance companies may face competitive challenges down the road. As the pass-through of higher interest rates to policyholders occurs only gradually, consumers may be tempted to consider alternative savings products with higher yields. This change in consumer behavior could lead to a reduction in new business as well as an increase in surrender rates.

Finally, in the current economic outlook, EIOPA estimates that insurance companies' liquidity positions may come under stress as rising interest rates decrease the value of liquid assets. Rising claims costs, policy surrender or maturity, and potential margin calls on derivatives represent additional sources of liquidity risk, although projections indicate that insurance companies have sufficient liquid assets to meet these demands.

Tables: macroeconomic forecast scenarios

Table A-1
Baseline and stressed scenarios: gross domestic product
[% 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	2.5	-2.2	5.8	1.9	2.3	0.6	2.5	-2.2	5.8	1.9	2.2	0.1
Eurozone	1.6	-6.3	5.6	3.4	0.5	0.7	1.6	-6.3	5.6	3.4	0.5	0.5
Germany	1.1	-4.2	3.1	1.9	-0.5	0.3	1.1	-4.2	3.1	1.9	-0.6	0.0
France	1.9	-7.7	6.4	2.5	0.9	0.7	1.9	-7.7	6.4	2.5	0.8	0.5
Italy	0.5	-9.0	8.3	3.9	0.6	0.4	0.5	-9.0	8.3	3.9	0.6	0.0
Spain	2.0	-11.2	6.4	5.8	2.5	1.3	2.0	-11.2	6.4	5.8	2.4	1.0
United Kingdom	1.6	-10.4	8.7	4.3	0.5	0.3	1.6	-10.4	8.7	4.3	0.4	0.0
Japan	-0.4	-4.3	2.3	1.0	1.6	1.1	-0.4	-4.3	2.3	1.0	1.5	0.8
Emerging markets	3.6	-1.8	6.9	4.1	4.3	3.7	3.6	-1.8	6.9	4.1	4.3	3.4
Latin America	0.2	-7.0	7.4	4.1	1.9	1.6	0.2	-7.0	7.4	4.1	1.8	1.1
Mexico	-0.3	-8.8	6.1	3.9	2.9	1.8	-0.3	-8.8	6.1	3.9	2.9	1.3
Brazil	1.2	-3.6	5.3	3.0	3.1	1.5	1.2	-3.6	5.3	3.0	3.0	1.0
Argentina	-2.0	-9.9	10.7	5.0	-2.2	0.2	-2.0	-9.9	10.7	5.0	-2.5	-0.4
Colombia	3.2	-7.3	11.0	7.3	1.0	1.9	3.2	-7.3	11.0	7.3	0.9	1.7
Chile	0.7	-6.4	11.9	2.5	-0.4	1.9	0.7	-6.4	11.9	2.5	-0.7	1.6
Peru	2.3	-11.0	13.4	2.7	1.1	2.9	2.3	-11.0	13.4	2.7	0.8	2.9
Emerging markets, Europe¹	2.5	-1.6	7.3	0.8	2.4	2.2	2.5	-1.6	7.3	0.8	2.3	2.0
Turkey	0.8	1.9	11.4	5.5	3.7	2.0	0.8	1.9	11.4	5.5	3.6	1.4
Asia Pacific	5.2	-0.5	7.5	4.5	5.1	4.4	5.2	-0.5	7.5	4.5	5.1	4.3
China	6.0	2.2	8.5	3.0	5.1	4.4	6.0	2.2	8.5	3.0	5.1	4.2
Indonesia	5.0	-2.1	3.7	5.3	5.1	4.8	5.0	-2.1	3.7	5.3	5.1	4.3
Philippines	6.1	-9.5	5.7	7.6	5.1	4.9	6.1	-9.5	5.7	7.6	5.0	4.6
Global	2.8	-2.8	6.3	3.5	2.9	2.2	2.8	-2.8	6.3	3.5	2.8	1.8

Source: MAPFRE Economics

¹Eastern Europe
Forecast end date: October 30, 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	4.5	3.2
Eurozone	1.2	0.3	2.6	8.4	5.6	2.5	1.2	0.3	2.6	8.4	5.7	3.0
Germany	1.4	0.5	3.1	6.9	6.0	2.0	1.4	0.5	3.1	6.9	6.1	2.5
France	1.1	0.5	1.6	5.2	5.8	2.6	1.1	0.5	1.6	5.2	5.9	2.8
Italy	0.6	-0.1	1.9	8.2	6.0	2.9	0.6	-0.1	1.9	8.2	6.1	3.6
Spain	0.7	-0.3	3.1	8.4	3.5	2.5	0.7	-0.3	3.1	8.4	3.7	2.8
United Kingdom	1.8	0.9	2.6	9.1	7.4	3.4	1.8	0.9	2.6	9.1	7.5	4.0
Japan	0.5	0.0	-0.2	2.5	3.0	2.1	0.5	0.0	-0.2	2.5	3.1	2.4
Emerging markets	5.1	5.2	5.9	9.8	8.6	9.4	5.1	5.2	5.9	9.8	8.8	10.5
Latin America	7.6	6.4	9.8	14.0	21.2	21.8	7.6	6.4	9.8	14.0	21.8	22.2
Mexico	3.6	3.4	5.7	7.9	5.6	4.1	3.6	3.4	5.7	7.9	5.9	4.2
Brazil	3.7	3.2	8.3	9.3	4.7	4.3	3.7	3.2	8.3	9.3	4.7	4.5
Argentina	53.5	42.0	48.4	72.4	132.0	157.0	53.5	42.0	48.4	72.4	136.0	159.0
Colombia	3.5	2.5	3.5	10.2	11.8	5.6	3.5	2.5	3.5	10.2	11.9	5.8
Chile	2.3	3.0	4.5	11.6	7.7	3.3	2.3	3.0	4.5	11.6	7.8	3.5
Peru	2.1	1.8	4.0	7.9	6.6	3.8	2.1	1.8	4.0	7.9	6.7	3.9
Emerging markets, Europe¹	6.7	5.4	9.6	27.9	18.9	19.9	6.7	5.4	9.6	27.9	19.7	20.8
Turkey	15.2	12.3	19.6	72.3	50.9	51.6	15.2	12.3	19.6	72.3	51.3	63.1
Asia Pacific	3.3	3.2	2.2	3.8	1.0	2.0	3.3	3.2	2.2	3.8	1.0	2.4
China	2.9	2.5	0.9	2.0	0.5	1.9	2.9	2.5	0.9	2.0	0.5	2.3
Indonesia	2.8	2.0	1.6	4.2	3.7	2.4	2.8	2.0	1.6	4.2	3.7	2.7
Philippines	2.4	2.4	3.9	5.8	5.9	3.2	2.4	2.4	3.9	5.8	6.0	3.8
Global	3.5	3.2	4.7	8.7	6.6	6.1	3.5	3.2	4.7	8.7	6.8	6.8

Source: MAPFRE Economics

¹Eastern Europe
 Forecast end date: October 30, 2023.

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

	Baseline Scenario (BS)					
	2019	2020	2021	2022	2023(f)	2024(f)
United States	1.92	0.93	1.52	3.88	4.65	4.07
Eurozone	0.32	-0.19	0.32	3.39	3.95	3.51

Stressed Scenario (SS)					
2019	2020	2021	2022	2023(f)	2024(f)
1.92	0.93	1.52	3.88	4.65	5.08
0.32	-0.19	0.32	3.39	3.95	4.54

Source: MAPFRE Economics
Forecast end date: October 30, 2023.

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

	Baseline Scenario (BS)					
	2019	2020	2021	2022	2023(f)	2024(f)
USD-EUR	0.89	0.81	0.88	0.94	0.95	0.93
EUR-USD	1.12	1.23	1.13	1.07	1.05	1.07
GBP-USD	1.32	1.36	1.35	1.20	1.22	1.24
USD-JPY	109.12	103.54	115.00	132.65	151.53	138.61
USD-CNY	6.99	6.52	6.35	6.90	7.30	7.10

Stressed Scenario (SS)					
2019	2020	2021	2022	2023(f)	2024(f)
0.89	0.81	0.88	0.94	0.95	0.93
1.12	1.23	1.13	1.07	1.05	1.07
1.32	1.36	1.35	1.20	1.22	1.24
109.12	103.54	115.00	132.65	151.60	138.58
6.99	6.52	6.35	6.90	7.30	7.10

Source: MAPFRE Economics
Forecast end date: October 30, 2023.

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

	Baseline Scenario (BS)					
	2019	2020	2021	2022	2023(f)	2024(f)
United States	1.75	0.25	0.25	4.50	5.50	4.50
Eurozone	0.00	0.00	0.00	2.50	4.50	3.00
China	3.25	3.00	3.00	2.75	2.50	3.00

Stressed Scenario (SS)					
2019	2020	2021	2022	2023(f)	2024(f)
1.75	0.25	0.25	4.50	5.75	4.75
0.00	0.00	0.00	2.50	4.50	3.25
3.25	3.00	3.00	2.75	2.50	2.75

Source: MAPFRE Economics
Forecast end date: October 30, 2023.

[Click here to access the interactive version of this information](#)

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References

1/ See: MAPFRE Economics (2023), *2023 Economic and Industry Outlook: Third-Quarter Perspectives*, Madrid, Fundación MAPFRE.

2/ Chart 2.1.2 and subsequent can be viewed for other months and currencies on the interactive charts included at the following link: <https://app.klipfolio.com/published/29577612d0ba9ff3681af85b8ee8a998/curvas-eiopa>

3/ See: <https://www.eiopa.europa.eu/system/files/2023-09/Joint%20Committee%20Report%20on%20risks%20and%20vulnerabilities%20in%20the%20EU%20financial%20system%20-%20Autumn%202023.pdf>

4/ See: <https://www.eiopa.europa.eu/system/files/2023-10/Report%20on%20the%20impact%20of%20inflation%20on%20the%20insurance%20sector.pdf>

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