Box 1

MACROECONOMIC PROJECTIONS FOR SPAIN (2019-2021)

This box describes the most notable features of the update to the Banco de España's macroeconomic projections for the Spanish economy published on 7 June 2019.[1] In particular, the present projections take on board the changes to the technical assumptions arising from the new information that became available between the two exercises (see Table 1)[2] and the latest National Accounts data. The latter include a revision made by the National Statistics Institute (INE) to the time series for the period 1995-2018 and, also, preliminary results for the quarterly time series up to 2019 Q2 (see Box 8). This recent revision of the National Accounts time series means that it is particularly hard to make comparisons with the June projections.[3]

The present projections point to continuation of the Spanish economy's expansionary phase over the period 2019-2021 (see Table 2). Growth will continue to be underpinned by the accommodative stance of monetary policy, reinforced by the measures adopted by the Governing Council of the European Central Bank (ECB) at its last meeting, the favourable financial position of firms and households on aggregate (although some groups of agents are still in a comparatively vulnerable situation),

Table 1
INTERNATIONAL ENVIRONMENT AND MONETARY AND FINANCIAL CONDITIONS (a)

Annual rates of change unless otherwise indicated

		September 2019 projections			Differences between September and June 2019 projections (b)		
	2018	2019	2020	2021	2019	2020	2021
International environment							
World GDP	3.6	2.8	3.2	3.3	-0.2	-0.2	-0.1
Spain's export markets	3.0	1.9	2.5	3.0	-0.7	-0.5	-0.2
Oil price in US dollar/barrel (level)	71.1	64.0	60.0	57.9	-4.1	-5.8	-4.8
Monetary and financial conditions							
US dollar/euro exchange rate (level)	1.18	1.12	1.10	1.10	-0.01	-0.02	-0.02
Nominal effective exchange rate against non-euro area (c) (2000 = 100 and percentage differences)	121.5	116.4	115.1	115.1	-0.3	-1.1	-1.1
Short-term interest rate (3-month EURIBOR) (d)	-0.3	-0.4	-0.5	-0.5	0.0	-0.2	-0.3
Long-term interest rate (10-year bond yield) (d)	1.4	0.6	0.4	0.6	-0.5	-0.9	-1.0

SOURCES: ECB and Banco de España.

a Cut-off date for assumptions: 17 September 2019. Figures expressed as levels are annual averages. Figures expressed as rates are calculated based on the relevant annual averages.
b Differences between rates for world output and export markets and between levels for oil prices and the dollar/euro exchange rate. Percentage differences for the effective nominal exchange rate and percentage point differences for interest rates.
c A positive percentage change in the nominal effective exchange rate denotes an appreciation of the euro.
d For the projection period, the figures in the table are technical assumptions, prepared using the Eurosystem's methodology. These assumptions are based on futures market prices or on proxies thereof and should not be interpreted as a Eurosystem prediction as to the course of these variables.

1 Macroeconomic projections for the Spanish economy (2019-2021): the Banco de España's contribution to the Eurosystem's June 2019 joint forecasting exercise.

2 The June 2019 projections were based on the information available as at 15 May for those variables that have a bearing on the projections. In the latest exercise the cut-off was 17 September, except for data on export markets and the prices of competitors in their national currencies, which were taken from the ECB staff macroeconomic projections for the euro area, September 2019, which use information up to 19 August.

3 A further difficulty is that sector accounts consistent with the annual National Accounts and the preliminary quarterly results have still not been published.

and the assumption that, following their recent weakness, export markets will tend to recover gradually over the projection horizon. As a result of all this, it is expected that the growth rate of the economy will continue to enable the still high volume of unemployment to be reabsorbed.

Notwithstanding this, activity will tend to become less buoyant over the projection horizon. In terms of average annual rates, after growing by 2.4% in 2018, GDP is projected to grow by 2% in 2019, and by 1.7% in 2020 and 1.6% in 2021. This profile of deceleration is partly a result of weaker domestic demand, revealed by the latest National Accounts data, and partly a consequence of the latest economic data available, which point to a weakening of activity over the summer months. Overall, this new information shows that the deterioration of the external environment and the uncertainties originating from the rest of the world (and possibly also other domestic ones) appear to be having a moderating impact on business and household spending. This context of greater uncertainty is expected to continue to weigh on agents' spending decisions, particularly in the short term, leading to more moderate activity growth than in recent years.

Notable, in comparison with the June projections, are the significant changes made to three of the assumptions on which the projections are based. First, the expected dynamism of Spain's export markets is now less than it was three months ago, especially in 2019 and 2020, as a result of the lower growth projected for the euro area and, especially, for the economies outside the euro area (see Table 1). The cumulative growth of external markets over

Table 2
PROJECTIONS FOR THE MAIN MACROECONOMIC AGGREGATES OF THE SPANISH ECONOMY (a)

Annual rate of change in volume terms and % of GDP

		September 2019 projections			Differences between September and June 2019 projections		
	2018	2019	2020	2021	2019	2020	2021
GDP	2.4	2.0	1.7	1.6	-0.4	-0.2	-0.1
Private consumption	1.8	1.0	1.3	1.4	-0.8	-0.4	-0.1
Government consumption	1.9	1.8	1.3	1.2	0.0	0.0	0.0
Gross fixed capital formation	5.3	2.3	3.4	2.6	-1.9	-0.5	-0.3
Investment in equipment, intangibles and other (b)	4.1	2.3	2.9	2.3	-1.4	-0.6	-0.3
Investment in construction	6.6	2.3	3.9	2.9	-2.3	-0.4	-0.3
Exports of goods and services	2.2	2.2	3.0	3.3	0.6	-0.2	-0.2
Imports of goods and services	3.3	0.5	3.2	3.4	-0.9	-0.6	-0.2
Domestic demand (contribution to growth)	2.7	1.4	1.7	1.5	-0.9	-0.4	-0.2
Net external demand (contribution to growth)	-0.3	0.6	0.0	0.1	0.5	0.2	0.0
Harmonised index of consumer prices (HICP)	1.7	0.8	1.1	1.5	-0.3	-0.2	0.0
HICP excluding energy and food	1.0	1.1	1.4	1.6	-0.1	-0.1	-0.1
Employment (full-time equivalent jobs)	2.5	1.8	1.3	1.5	-0.2	-0.2	-0.1
Unemployment rate (% of labour force). End-of-period data	14.4	14.1	13.2	12.8	0.2	0.8	1.0
Unemployment rate (% of labour force). Annual average	15.3	14.1	13.6	13.0	0.2	0.6	0.9
General government net lending (+) / net borrowing (-) (% of GDP)	-2.5	-2.4	-1.8	-1.5	0.0	0.0	0.1

SOURCES: Banco de España and INE.
Latest QNA figure published: 2019 Q2.

a Projections cut-off date: 17 September 2019.
b Includes machinery, capital goods, weapons systems, cultivated biological resources and intellectual property products.

the whole of the time horizon considered has been revised downwards by 1.4 pp. Compared with the negative impact on activity that this change gives rise to, the other two changes work in the opposite direction. In particular, there has been a notable downward revision to the oil price, which boosts the growth of private agents' real incomes. Also, the paths of interbank market interest rates and government debt yields are now considerably below those anticipated three months ago, which results in lower financing costs for the economy as a whole. This revision to the interest rates expected by the financial markets is explained by two main factors: the latest euro area activity and inflation data (which is less favourable than was anticipated three months ago); and the loosening of monetary policy in the United States and the new monetary stimulus measures adopted by the Governing Council of the ECB on 12 September.[4]

The changes in the fiscal policy assumptions for the projection horizon, relative to the June projections exercise, are of little significance. As in June, the fiscal policy forecasts incorporate the extension to 2019 of the 2018 State and Social Security budgets, the measures approved by parliament before the April general elections,[5] the regional government and local government budgets approved for 2019, as well as the information available on the budget outturn. As regards the assumptions for the rest of the time horizon considered, the upcoming general elections make it practically impossible for the draft budget for 2020 to be presented in 2019. Also, as at the cut-off date for the projections, the new National Accounts time series for general government, to be published on 30 September, were still not available. Accordingly, the projections take as their starting point the previously released 2018 data.

Against this background, when projecting the expected paths of certain budgetary items over the period 2020-2021, certain technical assumptions have been made, as in the June projections. First, that the items subject to greater discretion, including notably, on account of their size, purchases of goods and services and public investment, will grow in line with the Spanish economy's potential growth rate. Second, it is considered that the paths of the other items, making up the general government accounts will be determined, in the absence of additional measures, by their usual determinants. Specifically, it is assumed that public revenues will grow in line with the tax bases, which basically depend on the macroeconomic context. Similar assumptions have been made for less discretionary spending items, including spending on pensions (which is determined, along with the increases agreed for 2018-2019, by the revaluation formula established by law and by population ageing), unemployment benefits (the growth of which will depend basically on developments in unemployment) and interest (changes in which reflect the growth of government debt and the course of interest rates). This last item, in particular, has been revised down on account of the changes observed in market interest rates compared with the previous projections. In accordance with these assumptions, the fiscal policy stance will be expansionary in 2019, and approximately neutral over the following two years.[6]

The changes to the assumptions on which the projections are based have, overall, a neutral impact on GDP growth over the projection horizon. Specifically, the negative impact of the deterioration in external markets on activity is offset by the positive effect of lower financing costs and lower oil prices. Notwithstanding this, the information that has become available since June has led to a downward revision in the GDP growth rates projected over the projection horizon, in comparison with those published in June. This is a consequence of two types of factors. First, the revised National Accounts time series indicate that the Spanish economy's resilience to the context of global uncertainty which began to gradually take hold last year is actually lower than estimated three months ago. Indeed,

4 See Section 3.2 of the main text for a detailed description of these measures.

5 Among these measures, which were already included in the March and June projections, the following are notable for the size of their impact on spending: (i) the increase in pensions in 2019 in line with CPI forecasts; (ii) the increase in public sector wages; (iii) the progressive extension of paternity leave to 8 weeks this year, 12 weeks in 2020 and 16 weeks in 2021; and (iv) the reintroduction of the unemployment benefits for the over-52s. As regards revenues, the projections include the increases in the minimum (due to the increase in the national minimum wage) and maximum contribution bases (by 7%), as well as in the rates for self-employed workers.

6 In 2018 and in 2019, a number of temporary measures are budgeted (such as the costs of the insolvent toll motorways, the asset protection schemes and deferred fiscal assets of banks, and the judgement on the exemption of maternity and paternity benefits from personal income tax), with a rising impact on the budget deficit of 0.4% and 0.3% of GDP, respectively.

the new data show a profile of slowing activity (and, in particular, of slowing domestic demand) that is more pronounced than the one according to the previous time series. Second, the increase in global uncertainty over the summer months and the deterioration of the external setting (the recovery in which is expected to be postponed by several quarters) led to a downward revision to the growth anticipated in the second half of the year and, more modestly, over the rest of the forecast. As a result of all this, the GDP growth projected for 2019 has been revised down by 0.4 pp, the revision of National Accounts data and the less favourable economic developments since the spring and their effects on the short-term outlook having made contributions of approximately the same magnitude to this revision. The downward revisions in 2020 and 2021 are of 0.2 pp and 0.1 pp, respectively.

The projected GDP growth path is underpinned by a lower positive contribution of domestic demand than in the recent past. The rate of growth of the main domestic demand components has also been revised down, largely because it has eased recently. Thus, the more recent data reflect a slowdown in spending on consumer goods and services. This loss of dynamism may be connected to the heightened uncertainty. Going forward, growth in consumption is expected to be underpinned by labour market developments, which are expected to remain positive (despite feeling the impact of the recent slowdown), and by continuing favourable financing conditions. Private consumption growth has been revised down compared with the June projections. This is the result of the inclusion of the more recent information, not only on the new historical series but also on the recent less expansionary labour market performance.

As regards the components of gross fixed capital formation, over the course of the projection horizon both residential and business investment are expected to be less dynamic than in recent years, against a backdrop of greater uncertainty, lower new plant capacity requirements and more moderate growth in the real estate market after years of recovery. In annual average terms, over the 3-year projection horizon analysed, both aggregates will record lower growth than forecast in June. The downward revision is especially marked for 2019 and is largely the result of the inclusion of the data on the latest quarters recently released by the INE.

The average growth projection for exports in 2019 has been revised up. This is due to the inclusion of the new data series since, conversely, the heightened uncertainty and the weaker performance expected of the export markets suggest that in coming quarters sales abroad will be less robust than forecast three months ago. This deterioration in the external environment explains why export growth expectations have been revised down in the rest of the projection horizon. Import growth expectations over the projection horizon are also lower now than in June. This reflects both the import sluggishness observed in the latest quarters and the lower final demand momentum expected going forward.

The slower GDP growth forecast over the projection horizon will translate into a gradual decline in the pace of job creation, as has already been observed in the most recent employment indicators. In any event, the increase in employment will mean that the unemployment rate will continue to decline, although less markedly than expected in June. This is also a reflection of higher growth in the labour force owing to the higher population dynamism projected, which is in turn a consequence of the inclusion of the most recent information on net migration (see Box 5). The unemployment rate is now expected to fall to 12.8% at the end of the projection horizon, 1 pp above the level forecast three months ago.

Inflation, measured as the year-on-year rate of change of the harmonised index of consumer prices (HICP), is expected to rise over the projection horizon. This is a consequence of the decrease in the cyclical slack in the labour market, as a result of the continued economic expansion, which will drive up unit labour costs. The expansionary monetary policy stance will also contribute in the same direction. By contrast, the assumptions on which the projection exercise is based suggest that external inflationary pressure will decline in coming years, reflecting the downward path of oil prices. As a result of these combined effects, in annual average terms HICP growth is expected to rise gradually, from 0.8% in 2019 to 1.5% in 2021. For its part, the rate of growth of core inflation – measured as the rate of change of the HICP excluding energy and food – will rise over the projection horizon, from 1.1% in 2019 to 1.6% in 2021.

With all due caution, considering that budget deficit series consistent with the new national accounts series are not yet available, it is estimated that the general government budget balance in 2019 could be -2.4% of GDP. This would imply maintaining the deficit forecast for 2019 compared with the June projections, as it is estimated that the negative impact of the cyclical deterioration on public finances will be offset by the positive effect of lower interest rates, together with the additional effects deriving from certain non-recurring items and from the better than expected performance of some tax revenues.

The current HICP growth projections entail a downward revision of 0.3 pp in 2019 and 0.2 pp in 2020. Part of the reason for this is that, in the more recent months, energy prices and, to a lesser extent, prices of other goods have been less dynamic than expected in the previous projection exercise. Moreover, the levels projected for crude prices are now lower and the growth forecast for non-energy prices is more contained. The forecasts for 2021 remain unchanged, as a result of two contrasting effects. On the one hand, the fall in crude prices expected in the futures markets has eased compared with that considered in the projection exercise three months ago. On the other hand, as in all the other years in the projection horizon, core inflation has been revised down by 1 pp owing to weaker demand and more moderate inflation expectations.

The risks to the central scenario for growth in activity remain on the downside. On the external front, as indicated, the near-term growth outlook for Spain's export markets has been revised down, in accordance with the recent data on activity worldwide (and in particular in the euro area which is Spain's main trading partner). The assumptions on future export market behaviour – taken from the latest ECB staff projections – assume that the recent adverse performance is temporary and that it will start to reverse in early 2020. However, if the recent weakening of activity proves to be more persistent than envisaged in the assumptions, the course of the Spanish economy would be less favourable than envisaged in the central scenario. Other sources of uncertainty are the possible adoption of new protectionist measures and the question marks over the form that Brexit will take. Lastly, the recent spike in oil prices following the attacks on Saudi production facilities is a reminder that latent geopolitical tensions can give rise to reductions in the oil supply, with the consequent negative impact on activity. On the domestic front, there is still a high degree of uncertainty over the future economic policy stance and the adoption of measures that will increase the resilience of the Spanish economy to a possible deterioration of the global macro-financial environment and boost its potential growth. In particular, there are few details on fiscal policy, in a setting in which the persistently high levels of government debt mean that Spanish public finances still have pockets of vulnerability to possible adverse shocks.

The risks of inflation departing from the central scenario are also on the downside, as a consequence of the hypothetical materialisation of the risks to activity described above. However, some of these risks also contain potential inflationary elements. For instance higher tariffs, which imply higher import prices at the different stages of the value chain and, therefore, could have an indirect effect on the prices of purchases made by the Spanish economy abroad, and also hypothetical oil price rises as a consequence of an increase in certain geopolitical tensions.