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Macroeconomic projections and quarterly report on the Spanish economy. June 2024

Contents

EDITORIAL

Editorial

In recent months, global economic activity has picked up somewhat, while the disinflationary process has continued worldwide, albeit less intensely than expected. The pace of growth of activity accelerated slightly in the first few months of the year – particularly in services-related sectors – and was more buoyant than expected in certain geographical areas, such as the euro area. Inflation continued to slow in the early months of 2024, although less intensely than over the course of 2023. This is partly because in regions such as the euro area and the United States, services inflation (which has historically been stickier than the other components of the consumption basket) has recently displayed greater downward stickiness than anticipated. Also, in recent months, oil and gas prices have been higher than anticipated on international markets, while considerable geopolitical tensions have persisted.

Looking ahead to the coming quarters, these relatively favourable macro-financial dynamics are not expected to change significantly. In particular, in a setting in which world services and labour markets continue to show considerable vigour, the consensus forecasts expect global economic activity to gain some traction over the period 2024-2026. In any event, it seems that global GDP in this period will grow at a relatively modest pace in historical terms as a result of, among other factors, the high uncertainty that still characterises the geopolitical scenario and the especially tight global monetary policy stance anticipated over much of this horizon. Also, most analysts forecast that inflation rates will continue to decline over the next quarters, although in light of the most recent trends, this process will likely be somewhat more gradual than anticipated a few months ago. For instance, the June European Central Bank (ECB) staff macroeconomic projection exercise has revised upwards the projected GDP growth for the euro area in 2024 (by 0.3 percentage points (pp), to 0.9%). It has also raised the average headline inflation rates envisaged for 2024 (by 0.2 pp, to 2.5%) and 2025 (by 0.2 pp, to 2.2%).

In this context, at their latest monetary policy meetings the central banks of some advanced economies reduced their key policy interest rates. In particular, the ECB decided to lower its key interest rates by 25 basis points (bp) at its meeting of 6 June, having held them steady since September 2023. The markets expect that most of the central banks of the other advanced economies (including the US Federal Reserve System) will follow suit during the coming months. That said, the future path of policy interest rates expected by the financial markets has shifted slightly upwards since the cut-off date for the Banco de España's March projections, mainly as a result of recent upside inflation surprises.

In Spain, economic activity was particularly buoyant (and higher than expected) in Q1 and the indicators available for Q2 suggest that GDP has continued to expand at a considerable pace. In the first three months of the year, the Spanish economy posted quarter-on-quarter growth of 0.7% (compared with the Banco de España's March forecast of 0.4%), according to the Quarterly National Accounts (QNA) flash estimate published by the National Statistics Institute. In the light of the disaggregated QNA data, the positive surprise in activity was mainly due to buoyant exports of travel services, against a background of significant tourist inflows, changes in the seasonal patterns of tourist arrivals, greater diversification of destinations and higher average spending per tourist. The latest short-term indicators suggest that GDP growth remained strong in the second quarter of the year, with the quarter-on-quarter growth rate possibly standing at 0.5%.

Compared with the March projections, GDP growth for 2024 is revised up by 0.4 pp to 2.3%, and remains unchanged for 2025 (1.9%) and for 2026 (1.7%). The main factor behind this upward revision of the average rate of growth of GDP for 2024 is the positive carry-over effect resulting from the new data in the QNA flash estimate, specifically the upward revision in the growth rates for the last two quarters of 2023 and the higher than expected growth in 2024 Q1. In this respect, the GDP growth rates projected for the coming quarters are not very different from those envisaged in March and are expected to gradually converge towards rates consistent with the Spanish economy's potential growth. Meanwhile, inflation is forecast to continue to ease gradually in the coming quarters. Nonetheless, compared with the March projection exercise, the headline inflation rate is revised up, for 2024 by 0.3 pp to 3%, and for 2025 and 2026 by 0.1 pp, to 2% and 1.8%, respectively. The upward revision for 2024 reflects the higher contributions expected from the energy component and core inflation. The upward revisions for 2025 and 2026 are mainly explained by the slightly slower deceleration in services inflation than was anticipated in March, in a setting in which services inflation has fallen by barely 0.2 pp since the start of the year.

Under the baseline scenario, the risks to these projections are on the downside for activity, whereas for inflation they are on the upside for the coming quarters and are balanced for 2025 and 2026. On the external front, the main sources of uncertainty continue to be developments in the current focal points of geopolitical tensions worldwide, global economic growth, the Chinese real estate sector and the international financial markets, with some stock indices close to all-time highs and relatively low risk premia. In the domestic arena, there is considerable uncertainty as to how long services – especially travel services – can maintain the strong dynamism they have shown in Spain in recent quarters. Also notable are the risks associated with the reactivation of the European fiscal rules. In particular, compliance with these rules will require the design and implementation in Spain of a medium-term fiscal consolidation plan that will result in a sharper correction of the structural public deficit than is envisaged in these projections.

Figure 1

	2024	2025	2026
GDP	2.3% ↑ 0.4 pp	1.9% =	1.7% =
Inflation	3.0% ↑ 0.3 pp	2.0% ↑ 0.1 pp	1.8% ↑ 0.1 pp

SOURCE: Banco de España.

REPORT

1 The outlook for global economic activity is virtually unchanged

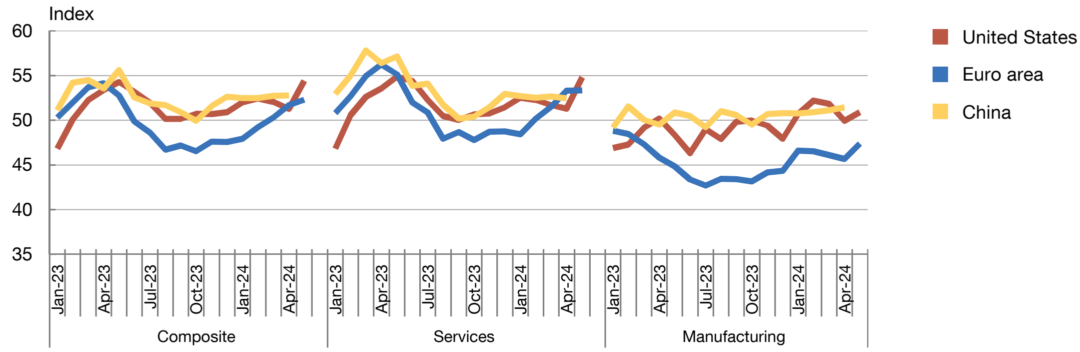
— Global GDP grew by 0.8% in 2024 Q1, somewhat more than expected. Among the advanced economies, GDP growth surprised on the upside in the euro area (0.3%) and the United Kingdom (0.6%), but was below consensus forecasts in the United States (0.4%) and Japan (-0.5%). Among the emerging market economies, China posted notable GDP growth of 1.6%, up by 0.6 percentage points (pp) on end-2023.

— Broadly speaking, these favourable developments in global economic activity were mainly underpinned by momentum in both private and government consumption, amid the continued strong performance of labour markets. On the supply side, activity was again primarily driven by services (see Chart 1.a).

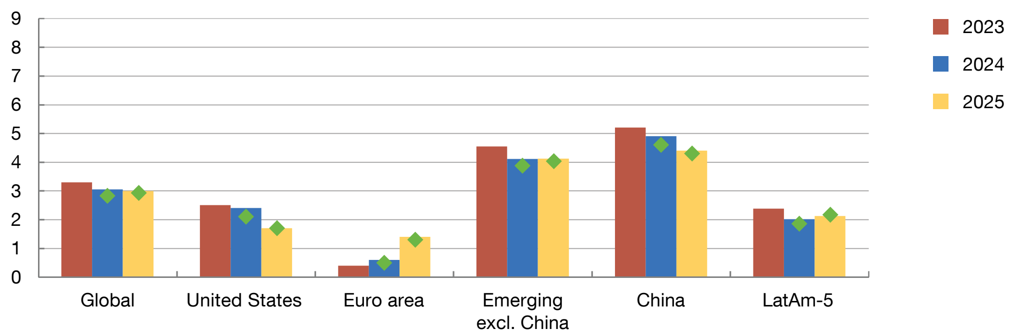
— In the light of these developments and the latest indicators, the consensus outlook for global growth in 2024 has been revised upwards slightly in recent months, to around 3%, a level that remains moderate by historical standards (see Chart 1.b).

Chart 1

1.a PMIs



1.b Consensus growth forecasts (a)



SOURCES: S&P Global and Consensus Economics.

a The May 2024 forecasts (bars) are compared with the February forecasts (diamonds). "Emerging excl. China" includes India, Indonesia, Malaysia, Philippines, Thailand, Bulgaria, Hungary, Poland, Romania, Russia, Türkiye and Ukraine. "LatAm-5" includes Mexico, Colombia, Peru, Chile and Brazil. Lastly, "Global" includes all the foregoing plus the United States, China and the euro area.

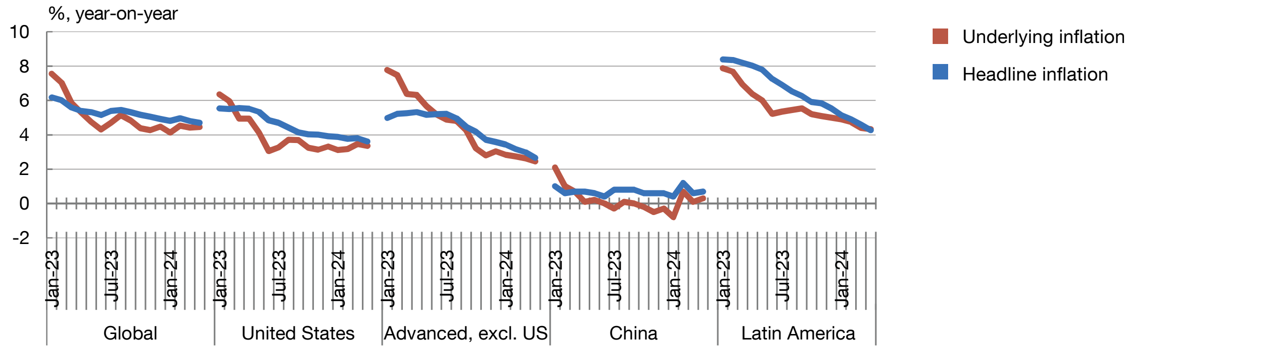
2 The global disinflation process has continued in recent months, although at a slower pace than in 2023

— Two factors in particular have contributed to the recent moderation in the easing of global inflationary pressures (see Chart 2.a). First, against a backdrop of persistently high geopolitical tensions that particularly affect certain key geographical areas for energy commodity supply, oil and natural gas prices have been, in recent months, higher than expected three months earlier, which has exerted upward pressure on energy inflation (see Chart 2.b).

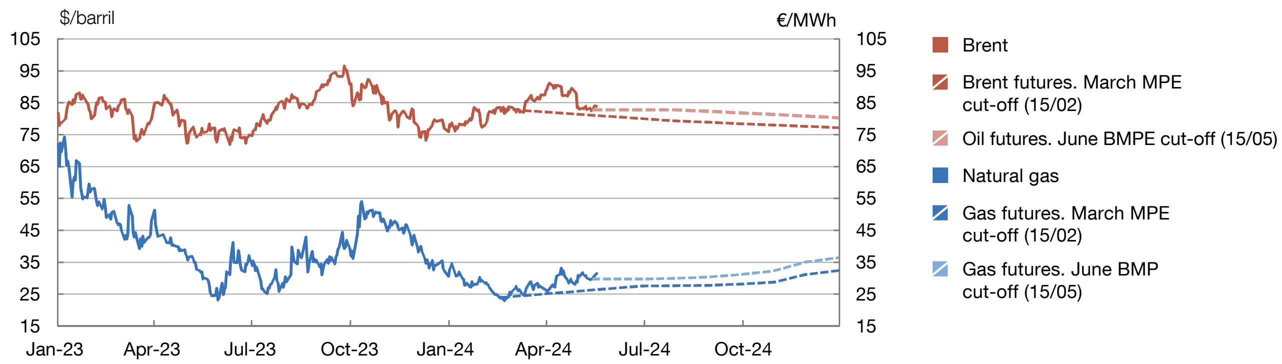
— Second, regarding the underlying component of prices, even while non-energy industrial goods inflation has continued to fall lately, this has been countered by persistent inflation in services. For example, services inflation has remained stubbornly high by historical standards in the United States (around 5%) and the euro area (around 4%) since the beginning of the year. This appears to be partly the result of the significant momentum in wages, in an environment in which global labour markets continue to show clear signs of tightness.

Chart 2

2.a Inflation



2.b Oil and gas prices and futures



SOURCES: National statistics and Refinitiv.

3 Some advanced economies have recently lowered interest rates, although market expectations for interest rate developments have broadly been revised up in the second quarter

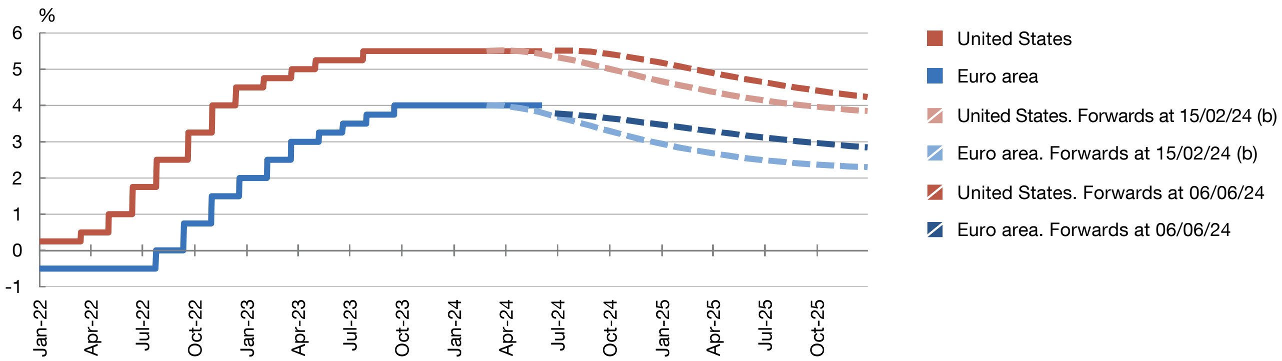
— At their latest monetary policy meetings, the European Central Bank (ECB) and the central banks of Canada, Switzerland and Sweden decided to cut their policy interest rates, initiating a process that many emerging economies had begun in the second half of 2023.

— Markets expect the other major advanced economies (with the exception of Japan) to likewise begin this process in the coming months. For instance, at the cut-off date for this report, the markets assigned a roughly 80% probability of the US Federal Reserve setting its policy interest rates at least 25 bp below their current level at its November meeting.

— That said, in economies such as the United States and the euro area, market expectations are for interest rates – while still declining – to stand at higher levels in the coming months than envisaged midway through the first quarter (see Chart 3.a). This upward revision largely reflects the market perception that inflationary pressures could prove somewhat more persistent than expected a few months ago, amidst the continued and considerable strength of activity, employment and wages.

Chart 3

3.a Policy interest rates observed and forwards (a)



SOURCES: Refinitiv Datastream and Banco de España.

a Instantaneous forwards estimated based on market data on OIS rates at different maturities using the Svensson parametric model (Lars E. O. Svensson (1994). "Estimating and Interpreting Forward Interest Rates: Sweden 1992-1994". IMF Working Papers, 94/114, International Monetary Fund) and adding the spread between the policy rate and the overnight interest rate at the estimation date.
b 15 February 2024 is the cut-off date of the Banco de España's March 2024 projection exercise.

4 Global financial markets have shown highly positive dynamics this quarter

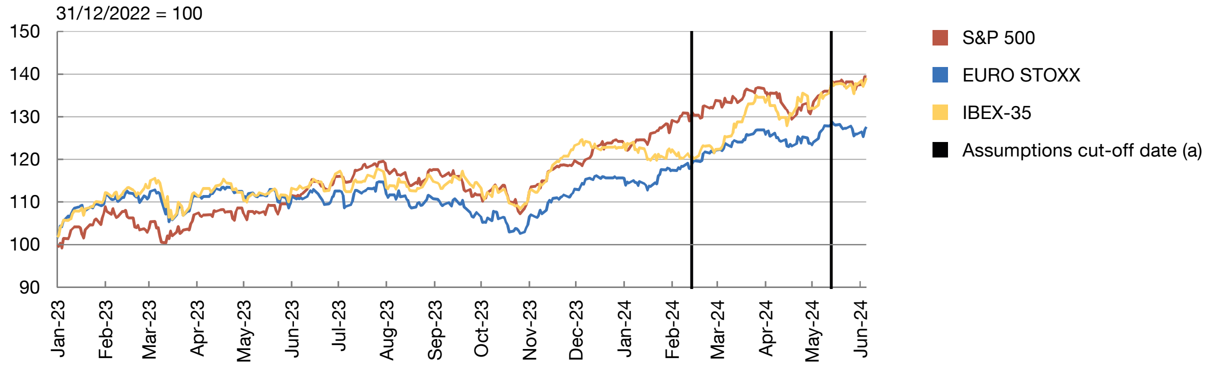
— Despite several persistent sources of geopolitical uncertainty (e.g. the conflicts in Ukraine and the Gaza Strip and US-China trade tensions), the world's major stock markets continued to trend upwards in the second quarter (standing close to all-time highs), underpinned by the favourable performance of economic activity and corporate earnings (see Chart 4.a).

— On sovereign debt markets, long-term yields have risen slightly during the quarter (see Chart 4.b), essentially due to the upward revision of the expected path of policy interest rates. In any event, credit risk premia in these markets remain broadly unchanged, holding at low levels.

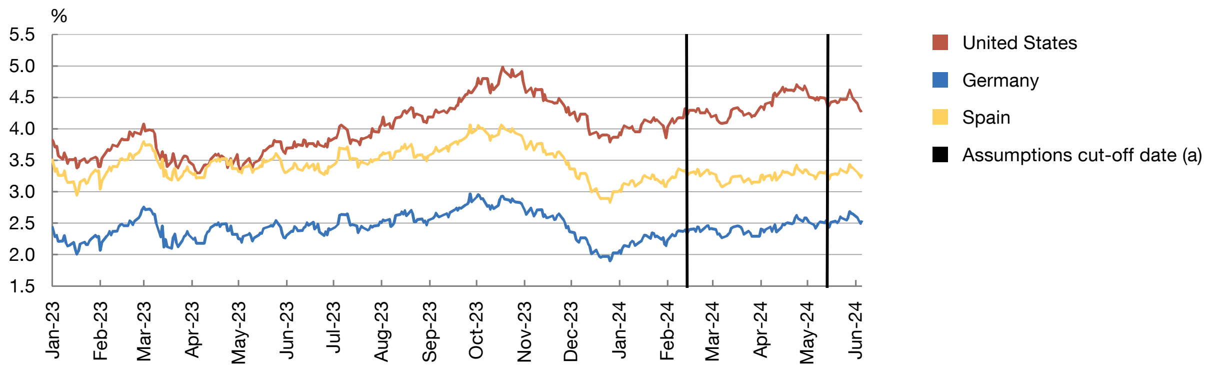
— On foreign exchange markets, the euro has appreciated since the end of March in nominal effective terms and against the US dollar. In the latter case, this appreciation appears consistent with the improved macroeconomic data and somewhat larger increase in long-term yields in the euro area, along with a decline in global risk perception among investors.

Chart 4

4.a Stock markets



4.b 10-year sovereign debt yields



SOURCE: Refinitiv Datastream.

a 15 February 2024 and 15 May 2024 are the cut-off dates for assumptions of the Banco de España's March 2024 and June 2024 projection exercises, respectively.

5 Euro area economic activity is showing early signs of a recovery that could take hold over the coming quarters

— According to the Eurostat estimate, euro area GDP grew by 0.3% in 2024 Q1, compared with a slight drop of 0.1% in the previous quarter. That figure was 0.2 pp higher than the growth envisaged in the March ECB staff macroeconomic projections and entailed considerable upward surprises in the region's four major economies.

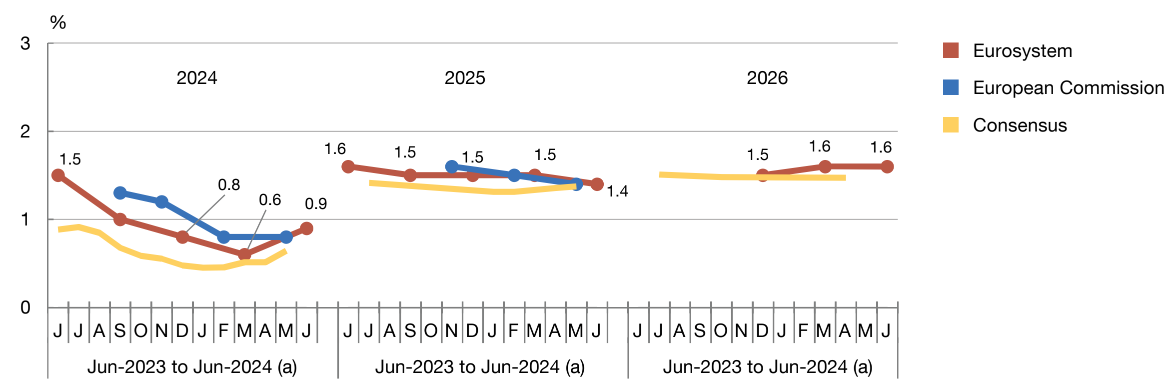
— The latest short-term economic indicators, particularly for the services sector, suggest that this renewed momentum has continued into the second quarter, meaning the euro area may be emerging from the economic sluggishness it has experienced since end-2022.

— Against this backdrop, the Eurosystem's June projection exercise revised up euro area GDP growth for 2024 to 0.9%, 0.3 pp up on the March forecast (see Chart 5.a). This revision essentially reflects stronger momentum in exports and, to a lesser extent, private consumption. In any event, the significant uncertainty that still persists is likely to continue undermining agents' confidence, hindering a stronger recovery in consumption (despite the gradual recovery in real income and buoyant employment) and particularly in private investment.

— The latest projection exercise puts GDP growth in 2025 and 2026 at 1.4% and 1.6%, respectively, virtually unchanged from the figures envisaged in the March exercise.

Chart 5

5.a Euro area. GDP growth forecasts



SOURCES: European Commission, Consensus Economics, Eurosystem and Eurostat.

a The letters refer to the month in which the corresponding forecast was published.

6 Euro area inflation has continued to decline in the first few months of 2024, with services making the largest and most persistent contribution to current inflationary pressures

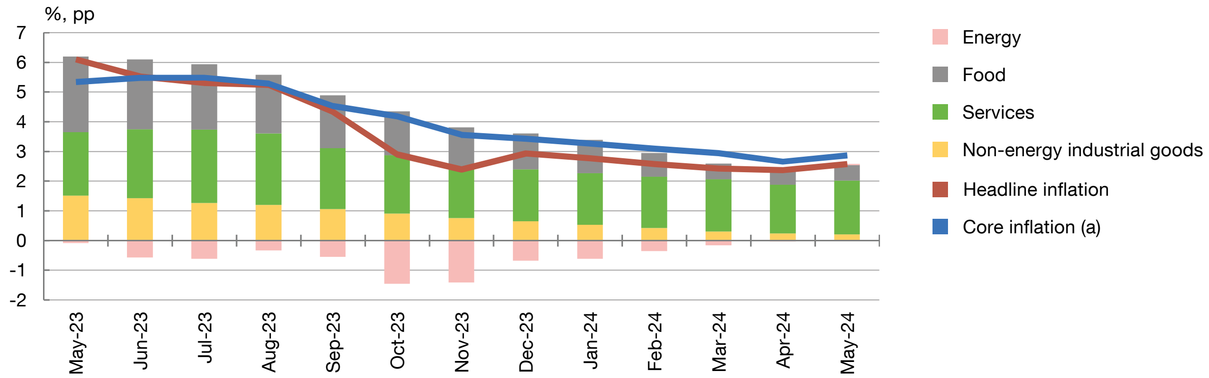
— According to the leading indicator, headline inflation in the euro area stood at 2.6% in May, while core inflation reached 2.9% (see Chart 6.a).

— In recent months the moderation in inflation has been supported by easing food price pressures and a deceleration, albeit more subdued, in non-energy industrial goods prices. By contrast, the recent pick-up in energy prices appears to be undermining this component's contribution to the disinflationary process. Similarly, services inflation seems to showing greater downward stickiness, more than was expected a few months ago.

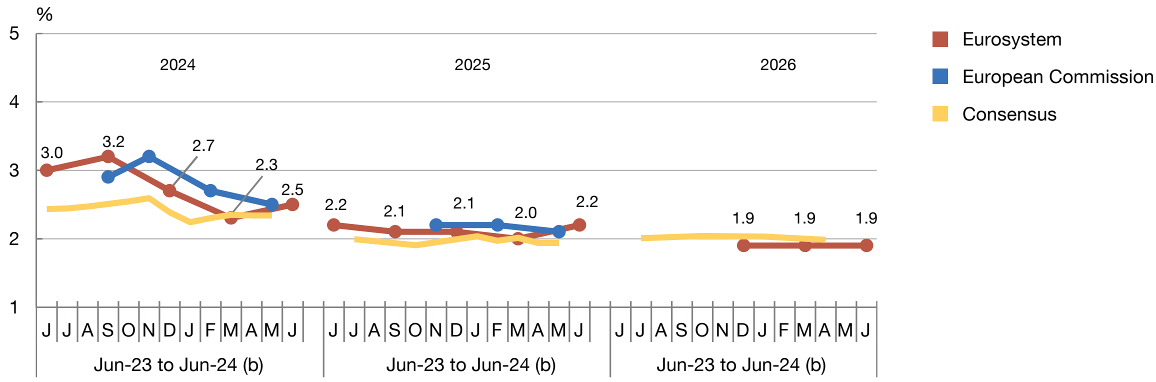
— Against this background, the Eurosystem's June projection exercise slightly revised up the headline inflation rates for 2024 and 2025 (as compared with the March forecast), lifting them by 0.2 pp to 2.5% and 2.2%, respectively. These revisions mainly reflect upward changes in energy prices and more persistent underlying inflation. For 2026 inflation is expected to remain unchanged at 1.9% (see Chart 6.b).

Chart 6

6.a Euro area inflation and contribution of components



6.b Euro area inflation forecasts



SOURCES: European Commission, Consensus Economics, Eurosystem and Eurostat.

a Headline HICP excluding energy and food.
b The letters refer to the month in which the corresponding forecast was published.

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7 The European Central Bank lowers its key interest rates by 25 basis points at its June meeting

— After nine months of holding interest rates steady, the ECB Governing Council deemed it appropriate to moderate the degree of monetary policy restriction, on the basis of an inflation outlook that has improved markedly since the September 2023 meeting, underlying inflation that has also eased and the continued transmission of monetary policy to financing conditions, which have remained restrictive.

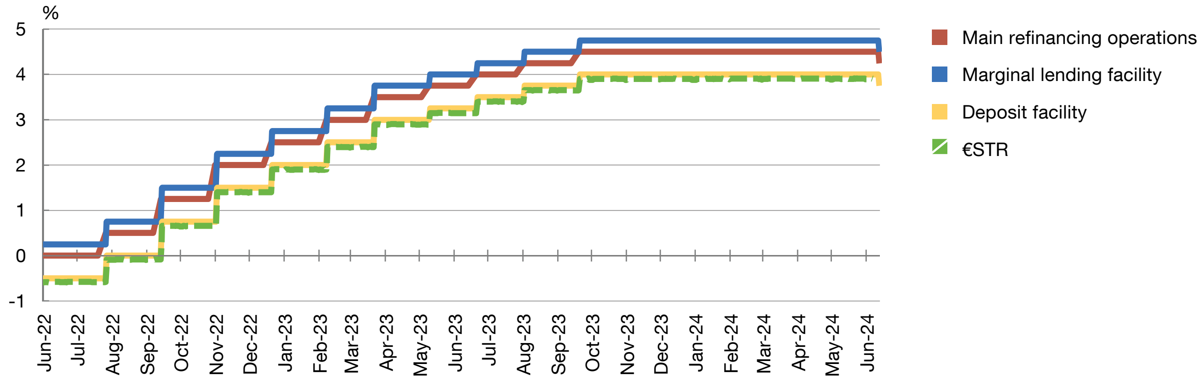
— As a result, at its June meeting the Governing Council decided to lower its key interest rates by 25 bp, taking the deposit facility rate to 3.75% (see Chart 7.a).

— The Governing Council will continue to follow a data-dependent and meeting-by-meeting approach to its interest rate decisions, without pre-committing to a particular rate path.

— The Governing Council has also confirmed that it will reduce the holdings of securities acquired under the pandemic emergency purchase programme (PEPP) by €7.5 billion per month on average over the second half of the year, broadly in line with the modalities for reducing holdings followed under the asset purchase programme (APP).

Chart 7

7.a Key ECB interest rates and €STR



SOURCES: Banco de España and Refinitiv Datastream. Latest data observed: 06/06/2024.
NOTE: The latest decision to lower key ECB interest rates was announced on 6 June 2024 and will take effect on 12 June.

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8 In Spain, economic activity proved more buoyant in Q1 than expected

- According to the Quarterly National Accounts (QNA) flash estimate, GDP growth gathered pace in 2024 Q1 to 0.7%, 0.3 pp more than envisaged in the Banco de España's March projection exercise (see Chart 8.a).

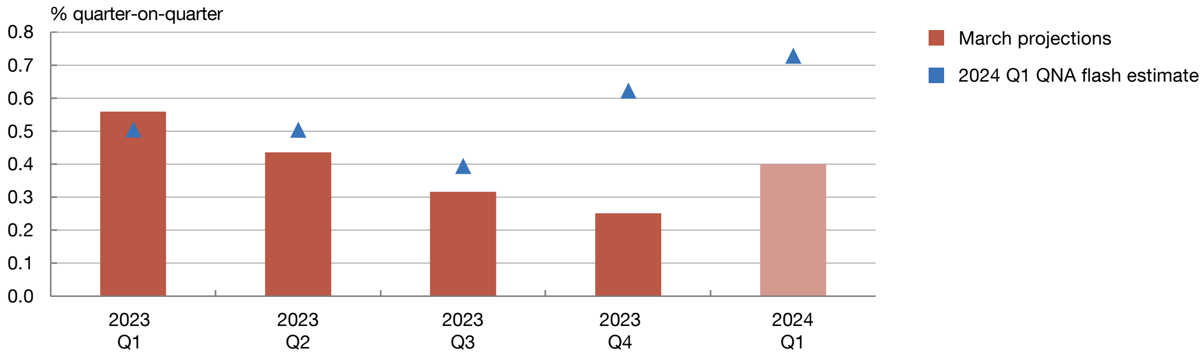
- This growth was underpinned by the strength of net external demand (see Chart 8.b), with exports growth (2.4%) surprising on the upside, especially in travel services (up 19%).

- Among the components of domestic demand, gross capital formation rose by 1.3% – more than in the previous quarter (+0.6%) and above the growth forecast in the March projection exercise (+0.9%) –, while private consumption continued to show some weakness (rising by 0.3%, just as it did in the last quarter of 2023) and government consumption contracted following its notable dynamism in the second half of last year.

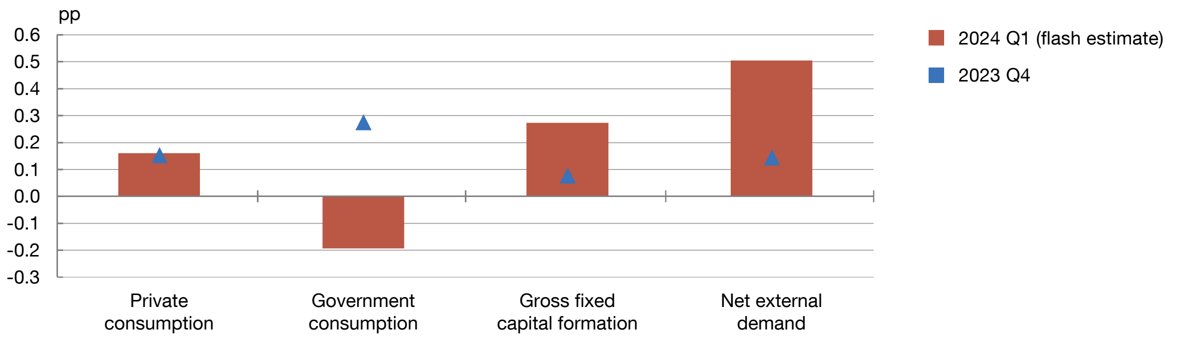
- On the supply side, there was an acceleration in the market services and construction sectors, while agriculture and industry were less buoyant than in the previous quarter and activity declined in non-market services.

Chart 8

8.a GDP growth in Spain



8.b Contributions to GDP growth in Spain



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SOURCES: INE and Banco de España.

9 The available indicators for Q2 suggest that activity will continue to grow at a significant pace

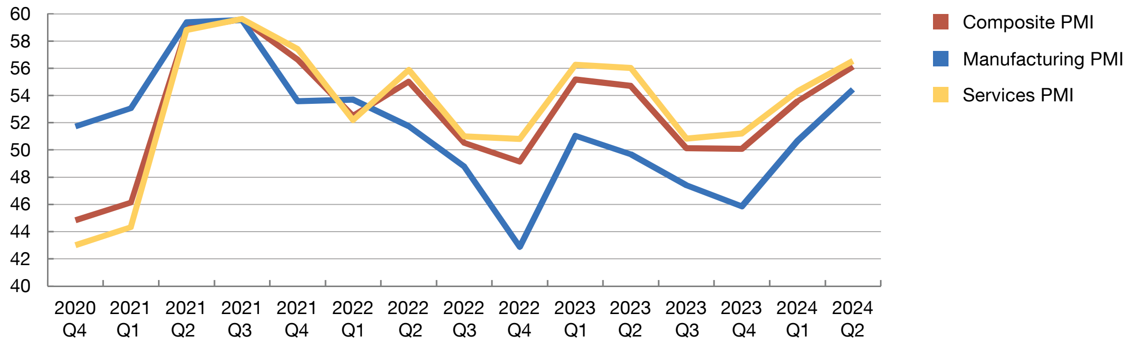
— Taken together, the various economic indicators (which include employment, consumption and confidence indicators and provide partial, and as yet incomplete, information on economic activity in 2024 Q2) suggest that Spanish GDP growth remains high in Q2, at around 0.5% quarter-on-quarter. There is, however, considerable uncertainty surrounding this estimate.[1]

— Confidence indicators in particular are consistent with strong activity growth in Q2: both the services and the manufacturing Purchasing Managers' Indices (PMIs) have risen steadily in recent months, with the latter now in expansionary territory (see Chart 9.a).

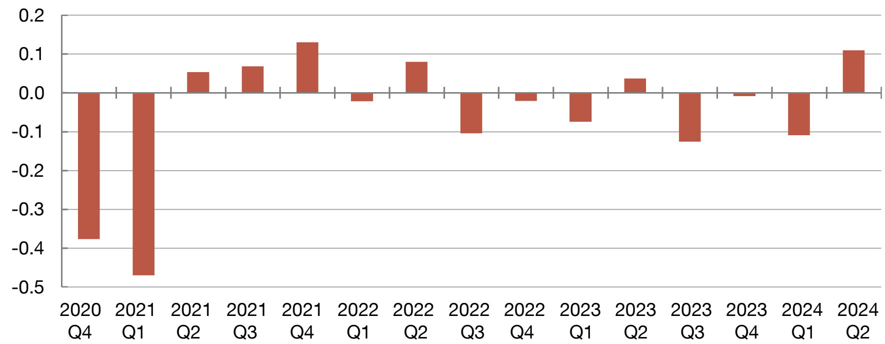
— The results of the Banco de España Business Activity Survey (EBAE) also point in this direction[2] and suggest that Spanish firms' turnover increased markedly between March and June (see Chart 9.b).

Chart 9

9.a PMIs (a)



9.b Quarterly change in turnover according to the EBAE (b)



SOURCES: S&P Global and EBAE (Banco de España).

a The 2024 Q2 PMI figure is the average of April and May.
b The qualitative responses from the EBAE are converted into a numerical scale as follows: significant decrease = –2; slight decrease = – 1; stability = 0; slight increase = 1; significant increase = 2.

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1 For more details, see the Projections in this report.

2 Fernández Cerezo and Izquierdo (2024).

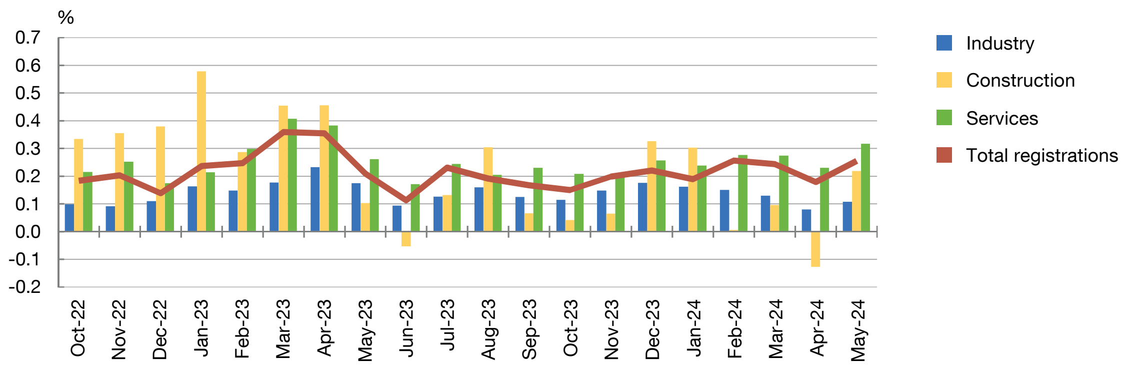
10 Job creation remains very strong, especially among larger firms

— In April and May social security registrations rose by 0.2% and 0.3%, respectively, in seasonally adjusted monthly terms. These growth rates are similar to those observed in the first three months of the year (see Chart 10.a). By activity, the dynamism of employment in the services sector over the past two months was particularly noteworthy, especially in transportation, accommodation and food services and in professional, scientific and technical activities.

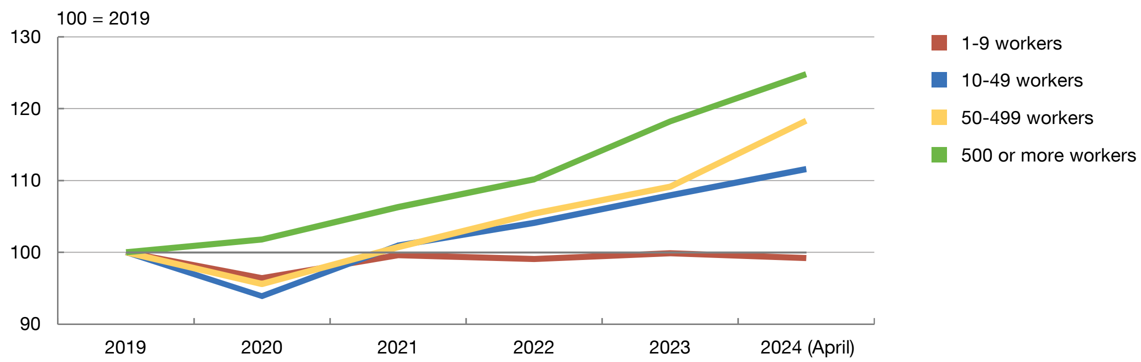
— According to the statistics for social security-registered firms, job creation in recent months has continued to be driven by larger firms (see Chart 10.b). In particular, the percentage of social security-registered workers in Spain accounted for by firms with 500 or more employees rose from 33.2% at end-2019 to 35.7% at end-2023 and 36.1% in April this year. By contrast, the share of microenterprises (firms with 1-9 employees) in total employment decreased from 21.6% to 18.7% over the same period.

Chart 10

10.a Total social security registrations in industry, construction and services (a)



10.b Change in social security registrations by firm size (b)



SOURCES: Banco de España and Ministerio de Inclusión, Seguridad Social y Migraciones.

a Seasonally adjusted monthly rates.
b Statistics on firms registered with social security.

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11 Financing flows are beginning to show tentative signs of recovery, although interest rates remain high

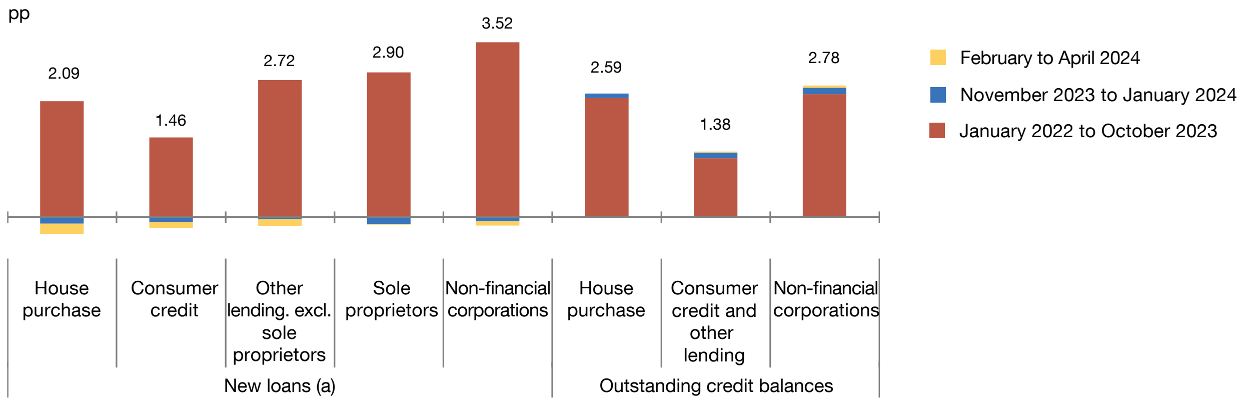
— Up to April 2024, interest rates on new lending continued on the slowly easing course they have taken since end-2023, while the cost of outstanding credit remained stable (see Chart 11.a).

— According to the Bank Lending Survey, credit standards tightened somewhat in 2024 Q1 for consumer credit and other lending to households, although at a slower pace than in the previous quarter, and remained unchanged for other segments. Credit demand contracted slightly, except in the case of consumer credit and other lending, where it stayed constant. Banks expect that both credit supply and demand will continue to gradually stabilise/improve in Q2.

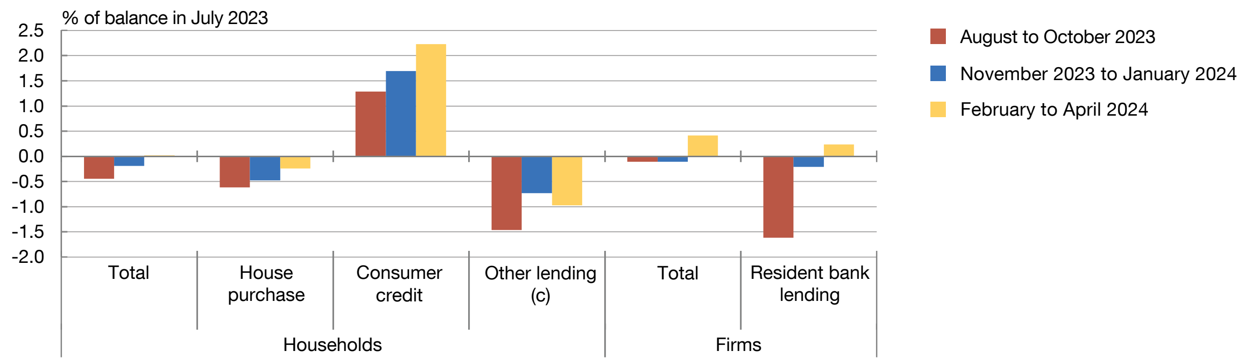
— Against this backdrop, the pace of contraction in loans to households for house purchase slowed in recent months (up to April), while consumer credit continued to grow and financing to firms began to record slight increases (see Chart 11.b).

Chart 11

11.a Change in the cost of credit since the start of the monetary policy tightening cycle



11.b. Change in financing to households and firms: three-month cumulative net flows (b)



SOURCE: Banco de España.

a Bank interest rates are narrowly defined effective rates (NDERs), i.e. they exclude related charges, such as repayment insurance premia and fees, and are adjusted seasonally and for the irregular component.
b Seasonally adjusted data that include securitisations. The total includes the rest of the world and debt securities.
c Includes loans to sole proprietors.

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12 The growth rate of private consumption could rise in the coming quarters

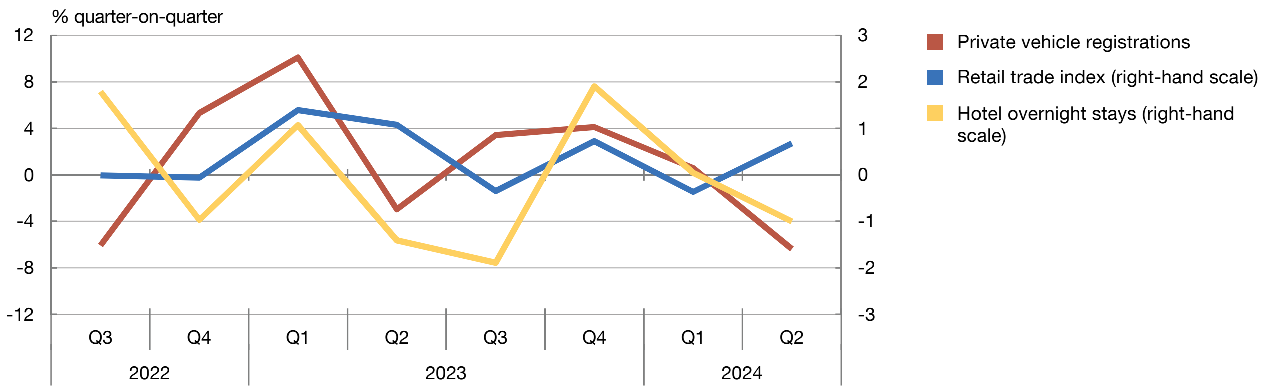
— Private consumption has been somewhat sluggish in 2023 Q4 and 2024 Q1, with a quarter-on-quarter growth rate of 0.3% in both quarters. The relative weakness of this demand component was also noticeable over a broader timescale: while GDP is 3.7 pp above its end-2019 level, private consumption is only 0.3 pp higher.

— The as-yet-incomplete data available for Q2 show mixed signals for recent developments in consumption (see Chart 12.a). Nevertheless, in this and future quarters household consumption is projected to gather pace in a setting in which it is expected that, in line with recent developments, employment will remain buoyant, inflationary pressures will ease, consumer confidence will recover further and financing conditions will continue to gradually improve.

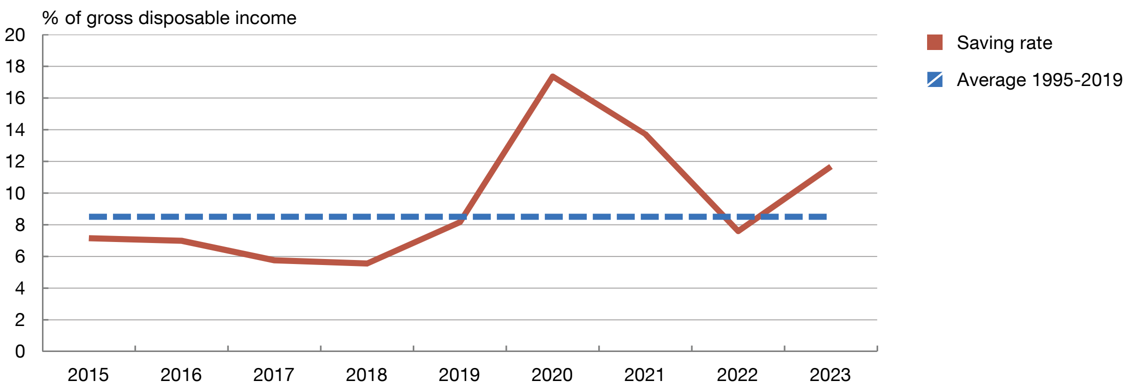
— This expected increased consumption momentum appears to be partly underpinned by a slight downward correction in the saving rate, which is high in historical terms (see Chart 12.b).

Chart 12

12.a Changes in common indicators of expenditure (a)



12.b Household saving rate



SOURCES: Asociación Española de Fabricantes de Automóviles y Camiones and INE.

a The rate for 2024 Q2 was calculated using data for April in the case of the retail trade index and hotel overnight stays and for the period April-May in the case of private vehicle registrations

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13 The recovery of productive investment is expected to continue in Q2

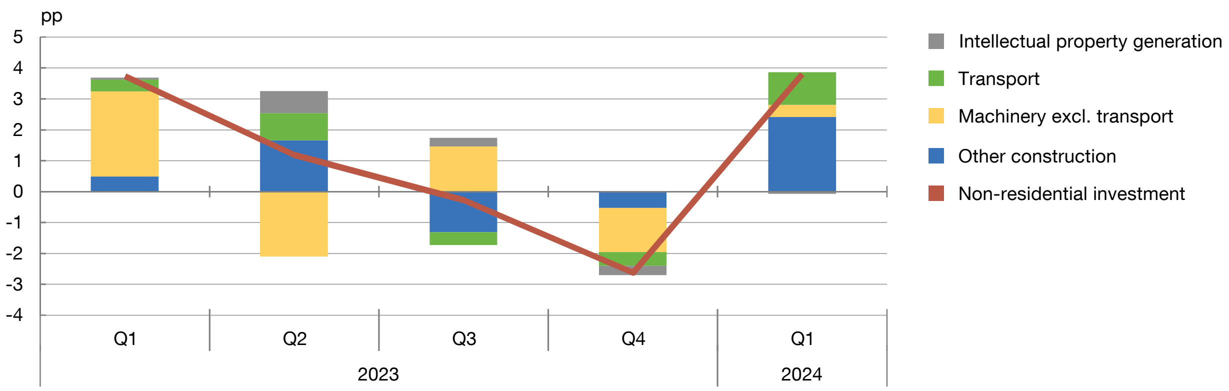
— Following the falls in 2023 H2, productive investment picked up in 2024 Q1 on the back of investment in other construction and, to a lesser extent, transport equipment (see Chart 13.a). In spite of this uptick, productive investment in Spain remains 0.2 pp below its pre-pandemic level, accounting for 13.6% of GDP (0.6 pp less than in 2019).

— In a highly volatile environment, in which financing costs and uncertainty are still high, the qualitative indicators available – including the Purchasing Managers' Index (PMI) for capital goods and quarterly developments in investment according to the EBAE – suggest that productive investment could continue to improve in 2024 Q2.

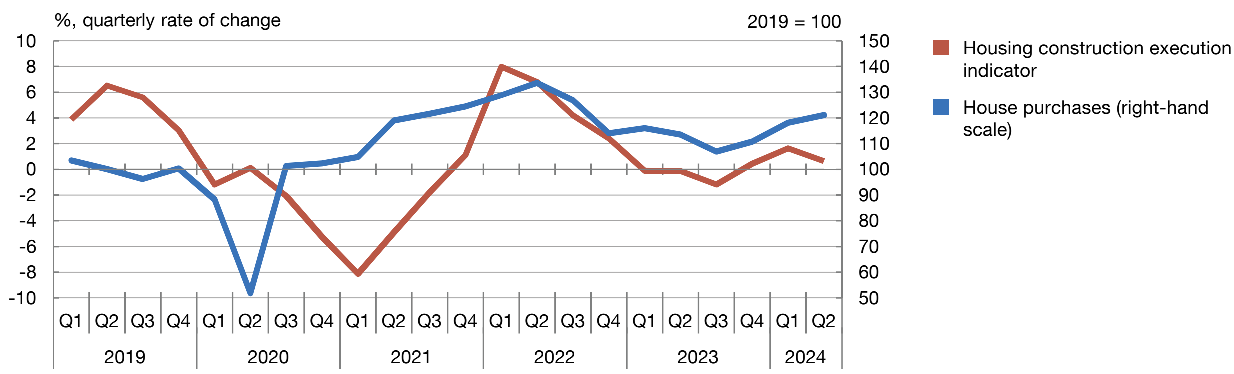
— Elsewhere, following the decline recorded in Q1, residential investment is expected to pick up somewhat in the coming quarters in view of recent developments in the indicators of housing construction execution and house purchases (see Chart 13.b). In any event, upward pressure on house prices persists, with a 6.3% year-on-year rise in Q1.

Chart 13

13.a Contributions to quarter-on-quarter growth in non-residential investment



13.b Changes in the main residential investment indicators (a)



SOURCES: INE, Centro de Información Estadística del Notariado and Ministerio de Transportes y Movilidad Sostenible.

a For the housing construction execution indicator, the time frame considered is three months from issuance of the building permit to the construction start date and 18 months for the construction work. Seasonally adjusted series for house purchases. For this series, 2024 Q2 is represented by the average of the last three months with data available (February, March and April).

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14 The external sector's contribution to GDP growth, which was very marked in Q1, will probably ease in the rest of the year

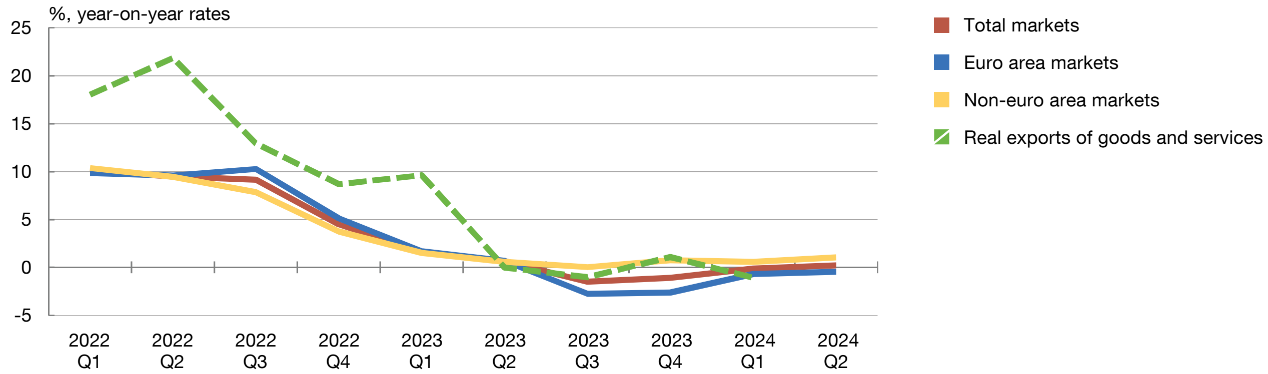
— The positive contribution of net external demand to GDP growth in 2024 Q1 (0.5 pp) was underpinned by the robust performance of services exports (with a quarter-on-quarter jump of 11.1%), especially travel services exports. Services imports also showed notable vitality, rising by 6.8%. In particular, after the sluggishness of previous quarters, travel services imports rallied decisively, by 20.4%. This momentum is expected to endure in the coming quarters.

— Amid the gradual improvement in external markets (see Chart 14.a), the most recent indicators, such as the expectations reported by firms in the latest quarterly survey of exporters and the PMI indicators of new export orders (see Chart 14.b), suggest that goods exports, which fell by 1.7% in Q1, could perform more strongly in the coming months.

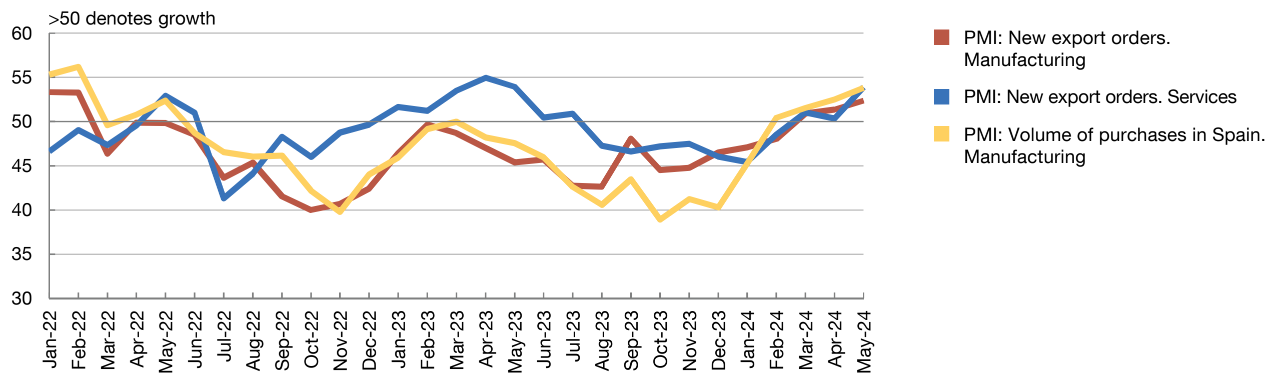
— However, this buoyancy may be offset by an upturn in imports, which appear to be driven, among other things, by an improvement in manufacturing activity and business investment, which have a high import content.

Chart 14

14.a Spain's export markets



14.b PMIs



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SOURCES: INE, ECB and S&P Global.

15 International tourism has been quite dynamic in recent months, partly supported by greater geographical and seasonal diversification of arrivals

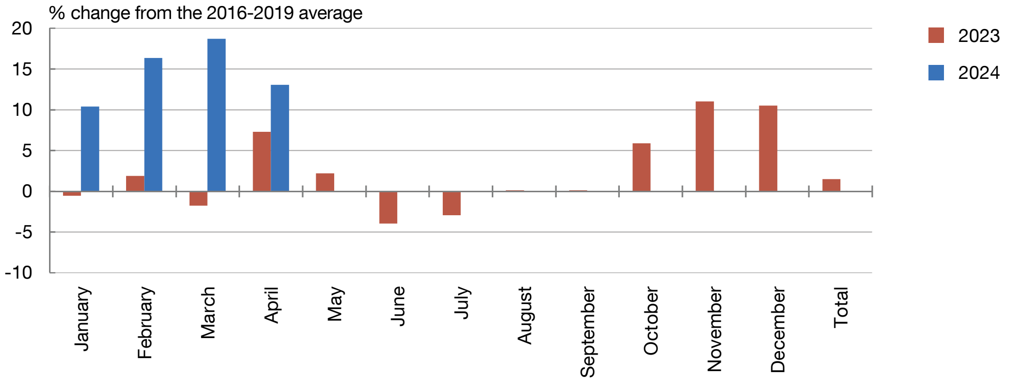
— In early 2024, international tourism maintained the vibrancy seen in 2023. Up to April, hotel overnight stays were up by 12% on the same period in 2023 and were well above pre-pandemic levels (see Chart 15.a). This appears to have been partly driven by the persistence of the trend towards greater geographical and seasonal diversification of tourist flows to Spain and also by the recovery of tourism flows from traditionally leading source countries, such as Germany.

— Overall, between January and April 2024, tourist expenditure in real terms stood 36% higher than in the same period between 2016 and 2019 (see Chart 15.b) and continued to rise on a per-tourist basis, likely owing to the contribution of the relatively sharper rise in overnight stays in higher category hotels.

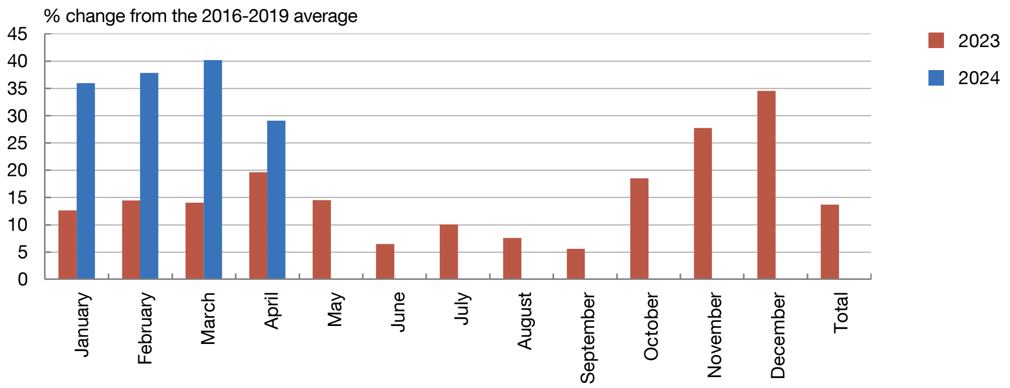
— These trends may endure in the short term, supported, among other factors, by the greater potential dynamism of business tourism and by an eventual recovery in arrivals of tourists from countries where these remain below pre-pandemic levels, such as Japan.

Chart 15

15.a Foreigner hotel overnight stays



15.b Deflated tourist spending, by month (a)



SOURCE: INE.

a Spending excluding transport and package holidays deflated using a weighted indicator of several tourism items in the CPI.

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16 Government revenue and expenditure, excluding the more volatile components, continued to grow at a significant rate in the early months of the year

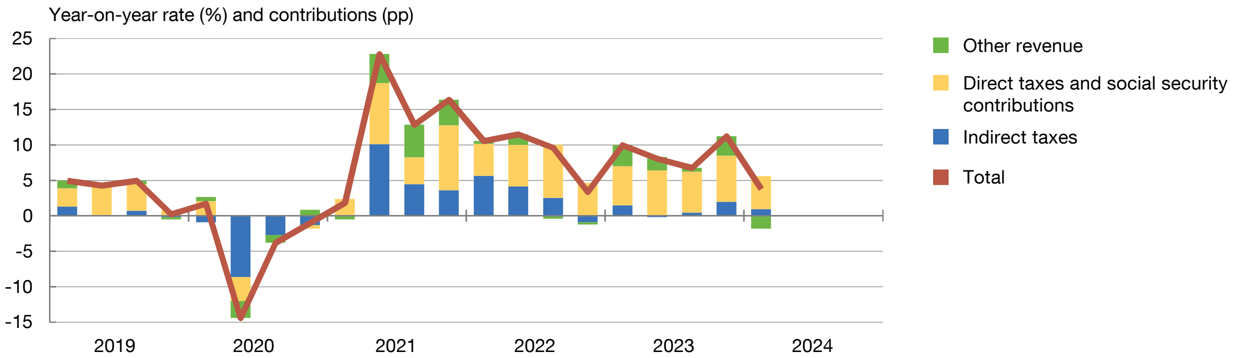
— In 2024 Q1 revenue from taxes and social security contributions grew by 6.2% year-on-year (see Chart 16.a). The main factors contributing to this growth were the tax base increases and, to a lesser extent, the gradual withdrawal of some of the support measures deployed in response to the energy crisis. That said, such growth continued to be mainly underpinned by growth in direct taxes and social security contributions (7.8%), rather than by indirect taxes (3.0%).

— In Q1 public expenditure in social benefits and consumption increased by 6.5% and 6.0%, respectively (see Chart 16.b). Notably, the latter figure does not include the projected 2% increase in public sector wages for 2024, but does include the 0.5% payment, with retroactive effect from January 2023, relating to the wage increase linked to GDP growth that year.

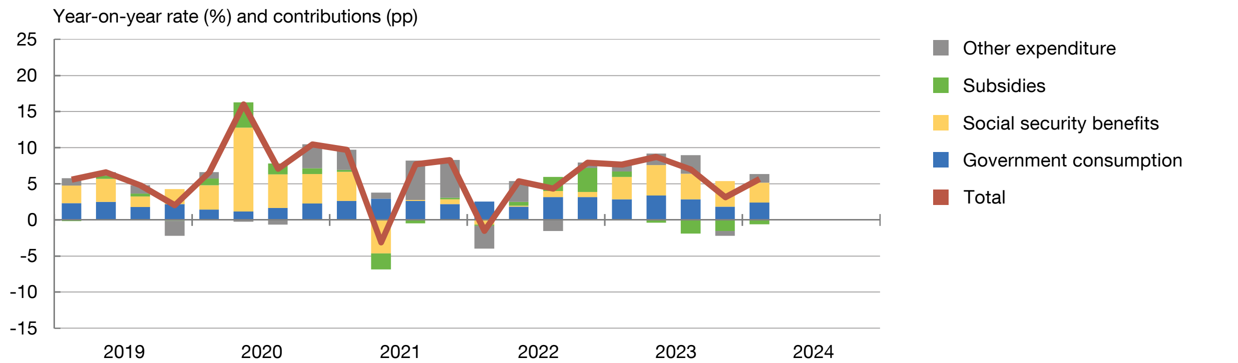
— As a result of these developments, it is estimated that the general government deficit, in cumulative 12-month terms, stood at 3.8% of GDP in March, compared with 3.6% at end-2023.

Chart 16

16.a Government revenue (a)



16.b Government expenditure (a)



SOURCES: Banco de España and Intervención General de la Administración del Estado.

a The data for 2024 Q1 do not include local government.

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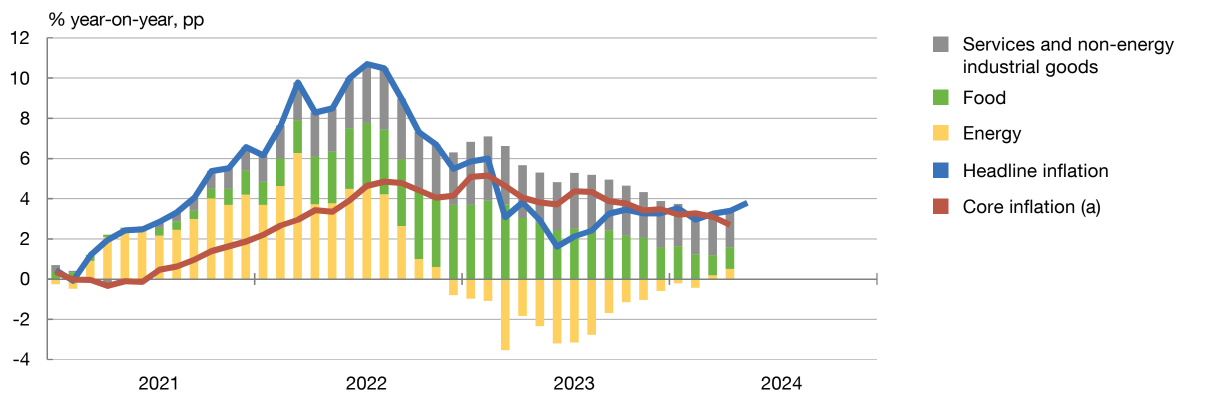
17 Headline inflation has increased in recent months owing to the pick-up in energy prices, while core inflation declined slightly

— Inflation increased by 0.9 pp between February and May, to a year-on-year HICP rate of 3.8% (see Chart 17.a). With disaggregated data to April, this increase reflects a pick-up in energy prices that were driven up by the partial withdrawal of some of the measures rolled out to address the energy crisis and the recent rise in oil prices in the international markets. Food inflation has continued to slow in recent months, although this trend was interrupted in April (with a year-on-year rate of 4.6%, 0.3 pp higher than in March) owing to the rise in certain fresh food prices.

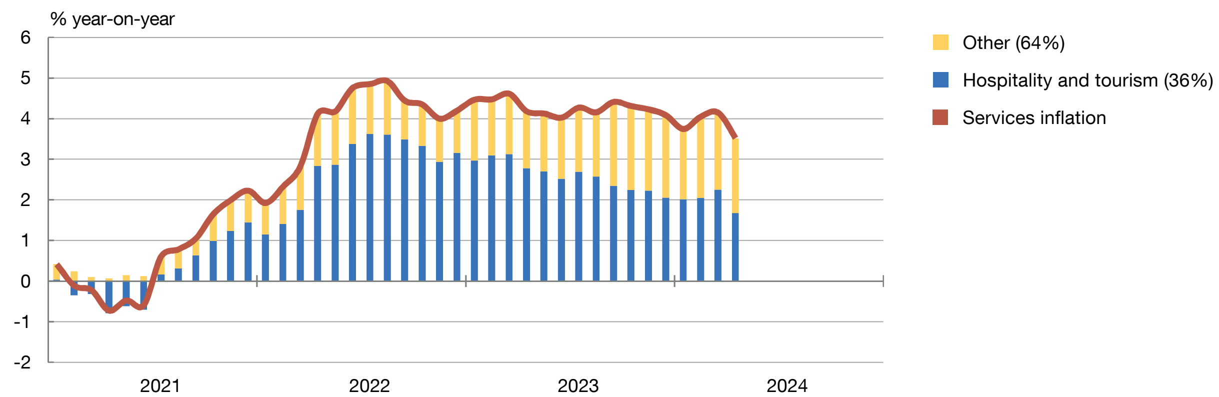
— Core inflation declined to 2.7% in April, the lowest year-on-year rate since February 2022. Noteworthy among its components was the sharp slowdown in the prices of non-energy industrial goods, while services prices have recently showed a slightly higher than expected persistence, with hospitality and tourism accounting for nearly half of their growth (see Chart 17.b).

Chart 17

17.a Inflation in Spain: changes and contribution of components



17.b Services inflation and contributions (b)



SOURCES: Eurostat and Banco de España.

a Headline inflation excluding energy and food.
b The weight of each group in services inflation is shown within brackets.

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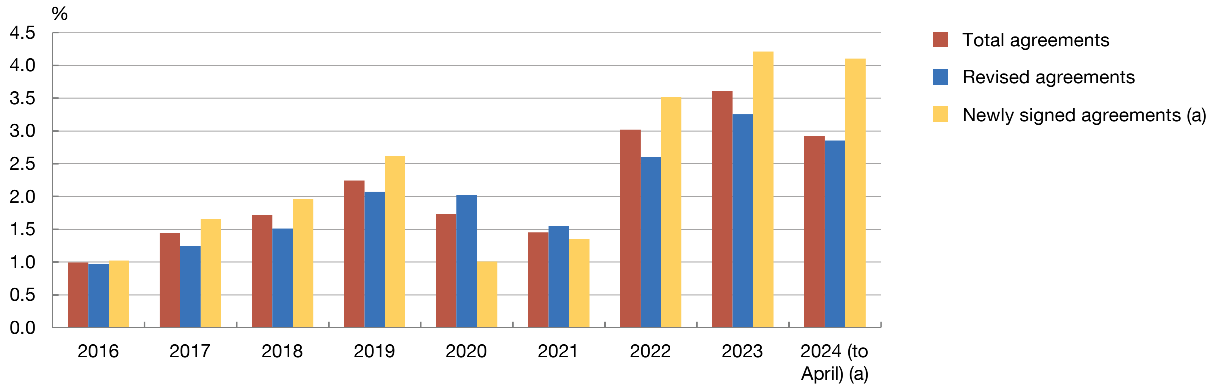
18 In Q1 the pace of growth of compensation per employee slowed, but remained substantially above the wage increases negotiated under collective agreements

— Based on data to April, wage settlements agreed for 2024 stand at 2.9%, 0.5 pp below the figure agreed for 2023 (see Chart 18.a). Almost all of the 8.6 million wage-earners with an agreement in force for 2024 had wage agreements in previous years. However, there are very few new collective agreements signed in 2024, which only cover about 5% of workers with an agreement signed for 2024. Up to April, these new collective agreements reflect a wage increase of 4.1%, slightly below the 4.4% envisaged in agreements of this kind until March.

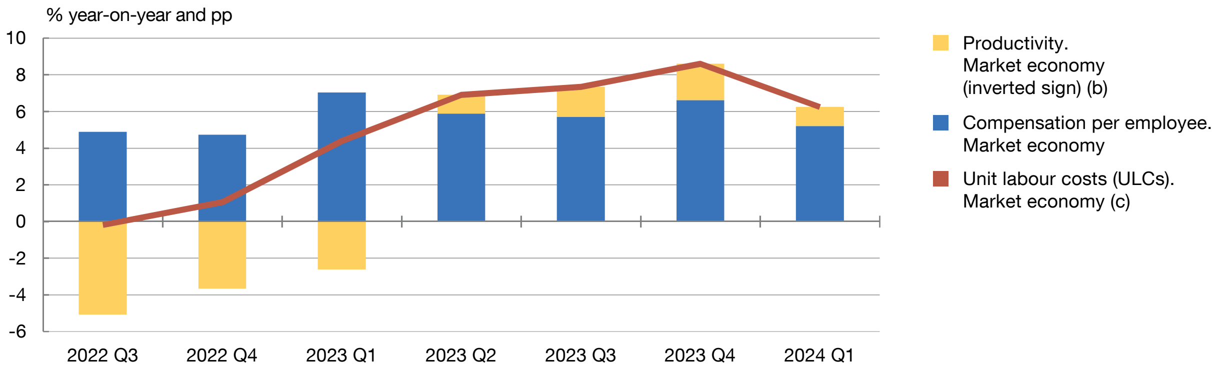
— In Q1 unit labour costs in the market economy grew by 6.2% year-on-year (see Chart 18.b), pushed up both by the fall in productivity and by the increase in compensation per employee. The latter slowed in Q1 to a year-on-year rate of 5.2%, which nonetheless remained, as in prior quarters, above the wage increases negotiated in collective agreements, reflecting a positive wage drift.

Chart 18

18.a Negotiated wage increase



18.b Unit labour costs. Market economy. Changes and contributions



SOURCES: Ministerio de Trabajo y Economía Social and INE.

a The newly signed agreements in April 2024 are not representative, as they only cover 480,247 workers (5.6% of the total workers with an agreement signed for 2024).
b Productivity is defined as GVA relative to total employees in a given sector.
c The change in unit labour costs can be proxied as the sum of the change in compensation per employee and the change in productivity (with an inverted sign). Therefore, a positive contribution of productivity in the chart is interpreted as the effect of a fall in productivity.

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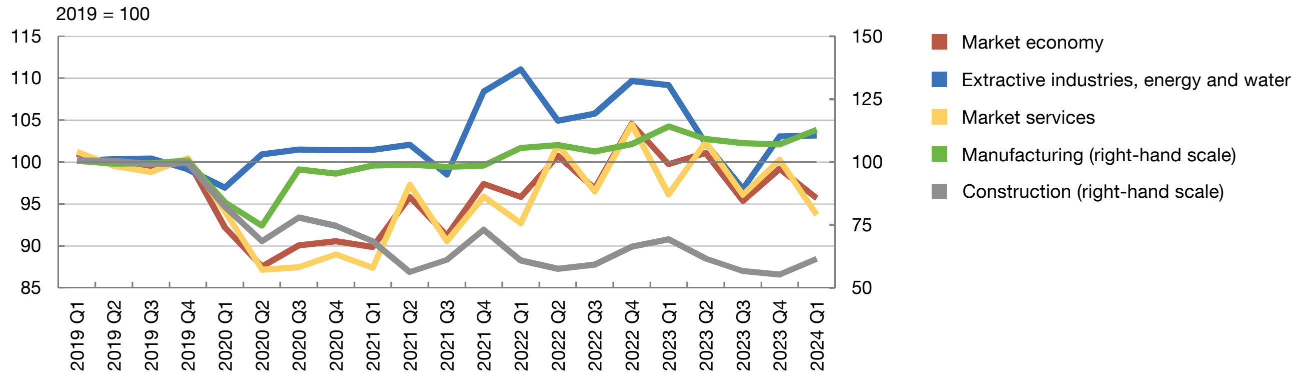
19 Profit margins show a slight downward trend, although marked sectoral heterogeneity persists

— According to National Accounts data, the ratio of gross operating surplus (GOS) to gross value added (GVA) in the market economy appears to have trended slightly downwards since 2023 Q2 (see Chart 19.a). However, cross-sector heterogeneity remains high, with the ratio behaving more dynamically in the case of manufacturing and substantially more moderately in construction.

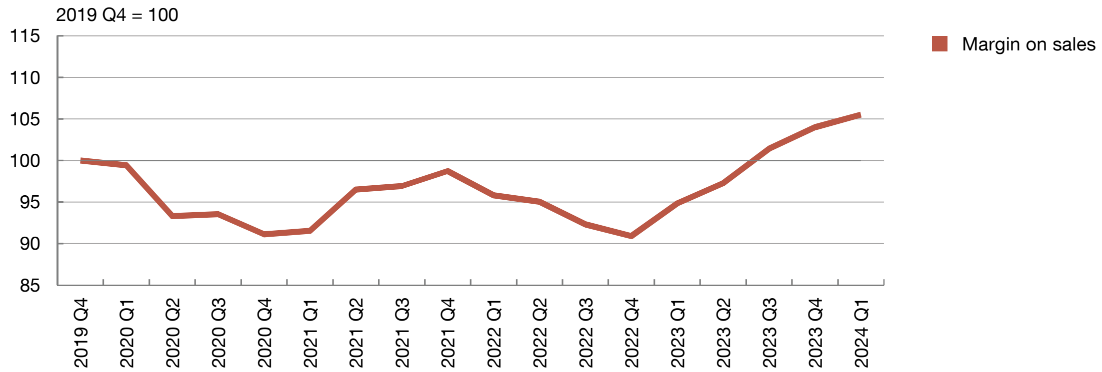
— Net operating income, defined as the ratio of gross operating profit (GOP) to turnover (and therefore including intermediate costs), which can be obtained from Spanish Tax Agency (AEAT, by its Spanish abbreviation) information on turnover of large corporates and SMEs, has remained somewhat dynamic over the past year (see Chart 19.b).

Chart 19

19.a Changes in profit margins (GOS/GVA) on National Accounts data. Breakdown by sector



19.b Changes in profit margins on AEAT data (a)



SOURCES: Banco de España, INE and tax forms for VAT and withholdings on labour income and income from economic activities (AEAT).

a All firms excluding petroleum refining (NACE 19), wholesale of fuels (NACE 4671) and gas and electricity (NACE 35) sectors. Margin on sales is defined as the ratio of GOP to turnover. Four-quarter cumulative data, current population.

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MACROECONOMIC PROJECTIONS FOR THE SPANISH ECONOMY (2024-2026)

Macroeconomic projections for the Spanish economy (2024-2026)

This section presents the key features of the most recent update to the Banco de España's macroeconomic projections for the Spanish economy for 2024-2026.[1]

Under the assumptions of the exercise, Spanish GDP – which grew by 2.5% in 2023 – is expected to grow more slowly over the projection horizon, rising by 2.3%, 1.9% and 1.7% in 2024, 2025 and 2026, respectively (see Table 1). Meanwhile, the unemployment rate, which stood at 12.2% in 2023, will continue trending downwards in the coming years, albeit remaining above 11% in 2026. As for prices, headline inflation – which stood at 3.4% on average in 2023 – will fall over the next three years, to stand at 3% in 2024, 2% in 2025 and 1.8% in 2026. Core inflation will also decline gradually over this period, falling from 4.1% in 2023 to 2.6%, 2% and 1.9% in 2024, 2025 and 2026, respectively.

The rest of this section is structured as follows. First, the key assumptions and determinants underlying these projections are described. Then, the main features of the outlook for activity and prices over the projection horizon are detailed. Lastly, some of the main risks to these projections are discussed.

Main determinants and assumptions underlying the projections

The projections are based on a set of technical assumptions regarding the expected future path of certain macro-financial and fiscal variables, which are key to assessing how activity and inflation may evolve in the coming quarters. Moreover, the new GDP data for preceding quarters mean that the starting point used to project the future paths of activity and prices has changed from the previous projections.[2] The role that these factors play in the current projection exercise is described briefly below.

Assumptions about future energy price developments. Eurosystem projection exercises use energy commodity futures to proxy the expected future path of energy commodity prices over the projection horizon. Futures markets currently signal somewhat higher oil prices than those used in the March projections (see Chart 1). Meanwhile, although in recent months the wholesale electricity price has been lower than anticipated in March, based on current futures market prices, in the second half of 2024 it is expected to be somewhat higher than forecast three months ago.

1 Compared with those published on 12 March, these projections incorporate the new information that has become available since then. This includes, in particular, the Quarterly National Accounts (QNA) flash estimate for 2024 Q1, the Quarterly Non-Financial Accounts for the Institutional Sectors (QNFAIS) for 2023 Q4 and the changes observed in the technical assumptions for the key projection variables. The projection cut-off date is 22 May, and the assumptions cut-off date is 15 May.

2 "Macroeconomic projections for the Spanish economy (2024-2026)". *Economic Bulletin – Banco de España*, 2024/Q1.

Table 1
Macroeconomic projections for the Spanish economy (a)

Annual rate of change (%)

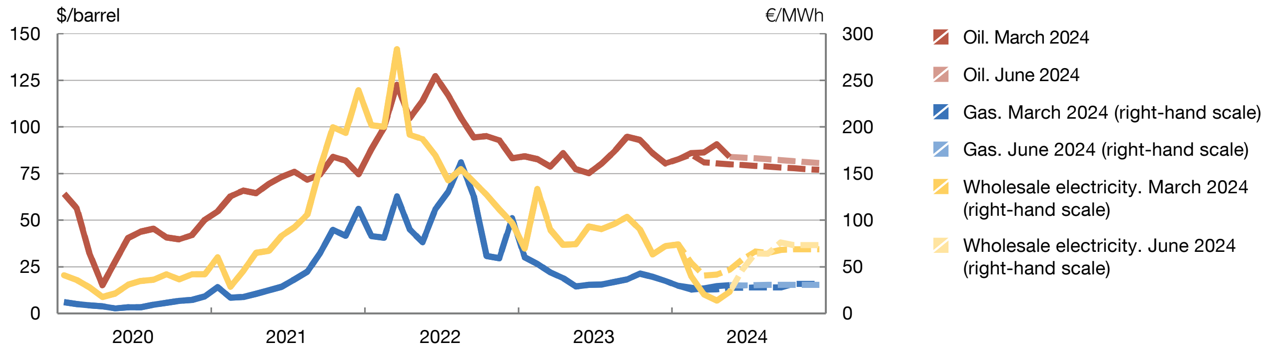
	GDP				Harmonised index of consumer prices (HICP)				HICP excluding energy and food				Unemployment rate (% of labour force) (b)			
	2023	2024	2025	2026	2023	2024	2025	2026	2023	2024	2025	2026	2023	2024	2025	2026
June 2024	2.5	2.3	1.9	1.7	3.4	3.0	2.0	1.8	4.1	2.6	2.0	1.9	12.2	11.5	11.3	11.2
March 2024	2.5	1.9	1.9	1.7	3.4	2.7	1.9	1.7	4.1	2.2	1.9	1.8	12.1	11.6	11.5	11.3

SOURCES: Banco de España and INE.
NOTE: Latest QNA figure published: 2024 Q1.

a Projections cut-off date: 22 May 2024.
b Annual average.

Chart 1

1.a Energy prices



SOURCES: Mercado Ibérico del Gas, OMIE and Reuters.

Assumptions about future interest rate developments. Based on the expectations of the international financial markets,[3] short-term interest rates are expected to fall progressively over the projection horizon (see Table 2). Nonetheless, this decline will be more gradual than envisaged a few months earlier, and the projected paths of interest rates on the money markets have therefore been revised upwards from the March projections. Moreover, Spanish long-term sovereign debt yields are now expected to be slightly lower than projected three months ago, as both risk premia and expectations for long-term risk-free interest rates have eased slightly.

Assumptions about future external market developments. The technical assumptions envisage a gradual recovery in Spain's export markets in the coming quarters, in line with the

3 The assumptions regarding the future paths of market interest rates are based on the prices observed in the respective markets at the cut-off date of the projections (15 May).

Table 2
International environment and monetary and financial conditions (a)

Annual rate of change (%), unless otherwise indicated

		June 2024 projections			Difference between the current projections and the March 2024 projections (b)		
	2023	2024	2025	2026	2024	2025	2026
Spain's export markets (c)	-0.1	1.0	3.3	3.2	-0.4	0.1	0.1
Oil price in dollars/barrel (level)	83.7	83.8	78.0	74.5	4.0	2.8	1.4
Monetary and financial conditions							
Dollar/euro exchange rate (level)	1.08	1.08	1.08	1.08	0.00	0.00	0.00
Nominal effective exchange rate against non-euro area countries (d) (2000 = 100)	115.6	116.1	116.2	116.2	0.7	0.8	0.8
Short-term interest rate (3-month EURIBOR; level) (e)	3.4	3.6	2.8	2.5	0.2	0.4	0.2
Long-term interest rate (10-year Spanish government bond yield; level) (e)	3.5	3.2	3.2	3.4	-0.1	-0.1	-0.2

SOURCES: ECB and Banco de España.

a Cut-off date for assumptions: 15 May. Figures expressed as levels are annual averages, figures expressed as rates are calculated on the basis of the related annual averages.
b Differences in rates for export markets, in levels for oil prices, the dollar/euro exchange rate and the nominal effective exchange rate, and in percentage points for interest rates.
c The assumptions regarding the behaviour of Spain's export markets presented in the table are obtained from the June 2024 *Eurosystem staff macroeconomic projections for the euro area*.
d A positive percentage change in the nominal effective exchange rate denotes an appreciation of the euro.
e For the projection period, the figures in the table are technical assumptions, prepared following 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 path of these variables.

relatively favourable outlook for future global economic activity and, in particular, the projected acceleration in activity in the euro area.[4] The outlook for Spain’s export markets in the coming quarters remains largely unchanged from three months ago. Specifically, while the projected pace of growth has been revised slightly downwards for such markets for 2024 overall (see Table 2), this can be attributed to lower imports from outside the euro area in the final stretch of 2023 and in 2024 Q1 than expected in March.[5] Meanwhile, compared with the previous projection exercise, the nominal effective euro exchange rate has appreciated somewhat, albeit remaining unchanged against the dollar.

Assumptions about fiscal policy in Spain.

Compared with the March forecasts, certain new developments with an impact on the budget deficit over the projection horizon have now been included in the fiscal assumptions. In particular:

4 This outlook is in keeping with the most recent forecasts published by the Eurosystem, the European Commission and the OECD, among others.

5 This sluggish import performance was recorded in a context in which the elasticity of imports to final demand was very low by historical standards worldwide. This would appear consistent with the relative weakness of activity in the industrial sectors at global level in recent quarters, as compared with the services sectors.

— The extension to 2025 of the transitory revenue-raising measures relating to the temporary levies on energy firms and financial institutions,[6] which, together with other smaller changes, will reduce the deficit by 0.1 pp of GDP in 2025, before increasing it by 0.1 pp in 2026.[7]

— The recent rulings on the right of some mutual society members to a personal income tax deduction and on the unconstitutional nature of various corporate income tax-related provisions introduced by Royal Decree-Law 3/2016. Overall, it is estimated that the additional government spending obligations entailed by these two court rulings could increase the deficit by around 0.2 pp of GDP in 2024.[8]

Meanwhile, the expected path of spending financed with the Next Generation EU (NGEU) funds, and in particular with its main instrument, the Recovery and Resilience Facility (RRF), remains unchanged from the March projections. Specifically, the new projections envisage that the spending associated with these funds (which stood at 0.2% and 0.4% of GDP in 2021 and 2022, respectively) will have risen to 0.7% in 2023, and will continue rising in 2024, to stand at around 1% of GDP, where it will remain over the rest of the projection horizon. All of which is consistent with the fact that the NGEU programme is expected to have its biggest impact on Spanish GDP between 2025 and 2026.

Overall, the fiscal policy stance (proxied by the variation in the structural primary balance) is expected to be slightly contractionary in 2024. Nonetheless, the budgetary stance is likely to be roughly neutral in 2025 and 2026. It is important to note here that the new European fiscal rules (in force since 30 April) mean that the Spanish fiscal policy stance will have to be contractionary from 2025 onwards, and this has not been included in these projections.[9]

New data and statistical revisions. The flash QNA estimate for 2024 Q1 points to higher GDP growth in the quarter (0.7%) than had been anticipated by the Banco de España in its March projections (0.4%). The GDP growth rates for the last two quarters of 2023 were also revised up, from 0.4% to 0.5% for 2023 Q3 and from 0.6% to 0.7% for 2023 Q4.[10] Taken on their own, these new figures would automatically entail a higher starting point for GDP for the current projections and a higher GDP growth rate in 2024.

Activity

In 2024 Q1 Spanish GDP grew more than projected by the Banco de España in March, mainly because of the high momentum of travel services exports. On QNA flash estimates,

6 There is still considerable uncertainty as to whether such taxes will be made permanent, but there is insufficient information on the matter so this has not been included in the current projections.

7 These changes include the suspension, from 2025 onwards, of the ordinary contributions to the Deposit Guarantee Scheme (a general government entity), after its statutory target size was exceeded this year.

8 A Court of Justice of the European Union (CJEU) judgment ruling that the regional rate of the hydrocarbons tax (levied between 2013 and 2018) is incompatible with EU law was published on 30 May (after the cut-off date for these projections). This could trigger fresh general government spending obligations not included in these projections.

9 For further details on the implications of the new European fiscal governance framework for Spain's public finances, see Section 9.3 of Chapter 2 of the Banco de España Annual Report 2023.

10 Conversely, the GDP growth rate for 2023 Q1 was revised down by 0.1 pp (to 0.4%).

GDP grew by 0.7% quarter-on-quarter in 2024 Q1, considerably higher than forecast by the Banco de España in March (0.4%) and in line with 2023 Q4 (0.7%, following the National Statistics Institute's latest upward revision to this figure). The buoyancy of activity in the first three months of the year was underpinned by net external demand (contributing 0.5 pp to GDP growth), against a backdrop of higher than expected quarter-on-quarter growth in travel services exports (19%), driven by the strong performance of inbound tourism over Easter. By contrast, the contribution of domestic demand to GDP growth (0.2 pp) declined compared to that observed in the final stretch of 2023. One contributing factor was the fall in government consumption, which, while somewhat sharper than expected, was in line with the March projection exercise, after the high increases recorded in this item during much of 2023. Meanwhile, in the first months of 2024 private consumption grew moderately (less than projected, although in line with the 2023 Q4 figure), while gross capital formation accelerated slightly, after proving markedly sluggish in 2023.

The latest short-term economic information points to economic activity in Spain continuing to grow apace in Q2. Specifically, an overall assessment of the various indicators available for 2024 Q2 – such as the Banco de España Business Activity Survey (EBAE), social security registrations and Purchasing Managers' Indices – suggests that GDP will grow at a quarter-on-quarter rate of around 0.5% in the period. This rate would be consistent with year-on-year output growth in Q2 of 2.4%, the same as in Q1.

Looking ahead to the coming quarters, GDP growth is expected to gradually converge towards rates consistent with the Spanish economy's potential growth, which, according to Banco de España estimates, will be around 1.6% year-on-year at the end of the projection horizon. In this respect, the projections envisage that, in annual average terms, GDP growth will slow from 2.5% in 2023 to 2.3% in 2024, 1.9% in 2025 and 1.7% in 2026 (see Table 3). The projected path of GDP reflects the net impact on economic activity of various factors operating in opposite directions. On the one hand, some of the recent tailwinds behind Spanish economic growth (such as significant pent-up demand for certain goods and services and the correction of some negative supply shocks that weighed on activity in 2021 and 2022) are expected to die down in the coming quarters. On the other, the factors that will underpin GDP growth over the coming quarters notably include the gradual easing of the adverse impact of the cumulative tightening in financing conditions on activity, the gradual recovery of the European and global economy, projected population growth,[11] the increase in economic agents' real income against the backdrop of disinflation and the greater deployment of NGEU funds.

As a result of these developments, at end-2026 Spanish GDP will stand 8.9% above its pre-pandemic level; however, this increase will be considerably lower in per capita terms (4.8%). These projections also mean that the Spanish economy's output gap – virtually zero at present – will gradually widen over the projection horizon to slightly above 1%. By comparison, according to the Eurosystem staff macroeconomic projections published on 6 June, at end-2026 euro area GDP will be 7.8% higher than its end-2019 level, while, in per capita terms, the gap will be 6.0% (see Chart 2).

11 According to Eurostat's latest population projections, in the period 2024-2026 the Spanish population will grow by almost 700,000 people, a cumulative increase of 1.4% relative to 2023 levels.

Table 3

Projections for the main macroeconomic aggregates of the Spanish economy (a)

Annual rate of change in volume terms (%) and % of GDP

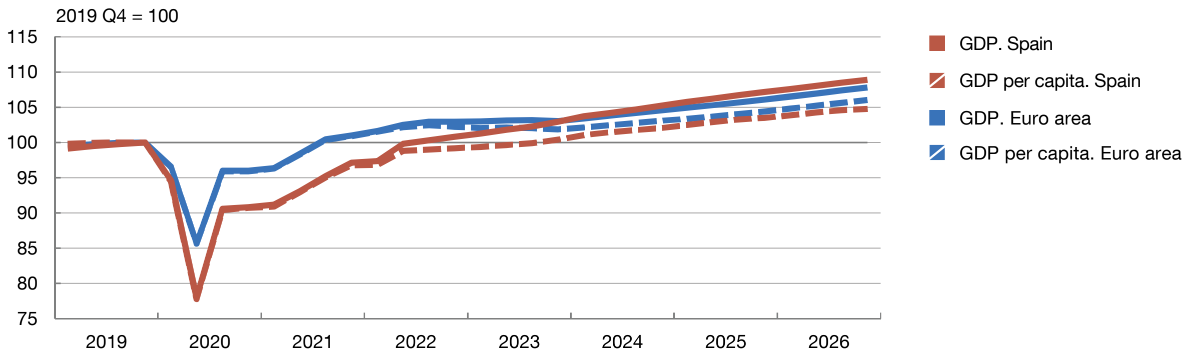
		June 2024 projections			March 2024 projections		
	2023	2024	2025	2026	2024	2025	2026
GDP	2.5	2.3	1.9	1.7	1.9	1.9	1.7
Private consumption	1.8	2.4	2.0	1.7	2.3	1.9	1.7
Government consumption	3.8	1.6	1.7	1.5	1.2	1.7	1.5
Gross capital formation	-0.4	2.2	2.4	2.1	1.9	2.4	2.0
Exports of goods and services	2.3	2.4	2.4	2.7	1.7	3.0	2.9
Imports of goods and services	0.3	2.0	2.7	3.0	2.1	3.4	3.0
Domestic demand (contribution to growth)	1.7	2.1	1.9	1.7	2.0	1.9	1.6
Net external demand (contribution to growth)	0.8	0.2	0.0	0.0	-0.1	0.0	0.1
Nominal GDP	8.6	5.4	4.0	3.5	4.8	4.1	3.6
GDP deflator	5.9	3.0	2.1	1.8	2.9	2.2	1.9
HICP	3.4	3.0	2.0	1.8	2.7	1.9	1.7
HICP excluding energy and food	4.1	2.6	2.0	1.9	2.2	1.9	1.8
Employment (hours)	1.9	1.1	1.7	1.2	1.8	1.1	0.9
Unemployment rate (% of labour force). Annual average	12.2	11.6	11.3	11.2	11.6	11.5	11.3
Net lending (+)/net borrowing (-) of the nation (% of GDP)	3.7	3.6	3.7	3.7	3.4	3.5	3.6
General government net lending (+)/net borrowing (-) (% of GDP)	-3.6	-3.3	-3.1	-3.2	-3.5	-3.5	-3.5
General government debt (% of GDP)	107.7	105.8	106.2	107.2	106.5	107.2	108.4

SOURCES: Banco de España and INE.
NOTE: Latest QNA figure published: 2024 Q1.

a Projections cut-off date: 22 May 2024.

Chart 2

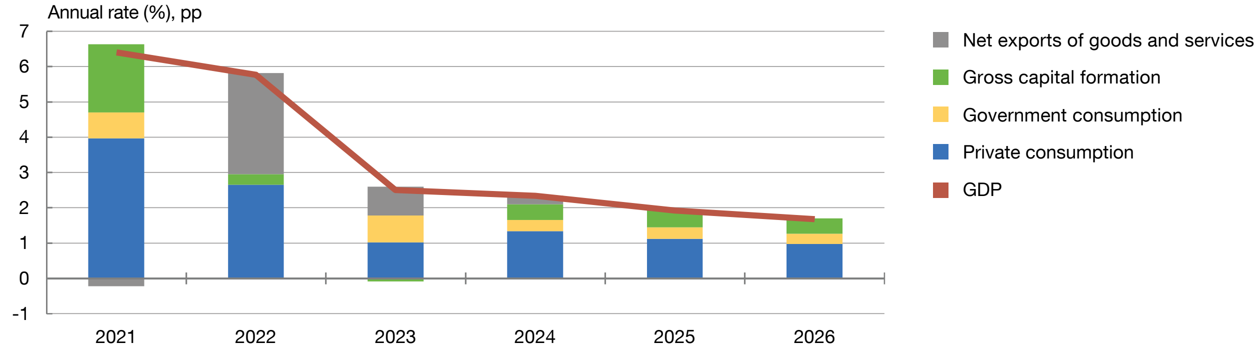
2.a GDP and GDP per capita in Spain and the euro area



SOURCES: ECB, Banco de España and European Commission.

Chart 3

3.a GDP growth and contributions of main components



SOURCES: Banco de España and INE.

Throughout the projection horizon activity will mainly be underpinned by domestic demand (see Chart 3). Household consumption, the component set to make the largest positive contribution to GDP growth, will gather momentum over the coming quarters, spurred by the increase in real income (in keeping with the projected path of job creation, wages and inflation), population growth and the improvement in household confidence. However, consumption per capita will not recover its pre-pandemic level until 2025. Meanwhile, gross fixed capital formation, which remains 2.2 pp below its pre-pandemic level, will also rise over the projection horizon. Specifically, against a backdrop in which firms' and households' overall financial position is relatively healthy, the recovery in investment will be driven by the impetus from the NGEU-related projects – whose roll-out is expected to gain momentum in 2024 and 2025 – and a slight improvement in financing conditions. In any event, at end-2026 investment will be the demand component with the lowest cumulative growth since 2019. Over a broader time frame, this could weigh on productivity growth and, therefore, the Spanish economy's potential growth going forward.

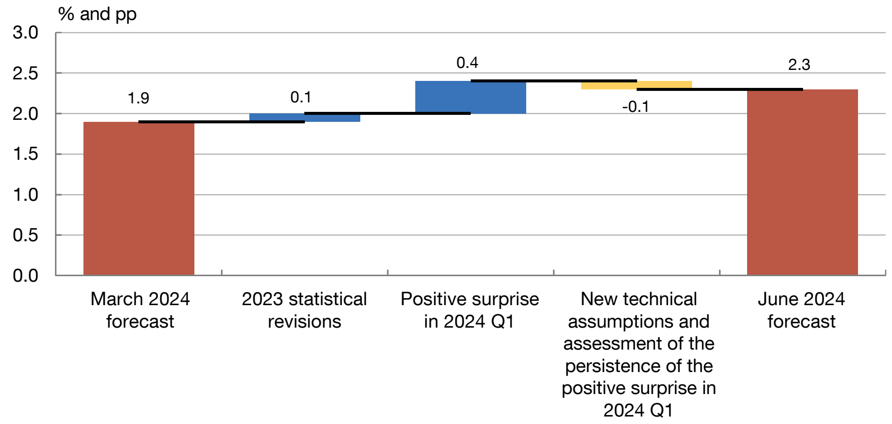
Net external demand will make a positive contribution to GDP growth in 2024, before shrinking to zero in 2025 or 2026. Inbound tourism flows will continue to give impetus to activity over the coming months, driven, among other factors, by the growing geographical and seasonal diversification of inbound tourism to Spain.[12] Meanwhile, the projected recovery in external markets will help goods exports, which fell in 2023, to gradually increase over the projection horizon. Imports are expected to accelerate more sharply than exports, in step with the greater momentum of gross fixed capital formation and goods exports, which are the final demand components with the highest import content. Overall, the external sector's contribution to growth will slow down in 2024 – compared with the high figures recorded in 2022 and 2023 – and will stand at close to zero in the following two-year period.

Compared with the March projections, GDP growth has been revised up for 2024 and is unchanged for 2025 and 2026. Specifically, the average GDP growth rate projected for 2024

12 Blanca Jiménez-García and Coral García Esteban. (2024). "Recent diversification of international tourist flows to Spain". *Economic Bulletin - Banco de España,* 2024/Q2, 03. https://doi.org/10.53479/36594

Chart 4

4.a Changes in the GDP growth forecast for 2024



SOURCES: Banco de España and INE.

has been revised up by 0.4 pp, to 2.3% (see Chart 4). This revision mainly reflects the following factors:

— As mentioned above, the QNA flash estimate for 2024 Q1 (i) incorporated an upward revision to the GDP growth rates in 2023 Q3 and Q4, and (ii) pointed to activity growing more in 2024 Q1 than expected in the March Banco de España projection exercise. Without changing the output growth rates in the other quarters of 2024, these two factors would automatically result in a positive carry-over effect of 0.5 pp on the average GDP growth rate in 2024 (0.1 pp associated with the latest information on the performance of activity in 2023 H2 and 0.4 pp associated with the positive surprise in GDP growth in 2024 Q1).

— Leaving to one side the automatic adjustments to the average GDP growth rate projected for 2024 that stem from past data, such rate will also be affected by several factors that impact the expected GDP growth rate in the future, i.e. in the remaining quarters of 2024. Two of these factors should be highlighted. First, according to the latest technical assumptions, future projected oil prices and short-term interest rates are now higher than those envisaged in the March projections and, therefore, entail less favourable conditions for activity growth in the coming quarters. Second, the positive surprise in output growth in 2024 Q1 mainly stemmed from the extraordinary buoyancy of travel services exports. Most of this surprise is incorporated into the new projections in the form of a more favourable path for this item over the course of 2024 than envisaged a few months ago. However, against a backdrop of considerably volatile quarter-on-quarter rates of change, another portion of the surprise is deemed to be essentially temporary. Overall, it is estimated that these two factors entail a downward revision of some 0.1 pp to the average GDP growth rate in 2024.

Turning to the labour market, job creation will continue throughout the projection horizon, albeit at a somewhat slower pace than observed in recent quarters, resulting in a slight

recovery in productivity. Specifically, while apparent labour productivity will remain markedly weak in 2024, it is expected to recover slightly over the rest of the projection horizon, to reach growth rates that are consistent with its historical performance. Meanwhile, the unemployment rate will continue to decline in the coming years, albeit at a slower pace than in previous years, owing to the expected moderation of job creation and the projected growth of the labour force, which, as in recent years, will continue to be driven by relatively high immigration flows. As a result, the unemployment rate in the Spanish economy will hold at over 11% in 2026.

Prices and costs

Headline inflation has risen sharply in recent months. Specifically, the year-on-year rate of change in the harmonised index of consumer prices (HICP) stood at 3.8% in May (according to the flash estimate), 0.9 pp higher than in February. This increase is essentially due to faster growth in the energy component, which was driven by two contributing factors. First, the gradual reversal in recent months of the tax cuts introduced by the authorities in response to the energy crisis has resulted in higher gas and electricity prices.[13] Second, in the same period, oil prices on international markets have risen unexpectedly, driving up the prices of heating and vehicle fuels in the household consumption basket.

In any event, according to the more disaggregated data (available only up to April), so far this year core and food inflation have continued to ease gradually. Specifically, food inflation fell by 2.3 pp to 4.6% between January and April, although it gained pace slightly (0.3 pp) between March and April as a result of the increase in price of some fresh food items, such as fruit and vegetables. Core inflation also fell, from 3.2% in January to 2.7% in April. However, this deceleration is less marked than that envisaged in the March projection exercise, mainly due to the greater than expected downward stickiness in services inflation. In this regard, since the start of the year, services inflation has fallen by barely 0.2 pp, from 3.7% in January to 3.5% in April, partly as a result of the strength of prices of package holidays and of accommodation and, to a lesser extent, food service activities. By contrast, since January, non-energy industrial goods (NEIG) inflation has decelerated by 1.1 pp to 0.9%, which is less than projected in March.

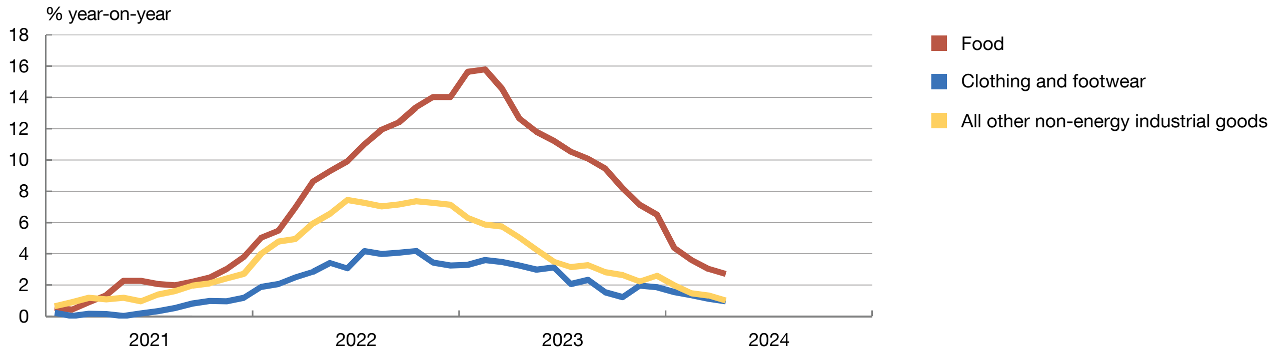
Looking ahead to the coming quarters, both food and core inflation are expected to continue to ease. In particular, food inflation will decline from an annual average of 11.1% in 2023 to 4.5% in 2024 and to rates around 2.5% in 2025 and 2026. This is consistent, inter alia, with futures market prices for various food commodities[14] and with the marked slowdown in food prices observed in recent months at the early stages of the production process (see Chart 5). In any event, this easing in consumer food prices will include some ups and downs in the coming months. For instance, the reversal of the cut in the VAT rate on food as from July 2024 will exert

13 The increase in gas prices was largely due to the VAT rate which reverted back to 21% in April, compared with 10% in March. The rise in electricity prices was mainly associated with the increase in the VAT rate, which rose to 21% in March (up from 10% in the early months of the year), and in the excise duty on electricity, which rose to 3.8% in April (up from 2.5% in Q1).

14 For instance, dairy and edible oil prices on European futures markets suggest that year-on-year rates will drop to around 0.5% in 2025, while meat futures prices suggest that year-on-year rates will drop to just over 1%.

Chart 5

5.a Industrial producer price indicators (a)



SOURCES: Banco de España and INE.

a Indicators calculated on the basis of the corresponding subgroups of the Industrial Producer Price Index (IPRI), weighted by their respective weight in the HICP consumption basket.

some upward pressure on these prices in the second half of the year.[15] Meanwhile, core inflation will decline from an annual average of 4.1% in 2023 to 2.6% in 2024 and to rates around 2% in 2025 and 2026, underpinned by two factors. First, NEIG inflation is expected to steady at relatively subdued rates, in keeping with producer prices for these goods in recent quarters (see Chart 5). Second, services inflation is expected to slow. In line with some of the latest developments, this will be as a result, inter alia, of lower growth in unit labour costs, owing not only to moderation in compensation per employee but also to somewhat higher productivity and weaker profit margins. All told, at the end of the projection horizon the relationship between HICP services and HICP NEIG inflation is expected to return to the long-term trend observed prior to the outbreak of the COVID-19 pandemic.

In consequence, headline inflation will resume a downward path in the coming quarters, falling from 3.4% on average in 2023 to 3% in 2024, 2% in 2025 and 1.8% in 2026 (see Chart 6.a). Food and core inflation will contribute to this slowdown in headline inflation, as will the energy component. It should be noted that, despite energy prices driving inflationary pressures in 2024 as mentioned above,[16] their contribution to HICP growth will be virtually zero in 2025 and even negative in 2026 (see Chart 6.b), once various positive base effects have disappeared and considering present energy commodity futures market prices.

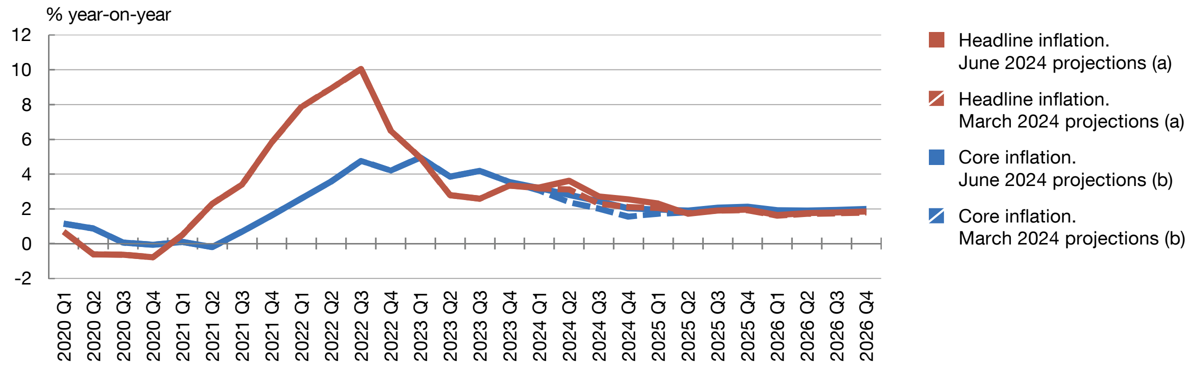
Compared with the previous projections, headline inflation has been revised upwards, mainly for 2024. Specifically, prices are expected to rise by 0.3 pp more on average in 2024 than was forecast in March, owing to the upward revision to the contributions of both the energy and the core inflation component (see Chart 7). First because, as indicated above, energy prices have

15 In line with the measures approved by the Government, it is assumed that in July 2024 the VAT rate on certain staple food products will revert to 4% (from 0% at present) and that the VAT rate on other food products will revert to 10% (from 5% at present). This assumption was already included in the March projections.

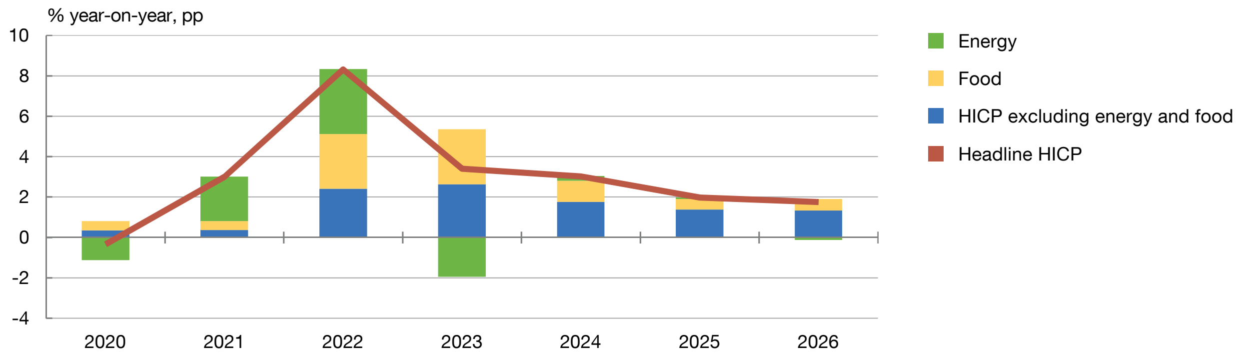
16 By way of illustration, the rate of change of HICP energy inflation, which was close to -9% in 2023 Q4, will rise to around 4% in 2024 Q4.

Chart 6

6.a Headline and core inflation



6.b Contributions to HICP growth, by component



SOURCES: INE and Banco de España.

a Measured by the HICP.
b Measured by the HICP excluding energy and food.

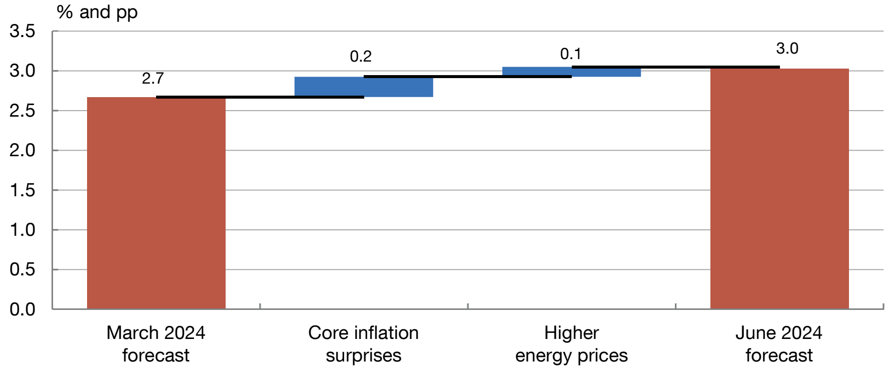
recently seen stronger increases than were expected a few months ago, and also because the futures markets are now anticipating somewhat higher oil prices for the coming months than in March. Second, also as described above, because of the positive surprises in core inflation in recent months, associated with the greater than expected downward stickiness in services inflation. This appears to have been largely due to the recent unexpected strength of tourism, part of which looks set to continue and will exert further inflationary pressures.

Main risks to these projections

As in previous exercises, these projections are subject to high uncertainty, and there have been no major changes in either the nature or the assessment of the main sources of risk. On the external front, geopolitical tensions – such as those associated with the conflicts in Ukraine and the Gaza Strip, or with US-China trade tensions – pose considerable downside risk to activity and upside risk to prices should they escalate. Moreover, in view of the highly positive performance

Chart 7

7.a Changes in the inflation forecast for 2024



SOURCES: INE and Banco de España.

of financial markets in recent months, with some international stock indices close to all-time highs and relatively low risk premia, fresh episodes of financial market turmoil, giving rise to a sharp correction in financial asset prices and a deterioration in the macroeconomic outlook in the short and medium term, cannot be ruled out. Such episodes could be triggered, for example, by adverse developments in the Chinese real estate sector or by an abrupt shift in financial market expectations regarding future monetary policy developments around the world. In the domestic sphere, there is still high uncertainty regarding (i) the pace of implementation of the projects associated with the NGEU programme and their impact on private investment and economic activity, and (ii) the extent to which household saving, which rose in 2023, may fuel private consumption in the coming quarters. In addition, as in March, the current projections do not include a fiscal adjustment path for the Spanish economy that is compatible with the new European fiscal rules due to come into force in 2025. Although the economic impact of this fiscal adjustment plan is uncertain – and will depend, essentially, on its design – its implementation will foreseeably lead to lower economic momentum over the projection horizon than that envisaged in these projections.

In any event, in recent months, financial markets and analysts have increasingly shifted their focus to the possible pace of disinflation (globally, in the euro area and in Spain) in the coming quarters, which is still highly uncertain. In this regard, in the coming months, and especially in the case of the Spanish economy, it will be essential to monitor:

i) developments in the labour market, which continues to show strong momentum, as regards both wages and job vacancies/labour supply;

ii) productivity dynamism, which has so far been rather limited in Spain but is key to developments in unit labour costs and domestic inflationary pressures, and the ability of profit margins to accommodate such pressures;

iii) activity in the services sector – and, in particular, in travel services – which has shown considerable strength in recent quarters, while it is precisely services inflation that is showing the most downward stickiness.

The overall assessment of these various sources of uncertainty suggests that the risks to the current economic growth projections are on the downside, whereas the risks to the inflation projections are on the upside for the coming quarters and are balanced for 2025 and 2026. In recent months, core inflation in Spain has cooled somewhat less quickly than expected and, therefore, considerable caution should be exercised before assuming that the current inflationary episode is under control. Especially in a setting marked by still considerable growth in compensation per employee, modest productivity gains, clear signs of labour market tightness and strong momentum in the services sector, especially in travel services.