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

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EDITORIAL

Editorial

In recent months, the global economy appears to have grown at a robust pace (similar to that recorded in Q2), while inflation has continued to fall and signs of labour market easing have begun to emerge in the main advanced economies. That said, these relatively broad-based trends mask some significant divergence. First, the strength of global economic activity continues to be underpinned by buoyant services, while manufacturing, which in late 2023 and early 2024 appeared to be embarking on a gradual recovery, is once again showing clear signs of weakness. Second, notable differences are discernible in the level of economic momentum in some of the world's main economies. In particular, even after some recent negative surprises (consistent with a certain slowdown in the rate of growth), economic activity remains notably buoyant in the United States. In contrast, activity in the euro area and in China, which surprised on the downside in Q2, seems unlikely to improve significantly in the second half of the year, given the short-term indicators currently available. Third, the gradual decline in inflation in recent months has generally been driven by downward surprises in energy (particularly oil) and food prices. However, underlying and, especially, services inflation continue to be more downwardly sticky than expected. And all this even though signs are beginning to emerge of incipient alleviation of labour market tightness (for example in the United States and in the euro area), as reflected in easing rates of job creation and wage growth.

In this scenario (compatible with a soft landing for the world economy following the extraordinary bout of inflation of recent years), the world's main central banks are beginning to reduce the restrictiveness of their monetary policy stance and financial markets have significantly revised down their expectations for future interest rates. Indeed, the central banks of some developed economies (including the European Central Bank (ECB), the Bank of England and the Bank of Canada) have in recent months begun to reduce the degree of monetary restriction, with cuts in their policy interest rates, a process that began several quarters earlier in the emerging economies. According to recent messages from various members of the Federal Reserve System, monetary easing is also likely to begin in the United States this month. In this setting, and also in the light of the latest macro-financial dynamics, financial markets are now discounting significantly lower future policy interest rates in the main developed economies than they were in June,[1] especially in the United States. This relatively sudden adjustment in market expectations has led to some significant movements in bilateral exchange rates (notably the appreciation of the euro against the US dollar) and it has also been responsible for bouts of instability and volatility in international financial markets. Particularly notable was the episode of heightened volatility in early August, which was linked, among other factors, to an unexpected increase in policy interest rates in Japan and to weak US job data. Admittedly, this bout of instability died down relatively quickly and innocuously,

1 The notable exception is Japan, where expected future interest rates have been revised upwards following the Bank of Japan's unexpected decision in July to increase its key policy interest rates to 0.25%.

but with financial asset prices at very high levels in many market segments, it demonstrated how sensitive they are to unexpected changes in the macro-financial and geopolitical environment.

Looking ahead to the coming quarters, the consensus forecasts show no appreciable changes in the growth rate of global economic activity or in the downward path of inflation. This outlook for the world economy, which naturally depends heavily on future developments in various current geopolitical sources of uncertainty, is also valid for the euro area. In particular, the ECB's September projections exercise maintains as its central scenario a gradual domestic demand-led recovery. That said, in the light of the recent negative surprises (by sector, in manufacturing; by demand component, in household consumption and investment; by country, in Germany), euro area GDP growth is revised down by 0.1 percentage point (pp) in each year of the projection horizon, to 0.8% in 2024, 1.3% in 2025 and 1.5% in 2026. Turning to inflation, the outlook for the euro area as a whole is barely changed (except for a slight upward revision of 0.1 pp to core inflation in 2024 and 2025) and continues to be compatible with a gradual easing of inflationary pressures, allowing headline inflation to reach the target rate of 2% in the latter part of 2025.

In Spain, GDP growth surprised again on the upside in Q2, standing at 0.8%, the same rate of growth as in Q1, and the latest short-term indicators suggest that economic activity will remain considerably buoyant in Q3, albeit growing at a somewhat slower pace – around 0.6% – than in the first half of the year. The notable strength of the Spanish economy in recent quarters – both compared with the euro area and with the economy's potential growth capacity – owes at least in part to a combination of factors. Noteworthy, among others, are the increase in the population (via migratory flows), the relative resilience of Spanish manufacturing compared with that of other European economies and, above all, the high contribution of net external demand to output growth. The latter reflects, among other factors, weak imports, the sustained growth of exports of non-travel services and, in particular, the extraordinary momentum of tourism exports, underpinned by the growing geographical and seasonal diversification of international tourist flows to Spain. In any event, it is important to note that, despite these favourable dynamics, household consumption and investment in the first half of the year surprised on the downside, so these demand headings, which are fundamental for robust and sustainable growth, continued to make relatively modest headway. This could limit the Spanish economy's ability to maintain its recent strong momentum in the coming quarters, especially considering that, as some indicators suggest, the external sector's contribution to growth could ease in the future.

Compared with the June projections, in this projection exercise GDP growth is revised up over the entire projection horizon, to 2.8% in 2024, 2.2% in 2025 and 1.9% in 2026, while no substantial changes are made to the inflation trajectory which is expected to gradually ease. The main factor behind the upward revision of the GDP growth rate for 2024 – by 0.5 pp – is the positive carry-over effect resulting from the latest Quarterly National Accounts data published by the National Statistics Office (INE, by its Spanish abbreviation) at end-July. In addition, these latest projections also envisage a somewhat less favourable outlook for imports and a more positive outlook for the tourism sector, leading to a larger – albeit decreasing – contribution of net external demand to GDP growth both in the second half of 2024 and the following two years. Specifically, in 2025 and 2026, interest rates should also underpin growth momentum, as international financial markets now expect rates to be significantly lower than anticipated in June. As for the inflation forecasts, the differences compared with the June projections are relatively minor and mostly reflect the recent surprises in energy and food prices (on the downside) and in services inflation (on the upside). They also reflect various adjustments stemming from the extension of the lower rate of VAT on basic foodstuffs, approved by the Spanish Government at end-June, and the inclusion of olive oil in this product category. In consequence, the headline inflation rate is revised down slightly for 2024, by 0.1 pp, to 2.9%, and up slightly, by 0.1 pp, to 2.1%, for 2025, while the forecast for 2026 remains unchanged on the June projection exercise at 1.8%.

The risks to the baseline scenario of these projections are on the downside for activity and balanced for inflation. Overall, the current heightened geopolitical tensions continue to be the main source of risk. Another significant source of uncertainty relates to the possibility of sudden corrections in financial asset prices on international capital markets, such as the – albeit temporary – ones seen in early August. While it is too early to assume that the current inflationary episode is fully under control, especially in view of the continued downward stickiness of services inflation, the latest information available does offer some relief compared with the upside risks that have characterised the expected path of inflation in recent quarters, especially in Spain. This is mainly due to the surprises seen in the first half of the year, in terms of stronger than expected productivity growth and lower than expected compensation per employee, which have resulted in a significant moderation in unit labour costs. On the domestic front, considerable uncertainty persists as to the future behaviour of household consumption and business investment. These headings have surprised on the downside in recent quarters; however, going forward, they could still receive significant support, for instance from high saving rates or the progressive roll-out of NextGenerationEU-related projects. As in previous exercises, these projections do not include a fiscal adjustment path for the Spanish economy that is compatible with the new European fiscal rules. The design and implementation of such a plan will be essential to strengthen the sustainability of Spanish public finances and boost economic agents' confidence in the Spanish economy, even though, in the short term, they will likely reduce the projected growth. The importance of implementing the necessary plan without delay and in a transparent manner was highlighted in the ECB Governing Council's latest monetary policy statement agreed at its September meeting.[2]

2 Specifically, the statement notes as follows: "Implementing the EU's revised economic governance framework fully, transparently and without delay will help governments bring down budget deficits and debt ratios on a sustained basis. Governments should now make a strong start in this direction in their medium-term plans for fiscal and structural policies".

Figure 1

	2024	2025	2026
GDP	2.8% ↑ 0.5 pp	2.2% ↑ 0.3 pp	1.9% ↑ 0.2 pp
Inflation	2.9% ↓ 0.1 pp	2.1% ↑ 0.1 pp	1.8% =

SOURCE: Banco de España.

REPORT

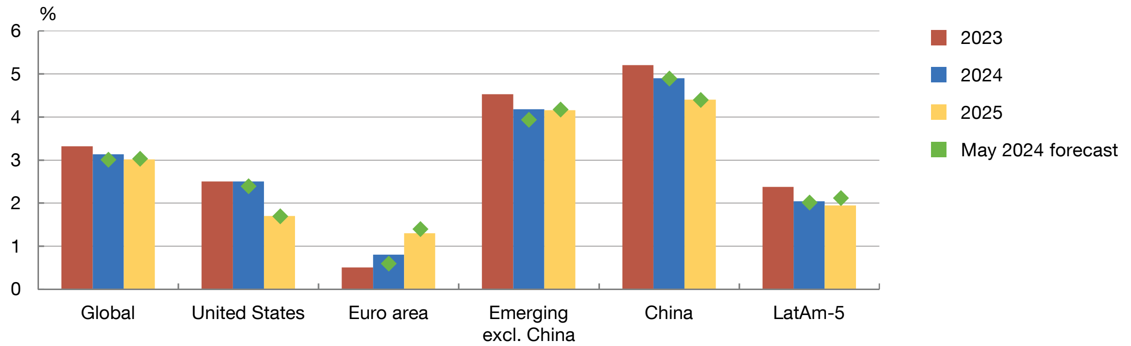
1 The global economy posted robust growth in 2024 Q2 which, despite some signs of weakness, is expected to continue in H2

— Global economic activity grew by 0.7% in Q2 (compared with 1.1% in Q1), although there were notable differences across the main world economies. For instance, GDP growth was unexpectedly high in the United States, accelerating to 0.7% (from 0.4% in Q1), whereas the euro area recorded growth of 0.2%, below both the forecast and Q1 levels. Among the emerging market economies, China and Latin America saw notable slowdowns in growth, posting quarter-on-quarter rates of 1% and 0.2%, respectively.

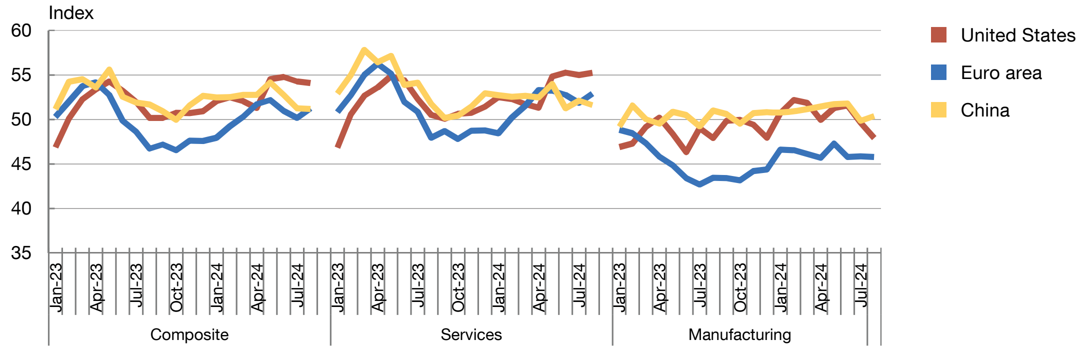
— Nevertheless, the global growth forecasts for 2024-2025 have remained largely unchanged in recent months (see Chart 1.a), and the latest short-term economic indicators suggest that momentum over the coming quarters will remain on a par with that recorded in Q2, despite fresh signs of pervasive weakness in manufacturing among the main world economies (see Chart 1.b).

Chart 1

1.a Consensus growth forecasts (a)



1.b PMIs



SOURCES: S&P Global and Consensus Economics.

a The August 2024 forecasts (bars) are compared with the May 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 China, the United States, Canada, Japan, Norway, Sweden, Switzerland, the United Kingdom and the euro area.

2 The disinflationary process has continued at global level in recent months, but it remains limited by persistent inflationary pressures in services

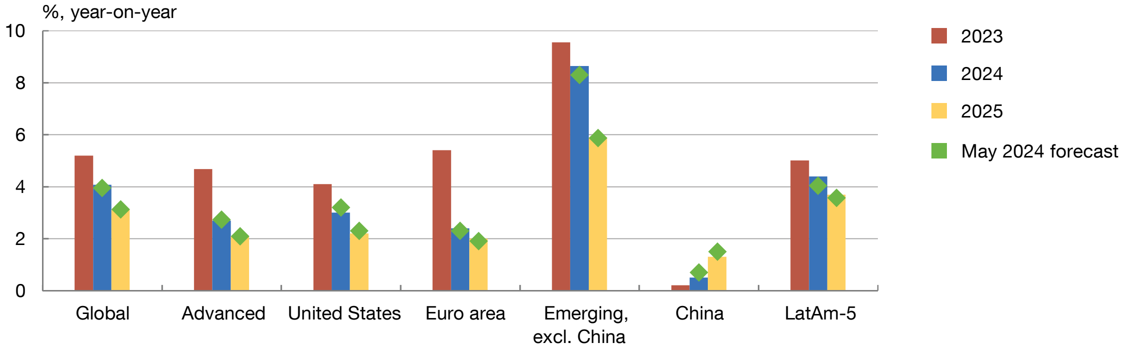
— The inflation rate in the United States slowed from 3% in June to 2.5% in August, while in the euro area it eased from 2.6% to 2.2%. In both regions, this gradual disinflationary process is being shaped by stickier than expected services inflation, which is still at 4.6% and 3.5%, respectively. In China, inflation remains below 1%, with core inflation standing at 0.4%, in line with weak domestic demand.

— Short-term inflation expectations have corrected downwards in recent months, particularly in the United States, and are consistent with the continuation of the disinflationary process (see Chart 2.a). However, these expectations have risen for Latin America, attributable to a recent pick-up in energy prices, which could jeopardise the continuation of the monetary easing cycle in the region.

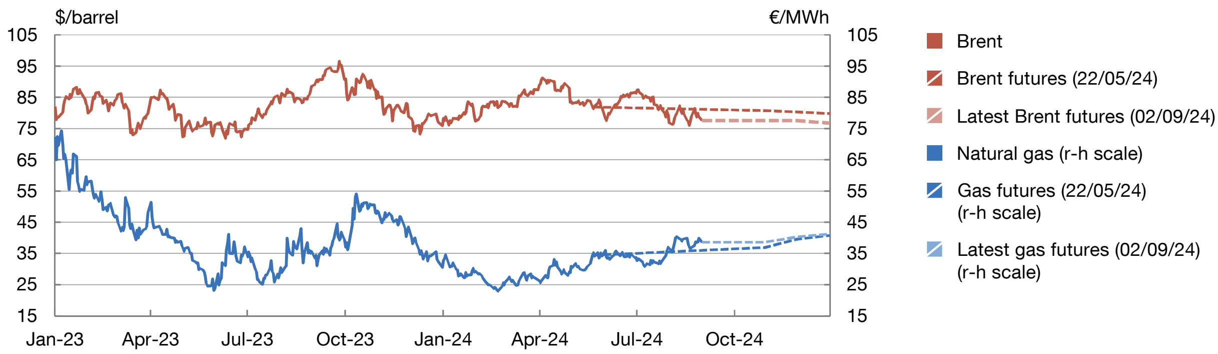
— In any event, future inflation developments at global level will depend, inter alia, on energy prices, which have been considerably volatile in recent months (see Chart 2.b).

Chart 2

2.a Consensus inflation forecasts (a)



2.b Oil and gas prices and futures



SOURCES: National statistics and Refinitiv.

a The August 2024 forecasts (bars) are compared with the May 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 China, the United States, Canada, Japan, Norway, Sweden, Switzerland, the United Kingdom and the euro area.

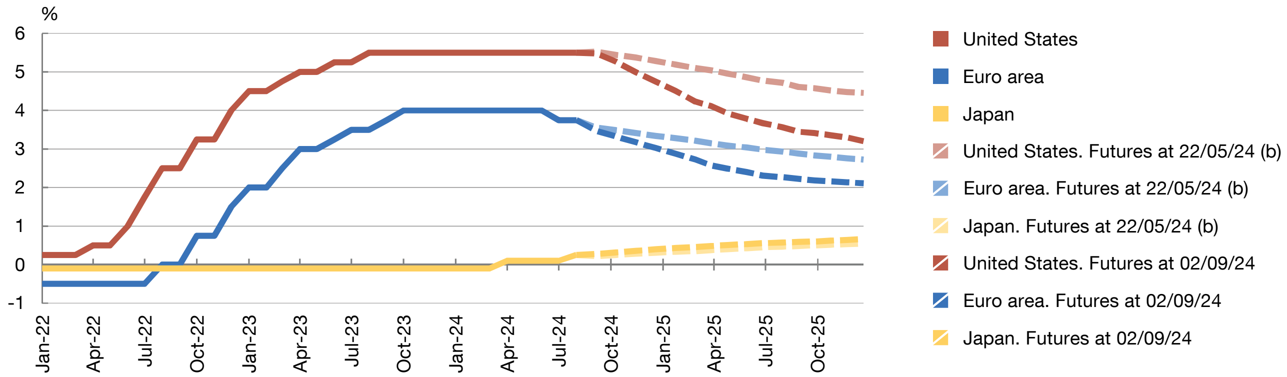
3 The financial markets are now factoring in bigger policy rate cuts in the United States and the euro area compared with a few months ago

— Recent months have seen the first policy rate cuts by some of the main advanced economies since 2020, such as Canada (in June, July and September), the euro area (in June and September) and the United Kingdom (in August). By contrast, the Bank of Japan unexpectedly raised its policy rates to 0.25% in August, triggering tensions on the international financial markets. Meanwhile, in the most recent period monetary policy has continued to ease (albeit at a slower pace than in previous quarters) in the emerging market economies, except in most of Asia.

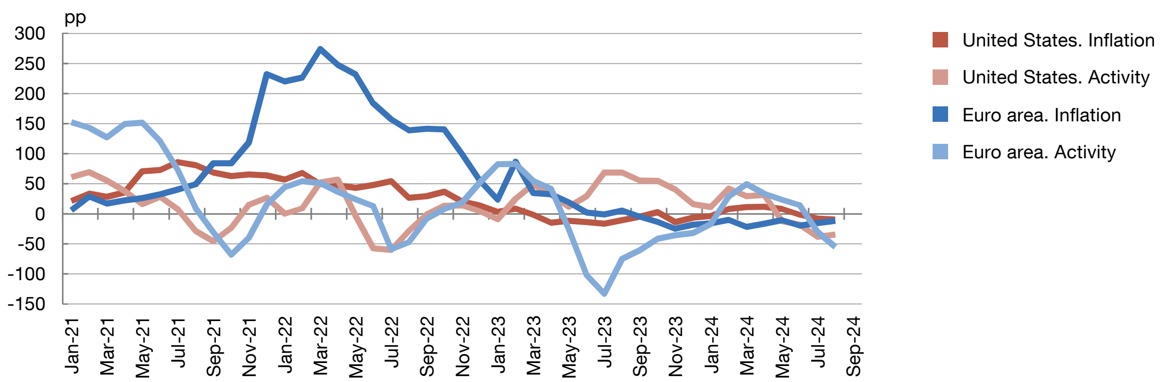
— Compared with three months ago, the futures markets are now pricing in bigger policy rate cuts in the United States and the euro area (see Chart 3.a). This is mainly due to an improvement in investors' future inflation outlook and the downside surprises observed in some recent macroeconomic indicators (see Chart 3.b), especially in the US employment data for July and August.

Chart 3

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



3.b Economic Surprise Index (c)



SOURCES: Refinitiv Datastream, Banco de España and Federal Reserve.

a Interest rates priced in by the respective futures markets (30-day Federal Funds futures, euro area overnight index futures, Japanese overnight index swaps).
b 22 May is the cut-off date for the Banco de España's June 2024 projection exercise.
c Citigroup surprise index, calculated as the difference between official figures and forecasts. Monthly average for activity indicators.

4 Long-term bond yields have declined and stock markets have stabilised following the bout of financial instability in early August

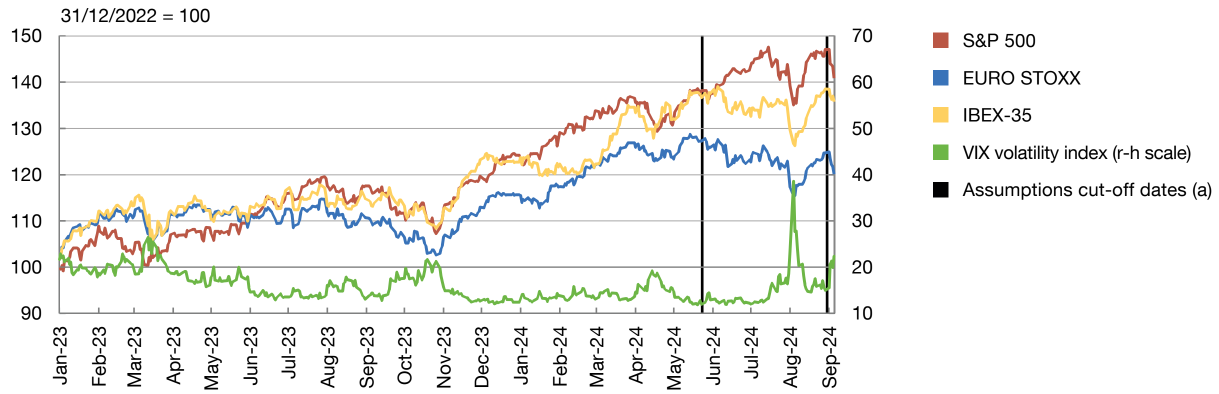
— Early August saw a bout of sharp volatility on the international financial markets, associated mainly with weak employment data in the United States and the surprise policy rate hike in Japan. The sharp drop in global stock prices (see Chart 4.a) was also the result of some technical factors, such as the unwinding of yen carry trades and the usual dip in trading volumes in August.

— Although this episode was short-lived and stock market indices recovered swiftly, there remain greater volatility and heightened sensitivity to incoming macroeconomic information. However, the more accommodative monetary policy outlook in the euro area and particularly the United States has prevailed, bringing down long-term bond yields, against a backdrop of negligible cumulative changes in sovereign risk premia (see Chart 4.b).

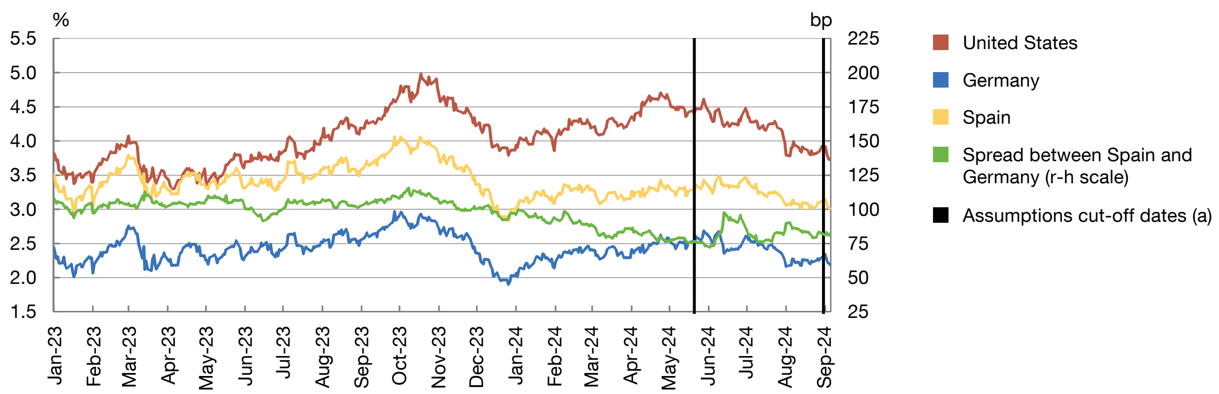
— On the foreign exchange markets, both the dollar and the euro have depreciated notably against the yen during Q3, but the euro has appreciated against the dollar and hardly changed in nominal effective terms.

Chart 4

4.a Stock markets



4.b 10-year sovereign debt yields



SOURCES: Refinitiv Datastream and Banco de España.

a 22 May and 2 September for the Banco de España's June and September projection exercises, respectively.

5 The pace of economic growth has eased in the euro area

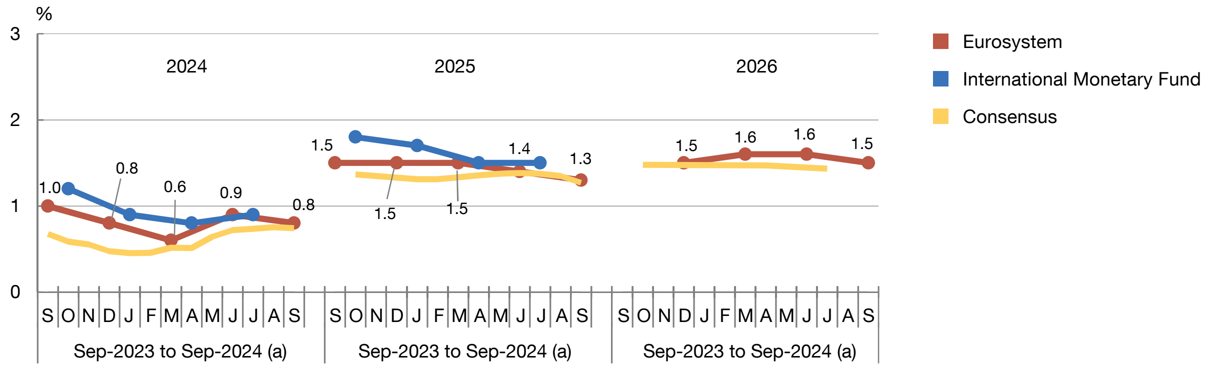
— According to Eurostat, euro area GDP grew at a rate of 0.2% in Q2, 0.1 percentage points (pp) below Q1 levels and 0.2 pp short of the Eurosystem's June forecast. By component, the external sector presented notable momentum, in contrast to weak household consumption and private sector investment. Among the main economies, Germany surprised on the downside, with GDP contracting by 0.1%, while the strongest growth was posted in Spain (0.8%).

— The latest short-term economic indicators, including the Purchasing Managers' Indices (PMIs), suggest that euro area economic activity in 2024 H2 will grow at a rate similar to that in Q2. As in previous quarters, growth will be driven by a strong services sector, in contrast to the persistent weakness in manufacturing.

— In this context, compared with the June exercise, the September European Central Bank (ECB) staff macroeconomic projection exercise revises downwards slightly the GDP growth path over the entire projection horizon. However, a smooth recovery in activity is still expected, driven by a progressive strengthening of real income, labour market resilience and the gradual fading of the impact of past interest rate hikes. Specifically, GDP is expected to grow 0.8% in 2024 and to then quicken to 1.3% and 1.5% in 2025 and 2026, respectively (see Chart 5.a).

Chart 5

5.a Euro area. GDP growth forecasts



SOURCES: IMF, Consensus Economics and Eurosystem.

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

6 The gradual disinflation process in the euro area is unfolding broadly as expected

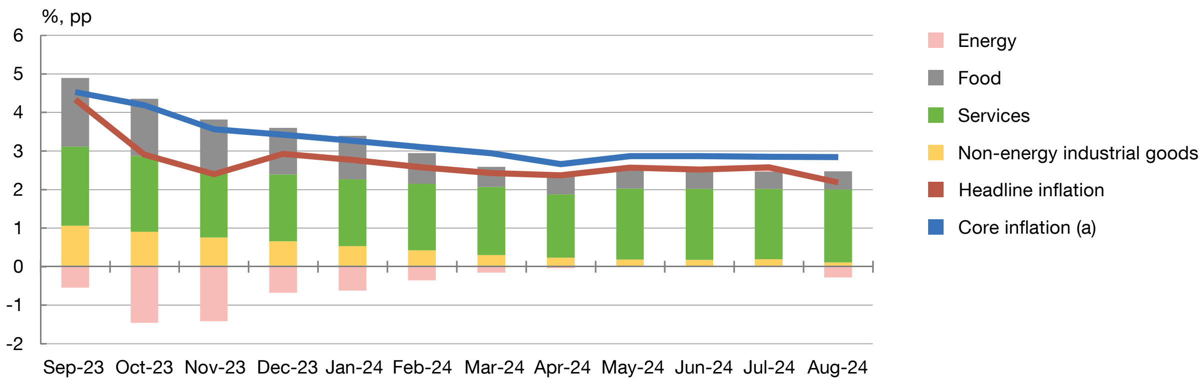
- In August the euro area headline inflation rate fell by 0.4 pp, to 2.2%, after a slight increase in July, while underlying inflation decreased by 0.1 pp, to 2.8% (see Chart 6.a).

- By component, the persistence of services inflation – which has remained above the forecasts made in recent months – continues to be noteworthy. By contrast, energy prices, which are more volatile, have recently surprised on the downside and inflationary pressures in food and, especially, non-energy industrial goods have continued to ease or are now relatively contained.

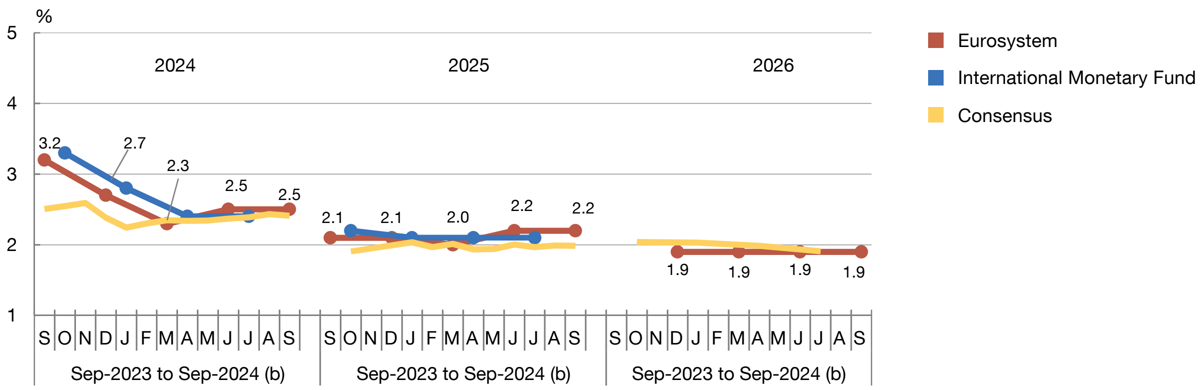
- The September ECB staff projection exercise expects the inflation path to remain practically unchanged from that forecast in June. Specifically, headline inflation is projected to average 2.5% in 2024 and to then moderate to 2.2% in 2025 and 1.9% in 2026 (see Chart 6.b). This would be consistent with inflation rates picking up slightly during 2024 Q4 – mainly due to base effects – and converging towards the 2% target in the final months of 2025.

Chart 6

6.a Euro area inflation and contribution of components



6.b Euro area inflation forecasts



SOURCES: IMF, 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 ECB has continued to reduce the degree of monetary policy restriction

— At its September meeting the ECB Governing Council took another step in moderating the degree of monetary policy restriction with its decision to lower the deposit facility rate by 25 basis points (bp), to 3.5% (see Chart 7.a). This is the rate through which it currently steers the monetary policy stance in the euro area.[1]

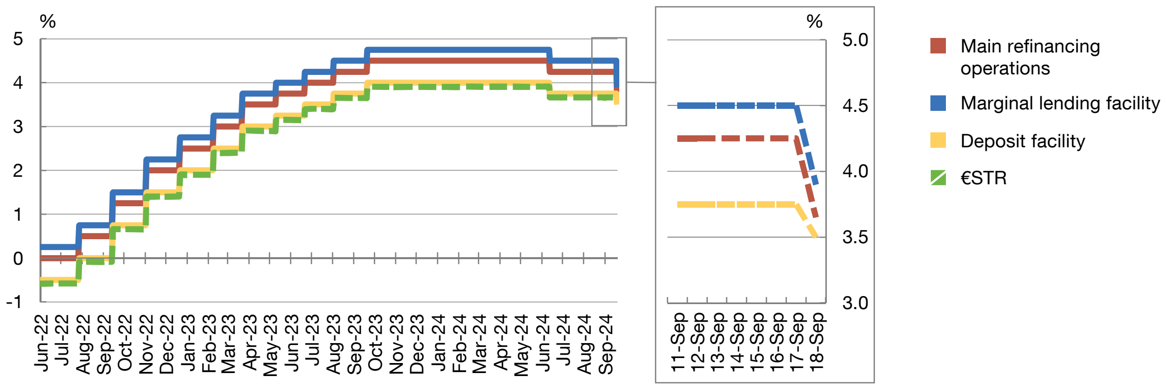
— This decision was based on the Governing Council's updated assessment. In particular, recent inflation data have come in broadly as expected and the latest ECB staff projections confirm the previous inflation outlook. Moreover, despite the persistence of domestic inflation, labour cost pressures are moderating and profits are partially buffering the impact of higher wages on inflation. Financing conditions remain restrictive and economic activity is still subdued.

— Meanwhile, from 18 September the spread between the interest rate on the main refinancing operations and the deposit facility rate will be reduced to 15 bp, from the current 50 bp. This change in the operational framework was announced in March 2024 with the aim of limiting money market rate volatility without affecting the monetary policy stance.

— The Governing Council will continue to follow a data-dependent and meeting-by-meeting approach to determining the appropriate level and duration of restriction without pre-committing to a particular rate path.

Chart 7

7.a Key ECB interest rates and €STR



SOURCES: Banco de España and Refinitiv Datastream. Latest data observed: 11 September 2024.
NOTE: The new interest rate level will take effect on 18 September.

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1 See the Banco de España blogpost "Which ECB interest rate affects my loan or mortgage?", published on 25 October 2023.

8 Spain's economic momentum surprised on the upside again in Q2, driven by strong net external demand

— According to the Quarterly National Accounts (QNA) flash estimate, GDP grew by 0.8% in Q2, the same rate as in Q1 and 0.3 pp more than envisaged in the Banco de España's June projection exercise (see Chart 8.a).

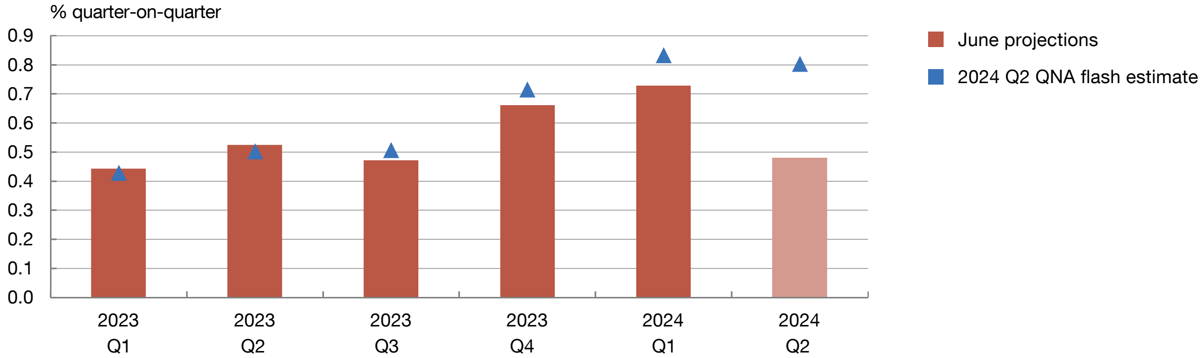
— This growth was mainly underpinned by strong net external demand (see Chart 8.b), which once again contributed 0.5 pp to GDP growth, with positive surprises in services exports and negative surprises in travel services imports.

— Among the components of domestic demand, private consumption and gross capital formation surprised on the downside and slowed down from Q1, while residential investment and government consumption were somewhat more expansionary.

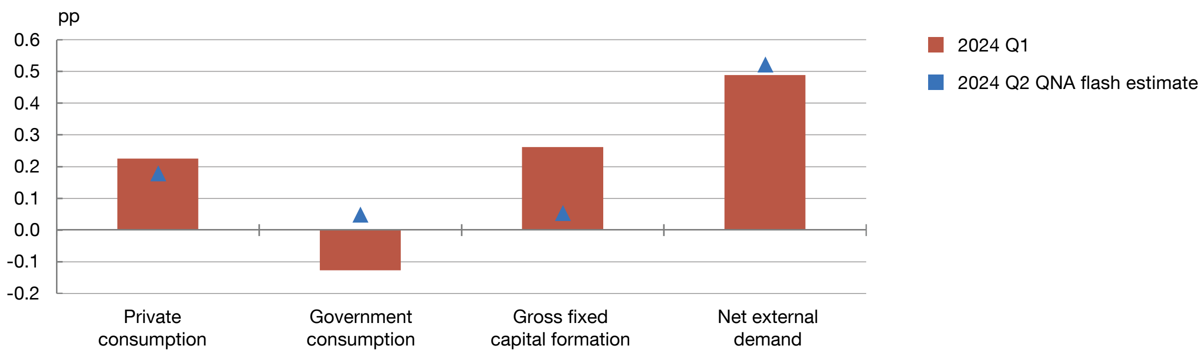
— On the supply side, all productive sectors – except agriculture and fishing and real estate activities – recorded positive growth rates, although activity in industry and construction slackened compared with Q1. By contrast, the services sector showed greater dynamism, especially in trade and hospitality as well as recreation and arts.

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 latest conjunctural data suggest that economic activity in Spain continues to grow at a robust pace in Q3, albeit somewhat more slowly than in previous quarters

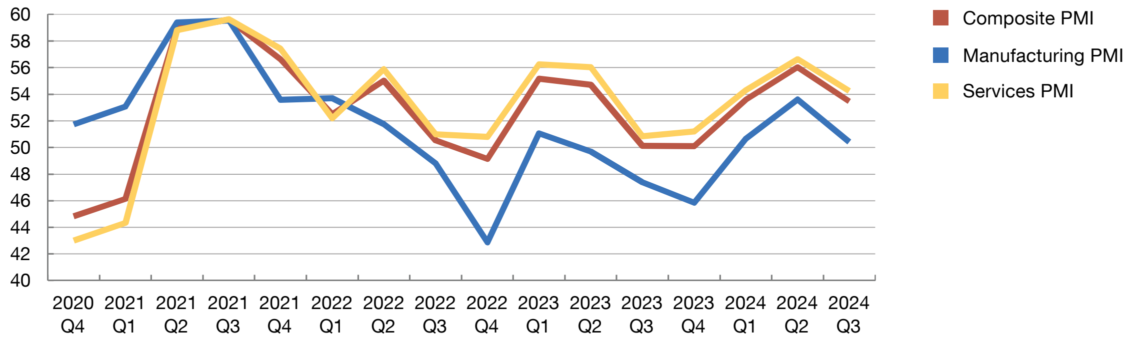
— The various indicators available, which provide partial, and as yet incomplete, information on activity in 2024 Q3, suggest that Spanish GDP could grow in this period by 0.6% quarter-on-quarter. There is, however, considerable uncertainty surrounding this estimate. [2]

— The indicators consistent with less buoyant activity in Q3 notably include the employment and confidence indicators. As regards the latter, the average PMI levels for July and August were lower than in the previous quarter, in both manufacturing and services (see Chart 9.a).

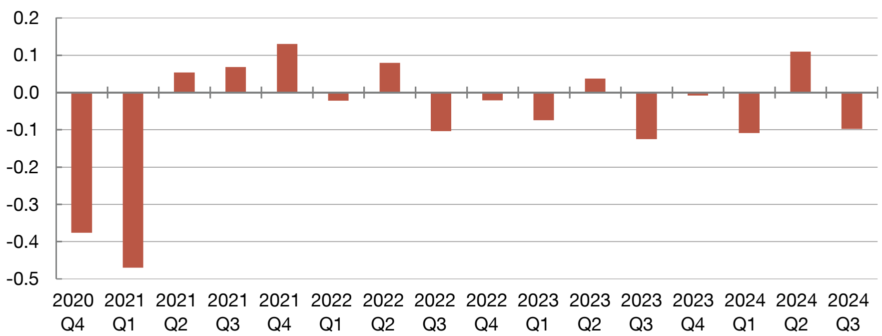
— The results of the Banco de España Business Activity Survey (EBAE) also point in this direction, [3] suggesting that Spanish firms' turnover weakened slightly between July and September (see Chart 9.b).

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 Q3 figure is the average of July and August.
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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2 For more details, see the Projections in this report.

3 Fernández and Izquierdo (2024).

10 Job creation appears to have slowed in Q3, after a highly buoyant first half of the year

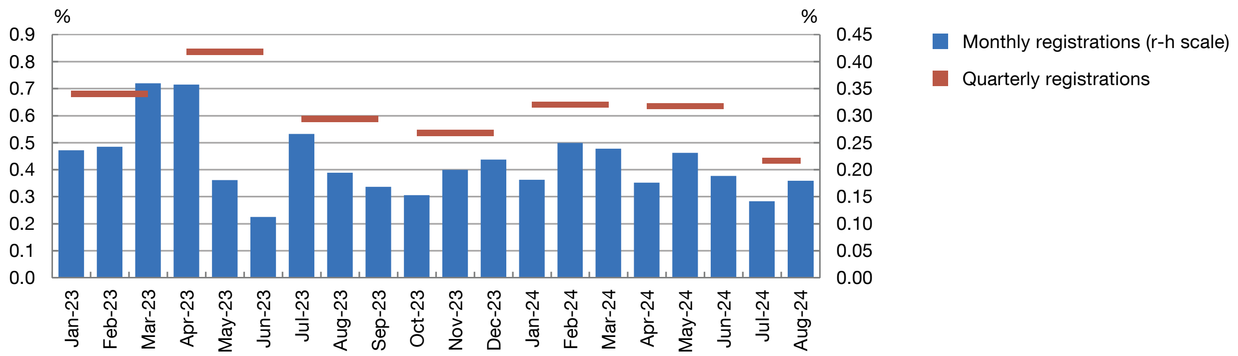
— In seasonally adjusted monthly terms, social security registrations increased by 0.14% in July and 0.18% in August. These growth rates are lower than those observed in the first half of the year (see Chart 10.a), pointing, pending the publication of the September data, to some moderation in job creation throughout Q3.

— By sector of activity, developments in employment remain mixed (see Chart 10.b). On the one hand, social security registrations in construction have recently picked up momentum after a sluggish start to the year and employment in market services remains robust, thanks to buoyant activity in tourism-related sectors such as transportation and hospitality. On the other, social security registration growth in industry has remained steady in recent months and the significant slowdown in non-market services employment that began in May has persisted.

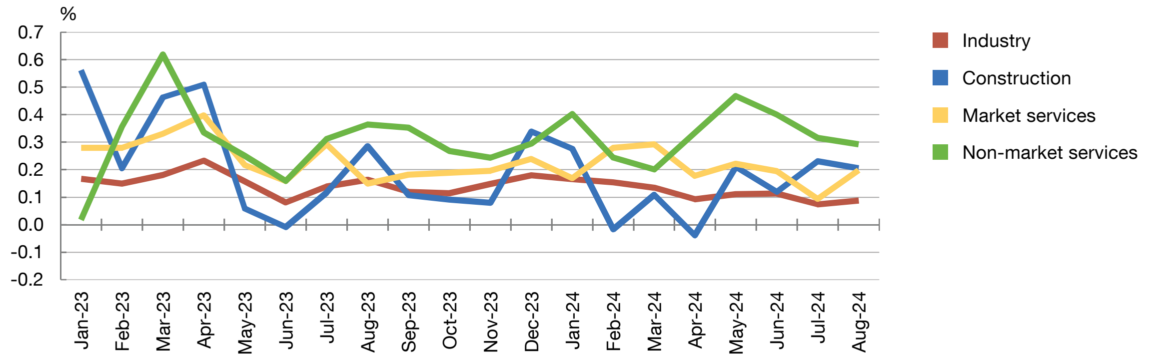
— Between January and August 2024, foreign workers continued to provide a strong boost to social security registrations, which grew by 7.7% on average for this group, compared with 1.7% for Spanish nationals. As a result, the share of foreign nationals in total registrations has increased by 0.7 pp since end-2023, to 13.5%.

Chart 10

10.a Total social security registrations. Monthly and quarterly rates (a)



10.b Monthly change in social security registrations in industry, construction and services (b)



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

a Seasonally adjusted monthly and quarterly rates. The 2024 Q3 rate has been calculated based only on the data for July and August.
b Seasonally adjusted monthly rates.

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11 Financing flows to the private sector have improved slightly amid shallow interest rate cuts

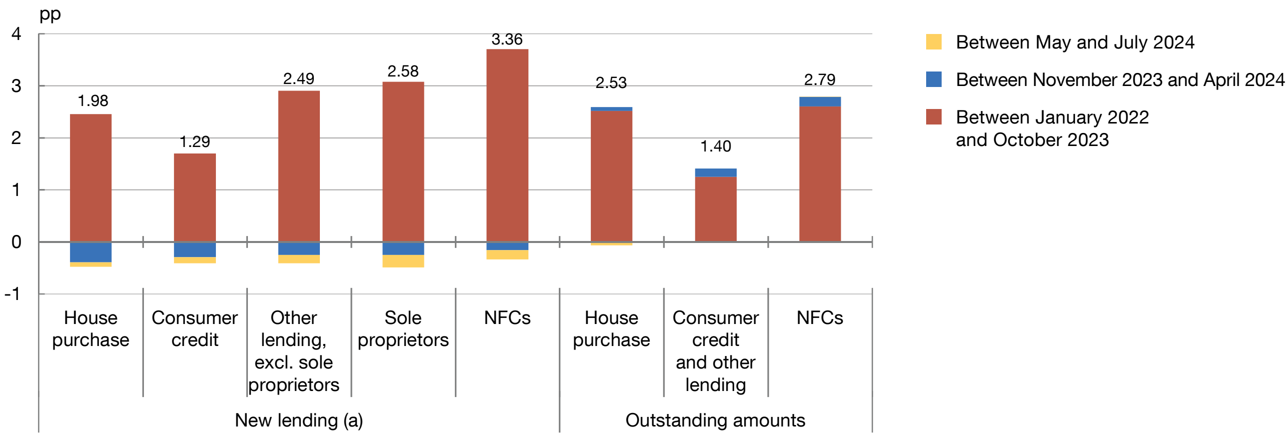
— Interest rates on new loans continued to fall slightly between May and July, while those applicable to outstanding amounts barely changed (see Chart 11.a).

— According to the Bank Lending Survey, in Q2 credit standards were unchanged for loans to firms, but tightened slightly for households, with no significant changes expected in Q3. Meanwhile, for the first time since 2021 and somewhat more sharply than expected, loan demand increased across the board. Respondent banks expect loan demand to continue to grow in Q3.

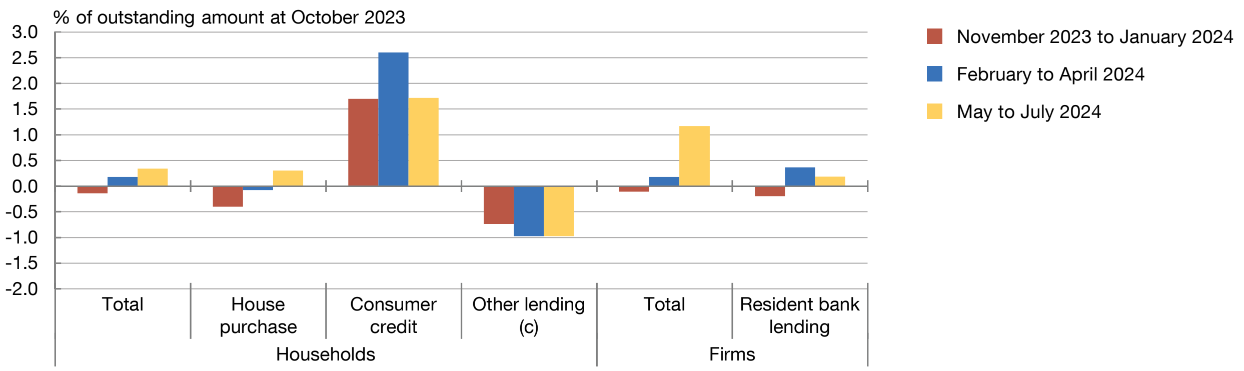
— Based on the survey on the access to finance of enterprises in the euro area, SMEs' perceptions of banks' willingness to lend improved in Q2. Against this background, the financing obtained by firms and households increased between May and July in almost all segments, with consumer credit remaining the fastest growing segment (see Chart 11.b).

Chart 11

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



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



SOURCE: Banco de España.

a Narrowly defined effective rates, i.e. excluding related charges, such as repayment insurance premiums and fees. Adjusted seasonally and for the irregular component.
b Seasonally adjusted data. Includes securitisations. "Total" includes financing to the rest of the world and debt securities.
c Includes loans to sole proprietors.

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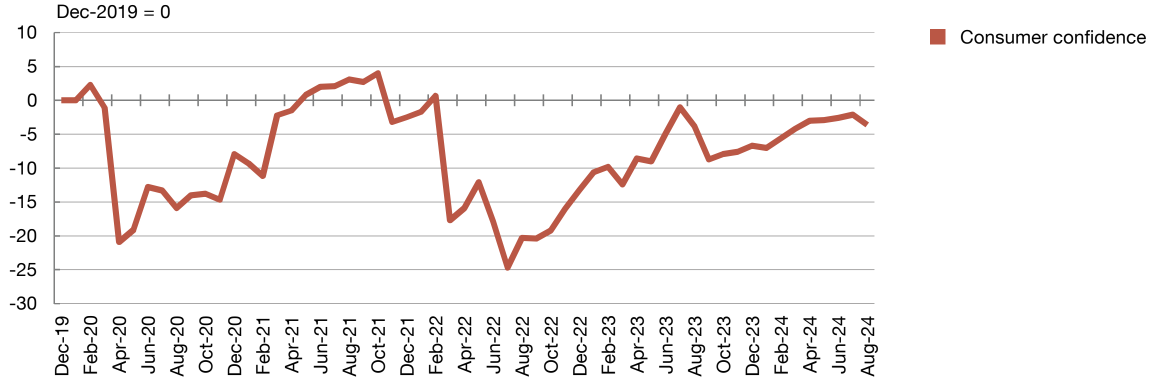
12 The recovery in private consumption is expected to continue in Q3

— In recent quarters, despite the relative strength of the employment and disposable income indicators, household consumption growth rates have been modest and lower than expected. The factors behind these downside surprises remain highly uncertain and could include a possible greater adverse impact of the cumulative monetary tightening on consumption and a potential adverse effect of the recent marked changes in the composition of Spanish households on aggregate spending levels.

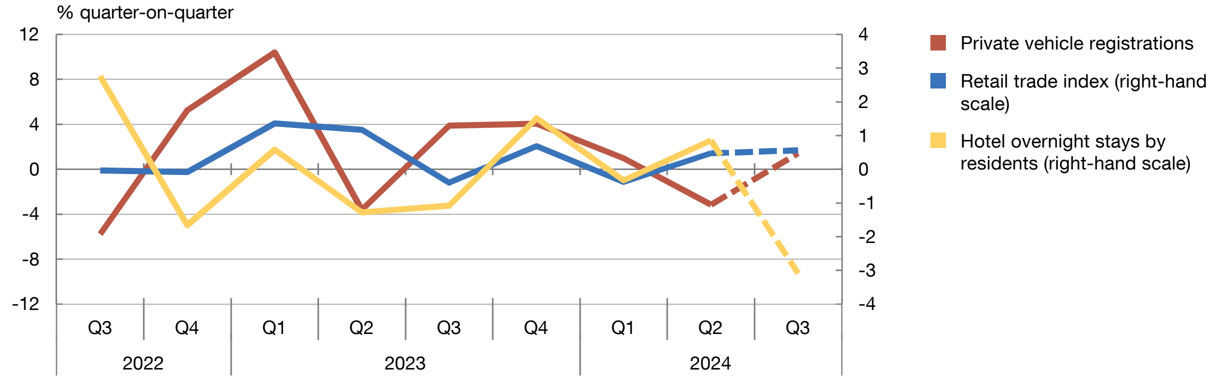
— In any event, according to the latest short-term economic indicators, household consumption is expected to continue its gradual recovery in Q3. The upward path of consumer confidence (see Chart 12.a) and the growth of consumer credit, for example, appear to point in this direction. Other signs include the increase in the retail trade index in July and in new car registrations (average for July and August). These positive developments would be partially offset, however, by the decline in hotel overnight stays by residents in Spain in July (see Chart 12.b).

Chart 12

12.a Consumer confidence



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



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

a The rate for 2024 Q3 was calculated using data for July in the case of the retail trade index and hotel overnight stays and based on the average of July and August in the case of private vehicle registrations.

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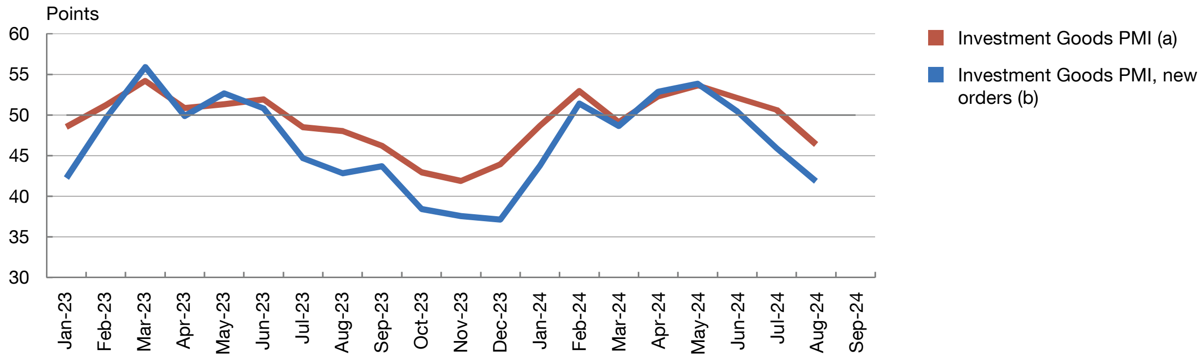
13 Investment is expected to slow somewhat

— Productive investment performed soundly in 2024 H1, mainly driven by the growth of investment in other construction. By contrast, investment in machinery and equipment was weaker and remains 6% below its pre-pandemic level. Looking ahead to Q3, the decline in the Investment Goods Purchasing Managers' Index (PMI) – impacted by the fall in new orders (see Chart 13.a) – suggests that productive investment has slowed in this period.

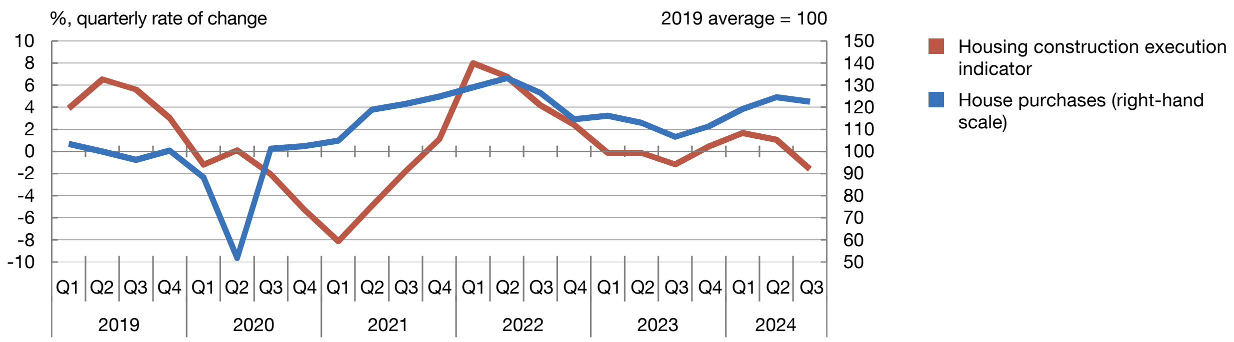
— Turning to residential investment, recent developments in the housing construction execution indicator (see Chart 13.b) are consistent with some sluggishness in this component in Q3, although house purchases continue to record strong growth, with the January-July period seeing the second highest number of transactions in these months since 2008, behind the 2022 figure. Meanwhile, the relative tightness of supply in the short term compared with the strength of demand – partly driven by purchases by foreign citizens – continues to exert upward pressure on house prices, which rose by 7.8% year-on-year in Q2.

Chart 13

13.a Qualitative indicators of investment



13.b Main indicators of residential investment (c)



SOURCES: S&P Global, European Commission, INE, Banco de España, Centro de Información Estadística del Notariado and Ministerio de Transportes y Movilidad Sostenible.

a Composite index of activity in the investment goods sector. A value above (below) 50 points denotes expansion (contraction).
b A value above (below) 50 points denotes an increase (a decrease) in new orders.
c 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 time series for house purchases. For this time series, 2024 Q3 is represented by the average of the last three months with data available (May, June and July).

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14 After making a strong contribution in Q2, the external sector's contribution to GDP growth is expected to ease in Q3

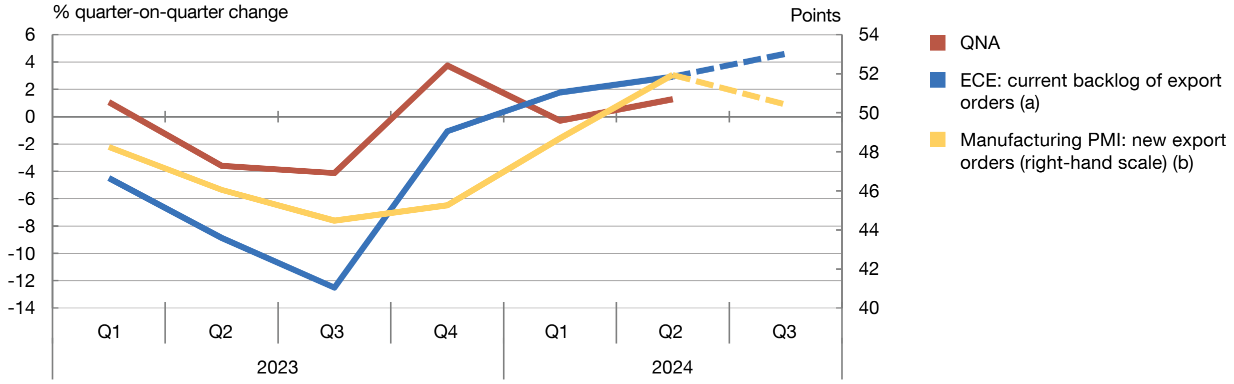
— In the first two quarters of the year, net external demand made a very significant contribution (0.5 pp) to the quarter-on-quarter GDP growth of 0.8%. In Q2 specifically, the positive contribution of net exports was the result of the high growth of exports of both goods (+1.3%, in quarter-on-quarter terms) and services (+1%), and a slight slip in imports (-0.2%), particularly in travel services (-11.4%).

— Looking ahead to Q3, there are mixed signals for goods exports. On the one hand, the PMI new export orders index points to a slight slowdown in sales abroad in Q3. On the other, business owners that responded to the quarterly survey of exporters (ECE, by its Spanish initials) continue to have a relatively positive outlook for goods exports (see Chart 14.a).

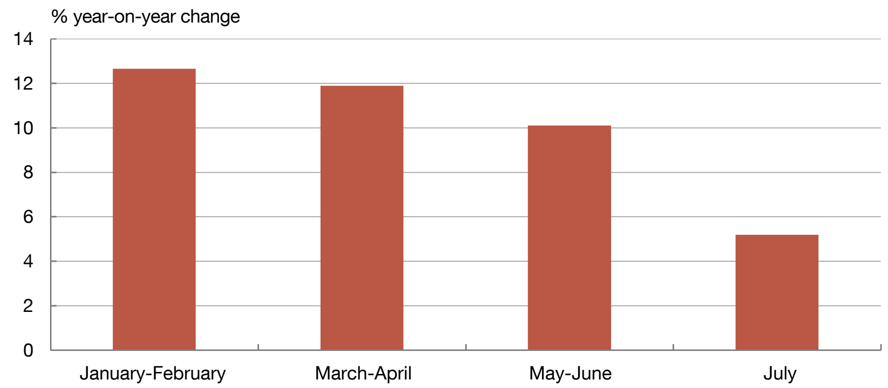
— Services exports are expected to continue to grow somewhat in Q3 (as suggested by the rise in the Services PMI), but the year-on-year rate of change of hotel overnight stays by foreign tourists has clearly slowed in recent months (see Chart 14.b)

Chart 14

14.a Real goods exports



14.b Hotel overnight stays by foreign tourists in Spain in 2024



SOURCES: INE, Ministerio de Industria, Comercio y Turismo and S&P Global.

a Latest observation: 2024 Q2.
b Latest observation: August 2024.

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15 Government revenue and expenditure continued to grow at a robust pace in Q2

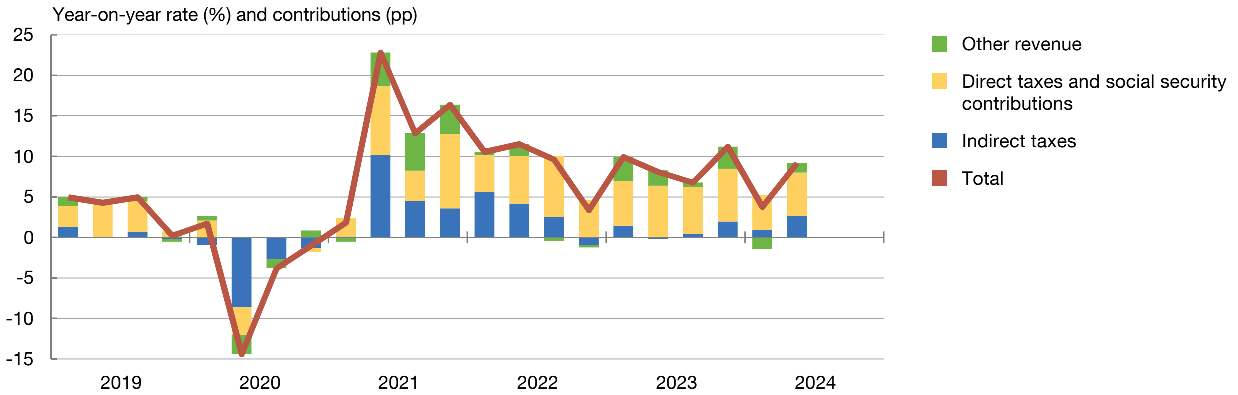
— After a first quarter in which government revenue again grew at slower pace than its macroeconomic determinants, government revenue recovered in the months leading up to the summer (with year-on-year growth of 9.2%), thanks to the vigour of the macroeconomic bases, particularly in the case of direct taxes and social security contributions (see Chart 15.a). In the second half of the year indirect tax revenue will be affected by the extension, agreed in June, of the reduced VAT rate on certain food items and the reclassification of olive oil as a consumer staple.

— Despite the slight slowdown in some of its components, government expenditure continued to grow at a rapid pace in Q2 (5.0%) (see Chart 15.b). Against this background, to ensure that the country meets the European Commission's recommendation for Spain in 2024 (that nominal growth of nationally financed net primary expenditure should not exceed 2.6% this year), additional compensatory measures to cut expenditure or raise revenue may be required in the coming months.

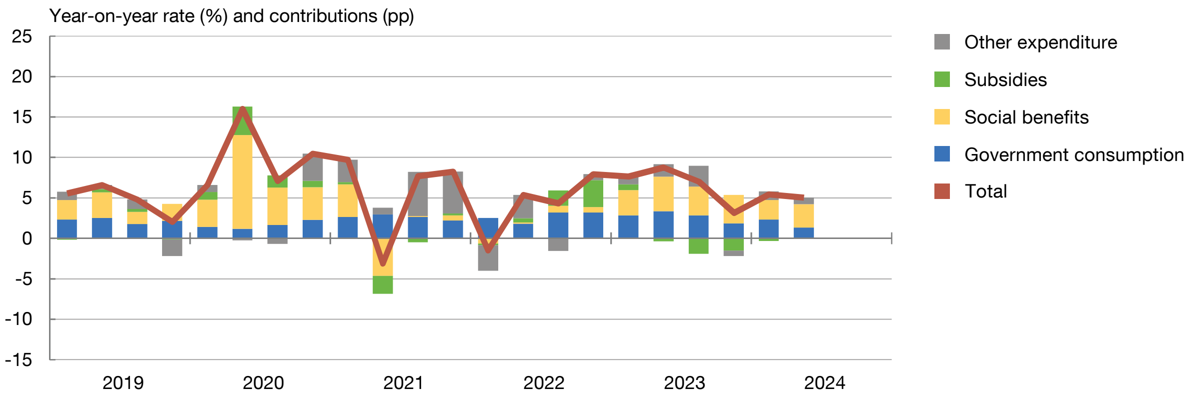
— Overall, it is estimated that the general government deficit, in cumulative 12-month terms, stood at 3.4% of GDP in May, down 0.2 pp on end-2023.

Chart 15

15.a Government revenue (a)



15.b Government expenditure (a)



SOURCES: Banco de España and IGAE.

a The data for 2024 Q2 do not include local government.

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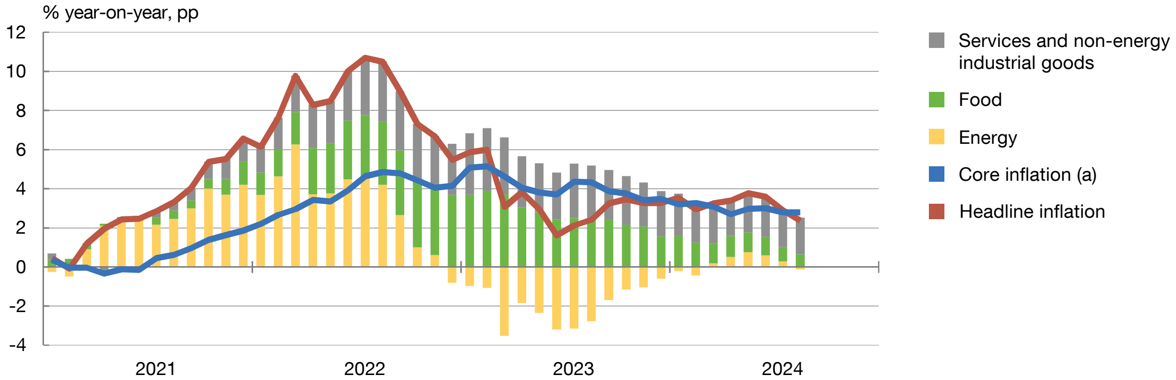
16 Headline inflation has continued to ease, reflecting the slowdown in energy and food prices, while core inflation remains stickier

— Headline inflation, as measured by the harmonised index of consumer prices (HICP), declined by 1.4 pp between May and August, to a year-on-year rate of 2.4% (see Chart 16.a). This decrease reflected, first, developments in food prices, which eased more markedly from July (continuing the slowdown observed in Q2), owing in particular to the prices of certain fresh foods, such fruits and vegetables, and olive oil.[4] Second, the decline in fuel prices helped to slow the rise in energy prices.[5]

— In August, core inflation reached a year-on-year rate of 2.8%, down by 0.2 pp on the May figure. By component, non-energy industrial goods prices maintained very moderate growth rates (0.6% in August), while services inflation remained more persistent (3.7% in August compared with 3.9% in May). In particular, hospitality and tourism-related services inflation has been somewhat volatile over the summer season (reaching 4.9% in August), while other services inflation remained stable (see Chart 16.b).

Chart 16

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



SOURCES: Eurostat and Banco de España.

a Headline inflation excluding energy and food.

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4 The slowdown in olive oil prices owes, at least in part, to the VAT rate being lowered from 5% to 0% in late June. This would have reduced the year-on-year increase in the food, beverages and tobacco component of the HICP by 0.1 pp in July and August.

5 The moderation of energy prices in July was driven by the reduction in the VAT rate on electricity to 10%. In any event, the VAT reduction was somewhat offset by the excise duty on electricity reverting to 5.1%, having been 3.8% since April.

17 Unit labour costs decelerated in Q2, reflecting both a moderation in compensation per employee and improved productivity

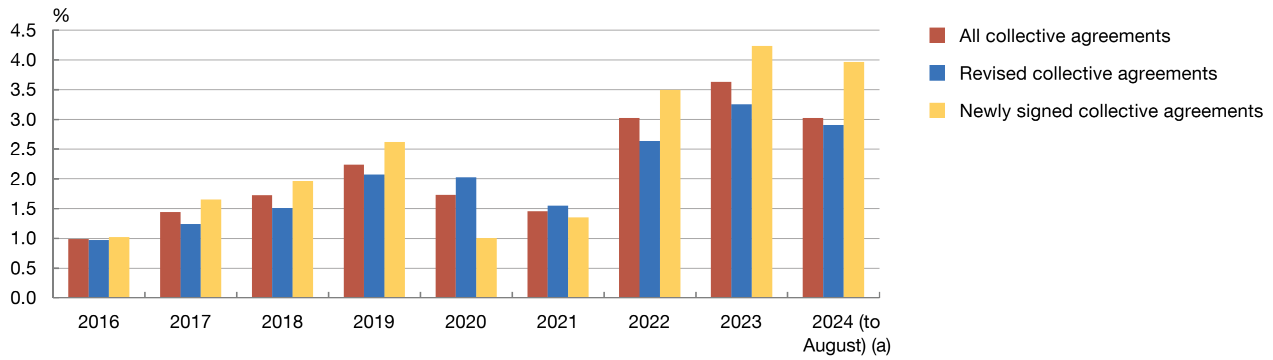
— On data to August, the average negotiated wage settlement for 2024 held at 3%, down by 0.6 pp on the increase agreed for 2023 (see Chart 17.a). For most wage-earners with wage agreements for 2024 (nearly 90%), these were signed in previous years and include an average wage increase of 2.9%. By contrast, new agreements signed in 2024 provide for an increase of 4%, although they only cover slightly more than one million workers.

— Compensation per employee in the market economy slowed in Q2 to a year-on-year rate of 4.8%, compared with the increases of more than 6% observed in 2023. This growth continued to outpace negotiated wage increases, reflecting positive wage drift, albeit less pronounced than last year.

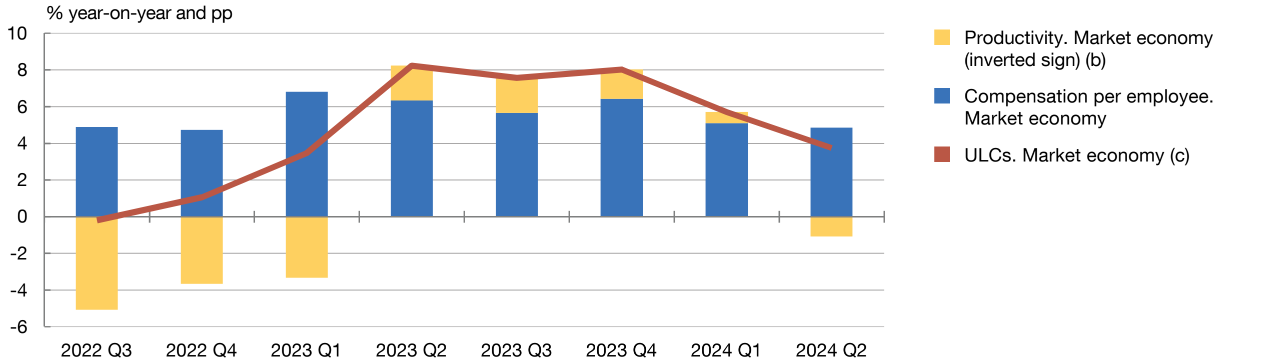
— The slowdown in compensation fed through to unit labour costs (ULCs), resulting in a year-on-year increase of 3.8% (nearly 2 pp less than in Q1), which was also tempered by the recovery in productivity (see Chart 17.b).

Chart 17

17.a Wage settlements



17.b ULCs. Market economy. Changes and contributions



SOURCES: Ministerio de Trabajo y Economía Social and INE.

a The newly signed agreements to August 2024 are unrepresentative, since they only cover 1,054,221 workers (11.2% of the total number of workers with agreements signed for 2024).
b Productivity is defined as GVA divided by the total number of employees in a given sector.
c The change in ULCs 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 decline in productivity.

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18 Profit margins are hovering close to pre-pandemic levels, albeit with marked cross-sector heterogeneity

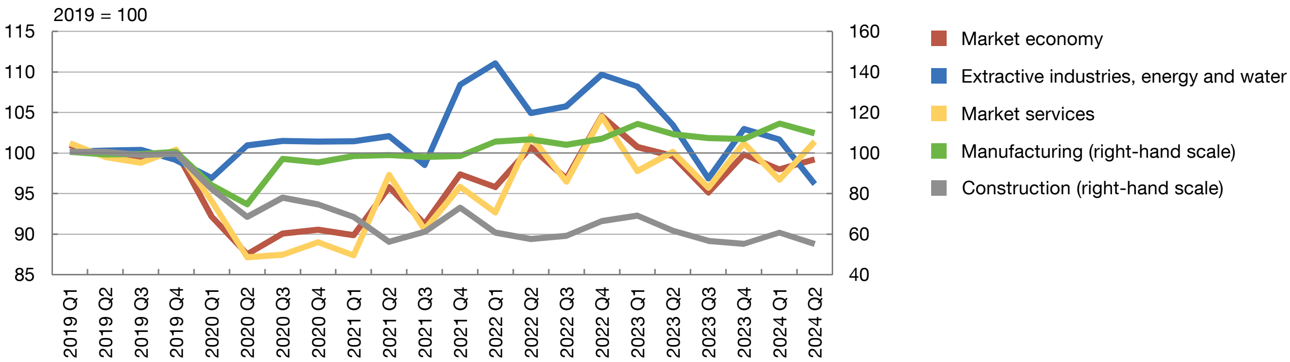
— On QNA data, since end-2023 the ratio of gross operating surplus (GOS) to gross value added (GVA) of the market economy has held relatively stable, standing very close to pre-pandemic levels (see Chart 18.a). Even so, marked cross-sector heterogeneity persists, with notable differences between this ratio in manufacturing and construction.

— According to Spanish Tax Agency (AEAT) information on the turnover of large corporates and SMEs, operating margin, defined as the ratio of gross operating profit (GOP) to turnover, has maintained the momentum observed since early 2023. It is important to note that this indicator does not factor in borrowing costs, which have been rising with higher interest rates.

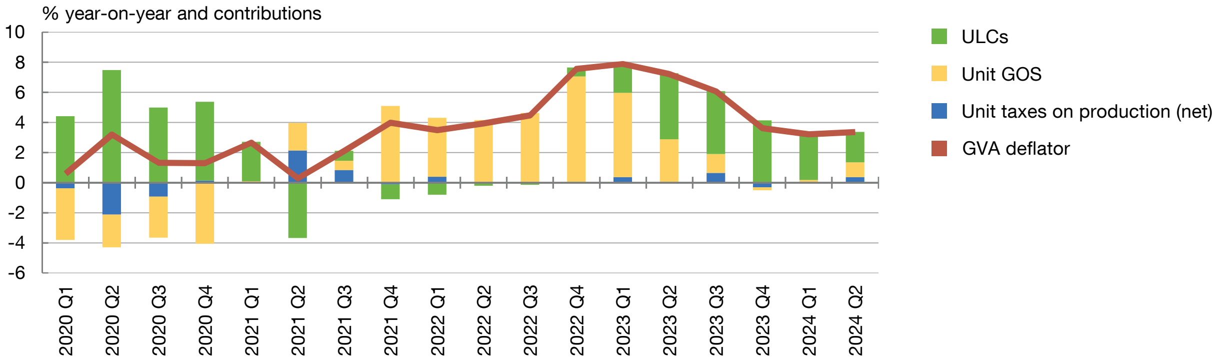
— The gross value added deflator showed relatively stable year-on-year growth in 2024 Q2, as the moderation in ULCs was offset by the increase in unit GOS (see Chart 18.b).

Chart 18

18.a Changes in profit margins (GOS/GVA) on QNA data. Breakdown by sector



18.b Value added deflator. Market economy



SOURCES: Banco de España and INE.

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 will grow by 2.8% in 2024, 0.3 percentage points (pp) more than in 2023. GDP growth will gradually slow down over the following two years, to 2.2% in 2025 and 1.9% in 2025. Meanwhile, the unemployment rate will remain on a declining path in the coming years, reaching just under 11% in 2026. As for prices, headline inflation – which averaged 3.4% in 2023 – will fall over the projection horizon, to stand at 2.9% in 2024, 2.1% in 2025 and 1.8% in 2026. Core inflation (which excludes energy and food) will also follow a downward path, dropping from 4.1% in 2023, to 2.8% in 2024, 2.2% in 2025 and 1.9% in 2026 (see Table 1).

The remainder 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 are detailed. Lastly, some of the main elements of uncertainty surrounding these projections are discussed.

Main assumptions and determinants underlying the projections

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

Assumptions about energy price developments.[3] Futures markets currently anticipate a somewhat more marked decline in oil prices over the coming quarters than envisaged in the June projections (see Chart 1). Conversely, the markets now expect future gas and electricity prices to be higher than forecast three months ago.

Assumptions about interest rate developments.[4] Based on international financial market expectations, short-term interest rates are expected to fall progressively over the projection

1 Compared with the projections published on 11 June, the current projections incorporate the new information that has become available since then. This includes, in particular, the Quarterly National Accounts (QNA) flash estimate for 2024 Q2, the Quarterly Non-Financial Accounts for the Institutional Sectors for 2024 Q1 and the changes observed in the technical assumptions for the key projection variables. The cut-off date for the projections and data is 9 September, except for the data on overseas markets and the technical assumptions, for which it is 30 August.

2 "Macroeconomic projections for the Spanish economy (2024-2026)". *Economic Bulletin – Banco de España,* 2024/Q2.

3 Eurosystem projection exercises use energy commodity futures to proxy the expected future path of energy commodity prices over the projection horizon.

4 As with oil and other commodity prices, the assumptions regarding the future paths of market interest rates are based on the prices observed on the projection cut-off date (30 August).

Table 1
Macroeconomic projections for the Spanish economy (a)

Annual rate of change (%)

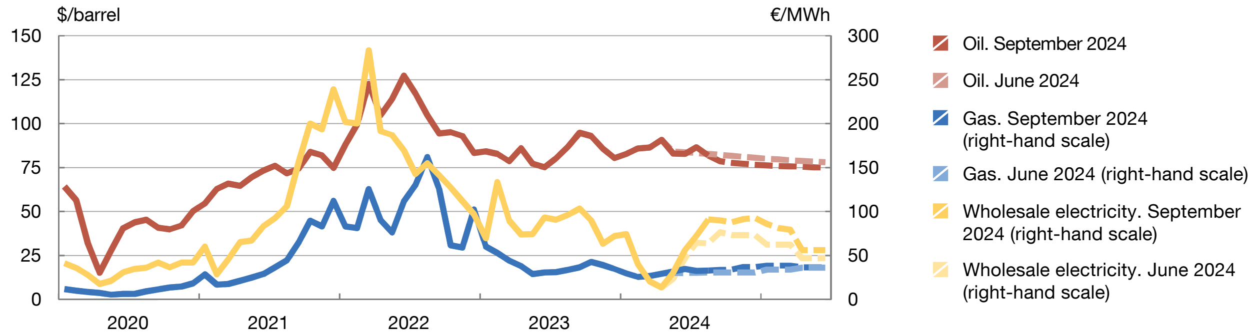
	GDP				Harmonised index of consumer prices (HICP)				HICP excluding energy and food				Unemployment rate (% of labour force) (b)			
	2023	2024	2025	2026	2023	2024	2025	2026	2023	2024	2025	2026	2023	2024	2025	2026
September 2024	2.5	2.8	2.2	1.9	3.4	2.9	2.1	1.8	4.1	2.8	2.2	1.9	12.2	11.5	11.0	10.7
June 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

SOURCES: Banco de España and INE.
NOTE: Latest QNA figure published: 2024 Q2.

a Projections cut-off date: 9 September 2024.
b Annual average.

Chart 1

1.a Energy prices



SOURCES: Mercado Ibérico del Gas, OMIE and Reuters.

horizon. This decline would be more pronounced than envisaged three months earlier, meaning looser monetary conditions over the projection horizon than in the June exercise. Moreover, under the updated technical assumptions, Spanish long-term sovereign bond yields will follow a path similar to that projected in the previous exercise (see Table 2).

Assumptions about external market developments. The technical assumptions envisage a gradual recovery in Spain's export markets over the coming quarters, albeit a slightly weaker one than in the June projection exercise, particularly in 2024 and, due to a carry-over effect, in 2025. Meanwhile, compared with the previous projection exercise, the euro exchange rate has appreciated somewhat, both against the dollar and in nominal terms (see Table 2).

Assumptions about fiscal policy in Spain.

Compared with the June forecasts, the fiscal assumptions have been updated to include the following new developments with an impact on the budget deficit:

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

Annual rate of change (%), unless otherwise indicated

		September 2024 projections			Difference between the current projections and the June 2024 projections (b)		
	2023	2024	2025	2026	2024	2025	2026
Spain's export markets (c)	0.0	0.6	3.1	3.2	-0.4	-0.2	0.0
Oil price in dollars/barrel (level)	83.7	82.6	74.9	72.4	-1.2	-3.1	-2.0
Monetary and financial conditions							
Dollar/euro exchange rate (level)	1.08	1.09	1.11	1.11	0.01	0.03	0.03
Nominal effective exchange rate against non-euro area countries (d) (2000 = 100)	115.6	116.8	117.8	117.8	0.7	1.6	1.6
Short-term interest rate (3-month EURIBOR; level) (e)	3.4	3.6	2.4	2.2	0.0	-0.4	-0.3
Long-term interest rate (10-year Spanish government bond yield; level) (e)	3.5	3.2	3.2	3.4	0.0	0.0	0.0

SOURCES: Banco de España and ECB.

a Cut-off date for assumptions: 30 August. 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 September 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.

— The unemployment assistance benefit reform (Royal Decree-Law 2/2024), which extends the scheme's coverage to a broader population and increases the monthly benefit amount for the first 12 months. The reform also includes measures to encourage a faster transition to employment for recipients of both unemployment assistance and unemployment insurance benefits. In particular, it allows individuals to receive assistance and insurance benefits alongside wage income for the first few months of their return to employment.

— The partial extension until December 2024 of the temporary reduction of VAT on certain foodstuffs, and the permanent classification of olive oil in the group of goods that qualify for the "super reduced" VAT rate (Royal Decree-Law 4/2024).

Overall, these changes will entail a deterioration in the general government balance of just under 0.1 pp of GDP in each year of the projection horizon. It should, however, be pointed out that this estimate is subject to considerable uncertainty, associated primarily with how transitions to employment could potentially be affected by the partial combination of unemployment assistance (or insurance) benefits with wage income. A more accurate estimate of the scale of this impact will be possible in the coming quarters as more evidence becomes available.

As regards the disbursements associated with various court decisions, the estimated expenditure remains unchanged at 0.2 pp of GDP in 2024, although there is a risk of a greater impact on public finances in the current and following years. For instance, the impact of a recent Court of Justice of the European Union judgment ruling that the regional rate of the hydrocarbons tax (in force from 2013 to 2018) was contrary to European Union (EU) law has not been included, as its final application is still pending further court decisions by the Spanish courts. Moreover, the Spanish general government balance will be negatively affected by other international arbitration proceedings and decisions (related to mobile phone operators and renewable energies), whose quantitative impact has yet to be determined.

Similarly, the assumptions underlying the expected path of expenditure financed with European funds remain unchanged. Thus, it is assumed that the expenses associated with the Recovery, Transformation and Resilience Plan will stand at around 1% of GDP in 2024 (compared with 0.7% in 2023) and will peak in 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 and roughly neutral in 2025-2026. In any event, the Banco de España estimates that application of the new European fiscal framework will require Spain to maintain a contractionary fiscal policy stance over the coming years.[5] The projections do not include any such fiscal adjustment, in the absence of greater details of the revenue and expenditure measures that would be needed in this respect.

New data and statistical revisions. The QNA flash estimate for 2024 Q2 points to higher GDP growth in the quarter (0.8%) than had been anticipated by the Banco de España in its June projections (0.5%). In addition, the National Statistics Institute (INE) has revised upwards the GDP growth rates for previous quarters. For instance, the growth rate for Q1 has been revised from 0.7% to 0.8%. 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

The Spanish economy maintained strong momentum in Q2. According to the QNA flash estimate published by the INE, GDP grew quarter-on-quarter by 0.8%, more than envisaged in the Banco de España's June projections (0.5%).[6] This growth rate entailed a continuation of the growth recorded in Q1 (0.8%), and clearly surpassed that observed in the euro area as a whole (0.2%). Spanish GDP growth in this period was underpinned by net external demand, which made an unexpectedly high contribution of 0.5 pp to GDP growth, as in Q1. Within this aggregate, in addition to the buoyancy of exports (particularly exports of travel services), which grew more than expected, the slight decline in imports was also noteworthy. Meanwhile, domestic demand surprised on the downside, contributing just 0.3 pp to GDP growth. This was mainly attributable

5 For further details on the implications of the new European fiscal governance framework, see Section 9.3 of Banco de España. (2024). "Chapter 2. Structural challenges facing the Spanish economy". In Banco de España, *Annual Report 2023.*

6 "Macroeconomic projections and quarterly report on the Spanish economy. June 2024". *Economic Bulletin - Banco de España,* 2/2024.

to the continued relative weakness of private consumption and gross capital formation, whose growth rates eased between Q1 and Q2 (from 0.4% to 0.3% and from 1.2% to 0.3%, respectively).[7]

The latest economic data suggest that the pace of activity growth in Q3 may have edged down from H1, but will still be high. Specifically, an overall analysis of all the information available at the cut-off date for this projection exercise – which includes the Banco de España Business Activity Survey (EBAE), social security registrations and the Purchasing Managers' Indices – suggests that quarter-on-quarter GDP growth could stand at around 0.6% in Q3. This rate would be compatible with activity growing by 2.9% year-on-year, a level similar to that observed in Q2 and significantly higher than the estimated potential growth rate for the Spanish economy.

Looking ahead to the coming quarters, GDP growth rates are expected to gradually converge towards those consistent with the Spanish economy's potential growth, which, amid greater population growth (due to migratory flows), will be somewhat higher at the end of the projection horizon than estimated in June (albeit below 2%). In this respect, GDP will grow at an annual average rate of 2.8% – up 0.3 pp on 2023 – in 2024, before easing to 2.2% in 2025 and 1.9% in 2026 (see Table 3). The bulk of this moderation will reflect the external sector's smaller contribution to GDP growth, mainly stemming from a foreseeable slowdown in the pace of growth of travel services exports from their current high rates. Meanwhile, activity will continue to be underpinned over the coming quarters by the factors highlighted in previous reports, most notably the progressive easing of financing conditions, the gradual recovery in the European and global economy, projected population growth,[8] rising real income due to lower inflation and the greater roll-out of NextGenerationEU (NGEU) funds.

According to these projections, economic growth in the period 2024-2026 will be underpinned by the momentum of domestic demand. In particular, over this period, private consumption will be the component with the largest contribution to GDP growth, as a result of favourable developments in employment, wages and inflation and of population growth and the gradual recovery in household confidence (see Chart 2). Meanwhile, the contribution to GDP growth of gross fixed capital formation – the demand component with the slowest return to pre-pandemic levels – will also increase over the projection horizon. Specifically, against a backdrop in which firms' overall financial position is relatively healthy, the recovery in investment will be driven by the impetus from the NGEU funds – whose roll-out is expected to gain momentum in 2024 and 2025 – and the above-mentioned improvement in financing conditions.

The contribution of net external demand to GDP growth will be positive in 2024 and of a similar size to that recorded in 2023, but it will ease in 2025-2026. Since 2022 net sales of goods and services abroad have made a very considerable contribution to output growth. A

7 According to the INE's Household Budget Survey, the weakness in consumption is particularly pronounced among households whose reference person is a foreign national and among those in the top quartile of the income distribution. See Carmen Martínez Carrascal. (2024). "Factores explicativos de la debilidad reciente del consumo". *Boletín Económico - Banco de España.* Forthcoming.

8 According to the INE's latest demographic projections, between 1 January 2024 and 1 January 2027 the population resident in Spain will grow by 3.9% or 1.9 million people.

Table 3
Projections for the main macroeconomic aggregates of the Spanish economy (a)

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

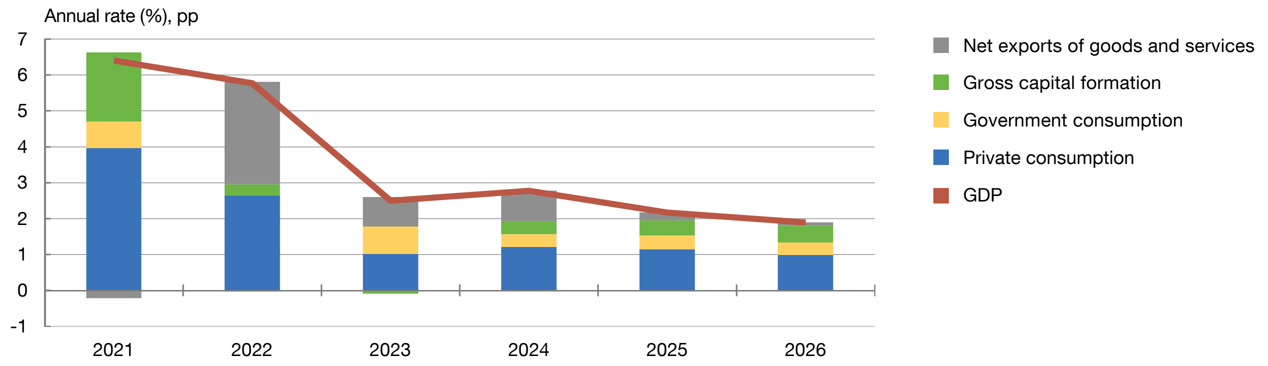
		September 2024 projections			June 2024 projections		
	2023	2024	2025	2026	2024	2025	2026
GDP	2.5	2.8	2.2	1.9	2.3	1.9	1.7
Private consumption	1.8	2.2	2.1	1.8	2.4	2.0	1.7
Government consumption	3.8	1.8	2.0	1.7	1.6	1.7	1.5
Gross capital formation	-0.4	1.8	2.1	2.4	2.2	2.4	2.1
Exports of goods and services	2.3	3.5	2.7	3.2	2.4	2.4	2.7
Imports of goods and services	0.3	1.4	2.5	3.5	2.0	2.7	3.0
Domestic demand (contribution to growth)	1.7	2.0	2.0	1.8	2.1	1.9	1.7
Net external demand (contribution to growth)	0.8	0.8	0.2	0.1	0.2	0.0	0.0
Nominal GDP	8.6	5.9	4.4	3.7	5.4	4.0	3.5
GDP deflator	5.9	3.0	2.2	1.8	3.0	2.1	1.8
HICP	3.4	2.9	2.1	1.8	3.0	2.0	1.8
HICP excluding energy and food	4.1	2.8	2.2	1.9	2.6	2.0	1.9
Employment (hours)	1.9	1.8	1.7	1.1	1.1	1.7	1.2
Unemployment rate (% of labour force). Annual average	12.2	11.5	11.0	10.7	11.5	11.3	11.2
Net lending (+)/net borrowing (-) of the nation (% of GDP)	3.7	4.5	5.0	5.0	3.6	3.7	3.7
General government net lending (+)/net borrowing (-) (% of GDP)	-3.6	-3.3	-3.1	-3.2	-3.3	-3.1	-3.2
General government debt (% of GDP)	107.7	105.4	105.4	106.3	105.8	106.2	107.2

SOURCES: Banco de España and INE.
NOTE: Latest QNA figure published: 2024 Q2.

a Projections cut-off date: 9 September 2024.

Chart 2

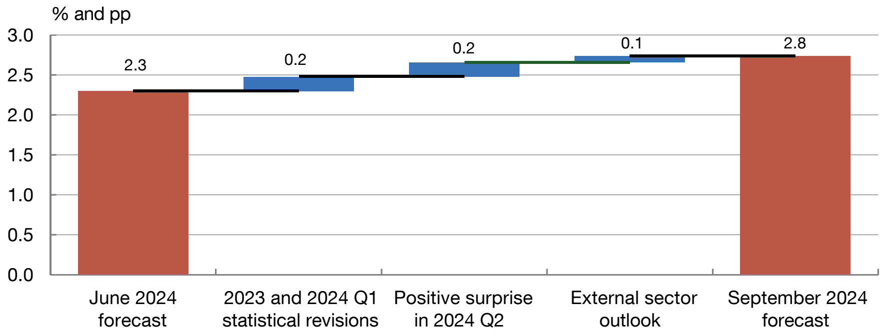
2.a GDP growth and contributions of main components



SOURCES: Banco de España and INE.

Chart 3

3.a Changes in the GDP growth forecast for 2024



SOURCE: Banco de España.

sizeable portion of this positive contribution has been associated with the robust growth of international tourism flows to Spain, which have surprised on the upside and shown increasing geographical and seasonal diversification.[9] These flows are expected to maintain considerable momentum over the projection horizon. However, the latest developments suggest that, in growth rate terms, their contribution to GDP growth will gradually decrease. For instance, according to INE data, hotel overnight stays by foreign tourists in Spain grew by 5.2% year-on-year in July, a considerable slowdown from H1's average year-on-year rate of 12%. These overnight stays also grew robustly (13.2%) in 2023 Q4, raising the prospect of a further decline in their year-on-year growth rate in the final months of the year. Meanwhile, the projected recovery in the Spanish economy's external markets will help goods exports, which fell in 2023, to gradually increase over the projection horizon. Despite their recent weakness, imports are expected to accelerate slightly over the coming quarters, in step with a growth pattern in which gross fixed capital formation and goods exports – the final demand components with the highest import content – come more to the fore. Overall, the external sector will contribute 0.8 pp to growth in 2024 (the same figure as in 2023) and 0.2 pp and 0.1 pp in 2025 and 2026, respectively (see Chart 2).

Compared with the June projections, the current projections revise up GDP growth over the entire projection horizon. In particular, the GDP growth rates projected for 2024, 2025 and 2026 are revised up by 0.5 pp (to 2.8%), 0.3 pp (to 2.2%) and 0.2 pp (to 1.9%), respectively. The higher growth now projected for 2024 is the result of a confluence of several factors:

— As mentioned above, the new data that have become available include an upward revision to the GDP growth rates in 2023 Q3 and Q4 and 2024 Q1. In addition, the QNA flash estimate published in late July pointed to activity growing more markedly in 2024 Q2 than expected in the June projection exercise. These two factors automatically entail a positive carry-over effect of 0.4 pp on the average GDP growth rate for 2024 (see Chart 3).

9 Blanca Jiménez-García and Coral García Esteban. (2024). "Recent diversification of international tourist flows to Spain". *Economic Bulletin - Banco de España,* 2024/Q2, 03.

— The outlook for the external sector in H2 is somewhat brighter than was the case in June. This can essentially be attributed to two different dynamics. First, although, as noted above, the pace of growth in travel services exports has been slacker in recent months, this deceleration has been slower than expected. In line with some leading indicators of tourism activity, part of this better than expected performance has been maintained for the coming quarters. Second, Spain's imports have proven fairly lacklustre in recent quarters. Apart from composition effects, the factors behind the current modest elasticity of imports to final demand remain unclear. Possible explanations of this state of affairs notably include, for instance, the Spanish economy's lower energy dependence thanks to the increase in energy generated using renewable sources (see the presentation associated with this report).[10] In any event, these recent developments, which may have to do with certain structural aspects, warrant a downward revision to the recovery in imports projected for 2024 and the rest of the projection horizon. Overall, these two external sector-related factors entail a 0.1 pp upward revision to GDP growth in 2024.

The upward revision to the growth forecast for 2025 and 2026 is largely due to two factors. First, the new technical assumptions envisage lower future interest rates than anticipated in June, thus entailing financing conditions more conducive to activity throughout the projection horizon. Second, and as for 2024, net external demand is expected to make a slightly larger contribution to output growth than previously forecast, thanks both to slightly higher growth in travel services exports than had been expected in June (in keeping with the ongoing process of geographic and seasonal diversification in international tourist arrivals referred to above) and to slower growth in imports.

As far as the labour market is concerned, job creation is set to continue over the projection horizon, albeit at a slower pace than in recent quarters. In particular, compared with the 1.9% rise recorded in 2023, employment (measured in terms of hours worked) is expected to increase by 1.8% in 2024, 1.7% in 2025 and 1.1% in 2026 (see Table 3). These figures, lower than those projected for activity, will boost productivity, which has seen relatively modest growth in recent quarters (see Chart 4.a).

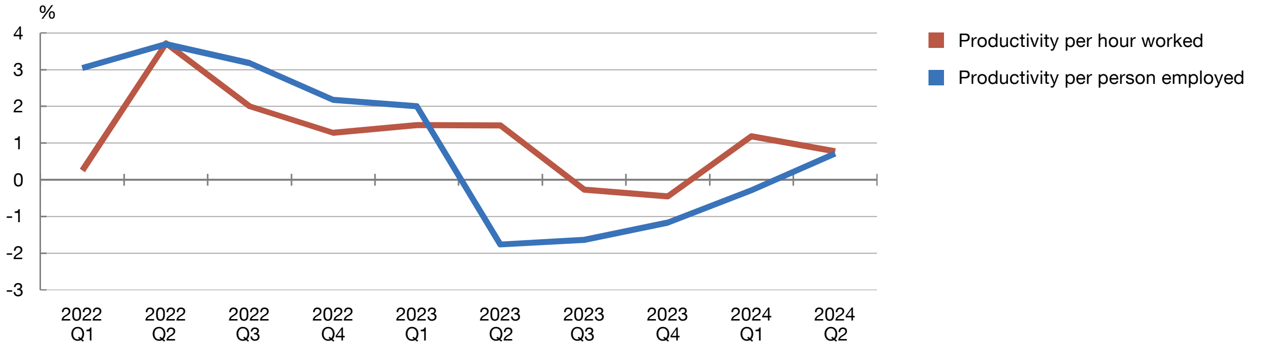
The unemployment rate will continue to fall gradually over the coming years. The pace at which the unemployment rate will continue declining between 2024 and 2026 will be limited by the expected slowdown in the pace of job creation and by notably strong labour force dynamics (owing to relatively high immigration flows) (see Chart 4.b). Moreover, these factors will combine in a context in which the progressive ageing of the employed population may be making the labour market less fluid[11] and in which certain indicators appear to point to a worsening of the market's ability to match firms and workers. Here, it is worth noting that the stock of long-term unemployed persons has levelled off over the past year at around 1.1 million persons, with the

10 In this regard, looking ahead the Spanish economy may prove more resilient than its European counterparts in the event of potential external shocks impacting the prices of energy commodities. Rubén Domínguez-Díaz and Samuel Hurtado. (2024). "Green energy transition and vulnerability to external shocks". Documentos de Trabajo, 2425, Banco de España.

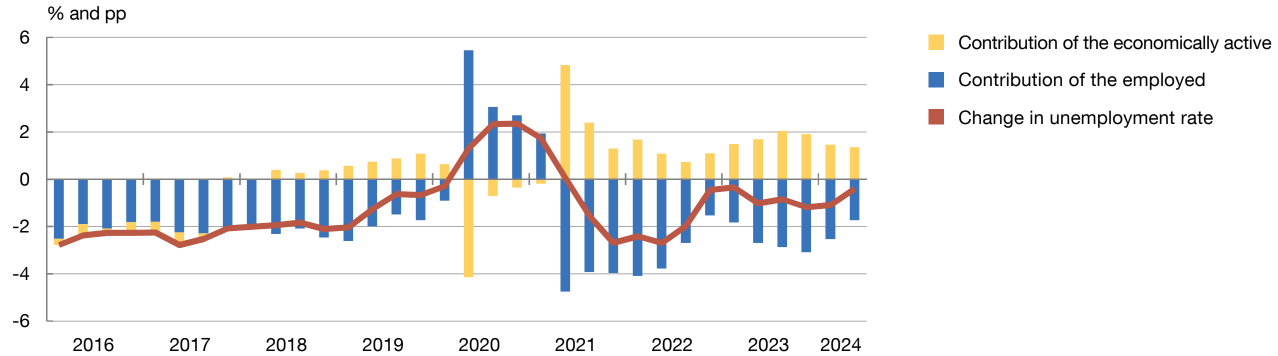
11 Brindusa Anghel and Sergio Puente. (2024). "The impact of population ageing on Spanish labour market flows". *Economic Bulletin - Banco de España,* 2024/Q3, 07.

Chart 4

4.a Productivity (year-on-year rate of change) (a)



4.b Unemployment rate (year-on-year change and contribution of the employed and economically active)



SOURCES: Banco de España and INE.

a Seasonally adjusted data.

figure as a share of total unemployed workers remaining somewhat stubbornly above 40%. This could suggest that much of the current stock of unemployed workers is of a structural nature, meaning that it will be hard to rely on cyclical activity growth to reduce their numbers. As a result, the unemployment rate in the Spanish economy will hold at around 11% in 2026.

Expected outlook for inflation and labour costs

Headline inflation has fallen notably in recent months. The year-on-year rate of change in the harmonised index of consumer prices (HICP) stood at 2.4% in August, 1.4 pp below the figure for May. This decline can largely be explained by the slowdown in energy and food prices, which fell faster than anticipated in the June projections exercise, particularly in the case of food.[12]

12 The surprise in the food component can essentially be attributed to the extension to the reduced VAT on essential foods and the cut to the VAT rate on olive oil, both measures announced after the cut-off date for the June projections exercise. Specifically, under Royal Decree-Law 4/2024 of 26 June 2024 the Government held VAT on pasta and seed oils at 5% until September, before increasing it to 7.5% between October and December, and restoring the 10% rate from January onwards. The VAT on essential

Energy price growth was tempered by cheaper fuel prices and the decrease in electricity prices in July. Among the measures approved towards the end of last year, the VAT rate on electricity for 2024 was set at 10%, unless the average monthly wholesale market price drops below €45/MWh, in which case the rate for the next month would rise to 21% (as occurred in the period February-May). However, in June, the average monthly wholesale price exceeded that threshold and therefore the reduced VAT rate applied in July. In any event, July also saw the excise duty on electricity revert to 5.1% (from 3.8% since April), which partially offset the reduced VAT rate on electricity.

Food prices eased more markedly from July, following a period of slower disinflation in May and June. This was especially true of fresh food prices, which were impacted by a significant base effect, attributable to price rises in July 2023 as a result of adverse weather conditions. Processed food prices continued to ease in recent months, albeit at a slower pace than observed in early 2024. Products such as processed meat and fish were the main contributors to the recent slowdown in food prices, while olive oil prices at origin have moderated significantly from their February peak. In addition, starting in July olive oil has been reclassified as an essential food item, resulting in a VAT reduction from 5% to 0%.

Core inflation stood at 2.8% in August, 0.2 pp down on its May level. The path of core inflation was largely shaped by the services component. The latter decreased by 0.2 pp in the period May-August (to 3.7%), a milder slowdown than expected in the June projection exercise. The year-on-year rise in the prices of non-energy industrial goods eased by 0.4 pp between May and August (to 0.6%). Among the services items, in July inflation softened markedly in package holidays and accommodation services (after a notable increase in May), although it picked up slightly in August. As for non-energy industrial goods, the prices of motor cars and information processing equipment accelerated, while the prices of appliances for personal care experienced a marked slowdown. Meanwhile, as in recent periods, the sales period once again caused volatility in the pace of growth in garment prices.

Headline inflation will hold close to current levels – or slightly higher – in the final stretch of this year and early 2025, and will resume its slowing trajectory thereafter (see Chart 5.a). In particular, headline inflation will taper off from an average of 3.4% in 2023 to 2.9% in 2024, 2.1% in 2025 and 1.8% in 2026. The slowdown in price growth projected for 2025 and 2026 owes primarily to a gradual easing in food and core inflation (see Chart 5.b).

The projected moderation in food inflation is consistent with the developments anticipated by futures markets in food producer prices and food commodity prices. Furthermore, in the months ahead, improved agricultural production compared with the previous season (hit by adverse weather conditions) will also help to curb inflationary pressures. In any event, the slowdown in food inflation is likely to pause temporarily in October when the reduced VAT rate on

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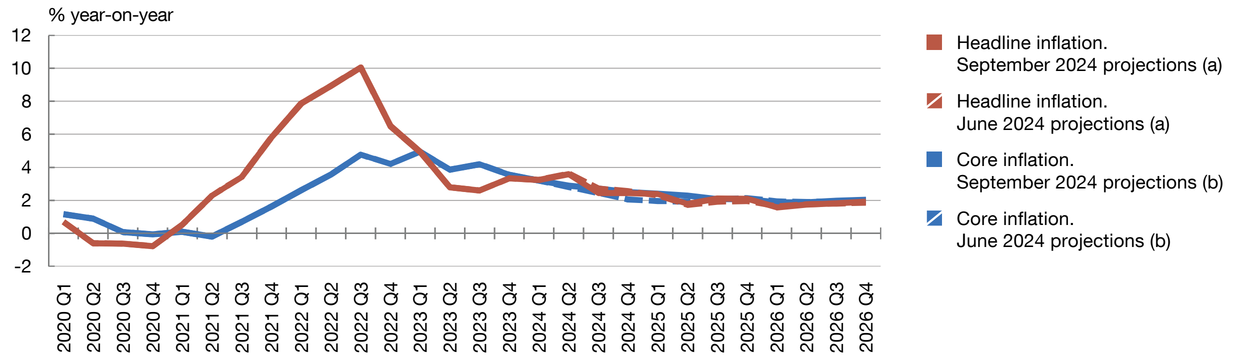
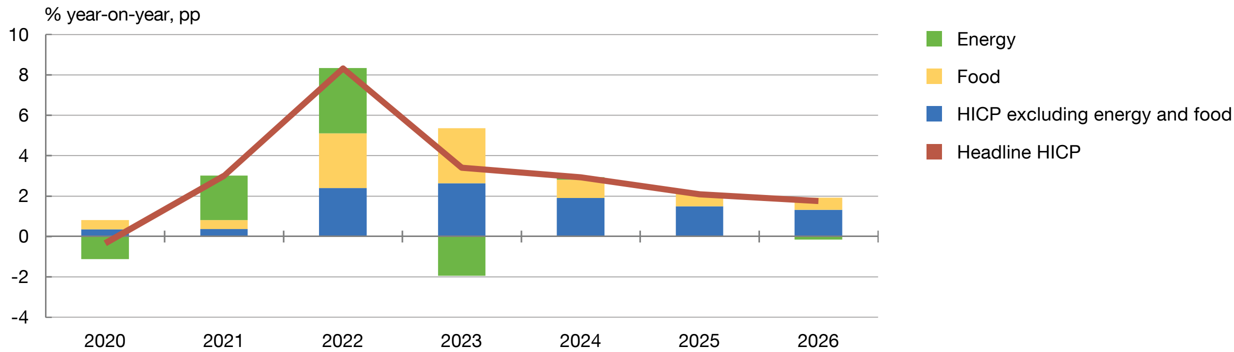
foods will be held at 0% until September, rising to 2% between October and December and returning to a 4% rate from January onwards. This VAT rate path will also apply to olive oil in the coming months, after deciding to grant it essential food status from July onwards. In the June projections exercise it was assumed that the VAT on pasta and oils (including olive oil) would return to 10% starting in July, and that the VAT on essential foods would be 4% from that month onwards.

Chart 5

5.a Headline and core inflation



5.b Contributions to HICP growth, by component



SOURCES: Banco de España and INE.

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

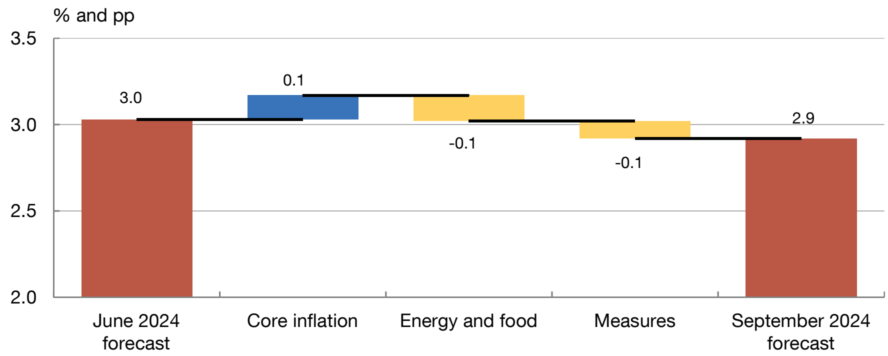
essential food items is partially reversed, and again in January 2025 when the reduction is fully reversed.

Core inflation will continue to moderate over the course of this year, and is expected to average close to 2% in 2025-2026. Specifically, core inflation, which averaged 4.1% in 2023, will gradually ease to 2.8% in 2024, 2.2% in 2025 and 1.9% in 2026. This performance mainly owes to the anticipated slowdown in the growth of demand and production costs over the projection horizon. Conversely, the expected discontinuation of public transport discounts in early 2025 will exert upward pressure on the core inflation rate for that year.

Compared with the previous projections, headline inflation has been revised down slightly for 2024 and up slightly for 2025. The revision for 2024 essentially owes to the smaller contribution to price growth now anticipated from the food and energy components, partially offset by the upward revision in core inflation. In particular, the recent decline in food and energy prices, combined with the more benign outlook for future oil price developments (more than offsetting the rise now expected in wholesale electricity prices), imply a downward revision of

Chart 6

6.a Changes in the inflation forecast for 2024



SOURCE: Banco de España.

0.1 pp in the average inflation rate for 2024 (see Chart 6). In addition, the extension of the VAT reduction on essential food items, and the inclusion of olive oil in this group, result in an additional decrease of 0.1 pp in the headline inflation rate for 2024. Conversely, due to the recent upward surprises in core inflation, its future trajectory has been revised up, resulting in an increase of 0.1 pp in the average headline inflation rate for 2024. For 2025, headline inflation is revised up by 0.1 pp due to a somewhat higher core inflation rate for that year than forecast in June, and because of the full reversal in 2025 of the reduced VAT rate on essential food items.

Main risks to these projections

The risks to the economic growth projections are mainly on the downside, while the risks to the inflation projections are considered to be balanced.

Globally, the current elevated geopolitical tensions still constitute the main source of risk. Such tensions include those relating to the armed conflicts in Ukraine and the Gaza Strip, the latest electoral results in France and Germany (and the upcoming presidential elections in the United States), and the increasing trade tensions observed around the world. Both a possible escalation of the ongoing wars and greater trade fragmentation would pose downside risks to activity and upside risks to prices. Meanwhile, the heightened uncertainty surrounding present and future economic policies stemming from certain elections is likely to exert downward pressure on both economic growth and inflation.

International financial markets are another source of significant uncertainty regarding the baseline scenario in these projections. In an environment in which high valuations persist in several market segments, there is still a risk of financial asset prices undergoing a sharp correction. The materialisation of this risk – which could be triggered by, for example, an abrupt shift in expectations for the future path of policy interest rates in the United States or the euro area, or a deterioration in China's economic outlook – could have a negative impact on global economic activity and, therefore, on inflation. As such, the bout of instability in early August in international financial markets (linked to a negative surprise in US employment data and an unexpected increase in policy interest rates in Japan), while short-lived, revealed the current sensitivity of financial markets and many listed assets' value to possible shocks to or changes in the macro-financial outlook.

There is still significant uncertainty surrounding the speed at which the disinflationary process could take place over the projection horizon, in a context in which core inflation and, in particular, services inflation are showing greater persistence than initially expected. In any case, it should be highlighted that the latest data signal a slight easing of the upside risks that, in recent months, have characterised the expected path of inflation, especially in Spain. In particular, in the first half of this year there has been a sharper decline in wage drift (the difference between growth in average compensation per employee and growth in negotiated wages) than anticipated a few months ago.[13] This development was accompanied by an increase (also greater than expected) in apparent labour productivity,[14] leading to a considerable easing of unit labour costs. Although profit margins have behaved broadly in line with expectations, reflecting a degree of stability since late 2023, the responses to the EBAE[15] suggest that firms foresee a greater reduction in their one-year forward sales than they had envisaged in late 2023 and 2024 H1. In any event, as already mentioned, the notable downward stickiness of services inflation in recent months suggests that considerable caution should be exercised before assuming that the current inflationary episode is under control.

In the domestic sphere, it is important to note the persistent uncertainty that has surrounded the future course of household consumption and business investment, since these components have performed below expectations in recent quarters and the contribution of net external demand to growth will gradually wane. The future dynamics of consumption and investment will be greatly affected by, among other factors, changes in economic agents' confidence and the degree of uncertainty regarding domestic and international macro-financial scenario and economic policies. The intensity of the pass-through of global monetary tightening in 2022-23 and its effects will also play a role, as will the easing now getting under way. Another key factor driving business investment is the pace and impact of the roll-out of NGEU-related projects. These aspects are also fundamental determinants of future productivity and wages in Spain.

Lastly, in the fiscal realm, the Banco de España's estimates suggest that Spain would need to implement a fiscal adjustment of around 0.5 pp of GDP per year in the next few years to comply with the new European fiscal rules. These projections do not account for

13 Against a background of no significant surprises in collective bargaining, compensation per employee in the market economy is estimated to have increased between 2023 Q4 and 2024 Q2 by 2.1%, less than the 2.6% envisaged in the June projection exercise.

14 On the latest QNA data, between 2023 Q4 and 2024 Q2, apparent labour productivity growth stood at 0.8%, above the 0.1% envisaged in the June projection exercise.

15 Alejandro Fernández Cerezo and Mario Izquierdo. (2024). "The Banco de España Business Activity Survey: 2024 Q3." *Economic Bulletin - Banco de España,* 2024/Q3, 10

such a fiscal adjustment, since the income and expenditure measures that it would comprise are not sufficiently specified. However, the eventual implementation of a medium-term structural adjustment programme of the aforementioned magnitude would foreseeably entail lower growth in activity over the projection horizon, below the figures set out in this projection exercise. In any case, the design and execution of such a plan would fundamentally shore up the sustainability of Spanish public finances and economic agents' trust in the country's economy. The ECB, in its latest monetary policy statement (approved by the Governing Council at its September meeting) noted that "Implementing the EU's revised economic governance framework fully, transparently and without delay will help governments bring down budget deficits and debt ratios on a sustained basis. Governments should now make a strong start in this direction in their medium-term plans for fiscal and structural policies."