This box presents the Banco de España's latest macroeconomic projections, updating those published on 7 June.[1] The new projections include the information that has come to light between 18 May and 23 September, the respective cut-off dates for the previous and current exercises (see Table 1).[2] One specific and significant change arises in the latest Quarterly National Accounts (QNA) estimates, which include the data for the first two quarters of 2016 (these were not available at the time the projections published in June were prepared).[3]

The estimates point to the continuation throughout the projection period of the expansionary phase of the Spanish economy. This development will be assisted by a series of different factors, including some that have conferred a high degree of sustainability on the expansion (including most notably the correction, over recent years, of imbalances such as the loss of external competitiveness), along with others that entail a greater or lesser degree of temporariness, such as the improvements in resident agents' financial conditions, largely supported by monetary policy conduct, the expansionary fiscal policy stance applied in the two years spanning 2015-2016 and the delayed effects of the recently observed fall in oil prices and depreciation of the euro. Specifically, it is estimated that GDP will grow by 3.2% this year, slowing to 2.3% and 2.1% in 2017 and 2018, respectively (see Table 2), as a result of the disappearance of a significant portion of the temporary impulses listed. Turning to consumer prices, after posting a fall of -0.3% in 2016 on average, they are expected to rise to 1.5% and 1.6% in each of the next two years, driven by higher oil prices and by the progressive reduction in cyclical slack.

The main change from the June to the September exercise in the assumptions underlying the projections is the downward revision in the expected rate of expansion of the Spanish economy's external markets. This is chiefly a consequence of the estimated impact on UK imports arising from this country's referendum to remain in or exit the European Union and, to a lesser extent, of a downward reassessment of the growth rate

1 Available in this link.
2 The respective cut-off dates for information-gathering in respect of the assumptions are 10 May and 19 September, except in the case of developments in Spain's export markets, for which the assumptions for the current exercise are taken from the September 2016 ECB staff macroeconomic projections for the euro area, produced by ECB staff members, whose cut-off date is 15 August.
3 INE has also published in September a revision of the Annual National Accounts series for the period 2012-2015, which revises downwards the real GDP growth rate for the first of these years and leaves the rest unchanged, and it sets out, in cumulative terms, a higher contribution of external demand to GDP growth (at the expense of less robust national demand). These annual series have not been used for the preparation of the current projections, given that the methodology employed requires the use of quarterly series and INE will not disclose the series with this frequency consistent with the annual data now published until 24 November.

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

Annual rates of change, unless otherwise indicated

		September 2016 projection			Changes from the June 2016 projection		
	2015	2016	2017	2018	2016	2017	2018
International environment							
World output	3.0	2.9	3.3	3.5	0.0	-0.1	0.0
World markets	1.9	1.8	3.3	3.9	-0.7	-0.6	-0.3
Spanish export markets	3.1	1.8	3.4	3.8	-1.2	-0.7	-0.4
Oil price (in USD) (b)	52.4	43.6	50.2	50.8	0.1	1.2	-0.5
Monetary and financial conditions							
Dollar/euro exchange rate (USD per euro)	1.11	1.12	1.12	1.12	-0.01	-0.02	-0.02
Nominal effective exchange rate vis-à-vis the non-euro area countries (c) (2000=100 and pp changes)	113.0	114.2	114.8	114.8	-0.6	-0.7	-0.7
Short-term interest rates (3-month Euribor) (b)	0.0	-0.3	-0.3	-0.4	0.0	0.0	-0.1
Long-term interest rates (10-year bond yields) (b)	1.7	1.3	1.3	1.5	-0.3	-0.7	-0.8

SOURCES: ECB and Banco de España.

a Assumptions cut-off date: 19 September 2016. Figures in levels are annual averages and the percentage rates are calculated on the basis of the related annuaaverages.
b For the projection period, the values in the table are technical assumptions, prepared following the Eurosystem's methodology. These assumptions are based on the prices on futures markets or on approximations thereto, and they should not be interpreted as a Eurosystem forecast about the course of these variables.
c A positive percentage change in the nominal effective exchange rate denotes an appreciation of the euro.

of world trade.[4] Moreover, compared with the June forecasts, a somewhat higher level of oil prices is projected, in line with the observed trend on the spot and futures markets for this commodity. It is further estimated that competitors' prices will grow somewhat less than expected three months ago, despite the slight depreciation of the euro since then. Finally, there will be a further reduction in the cost of credit financing to households and non-financial corporations, prompted by the downward revision of the expected interest-rate paths on interbank and government debt markets, according to the expectations implied in the yield curve. Moreover, in the case of firms a reduction in the cost of financing received via securities issues is included, which reflects in part the effects of the launch of the corporate sector purchase programme (CSPP) by the ECB (see Box 4).

The fiscal policy assumptions for 2016 rest on the measures approved in the budgets of the different tiers of government for this year, as in June, and on the budget outturn figures available. However, none of the further measures announced have been included, such as that relating to the re-establishment of minimum amounts for corporate income tax prepayments, given the failure

4 In the projections for the United Kingdom it is assumed that the referendum outcome will give rise to a significant downward revision of household and business spending, as a prolonged stage of uncertainty commences. This reduction in demand, along with the depreciation of sterling, will prompt a significant decline in British imports, which affects Spanish exports (along with the second-round effects via third markets). Following the referendum, a notable downward revision has been observed in the expected path of long-term interest rates which, in part, might be related to the referendum result, in so far as it reflects expectations of monetary policy easing. For further details on the way in which the United Kingdom's exit from the EU impacts the projections for Spain and for the rest of the euro area, see Box 1 in September 2016 ECB staff macroeconomic projections for the euro area.

Table 2
PROJECTIONS OF THE SPANISH ECONOMY'S MAIN MACRO-MAGNITUDES (a)

Annual rate of change in volume terms and % of GDP

		September 2016 projection			Changes from the June 2016 projection		
	2015	2016	2017	2018	2016	2017	2018
GDP	3.2	3.2	2.3	2.1	0.4	0.0	0.0
Private consumption	3.1	3.4	2.0	1.5	0.4	0.2	0.0
Government consumption	2.7	1.0	0.8	0.8	-0.1	-0.1	0.1
Gross fixed capital formation	6.4	4.0	4.8	4.5	-0.7	-0.7	-0.4
Investment in equipment	10.2	7.9	6.6	5.7	-0.2	-0.5	-1.0
Investment in construction	5.3	2.1	4.2	4.4	-1.3	-1.2	-0.2
Exports of goods and services	5.4	5.3	4.5	4.8	0.9	-0.3	-0.2
Imports of goods and services	7.5	5.4	4.9	4.9	0.1	-0.6	-0.4
National demand (contribution to growth) (b)	3.7	3.1	2.3	2.0	0.2	-0.1	-0.1
Net external demand (contribution to growth)	-0.5	0.1	0.0	0.1	0.3	0.1	0.1
Nominal GDP	3.8	3.5	3.3	3.7	0.3	0.0	-0.1
GDP deflator	0.6	0.3	1.1	1.6	-0.1	0.0	-0.1
Consumer price index (CPI)	-0.5	-0.3	1.5	1.6	0.3	0.1	-0.1
CPI excl. energy and unprocessed food prices	0.6	0.9	1.3	1.7	0.0	0.0	-0.1
Employment (full-time equivalents)	3.0	2.9	2.0	1.8	0.4	0.0	0.0
Unemployment rate (% of labour force) End-of-period data	20.9	19.0	17.8	16.7	-0.7	-0.5	-0.6
Unemployment rate (% of labour force) Average data	22.1	19.8	18.3	17.1	-0.3	-0.6	-0.6
Net lending (+)/net borrowing (–) of the nation (% of GDP)	2.1	2.6	2.2	1.9	0.6	0.7	0.7
General government net lending (+)/net borrowing (–) (% of GDP) (c)	-5.0	-4.9	-3.6	-3.1	-0.8	-0.2	-0.2

SOURCES: Banco de España and INE.
Latest QNA figure: 2016 Q2.

a Projections cut-off date: 23.09.2016.
b Difference, to one decimal place, between GDP growth and the contribution of net external demand.
c Excludes aid to financial institutions.

to specify such amounts at the time these forecasts were formulated (see Box 2). With regard to 2017 and 2018, the fact that the preparatory cycle for the budgets of the different tiers of government has not been set in train means that there is a high degree of uncertainty about how budgetary policy will be specifically formulated. Against this background, it has been decided to prepare a scenario that involves assuming a neutral fiscal policy stance. Specifically, it is assumed that budget items subject to a greater degree of discretionality (e.g. inputs or public investment) will move in line with the (nominal) trend growth projections for the economy. Notwithstanding this assumption, the forecast for public revenues and the dynamics underlying certain expenditure items, such as that earmarked for the payment of unemployment benefits, are derived from the forecast macroeconomic aggregates. In-house estimates are also made of demographic trends, with an impact on pension spending, and of the debt interest burden. The fiscal policy stance derived from the projections in this report is expansionary in 2016 (for which year a deterioration in the primary structural balance of close to 1 pp of GDP is estimated, similar to that estimated for 2015) and, in accordance with the foregoing criterion, it is neutral in 2017-18.

Compared with the projections published over three months back, the GDP growth forecast in 2016 has been revised upwards by 0.4 pp. This revision for the current year incorporates the more favourable course of activity in Q2, according to QNA results, compared with what had been anticipated in June. Moreover, the conjunctural information for the summer months suggests a more dynamic behaviour of activity in the second half of the year than was projected in the previous exercise.

The growth envisaged for 2017 remains unchanged, which is the outcome of two opposing effects. As regards the technical assumptions, the less favourable outlook for the behaviour of export markets and, to a lesser extent, competitors' lower prices and higher oil prices entail, overall, unfavourable consequences for activity which are offset only in part by the additional easing in financial conditions that private agents face. Further, this is not ultimately reflected in a lower average GDP growth rate for the coming year, as it is offset by a more favourable carryover effect for 2016.[5] In 2018, the changes in the external assumptions exert, overall, a neutral impact on activity.

The expansion in GDP throughout the projection period is explained by the buoyancy of national demand which, however, will tend to be less robust as from the coming year. Net external demand, whose contribution to GDP growth was negative in the period 2014-2015, will make an approximately neutral or slightly positive contribution over the time horizon envisaged.

Among the components of national demand, household spending on goods and services will continue to show notable strength in the short term. Subsequently, the high rate of job creation will continue to underpin this spending component, although the disappearance of the effects of some temporary factors that have been supporting household income in the recent period (and which include, in particular, the decline in oil prices and the reductions in income tax that came into force in 2015) are expected to contribute to tempering the rate of increase of private consumption. As a result, following the projected increase of 3.4% this year, a slowdown to 2% in 2017 and to 1.5% in 2018 is expected.

Favourable developments on the labour market and the persistence of benign financing conditions will prove conducive to the continuation of the course of recovery of residential investment. The increases in the pace of housing starts and house sales recently observed are along these lines. Notwithstanding the propitious context described, the intensity of the rise in this demand component will be checked by the prospect that the net household creation figures will be modest and, possibly, in some regions, by the high stock of unsold housing.

Business investment in capital goods will continue to expand at a high though diminishing rate, in step with the easing in the dynamism of final demand, in a setting in which financial conditions are expected to continue to be conducive to spending by non-financial corporations. The slowdown under the heading of other construction, prompted for reasons similar to those described in the case of investment in equipment, will be mitigated by the assumption made that the level of the public investment components will stabilise in 2017, after the fall-off observed in 2016.

As regards exports, which have recently moved on a very favourable trajectory, the moderate dynamism of external markets (and, to a lesser extent, lower competitors' prices) will give rise to somewhat more modest rates of increase. However, sales abroad are expected to continue showing a more expansionary course than the markets on which they are targeted, owing to the gains in competitiveness accumulated in the past (and which are not projected to continue in the future) and to the sustained increase in the number of firms which, having initiated export activity in a specific external market, remain present in such markets after several years. Furthermore, it is estimated that the tourism component will continue to be boosted by the political instability and the security problems in some of Spain's Mediterranean competitors. The course of imports will be determined by the slowdown in the main components of final demand.

On the estimates made, the surplus on the rest-of-the-world account may rise to 2.6% of GDP in 2016, 0.5 pp up on 2015,

5 The carryover effect denotes the arithmetic contribution that the quarter-on-quarter growth rates of one year exert on the annual average growth rate of the following year. On this occasion, specifically, the estimated contribution of the quarter-on-quarter GDP growth rates in 2016 to the average growth of this variable in 2017 is now greater than was estimated in June. On one hand, as indicated, the behaviour of activity was more expansionary in 2016 Q2 than expected in June. Moreover, on the other hand, the present projections include an upward revision of expected growth in the final two quarters of this year. In mechanical terms, this gives a higher increase in GDP not only in 2016 but also in 2017.

underpinned by the favourable trend of trade flows in real terms, the previous fall in oil prices and the lower net interest charge paid abroad. In subsequent years, the nation's lending capacity may be expected to ease as a result of the higher level of oil prices.

With regard to the labour market, the high pace of job generation is expected to persist, with low growth in apparent labour productivity, as is habitual in expansionary phases in the Spanish economy. The buoyancy of employment will be underpinned, moreover, by the projected continuation of wage moderation, which will contribute to the maintenance of modest though rising rates of increase in unit labour costs. The growth of employment will lead to further declines in the unemployment rate, which will be strengthened by a downward revision of the estimated growth of the labour force related to population ageing, as is set out in greater detail in Box 6.

Inflation, measured by the rate of change of consumer prices, has been rising since the spring, exhibiting increasingly less negative rates. This has essentially been the result of the increase in oil prices, although the indices that exclude the energy component – and, in particular, the index excluding unprocessed food and energy – have recently begun to show signs of picking up.

The CPI index excluding unprocessed food and energy is expected to continue quickening over the projection period, as a result of the prolongation of the period of expansion in spending on consumer goods, the gradual closing of the output gap and, towards the end of the projection horizon, the above-mentioned moderate rise in unit labour costs. As regards the energy component, and under the assumptions for the exercise, the recent quickening phase is projected to run into the coming months, with increasingly higher rates of change that will peak in spring 2017, slowing subsequently.

As a result of the course of the various components, the overall indicator is expected to start posting increasingly positive rates as from September this year, which would nevertheless not prevent a fall-off of -0.3% being observed for 2016 on average. In 2017 and 2018, respective increases of 1.5 % and 1.6 % are estimated, in a setting in which the overall effect of the changes in the assumptions on the inflation rate is slightly negative, which explains the 0.1 pp downward revision in 2018 with respect to the June projections.

Chart 1 shows the year-on-year growth paths for GDP and for the CPI index excluding energy and unprocessed food under the baseline scenario, along with a measure of uncertainty surrounding these paths, constructed drawing on the past deviations of projections with respect to the figures actually observed. Under this approach, the probability that declines in GDP may be observed towards the end of the projection horizon would be around 10%, while the probability of the CPI index excluding unprocessed food and energy posting negative rates from now to end-2018 is very low according to the deviations in past projections. These probabilities have not undergone substantial changes from the June projections exercise.

A limitation of this type of approach based on past forecasting deviations is that it ignores the possibility that, at a specific point in time, the perceived level of uncertainty may be higher than at

GROWTH AND INFLATION OUTLOOK FOR SPAIN

Chart 1
GROSS DOMESTIC PRODUCT
Year-on-year rate of change

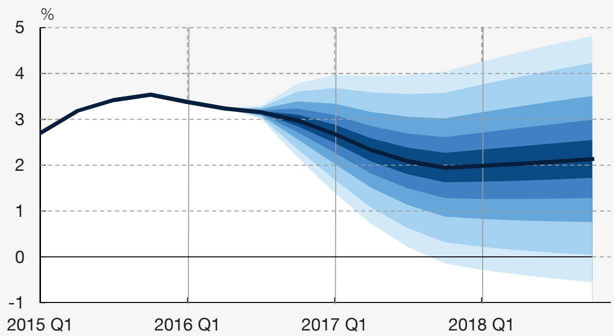
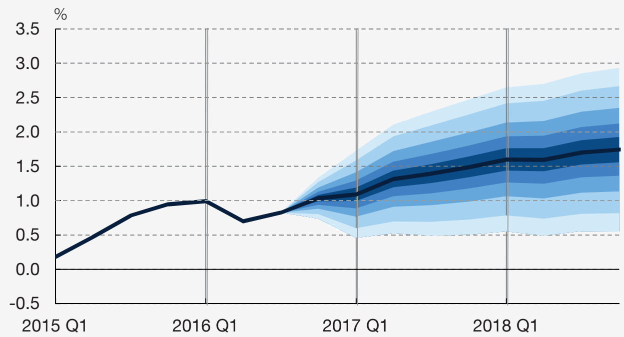


Chart 2
CPI EXCL. ENERGY AND UNPROCESSED FOOD PRICES
Year-on-year rate of change



Probability of GDP or the CPI excluding energy and unprocessed food prices being within the interval (a)

20% 40% 60% 80% 90%

SOURCES: INE and Banco de España.
Latest figure: 2016 Q2 for GDP and August 2016 for the CPI excluding energy and unprocessed food prices.

a The right- and left-hand charts show the uncertainty around the central projection. Intervals with probabilities of 20%, 40%, 60%, 80% and 90%, respectively, based on historical projection errors.

others, or that the risks may appear more likely in one direction than in the opposite direction. In this respect, in the present projections exercise it is considered that the risks surrounding the baseline scenario for GDP growth will, as in June, remain tilted to the downside.

From the standpoint of the external environment, doubts remain in some emerging economies in particular concerning their ability to redress in an orderly fashion some of the imbalances observed. Moreover, in these projections it has been assumed that the impact on the baseline scenario of British voters' decision to exit the EU will be manifest only through a downward revision of UK imports, meaning that the referendum outcome will not have direct adverse consequences on euro area agents' confidence and spending decisions. However, it cannot be ruled out that, during the negotiation of the new trading arrangements between the United Kingdom and the EU, certain adverse effects of this type not envisaged in the baseline scenario may materialise.

External risks also include a potential stepping up of global geopolitical tensions, which might harm both world trade and euro area agents' confidence. In addition, the foreseeable tightening of monetary policy in the United States might exert certain adverse consequences on the net capital flows received by the most vulnerable emerging economies. Further, although the normalisation of financial conditions in the euro area in train since late 2012 appears to be firmly embedded, this process might not be completely immune to any potential increase in the perception of risks to the banking sector in certain countries in the area. Conversely, it cannot be ruled out that the impact on activity of the set of monetary policy measures deployed by the ECB may be greater than envisaged in these projections, owing to possible delays in the transmission of some of them to real activity.

Regarding domestic risks, the stability of GDP growth throughout the present exercise reflects the fact that the possible adverse effects arising from the prolongation of the current interim status of the government may have been offset during this period by other factors. Yet it cannot be ruled out that the adverse effects in question may ultimately materialise. In particular, the provisional nature of the central executive power has consequences for the budgetary process (as set out in Box 2) and, generally, for legislative activity, which may ultimately affect private agents' confidence and, therefore, their consumption, investment and hiring decisions.

In the fiscal policy arena, the macroeconomic projections have, as indicated, been prepared on the basis of the absence of additional budgetary measures in the current exercise and under the assumption of a neutral fiscal policy stance in respect of activity during these years. Under these assumptions, the budget deficit is expected to exceed the fiscal targets agreed with the EU Council last August, thereby illustrating the need for fiscal policy to resume a restrictive stance in order to strengthen the sustainability of public finances and to ensure compliance with the targets. Any such additional budgetary consolidation measures could entail some cost in terms of growth over the course of the projection horizon.

The extended delay in forming a Spanish government also affects the timing of the approval of the structural reforms needed to increase the economy's potential growth. Any delay along these lines has adverse consequences for activity, since there are usually considerable lags between the adoption of the measures and the time at which such measures begin to have palpable effects.

Conversely, the resilience recently demonstrated by the economy, despite the prevailing uncertainty surrounding economic policies and the materialisation of certain significant risks in the external environment, suggests that the dynamics of activity in our country retain a high degree of inertia which, should this hold for some time longer, might lessen the final incidence of the foregoing factors of risk.

In terms of inflation, it is considered that the balance of risks is moderately tilted to the downside. In particular, the materialisation of any of the adverse events described affecting activity might give rise to a fresh disinflationary impulse, in particular under those scenarios in which external markets might perform less favourably, possibly accompanied by declines in commodities prices and an appreciation of the euro. Moreover, the recent situation of very low inflation rates might tend to be prolonged should agents extrapolate the trend observed to their expectations-formation process. Conversely, these risks would be alleviated if the expansionary monetary policy measures were to give rise to more buoyant consumer prices than was described under the baseline scenario.