

MACROECONOMIC PROJECTIONS FOR THE 2015-2016 PERIOD

This section describes the growth and inflation projections for the Spanish economy made by DG Economics, Statistics and Research for the 2015-2016 period, with the information available as at 16 March.

The year 2014 was marked by the strengthening of the recovery dating back to mid-2013, evidenced by average GDP growth of 1.4%, its first positive figure since 2008. As earlier set out in this Bulletin, the most recent phase has been marked by a slight acceleration in activity and employment, such that output is estimated to have grown at a year-on-year rate of close to 2.5% in 2015 Q1. In a setting in which this expansionary phase is expected to continue, annual average rates of increase for GDP of 2.8% and 2.7% are projected in 2015 and 2016, respectively, along with a growth pattern characterised by robust private domestic demand and the progressive strengthening of exports (see Table 2).

This favourable outlook for activity is essentially underpinned by two types of factors. The first more permanent group of factors is related to the progressive headway made in recent years in correcting the economy's imbalances and the improved macro-financial environment in Spain, driven by the policies deployed both nationally and Europe-wide. These developments have helped ease financial conditions and have provided for an upturn in net job creation, the progressive reduction of the budget deficit and major gains in competitiveness, all of which shape a scenario conducive to the continuation of expanding economic activity over the projection period.

The second, more recent group of factors exert – in principle, and having regard to the assumptions made – a less persistent influence on the pace of output, bearing principally on its level in the short run. These factors include most notably the fall in oil prices, which is translating into a boost to household income and a reduction in firms' production costs, and the depreciation of the euro (see Box 1). It is estimated that the positive impact of the tax reform that came into force in January, and which has reduced personal and corporate income tax, will be felt with greater intensity in 2015. Finally, among the newest elements influencing the projections, mention should be made of the monetary policy measures recently adopted by the ECB, and in particular its various asset purchase programmes, which will likewise support GDP growth over the projection horizon.

Overall, the outlook for the Spanish economy has improved significantly in the recent period; but the impact of the depth of the crisis on the economic and financial position of households, firms and the general government sector has not been fully dispelled, and this will require perseverance with the economic policy measures needed to shore up the foundations of the recovery.

Expected GDP growth in 2015 entails a 0.8 pp upward revision of the projection published in the *Economic Bulletin* last December. This revision is chiefly due to the favourable course since then of most of the technical assumptions underlying the projection (see Box 1) and, in particular, to the improved outlook for the euro area. Moreover, the results for end-2014 and early 2015, both more favourable than envisaged in December, also contribute to explaining the upward revision of projected growth for this year.

PROJECTION OF THE MAIN MACROECONOMIC AGGREGATES OF THE SPANISH ECONOMY (a)

TABLE 2

Annual rate of change in volume terms and % of GDP

	2013	2014	Projection		Difference between current projections and those made in December 2014	
			2015	2016	2014	2015
GDP	-1.2	1.4	2.8	2.7	0.0	0.7
Private consumption	-2.3	2.4	3.4	2.4	0.1	0.7
Government consumption	-2.9	0.1	-0.4	-0.1	-0.6	1.2
Gross fixed capital formation	-3.8	3.4	5.9	6.7	0.6	0.7
Investment in capital goods	5.6	12.2	9.1	9.1	0.3	1.1
Investment in construction	-9.2	-1.5	4.1	5.1	1.2	0.7
Exports of goods and services	4.3	4.2	5.2	5.8	-0.1	0.6
Imports of goods and services	-0.5	7.6	6.2	6.3	0.1	0.5
National demand (contribution to growth)	-2.7	2.2	3.0	2.7	0.1	0.7
Net external demand (contribution to growth)	1.4	-0.8	-0.2	0.0	-0.1	0.0
GDP deflator	0.7	-0.5	0.4	0.7	-0.1	0.0
Consumer price index (CPI)	1.4	-0.2	-0.2	1.2	0.0	0.6
Unit labour costs	-0.4	-0.4	0.4	0.3	0.0	0.5
Employment (full-time equivalents)	-3.3	1.2	2.7	2.6	0.3	1.1
Unemployment rate (% of labour force)	26.1	24.4	22.2	20.5	0.1	-0.4
Household saving rate (b)	10.4	9.4	9.5	8.7	-0.4	-0.6
National economy's net lending (+)/net borrowing (-) (% of GDP) (b)	2.1	0.5	1.0	0.8	0.0	0.0
General government's net lending (+)/net borrowing (-) (% of GDP) (b)	-6.3	-5.5	-4.5	-3.9	0.2	0.7

SOURCES: Banco de España and INE.
Latest QNA data: 2014 Q4.

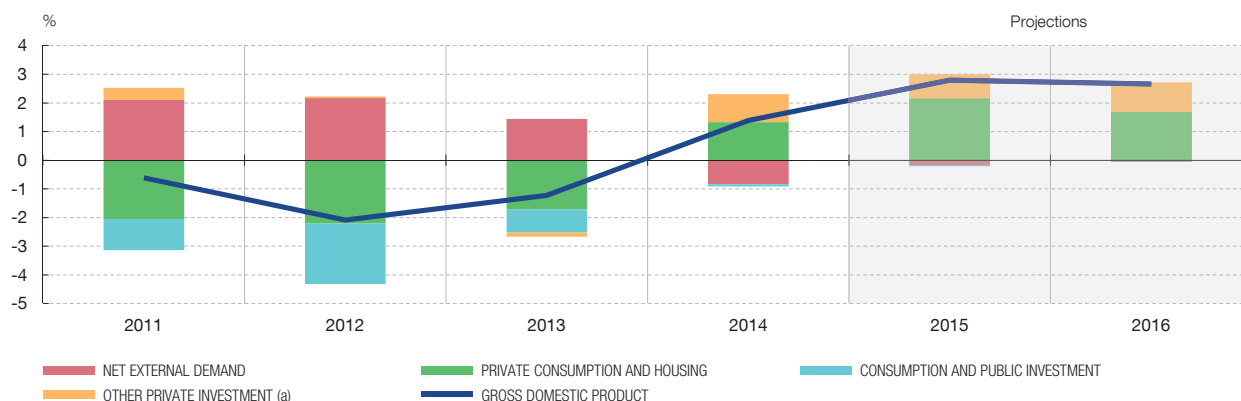
a Projections cut-off date: 16.3.2015.

b At the time of going to press, the final figures for the household saving rate, the national economy's net borrowing and the general government's net lending/borrowing in 2014 are not known. The projected net borrowing of the national economy is an estimate based on balance of payments data up to December 2014. The general government's net lending/borrowing includes the estimated impact of the assistance provided to financial institutions.

Among the components of domestic demand, household consumption is expected to continue in a notably expansionary vein (see Chart 2). This behaviour will be underpinned by the growth of nominal incomes derived, above all, from job creation and from the aforementioned tax reform. In 2015, moreover, household purchasing power will continue to be boosted by the recent decline in crude oil prices. Into 2016, a modest rise in oil prices is expected, prompting a lower increase in real income compared with this year. This explains why private consumption is expected to post a higher increase in 2015 (3.3%) than in 2016 (2.4%), even though households will tend to smooth their expenditure over time, thereby adjusting their saving rate, dipping from 9.5% of their gross disposable income in 2015 to 8.7% in 2016.

After showing the first signs of recovery last year, the increase in residential investment is expected to continue over the projection period, rising to annual average growth rates of 4.2% and 6.6% in 2015 and 2016, respectively. The foreseeable pick-up in residential construction is based, firstly, on some strengthening in demand (underpinned by the improved labour market conditions and by access to financing) and, moreover, on the reduction in the stock of finished housing, particularly in certain regions. However, the intensity of the recovery will be tempered, according to the projections available, by the relatively low rate of household creation over the projection horizon.

The current expansionary phase in investment by non-financial corporations will extend over the projection period, in the aforementioned setting of robust final demand and improved financial conditions. In that respect, the evidence available points to a recent



SOURCES: INE and Banco de España.
Latest data: 2014 Q4.

a Includes the change in stocks.

reduction in the proportion of companies that have seen their credit applications rejected, which may denote that financial institutions are perceiving an improvement in the creditworthiness of potential borrowers. Moreover, some indicators suggest that the greater availability of credit is progressively extending to smaller companies, which are those that in recent years had encountered greater difficulties in gaining access to bank lending. As a result, investment in equipment might be expected to grow at rates of around 9% both in 2015 and in 2016.

Public spending on consumer and investment goods will foreseeably make an approximately neutral contribution to output growth over the projection period. Taking as a starting point the plans announced concerning numbers of general government employees and of goods and services purchases by this sector, government consumption is expected to fall by 0.4% in 2015 and to practically stabilise in 2016. Public investment will post slight increases during the projection period, after having recorded declines for five consecutive years.

Turning to the external sector, goods and services exports are expected to continue on a rising path over the projection horizon, in keeping with the foreseeable course of external markets, especially as a result of the projected better performance of the euro area. As in previous years, the growth of sales abroad is likely to outpace that of the markets for such sales, which will foreseeably give rise to additional, though moderate, increases in the market share of Spanish exports. That will be possible thanks primarily to the gains in competitiveness arising from the lower relative growth of unit labour costs vis-à-vis Spain's main competitors – albeit at a slacker rate than in the past – and to the depreciation of the euro. Goods and services exports are expected to grow by 5.2% this year and 5.8% in 2016.

Following the high growth of imports in 2014 – brought on partly by temporary factors linked to the concentration over the course of last year of consumer and investment spending decisions (with a high import content) that had been postponed in previous years – the elasticity of imports with respect to final demand is expected to return to values close to their historical average, which stands below that observed in 2014. The greater cost of purchases from non-euro area countries as a result of the euro's depreciation will likewise tend to moderate import growth. Consequently, imports are projected to grow by 6.2% and 6.3% in 2015 and 2016, respectively.

With regard to the labour market, employment is expected to continue posting high growth rates relative to the rate of increase in output. In this setting, employment is projected to grow by 2.7% this year and by 2.6% in 2016, which would entail slightly positive rates of increase in apparent labour productivity. These projections rest on the assumption that the moderation observed in recent years in the market economy in labour costs, measured by compensation per employee, will continue over the 2015-2016 two-year period. The containment of labour costs will be assisted by moderate increases in wage settlements under collective bargaining, by the use of the various rebate arrangements provided for in social security contributions and by the negative contributions to the growth of compensation per employee by wage drift (reflecting, *inter alia*, changes in the composition of employment), although such contributions will be lower than those observed since the onset of the crisis. As a result, the growth of compensation per employee in the market economy in 2015 is estimated to be similar to that recorded in 2014, with this variable rising to a rate slightly below 1% in 2016.

After two consecutive years of declines, a gradual recovery in the labour force is projected. That is the result of the population of working age having stabilised, following the declines observed since 2012 as a result of immigrant outflows, and of a mild pick-up in the participation rate, underpinned by improved working conditions. Nonetheless, the increase in employment will enable the unemployment rate to continue shrinking at an even faster pace than in 2014, and to settle at around 20% at the end of the projection horizon.

The projections for consumer prices are highly conditional upon the assumptions about oil prices, given the marked fluctuations of the latter in recent months. On the information available as at the cut-off date for this report, CPI inflation is estimated to be at a negative rate of -0.2% in 2015 and at 1.2% in 2016. Stripping out the energy component, consumer prices are expected to rise modestly during the projection horizon, in step with the expansionary momentum of household spending, with the lesser slack in the economy and with the depreciation of the euro.

In 2014, there was a slowdown in the ongoing improvement in the balance of the account with the rest of the world. Net lending, which had stood at 2.1% of GDP in 2013, dipped last year to 0.5% of GDP according to preliminary balance of payments estimates. For 2015, the external surplus is expected to widen to around 1% of GDP, underpinned by various factors. Firstly, as described above, the behaviour of net trade flows in real terms is expected to be less unfavourable than in 2014. Further, cheaper oil will contribute to lessening the energy bill. Finally, some improvement is expected in the income balance as a result of the low level of interest rates and of the reduction in the external debt position. In 2016, the nation's net lending might ease slightly against a backdrop of some worsening in the terms of trade.

From a sectoral standpoint, the net lending capacity of general government will foreseeably follow an opposite course to that of the private sector during the projection period. Specifically, over these two years, the increase in household and corporate expenditure is expected to translate into a 1.3 pp reduction in their overall net lending to 2.6% of GDP in the case of households and to 2.2% in that of firms. In parallel, private-sector debt ratios will continue to fall gradually. Between 2014 and 2016, households' debt is forecast to fall by 4 pp relative to their disposable income, while non-financial corporations' debt relative to GDP would do so by around 7 pp.

Set against the moderation in private-sector net lending, an additional correction in the general government deficit is expected, down from the level of 5.5% of GDP for end-2014

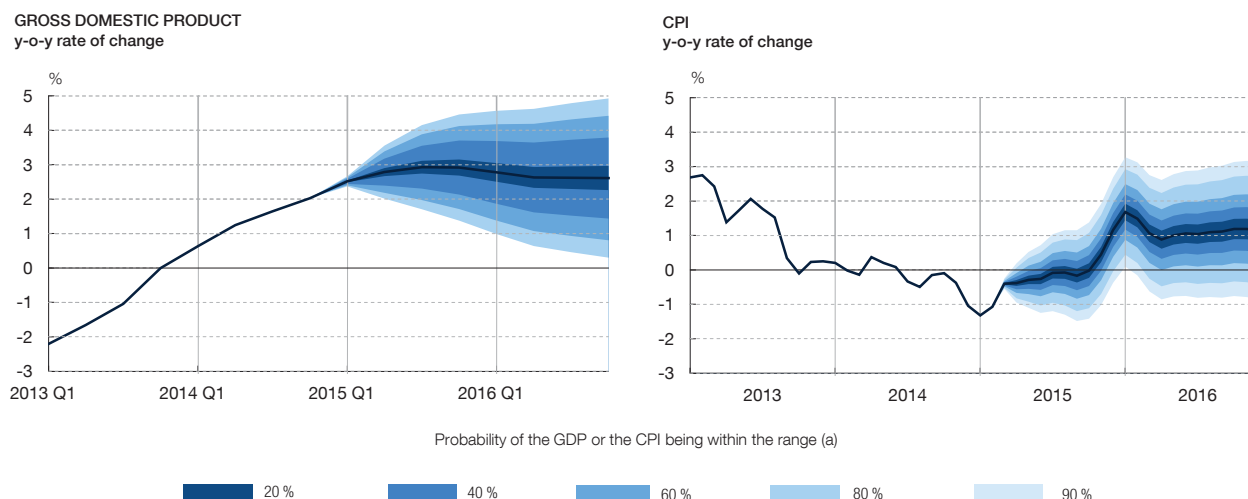
(on the provisional estimate available) to 4.5% and 3.9% of GDP in 2015 and 2016, respectively. On the expenditure side, and in addition to the measures already approved, these forecasts include an estimate of the impact of official plans in the medium term and the continuation over the forecasting horizon of the recent trend of certain items. In the case of revenue, only the official impact of the measures that have already been adopted is included (see Box 1 for greater details). These criteria differ in some respects from the traditional assumption of an absence of changes in fiscal policy over the projection horizon, as has been the case during the current phase of fiscal consolidation. In this setting, the slippage in 2015 from the official target (4.2%) reflects a somewhat less dynamic projection for revenue, while in 2016 this discrepancy is the outcome, in part, of the budgetary plans for that year not having been specified at the time of this report going to press. The slippage in this latter case should lessen once the Updated Stability Programme for the 2015-2018 period (before 30 April, as the European Semester dictates) and the budgets for the different tiers of government (which will be known in autumn) are published. Compliance with fiscal targets is necessary to curb the upward course of the public debt ratio over the projection horizon.

The Spanish economy's vulnerability to external shocks has lessened over the past two years as headway has been made in correcting imbalances and in strengthening economic activity and employment generation. However, the scenario of a firming of the recovery suggested by these projections is not free from uncertainty. One statistical approach for evaluating the uncertainty associated with these projections involves using the confidence intervals constructed by calculating the deviations from the above-mentioned central scenario that may be expected, with different probabilities, on the basis of the forecast errors made in the past (see Chart 3).

In the present projections exercise, the risks of the GDP path deviating from that envisaged in the central scenario are considered to have turned somewhat more positive with respect to the previous exercise published in the December 2014 *Economic Bulletin*, and now they would be skewed slightly to the upside. In particular, it cannot be ruled out that the virtually simultaneous materialisation of a variety of factors conducive to activity, including the recent fiscal reform, cheaper oil prices, the improvement in financial conditions, the depreciation of the euro and the recent upward revision in the euro area growth outlook, may give rise to a somewhat more positive aggregate effect than that considered in these projections. Furthermore, the quantitative tools habitually used in projection exercises may lead to underestimation of the effects of the significant non-conventional monetary policy measures adopted in recent months by the Eurosystem, in terms, for instance, of their impact on the ongoing normalisation of financial conditions, on confidence or on the exchange rate of the euro.

Acting in the opposite direction, the adverse trend of certain factors external to the Spanish economy – especially a potential worsening of tensions within the euro area linked to the Greek economy or of the geopolitical conflicts in eastern Europe or in the Middle East – would adversely affect the projections considered in the central scenario. Along these same lines, a sharper-than-expected tightening of global monetary and financial conditions might exert an unfavourable effect on some emerging economies, which could prove harmful, to a degree difficult to estimate, to the external environment of the Spanish economy. On the domestic front, uncertainty over the economic reform agenda for the coming years may give rise to a decline in agents' confidence, which is not implicit in the central scenario.

As regards inflation, the downside risks have diminished somewhat compared with the analysis made three months earlier, in an environment which, however, continues to pose



SOURCES: INE and Banco de España.
Latest data: GDP 2014 Q4 and CPI February 2015.

a The chart shows the uncertainty surrounding the central projection. Probability ranges are set at 20%, 40%, 60%, 80% and 90%, respectively, based on past projection errors.

high uncertainty. As earlier indicated, oil prices remain the main source of volatility in the short run, without it being possible, at present, to discern the direction in which developments may deviate from the assumed path. The extraordinary monetary policy measures have lessened the risks of a persistent downward revision of inflation expectations, which should begin to have some positive effect on actual inflation and which appears to be significantly affecting the exchange rate of the euro.

One significant factor of uncertainty at the current juncture concerning the foreseeable course of inflation in the medium term is the fact that negotiations among the social partners on a new so-called “Agreement for Employment and Collective Bargaining” have not concluded at the time of this report going to press. Also, uncertainty over measures of the degree of slack in the economy is particularly marked in the current setting of high growth rates of output and employment, with very high unemployment levels and very low core inflation.

24.3.2015.

The projections presented in this section are conditional upon a set of assumptions as to the behaviour of a number of exogenous variables over the projection horizon (see table below). The procedure used to formulate these assumptions is the same as that used in the Eurosystem's quarterly macroeconomic projection exercises. For a set of variables, including the euro exchange rate, oil prices, the IBEX (Spain's main stock market index), 3-month interest rates and 10-year bond yields, the assumptions are based on the average of the prices traded on the relevant markets over the ten business days immediately preceding the cut-off date for the data on which the projections are based (16 March).

The exchange rate is assumed to hold throughout the projection period at the average level observed on the spot market in the reference period, which in the case of the US dollar/euro exchange rate results in a depreciation of 18% on average in 2015 in comparison with 2014. The assumptions for the US-dollar oil price are based on futures market prices, which give a drop of 41% in 2015 and a rebound of 10% in 2016. Three-month Euribor interest rates, based on the expectations implicit in futures markets, are assumed to remain very close to zero throughout the projection period, while 10-year government bond yields, based on the expectations implicit in the yield curve, are assumed to decline from 2.7% in 2014 to 1.3% in 2015 and 1.4% in 2016.

The assumptions made for 3-month and 10-year interest rates serve as the basis for the projections of the cost of financing for households and firms. This cost is expected to fall slightly in comparison with current levels. Moreover, credit conditions other than interest rates are expected to improve gradually over the

projection period. Among the determinants of household wealth, house prices are expected to rise moderately, as a continuation of the most recent trend, while share prices are expected to remain relatively stable.

The projections for Spanish export markets are based on the macroeconomic projection exercise for the euro area made by ECB staff and published on the ECB's website on 5 March. In particular, the growth of these markets is expected to gradually recover, reaching 3.5% in 2015 and 4.9% in 2016.

In the case of the fiscal assumptions, the criteria used in these projections are similar to those used in the Projection Reports published in 2012 to 2014. Against a backdrop of continued budgetary consolidation, these criteria depart in certain respects from the usual practice of assuming that fiscal policy remains unchanged over the projection horizon and of including in the projections only measures already approved. The automatic application of this assumption is not appropriate during processes of fiscal adjustment such as the present one, as it would give rise to a bias in the macroeconomic projections. To minimise this problem, these projections include, on the expenditure side, not only the measures already approved but also an estimate of the impact of official medium-term plans and the continuation of the latest trend among certain items, while on the revenue side they include only the impact of the measures already approved.

In this setting, the fiscal assumptions that have served as a basis for the macroeconomic projections include the 2015 Budget Plan measures, which were subsequently validated by the state, social

INTERNATIONAL ENVIRONMENT AND MONETARY AND FINANCIAL CONDITIONS (a)

Annual rates of change, unless otherwise indicated

		Current projection		Change from December 2014 projection	
	2014	2015	2016	2014	2015
International environment					
World output	3.3	3.5	3.8	0.0	-0.3
Global markets	3.0	3.8	5.0	0.1	-0.2
Spain's export markets	2.8	3.5	4.9	0.3	0.1
Oil price (in USD)	99.3	58.7	64.4	-0.2	-9.3
Monetary and financial conditions					
Dollar/euro exchange rate (USD per euro)	1.33	1.09	1.08	0.00	-0.14
Short-term interest rate (3-month EURIBOR)	0.2	0.0	0.0	0.0	-0.1
Long-term interest rate (10-year bond yield)	2.7	1.3	1.4	0.0	-1.1

SOURCES: ECB and Banco de España.

a Projections cut-off date: 16.3.2015.

security system and regional government budgets for this year, as well as the content of the 2014-2017 Stability Programme. Specifically, the expenditure side includes a 0.25% rise in pensions, by application of the adjustment factor, the public sector wage freeze, the payment of a quarter of the Christmas bonus payment eliminated in December 2012 (that is, 25% of one of the 14 instalments into which annual pay is divided) to public sector employees, the continued restrictions on public sector hiring and the decrease in final consumption expenditure in line with official estimates. Also assumed is a further fall in spending on unemployment benefits due to labour market dynamics and a decline in the public

debt interest burden associated with the continued improvement expected in financing conditions. In turn, it is assumed that public investment will grow over the projection horizon, in keeping with official plans, after five consecutive years of decline.

On the revenue side, the main measures include the effects of the personal income tax and corporate income tax reforms, which entail a decrease in public revenue of 0.4 pp and 0.5 pp of GDP, respectively, in 2015 and 2016, and the reductions in social security contributions for permanent hires approved over the course of 2014.