BANCO DE ESPAÑA
Eurosistema

03.04.2017

Briefing note on macroeconomic projections of the Spanish economy, 2017-2019

This note describes the key features of the macroeconomic projections of the Spanish economy for the period 2017-2019 which the Banco de España is publishing today on its website (link). The current projections include the changes observed to 23 March in the technical assumptions, with the exception of those relating to the performance of external markets, for which the cut-off date was 20 February. In particular, it is worth noting that the projections, as they were adopted after the assumptions cut-off date, do not include the information in the draft State and Social Security Budget for 2017, which was approved by the Council of Ministers on 31 March.

The projections envisage a **continuation of the growth phase** in activity and employment in the Spanish economy over the 2017-2019 period, underpinned by some of the factors that have been present for much of the current upturn, such as the gains in competitiveness built up since the start of the crisis and favourable financial conditions, to which the accommodative monetary policy stance contributes. However, as the projection period unfolds, there is expected to be some slowing in activity, as the lagged effects of the past declines in oil prices and in interest rates taper off, and as the fiscal policy stance changes, after having been expansionary over the two-year 2015-2016 period.

Specifically, **GDP growth is expected to stand at 2.8% this year**, before easing to **2.3 % and 2.1 % in 2018 and 2019, respectively. Compared with the previous projections**, published on 14 December, these figures represent an **upward revision of 0.3 pp, 0.2 pp and 0.1 pp in the GDP forecast for 2017, 2018 and 2019, respectively.** Various different factors lie behind these changes. In the short term, the latest information on the Spanish economy indicates that activity has performed more favourably in the opening months of 2017 than was anticipated in December. Moreover, the business and global trade indicators also suggest more expansionary behaviour in foreign markets, which has prompted an upward revision in export growth. Finally, a somewhat less dynamic performance by imports has been considered, in line with their recent trend.

In terms of components, **the increase in output is expected to continue to be underpinned by national demand;** for this latter variable, however, the deceleration observed in 2016 is forecast to continue. It is estimated that **net external demand will continue to make a positive contribution** throughout the projection horizon.

Turning to the labour market, the projection includes **continuing high job-creation rates**. The increase in employment will provide for **further declines in the unemployment rate**, the level of which is expected to fall to around 14 % at end-2019.

As to inflation, the consumer price index, after falling by 0.2 % in 2016, is forecast to increase by 2.2 % in 2017, reflecting the sharp acceleration in energy prices in the recent period. Subsequently, more moderate increases in the CPI are expected, of the order of **1.4 % in 2018 and 1.6 % in 2019**, in annual average terms, as a result of the slowdown in the energy component. Core inflation (which excludes energy and unprocessed food prices) is expected to rise gradually from 1.1 % in 2017 to 1.8 % in 2019, owing to the gradual closing of the output gap and the progressive rise in unit labour costs. This will be in a setting in which, in line with past experience, the pass-through of the previous increase in energy prices to other prices in the economy and to wages is expected to be modest. Compared with the December projections, overall inflation has been revised upwards by 0.5 pp in 2017, on account of the increase in oil prices, and downward in each of the two following years, in step with the recent futures market prices for this commodity.

The **risks surrounding the baseline scenario for GDP growth are tilted predominantly to the downside**, chiefly **in relation to the external environment.** The causes here are a hypothetical further tightening of global financial conditions, a potential increase in trade protectionism and the uncertainty over Brexit and the forthcoming elections in some of the main euro area countries. On the **domestic front**, some uncertainty remains over the course of economic policies, in relation both to the fiscal consolidation process and to the application of structural reforms, given the lack of a stable parliamentary majority. In this respect, the high public debt underscores the need to resume a fiscal consolidation path, harnessing the current context of high-growth and low interest rates, with a view to tempering the future financial costs associated with public debt, to reducing the economy's vulnerability to any future tightening of financing conditions and to restoring a degree of fiscal policy leeway in the event of future shocks. Moreover, improving the outlook for growth in activity and employment in the Spanish economy over the medium and long term calls for deepening the application of structural reforms in various areas.

With regard to inflation, the risks of slippage are tilted moderately to the downside. On the external front, the negative balance reflects the hypothetical materialisation of the above-mentioned risks to activity. From the domestic perspective, there is a risk that the expected rise in core inflation may not materialise with the intensity projected, in line with the evidence built up over the past two years. Conversely, it cannot be ruled out that the pass-through of dearer oil in the recent period to other prices and to wages may prove more acute than is being anticipated.