During 2014 the Spanish economy's path of recovery initiated in the second half of 2013 moved onto a firmer footing, against a background of continuous improvement in financial conditions, increased confidence and the favourable performance of the labour market. Based on the available information, the economy is estimated to have grown by 0.6% quarter-on-quarter in Q4, which, if confirmed, would place the year-on-year rate of change of GDP at 1.9%. As in previous quarters, this growth in activity is estimated to be underpinned by the strength of private domestic demand, while the contribution of net external demand to output remains slightly negative. If these figures hold, GDP is projected to rise by 1.4% in 2014 as a whole (0.1 pp up on the previous projections) (see Chart 1 and Table 1).

The recovery is expected to continue in 2015, when growth is projected at 2%, similar to that estimated in the last projection exercises (see Box 1). In recent months the external environment, particularly the euro area, has continued to worsen, prompting a downward revision of the growth outlook for numerous countries in 2015. It is considered, however, that the foreseeable weakening of our export markets over the coming year will be offset by a continued improvement in financing conditions, the depreciation of the euro exchange rate and the considerably lower oil prices envisaged in current projections.

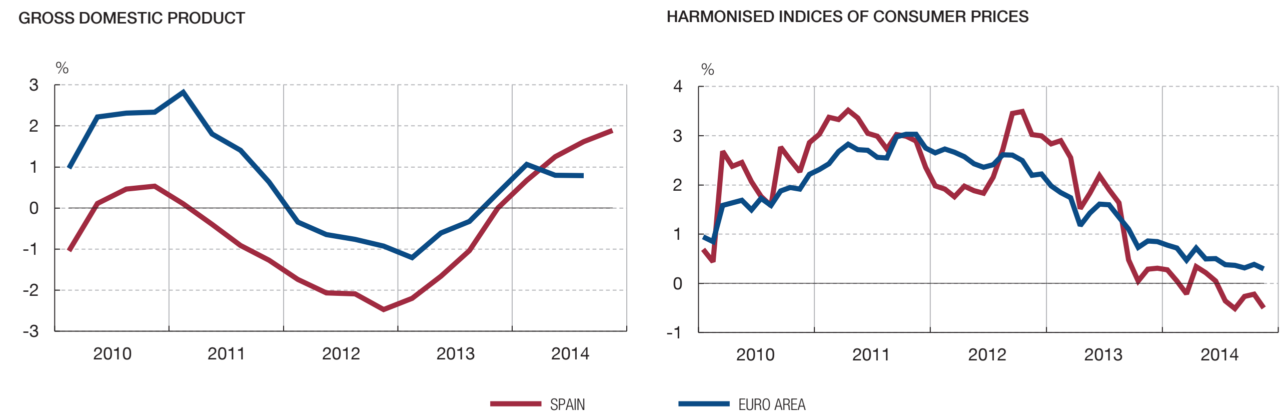
This baseline scenario is, however, shrouded in high uncertainty linked largely to doubts over the future path of oil prices following their collapse in recent weeks. In these circumstances, the GDP projection for 2015 is subject to slippage in both directions. Among the downside risks is that of a less favourable performance of foreign markets. The factors which, by contrast, may contribute to output being more buoyant than envisaged in this projection include a more marked moderation in oil prices, a sharper depreciation in the euro exchange rate and an additional improvement in financial conditions, as a possible result of the latest monetary policy measures and of the effects of publication of the results of the comprehensive assessment of the banking sector.

The fall in the inflation rate intensified in Q4, at a faster pace than had been expected some months ago as a result of the accelerating decline in oil prices in the final stretch of the year and of the attendant impact on the prices of energy products. However, these developments coincided with a more widespread trend towards lower or even negative inflation affecting practically all components of the overall index, as evidenced by core inflation (proxied by the CPI excluding unprocessed food and energy), which has held at zero or slightly negative growth since May. The price falls in Spain in the last few months outpaced the slowdown in the inflation rate in the euro area, meaning the inflation differential became more favourable to Spain, standing at 0.8 pp in November.

In these circumstances, the inflation projections were revised downward, both for the year as a whole, with an estimated decrease of 0.4% in the GDP deflator, and for 2015, with an estimated increase of 0.4%. In terms of the CPI, if the marked moderation in oil prices continues, inflation can be expected to remain negative in the initial quarters of the projection horizon. In this case, the risk of slippage from the baseline scenario is skewed somewhat downward as a result of the persistently high degree of slack in capacity utilisation and of a possible further decrease in oil prices on top of that contained in the projections for this year.

GROSS DOMESTIC PRODUCT AND CONSUMER PRICES (a)

CHART 1



SOURCES: Eurostat, INE and Banco de España.

a Year-on-year rate of change calculated on the basis of seasonally adjusted series in the case of GDP and CPI original series.

The favourable trend in financial conditions in Spain has continued in the last few months, interrupted by sporadic bouts of instability, the last of which, linked to the impact of the sharp oil price slump on some oil-producing economies, was in the days before the cut-off date of this report. The persistent strong demand for government bonds and its impact on their yield allowed general government to be financed under favourable conditions, continuing a tendency that has gathered momentum during the year. In turn, cheaper bank funding has continued to be passed through gradually by banks to corporate and household loans and a certain pick-up is apparent in new loans to the private sector, whereby the rate of decline of corporate and household debt is slowing, more sharply so in the case of the latter. This contributes to a sounder financial position of households and firms, exerting a favourable impact on private sector spending and investment decisions.

In the final months of the year the main components of private domestic demand remained buoyant, underpinned by the positive course of confidence and employment, which in recent months have performed better than anticipated. The consumption component of household spending appears to have risen in Q4, at a quarter-on-quarter rate of 0.6%, while the residential investment component may also have increased slightly, after posting a positive rate in Q3 for the first time since 2007. Business investment also performed positively in this period; it is estimated that investment in capital goods increased and investment in other construction rose moderately. Overall, the indicators relating to investment in construction suggest that its adjustment has been completed this year, after six years of contraction which have reduced its weight in GDP by slightly more than 50% from its peak in 2006. The decline in house prices may likewise have bottomed out in 2014, following two consecutive quarters of small increases which are estimated to have put the year-on-year rate of change at 0.3% in Q3 this year and the total adjustment since its peak (in 2007 Q3) at 36%. The outlook for this sector is, in any event, one of very moderate recovery, still subject to some uncertainties. Lastly, the public component of domestic demand is expected to have remained contained in the closing months of 2014, in step with ongoing budgetary retrenchment.

The firming of the buoyancy of the private components of domestic demand (with a contribution of 2 pp to the increase in GDP this year, compared with a negative contribution of a similar amount last year), would confirm that this phase of the recovery in the Spanish

SPAIN: MAIN MACROECONOMIC AGGREGATES (a)

TABLE 1

	2013	2014	2013 Q1	2013 Q2	2013 Q3	2013 Q4	2014 Q1	2014 Q2	2014 Q3	2014 Q4
National Accounts										
Quarter-on-quarter rate of change, unless otherwise indicated										
Gross domestic product	-1.2	1.4	-0.3	-0.1	0.1	0.3	0.3	0.5	0.5	0.6
Contribution of national demand (b)	-2.7	2.1	-1.2	-0.2	0.4	0.4	0.5	0.8	0.7	0.6
Contribution of net external demand (b)	1.4	-0.8	0.8	0.1	-0.3	-0.1	-0.1	-0.3	-0.2	-0.1
Year-on-year rate of change										
Employment	-3.3	0.8	-4.3	-3.9	-3.0	-1.8	-0.6	0.8	1.4	1.9
Price indicators (year-on-year change in end-of-period data) (c)										
CPI	1.4	-0.1	2.4	2.1	0.3	0.3	-0.1	0.1	-0.2	-0.4
CPI excl. unprocessed food and energy	1.4	0.0	2.3	2.0	0.8	0.2	0.0	0.0	-0.1	-0.1

SOURCES: INE and Banco de España.

a Information available up to 15 December 2014.
b Contribution to the quarter-on-quarter rate of change of GDP in pp.
c The latest CPI data are for November 2014.

economy can be sustained by domestic spending at a time when the contribution of the external sector remains weak. Indeed, the information on foreign trade for the last quarter is still very limited, although it seems to indicate that the contribution of the external sector in Q4 was slightly negative. It is estimated that goods exports increased moderately — against a backdrop of depreciation of the euro exchange rate, weak growth in the euro area and a slight deterioration in certain emerging areas — and that tourism flows have held on a favourable path. In turn, imports seem to have continued to perform robustly, albeit to a slightly lesser degree than in previous quarters, underpinned by strong domestic demand. If this prediction is confirmed, the external sector will have made a negative contribution to GDP in 2014 for the first time since 2007 and the correction of the external imbalance will have slowed. Although part of the deceleration stems from the significant weakening of Spain's export markets, the high sensitivity of Spanish imports to changes in final demand underlines the need to further improve the competitiveness of the Spanish economy.

Net job creation continued apace in the closing months of the year. This, along with the decrease in the labour force, allowed the downward path in the rate of unemployment seen in recent quarters to continue. The increase in employment in NA terms in Q4 is estimated to be similar to that of the July-September period (0.5% quarter-on-quarter) with a rising contribution from industry and construction – the sectors that have taken longest to contribute to this process. If this estimation is confirmed, employment will have risen by a rate of close to 1% in 2014, in stark contrast to the decline of 3.3% last year. The recovery in employment over the year has been based primarily on temporary jobs, although permanent employment has been rising gradually since Q2. Greater scope for adapting working conditions to the different economic situations of companies and sectors is a key factor in the performance of employment in the current year. Building on these mechanisms of flexibility and diversification, which have been shaped by the reforms introduced, will be essential for the still high numbers of unemployed persons to be rapidly absorbed.

18.12.2014.

This box sets out an update of the Spanish macroeconomic projections for the period 2014-2015, prepared by the Banco de España as part of the joint Eurosystem forecasting exercise.[1] They have been adapted to include several changes made since that exercise was completed, including most notably the publication by INE of the new Quarterly National Accounts (QNA) series using ESA 2010 methodology on 27 November. The changes to the assumptions since the cut-off date of the joint exercise have also been included, especially in view of the sharp drop in the price of oil (see Panel 1).[2]

The results of the update show that Spanish GDP can be expected to continue to expand over the projection horizon, with estimated GDP growth of 1.4% and 2% in annual average terms in 2014 and 2015, respectively (see Panel 2). In comparison with the forecasts published in July, the GDP growth estimate for 2014 has been raised by 0.1 pp, as a result of the inclusion of the new QNA series and the slight upward revision of the GDP flash estimate for Q4. The GDP growth projection for 2015 remains unchanged, although the individual components have been revised significantly, in a setting where the recent positive employment trend is expected to continue and a further improvement in financing conditions for the private sector is projected, prompting an upward revision of the path forecast for private national demand. Conversely, a worsening of the external environment has been factored into the projections, reflected in a downward revision of expected export growth.

1 The aggregate projections for the euro area were submitted to the ECB's Governing Council on 4 December and published by the ECB a day later.
2 The projections were prepared based on information available up to 15 December.

As indicated, one notable aspect of the external assumptions underlying the projections is the weaker performance of Spanish export markets in comparison with the July forecast, in view of the worsening international economic outlook since the summer, especially in the euro area. The exchange rate assumptions reflect a depreciation of the euro against the dollar that was not envisaged in July, while the oil price has been revised down significantly, in step with its performance on the spot and futures markets. Three-month Euribor interest rates have remained stable, at minimum levels, while 10-year government debt yields, in view of the expectations implicit in the yield curve, have been revised down in comparison with the July assumptions, to 2.8% and 2.4% in 2014 and 2015, respectively. Additionally, the gradual decline in the cost of financing extended to households and firms in 2015 is projected to be somewhat more substantial than that foreseen in July.

The budget policy projections include the fiscal measures approved since the last biannual forecasting exercise in July. In particular, they incorporate the information on the 2015 Budget Plan outlining the overall general government fiscal policy strategy for 2015 and providing partial information on the link between that strategy and the budget plans of each tier of government.

The projected path of GDP growth is underpinned by a relatively large contribution from domestic demand (of approximately 2.2 pp in both 2014 and 2015), while net external demand is expected to make a negative contribution [that is significantly larger in 2014 (-0.8 pp) than in 2015 (-0.2 pp)]. The positive contribution from domestic demand would be based on continuing high levels of confidence among domestic agents, underpinned, in turn, by employment generation, improved aggregate financial conditions and, in 2015, the impact of the tax reform due to enter into force on

1 INTERNATIONAL ENVIRONMENT AND MONETARY AND FINANCIAL CONDITIONS (a)

Annual rates of change, unless otherwise indicated

		Current projection		July 2014 projection	
	2013	2014	2015	2014	2015
International environment					
World output	3.2	3.3	3.7	3.2	3.8
Global markets	2.8	2.9	4.0	4.8	6.0
Spain's export markets	2.2	2.5	3.4	3.8	5.1
Oil price (in USD)	108.8	99.5	68.0	108.8	107.0
Competitors' export prices in euro	-2.1	-1.0	1.6	-1.2	1.4
Monetary and financial conditions					
Dollar/euro exchange rate	1.33	1.33	1.24	1.37	1.36
Short-term interest rate (3-month EURIBOR)	0.2	0.2	0.1	0.2	0.2
Long-term interest rate (10-year bond yield)	4.6	2.8	2.4	3.0	3.2

SOURCES: ECB and Banco de España.

a Projections cut-off date: 15.12.2014.

1 January. In particular, household consumption is expected to grow by 2.3% in 2014 and by 2.6% in 2015, against a background of improvement in the labour market, which will be conducive to a recovery in household disposable income. Private productive investment is projected to continue to expand, driven by the increase in domestic demand, the gradual improvement in financial conditions, the need for a growing proportion of businesses to replace part of their capital and the expected growth of exports. However, the latter is now projected to be more moderate than in the summer, as a consequence of the poorer outlook for some emerging markets and for the euro area, this being partly offset by the depreciation of the euro. In this setting, the net lending of the economy is projected to be 0.5% of GDP in 2014 and 1.1% in 2015.

In the labour market, the sustained employment creation observed in recent quarters is projected to continue, underpinned by ongoing wage moderation and greater labour market flexibility. The expected rate of increase in net jobs is somewhat higher than in the July projections. This increase in employment, along with the contraction in the labour force, will lead to a further decline in the rate of unemployment.

The forecasts for consumer price growth have been revised down significantly owing to the sharp fall in the price of oil on international markets in recent months. In addition, the high degree of slack still present in the economy and the moderate behaviour of wage costs should also help to keep prices contained. Given these factors, consumer price inflation is expected, on current assumptions, to remain at negative rates during the initial quarters of the projection horizon. In terms of the GDP deflator, prices may fall by 0.4% in 2014, and then rise slightly in 2015, with average growth during the year of approximately 0.4%.

The baseline scenario is subject to risks of divergence in both directions. As regards the external environment, export market developments may be more unfavourable than projected, given the scenario of fragile euro area growth and the uncertainty over the extent of the slowdown in some emerging market economies, in particular those which, owing to their producer status, are suffering revenue losses as a result of oil price developments. On the other hand, an improvement in financial conditions, linked to the extraordinary monetary policy measures adopted recently and the potentially positive impact on credit supply conditions of the comprehensive assessment of the banking sector completed in October, along with a further decline in oil prices and the euro exchange rate relative to the hypothesis implicit in these projections, could lead to more positive GDP developments. With regard to prices, the risks of divergence from the baseline inflation scenario are skewed somewhat downwards, as a consequence of the persistently high degree of slack and the possibility that oil prices may fall even further than assumed for this exercise. Nonetheless, there are some potential sources of upward divergence, which may partly offset the disinflationary effect of the above factors, such as a sharper depreciation of the euro.

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

Annual rate of change in volume terms and % of GDP

		Current projection		July 2014 projection (b)	
	2013	2014	2015	2014	2015
GDP	-1.2	1.4	2.0	1.3	2.0
Private consumption	-2.3	2.3	2.6	1.6	1.6
Government consumption	-2.9	0.7	-1.6	-0.8	-1.5
Gross fixed capital formation	-3.8	2.8	5.2	1.8	4.2
Investment in capital goods and intangible assets	5.6	11.8	8.0	8.7	7.7
Investment in construction	-9.2	-2.7	3.4	-3.2	1.7
Exports of goods and services	4.3	4.3	4.6	4.6	5.9
Imports of goods and services	-0.5	7.5	5.6	4.7	4.5
National demand (contribution to growth)	-2.7	2.1	2.2	1.2	1.4
Net external demand (contribution to growth)	1.4	-0.8	-0.2	0.1	0.6
GDP deflator	0.7	-0.4	0.4	-0.1	0.6
Employment (full-time equivalent jobs)	-3.3	0.8	1.6	0.4	1.4
Nation's net lending (+)/net borrowing (-) (% of GDP)	2.1	0.5	1.1	1.3	1.6

SOURCES: Banco de España and INE.
Latest QNA data: 2014 Q13. Base 2010 figures.

a Projections cut-off date: 15.12.2014.
b The July projections were made on the basis of ESA 95 (base 2008) series.