OVERVIEW

During the first half of the year, the dynamism of the Spanish economy continued to firm. Following the 0.9% increase in GDP in 2015 Q1, the conjunctural information available indicates that activity might quicken slightly more in Q2, to 1% quarter-on-quarter, placing the year-on-year rate at 3.1% (see Chart 1 and Table 1). This high growth rate, which is accompanied by rapid job creation, comes about in a setting marked by progress in the correction of imbalances and improved financing conditions, in the wake of the significant non-standard monetary policy measures adopted by the Eurosystem since mid-2014.

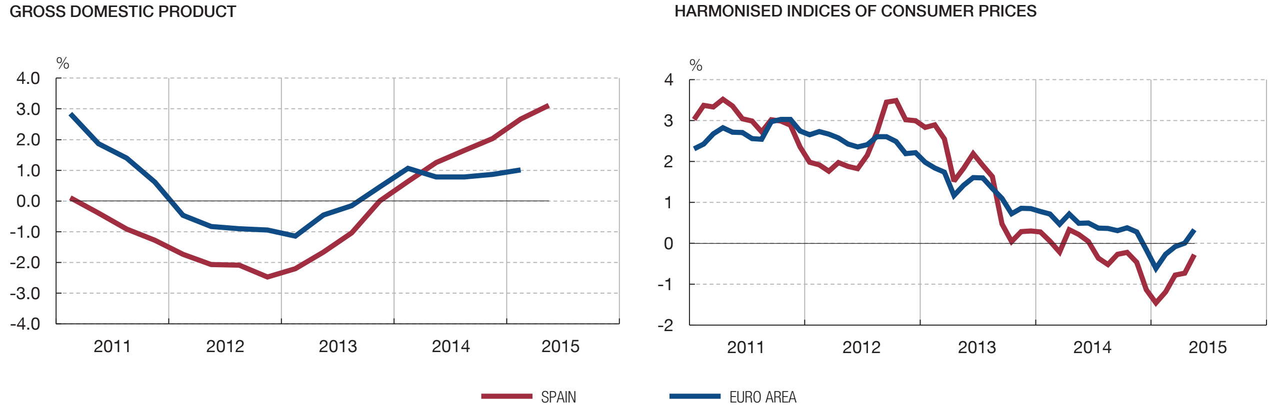
As a result of the behaviour of activity in the first half of the year, which has been more favourable than anticipated in March, estimated GDP growth for 2015 has been revised upwards by 0.3 pp to 3.1% in annual average terms (see Box 1). For 2016, the buoyant upturn is expected to continue, albeit on a somewhat more contained path that might begin to be discernible in the second half of the current year, once the impact on the pace of GDP of some of the recent expansionary impulses, such as the fall in oil prices and the depreciation of the euro, begins to ease. Accordingly, annual average growth of 2.7% is estimated for 2016, a rate unchanged on that projected in March. The risks of slippage from this baseline scenario are balanced, although the recent volatility on financial markets heightens the uncertainty.

The year-on-year rate of change in the CPI – which has been in negative territory virtually since the onset of the recovery – continued in Q2 on the rising trajectory on which it embarked at the beginning of the year, standing in May at -0.2%. This was the outcome of the slight rise in oil prices and of the gradual recovery in core inflation which, after bottoming out at -0.1% last autumn, has progressively risen, up to 0.5% in May, set against the cyclical improvement and the depreciation of the euro. This has been accompanied by something of a rise in inflation expectations in recent months. The projections of the change in consumer prices have scarcely altered from those made in March. After ending the year posting positive figures, the rate of change of the CPI is estimated to stand at -0.2% on average in 2015, rising to 1.3% in 2016. In this case, the risks of deviation from the baseline scenario have turned slightly to the upside, although the degree of uncertainty about the future course of oil prices continues to weigh on the projected path of inflation.

In recent months, favourable developments in financial conditions in Spain, despite the rise in long-term yields induced by the worsening of the Greek crisis, have supported the buoyancy of the main components of domestic demand. The general government sector has continued to finance itself under beneficial conditions (see Box 4 in the original Spanish version of this report) and credit institutions have continued reducing the cost of new bank loans to households and firms. The volume of new lending business has continued to increase, while the pace of the decline in aggregate debt has eased once more.

Household consumption is being driven by increased confidence and by the impact that the favourable trend of labour income, lower oil prices and the personal income tax reform are exerting on household disposable income. In turn, residential investment continues to show signs of an incipient recovery, as indicated both by the rise in building approvals and real estate transaction figures (which nonetheless remain at historically low levels), and the slight increase in prices in certain real estate market segments. Lastly, business investment

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.

SPAIN: MAIN MACROECONOMIC AGGREGATES (a) TABLE 1

			2014				2015	
	2013	2014	Q1	Q2	Q3	Q4	Q1	Q2
National Accounts								
Quarter-on-quarter rate of change, unless otherwise indicated								
Gross domestic product	-1.2	1.4	0.3	0.5	0.5	0.7	0.9	1.0
Contribution of national demand (b)	-2.7	2.2	0.6	0.9	0.7	0.5	0.8	1.0
Contribution of net external demand (b)	1.4	-0.8	-0.3	-0.4	-0.2	0.2	0.1	0.0
Year-on-year rate of change								
Employment	-3.3	1.2	-0.4	1.0	1.7	2.4	2.8	2.9
Price indicators (year-on-year change in end-of-period data) (c)								
CPI	1.4	-0.2	-0.1	0.1	-0.2	-1.0	-0.7	-0.2
CPI excluding unprocessed food and energy	1.4	0.0	0.0	0.0	-0.1	0.0	0.2	0.5

SOURCES: INE and Banco de España.

a Information available up to 19 June 2015.
b Contribution to the quarter-on-quarter rate of change of GDP in pp.
c The latest CPI data are for May 2015.

is being supported by the progressive improvement in financial determinants, in a setting in which the favourable demand outlook is fomenting the adoption of new investment projects. Overall, the strengthening of households' and firms' financial position is beginning to play a part in the non-financial private sector's spending decisions.

The contribution of net external demand to the quarter-on-quarter increase in GDP in Q2 is estimated to have been practically neutral, although the information on trade flows abroad is as yet very incomplete. Foreseeably, the growth rate of goods exports will quicken slightly over the quarter, against the background of recovery in the euro area and continuing gains in competitiveness. In turn, the tourism indicators presage robust growth in activity in the sector, which might reach new historical highs in Q2. Also estimated is greater buoyancy in imports from the rest of the world, associated with the consumer durable and investment good components, in line with the intensity of the pick-up in household and business spending.

Turning to the labour market, the already-high growth rate of employment quickened somewhat in Q2, with a further rise in Social Security registrations in industry and market services, and continuing high job creation rates in the remaining productive sectors. In turn, registered unemployed numbers in the National Public Employment Service (SEPE) fell significantly (7.8% in May). Against this backdrop, the estimate is for a year-on-year rate of change in employment in QNA terms of around 0.9% in Q2 and for a further decline in the unemployment rate. Labour costs have continued on a path of wage moderation over the most recent period, with an agreed rise under collective bargaining of 0.7% in May, although the number of signed agreements remains low. The signature by the social agents of the third Accord on Employment and Collective Bargaining, on 8 June (which, inter alia, sets out recommendations for wage increases up to 1% in 2015 and 1.5% in 2016, conditional upon inflation developments), might smooth the negotiations under way; however, it would be highly desirable that these recommendations be adopted with sufficient flexibility as to take into account the disparity of starting situations and levels of productivity growth facing firms and sectors of activity.

19.6.2015.

The update of the Spanish macroeconomic projections for the period 2015-2016 set out in this box is based on the contribution by the Banco de España to the Eurosystem's joint forecasting exercise for the euro area economy, which was published by the ECB in early June.[1] The projections have been adapted to include the Quarterly National Accounts (QNA) information for 2015 Q1 and the latest developments in the technical assumptions (see Panel 1).[2]

On these projections, the upturn in the Spanish economy's output is projected to continue over the two-year period 2015-2016. Specifically, this year, GDP growth is expected to reach 3.1% in annual average terms, a rate resulting from highly dynamic activity in the first half of the year and a gradual slowdown subsequently, which would run into 2016, meaning that the average annual increase in GDP in this latter year would be 2.7% (see Panel 2). This easing in the GDP growth rate would be attributable to the foreseeable softening of some of the expansionary impulses arising from the fall in oil prices and the depreciation of the euro.

Compared with the projections published in the March *Economic Bulletin*, GDP growth has been revised upwards by 0.3 pp in 2015 further to the inclusion of the QNA estimates for Q1 and the conjunctural information for Q2. In both cases these data were more favourable than those projected three months back, since the changes in the external assumptions in this same period have been limited. The GDP growth rate for 2016 as a whole does not differ from that projected in March. As was then the case, the increase in GDP over the projection horizon will be essentially determined by the robustness of domestic demand, set against the continuing firmness of employment and of household and business financing conditions, and by the progressive strengthening in exports.

With regard to the external assumptions, export market projections have scarcely changed. Indeed, although the outlook for demand in certain emerging regions has worsened somewhat over the past three months, this has been countered by the improvement in the projections of imports originating in the rest of the euro area. Further, the change in oil prices both on spot and futures markets from 2015 to 2016 is small, having risen modestly in comparison with the levels observed at the start of spring. The projected path for the exchange rate of the euro against the dollar is similar to that set out in the March exercise. Nor are there significant changes in the expected course of the three-month Euribor interest rate, while the changes are on a greater scale in the case of 10-year government bond yields; according to expectations implicit in the yield curve, both variables have risen in relation to the previous exercise to levels of 2% and 2.7%, respectively, in each of the two years of the projection horizon. However, these developments involve a more modest revision to the cost of household and business financing, due partly to the fact that short-term rates, whose weight is significant in determining total financial costs for these agents, have scarcely varied during this period.

1 The aggregate projections for the area as a whole were submitted to the ECB Governing Council on Wednesday, 3 June, and published on that same date on the ECB's website.

2 Specifically, the Eurosystem's projections were prepared with information relating to the external assumptions available up to 12 May, while in the case of the projections presented in this box, the data cut-off date is 15 June.

1 INTERNATIONAL ENVIRONMENT AND MONETARY AND FINANCIAL CONDITIONS (a)

Annual rates of change, unless otherwise indicated

		Current projection		Change from March 2015 projection	
	2014	2015	2016	2015	2016
International environment					
World output	3.4	3.2	3.8	-0.3	0.0
Global markets	2.9	2.6	5.0	-1.2	0.0
Spain's export markets	3.0	3.4	5.0	-0.1	0.1
Oil price (in USD)	98.9	61.8	68.1	3.1	3.7
Monetary and financial conditions					
Dollar/euro exchange rate (USD per euro)	1.3	1.1	1.1	0.0	0.0
Short-term interest rate (3-month EURIBOR)	0.2	0.0	0.1	0.0	0.1
Long-term interest rate (10-year bond yield)	2.7	2.0	2.7	0.7	1.3

SOURCES: ECB and Banco de España.

a Projections cut-off date: 15.06.2015.

The fiscal assumptions include the budgetary measures approved after the March macroeconomic projection exercise. Specifically, the information contained in the updated Stability Programme submitted by the Government to the European Commission on 30 April, and which is detailed in Box 4 of the Spanish original of this report, is included here.

Projected GDP growth in 2016 is underpinned by the momentum of domestic demand which is expected to contribute 3.1 pp in 2015 and 2.7 pp in 2016 to the increase in GDP, while net external demand is estimated to make a practically neutral contribution both in 2015 and in 2016. Current projections envisage that household consumption will grow by 3.4% in 2015, mainly boosted by the notable improvement in labour market conditions and, more temporarily, by the positive effect on household disposable income of the decline in oil prices and the reduction in direct taxation. The gradual loss of momentum of the latter factors over the projection horizon is expected to give rise to a moderation in the buoyancy of private consumption with the result that the attendant average annual rate of change would slow to 2.3% in 2016.

Business investment is expected to continue to grow robustly in a setting of strong final demand and favourable financial conditions, in which there is a continuing need to increase existing capital. The nascent stabilisation of the housing market, both in terms of prices and amounts, will pave the way for a gradual, moderate recovery in residential investment against the backdrop of a relatively still-high stock of unsold housing units.

In the area of foreign trade, exports are anticipated to move on a rising path, boosted by the gradual recovery of export markets, which will be more pronounced in 2016, and by the lagged effects of the recent euro depreciation. Imports are expected to remain buoyant in line with final demand. As a result of these changes in real trade flows and the projected path of foreign trade deflators, it is expected that the goods and services balance will continue to run a slightly higher surplus than that seen in 2014 over the projection period.

The current projections envisage that the robust job creation and wage moderation observed since the beginning of the recovery will continue. The increase in employment will entail further reductions in the unemployment rate which, however, will be tempered by the modest rise projected in the labour force.

The projections for consumer prices have hardly changed in comparison with the March exercise. As indicated above, the changes in the external assumptions were very small and the data of recent months have broadly confirmed the projections made at that time. In the projection period, inflation is expected to rise, partly owing to the moderate increase in oil prices indicated by

2 PROJECTIONS OF THE SPANISH ECONOMY'S MAIN MACROECONOMIC VARIABLES (a)

Annual rate of change in volume terms and % of GDP

		Current projection		March 2015 projection	
	2014	2015	2016	2015	2016
GDP	1.4	3.1	2.7	2.8	2.7
Private consumption	2.4	3.4	2.3	3.3	2.4
Government consumption	0.1	0.1	0.1	-0.4	-0.1
Gross fixed capital formation	3.4	5.9	6.1	5.9	6.7
Investment in capital goods and intangible assets	12.2	8.8	8.9	9.1	9.1
Investment in construction	-1.5	4.8	4.5	4.1	5.1
Exports of goods and services	4.2	5.1	5.7	5.2	5.8
Imports of goods and services	7.6	5.3	5.9	6.2	6.3
National demand (contribution to growth)	2.2	3.1	2.6	3.0	2.7
Net external demand (contribution to growth)	-0.8	0.0	0.1	-0.2	0.0
Nominal GDP	0.9	3.3	3.3	3.2	3.4
GDP deflator	-0.5	0.2	0.6	0.4	0.7
Consumer price index (CPI)	-0.2	-0.2	1.3	-0.2	1.2
Employment (full-time equivalents)	1.2	2.9	2.6	2.7	2.6
National economy's net lending (+)/net borrowing (–) (% of GDP)	1.0	1.2	1.1	1.0	0.8

SOURCES: Banco de España and INE.
Latest QNA figure: 2015 Q1.

a Projections cut-off date: 19.06.2015.

futures markets and partly due to higher core index prices, as a result of the impact of the euro deprecation and the reduction in the degree of slackness in the economy. The growth rate of the CPI is estimated to turn positive in the final stretch of 2015 and to quicken moderately thereafter, although it would not reach levels of close to 2% until after the end of the projection horizon. In terms of the GDP deflator, it is estimated that price growth might average 0.3% in 2015 and 0.6% in 2016.

The risks surrounding the baseline scenario for GDP growth are balanced. Some degree of uncertainty about potential developments in the euro area persists. Similarly, a potential worsening of the existing geopolitical conflicts would adversely affect the growth path described in these projections, as would a worse-than-projected performance of certain emerging and advanced economies outside the EU. On the domestic front, uncertainty about the medium-term reform agenda could diminish agents' confidence. Conversely, it cannot be ruled out that the effects of some of the impulses currently operating may extend beyond the baseline scenario, with the result that the strong rate of recovery in domestic demand observed in the most recent period may continue in the coming months. For instance, it is difficult to accurately estimate the effects of the considerable non-standard measures adopted by the Eurosystem on financing conditions, the exchange rate and credit and, in particular, the possible delays in their positive effects on activity.

As regards inflation, since the previous projections were published in March, the risks of deviation are skewed slightly to the upside. Specifically, coinciding with the simultaneous application of the latest extraordinary monetary policy measures adopted by the ECB, the risks of a possible disanchoring of inflation expectations have fallen notably. In fact, the various indicators available point to a slight increase in these expectations in recent months which, if they hold in the future, could contribute to increasing the inflation rate at a faster pace than that envisaged in the baseline scenario. That said, the degree of uncertainty about the future path of oil prices remains high, weighing on the projected path of inflation.