

MACROECONOMIC PROJECTIONS FOR THE SPANISH ECONOMY (2021-2023): THE BANCO DE ESPAÑA'S CONTRIBUTION TO THE EUROSISTEM'S JUNE 2021 JOINT FORECASTING EXERCISE

Overview

After its Governing Council meeting on 10 June, the European Central Bank (ECB) released its latest projections for the euro area, covering the period 2021-2023.¹ This box describes the projections for the Spanish economy that constitute the Banco de España's contribution to these aggregate euro area forecasts. The projections for Spain include the new information that has come to light in the period from the publication date of the previous projections (23 March, in *Economic Bulletin 1/2021*²) to 27 May.

The recovery the Spanish economy embarked on in the second half of last year was interrupted in 2021 Q1, when GDP fell by -0.5%, according to INE's preliminary estimates (a rate very close to the Banco de España figure of -0.4% in its March baseline scenario). This fall-off in output was in a setting in which the rise in the incidence of the pandemic around the turn of the year made a tightening of the measures applied to contain it necessary, and in which other temporary factors (including the snowstorm in early January and the blocking of the Suez Canal) also exerted something of an adverse impact on economic activity. In any event, the decline in the incidence of the pandemic as from early February allowed for a gradual easing in restrictions, which was conducive to a progressive improvement in activity over the course of the quarter.

On the latest information available, this rebound in activity has stepped up notably in Q2, in line with the more favourable course of the pandemic. Specifically, progress in the vaccination campaign has led to a reduction in infections which, since they are moreover concentrated in younger population groups, has given rise to a fall in the proportion of serious cases and, therefore, of deaths. That has provided for a gradual easing of the lockdown

measures, marked most notably by the end of the state of alert on 9 May.

The improved conjunctural data is particularly patent in firms' response to the latest edition of the Banco de España Survey on Economic Activity (EBAE by its Spanish acronym),³ in effective Social Security registrations (i.e. discounting furloughed workers) and in the confidence indicators. In all instances, a common feature is that the recovery is sharper in services, in keeping with the partial lifting of the restrictions that weighed on those activities in which social interaction plays a key role. And that, in short, is – from the standpoint of the productive sectors – widening the base underpinning the recovery. By way of example, the PMI services index has stood since April, for the first time in almost a year, at levels consistent with the expansionary behaviour of the sector's value added.

In light of this information, GDP is expected to rise significantly in quarter-on-quarter terms in Q2. However, the uncertainty over the scale of this rebound is high. First, estimates from the short-term models are beset by the logical constraints derived from the relative shortage of data for Q2. In particular, there is no quantitative information on developments in activity in June, and that for May is very limited. Further, interpreting the incoming data has become more complex as from this quarter because the year-to-year comparisons have lost much of their informativeness (since they are set against the months in 2020 subsequent to the outbreak of the pandemic).⁴ Given the caution these considerations demand, it is estimated that GDP growth in Q2 could rise to 2.2% quarter-on-quarter under the baseline scenario of these projections.

Despite the favourable recent developments, the economic outlook for the rest of the year remains greatly

1 See the [Eurosistem staff macroeconomic projections for the euro area, June 2021](#).

2 Compared with the [Macroeconomic projections in Spain \(2021-2023\)](#), published as Box 1 of the "Quarterly report on the Spanish economy" in *Economic Bulletin 1/2021*, the current projections include the changes observed between 16 March and 18 May in the technical assumptions, in the budgetary assumptions and in the projected course of the external setting of the economy (except regarding the euro area, for which the data cut-off date is 26 May). Furthermore, the projections include the Quarterly National Accounts (QNA) preliminary estimates for 2021 Q1.

3 M. Izquierdo (2021), *Encuesta a las empresas españolas sobre la evolución de su actividad (EBAE): tercera edición*, Notas Económicas, *Economic Bulletin 2/2021*, Banco de España.

4 Further, from a more technical perspective, the difficulties the models are experiencing in correctly interpreting the incoming data (given that these are more influenced by the ups and downs of the pandemic and the restrictions adopted to counter its effects than they are by the changes in economic dynamics) are being compounded in these months, because of the diminished capacity of the procedures to isolate the purely seasonal component of the series.

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influenced by the uncertainty as to the time horizon needed to fully overcome the health crisis. The current acceleration in the ongoing vaccination rollout is contributing, as indicated, to containing the rate at which the pandemic is spreading. And that provides a favourable setting for the Spanish economy to embark upon a sustained growth phase. Yet, on the other hand, the very lifting of the containment measures is checking the decline in the rate of reproduction of the virus, which prevents fully ruling out the possibility of a fresh outbreak of the pandemic, as shown by the experience of some economies which have moved forward more swiftly than Spain in the vaccination process. These difficulties in fully controlling the virus in the short term, which also – naturally – affect other economies in our orbit, are significant for Spain insofar as our productive structure rests to a greater extent than in other countries on tourism, a fact all the more important given the proximity of the summer high season. Specifically, drawing on the tourist sector's latest forecasts, it is estimated under the baseline scenario of these projections that tourism exports will post, in Q3 this year, a level close to 50% of that recorded in the same period in 2019 (see Chart 2).

In line with the official forecasts, the projections consider that, by late August, 70% of the Spanish population will have been vaccinated. Thereafter, it would be possible to take further steps towards lifting and ultimately eliminating the containment measures by end-2021.⁵ Under this assumption, activity in Spain as from the second half of this year would cease to depend on epidemiological considerations.

The projections envisage a continuation of the surge in activity until end-2021, in step with the pick-up in the productive sectors that have so far been most affected by the pandemic-related restrictions. The increase in output will be boosted, moreover, by a series of additional factors. First, the outlook for growth in Spain's trading partners is gradually improving, assisted by the ongoing support of economic policies globally.⁶ The recovery in world markets is being led by the advanced economies, whose progress in terms of

vaccination has been much greater than that of the emerging countries taken as a whole. The improvement in Spanish export markets has been particularly marked in the cases of the United States – where the economic outlook has been assisted by the recent fiscal policy announcements – and, to a lesser extent, the United Kingdom.

Moreover, the monetary policy measures adopted by the ECB to date and the fiscal policy measures in Spain will continue, over the projection horizon, to provide considerable support to aggregate demand and to private agents' incomes. That will restrict, under this baseline scenario, the scarring the crisis may leave on the productive system and labour market (in terms of the destruction of firms and of increased structural unemployment). Also, that would limit the scale of the phenomena involving the financial amplification of the crisis, resulting from the “doom loop” of worsening solvency of households and firms on one hand, and of financial institutions on the other. Among the economic policy measures that will be conducive to increasing the pace of activity, it is specifically worth mentioning the Next Generation EU (NGEU) programme.

Compared with the March exercise, the overall impact of the changes in the current projection assumptions on economic growth is positive. Specifically, the favourable effects on activity of the more dynamic performance of external markets exceed the negative impact of certain other assumptions, including in particular higher crude prices and, to a lesser extent, the appreciation of the exchange rate.

In consequence, GDP growth is expected to reach 6.2% in 2021 overall (see Chart 3 and Table 1). The period of high output growth rates up to the end of 2021 will be followed by another period of more moderate growth up to the end of the projection horizon. However, the strong economic momentum during the rest of this year will give rise to a significant carry-over effect on the average rate of change of GDP in 2022, of 5.8%. In 2023, GDP growth will slow to 1.8%.⁷ GDP will not return to its pre-

5 The EU vaccination strategy calls on Member States to accelerate vaccine rollout, so that “by summer 2021, Member States should have vaccinated a minimum of 70% of the adult population”.

6 The assumptions on export market developments, which are set out in greater detail in Annex 1, are drawn from the Eurosystem staff macroeconomic projections for the euro area, June 2021.

7 See J. González Mínguez and C. Martínez Carrascal (2019), “The relationship between average annual and quarter-on-quarter GDP growth rates: implications for projections and macroeconomic analysis”, Analytical Articles, *Economic Bulletin* 3/2019, Banco de España.

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pandemic level until the last part of 2022, and will be 1.9% above that level at the end of the projection horizon. This suggests that the impact of the health crisis, albeit temporary, will be relatively persistent (see Chart 4).

These projections, in comparison with those published in March, include an upward revision of GDP growth for 2021 and 2022 (of 0.2 pp and 0.5 pp, respectively), which

reflects the positive impact on activity of the change in the projection assumptions and the greater dynamism of GDP in the current quarter. This offsets the modest negative effects associated with the revision of the historical data.⁸

The uncertainties relating to the pandemic and its economic consequences

The level of uncertainty surrounding the course of the pandemic has decreased significantly since the last

Chart 1
TOURISM EXPORTS (2019 = 100)

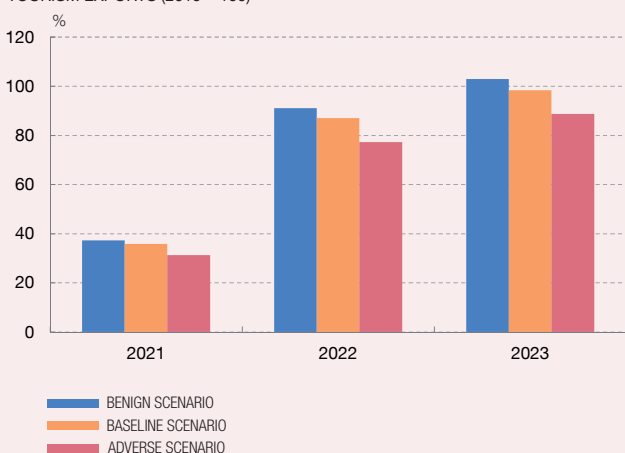
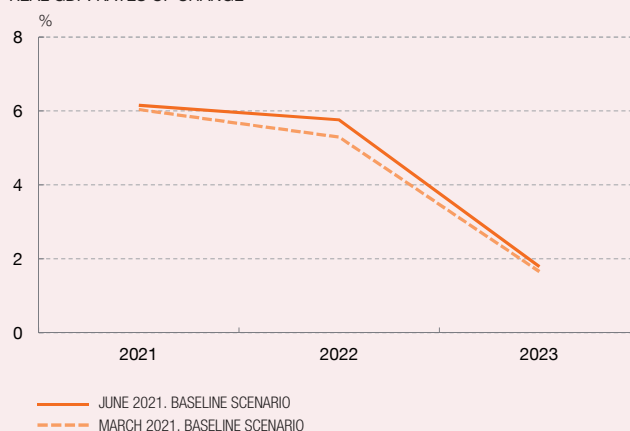


Chart 2
REAL GDP. RATES OF CHANGE



SOURCES: Banco de España and INE.

Chart 3
REAL GDP. LEVEL (2019 Q4 = 100)

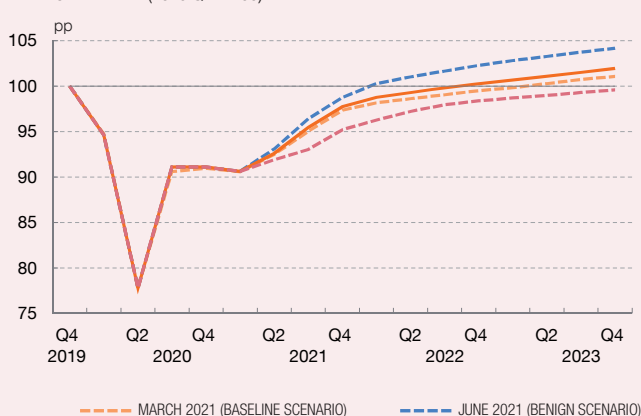
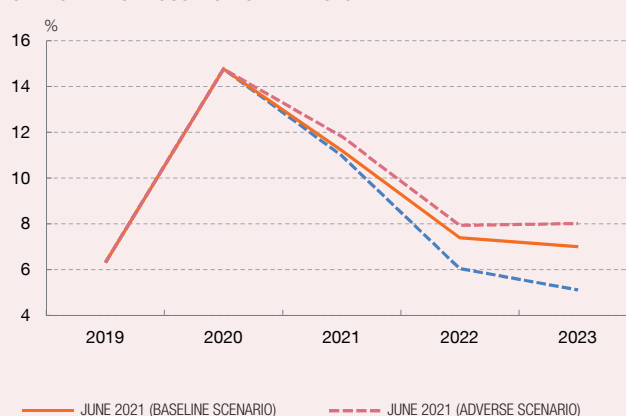


Chart 4
SAVING RATE OF HOUSEHOLDS AND NPISHs



SOURCES: Banco de España and INE.

⁸ According to the INE flash estimate, the quarterly decline in GDP in Q1 was 0.1 pp more than that envisaged in March under the baseline scenario. The latest Quarterly National Accounts figures also entailed minor revisions to the growth rates of the previous two quarters. All this means that the starting point of the level of activity for these forecasts is somewhat less favourable, from the standpoint of the annual average growth rate in 2021, than was anticipated under the baseline scenario published in March.

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projection exercise. However, as described above, these uncertainties are still relatively high, especially in the very short term. In addition, even when the health crisis is over, the consequences of the pandemic will remain. These consequences may take very different forms, ranging from possible scarring in terms of destruction of the productive system and higher long-term unemployment, to changes in economic agents' behaviour. In view of these sources of uncertainty, and as has been the case since the start of the pandemic, two alternative scenarios are formulated, the benign and the adverse scenario.

In the very short term, the differences between the two scenarios are warranted, as indicated above, by the scant volume of data available at the current juncture on 2021 Q2 and by their hard-to-calibrate relationship with economic activity, in a setting in which the relationship between this variable and the mobility indicators has recently tended to become less stable.

In the second half of 2021, one of the aspects that changes in the different scenarios is the course of the pandemic. The alternative scenarios include the same vaccination timeline as the baseline scenario, since considerably fewer uncertainties are now envisaged in this respect. Under the benign scenario the decline in the incidence of the pandemic observed in recent weeks continues, enabling the easing of the remaining restrictions

on economic activity to be brought forward. By contrast, the adverse scenario envisages the possibility of fresh infections, possibly linked to the appearance of variants of the virus that are more infectious and may be resistant to vaccines, requiring the re-establishment of restrictions on movement and on some economic activities that entail high levels of personal contact. These alternative assumptions are critical to determine the rate of recovery of tourism in the summer months.

In 2022 and 2023 the differences between the various scenarios are not related to the course of the pandemic, but they do have as a common denominator the uncertainty surrounding the economic consequences of the pandemic in the medium term, insofar as possible changes in economic agents' behaviour are concerned, and also the possible scarring of the Spanish productive system as a result of the crisis.

Possible changes in households' behaviour have direct implications for two components of aggregate demand: private consumption and tourism flows. In the case of private consumption, the pandemic has triggered a huge surge in the household saving rate, given that households have substantially reduced their current expenditure in a setting in which their income has scarcely been affected thanks to the economic policy measures adopted.⁹ This increase in the saving rate has been partly forced by the

Table 1
MACROECONOMIC PROJECTIONS FOR THE SPANISH ECONOMY (a)

Annual rate of change

	GDP				Harmonised index of consumer prices (HICP)				HICP excluding energy and food				Unemployment rate (% of labour force) (b)			
	2020	2021	2022	2023	2020	2021	2022	2023	2020	2021	2022	2023	2020	2021	2022	2023
June 2021 (baseline scenario)	-10.8	6.2	5.8	1.8	-0.3	1.9	1.2	1.2	0.5	0.3	1.0	1.1	15.5	15.6	14.7	13.7
March 2021 (baseline scenario)	-11.0	6.0	5.3	1.7	-0.3	1.4	0.8	1.2	0.5	0.5	1.0	1.1	15.5	17.0	15.1	14.1

SOURCES: Banco de España and INE.

NOTE: Latest QNA figure published: 2021 Q1.

a Projections cut-off date: 27 May 2021.

b Annual average.

⁹ See "Household saving during the pandemic and its possible effects on the future recovery in consumption", Box 4, "Quarterly report on the Spanish economy", *Economic Bulletin* 1/2021, Banco de España.

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pandemic containment measures which made it impossible to consume certain goods and services. And it is partly attributable to more precautionary saving by households against the backdrop of uncertainty.

Over the projection horizon, the lifting of the measures imposed thus far to contain the virus will see the forced saving component disappear completely, while the lower uncertainty should lead the voluntary saving component to shrink. Under the baseline scenario, it is assumed that the saving rate steadily declines over the coming years, although the average for 2023 would remain somewhat above its pre-crisis level (see Chart 1). This implies that the high volume of savings built up since the onset of the pandemic would not be reduced. Several factors support this assumption. First, it is chiefly higher-income households that have saved and they have a lower propensity to consume. Second, the suppressed spending may not be easily recovered, since most would have been spending on services (such as hotels and restaurants, for example) that cannot be easily deferred (unlike spending on durable goods). Lastly, households may decide to voluntarily restrict their spending levels in anticipation of higher taxes in the future on account of the high volume of government debt built up during the crisis.

Under the benign scenario, it is assumed that households will use a portion of the savings built up in the form of liquid assets during the crisis to increase their consumption. The corollary to this would be a more pronounced reduction in the household saving rate compared with the baseline scenario, to stand below pre-crisis levels from 2022. By contrast, under the adverse scenario, more cautious behaviour by households will lead to a somewhat slower recovery in consumption, such that the saving rate will hold above pre-crisis levels throughout the projection horizon.

The pace of recovery in tourism exports also varies between the scenarios. This owes, in the near term, to the differing assumptions regarding the course of the pandemic and, from 2022, agents' attitudes towards spending, including the levels of precautionary saving they wish to maintain, how far the preference – seemingly observed since the onset of the pandemic – for domestic tourism is reversed and, in the case of firms, the resumption of business travel. At the end of the projection horizon, inbound tourism flows will stand close to pre-crisis levels under the baseline scenario and above pre-

crisis levels under the benign scenario. They will remain around 10% below pre-crisis levels under the adverse scenario.

As regards the fallout of the crisis on the productive system, as has been noted, the baseline scenario envisages moderate scarring at the aggregate level. As an example, in the labour market, the average expected unemployment rate in 2023 (13.7%) is 0.4 pp below that observed in 2019, the last year prior to the onset of the pandemic, yet this does not reflect a decline in the labour force, which on the contrary is expected to grow by 0.4% between 2019 and 2023 in average annual terms. Similarly, given the projected trajectory for non-financial corporations' gross investment and the pace of consumption of fixed capital, the corporate capital stock would be higher in 2023 than prior to the pandemic. These favourable developments partially reflect the effectiveness of the policies deployed to address the crisis, one of whose central aims was precisely to stave off any lasting damage to the economy's productive capacity. They also, in part, owe to the fact that, although the crisis has had a very severe impact on some sectors (such as hospitality), the bulk of the effects are likely to be temporary, since a priori these sectors were not oversized; this stands in contrast to the global financial crisis, when there was an evident need to reduce capacity in the construction sector.

However, despite these positive aspects, it cannot be ignored that the crisis may bring about far-reaching structural changes in the economy's productive system, requiring the reallocation of factors of production between different sectors and firms. Unlike the baseline scenario, the more benign scenario assumes that this reallocation of resources will be frictionless. By contrast, under the adverse scenario, the overindebtedness of some segments of the corporate sector, on account of the lengthy period of severely reduced revenue during the pandemic, will lead to a higher volume of business failures. The subsequent adverse impact on banks' capital ratios would drive up the cost of finance for households and firms, while also reducing its availability, with the ensuing adverse repercussions for economic activity.

Under the benign scenario, GDP growth in 2021 would be somewhat higher than under the baseline scenario throughout the projection horizon, which would allow GDP to stand 4.2 pp above the pre-crisis level at end-2023 (see

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Chart 4). By contrast, the more moderate pace of GDP recovery under the adverse scenario would see GDP remain slightly short of its pre-crisis level at end-2023.

Developments in the main macroeconomic aggregates in the baseline scenario

From the standpoint of the composition of aggregate demand, the projected recovery will rely mainly on the domestic component. However, the contribution of the external sector to GDP growth will also be positive over the three-year projection horizon.

All components of private domestic demand will rebound strongly this year after declining sharply in 2020 (see Table 2). Private consumption declined in 2021 Q1, affected by the tightening of the pandemic-containment measures at the start of the year. However, according to the indicators available, this aggregate has strengthened in the current quarter. This greater dynamism seems to be borne out by the lower accumulation of household bank deposits and the slight increase in consumer lending. As vaccines are rolled out, a loosening of the restrictions that, despite the easing in Q2, still constrain some activities is to be expected. This will allow the expansionary behaviour of this aggregate to continue.

Consumption will also benefit from the gradual recovery in the labour market and, as a result, in household income, where the weight of labour income will increase at the expense of public transfers. In addition, the gradual decline in uncertainty over the health and economic developments will likely favour a reduction in the precautionary component of saving and further boost household spending. As a result, consumption would rise by 7.1% in 2021 under the baseline scenario. In 2022, on average, the rate would still be high (5.7%) owing to the positive carry-over effect stemming from the strong growth expected between Q2 and Q4 this year. Consumption would reach its pre-pandemic level in early 2023.

Among the components of gross capital formation, residential investment is similarly expected to regain upward momentum as uncertainty is dispelled and future household income expectations, which have been

adversely affected by the deterioration in the labour market since the outbreak of the pandemic, improve. An additional factor that will boost growth in this aggregate is the implementation of the NGEU. In this regard, in the detailed description of how Spain would use the transfers it receives from the European Recovery and Resilience Facility, a large amount is allocated to housing rehabilitation, according to the Recovery, Transformation and Resilience Plan (RTRP).

In line with its expected recovery profile over the projection horizon, investment by non-financial corporations will be particularly buoyant in 2021 H2, spurred by the implementation of the NGEU, the recovery in final demand (which will increase capacity utilisation) and the gradual decline in uncertainty. The different productive sectors' digitalisation needs, which have increased after the pandemic, would also contribute to a rise in this aggregate, in a setting of low financing costs, although these are expected to increase somewhat.

In any event, productive investment will foreseeably behave unevenly across sectors. In particular, in those industries whose revenues have dwindled significantly as a result of the measures applied to contain the pandemic, there will be firms emerging from the health crisis with a weakened financial position. They are therefore more likely to face a shortage of funds with which to undertake new investments.¹⁰ In this respect, it should be noted, first, that this financial distress should be alleviated by the measures put in place to support viable firms in a vulnerable situation and, second, that the investment needs of these firms are unlikely to be high, at least in the short term, given their current low level of capacity utilisation.

The pandemic has had a significant impact on trade with the rest of the world. Its effect has proved much more short-lived in the case of goods flows, which have now returned to pre-crisis levels, than in tourism, as the restrictions still in place impinge much more strongly on the movement of people between different countries. However, a number of factors simultaneously at play at the beginning of the year dampened the vigour of goods exports. These include the shortage of electronic

¹⁰ See Chapter 3 "The effects of the COVID-19 crisis on the productive sectors in Spain: economic and financial implications", Annual Report 2020, Banco de España.

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components – which especially affected the car industry, whose share of Spanish goods exports is particularly high (11%) – and certain logistical difficulties associated with the implementation of Brexit or the Suez Canal obstruction. The first of these factors is relevant, insofar as there is a risk that it could persist to some extent throughout 2021. By contrast, the different stimulus packages announced in the United States (the destination of 5% of Spain's goods exports), which are included in the external assumptions of this projections exercise, will contribute positively to the buoyancy of goods exports.

In the case of tourism exports, the fresh wave of the pandemic in Spain between end-2020 and early 2021 and the consequent restrictions on movement and activity

meant that flows of tourists remained at very low levels in Q1. Looking ahead to the summer, the strides made with the vaccination campaigns in Spain and in the main tourism generating markets will only lead to a slight and partial recovery, insofar as sufficiently high levels of population immunity are yet to be achieved. In the projections, inbound tourism flows will not return to pre-health crisis levels until end-2023.

Imports will also recover gradually over the projection horizon, in tandem with the trajectory of final demand. Further, growth in imports will be underpinned by the high momentum of components with a larger import content, such as investment in capital goods and exports. Similarly to exports, tourism by Spanish residents in the rest of the

Table 2
PROJECTIONS FOR THE MAIN MACROECONOMIC AGGREGATES OF THE SPANISH ECONOMY (a)

Annual rate of change in volume terms and % of GDP

	2020	June 2021 projections								
		Benign scenario			Baseline scenario			Adverse scenario		
		2021	2022	2023	2021	2022	2023	2021	2022	2023
GDP	-10.8	6.8	7.0	2.2	6.2	5.8	1.8	4.6	5.2	1.7
Private consumption	-12.1	7.6	7.3	2.4	7.1	5.7	1.7	5.9	5.4	1.3
Government consumption	3.8	1.8	0.1	0.8	1.9	0.3	0.9	2.0	0.4	0.8
Gross fixed capital formation	-11.4	8.2	9.4	1.7	8.1	9.3	1.6	7.0	8.8	1.4
Exports of goods and services	-20.2	13.4	10.7	4.3	11.9	9.5	4.3	8.5	6.4	4.1
Imports of goods and services	-15.8	11.8	8.8	3.6	11.6	8.4	3.4	10.4	6.3	2.4
National demand (contribution to growth)	-8.8	6.1	6.2	1.9	5.9	5.3	1.4	5.0	5.2	1.2
Net external demand (contribution to growth)	-2.0	0.7	0.8	0.3	0.3	0.5	0.4	-0.4	0.0	0.5
Nominal GDP	-9.9	8.0	8.5	3.8	7.2	7.1	3.4	5.5	6.4	3.2
GDP deflator	1.1	1.1	1.4	1.7	1.0	1.3	1.6	0.9	1.2	1.4
Harmonised index of consumer prices (HICP)	-0.3	1.9	1.3	1.3	1.9	1.2	1.2	1.9	1.1	1.1
HICP excluding energy and food	0.5	0.3	1.1	1.3	0.3	1.0	1.1	0.2	0.8	1.0
Employment (hours)	-10.4	7.2	6.4	2.1	6.7	5.4	1.8	5.4	4.9	1.8
Unemployment rate (% of labour force). Annual average	15.5	15.2	13.7	12.8	15.6	14.7	13.7	16.2	15.7	14.6
Net lending (+)/net borrowing (-) of the nation (% of GDP)	1.1	1.9	3.7	3.7	1.5	3.1	3.1	0.8	2.1	2.3
General government net lending (+)/net borrowing (-) (% of GDP)	-11.0	-7.8	-4.1	-3.3	-8.2	-4.9	-4.3	-8.9	-5.9	-5.4
General government debt (% of GDP)	120.0	119.0	114.7	113.3	120.1	117.9	118.0	122.6	122.1	123.4

SOURCES: Banco de España and INE.

NOTE: Latest QNA figure published: 2021 Q1.

a Projections cut-off date: 27 May 2021.

world will remain very weak for a relatively extended period of time.

In the labour market, hours worked will return to an upward path as of Q2, in line with the recovery in output. Hours worked are projected to grow by 6.7% in 2021, subsequently moderating to 5.4% and 1.8% in 2022 and 2023, respectively. This recovery in employment would lower unemployment, which would fall below its pre-pandemic level as of end-2022.

The general government balance is expected to improve significantly over the projection horizon, after the acute deterioration in 2020. The decrease in the budget deficit will be due to the temporary nature of some of the discretionary measures adopted to contend with the fallout from the pandemic and to the cyclical improvement. Nevertheless, the general government deficit will still be very high in 2023 (4.3% of GDP). As a result of these budget balance developments and the projected path for nominal GDP, the government debt-to-GDP ratio, which in 2020 surged to 120%, would barely decline by 2 pp over the projection horizon.

Prices and costs

Since the early summer of 2020, core inflation has recorded rates of change of approximately zero. Such low growth rates are largely associated with the negative base effects stemming from the decline in the prices of the services hardest hit by the pandemic. The disappearance of these base effects as of summer 2021, together with the gradual recovery in demand for consumer goods and services, above all precisely in those sectors most adversely affected by the containment measures, appears to lead to gradual increases in the core inflation rate from mid-2021. Despite this upward pattern, core inflation will remain at moderate levels over the projection horizon to stand at 1.1% on average in 2023.

Headline HICP has increased considerably in 2021 to date. This is above all the result of the energy component, which is being highly influenced by the base effects stemming from the sharp drop in oil prices during the initial stages of the pandemic. In 2022, the marked deceleration in energy prices would comfortably offset the increase in the prices of services and, to a lesser degree, of non-energy industrial goods, such that the change in headline HICP would moderate to 1.2%, the level at which it would remain in 2023.

Risks

The macroeconomic outlook remains highly uncertain. Among these uncertainties, the share of purely epidemiological aspects has fallen, against a background in which the vaccines have proven highly effective against the virus and the immunisation of the population has accelerated. However, epidemiological developments will continue to have a bearing on activity in the coming quarters, given the possibility of fresh bouts of infections, linked to a potential spread of variants of the virus that are more infectious and, in the worst-case scenario, resistant to vaccines. The likelihood of a variant with such characteristics emerging in Spain is low, given the headway made with the vaccination campaign, which has significantly reduced the spread of the virus. However, the probability of episodes of this kind arising from cases imported from abroad is somewhat higher. Nevertheless, in terms of the pandemic, the greatest risk to economic activity is the possible emergence of more contagious strains in emerging economies where the virus is more widely spread and fewer strides have been made with vaccination.

Furthermore, as described above, economic risks exist that, while linked to the pandemic, are essentially associated with how consumers might use the savings reservoir they have built up since the onset of the crisis, the pace of the recovery in tourism exports and the persistence of the effects of the crisis on potential growth (via the possible impact on long-term unemployment and business deaths). How all these risks might materialise has been captured by constructing alternative scenarios.

Lastly, these scenarios have not factored in other sources of uncertainty, such as how quickly the projects under the NGEU programme will be implemented and the difficulties of measuring their multiplier effect on activity, and the scope of the public policies to ward off fall-out effects from the crisis, help reallocate resources and drive the economy's structural transformation.

All these factors that may result in activity drifting from the pattern considered under the baseline scenario are also sources of uncertainty regarding the path of inflation. Further, under the baseline scenario it is assumed that there will be limited pass-through to final prices and wages of the higher input costs for firms. Otherwise, this would result in greater inflationary pressure. In the

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opposite direction, the response of consumer prices to the recovery in demand could be weaker than that included in the baseline scenario, in light of the low sensitivity of the former of these variables to the latter in recent years.

Considered overall, all these elements result in a risk profile that is balanced in relation to the projections' baseline scenario in terms of both activity and prices.

ANNEX 1

Projection assumptions

The assumptions are taken from the “June 2021 Eurosystem staff macroeconomic projections for the euro area”. The cut-off date for the data included in the projections is 18 May in all cases, except for Spain's euro area export markets, for which it is 26 May. The assumptions regarding the paths of interest rates, exchange rates, and oil and other commodity prices are based on the prices observed in the respective markets in the 10 working days prior to that date. The paths for export markets and the prices of competitors in their domestic currency have been prepared by Eurosystem staff.

In comparison with the March scenarios, some notable changes to the assumptions used for the baseline scenario have been made. First, export market developments are now expected to be more favourable than was anticipated three months ago, especially in 2021 and 2022, with upward revisions to growth rates of around 1pp in 2021 and 2022 and 0.3 pp in 2023 with respect to the March projections. Second, oil prices are now somewhat higher than anticipated in March, especially in 2022-2023. Following their sharp fall in 2020, oil prices increased notably in 2021, in line with the recovery in world demand. They are expected to stand on average this year at \$65.8 per barrel, an upward revision to the March assumption of 1.4%. Subsequently, they are expected to trend downwards, reaching \$61.9 in 2023 (5.2% higher than in the March projections exercise).

Third, non-energy commodity prices in 2021 have also been revised upwards significantly, with respect to March, but their subsequent downward trend is also more marked, so that in 2023 they will be somewhat lower than was anticipated three months ago.

The other changes to the external assumptions used in March are more modest and, consequently, have a smaller impact on the projections. The euro exchange rate (assumed in the projection horizon using its spot market rate) has appreciated slightly compared with three months ago. The appreciation with respect to March is somewhat greater against the dollar than in nominal effective terms, but is no more than 2% in either case.

Lastly, the yields on securities traded on 10-year sovereign bond markets have followed a slightly upward trend in recent months, and, as a result, are somewhat higher over the projection horizon than in the March projections exercise. As for market expectations of short-term interest rates, 3-month EURIBOR is assumed to rise slightly, from -0.5% in 2021 to -0.3% in 2023.

With regard to fiscal policy, the projections are based on the budgets for 2021 approved by the various tiers of government, as well as Spain's Stability Programme Update for 2021-2024 (SPU 2021) and the RTRP recently sent to Brussels. The latest available budget outturn data, based on National Accounts criteria and published by the National Audit Office (IGAE), are taken into account.

With respect to the previous quarter, the new extension, to September this year, of the special benefits for self-employed and furloughed workers approved on 27 May¹¹ is incorporated, as are subsidies to businesses with viability problems as a result of the pandemic, which were approved in March.¹² Also, the estimate of the revenue from the new taxes introduced at the beginning of this year or currently pending approval is revised slightly

11 The conditions applicable to the self-employed and employees whose activity is suspended due to COVID-19 are slightly revised for this extension. Most notably, however, new exemptions from social contributions are introduced for workers returning to their jobs and for the self-employed who were receiving benefits on 31 May (see Royal Decree-Law 11/2021).

12 These measures include: €7 billion in the form of direct subsidies to businesses, €3 billion for debt restructuring and €1 billion for capital injections (see Royal Decree-Law 5/2021). The negative impact on the general government balance is €10 billion, since the capital injections raise general government financial assets and debt, but do not affect the budget balance. The projections assume that the bulk of this impact will take place in 2021 (€8.5 billion).

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downwards.^{13 14} All in all, the net overall impact on the general government deficit of the measures approved for this year amounts to 2.1 % of GDP (2 pp less than in 2020).

Also, the assumptions on absorption by Spanish general government of the NGEU funds have been revised in the light of the new information contained in the RTRP (which, following its presentation on 30 April, must be approved

shortly by the European authorities) and the SPU 2021. The degree of detail on the projects to be undertaken using NGEU funds is now greater. However, a considerable degree of uncertainty still remains regarding the rate at which these funds can be absorbed by Spanish general government and, consequently, regarding the timing of their use. The new projections for 2021 incorporate around 50% of the amount announced by the Government

Table 3
INTERNATIONAL ENVIRONMENT AND MONETARY AND FINANCIAL CONDITIONS (a)

Annual rate of change, unless otherwise indicated

	2020	June 2021 projections			Difference between the current projections and those of the corresponding scenario of March 2021 (b)			
		2021	2022	2023	2021	2022	2023	
International environment								
Spain's exports markets (c)	Benign scenario		10.0	7.7	3.5	-0.1	1.9	0.3
	Baseline scenario	-10.9	8.6	6.4	3.5	0.9	1.0	0.3
	Adverse scenario		5.1	3.3	3.3	1.6	0.3	-0.4
Oil price in dollars/barrel (level)	42.3	65.8	64.6	61.9	0.9	3.3	3.0	
Monetary and financial conditions								
Dollar/euro exchange rate (level)	1.14	1.21	1.21	1.21	0.01	0.02	0.02	
Nominal effective exchange rate against the non-euro area (d) (2000=100)	117.8	122.7	123.0	123.0	0.9	1.4	1.4	
Short-term interest rates (3-month Euribor) (e)	-0.4	-0.5	-0.5	-0.3	0.0	0.0	0.1	
Long-term interest rates (10-year Spanish government bond yield) (e)	0.4	0.5	0.9	1.1	0.2	0.3	0.3	

SOURCES: Banco de España and ECB.

- a Cut-off date for assumptions: 18 May 2021. Figures expressed as levels are annual averages; the figures expressed as rates are calculated on the basis of the related annual averages.
- b The differences are in rates for export markets, in levels for oil prices and the dollar/euro exchange rate, in percentages for the nominal effective exchange rate and in percentage points for interest rates.
- c The assumptions regarding the behaviour of Spain's export markets presented in the table are obtained from the June 2021 ECB staff macroeconomic projections for the euro area.
- d A positive percentage change in the nominal effective exchange rate denotes an appreciation of the euro.
- e For the projection period, the figures in the table are technical assumptions, prepared following the Eurosystem's methodology. These assumptions are based on futures market prices or on proxies thereof and should not be interpreted as a Eurosystem prediction as to the course of these variables.

13 This includes the new taxes on certain digital services and financial transactions and the tax increases included in the State Budget for 2021, as well as the new taxes on non-reusable plastics and waste, currently before Parliament. The estimated overall impact is revised slightly downwards on the basis of the latest information available and the latest government estimates included in the SPU 2021.

14 The impact on the 2021 public finances of the reversion to the State of various motorway sections owned by ACESA is also taken into account, as is the compensation of that company for construction work carried out (see SPU 2021).

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for this year, considering both funds from the RRM and from REACT-EU. For the projection horizon as a whole, absorption is expected to be slightly above 80% of the total funds available in the form of grants, the largest stimulus being concentrated in 2022.

Beyond 2021, and excluding the impact of the European funds, the forecasts are based on the usual technical assumptions. In particular, those items subject to greater discretionality -such as public investment and procurement, in particular, given their volume- are expected to grow in line with the growth potential of the Spanish economy. Also, in the absence of specific measures, the trajectory of the remaining items of the

general government accounts is assumed to be governed by their usual determinants.¹⁵

With these assumptions and forecasts for the fiscal policy variables, and given the output gap estimated in a manner consistent with the other macroeconomic projections, the fiscal policy stance, measured as the change in the primary structural balance, net of European funds,¹⁶ is expected to be clearly expansionary again in 2021 (1.8 pp of GDP) and slightly expansionary in 2022 (0.4 pp), becoming contractionary in 2023 (-1.0 pp). These changes reflect the fact that the largest annual stimulus from the European funds is estimated to occur in 2021.

15 Specifically, it is assumed that government revenue will grow in line with tax bases, which mainly depend on the macroeconomic context. The same applies to pension expenditure (determined by demographic trends and expected indexation of its amount to the CPI), spending on unemployment benefits (which depends mainly on developments in unemployment) and interest expense (the changes in which reflect developments in public debt and interest rates).

16 The European NGEU funds to be received entail a smaller structural deficit, but not a more contractionary fiscal policy stance, as they do not result from taxes collected from resident agents. Consequently, to correctly measure the fiscal policy stance, the change in the primary structural balance must be adjusted for this effect by subtracting the change in the net balance of funds from the European Union.