MACROECONOMIC PROJECTIONS FOR THE SPANISH ECONOMY (2023-2025)

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This section describes the key features of the most recent update to the Banco de España's macroeconomic projections for the Spanish economy, the final version of which was completed in early March, before the appearance of tensions on the international financial markets. Under the assumptions of the exercise, Spanish GDP – which grew by 5.5% in real terms in 2022 – is projected to rise by 1.6%, 2.3% and 2.1% in 2023, 2024 and 2025, respectively (see Table 1).[1] On the price side, headline inflation – which stood at 8.3% on average in 2022 – will fall to 3.7% in 2023, before remaining virtually unchanged in 2024 (at 3.6%) and declining to 1.8% in 2025. Meanwhile, underlying inflation will stand at 3.9% this year (0.1 percentage points (pp) higher than in 2022) before slowing to 2.2% and 1.8% over the next two years.

Activity

Economic activity in Spain was lacklustre in the last quarter of 2022. Specifically, as per the flash estimates published by the National Statistics Institute (INE), GDP grew by 0.2% (unchanged on Q3), 0.1 pp more than predicted by the Banco de España in its December projections.[2] In the last three months of 2022, high inflation and increasingly tight financial conditions made for a complex setting for private agents' spending decisions. Against this backdrop, falling domestic demand deducted 0.9 pp from output growth in Q4, with significant declines in private consumption and gross capital formation. Imports also fell, in line with this weaker domestic demand, and did so considerably faster than exports. Thus, in net terms, external demand made a positive contribution (of 1.1 pp) to GDP growth over this period. Moreover, at the same time as publishing the 2022 Q4 data, the INE also revised the figures for the rest of the year, indicating more robust activity than had previously been estimated, especially in the second quarter.

A combination of various adverse factors has continued to weigh down on business and household spending in early 2023. Such factors notably include the overall loss of household purchasing power since the start of the current inflationary episode. Although this decline has slowed, its persistence over recent months has gradually eroded the ability to counter its effects

1 The projections incorporate the new information that became available between the cut-off date of the previous projections and 2 March, the cut-off date of the current projections (save with respect to the assumptions regarding developments in export markets, which come from the European Central Bank (ECB)'s March macroeconomic projections for the euro area). Consequently, they do not include any information regarding the episode of significant financial market strain that began on 8 March. Conversely, the new information considered includes the flash Quarterly National Accounts (QNA) estimate for 2022 Q4 – which also entailed significant revisions to the data for the three preceding quarters – and the Quarterly Non-Financial Accounts for the Institutional Sectors (QNFAIS) for 2022 Q3, together with the higher-frequency information that has come to light since the previous projections were prepared. The projections also factor in the changes observed in the technical assumptions used as a starting point for projecting the different macroeconomic aggregates (see Table 2).

2 "Box 1. Macroeconomic projections for the Spanish economy (2022-2025): the Banco de España's contribution to the Eurosystem's December 2022 joint forecasting exercise". *Economic Bulletin - Banco de España,* 4/2022.

Table 1
Macroeconomic projections for the Spanish economy (2023-2025) (a)

Annual rate of change (%)

	GDP				HICP				HICP excluding energy and food				Unemployment rate (% of labour force) (b)			
	2022	2023	2024	2025	2022	2023	2024	2025	2022	2023	2024	2025	2022	2023	2024	2025
March 2023	5.5	1.6	2.3	2.1	8.3	3.7	3.6	1.8	3.8	3.9	2.2	1.8	12.9	12.7	12.3	12.0
December 2022	4.6	1.3	2.7	2.1	8.4	4.9	3.6	1.8	3.8	3.4	2.2	1.8	12.8	12.9	12.2	12.0

SOURCES: Banco de España and INE.
NOTE: Latest QNA figure published: 2022 Q4.

a Projections cut-off date: 2 March 2023..
b Annual average.

Table 2
International environment and monetary and financial conditions (a)

Annual rate of change (%), unless otherwise indicated

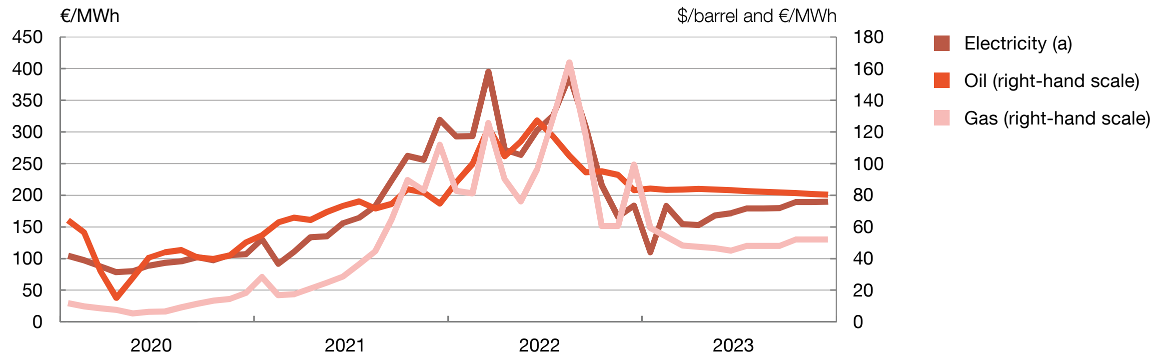
		March 2023 projections			Difference between the current projections and the December 2022 projections (b)		
	2022	2023	2024	2025	2023	2024	2025
Spain's export markets (c)	8.0	2.6	3.0	3.1	0.5	-0.1	0.0
Oil price in dollars/barrel (level)	103.7	81.9	77.2	73.6	-4.5	-2.5	-2.4
Monetary and financial conditions							
Dollar/euro exchange rate (level)	1.05	1.06	1.06	1.06	0.04	0.03	0.03
Nominal effective exchange rate against non-euro area countries (d) (2000 = 100)	112.1	114.0	113.9	113.9	2.8	2.6	2.6
Short-term interest rates (3-month EURIBOR. Level) (e)	0.3	3.5	3.7	3.2	0.6	1.0	0.7
Long-term interest rates (10-year Spanish government bond yield. Level) (e)	2.2	3.7	3.9	4.0	0.8	0.8	0.8

SOURCES: ECB and Banco de España.
NOTE: Latest QNA figure published: 2022 Q4.

a Cut-off date for assumptions: 15 February 2023 for Spain's export markets and 2 March 2023 for all other variables. 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, the dollar/euro exchange rate and 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 March 2023 Eurosystem 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.

Chart 1

1.a Energy prices



SOURCES: Mercado Ibérico del Gas, Operador del Mercado Ibérico-Polo Portugués and Reuters.

a Regulated rate for small consumers of electricity.

on spending by further reducing the saving rate.[3] Second, household and business spending has been affected (to an increasingly significant degree) by the progressive tightening of financial conditions since early 2022, due to a change in the monetary policy stance in the euro area in a context of high inflationary pressures. Specifically, since July last year the ECB has hiked its policy interest rates by 3.5 pp overall, 1.5 pp of which are the result of decisions adopted at its last three monetary policy meetings (in December 2022 and February and March this year). In step with this tightening of the monetary policy stance, the cost of borrowing by public and private agents has continued to rise in recent months. Indeed, in the specific case of bank lending, the rise in market interest rates has increasingly been passed through to the cost of new loans across all segments, as appears to be borne out by the slowdown in financing raised by firms and households, which is now showing a slight decline.

Cheaper energy prices have helped to counter these less favourable developments and have recently gone some way to boosting aggregate activity. In 2022 H2, the price of natural gas on the European and Spanish markets started to fall, a trend that has held in the opening months of 2023, thereby reversing – to a greater extent than initially envisaged – the negative supply-side shock that hit European economies particularly hard in the final stretch of 2021 and the first half of 2022 (see Chart 1). Indeed, this commodity is currently trading at levels similar to, or even lower than, the pre-Ukraine war price, thanks to the fall in demand – owing to the mild temperatures in the first half of winter and the measures rolled out to discourage consumption – and the diversification of supply sources. All of which means that Europe's gas reserves are more

3 In any event, the measures rolled out by the authorities to address the consequences of the energy crisis, which have been renewed on several occasions, have continued providing a degree of support to households' and firms' purchasing power. For an assessment of the impact of these measures on households by income level, see García-Miralles, Esteban (2023). "Support measures in the face of the energy crisis and the upswing in inflation: an analysis of the cost and distributional effects of some of the measures rolled out based on their degree of targeting", *Economic Bulletin - Banco de España,* 2023/1, 15. https://doi.org/10.53479/29769

plentiful than tends to be the case at this time of year, thus lessening the risk of supply cut-offs and helping to restore the confidence of economic agents and boost activity.

Moreover, the reopening of the Chinese economy after the country abandoned its zero-COVID policy has helped improve the global outlook for activity. In any event, the scale (and even the direction) of the effects of this reopening on global inflation dynamics are uncertain. On the one hand, in a context of fewer health restrictions in China, more robust activity in the Asian economy is likely to entail greater demand for goods produced elsewhere and for commodities, thereby exerting a degree of upward pressure on prices at a global level. This could, in turn, trigger a more contractionary monetary policy stance from some of the world's main central banks, such as the ECB. Conversely, the reopening of the Chinese economy could help to clear some of the bottlenecks that still remain in global production and logistics chains more quickly. This might help to mitigate the inflationary pressures that, although less acute than in previous quarters, still exist as a result of these mismatches between the global supply and demand for certain goods.

Overall, as a result of these developments and based on the as yet incomplete information offered by the most recent activity indicators, the Spanish economy appears to be performing somewhat better in the opening months of 2023 than had been anticipated in December. This is suggested, for instance, by the gradual improvement in confidence indicators seen in recent months. In terms of quantitative indicators, the pace of growth in social security registrations quickened in January and, above all, February, when compared with the final months of 2022. Moreover, tourism has continued to recover, as indicated by the statistics on overnight stays by foreign tourists, which in January reached the pre-COVID figures for the first time since the start of the pandemic. Meanwhile, according to the Banco de España Business Activity Survey (EBAE),[4] firms' perception of their turnover in 2023 Q1 was somewhat more encouraging than their expectations for this period in the previous round of the survey. With all of this in mind, subject to the caveats stemming from the partial nature of such information, quarter-on-quarter GDP growth is projected to stand at 0.3% in the first quarter of the year.

From spring onwards, economic activity is expected to gather momentum, albeit in a still highly uncertain setting in which various factors will continue to somewhat weaken the macro-financial dynamics of the Spanish economy. The faster pace of output growth will be helped, among other factors, by the expected easing of inflationary pressures – resulting in the recovery of agents' confidence and real income –, an end to the disruptions that still trouble global supply chains and the greater deployment of the Next Generation EU (NGEU) funds. However, economic growth will be constrained by a potential further tightening of financial conditions – in line with the current expectations on the financial markets –, as well as by the culmination of the pass-through of past market interest rate hikes to new lending rates and to the financial burden of borrowers – in other words, due to the delayed impact on activity likely to stem from the cumulative tightening of monetary policy that has already taken place.

4 Mario Izquierdo (2023). "Encuesta a las empresas españolas sobre la evolución de su actividad: primer trimestre de 2023", *Economic Bulletin - Banco de España*, 1/2023, Analytical Articles.

Table 3

Projections for the main macroeconomic aggregates of the Spanish economy (a)

Annual rate of change in volume terms (%) and % of GDP

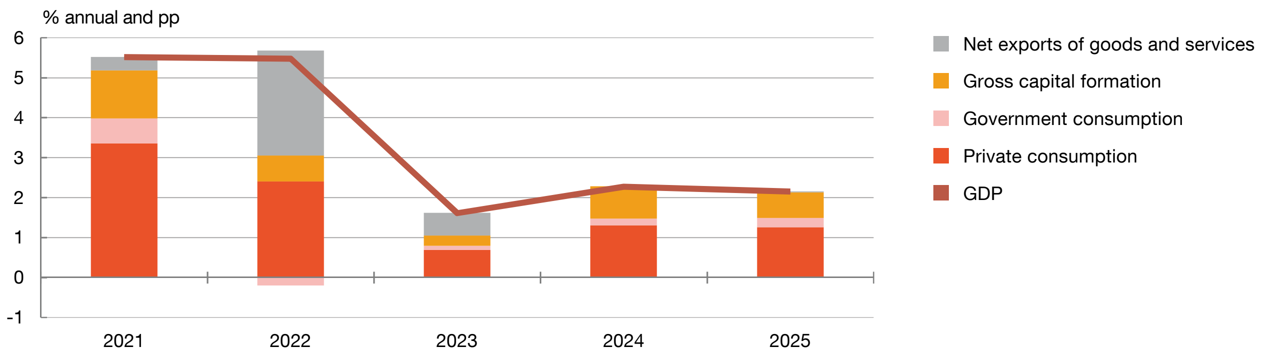
		March 2023 projections			December 2022 projections		
	2022	2023	2024	2025	2023	2024	2025
GDP	5.5	1.6	2.3	2.1	1.3	2.7	2.1
Private consumption	4.3	1.2	2.3	2.2	1.9	2.8	2.1
Government consumption	-0.9	0.5	0.8	1.2	0.3	0.9	1.2
Gross fixed capital formation	4.3	0.3	3.9	3.0	1.6	3.0	2.3
Exports of goods and services	14.9	3.1	2.9	3.0	3.8	3.0	3.1
Imports of goods and services	7.7	1.8	3.1	3.1	4.3	2.5	2.9
Domestic demand (contribution to growth)	2.9	1.0	2.3	2.1	1.4	2.4	1.9
Net external demand (contribution to growth)	2.6	0.6	0.0	0.0	-0.1	0.3	0.2
Nominal GDP	10.1	5.3	5.4	4.1	5.8	5.9	4.4
GDP deflator	4.4	3.6	3.0	1.9	4.5	3.2	2.2
HICP	8.3	3.7	3.6	1.8	4.9	3.6	1.8
HICP excluding energy and food	3.8	3.9	2.2	1.8	3.4	2.2	1.8
Employment (hours)	4.1	0.9	1.3	1.0	0.5	1.6	1.1
Unemployment rate (% of labour force). Annual average	12.9	12.7	12.3	12.0	12.9	12.2	12.0
Net lending (+)/net borrowing (-) of the nation (% of GDP)	2.1	2.3	2.1	1.5	2.1	2.4	2.3
General government net lending (+)/net borrowing (-) (% of GDP)	-4.6	-4.1	-3.5	-4.4	-4.1	-3.7	-4.5
General government debt (% of GDP)	113.1	111.1	108.8	109.9	110.6	108.8	109.8

SOURCES: Banco de España and INE.
NOTE: Latest QNA figure published: 2022 Q4.

a Projections cut-off date: 2 March 2023.

Chart 2

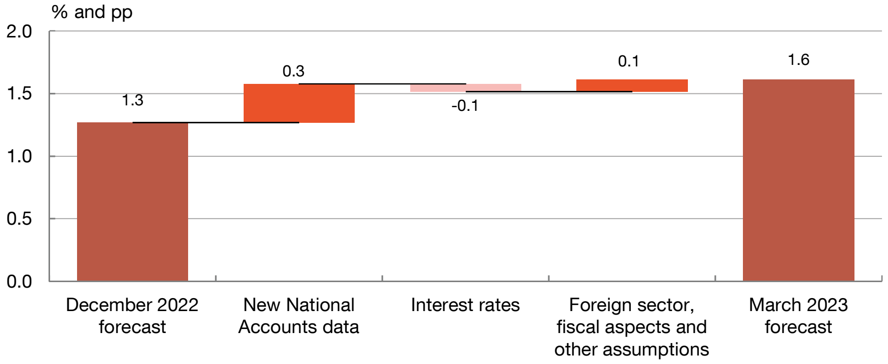
2.a GDP growth and contributions of main components



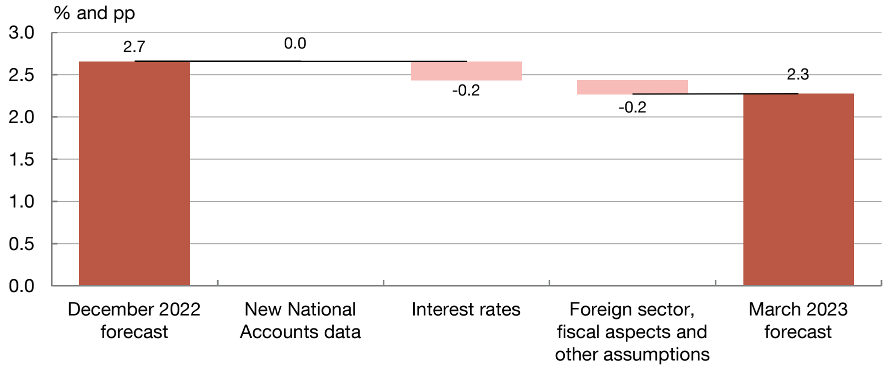
SOURCES: INE and Banco de España.

Chart 3

3.a Changes in the GDP growth forecast for 2023



3.b Changes in the GDP growth forecast for 2024



SOURCES: INE and Banco de España.

In average annual terms, GDP growth is set to slow substantially in 2023, to 1.6% (see Table 3 and Chart 2). The slowdown with respect to 2022 (of 3.9 pp) can be explained by weak activity in 2022 H2 – which exerts a negative carry-over effect[5] on the average GDP growth rate in 2023 – and the first quarter of this year, without this weakness ultimately being offset by the progressively higher growth expected in the rest of the year. Nonetheless, the increasing pace of output growth over the course of 2023 – based essentially on the recovery of private consumption and of gross capital formation – will yield an average annual growth rate of 2.3% in 2024, before slowing to 2.1% in 2025, a figure that would still exceed the Spanish economy's potential growth rate. Under the projected trajectory, Spanish GDP will return to its pre-pandemic level in the second half of this year.

Job creation will continue over the projection horizon, in line with the growth in activity. Despite the increase in the labour force, the unemployment rate will continue to fall thanks to rising employment.

5 José González Mínguez and Carmen Martínez Carrascal (2019), "The relationship between average annual and quarter-on-quarter GDP growth rates: implications for projections and macroeconomic analysis", *Economic Bulletin - Banco de España*, 3/2019, Analytical Articles.

As compared with those published three months ago, the current projections revise up GDP growth for 2023 by 0.3 pp (see Chart 3.a). This mainly owes to the flash QNA data for 2022 Q4, published by the INE in late January, and their carry-over effect on the annual average rate for 2023. As mentioned above, these provisional figures entail a substantial upward revision to the GDP growth rate for 2022 H1 and a slight positive surprise in output growth for 2022 Q4 compared with that envisaged in the Banco de España's December projections. The new assumptions underlying the projection exercise also have a slight net positive impact on GDP growth in 2023. In particular, the assumptions relating to overseas markets and fiscal variables are now somewhat more conducive to growth this year, offsetting the negative impact associated with the upward revision to the future path of interest rates. Conversely, the changes to the assumptions translate into a downward revision of 0.4 pp to GDP growth for 2024 (see Chart 3.b).

Prices and costs

Prices of energy consumer goods have declined significantly in recent months, causing annual energy inflation rates to turn negative since the beginning of the year. As noted above, gas prices in particular have fallen very sharply. Two further factors have also influenced energy price dynamics: (i) the discontinuance, at the end of last year, of the general subsidy of €0.20 per litre of fuel purchased (already factored into the baseline scenario of the Banco de España's December projection exercise), and (ii) the methodological change, introduced at the start of 2023, to the INE's measurement of electricity and gas price developments.[6]

Despite the sharp energy price correction, headline inflation climbed to 6% in February, ending the downward trend followed by this variable between July and December 2022 (see Chart 4.a). This reflected the broad-based pick-up in inflation across all non-energy aggregates: food (whose inflation rate has only partially been eased by the introduction of reduced VAT rates on some items since the start of the year),[7] non-energy industrial goods and services. In particular, underlying inflation rose from 4.1% in December to 5.2% in February, the highest level since the series began 1997. These underlying inflation developments probably owe to the fact that past increases in energy costs (which pass through with something of a lag) did not fully feed through to the final prices of consumer goods and services during 2022. Further, the downward stickiness of underlying inflation may also owe to potential pass-through asymmetries, whereby declining energy prices (such as those observed recently) may pass through less robustly or with a longer lag than rising energy prices (such as those seen during much of 2021 and in 2022 H1).

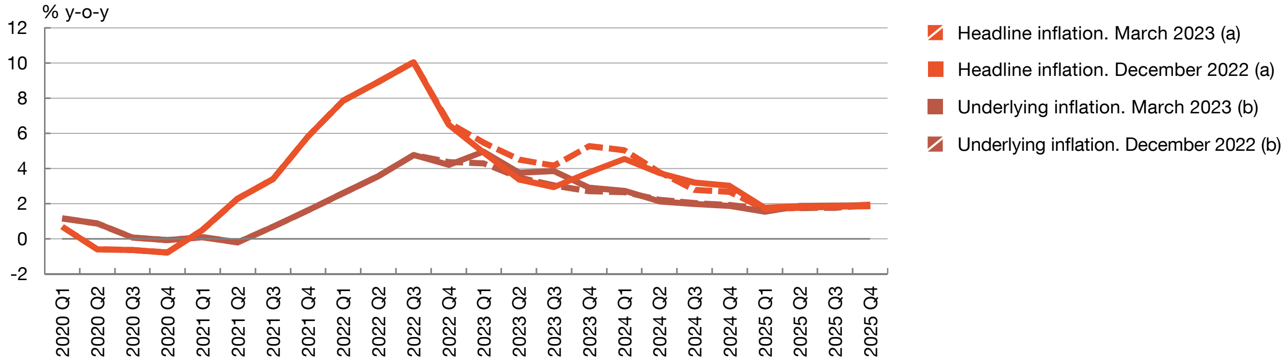
Headline HICP is expected to gradually ease from its current levels over the projection horizon. In 2023, this will largely be due to the expected decline in the energy component's

6 Since January, the INE has included free market contracts in its gas and electricity price calculations. Taken in isolation, it is estimated that this change increased headline inflation in January by 0.4 pp.

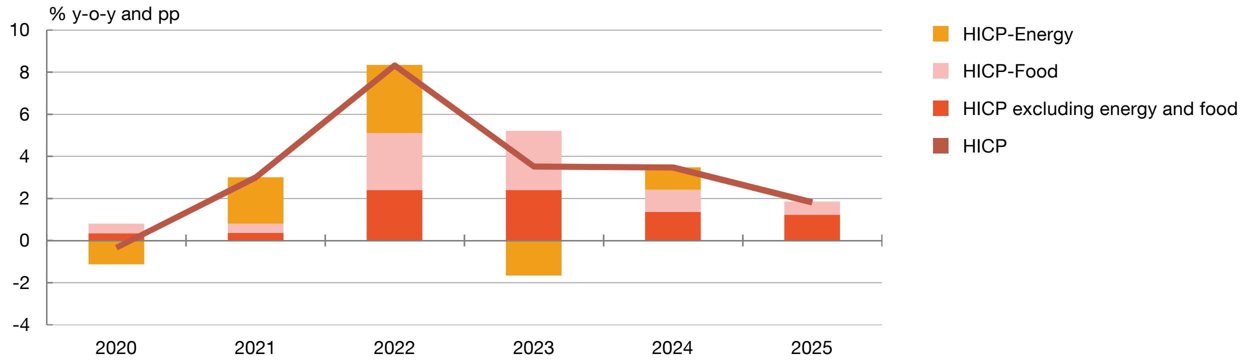
7 Royal Decree-Law 20/2022, of 27 December 2022, reduced the rate of VAT for the following foods from 4% to 0% until 30 June 2023: bread, baking flour, milk, cheese, eggs, fresh fruit, fresh vegetables, legumes, potatoes and cereals. The VAT rate on oil and pasta was reduced from 10% to 5%. However, if the year on-year rate of underlying inflation for the month of March is less than 5.5%, the VAT rates on all of these products will return to their previous level as of 1 May 2023.

Chart 4

4.a Headline and underlying inflation



4.b HICP: growth and contribution of components



SOURCES: INE and Banco de España.

a Measured by the HICP.
b Measured by the HICP excluding energy and food.

contribution to price growth (see Chart 4.b), which is driven by two main factors. First, negative base effects, since the year-on-year price growth for the coming months will be measured against price levels in the equivalent months in 2022, when the escalating energy crisis caused prices to soar. Second, based on futures markets, energy commodity prices are expected to decline over the coming months, leading to further reductions in fuel and gas prices. All of which will cause annual average inflation to ease from 8.3% in 2022 to 3.7% in 2023. The projections assume that the main measures deployed by authorities to mitigate the effects of the energy crisis will expire at end-2023, which would prevent any further significant reduction in the average headline inflation rate in 2024. In fact, in that year rising energy prices will virtually offset the anticipated easing of both underlying and food inflation. As a result, headline inflation will stand at 3.6% in 2024, before declining again in the final year of the projection horizon to 1.8%.

Underlying inflation is expected to ease more slowly than headline inflation over the projection horizon (see Chart 4.a). Indeed, recent developments indicate that underlying inflation, despite beginning to ease around spring, will rise by 0.1 pp in 2023 (to 3.9% on average) as compared with the figure for 2022. The gradual deceleration in underlying inflation will essentially be underpinned by (i) the remaining global supply chain disruptions fading away, (ii) the gradual impact on demand of monetary policy tightening and (iii) the recent energy cost declines progressively passing through (with something of a lag) to the prices of other goods and services. As a result, annual average inflation will stand at 2.2% in 2024 and 1.8% in 2025.

In any event, these projections rest on two critical assumptions. First, it is assumed that the pass-through of past cost increases is near completion, and that the pass-through of the recent declines will come to the fore over the coming months. Second, in line with the evidence available to date, it is assumed that no significant second-round effects that might trigger feedback loops between the current inflationary pressures will emerge over the projection horizon.

As compared with those published three months ago, the current projections revise up both underlying and food inflation in 2023, but also include a significant downward correction of headline inflation. The higher growth in food prices and underlying inflation anticipated in 2023 largely owes to the recent upside surprises in these categories, which are only partially offset by the more moderate increases in their future prices. However, the significant reduction in energy prices during recent months (sharper than anticipated in the December projections), coupled with a higher exchange rate, has prompted a very substantial adjustment to the energy component in 2023, which more than offsets the additional inflationary pressures stemming from the underlying and food components. The projected inflation rates for 2024 and 2025 (both headline and underlying) differ only slightly from those forecast in December (see Chart 4.a).

Risks

In the current context of heightened uncertainty, the risks surrounding the materialisation of the activity and inflation scenario described above are very pronounced, being tilted to the downside in terms of economic activity and balanced in terms of inflation. Just over a year since the Russian invasion of Ukraine, geopolitical uncertainty remains very high. As a result, energy prices may follow very different trajectories to the one envisaged in the baseline scenario of these projections, which, as is standard practice, is grounded on current energy commodity prices on the futures markets. In the case of gas, price uncertainty is further exacerbated by the difficulty in estimating how China's economic reopening will affect the country's purchases of liquefied natural gas. In any event, European gas demand declined over the course of this winter, drastically reducing the risk of gas supply restrictions in the main European economies in the near term.

In addition to these future energy price uncertainties, the pass-through of past energy price movements to consumer prices in the coming quarters can only be estimated vaguely. There is evidence that the rise in the HICP energy component between early 2021 and mid-2022 has fed through to the prices of other goods and services in the consumption basket more robustly (in average terms) than has been observed in recent decades.[8] However, how much of the pass-through is yet to take place is subject to much uncertainty. The recent downward stickiness of underlying inflation and EBAE data seem to suggest that firms are still passing some of the cost increases observed up to mid-2022 through to their selling prices. Further, the interplay between this incomplete pass-through and the more recent price declines across numerous commodities, energy and non-energy alike, is hard to pinpoint.

The pace at which inflation eases (in itself highly uncertain) will shape the course of other key and closely interconnected macro-financial variables. These include the strength of demand (since inflation influences households' and firms' purchasing power), the probability of a price-wage feedback loop emerging (the more persistent the current inflationary episode, the higher the probability), and the degree of monetary policy tightening that is required (whose impact on the financial vulnerability of households and firms, on their consumption and investment decisions, and on overall aggregate demand is also highly uncertain. This latter aspect has recently come to the fore amid the episode of acute financial tensions. These were prompted by the concern across international capital markets regarding the robustness of some financial institutions, against a backdrop in which, in the last few quarters and from a historical viewpoint, interest rates have been rising very sharply and swiftly, and in a synchronised fashion around the world. It is impossible to accurately predict whether, in the most immediate future, these financial tensions will persist or, conversely, will gradually ease. In any event, it seems likely that the uncertainty that has already emerged regarding the robustness of the international financial system will have a somewhat adverse bearing on economic activity over the coming quarters and will contribute to weakening the inflationary dynamic.

There are also others sources of uncertainty, both in the external environment and at the domestic level. For instance, in the international arena, as has been mentioned, it is unclear how the reopening of the Chinese economy will affect activity and inflation in other countries, such as Spain. On the purely domestic front, there is continued uncertainty over, for example, how the savings built up by households during the pandemic might contribute to private consumption, the pace at which the NGEU projects will be rolled out and their capacity to boost the economy's potential growth.

8 José González Mínguez, Samuel Hurtado, Danilo Leiva-León and Alberto Urtasun. (2023). "The spread of inflation from energy to other components". *Economic Bulletin - Banco de España,* 2023/Q1, 02. https://doi.org/10.53479/25119.

Annex 1
Assumptions underlying the projections

In comparison with the December projections, the most notable changes in the technical assumptions used as a starting point for the projection exercise affect energy prices (lower now for oil and gas), short and long-term interest rates (both now higher), and the growth rate of export markets (revised upwards for 2023, partly as a result of the upside surprises in global economic activity in the final stretch of 2022). The euro exchange rate is slightly higher than in the previous projection exercise (see Table 2).

The fiscal assumptions factor in a somewhat more negative Spanish general government balance at end-2022 than that anticipated in December, owing to the recent, significant slowdown in revenue from indirect taxes and to the greater-than-expected buoyancy of government consumption towards the end of last year.

As for 2023, the package of measures approved on 27 December 2022[9] to mitigate the impact of the energy crisis extended some of the measures implemented last year into 2023 and also introduced new ones, entailing an overall estimated budgetary cost of 0.6 pp of GDP in 2023.[10] Since the assumptions of the December projection exercise already factored in most of these measures (energy tax cuts, increase in the minimum living income and in non-contributory pensions, and public transport subsidies), new measures are limited to VAT cuts on food items, the one-off subsidy for vulnerable households and fresh subsidies for hauliers and firms, accounting for around 0.2 pp of GDP overall. It is assumed that all the measures contained in Royal Decree-Law 20/2022 will remain in force for the officially approved term (further extensions are not envisaged), so none of the above measures would be in force in 2024 or 2025.

Meanwhile, a series of measures to boost receipts will come into force in 2023. These include new social security contributions under the “intergenerational equity mechanism”, temporary taxes on energy utilities and financial corporations, the temporary solidarity wealth tax, and various tax changes included in the 2023 State Budget Law. Together, these measures – which the December projection exercise had already taken into account – represent around 0.5 pp of GDP in higher tax revenues, although the bulk of these (some 0.4 pp) are temporary and would likely disappear in 2025.

Over the rest of the horizon, the projections continue to assume some correction of the dramatic rise in the government revenue-to-GDP ratio since the outbreak of the COVID-19 pandemic, and also factor in the increase in defence spending announced by the Government. Otherwise, the projections are based on the usual technical assumptions. More discretionary spending items (such as procurement) are expected to evolve in line with the growth potential of the Spanish economy. Government investment and capital transfers paid will essentially be determined by the assumptions made with respect to the roll-out of NGEU and the announced increase in defence

9 See Royal Decree-Law 20/2022.

10 The measures under Royal Decree-Law 20/2022 whose impact falls in 2022 have a further budgetary cost of 0.2 pp.

spending. Further, tax revenue will grow in line with the tax bases while pension expenditure, unemployment benefits and interest payments will be shaped by the usual determinants.[11]

Overall, once the impact of the European funds is taken into account, the fiscal policy stance in 2023, measured by the change in the primary structural balance, is expected to be slightly expansionary.[12] This would be attributable to the increase in pension expenditure and higher investment funded by NGEU, which would amply offset the impact of the new taxes and the withdrawal of some of the temporary spending measures, such as the blanket discount on fuel prices or the COVID-19-related measures still in force. The withdrawal, assumed to take place in 2024, of the support measures deployed in response to the rise in energy prices would foreseeably entail a contractionary fiscal impulse in that year. However, that impulse would turn clearly expansionary in 2025, when, in addition to the structural increase in spending (mainly on account of pensions) and the fall in receipts (owing to the partial reversal of the upside surprises in tax revenues in 2020-2022), the temporary taxes introduced in 2023 are expected to be cancelled.

11 Pension expenditure is determined by demographic trends and by the indexation of pensions to the CPI, unemployment benefits depend on unemployment numbers and interest payments are shaped by government debt, interest rates and the cost of inflation-linked bonds.

12 The Recovery, Transformation and Resilience Plan funds do not affect the Spanish budget deficit, as they allow for a higher level of spending without the corresponding funds needing to be sourced from resident agents. As a result, they entail an expansionary impulse that does not result in a change in the structural balance.