This Box updates the macroeconomic projections for 2016 published by the Banco de España in December last year. The update incorporates the latest Quarterly National Accounts (QNA) estimates and the effects of the changes observed in the external assumptions from 11 December to 22 March, the cut-off dates for the information in the preceding and current exercises, respectively (see Panel 1).[1] Furthermore, projections for the year 2017 are published for the first time.

On the estimates made, the expansionary phase of Spanish output will continue over the next two-year period. GDP growth is expected to stand at 2.7% this year and slow gradually to 2.3% in 2017, as certain temporary factors that have recently been boosting activity, such as the recent reductions in oil prices and the budgetary stimuli introduced over the past year, progressively lose momentum (see Panel 2). With regard to prices, it is estimated that, after posting a decline of 0.1% in 2016, the CPI might grow by 1.6% next year, reflecting the trajectory of oil prices and a gradual, modest rise in core inflation.

Compared with the forecasts released in December, the main changes in the external assumptions for 2016 include a $5 reduction in the price per barrel of oil, according to the path observed in the spot and future markets for oil. The growth of Spanish export markets is revised downwards chiefly as a result of the worsening outlook for the emerging markets, with the expected growth of imports to the euro area countries as a whole remaining practically unchanged. It is further estimated that competitors' prices will fall modestly this year compared with the December projection, partly in response to the appreciation by the euro since then against a broad basket of currencies. The assumption about stock market prices this year entails a decline of close to 20%, reflecting the fall-off seen since December. Finally, the cost of bank financing received by households and non-financial corporations will be lower than projected in the previous forecasts by approximately 0.1 pp, evidencing the downward revision of the Euribor interest-rate path and of 10-year government debt yields, in accordance with the expectations implicit in the yield curve.

Against a background of notable uncertainty over the future course of budgetary policy, the macroeconomic projections hinge crucially on the attendant assumptions. Box 2 details the fiscal policy assumptions for the 2016-2017 period underpinning this projection exercise.

Compared with the December exercise, the GDP growth forecast for this year is revised slightly downwards, by 0.1 pp, in a setting in which the QNA results for 2015 Q4 were very similar to those projected. Likewise, the latest conjunctural information has tended to corroborate the projections then made for Q1, which entail a

1 The projected course of Spain's export markets is as set out in the March 2016 ECB Staff Macroeconomic Projections with data to 15 February.

Panel 1
INTERNATIONAL ENVIRONMENT AND MONETARY AND FINANCIAL CONDITIONS (a)

Annual rates of change, unless otherwise indicated

		Current projection		Changes from the December 2015 projection	
	2015	2016	2017	2015	2016
International environment					
Real world GDP growth	2.9	3.0	3.5	0.0	-0.3
World trade	1.8	2.8	4.2	0.3	-0.7
Spanish exports markets	2.8	3.1	4.5	0.4	-0.2
Oil price (in USD)	52.5	40.2	45.7	-0.1	-5.2
Monetary and financial conditions					
Dollar/euro exchange rate (USD per euro)	1.11	1.11	1.11	0.00	0.03
Nominal effective exchange rate vis-à-vis the non-euro area countries (b) (2000=100 and pp changes)	113.0	113.4	113.6	0.1	2.6
Madrid Stock Exchange General Index (2000=100 and pp changes)	107.2	84.6	81.9	-0.2	-16.7
Short-term interest rates (3-month Euribor)	0.0	-0.2	-0.3	0.0	-0.1
Long-term interest rates (10-year bond yields)	1.7	1.6	1.9	0.0	-0.2

SOURCES: ECB and Banco de España.

a Assumptions cut-off date: 22.3.2016.
b A positive percentage change in the nominal effective exchange rate denotes an appreciation of the euro.

slight slowdown in the pace of output at the start of the year. Hence, the downward revision of expected GDP growth in 2016 is prompted by the changes in the external assumptions considered as a whole. Specifically, the main changes in these assumptions, with an adverse impact on activity, include the worsening in the expected behaviour of external markets, the appreciation of the euro and the decline in stock market prices. These effects are only partly countered by the positive consequences for activity of the recent decline in oil and other commodities prices, and of the additional easing in financial conditions.

The expansion in output during the projection period is expected to continue to be underpinned, as has been the case over the past two years, by the momentum of national demand. It is estimated that net external demand will continue making a negative contribution to GDP growth, albeit on a lesser scale than in 2015. Among the national demand components, household consumption is projected to remain notably robust, supported by the continuing strength of employment creation and by the aforementioned temporary expansionary effects on disposable income, in particular those derived from the fall in oil prices. The impact of these temporary effects will reach a peak in the short term, which explains the slowdown in this demand component over the course of the projection period. Specifically, after growth of 2.9% this year, an increase of 2% is projected in this demand component in 2017.

Along with favourable financing conditions, employment creation will also be conducive to the continuation of the gradual recovery in residential investment. In a setting in which new housing needs will continue to be moderate, in line with demographic developments, the rise is expected to be gradual, as is also inferred from the recent trend of building approvals and house purchase figures.

Business investment will continue to post increases that are sizable although down on those observed in 2015, given the easing of the expansionary behaviour of final demand, in a context in which borrowing costs are projected to hold at very low levels. The slackening of the rate of increase will be more marked in the case of other construction than in that of investment in equipment, since the former of these two aggregates will be further affected by the projected slowdown in public investment.

As to foreign trade flows, export growth is projected to be relatively modest in the short run, and lower than the December projections,

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

Annual rate of change in volume terms and % of GDP

			Current projection		Changes from the December 2015 projection	
	2014	2015	2016	2017	2015	2016
GDP	1.4	3.2	2.7	2.3	0.1	-0.1
Private consumption	1.2	3.1	2.9	2.0	0.0	-0.3
Government consumption	0.0	2.7	1.0	0.5	0.2	0.6
Gross fixed capital formation	3.5	6.4	5.0	5.4	0.2	-0.4
Investment in capital goods	10.5	10.2	8.3	7.3	0.4	-0.3
Investment in construction	-0.2	5.3	3.5	4.9	-0.2	-0.7
Exports of goods and services	5.1	5.4	4.4	5.2	-0.4	-0.3
Imports of goods and services	6.4	7.5	5.3	5.9	0.0	-0.6
National demand (contribution to growth) (b)	1.6	3.7	2.9	2.4	0.1	-0.2
Net external demand (contribution to growth)	-0.2	-0.5	-0.2	-0.1	-0.1	0.1
Nominal GDP	1.0	3.8	3.4	3.4	-0.2	-0.3
GDP deflator	-0.4	0.6	0.7	1.0	-0.2	-0.2
Consumer price index (CPI)	-0.2	-0.5	-0.1	1.6	0.0	-0.8
CPI excl. energy and unprocessed food prices	0.0	0.6	1.1	1.4	—	—
Employment (full-time equivalents)	1.1	3.0	2.3	1.9	0.0	-0.1
Unemployment rate (% of labour force)	24.4	22.1	20.3	18.9	—	—
Net lending (+)/ net borrowing (–) of the nation (% of GPD)	1.6	2.1	1.9	1.5	0.1	0.3
General government net lending (+)/net borrowing (–) (% of GDP)	-5.9	-5.2	-4.4	-3.4	—	—

SOURCES: Banco de España and INE.
Latest QNA figure: 2015 Q4.

a Projections cut-off date: 31.3.2016.
a One-decimal figure difference between the GDP growth rate and the contribution of net external demand.

in line with the lesser buoyancy of external markets and with the appreciation of the euro, which restricts gains in competitiveness. In 2017, it is estimated that exports to the rest of the world will be somewhat more expansionary. The performance of exports by geographical area is expected to reflect not only cyclical differences, but also the trajectory of the exchange rate against the currencies concerned. Hence, the strength of exports to the United States will foreseeably reflect both the robustness of US domestic demand and the depreciation of the euro against the dollar; conversely, the weakness of exports to the emerging economies will be due not only to their less favourable cyclical trend but also to the loss of value of these countries' currencies. Imports, meanwhile, are projected to perform in line with final demand. In particular, the profile of purchases abroad will follow that of exports, given that it is this variable that marks the path of final demand over the course of the projection horizon. In any event, substantial changes are not expected from the pattern observed since the start of the crisis, characterised by limited substitution of domestic output for imports.

In 2016, the nation's lending capacity is projected to stand at 1.9% of GDP. This is 0.3 pp up on the related December estimate, which is explained by the lower energy bill and lesser interest burden associated with the improved foreign financing conditions. In parallel with these factors, increases are foreseen for the trade and income balances compared with the previous projection. The scale of the surplus on the rest of the world account will lessen in 2017 as crude oil prices rise, according to the technical assumption used, based on futures market prices.

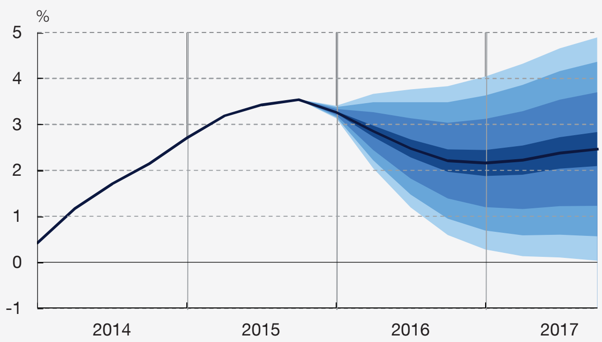
Employment growth will continue to be driven by the buoyancy of activity, despite the slight acceleration estimated for labour costs as a result of the fact that growth in compensation per employee is expected to outpace that of labour productivity. It is projected that job creation will lead to further reductions in the unemployment rate, taking it to slightly above 18% of the labour force at the end of the projection horizon.

Consumer prices will, under the assumptions of the exercise, show negative rates of change until the end of the summer, which would give rise to a 0.1% decline in the related annual average. The subsequent rise, essentially associated with the expected stabilisation in the year-on-year rate of oil prices, would lead to a 1.6% increase in the average for 2017. Against the backdrop of the expansionary behaviour of household spending and the closing of the output gap, core inflation is expected to quicken gradually, albeit on a modest scale (see Box 6 in the original Spanish edition of this Report). The accelerating profile of consumer prices would also be seen in terms of the GDP deflator, for which average growth of 0.7% and 1% is projected for 2016 and 2017, respectively.

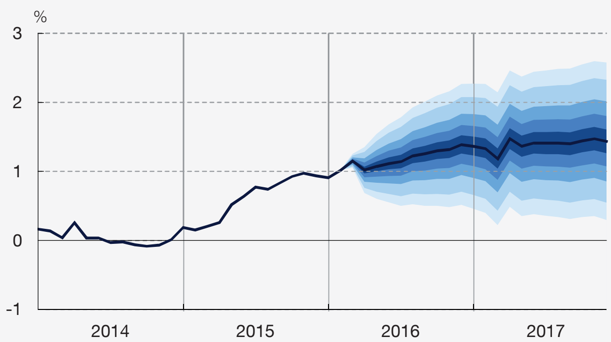
Panel 3 presents the results of a statistical procedure commonly used to approximate the uncertainty inherent in projections based on the construction of confidence intervals, for different levels of probability, drawing on the historical deviations of the projections. This approximation would assign a probability of below 5% to declines in GDP towards the end of the projection horizon, while the probability of core inflation posting negative rates over the

Panel 3
GROWTH AND INFLATION PROSPECTS FOR SPAIN

GROSS DOMESTIC PRODUCT
Year-on-year rates of change



CPI EXCL. ENERGY AND UNPROCESSED FOOD PRICES
Year-on-year rates of change



Probability of GDP or the CPI excluding energy and unprocessed food prices being within the interval (a)

20% 40% 60% 80% 90%

SOURCES: INE and Banco de España.
Latest figure: 2015 Q4 for GDP and February 2016 for the CPI excluding energy and unprocessed food prices.

a The right- and left-hand charts show the uncertainty around the central projection. Intervals with probabilities of 20%, 40%, 60%, 80% and 90%, respectively, based on historical projection errors.

next two-year period is marginal according to the deviations in past forecasts.

This methodology provides symmetrical confidence intervals, ignoring the fact that, at each point in time, the risks in a certain direction may be more prevalent. Specifically, on this occasion, the risks around the above-mentioned baseline scenario for output growth are more on the negative side than in December.

From the standpoint of the external environment, uncertainty persists over the course of the global economy, to a particularly high degree in the case of some emerging economies. A greater slowdown in those economies demanding commodities might prompt further reductions in commodities prices, harming activity in the producer countries and heightening tensions on certain financial markets, with potential knock-on effects to other economies, including Spain. Furthermore, increased geopolitical tensions are an additional source of risk to the international environment.

On the domestic front, the current situation of political uncertainty over the process of forming the nation's Government introduces doubts about the future course of economic policies. Such doubts may have an adverse effect on agents' decisions in the short term. Insofar as this uncertainty encroaches on different areas, such as budgetary policy or the reform agenda, estimating its macroeconomic impact and, especially, its distribution over time, proves extraordinarily complex. In the fiscal arena, the deviation of the deficit from budgetary plans in 2015 evidences the need to prioritise seeing through the process of fiscal consolidation in order to maintain confidence. The adoption of budgetary measures additional to those considered in the baseline scenario for these projections might alter the growth profile of output, entailing costs in the short term and generating benefits, in terms of the attendant gains in confidence, which would only become fully visible after some time. The materialisation of the positive effects of structural reforms on the functioning of markets and institutions normally involves what may be extensive time lapses. Accordingly, it is advisable to avoid delays in applying those reforms still needed.

Turning to inflation, the risks of slippage are also on the downside. Specifically, a more marked slowdown than hitherto anticipated in some emerging economies might generate an additional and widespread disinflationary impact. A scenario of these characteristics is more likely if the recent worsening in the global growth outlook is accompanied by exchange rate depreciations in these economies and by additional declines in the demand for and prices of commodities. In the opposite direction, it is likely that the recent ECB decisions will contribute to a more expansionary behaviour of consumer prices compared with the baseline scenario, by means of their positive impact on aggregate demand and the lesser probability of a deflationary scenario materialising, with persistent and widespread falls in prices.