

In the *Spanish economic projections report* published last March¹, the Banco de España announced its decision to make public the regular update of macroeconomic projections in the successive editions of its *Quarterly Report on the Spanish Economy*. This Box sets out the update of the projections released in March, on the basis of the information available as at 16 July, based on changes in the assumptions used for their preparation (see Table 1) and on economic and financial developments in the past few months.

The results of the update indicate that the performance of the Spanish economy will continue to improve gradually over the projection horizon, with estimated GDP growth of 1.3% and 2% in annual average terms in 2014 and 2015, respectively (see Table 2). It is expected that employment will continue to recover and that in Q4 this year inflation will return to slightly positive rates which will persist up to the end of the projection horizon, albeit at very low levels throughout this period. Compared with the projections published in March, GDP growth has been revised slightly upward in 2014 and 2015 since the recent performance of activity and employment has been stronger than envisaged in March and because of the impact of the tax reform announced on 20 June, against a background of continuing normalisation of financial market conditions and of diminishing aggregate uncertainty.

The external assumptions underlying the projections indicate a sustained progressive recovery in Spanish export market growth,

associated with the envisaged expansionary pace of activity in the developed economies as a whole. The assumptions as to the exchange rate have scarcely changed since March, while oil prices have been revised slightly upwards in line with the futures markets. Three-month EURIBOR interest rates have followed a slightly moderating path after the official interest rate cut last June, and ten-year public debt yields, according to the expectations implicit in the yield curve, show a significant decrease in 2014 to 3.0% and a slight rise in 2015 to 3.2%, having been revised downward with respect to March. Some decrease is projected in the cost of financing extended to households and firms during 2015.

The fiscal policy projections incorporate the fiscal measures already approved and those others that have been announced in sufficient detail. Specifically, they include the estimated impact of the budgetary measures for 2015 specified in the Stability Programme published in April and the estimated preliminary effect of the tax reform unveiled in June, based on the information contained in the draft bills.

The projected path of gradual GDP growth is based on the growing weight of domestic demand, somewhat higher than was expected four months ago, while a smaller positive contribution from net external demand is expected in comparison with what was then envisaged. The upward course of domestic demand appears to be driven by the gradual improvement in confidence, the favourable behaviour of employment, the easing of aggregate financial conditions and the impact of the tax reform. In particular, household consumption is expected to grow at a rate somewhat above 1.5% in both 2014 and 2015, in a setting of labour market improvement and recovery in

¹ <http://www.bde.es/f/webbde/SES/Secciones/Publicaciones/InformesBoletinesRevistas/BoletinEconomico/14/Mar/Files/be1403e-project.pdf>

1 INTERNATIONAL ENVIRONMENT AND MONETARY AND FINANCIAL CONDITIONS (a)

Annual rates of change, unless otherwise indicated

		Current projection		March 2014 projection	
		2014	2015	2014	2015
	2013				
International environment					
World output	2.9	3.2	3.8	3.6	3.7
Global markets	2.7	4.8	6.0	4.6	5.8
Spain's export markets	2.0	3.8	5.1	3.8	5.0
Oil price (in USD)	108.8	110.8	109.2	107.2	103.1
Competitors' export prices in euro	-2.1	-1.2	1.4	-1.2	1.1
Monetary and financial conditions					
Dollar/euro exchange rate (USD per euro)	1.33	1.37	1.36	1.38	1.38
Short-term interest rate (3-month EURIBOR)	0.2	0.2	0.2	0.3	0.4
Long-term interest rate (10-year bond yield)	4.6	3.0	3.2	3.6	4.0

SOURCES: ECB and Banco de España.
Latest QNA data: 2014 Q1.

a Projections cut-off date: 16.7.2014.

household disposable income. Meanwhile, private productive investment is projected to strengthen further, sustained by the buoyancy of the export sector, the increase in domestic demand and the higher numbers of firms needing to replace a part of their productive capital. In the external sector, the gradual recovery in Spanish export markets and the materialisation of additional gains in competitiveness are expected to be conducive to the demand for exports. That said, the expansion of exports will be somewhat smaller than envisaged in March, given the weak outlook for some emerging markets. Thus the external balance will remain positive over the next two years, albeit at levels below those projected in March. Specifically, the net lending of the economy will stand at 1.3% of GDP in 2014 and 1.6% in 2015.

In the labour market, the recovering trend in employment in recent months is expected to strengthen, underpinned by continuing wage moderation and greater labour market flexibility. Higher employment and the decrease in the labour force should lead to further reductions in the unemployment rate.

Inflation, as measured by the CPI, will remain very low throughout the projection horizon, basically reflecting the sizeable slack in the economy and moderate wage cost growth. However, the progressive recovery in consumption and the slower fall-off in unit labour costs will give rise to very modest rises in inflation from Q4 this year.

Following the slight upward revision in GDP growth, the risk of economic activity diverging from that projected under the

baseline scenario remains skewed moderately downwards, mainly in 2015. On the external front, foreign markets may perform more unfavourably than projected, given the scenario of fragile growth of the euro area and the uncertainty as to the slowdown of the emerging countries. In the domestic arena, meeting the budget targets may require a larger degree of budgetary consolidation in 2015 than projected. Moreover, there persists a certain vulnerability to possible domestic or foreign events disrupting the baseline scenario of continuing normalisation of financial conditions. In contrast, the favourable impact exerted by the ECB's latest measures to improve the transmission of monetary policy stimuli and by the completion of the comprehensive assessment of SSM-supervised institutions in the coming months may be greater than estimated. At the same time, as a result of the structural reforms adopted, particularly in the labour market, activity and employment may be more expansionary than projected.

The risks of deviations from the inflation projections are skewed somewhat downward, basically as a result of the persistent considerable slack in factor utilisation and of a relatively high euro exchange rate, although these risks have tended to become more balanced in recent months. Further, additional oil price rises, associated with an escalation of geopolitical tensions in the Middle East or in Eastern Europe, and/or tax measures entailing higher environmentally related indirect taxation, may give rise to bigger movements in prices than envisaged in these projections.

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

Annual rate of change in volume terms and % of GDP

	2013	Current projection		March 2014 projection	
		2014	2015	2014	2015
GDP	-1.2	1.3	2.0	1.2	1.7
Private consumption	-2.1	1.6	1.6	1.1	1.2
Government consumption	-2.3	-0.8	-1.5	-1.5	-2.5
Gross fixed capital formation	-5.1	1.8	4.2	0.0	4.2
<i>Investment in capital goods and intangible capital</i>	2.2	8.7	7.7	6.3	7.5
<i>Investment in construction</i>	-9.6	-3.2	1.7	-4.4	1.7
Exports of goods and services	4.9	4.6	5.9	5.1	6.1
Imports of goods and services	0.4	4.7	4.5	3.0	4.4
National demand (contribution to growth)	-2.7	1.2	1.4	0.3	0.9
Net external demand (contribution to growth)	1.5	0.1	0.6	0.8	0.7
Consumer price index (CPI) (b)	1.4	0.1	0.7	0.1	0.7
Employment (full-time equivalent jobs)	-3.4	0.4	1.4	0.4	0.9
National economy's net lending (+)/net borrowing (-) (% of GDP)	1.5	1.3	1.6	2.1	2.5

SOURCES: Banco de España and INE.
Latest QNA data: 2014 Q1.

a Projections cut-off date: 16.7.2014.

b CPI projections were not published in the Spanish Economic Projections Report of March 2014 (the private consumption deflator was published instead).