

## BANCO DE ESPAÑA EVALUATION PROGRAMME

# LETTER FROM THE GOVERNING COUNCIL ON THE EXTERNAL EVALUATION OF THE BANCO DE ESPAÑA MACROECONOMIC PROJECTIONS

### Banco de España

Last July the report on the independent external evaluation of the Banco de España macroeconomic projections, conducted as part of the Bank's evaluation programme, was submitted to its decision-making bodies.

The Evaluation Committee comprised three renowned independent macroeconomic projection experts: Gian Maria Milesi-Ferretti, senior fellow at the Hutchins Center on Fiscal and Monetary Policy of the Brookings Institution; Luca Onorante, head of the Nowcasting group at the Joint Research Centre of the European Commission; and Nikiforos Vidalis, adviser to the Governor of the Bank of Greece.

Social partners, economic analysts, the media and the general public pay close attention to the Banco de España macroeconomic projections for the Spanish economy. As a result, proper preparation and dissemination of the projections are crucial to the appropriate economic policy stance being adopted and have a positive impact on the institution's reputation and credibility. The usefulness and impact of the projections will be boosted by ongoing improvement in the procedures and tools used to prepare them. In light of this, the Governing Council believes that an evaluation of the projections, analysing the processes and methodologies used to prepare them and the accuracy of the projections, has been particularly useful.

In their report the evaluators highlighted the high quality of the projections, the clarity of the narrative underpinning the projections and the adaptability to changing circumstances. This is the result of the high calibre of Banco de España staff, which translates into extensive knowledge of the Spanish economy and of the tools enabling its analysis. The evaluators also underscored the Banco de España's influence on society through its projections and their utility in economic policymaking.

However, the report identifies potential room for improvement in the models used, governance, the procedure to prepare the projections and the publication and dissemination strategy. The recommendations include incorporating into the "Modelo Trimestral del Banco de España (MTBE)", whenever possible, the "off model tools" currently used to inform the expert assessment and alternative expectations assumptions. It suggests that the Banco de España might prepare and publish, at regular intervals, a forecast with a longer-term horizon for the prospects of the Spanish economy and include in the forecast its views on the cyclical position of the economy.

According to the report, the Bank would be well advised to study the establishment of a non-quantitative risk-assessment process and the regular use of alternative scenarios and sensitivity analyses. It recommends creating ad hoc cross-departmental working groups to study specific issues heavily affecting the projection exercise. The Evaluation Committee considers that the high analytical quality of the Banco de España staff involved in preparing the projections should be acknowledged. Lastly, the report makes some recommendations to improve the projections communication strategy.

In response to this report, management of the Banco de España has put forward an action plan that addresses fulfilment of all the priority recommendations. Work will continue on those for which measures, either referring to the projection exercise or to the Bank's activities, were already under way. In compliance with this action plan, the Banco de España will perform a cost-benefit analysis of the potential incorporation into the next version of the MTBE of some of the "off model tools", like the satellite models, and will document the version of the model developed in the most recent period, which incorporates different assumptions about agents' expectations and will continue to be refined in future versions. In addition, the Banco de España will publish an annual or biennial analysis of the potential growth of the economy in the medium and long term. The Banco de España will also regularly include in the different projection exercises an assessment of the cyclical position of the economy.

As for incorporating uncertainty into the projections, the Banco de España will, when deemed necessary, again publish alternative scenarios and sensitivity analyses to assess the impact of the materialisation of assumptions different from those included in the baseline scenario. The Banco de España will likewise assess and, where appropriate, implement a non-quantitative procedure to determine the risk factors in the projections, the likelihood of them materialising and the size of their potential impact, in addition to the possibility of constructing ranges around the baseline. The Banco de España will extend the practice of creating ad hoc cross-departmental groups to study issues heavily affecting the preparation of the projections.

Lastly, in reference to the macroeconomic projections section of the Banco de España's Economic Bulletin, explicit information on the main judgements will continue to be provided, a more detailed description of labour market developments will be included and greater importance will be attached to the public finances.

**The Governing Council is grateful for the evaluation conducted and views favourably the action plan submitted by management of the Banco de España in response to the evaluation.**