REPORT

1 Global economic activity gained traction over the first months of 2023, driven by the highly buoyant services sectors

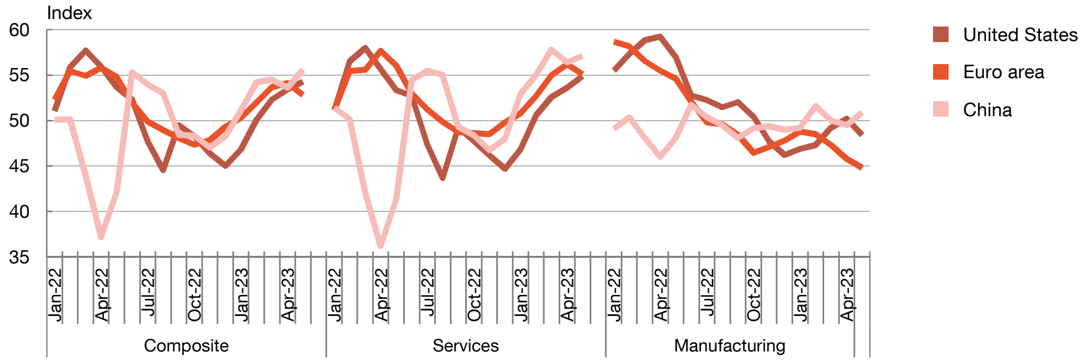
— Over the last few months, in a setting of relative sluggishness in manufacturing, the considerable buoyancy of services (see Chart 1.a) appears to be related both to the persisting positive impact of the post-pandemic reopening of the economy on demand in the most social-intensive sectors of activity and to the strong growth in information and communication activities and in professional services associated with the digital transformation process.

— Among the main world economies, in the United States the performance of employment continues to surprise on the upside, although activity slowed in the first quarter. In China, the end of the zero-COVID policy in late 2022 seems to have boosted activity more than expected in the first months of 2023, although the latest conjunctural indicators point to a slight slowdown.

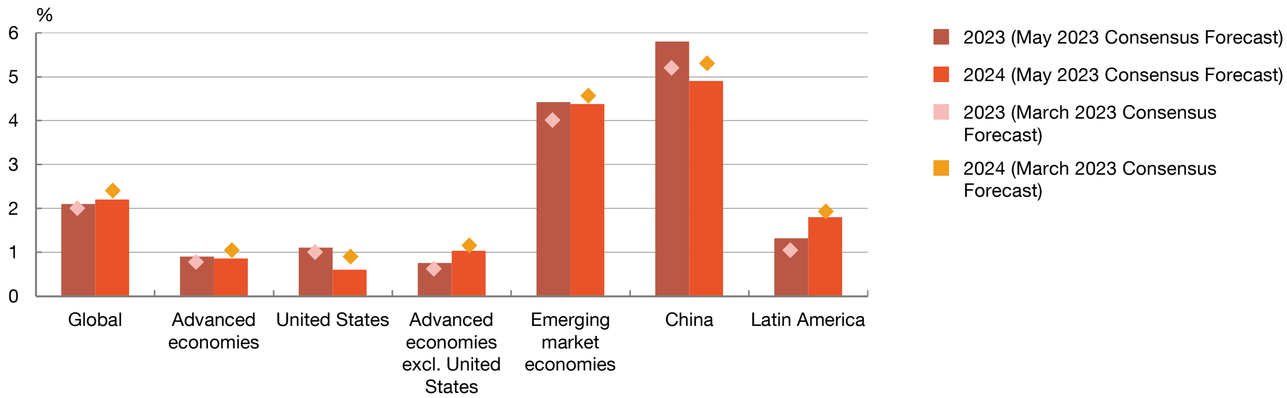
— Overall, these developments have recently prompted a slight upward revision of analysts' growth forecasts for 2023, especially in China (see Chart 1.b), and a slight downward revision for 2024, in view of persistent inflation and restrictive financial conditions.

Chart 1

1.a Purchasing Managers' Indices



1.b GDP growth forecasts, by geographical area (a)



SOURCES: Bloomberg, Consensus Forecast and S&P Global.

a Consensus Forecast projections (bars: May; diamonds: March). "Advanced economies" comprises 13 geographical areas: Canada, Czech Republic, Denmark, euro area, Iceland, Israel, Japan, Norway, South Korea, Sweden, Switzerland, United Kingdom and United States. "Emerging market economies" comprises 13 economies from Asia, eastern Europe and Latin America: China, India, Indonesia, Malaysia, Thailand, Hungary, Poland, Russia, Brazil, Chile, Colombia, Mexico and Peru.

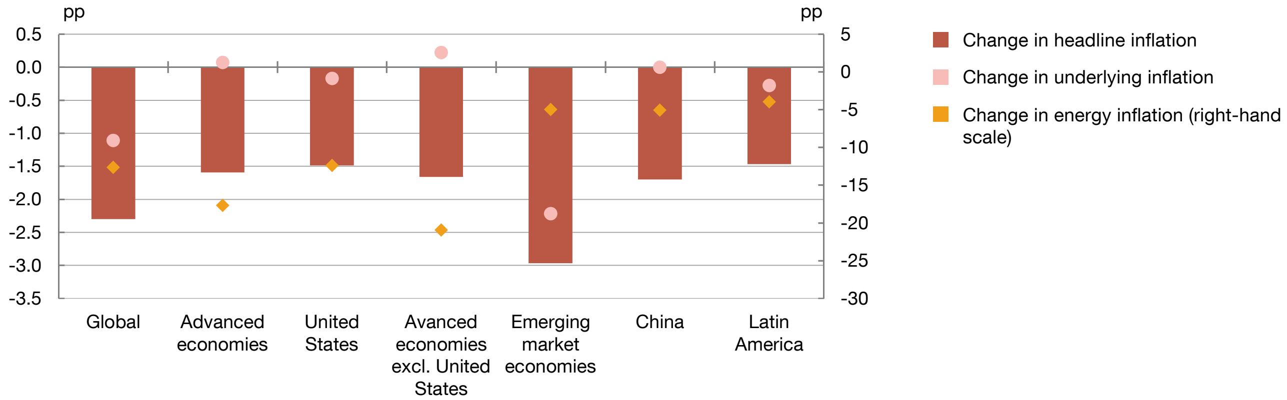
2 Headline inflation rates have prolonged their global moderating path, although as yet there has been no widespread downward shift in underlying inflation

— In recent months the decline in energy prices has continued to contribute to reducing global headline inflation rates. However, there has been no significant or widespread downward shift in underlying inflation rates, except in certain emerging market economies (see Chart 2.a).

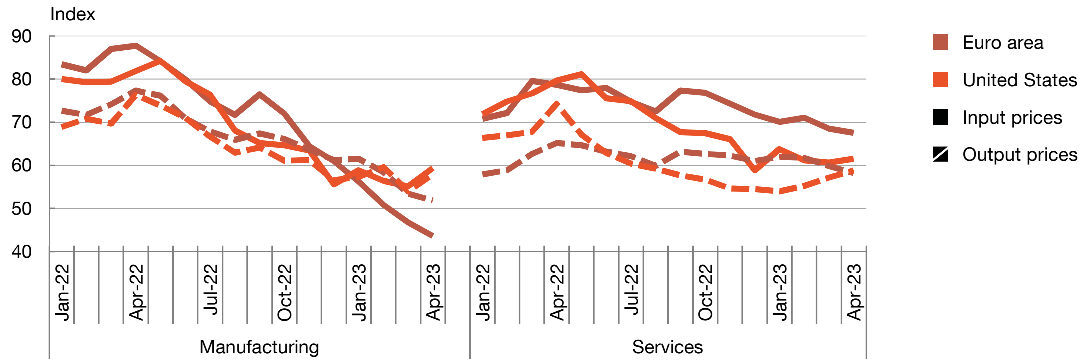
— Changes in prices are highly uneven by sector of activity (see Chart 2.b). On the one hand, the normalisation of global supply chains and the lower commodity prices have been conducive to a relatively strong slowdown in manufacturing prices in recent months. On the other, the recent strength in demand for services has meant that inflation has eased less in these sectors of activity, even increasing in some geographical areas.

Chart 2

2.a Change in headline and underlying inflation between December 2022 and April 2023 (a)



2.b Price indicators (PMI)



SOURCES: National statistics and S&P Global.

a "Global" comprises China, Czech Republic, euro area, Hong Kong, Hungary, India, Indonesia, Japan, Malaysia, Russia, Singapore, South Korea, Taiwan, Thailand, Turkey, United Kingdom and United States, as well as "Latin America" (comprising Brazil, Chile, Colombia, Mexico and Peru). "Advanced economies" comprises Canada, euro area, Japan, Norway, Sweden, Switzerland, United Kingdom and United States.

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3 The main central banks have reduced the pace of their monetary policy tightening

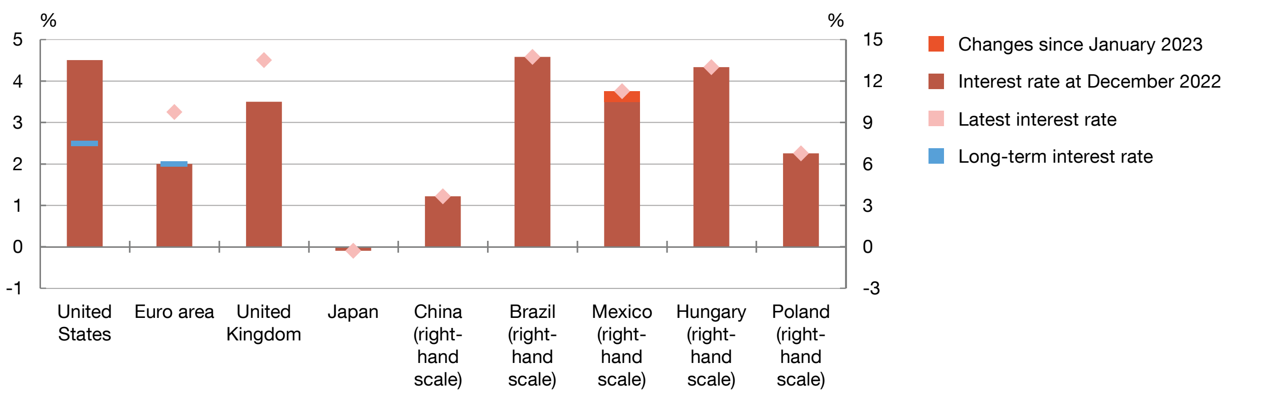
— For instance, the European Central Bank, which raised its policy interest rates by 50 basis points (bp) at its monetary policy meetings of December 2022 and February and March 2023, raised them by 25 bp at its latest two meetings in May and June 2023.

— A similar slowdown has also been seen in most developed economies' central banks, such as the Bank of England and the US Federal Reserve, which have also reduced the pace of policy rate hikes to 25 bp at their latest meetings.

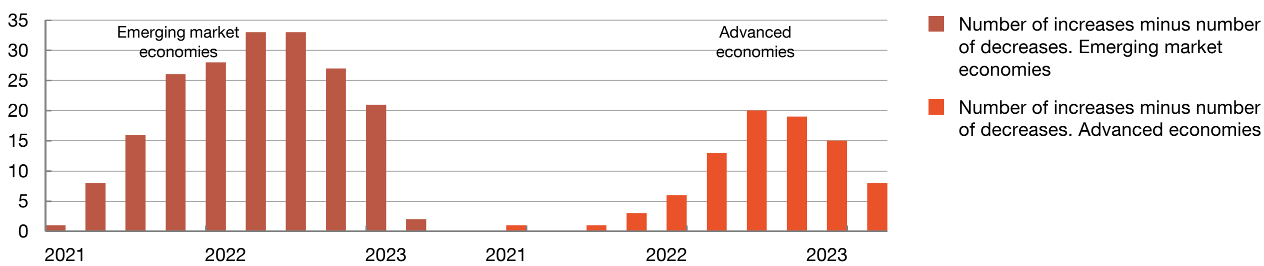
— Against this backdrop, in which policy interest rates are in restrictive territory in the world's main economies (see Chart 3.a) and the pace of further global monetary policy tightening has slowed significantly (see Chart 3.b), analysts' focus has begun to shift to when the first policy rate cuts might take place in certain regions.

Chart 3

3.a Policy interest rates



3.b Global monetary policy tightening decisions (a)



SOURCES: National central banks and Refinitiv.

a "Advanced economies" comprises 11 geographical areas: Australia, Canada, Denmark, euro area, Japan, New Zealand, Norway, Sweden, Switzerland, United Kingdom and United States. "Emerging market economies" comprises 23 economies from Asia, eastern Europe and Latin America: Brazil, Chile, China, Colombia, Czech Republic, Egypt, Hungary, India, Indonesia, Kazakhstan, Malaysia, Mexico, Peru, Philippines, Poland, Romania, Russia, South Africa, South Korea, Thailand, Tunisia, Turkey and Ukraine.

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4 International financial markets have recently been influenced by smaller policy interest rate increases and easing banking sector stress

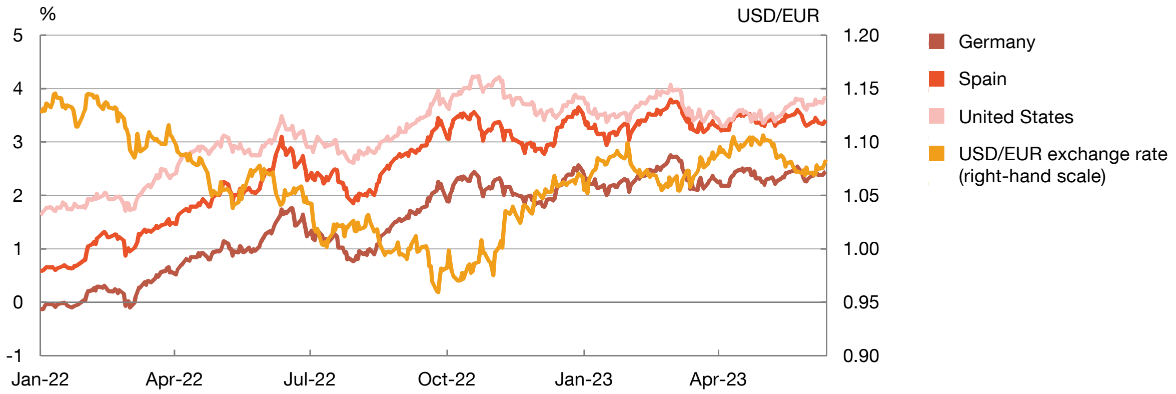
— Long-term sovereign bond yields have proven less volatile in recent months than during 2023 Q1, but they have increased slightly since the end of March. For instance, the yields on Spanish and German ten-year bonds have risen by 8 bp (to 3.4%) and 14 bp (to 2.4%), respectively, in Q2 to date (see Chart 4.a).

— The main international stock market indices have recorded slight gains in Q2; however, the bank indices have not yet recovered the levels recorded prior to the financial turbulence in March (see Chart 4.b), largely because of some uncertainty persisting over developments at US regional banks.

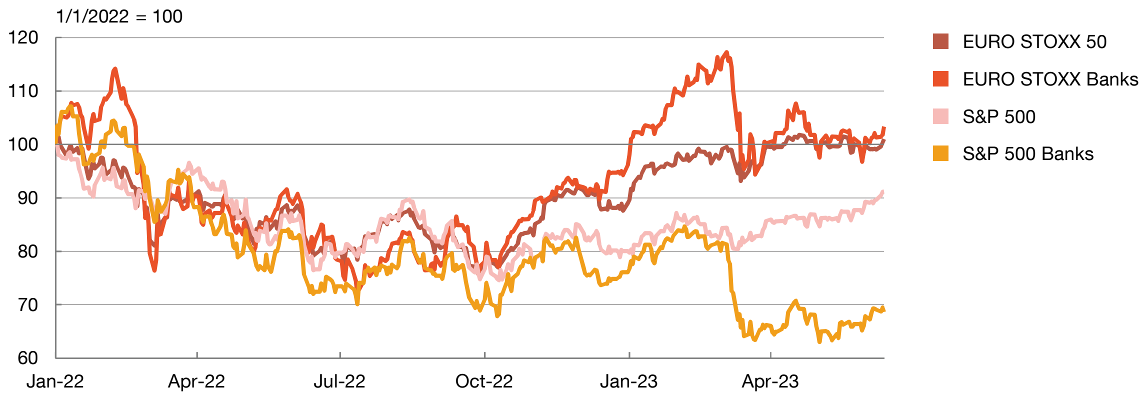
— On the foreign exchange markets, the euro has fluctuated between appreciating and depreciating slightly against the US dollar, with the USD/EUR exchange rate mainly unchanged in Q2 to date. However, the euro has appreciated against the dollar by over 11% since September 2022, when it was below parity.

Chart 4

4.a Ten-year sovereign bond yields and exchange rate



4.b Stock market indices



SOURCES: Refinitiv and Datastream.

5 In the euro area, economic activity has picked up somewhat in recent months, after falling slightly in previous quarters

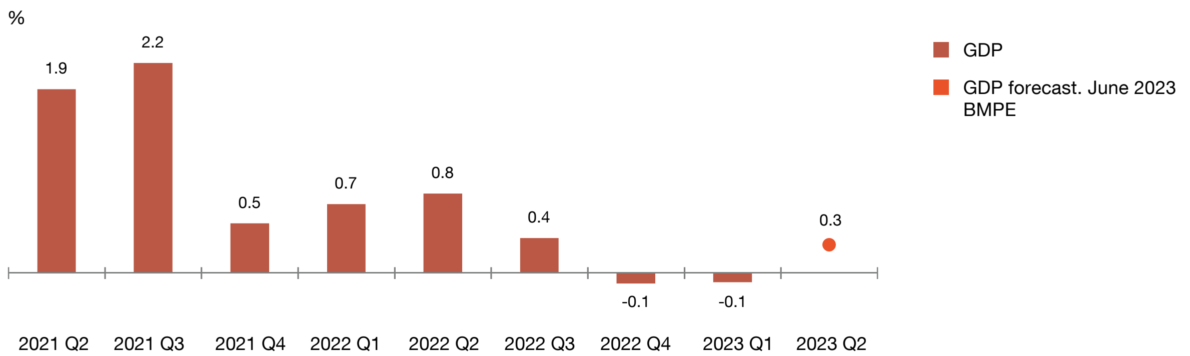
— After two quarters in which euro area GDP contracted slightly, the latest short-term economic indicators point, overall, to positive quarter-on-quarter growth of around 0.3% in Q2, according to the June Eurosystem projection exercise (see Chart 5.a).

— However, the latest information suggests that the pace of growth of output in Q2 will be slightly slower than expected a few weeks ago. In addition, persistent high inflation and the monetary tightening process launched at the end of 2021, whose full effects on activity may lag by 18-24 months (Banco de España, 2023), point to the pace of growth of euro area GDP slowing slightly in 2023 H2.

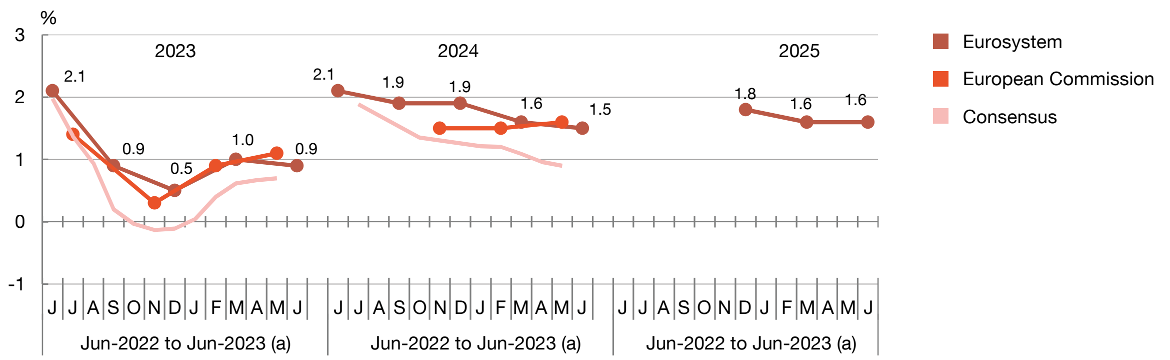
— As a result, the June Eurosystem projection exercise forecasts euro area GDP growth of 0.9% in 2023 and 1.5% in 2024 (a downward revision of 0.1 percentage points (pp) to the March projection for both years), while the growth forecast for 2025 remains practically unchanged (see Chart 5.b).

Chart 5

5.a Euro area. GDP (quarter-on-quarter rate of change)



5.b Euro area. GDP growth forecasts



SOURCES: European Commission, Consensus Economics, Eurosystem and Eurostat.

a Each letter refers to the month in which the corresponding forecast was published.

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6 Despite continuing to fall, euro area inflation remains high because of the momentum of food and services prices

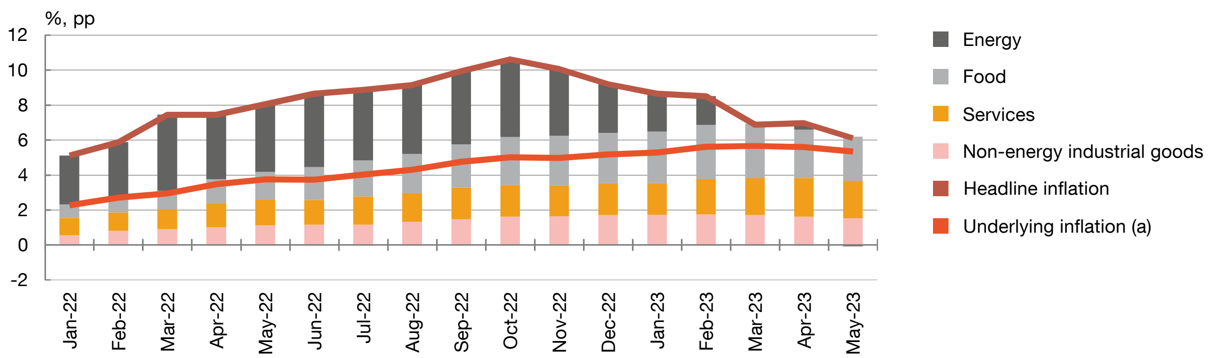
— Headline inflation continued to fall, to 6.1%, in the euro area in May (see Chart 6.a). Unlike in most of 2022, the energy component made practically zero contribution to these inflationary pressures, which remain very high. Meanwhile, the food and services contributions have barely budged from their recent all-time highs. In this respect, underlying inflation (which reflects changes in the prices of non-energy industrial goods and services) ran at 5.3% in May, down just 0.4 pp from its March peak.

— The future path of inflation is highly uncertain and depends on opposing forces. Lower energy prices, fading bottlenecks and the appreciation of the euro would make imports less expensive and lower imported inflation. Meanwhile, buoyant activity, especially in the services sectors, and the momentum of profit margins and wages could drive up domestic inflationary pressures.

— In light of this, compared with the March projections, the June Eurosystem projection exercise has revised up the average inflation rates forecast for 2023, from 5.3% to 5.4% for headline inflation and from 4.6% to 5.1% for underlying inflation. The current inflationary pressures are expected to gradually ease over the rest of the projection horizon (to 3% in 2024 and 2.2% in 2025, in the case of headline inflation), in line with the March projections.

Chart 6

6.a Euro area inflation and contribution of the components



SOURCE: Eurostat.

a HICP excluding energy and food.

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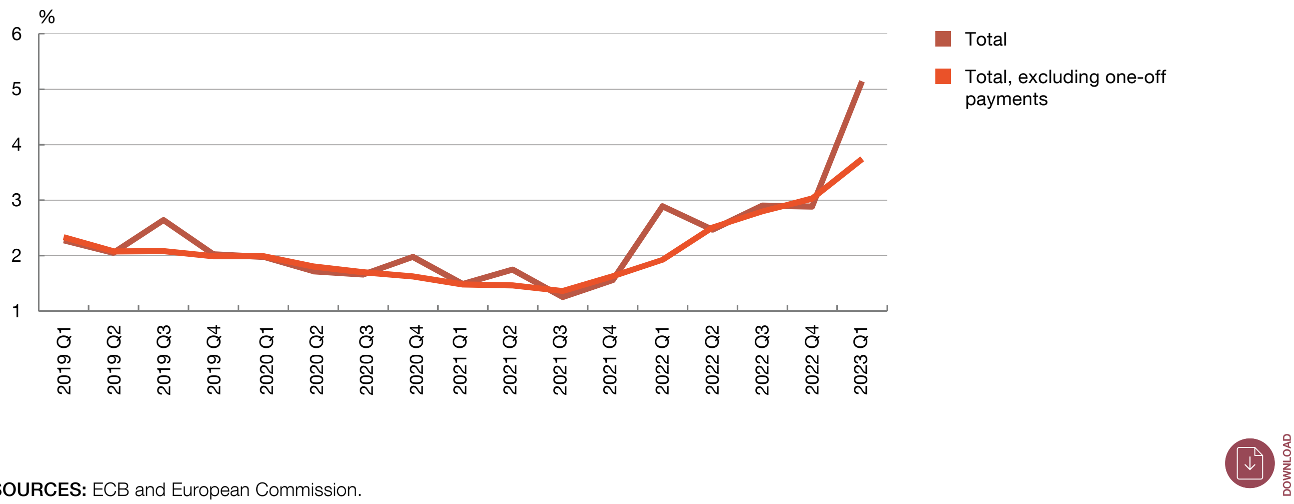
7 The uncertainty surrounding the euro area growth and inflation projections is very high and owes to external and domestic factors alike

— On the external side, the main sources of uncertainty are related to the course of the current geopolitical tensions – especially those associated with the war in Ukraine – and how the swift and sharp tightening of monetary policy worldwide could affect macroeconomic aggregates and international financial markets.

— On the domestic front, the possibility of significant second-round effects via wages and profit margins represents an upside risk to the inflation projections and a downside risk to growth, particularly against the backdrop of a still-strong euro area labour market (see Chart 7.a) and demand that continues to prove considerably resilient in certain sectors. Likewise, the reform of the European fiscal governance framework, and its impact on the fiscal policy stance of the different Member States in the coming years, also represents a significant element of uncertainty for the euro area medium-term growth and inflation projections.

Chart 7

7.a Euro area wage settlements. Year-on-year rates of change



SOURCES: ECB and European Commission.

8 The ECB has continued to raise its key interest rates to ensure that inflation returns to its 2% medium-term target

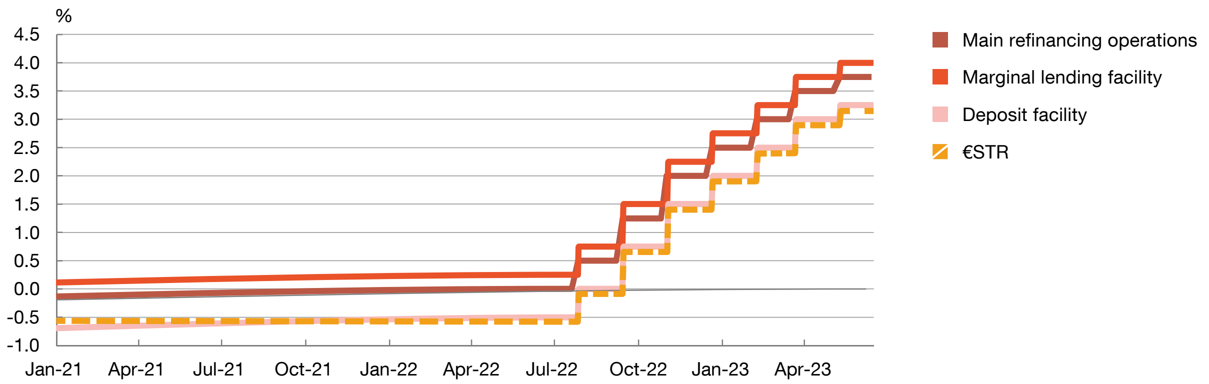
— Euro area inflation has declined, but the Eurosystem staff macroeconomic projections indicate that it will remain too high for too long. In consequence, the ECB's Governing Council has continued its monetary policy tightening. At its June meeting, the Governing Council raised its key interest rates by 25 bp, taking the deposit facility rate to 3.50%.[1] This means a cumulative increase of key ECB interest rates of 400 bp since July 2022 (see Chart 8.a).

— Going forward, the Governing Council will continue to follow a data-dependent approach. In particular, its interest rate decisions will continue to be based on its overall assessment of three aspects: (i) the inflation outlook in light of the incoming economic and financial data, (ii) the dynamics of underlying inflation and (iii) the strength of monetary policy transmission.

— Further, in line with the announcement at its May meeting, the Governing Council has confirmed in June that it will discontinue the reinvestment of the principal payments from maturing securities under the asset purchase programme (APP) as of July 2023. This decision, which will further reduce the size of the Eurosystem balance sheet, contributes to tightening financing conditions and therefore compliments the interest rate increases.

Chart 8

8.a Key ECB interest rates and €STR



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SOURCES: Banco de España and Refinitiv Datastream. Latest data: 15/06/2023

1 With effect from 21 June 2023.

9 In Spain, GDP growth was stronger than expected in 2023 Q1 owing to the contribution of net external demand

— In 2023 Q1, Spanish GDP grew by 0.5% quarter-on-quarter, slightly more than forecast in the Banco de España's March projection exercise and than recorded in 2022 Q4. In addition, as per the Quarterly National Accounts (QNA) flash estimate published by the National Statistics Institute (INE) in late April, a data review meant higher quarter-on-quarter growth rates for the last three quarters of 2022 (see Chart 9.a).

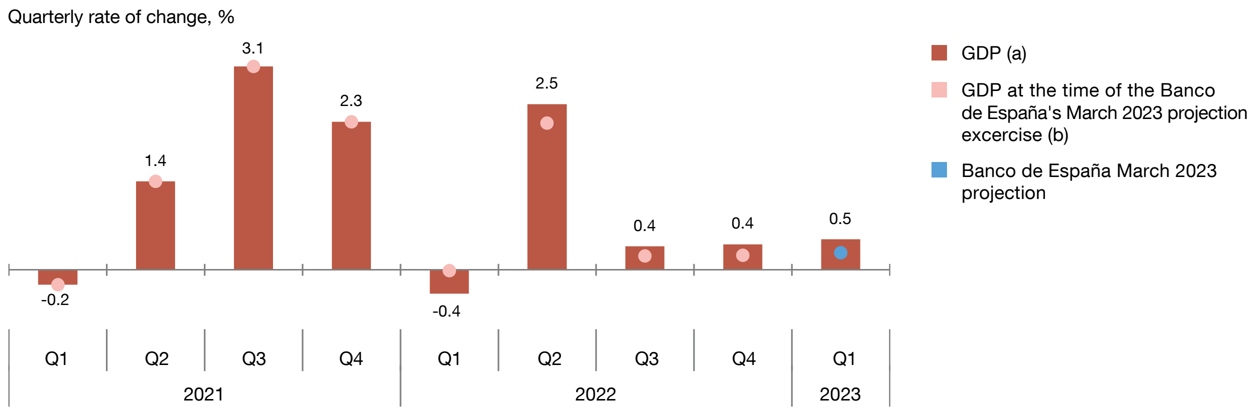
— According to the INE flash estimate, GDP growth in 2023 Q1 owed to the contribution of net external demand (1.3 pp), with domestic demand detracting -0.8 pp, as dynamism in investment failed to offset the decline in private consumption.

— On the supply side, the most buoyant sectors of activity in 2023 Q1 were those linked to the primary sector and to trade, transport and hospitality. Financial and insurance activities recorded the sharpest declines, while the industrial sectors performed somewhat sluggishly.

— As a result of these developments, in 2023 Q1 Spanish GDP stood 0.2% below its end-2019 level. By way of comparison, in that same quarter, overall euro area GDP exceeded its end-2019 level by 2.2%.

Chart 9

9.a Spanish GDP



SOURCES: Banco de España and INE.

a Latest series published by the INE (28 April 2023).
b Latest GDP series available (27 January 2023) at the time of the Banco de España's March 2023 projection exercise. Subsequently, on 24 March, the INE published its second QNA estimate for 2022 Q4 with a quarterly GDP path that was largely unchanged relative to the series published on 27 January.

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10 On balance, the latest short-term economic indicators suggest that economic growth in Spain may have accelerated slightly in Q2

— The various available indicators, which provide partial, and as yet incomplete, information on activity in 2023 Q2, suggest that Spanish GDP could grow in this period by around 0.6% quarter-on-quarter. However, there is considerable uncertainty surrounding this estimate.[2]

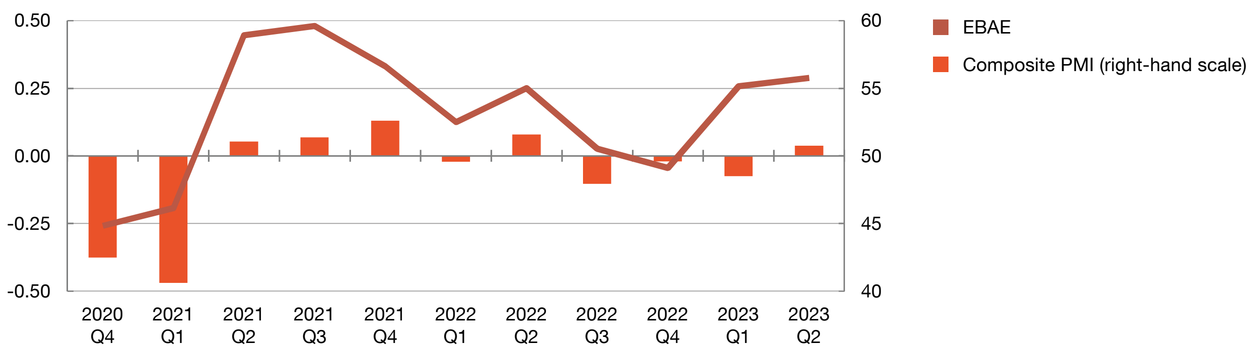
— Of note among the indicators consistent with more buoyant activity in Q2 are confidence indicators. For example, average PMI levels in April and May were higher than in the first three months of the year (see Chart 10.a), especially in the services sector.

— The results of the Banco de España Business Activity Survey (EBAE) point in the same direction, with Spanish firms reporting faster turnover growth in Q2 than in Q1.[3]

— However, some of the most recent indicators (for example, those relating to job creation) point to a certain moderation of activity in the final stretch of Q2.

Chart 10

10.a EBAE turnover and composite PMI (a) (b)



SOURCES: EBAE (Banco de España) and S&P Global.

a The qualitative responses from the EBAE are converted into a numerical scale as follows: significant decrease = -2; slight decrease = -1; stability = 0; slight increase = 1; significant increase = 2.
b The composite PMI figure for 2023 Q2 is the average in April and May.

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2 For more details, see the Projections in this report.

3 For more details, see Fernández Cerezo and Izquierdo (2023).

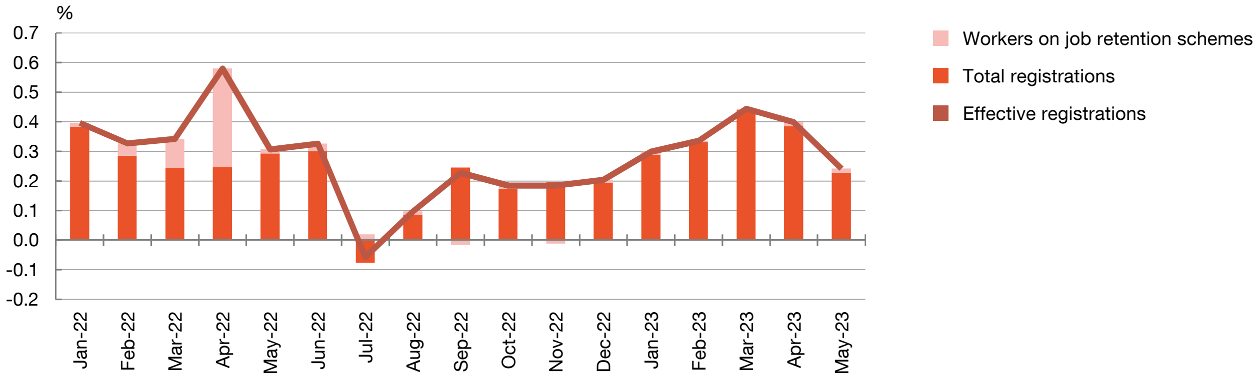
11 Job creation has remained very buoyant in recent months, especially in certain services sectors

— Social security registrations increased in seasonally adjusted terms by 0.4% in April and 0.2% in May (see Chart 11.a). Taking into account these increases and the trend in social security registrations during the first half of June, which points to a weaker job creation performance, in line with that seen in the second half of May, the quarter-on-quarter growth rate is expected to stand slightly above the 0.9% recorded in Q1.

— This strong employment performance can be seen across all sectors of activity. However, the recent vigour in employment is particularly noteworthy in services sectors linked to tourism, information and communications, and professional, scientific and technical activities. Some of these sectors are already seeing labour supply shortages which would at least partly explain the cross-sector differences in negotiated wage increases for 2023.

Chart 11

11.a Total social security registrations, workers on job retention schemes and effective social security registrations (a)



SOURCES: Ministerio de Inclusión, Seguridad Social y Migraciones and Banco de España.

a Seasonally adjusted monthly rate.

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12 The gradual tightening of bank lending conditions in Spain has continued

— The pass-through of the increase in market interest rates to the cost of new lending has continued to intensify in recent months (see Chart 12.a), although in the housing segment this process has been slower than in previous episodes of monetary tightening (Banco de España, 2023).

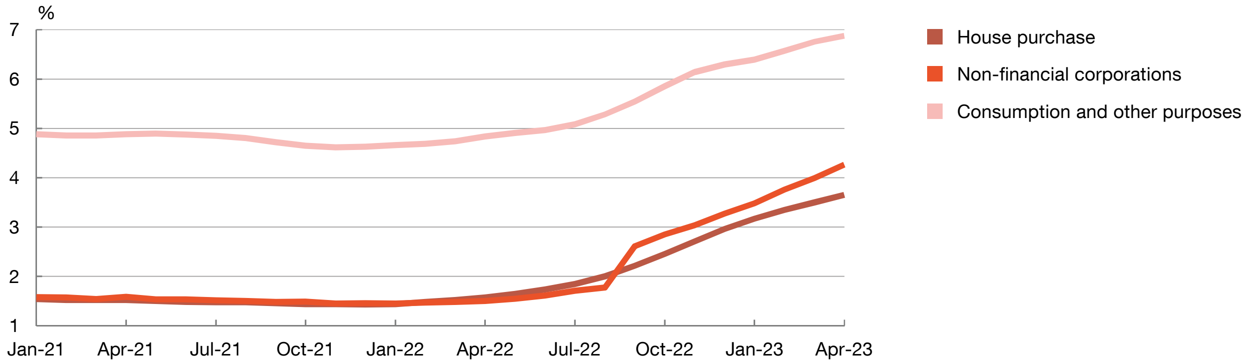
— The cost of loans for house purchase and business loans in Spain is similar to that in the euro area, while in the case of loans for consumption and other purposes the cost in Spain is higher than the euro area average, although the gap has narrowed in the most recent period.

— Meanwhile, according to the Bank Lending Survey, in 2023 Q1 credit standards and the terms and conditions applied to new loans tightened across the board for the fourth consecutive quarter. Also, the demand for credit saw a decline across all segments, which was particularly sharp in the case of loans for house purchase. For 2023 Q2, banks anticipate a further contraction in the supply and demand for credit.

— These dynamics have continued to translate into a contraction in the volume of new funding raised by households (especially for house purchase) and, to a lesser extent, by firms.

Chart 12

12.a Cost of new bank loans (a)



SOURCE: Banco de España.

a Bank interest rates are narrowly defined effective rates (NDERs) and are adjusted seasonally and for the irregular component.

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13 Private consumption appears to have recovered slightly during Q2, following the declines recorded in the previous quarters

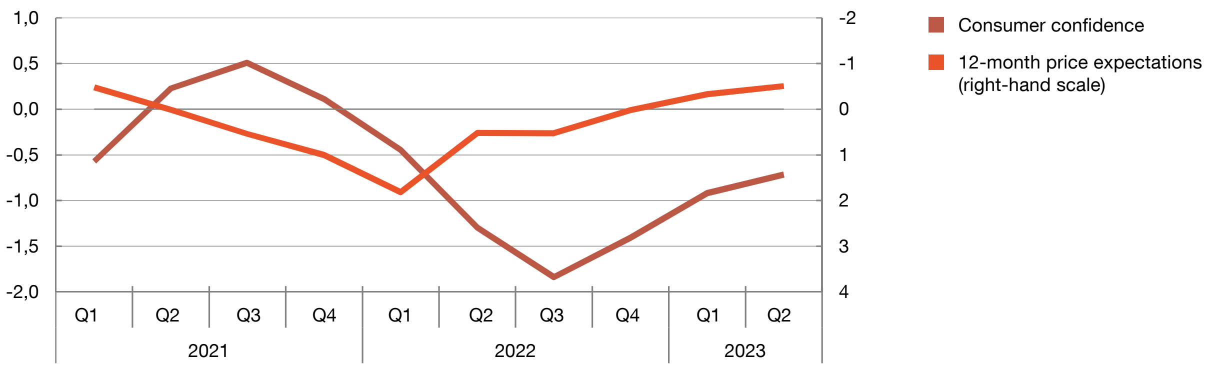
- Private consumption contracted in the first three months of 2023, weighed down by households' loss of purchasing power during the current inflationary episode and the adverse impact of the tighter bank lending conditions on their ability to spend (especially in the case of the most indebted households).

- However, in the second quarter to date, various factors point to more buoyant household consumption than in Q1, although it would remain somewhat subdued. Particularly notable are the strength of employment, the gradual improvement in confidence indicators and the prospect of a gradual easing of price pressures (see Chart 13.a), which will halt the deterioration in the purchasing power of wages and help shore up household confidence.

- That said, in the coming quarters the rate of expansion of household spending will continue to be constrained by more restrictive financial conditions and persistently high prices. Also, the rise in interest rates and the cost of debt may encourage households to devote more of their income and the savings they built up during the pandemic to loan repayment (Alves and Martínez-Carrascal, 2023).

Chart 13

13.a Household spending-related indicators (standardised data) (a)



SOURCES: European Commission and Banco de España.

a Latest available observation: May 2023.

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14 Business investment regained momentum in the first quarter and looks to have continued along an upward path in recent months

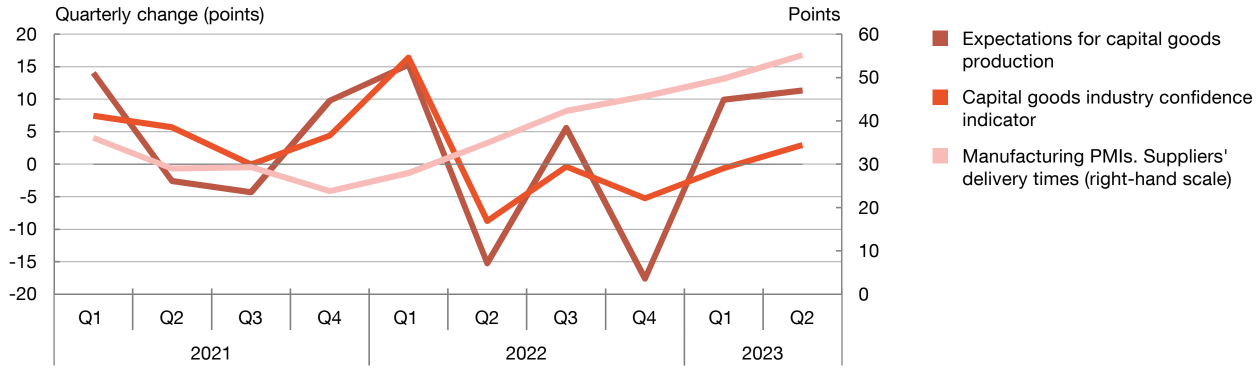
— Following its marked weakness in the last stretch of 2022, business investment regained considerable momentum in the first three months of 2023, partly driven by lower energy prices (and thus lower production costs) and by shorter suppliers' delivery times (as the supply chain bottlenecks eased). This helped lead to a gradual improvement in confidence indicators.

— A continuation of these patterns in recent months, together with the slow but steady roll-out of the Next Generation EU (NGEU) projects, seems to suggest that business investment continued to recover in 2023 Q2 (see Chart 14.a).

— However, similarly to household consumption, business investment will foreseeably remain constrained in the coming quarters by further monetary policy tightening, its impact on firms' financing conditions and persistently high levels of uncertainty.

Chart 14

14.a Industrial confidence indicators (a)



SOURCES: S&P Global and European Commission.

a Latest available observation: May 2023.

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15 As in previous quarters, housing investment appears to have been quite sluggish in Q2, weighed down by both supply and demand-side factors

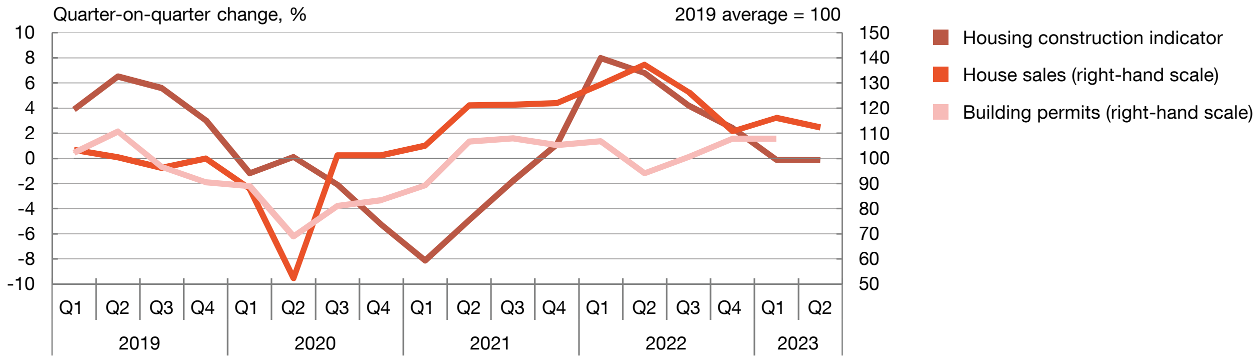
— On the supply side, the high costs of certain house building materials, labour shortages and the gradual tightening of financing conditions in the sector seem to be continuing to weigh on housing investment (San Juan, 2023). Nevertheless, building permits appear to have remained quite steady in the opening months of the year (see Chart 15.a).

— On the demand side, the tighter financing conditions facing households also look to have had a significant impact on housing investment in recent quarters, although house sales have shown considerable resilience since the start of the year (see Chart 15.a).

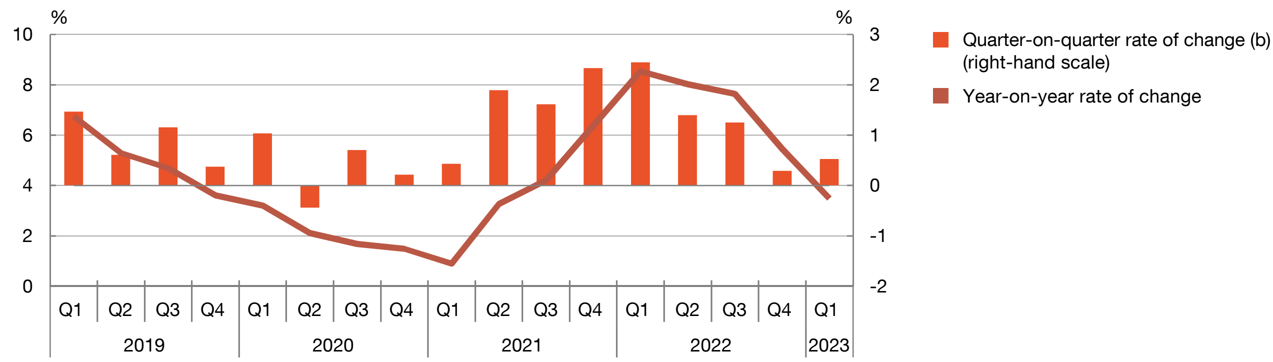
— The rate of growth of house prices moderated in Q1, down from 5.5% year-on-year in 2022 Q4 to 3.5%, an increase of 0.5% in quarterly terms (see Chart 15.b).

Chart 15

15.a Housing construction indicator, house sales and building permits (a)



15.b House prices



SOURCES: Banco de España, Centro de Información Estadística del Notariado, INE and Ministerio de Transportes, Movilidad y Agenda Urbana.

a For the housing construction indicator, the time frame considered is three months from issue of the building permit to the construction start date and 18 months thereafter for the construction work. Seasonally adjusted series for house sales. The latest observed data for house sales correspond to April 2023; the seasonally adjusted value is taken to represent 2023 Q2 as a whole.

b Calculated using the seasonally adjusted series.

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16 The foreign sector appears to have continued contributing positively to GDP growth in recent months, thanks to robust services exports and some competitiveness gains

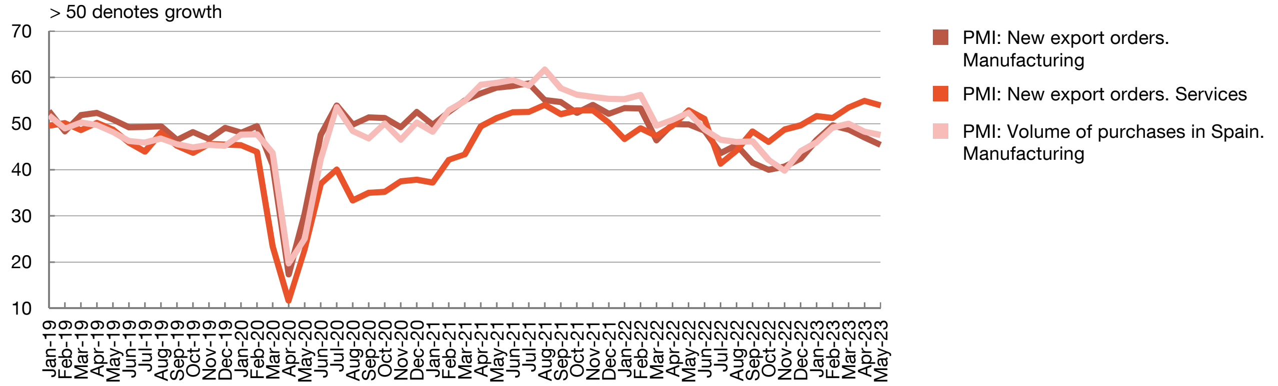
— In the early months of the year, the marked buoyancy in travel and non-travel services exports stood in contrast to the deceleration of goods exports. These movements seem to have continued throughout Q2, according to the May PMI for new export orders (see Chart 16.a).

— Meanwhile, the wage slowdown and more marked moderation of prices in Spain relative to the rest of the euro area recently appear to have led to improvements in the Spanish economy's competitiveness against its main trading partners. This can be seen, for instance, in competitiveness indicators based on unit labour costs (ULCs) and in consumer prices in comparison with the euro area (see Chart 16.b).

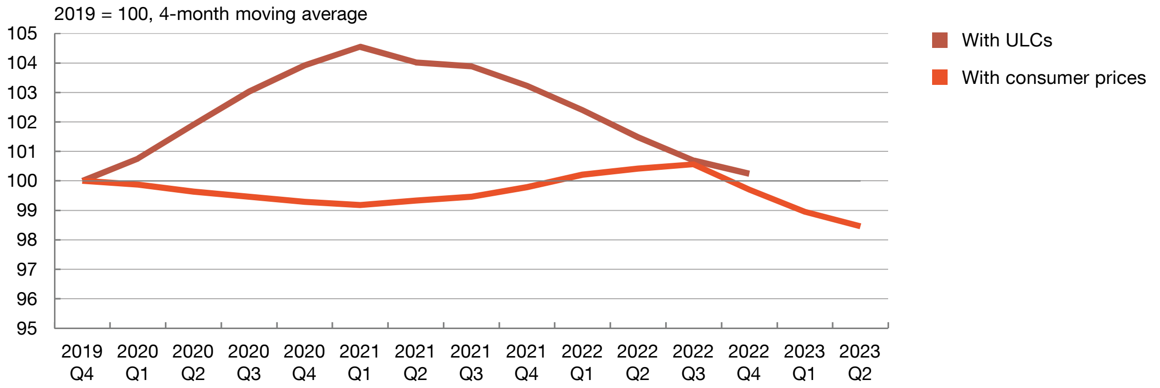
— In any event, in Q2 imports (which have seen a great deal of volatility in previous quarters) can be expected to be underpinned to a certain extent by strong capital goods investment. This would smooth net external demand's positive contribution to GDP growth in the quarter in comparison with Q1.

Chart 16

16.a Purchasing Managers' Indices



16.b Competitiveness indicators in Spain compared with the euro area (a)



SOURCES: Markit and ECB.

a Increases (decreases) of the indices reflect competitiveness losses (gains). Data as at May for 2023 Q2.

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17 The public sector may continue to underpin activity

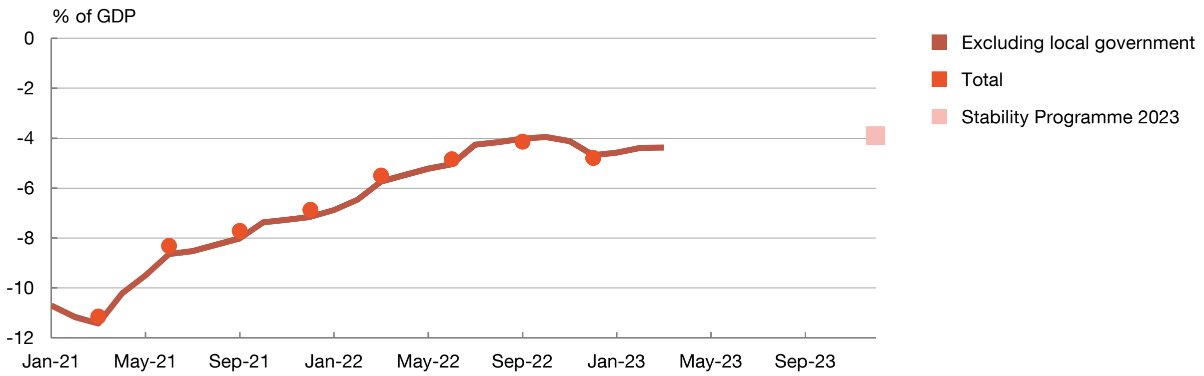
— A great deal of the support measures put in place to address the energy crisis were extended into 2023 and this, together with the increases approved for public sector wages and pensions and the roll-out of funding from the NGEU programme, appear to have led to an increase in government spending in recent months that more than offsets the increased receipts arising from the new taxes approved.[4] All of the above seems to have resulted in the public sector providing a broad-based boost to activity in the most recent period.

— However, as the stimulus provided by the NGEU programme has no impact on the general government balance,[5] the impulse will only be partially reflected in the public accounts. The 12-month cumulative general government balance appears to have improved slightly in 2023 Q1, rising by 0.4 pp, from -4.8% of GDP at end-2022 to -4.4% in March (see Chart 17.a).

— The recovery in revenue, which was the result of increased buoyancy in activity, the new taxes and the growth of other forms of revenue (mainly interest and dividends), provided a further boost. On the expenditure side, the uptick in social welfare benefits was noteworthy, rising 8.5% over the previous year's levels.

Chart 17

17.a General government balance (a)



SOURCES: Banco de España and IGAE.

a The IGAE only provides information on the overall general government sector quarterly.

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4 Mainly the increases in social security contributions, the new taxes on the financial sector, energy sector and wealth, and the new plastics and waste taxes. The combined impact of these measures on government revenue in 2023 is estimated to be around 0.6 pp of GDP.

5 Convention dictates that financial outlays of the NGEU programme are recorded at the same time as the corresponding receipt of the funds, such that there is no net impact on the general government balance.

18 Headline inflation continues to ease, owing to the energy component, while more recent months have seen early signs of a slowdown in food prices and underlying inflation

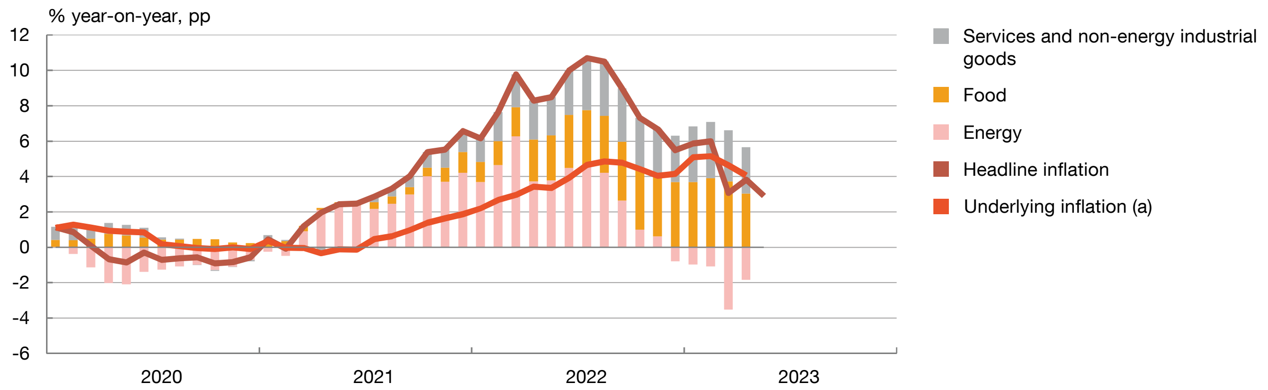
— Inflation in Spain stood at 2.9% in May – lower than expected and below the inflation rate recorded in the euro area –, down 7.8 pp on the July 2022 peak of 10.7% (see Chart 18.a).

— Until now, this correction has essentially been underpinned by the slowdown in energy prices. Nonetheless, Q2 so far appears to have seen the beginning of a slight downward trend in both food prices (particularly marked in the case of oil, bread and cereals, and dairy products) and underlying inflation (e.g. in the case of transport and, more recently, housing, recreation, hospitality and tourism).

— In any event, looking ahead, various factors could lead to a degree of downward stickiness in terms of the current inflationary pressures.[6] Such factors notably include, e.g. possible asymmetries in the way energy price variations pass through to consumer prices (in other words, falling energy costs pass through more slowly than rising energy costs), the drought that currently poses an upside risk to the future price of certain foods,[7] and the possibility that second-round effects on inflation might emerge via wages and/or profit margins.

Chart 18

18.a Inflation in Spain: variation and contribution of components



SOURCES: Eurostat and Banco de España.

a Headline inflation excluding energy and food.

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6 For further details on the future inflation outlook, see the Projections in this report.

7 It is estimated that food products affected by the drought are likely to account for between 15% and 20% of the total food component of the HICP.

19 Overall, wages continue to rise somewhat, slightly more so in the sectors hardest hit by labour supply shortages

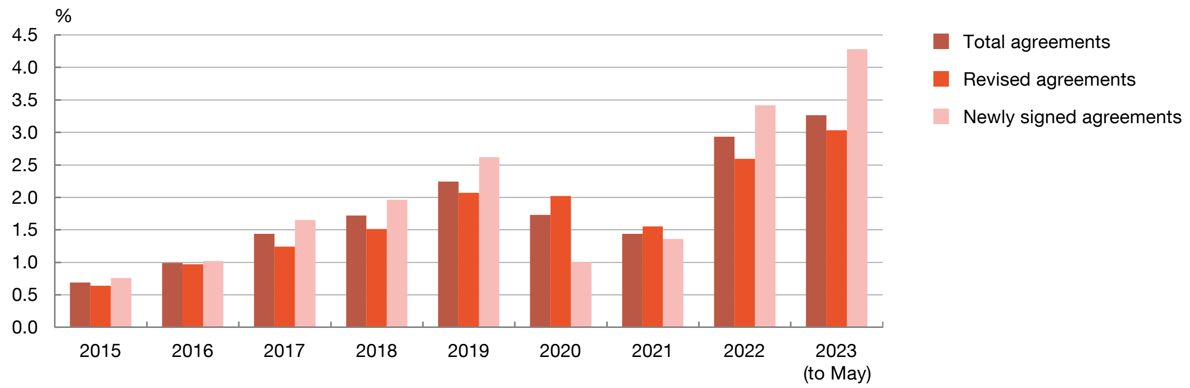
— According to the data on the collective bargaining agreements registered up to May, the average wage rise agreed for 2023 stands at 3.3%, slightly above the 2.9% agreed for last year. Within these agreements overall, those signed in 2023 – affecting around 1.5 million workers – provide for a higher average wage increase of 4.3% (see Chart 19.a).

— By activity, the wage increases agreed for 2023 tend to be higher in sectors in which workers are more scarce (proxied by the job vacancy rate), such as information and communication activities, and professional, scientific and technical activities (see Chart 19.b).

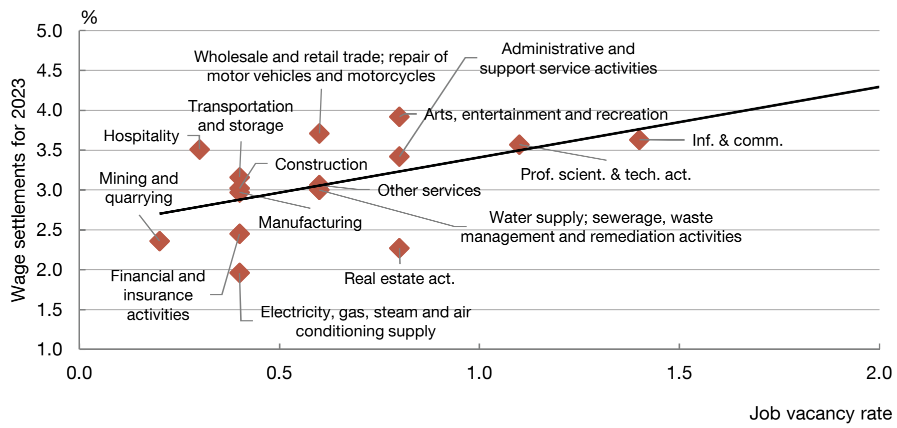
— Looking ahead, the fifth Employment and Collective Bargaining Agreement recently signed by Spain's main social partners includes recommended wage increases of 4% for 2023, and 3% for 2024 and 2025, notably mitigating the risks that second-round effects on inflation might emerge via wages.

Chart 19

19.a Wage settlements



19.b Wage settlements and job vacancy rate by sector



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SOURCES: Ministerio de Trabajo y Economía Social and EUROSTAT.

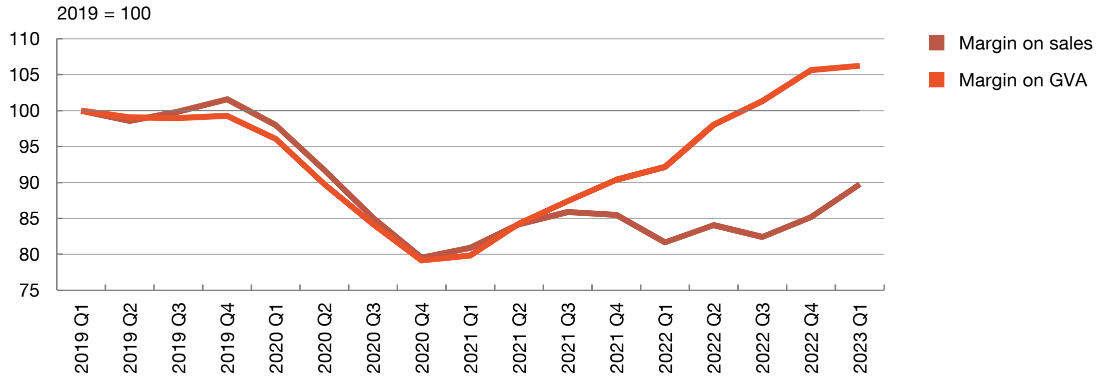
20 Profit margins seem to have continued to recover in the early months of 2023, albeit with high heterogeneity across sectors

— According to the information from the sample of firms in the Banco de España's Central Balance Sheet Data Office Quarterly Survey (CBQ), profit margins – proxied by both the ratio of gross operating profit (GOP) to gross value added (GVA) and the ratio of GOP to turnover – rose in 2023 Q1, although the margin on sales remains below its 2019 level (see Chart 20.a).

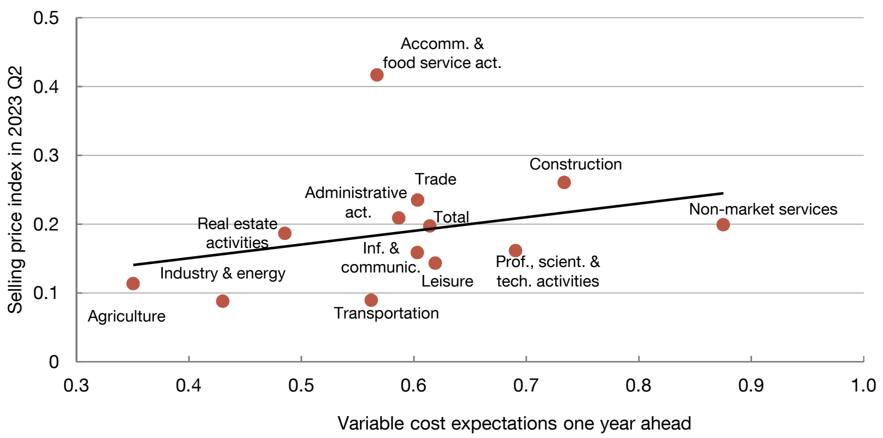
— Nevertheless, the results of the EBAE point to high heterogeneity in selling prices across sectors, which appears to be at least in part attributable to the differences in firms' expectations about future cost increases (see Chart 20.b). As these expectations have begun to edge down in recent months, a slight slowdown might be expected in price and profit margin increases in the future (Glover, Mustre-del-Río and Ende-Becker, 2023).

Chart 20

20.a Changes in profit margins according to CBQ data (a)



20.b Firms' selling prices and cost expectations (b)



SOURCES: INE and Banco de España.

a Margin on sales is defined as the ratio of GOP to net turnover. Margin on GVA is defined as the ratio of GOP to GVA. Both metrics are based on the CBQ. Four-quarter cumulative data.
b Results of the EBAE for 2023 Q2. The price and cost indices are constructed by assigning the following values to the firms' qualitative responses: significant increase = 2; slight increase = 1; unchanged = 0; slight decrease = -1; significant decrease = -2. Variable costs are calculated by weighting intermediate costs and labour costs by their weights calculated using National Accounts data.

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21 The Banco de España's latest macroeconomic projections revise GDP growth for 2023 upwards and average headline inflation for this year downwards

— The last section of this report describes the key features of the Banco de España's latest macroeconomic projections for the Spanish economy over the horizon 2023-2025.

— Under the assumptions of the exercise, Spanish GDP is projected to grow by 2.3%, 2.2%, and 2.1% in 2023, 2024 and 2025, respectively. Compared with the projections published in March, the current projections revise GDP growth for 2023 up by 0.7 pp, essentially due to stronger output growth in the year to date and the revision to the data for 2022 implied by the flash QNA data, published by the INE in April. Also, the commodity price assumptions are now somewhat more conducive to growth in 2023, although this effect is offset by tighter financial conditions having a more negative impact on economic activity than was envisaged in the March exercise. As regards the rest of the projection horizon, the growth projected for 2024 is revised downwards slightly (by 0.1 pp), while for 2025 it remains unchanged.

— Compared with the March projections, the average inflation rate for 2023 is revised downwards by 0.5 pp to 3.2%. This revision is mainly explained by a sharper-than-expected slowdown in energy prices – both in recent months and looking ahead – and, to a lesser extent, in food prices. Over the rest of the projection horizon, in line with the March projections, the rate of headline inflation is expected to rise to 3.6% in 2024 (as a result of the withdrawal of the measures rolled out by the authorities to tackle the energy crisis), before moderating, to 1.8%, in 2025.

— Against a backdrop in which uncertainty is still very high, the risks to the growth projections are mainly tilted to the downside, while for the inflation projections, they are considered to be balanced.

Figure 1

	2023	2024	2025
GDP	2.3% ↑ 0.7 pp	2.2% ↓ 0.1 pp	2.1% 0.0 pp
Inflation	3.2% ↓ 0.5 pp	3.6% 0.0 pp	1.8% 0.0 pp

SOURCE: Banco de España.