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. Under the assumptions of the exercise, Spanish GDP – which grew by 5.8% in real terms in 2022 – is projected to rise by 2.3%, 1.8% and 2% 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 3.6% in 2023 and increase slightly to 4.3% in 2024, before declining to 1.8% in 2025. Meanwhile, underlying inflation will stand at 4.1% this year (0.3 percentage points (pp) higher than in 2022), before slowing to 2.3% and 1.7% over the next two years.

Activity

In 2023 Q2 GDP growth in Spain was somewhat lower than projected by the Banco de España in June. Specifically, according to the flash estimate published by the National Statistics Institute (INE), quarter-on-quarter GDP growth decreased by 0.1 pp, to 0.4%, 0.2 pp below that projected by the Banco de España in June.[2] GDP growth during this period was underpinned by domestic demand, which contributed 1.9 pp, following the negative contributions in the two previous quarters. Within this aggregate, growth in consumption and investment in non-residential construction was particularly notable. Conversely, net external demand deducted 1.4 pp from growth, as a result of a sharp contraction in exports, concentrated in the goods and non-travel services components, which was more pronounced than that observed in imports.

When the INE published the flash estimate for 2023 Q2, it also revised the seasonally adjusted historical data of the QNA. This gave rise to a downward revision of GDP growth in 2022 Q1 and to slight upward revisions in the following four quarters. As a result of the historical data revision and GDP growth in Q2, the starting point for activity in the current projection exercise is somewhat more favourable than was anticipated in June. Specifically, all of this new information has a positive carry-over effect (of 0.1 pp) on GDP growth in the current year.

1 The current projections incorporate the new information that has become available since the publication of the previous projections – on 19 June – until 8 September, the cut-off date for this exercise. Specifically, the new information includes the Quarterly National Accounts (QNA) flash estimate for 2023 Q2 (which also entailed significant revisions to the data for preceding quarters), the Quarterly Non-Financial Accounts for the Institutional Sectors for 2023 Q1 and the higher-frequency information that has come to light since the cut-off date for the June projections. The projections also factor in the changes observed to 8 September in the technical assumptions used as a starting point for projecting the different macroeconomic aggregates (see Table 2). The exception is the assumptions regarding export market developments, which are taken from the September European Central Bank (ECB) staff macroeconomic projections for the euro area, with cut-off date of 22 August. Meanwhile, the National Statistics Institute (INE) released a revision of the Annual National Accounts (ANA) series on 18 September (one day before the publication of these projections). This information has not been included in the projections as it was not available before their cut-off date. Nevertheless, it would not have been possible to use these data consistently in the current projection exercise, since the methodological procedures used by the Banco de España in preparing its projections are based on quarterly series, and the quarterly series consistent with the new annual data will not be available until 22 September. In any case, the 2022 GDP growth rate of 5.8% referred to in the text corresponds to the revised ANA figure, as opposed to the 5.5% reported in the previous series.

2 "Macroeconomic projections for the Spanish economy (2023-2025)". *Economic Bulletin - Banco de España,* 2023/Q2.

Table 1
Macroeconomic projections for the Spanish economy (a)

Annual rate of change (%)

	GDP				HICP				HICP excluding energy and food				Unemployment rate (% of labour force) (b)			
	2022 (c)	2023	2024	2025	2022	2023	2024	2025	2022	2023	2024	2025	2022	2023	2024	2025
September 2023	5.5	2.3	1.8	2.0	8.3	3.6	4.3	1.8	3.8	4.1	2.3	1.7	12.9	12.0	11.5	11.3
June 2023	5.5	2.3	2.2	2.1	8.3	3.2	3.6	1.8	3.8	4.1	2.1	1.7	12.9	12.2	11.5	11.3

SOURCES: Banco de España and INE.
NOTE: Latest QNA figure published: 2023 Q2.

a Projections cut-off date: 8 September 2023.
b Annual average.
c The new GDP growth figure for 2022 would stand at 5.8%, instead of the 5.5% reflected in the table, following the revision to the Annual National Accounts time series for 2020-2022 published by the INE after the cut-off date for the projections (18 September).

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

Annual rate of change (%), unless otherwise indicated

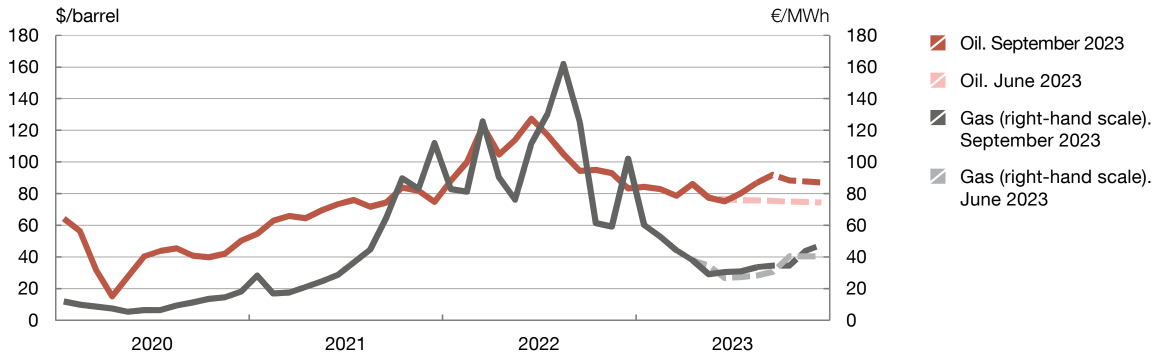
		September 2023 projections			Difference between the current projections and the June 2023 projections (b)		
	2022	2023	2024	2025	2023	2024	2025
Spain's export markets (c)	8.0	0.3	2.6	2.8	-0.5	-0.5	-0.1
Oil price in dollars/barrel (level)	103.7	83.8	83.5	78.8	5.8	10.9	8.4
Monetary and financial conditions							
Dollar/euro exchange rate (level)	1.05	1.08	1.08	1.08	0.00	-0.01	-0.01
Nominal effective exchange rate against non-euro area countries (d) (2000 = 100)	112.1	115.7	115.7	115.7	0.3	0.1	0.1
Short-term interest rate (3-month EURIBOR; level) (e)	0.3	3.4	3.6	3.0	0.0	0.2	0.1
Long-term interest rate (10-year Spanish government bond yield; level) (e)	2.2	3.5	3.7	3.8	0.0	0.1	0.0

SOURCES: ECB and Banco de España.

a Cut-off date for assumptions: 22 August for Spain's export markets and 8 September 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 September 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 and Reuters.

The tightening of financing conditions continued to be a drag on growth during the summer months. Although global monetary policy tightening has continued to slow down in recent months, the international financial markets have started to assume, in line with the persistence of considerable underlying inflationary pressures and the messages conveyed by the world's main central banks, that interest rates will remain relatively high for longer than expected a few months ago. This seems to have contributed to a rise in long-term interest rates during Q3. In parallel, in the Spanish economy, the cost of servicing the outstanding balances of existing variable-rate debt and the cost of refinancing past-due balances have continued to rise. This appears to be exerting increasing pressure on indebted agents' income. Also, the cost of new bank lending has continued to increase in recent months. This, together with the fresh tightening of credit standards, seems to have negatively impacted the volume of new loans to firms and to households for house purchase.[3]

A worsening of the external economic environment and a surge in energy prices have also been observed during the summer. Indeed, according to the latest indicators available, global economic activity has been slowing down over the last few months. This is particularly evident in China and the euro area (by geographical area) and in the manufacturing sector (by sector of activity). Furthermore, as a result of the materialisation of different negative supply shocks at international level, oil and natural gas prices have recently risen more than expected a few months ago. These increases have also been observed in the Spanish economy (see Chart 1).

Against this backdrop, Spanish economic growth appears to have moderated somewhat in 2023 Q3. Pointing in this direction, in particular, are Social Security registrations, which grew at a slightly slower pace in July and August than in Q2, and the results of the latest edition of the Banco de España Business Activity Survey (EBAE, by its Spanish acronym), which suggest a

3 Conversely, consumer credit has shown some strength recently. This could signal that some household groups are facing growing difficulties as regards carrying out their decisions to purchase goods and services using their current income and accumulated savings.

weakening of business turnover in this period (Fernández Cerezo and Izquierdo, 2023). In addition, the Purchasing Managers' Indices (PMIs) show that the growing weakness in industry has also been accompanied by the emergence of signs of a loss of momentum in the services sector in the final stretch of the quarter. The services sector, however, continues to be comparatively more buoyant than manufacturing, especially in activities connected to leisure and tourism. Overall, with the caveat that the information available is incomplete, quarter-on-quarter GDP growth in Spain in Q3 is estimated at around 0.3%.

Looking ahead to the coming quarters, activity is expected to continue to show relatively subdued growth, influenced by the effects of various factors operating in opposite directions and with a different timing. These factors include most notably:

— The continuation of the **pass-through of monetary policy tightening** to the cost of new loans and the interest burden of borrowers, which will still adversely impact the GDP growth rate over much of the projection horizon.

— The weak **external environment,** which will also weigh on economic activity in Spain in the final stretch of the year. However, Spanish goods exports will be boosted from 2024 by the expected recovery in external markets and the competitiveness gains over the rest of the euro area stemming from the greater labour cost moderation in Spain of late. **Inbound tourism** has contributed very positively to GDP growth in recent quarters and will also foreseeably continue to do so in Q3 and in the short term. However, as tourism exports have already recovered their pre-pandemic levels, their contribution to GDP growth should be expected to taper off in the longer term.

— The **public policies adopted in response to the energy crisis** and to rising inflation, which will continue to underpin activity in the remainder of the year. However, these measures eventually being withdrawn at the end of 2023 (according to the timetable announced) will hold Spanish economic growth back over the rest of the projection horizon, especially in 2024.

— Conversely, in the period 2024-2025 the Spanish economy will be increasingly bolstered by the gradual **softening of inflationary pressures,** the **progressive recovery in agents' confidence, labour market resilience** and the expected pick-up in the **roll-out of projects under the Recovery and Resilience Facility,** among other factors.

Considering all these factors, the annual average rate of GDP growth is expected to moderate substantially this year and have a relatively flat profile over the subsequent two-year period. GDP will grow by 2.3% in 2023, down 3.5 pp on 2022. As in Q2, domestic demand will continue, in the remainder of the year, to be the main driver of growth. However, in the year overall, the contributions of the external sector and domestic demand to output growth will be similar (see Table 3 and Chart 2). GDP will grow at around 2% in 2024-2025, essentially underpinned by private consumption and, to a lesser extent, gross fixed capital formation. The external sector will make practically zero contribution to growth in 2024 and 2025. In the labour market,

Table 3

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

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

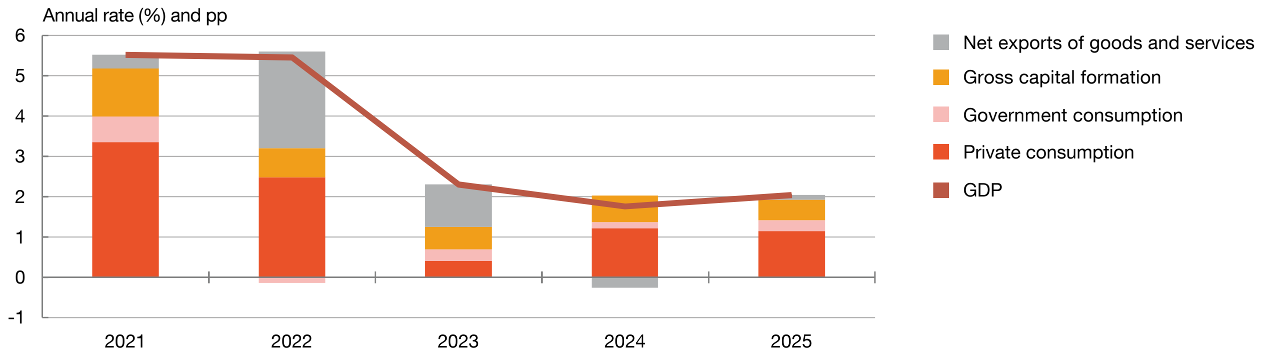
		September 2023 projections			June 2023 projections		
	2022	2023	2024	2025	2023	2024	2025
GDP	5.5	2.3	1.8	2.0	2.3	2.2	2.1
Private consumption	4.4	0.7	2.2	2.0	0.2	3.3	2.0
Government consumption	-0.7	1.4	0.8	1.4	0.6	0.8	1.3
Gross fixed capital formation	4.6	3.1	3.4	2.4	1.7	4.1	2.8
Exports of goods and services	14.4	4.0	2.2	3.0	7.1	2.2	3.0
Imports of goods and services	7.9	1.5	3.2	3.0	3.2	4.0	3.1
Domestic demand (contribution to growth)	3.1	1.2	2.1	1.9	0.6	2.8	2.0
Net external demand (contribution to growth)	2.4	1.1	-0.3	0.1	1.7	-0.6	0.1
Nominal GDP	10.0	7.6	5.1	3.8	6.8	5.4	4.1
GDP deflator	4.3	5.2	3.3	1.7	4.4	3.2	2.0
HICP	8.3	3.6	4.3	1.8	3.2	3.6	1.8
HICP excluding energy and food	3.8	4.1	2.3	1.7	4.1	2.1	1.7
Employment (hours)	4.1	1.3	1.5	1.3	1.7	1.8	1.1
Unemployment rate (% of labour force). Annual average	12.9	12.0	11.5	11.3	12.2	11.5	11.3
Net lending (+) / net borrowing (-) of the nation (% of GDP)	1.5	5.0	4.1	3.3	4.8	3.9	3.5
General government net lending (+) / net borrowing (-) (% of GDP)	-4.8	-3.7	-3.4	-4.1	-3.8	-3.4	-4.0
General government debt (% of GDP)	113.2	108.8	106.9	107.9	109.7	107.4	108.0

SOURCES: Banco de España and INE.
NOTE: Latest QNA figure published: 2023 Q2.

a Projections cut-off date: 8 September 2023.
b The figures for 2022 do not include the revision to the Annual National Accounts for 2020-2022 released by the INE after the projections cut-off date (18 September).

Chart 2

2.a GDP growth and contributions of main components (a)

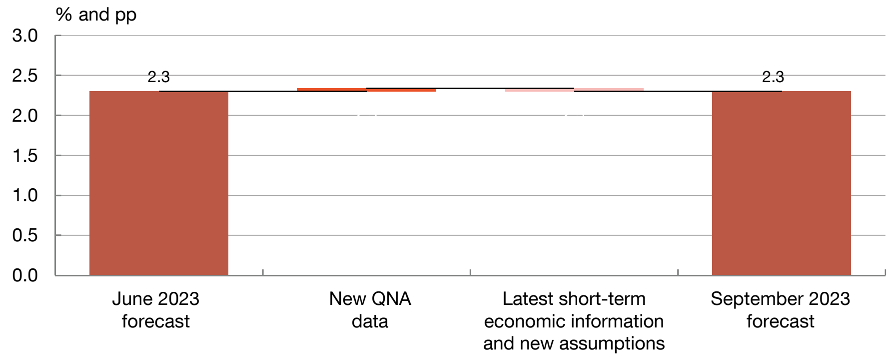


SOURCE: INE.

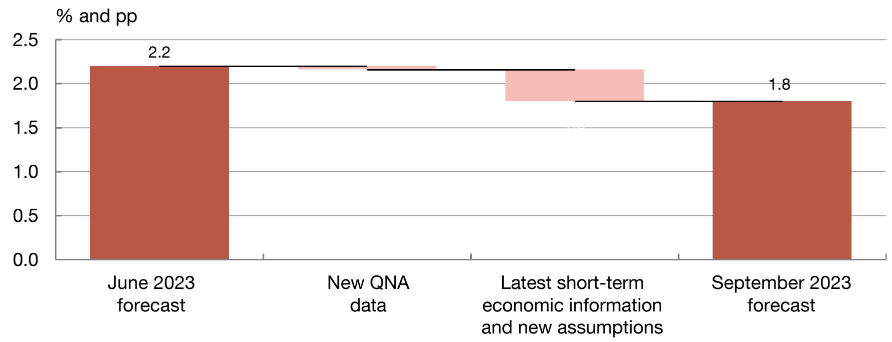
a Following the release of the INE's revised Annual National Accounts time series for 2020-2022 after the projections cut-off date (18 September), the figures for GDP growth and its components in 2021 and 2022 have changed and differ from those depicted in this chart.

Chart 3

3.a Changes in the GDP growth forecast for 2023



3.b Changes in the GDP growth forecast for 2024



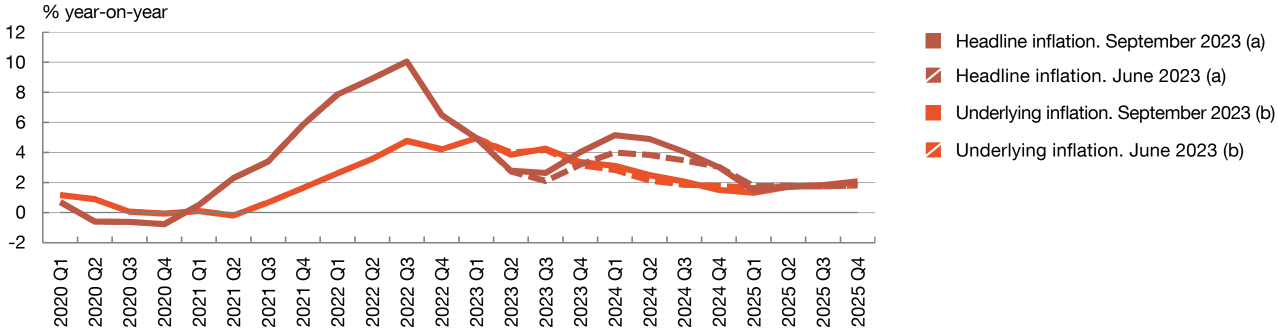
SOURCES: INE and Banco de España.

employment will remain highly buoyant this year (with the number of persons employed growing by 2.6%), but decelerate in 2024 and 2025, in line with the projections for activity, although apparent labour productivity will recover slightly. At the end of the projection horizon, the number of hours worked per person will remain below its 2019 level, reflecting the historically downward trend of this variable. Continued job creation explains the projected decline in the unemployment rate, which will stand at around 11% on average in 2025, amid sustained labour force growth, benefitting from the population growth associated with migratory flows.

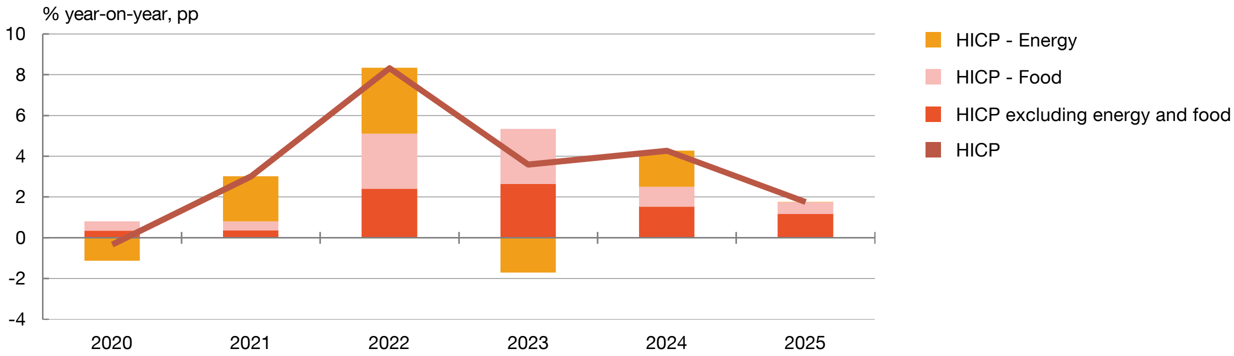
Compared with the June projections, GDP growth remains unchanged in 2023, but is revised down in 2024 and 2025. The unchanged projected growth rate for this year is due to a combination of different factors with opposite effects (see Chart 3.a). On the one hand, as mentioned above, the latest QNA data entail a 0.1 pp upward revision to the annual average GDP growth rate in 2023. On the other, however, estimated growth for 2023 H2 is now somewhat lower than projected in June, as a result of the latest short-term economic information and the new technical assumptions underlying these projections. In particular, the new assumptions entail higher energy prices, higher interest rates and less favourable export market developments for activity growth (see Table 2 and Annex 1). Meanwhile, the GDP growth rate projected for 2024 is now 0.4 pp lower than in June. Most of this revision (just over 0.3 pp) is due to activity now being

Chart 4

4.a Headline and underlying inflation



4.b Contributions to HICP growth by component



SOURCES: INE and Banco de España.

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

expected to perform worse in 2023 H2 – which has a negative carry-over effect on average growth for 2024 – and to the change in the technical assumptions, especially as regards the higher energy prices, but also, to a lesser extent, the deterioration in the external environment and the greater tightening of financing conditions. The remainder (just under 0.1 pp) is the result of the negative carry-over effect on output growth in 2024 stemming from lower GDP growth in 2023 Q2 than envisaged in the June Banco de España projections (see Chart 3.b). Lastly, the relatively slight downward revision to the GDP growth rate projected for 2025 is mainly the result of the negative carry-over effect on that rate of the less buoyant activity now expected for 2024.

Prices and costs

Headline inflation has increased slightly over the summer. Specifically, the year-on-year rate of change of the harmonised index of consumer prices (HICP) stood at 2.4% in August, having fallen to 1.6% in June, its lowest level since April 2021 (see Chart 4.a). By component, this increase reflects an easing of the pace of the year-on-year drop in energy prices, on account of the recent higher oil prices on international markets and the base effects stemming from the decline in energy product prices in 2022 Q3.

The deceleration in food prices initiated in late 2023 Q1 has continued in recent months. The slowdown in these prices has been relatively widespread. However, adverse weather conditions have exerted further inflationary pressures on some products (such as olive oil and certain fruits and vegetables) in recent months.

Similarly, underlying inflation has eased in 2023 to date. However, the deceleration has tended to level off over the summer months. In particular, underlying inflation increased in July and August compared with the rates recorded in the spring. This increase was partly the result of some temporary technical factors.[4] Yet it also stemmed from the relative momentum of leisure, hospitality and travel services prices, driven by considerably robust demand in these sectors over the summer.

In the short term, the path of headline inflation will be influenced by the behaviour of the energy component. The HICP energy index is expected to fall to a year-on-year rate close to 20% on average in 2023 Q3. However, the recent increase in the corresponding commodity prices (oil particularly), combined with the base effects stemming from drops in these products' prices in late 2022, means that the year-on-year rate of change of this component will fall to close to 0% in Q4. In addition, the assumption in these projections about the main measures rolled out by the authorities to mitigate the effects of the energy crisis being withdrawn in late 2023 will contribute to the increase in the pace of growth of energy prices extending into the early quarters of 2024, to stand at close to 25% in the spring. Given the path of energy prices on futures markets, energy inflation will start to ease in the final stretch of 2024, falling to practically zero at the end of the projection horizon.

Food inflation will follow a downward path over the coming quarters. The expected deceleration is explained by the decline in the costs of some production inputs, such as energy and fertilisers, after they surged during much of 2022. However, the extent of food price moderation will tend to be limited by the negative impact that adverse weather conditions could have on the production of certain agricultural goods in some geographical areas and, probably, by Russia's withdrawal from the Black Sea Grain Initiative. In any event, despite the idiosyncrasy of the different determinants of the current food price cycle, the recent deceleration in food prices generally appears to be in line with that observed historically following other episodes of rising prices.

Moreover, underlying inflation will slow from the final stretch of 2023 (see Chart 4.a). This will reflect the gradual impact of monetary policy tightening on demand, the easing of the inflationary pressures stemming from the post-pandemic reopening of the economy, and the

4 Specifically, the annual revision to the weights of the different goods and services in the index at the beginning of the year led to clothing and footwear items having a lower weight, which has reduced the effect of the summer sales in these items on headline HICP.

progressive, albeit somewhat lagged, pass-through of lower energy costs to the prices of non-energy industrial goods and services. Among the components of underlying inflation, the slowdown over the coming quarters is expected to be more pronounced in non-energy industrial goods than in services – as it has been so far this year – in line with the stronger demand for services (particularly for more contact-intensive services) and the differing cost structures of the productive sectors. Specifically, in the case of non-energy industrial goods, inputs account for a larger relative share of costs and their prices have begun to decline year-on-year over the course of the year; in the case of services, however, wages account for a greater share of the costs and are rising somewhat.

As a result, in terms of annual average rates, headline inflation in 2023 will moderate considerably from the rate of 8.3% in 2022, to then rebound in 2024 and fall back to below 2% in 2025. The annual average increase in the HICP will stand at 3.6% in 2023 and rise to 4.3% in 2024 owing to the greater contribution of the energy component, which will more than offset the expected reduction in food and underlying inflation for that year (see Chart 4.b). The stabilisation of the energy HICP and the continued disinflation in the non-energy HICP will result in headline inflation of 1.8% in 2025. Meanwhile, underlying inflation is expected to run at 4.1% in 2023 and to then ease to 2.3% in 2024 and 1.7% in 2025.

This inflation outlook rests on two key assumptions. First, in line with the empirical evidence available, some asymmetry in the pass-through of energy price changes to other consumer prices has been incorporated into the projections, whereby consumer prices respond more strongly when energy input prices rise than when they fall. This leads to some downward stickiness in underlying inflation, which appears to have been made stickier still by the recent rise in oil prices. Second, in line with developments to date, it is assumed that no significant second-round effects – via wages or profit margins – that might trigger a wage-price spiral will emerge over the projection horizon.

As compared with those published in June, the current projections revise up headline inflation in 2023 and 2024. Specifically, average headline inflation for these years is now expected to be 0.4 pp and 0.7 pp higher, respectively, than projected in June. For 2023, this primarily owes to the rise in oil prices observed during the summer. In 2024, it owes mainly to the higher cost of energy and, to a lesser extent, the effects on inflation for the year of the assumption regarding the renewal of the VAT rate reduction on food stuffs and of the public transport subsidy until end-2023.

Risks

Against a backdrop in which uncertainty remains very high, the risks to the projections are considered to be tilted to the downside for economic growth and balanced for inflation. The main risk factors relating to the projected GDP path stem from global economic activity potentially faring worse than considered in the underlying assumptions (associated specifically with a more pronounced slowdown in the Chinese economy) and from the tighter financing conditions having a potentially more severe impact on activity than envisaged in the baseline scenario (in turn, lowering the inflation path). Further, there is a risk that a hypothetical escalation in geopolitical tensions (for example, in the context of the war in Ukraine) could exert upward pressure on energy and food commodity prices and even disrupt the availability of these goods. Such a scenario would lead to a rise in inflation and a downturn in activity.

As a rule, quantifying the scale and timing of the impact of monetary policy tightening on activity and prices is a considerably complex exercise. One reason for this is that monetary policy operates with a lag whose duration is uncertain. In the current episode, such difficulties are also exacerbated by monetary tightening having been, like the surge in inflation, unusually rapid, intense and globally synchronised. In these circumstances, it is particularly hard to determine the appropriate dosage of monetary tightening, as a stronger-than-expected transmission of monetary policy would lead to a larger contraction in aggregate demand and, therefore, a lower inflation path.

A larger-than-expected increase in wages or profit margins would push the inflation path higher. So far, the easing of underlying inflation is proving modest in both Spain and, above all, other jurisdictions. Until a downward trend in underlying inflation becomes more firmly entrenched, the emergence of second-round effects on prices via wages and/or profit margins cannot be ruled out, especially amid substantially robust demand for labour. Such a scenario in the euro area overall could call for more forceful monetary policy action, leading to a further tightening of financing conditions and, therefore, a greater weakening of private agents' spending.

There are also other sources of uncertainty surrounding activity and prices on the domestic front. In particular, there are doubts as to the capacity of the household savings built up during the pandemic to support private consumption over the coming quarters, and as regards the pace at which the NextGenerationEU projects will be rolled out and their impact on activity. Another significant risk is that stemming from the persistence of the high structural budget deficit and public debt, amid rising borrowing costs and the reactivation of European fiscal rules.

Annex 1
Assumptions underlying the projections

In comparison with the June projections, the technical assumptions used as a starting point for the current projection exercise are somewhat less favourable for activity. Specifically, the new assumptions entail a downward revision to the growth of Spain's export markets, particularly in 2023 and 2024, and higher energy prices as regards gas and, especially, oil (see Table 2). Money market rates and sovereign debt yields expected by financial markets in the coming years are currently somewhat higher than they were three months ago. In line with this, new lending is now also expected to cost slightly more over the projection horizon than forecast three months ago. Lastly, the nominal effective exchange rate is now stronger.

The fiscal assumptions remain largely the same as in the June projections. As regards new measures, Royal Decree-Law 5/2023 of 28 June 2023 renewed, until the end of the year, some of the measures adopted in response to the economic and social consequences of the war in Ukraine, with an estimated impact on the general government deficit of 0.1 pp of GDP. Meanwhile, the latest data on actual revenue and expenditure for this year suggest the deficit for 2023 will be somewhat narrower than projected in June. Further, in the absence of new material information, the expected path of expenditure financed with European funds from the Recovery and Resilience Facility (RRF) is unchanged from the previous projection exercise.[5] Nevertheless, the uncertainty surrounding this path remains very high.

For the other budget items, the projections are based on the standard technical assumptions. As in previous exercises, the projections continue to assume that the upward surprises in tax revenue observed in 2020-2021 will partially reverse over the projection horizon, that the support measures approved during the energy crisis will be withdrawn in early 2024 and that the temporary revenue-raising measures will not be renewed further than currently approved.[6]

5 As a percentage of GDP, expenditure financed with RRF funds is expected to be slightly above 1% in 2023, to peak at around 1.3% in 2024 and to fall back to around 1% in 2025.

6 The temporary levies on the financial and energy sectors, a wealth tax and a limit for consolidated groups on offsetting losses for corporate income tax purposes.