MACROECONOMIC PROJECTIONS FOR THE SPANISH ECONOMY (2024-2026)

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This section presents the key features of the most recent update to the Banco de España's macroeconomic projections for the Spanish economy for 2024-2026.[1]

Under the assumptions of the exercise, Spanish GDP – which grew by 2.5% in 2023 – is expected to slow to a growth rate of 1.9% in 2024, with this figure holding steady in 2025, before again slowing to 1.7% in 2026 (see Table 1). Meanwhile, the unemployment rate, which stood at 12.1% in 2023, will continue trending slightly downwards in the coming years, albeit remaining just above 11% in 2026. On the price front, inflation is set to decline over the projection horizon, falling from an average of 3.4% in 2023 to 2.7%, 1.9% and 1.7%, in 2024, 2025 and 2026, respectively. Core inflation will also slow gradually over the next three years, from an average rate of 4.1% in 2023, to 2.2% in 2024, 1.9% in 2025 and 1.8% in 2026.

The remainder of this section is structured as follows. First, the key assumptions and determinants underlying these projections are described. Then, the main features of the outlook for activity and prices are detailed. Lastly, some of the main risks to these projections are discussed.

Main determinants and assumptions underlying the projections

The projections are based on a set of technical assumptions regarding the expected future path of certain macro-financial and fiscal variables, which are key to assessing how activity and inflation may evolve in the coming quarters. Moreover, the new GDP data for preceding quarters mean that the starting point used to project the future paths of activity and prices has changed from the previous projections. The role that these factors play in the current projection exercise is described briefly below.

Assumptions about future energy price developments. Eurosystem projection exercises use energy commodity futures to proxy the expected future path of energy commodity prices over the projection horizon. Futures markets currently signal lower oil, natural gas and electricity prices (particularly in the case of gas and electricity) than those incorporated into the December projections, although they remain above their pre-pandemic levels (see Chart 1).

Assumptions about future interest rate developments. Based on the expectations of the international financial markets,[2] the projected paths of interest rates on the money and sovereign

1 Compared with the projections published on 19 December, these projections incorporate the new information that has become available since then. This includes, in particular, the flash Quarterly National Accounts (QNA) estimate for 2023 Q4, the Quarterly Non-Financial Accounts for the Institutional Sectors (QNFAIS) for 2023 Q3 and the changes observed in the technical assumptions for the key projection variables. The cut-off date is 15 February, except for the data on overseas markets, for which it is 9 February.

2 As in the case of oil and other commodity prices, the assumptions regarding the future paths of market interest rates are based on the prices observed in the respective markets in the ten working days prior to the cut-off date of the projections (in this case, 15 February).

Table 1
Macroeconomic projections for the Spanish economy (a)

Annual rate of change (%)

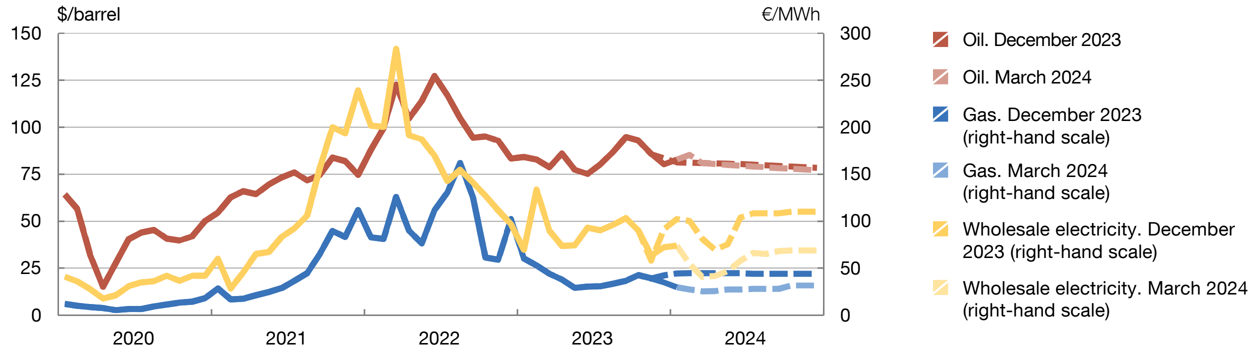
	GDP				Harmonised Index of Consumer Prices (HICP)				HICP excluding energy and food				Unemployment rate (% of labour force) (b)			
	2023	2024	2025	2026	2023	2024	2025	2026	2023	2024	2025	2026	2023	2024	2025	2026
March 2024	2.5	1.9	1.9	1.7	3.4	2.7	1.9	1.7	4.1	2.2	1.9	1.8	12.1	11.6	11.5	11.3
December 2023	2.4	1.6	1.9	1.7	3.4	3.3	2.0	1.9	4.1	1.9	1.9	1.8	12.1	11.7	11.4	11.3

SOURCES: Banco de España and INE.
NOTE: Latest QNA figure published: 2023 Q4.

a Projections cut-off date: 22 February 2024.
b Annual average.

Chart 1

1.a Energy prices



SOURCE: Mercado Ibérico del Gas, OMIE and Reuters.

debt markets have been revised downwards from the previous projection exercise (see Table 2). Accordingly, the cost of new lending between 2024 and 2026 is also now expected to be lower than anticipated three months ago. That said, it is worth noting that interest rates will remain relatively high throughout the entire projection horizon.

Assumptions about future external market developments. In step with the outlook for global economic activity in the coming quarters and, in particular, for euro area economic growth, the technical assumptions envisage a gradual recovery in Spain's export markets in the coming years. Nonetheless, the pace at which such markets are expected to grow in 2024 has been revised slightly downwards from the December projections (see Table 2). This revision is primarily due to the fact that activity in the euro area in the final stretch of 2023 was less robust than had been anticipated in December. Meanwhile, compared with the previous projection exercise, the nominal effective euro exchange rate has depreciated somewhat.

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

Annual rate of change (%), unless otherwise indicated

		March 2024 projections			Difference between the current projections and the December 2023 projections (b)		
	2023	2024	2025	2026	2024	2025	2026
Spain's export markets (c)	-0.1	1.4	3.1	3.1	-0.8	0.1	0.2
Oil price in dollars/barrel (level)	83.7	79.8	75.2	73.1	-0.3	-1.4	-0.5
Monetary and financial conditions							
Dollar/euro exchange rate (level)	1.08	1.08	1.08	1.08	-0.01	-0.01	-0.01
Nominal effective exchange rate against non-euro area countries (d) (2000 = 100)	115.6	115.5	115.4	115.4	-1.1	-1.2	-1.2
Short-term interest rate (3-month EURIBOR; level) (e)	3.4	3.4	2.5	2.3	-0.2	-0.4	-0.4
Long-term interest rate (10-year Spanish government bond yield; level) (e)	3.5	3.3	3.4	3.5	-0.3	-0.4	-0.4

SOURCES: Banco de España and ECB.

a Cut-off date for assumptions: 9 February for Spain's export markets and 15 February for all other variables. Figures expressed as levels are annual averages; figures expressed as rates are calculated on the basis of the related annual averages.
b Differences 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 March 2024 *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 path of these variables.

Assumptions about fiscal policy in Spain.

— The new fiscal assumptions now factor in the extension to 2024 (approved in late December 2023) of some of the support measures in place during 2023 to address the surge in inflation. Specifically, in addition to the extension of certain measures already anticipated in the December projections (e.g. the extension to June of the transport subsidies and the reduced VAT rate on food), the partial extension of the energy tax reductions from January onwards has also been included.[3] These projections also now include the extension of the wealth tax.[4] Overall, compared with the December forecast,

3 First, VAT on electricity and natural gas rose from 5% to 10% in January, as opposed to the 21% envisaged in the December projections on the understanding that the measures would be withdrawn in full. Based on the information available at the cut-off date for these projections, VAT on natural gas will again be charged at 21% from 2024 Q2 onwards. In the case of electricity, the VAT rate in 2024 will return to 21% for any month where the average wholesale market price in the month preceding the reference month is equal to or lower than €45/MWh, a requirement that, based on the most recent developments and the futures market prices, will be met in four months during 2024. Meanwhile, in the first quarter of 2024 the excise duty on electricity has risen from 0.5% to 2.5%, and is set to rise to 3.8% in Q2 and to 5.1% from Q3 onwards (i.e. tantamount to withdrawing the measure in full). See Royal Decree-Law 8/2023 of 27 December 2023.

4 Initially approved for 2023 and 2024, this tax has been extended until such time as wealth taxation is reformed as part of the overhaul of regional government funding. Moreover, on 6 February the Government approved a reform to reduce personal income tax withholdings so as to exempt the lower levels of employment income (around the national minimum wage).

these new measures are expected to increase the budget deficit by 0.2 percentage points (pp) of GDP in 2024, while barely having any impact in the two following years.

— The assumptions regarding the expenditure and investment financed with funds from the European NGEU programme remain unchanged from the December projections. Such expenditure and investment is expected to have its biggest impact on Spanish GDP between 2025 and 2026.

— All told, bearing in mind the impact of the NGEU programme, these projections anticipate a slightly contractionary fiscal policy stance in 2024, albeit less so than envisaged in the December exercise. Over the rest of the projection horizon, and in the absence of additional measures, the fiscal policy stance is likely to be virtually neutral. It is important to note here that a contractionary stance will be needed from 2025 onwards once the EU's new fiscal rules have been rolled out.

New data and statistical revisions. The flash QNA estimate for 2023 Q4 points to higher GDP growth in the quarter (0.6%) than had been anticipated by the Banco de España in its December projections (0.3%).[5] The GDP growth rate was also revised up for 2023 Q2 (from 0.4% to 0.5%) and 2023 Q3 (from 0.3% to 0.4%). Taken on their own, these new figures would automatically entail a higher starting point for GDP for the current projections exercise and a higher GDP growth rate in 2024.

Activity

The growth rate of the Spanish economy quickened unexpectedly in the last quarter of 2023, although private consumption and gross fixed capital formation surprised on the downside. As noted above, according to the QNA flash estimate published by the INE,[6] GDP grew quarter-on-quarter by 0.6% in Q4, significantly exceeding the Banco de España's December projections (0.3%) and the figure observed in the preceding quarter (0.4%). Nonetheless, this growth was the result of very contrasting dynamics in the main demand components. On the one hand, changes in inventories (a highly volatile component in recent years) made a notably positive contribution to output growth (0.5 pp). Government consumption also showed surprisingly strong momentum, a state of affairs that appears to have led to a 3.8% increase in this component for 2023 overall, surpassing the rates seen in 2020 and 2021 at the height of the health crisis. On the other hand, both private consumption and gross fixed capital formation performed worse than expected. The former due to a sharper than anticipated deceleration, growing at a rate (0.3%) far short of the increase (1.2%) recorded in Q3. Gross fixed capital formation contracted somewhat sharply (by 2%) across most components, with a particularly notable decline (of 4.8%) in investment in capital goods and machinery. Should it persist, the relative weakness of these two demand components, which tend to underpin stable growth in any economy, could undermine

5 See "Macroeconomic projections for the Spanish economy (2023-2026)". *Economic Bulletin - Banco de España,* 4/2023.

6 Note that the data offered by the QNA for 2023 Q4 is still provisional, and may therefore be revised.

the ability of the Spanish economy to maintain the sizeable momentum seen in late 2023 in the coming quarters.

The latest short-term economic indicators suggest that economic growth in Spain may have decelerated slightly in 2024 Q1. Specifically, according to these indicators, the growth rate of private consumption has been similar in early 2024 to that observed in 2023 Q4, while business investment remains somewhat sluggish. Government consumption and inventories also appear to have lost steam, after posting robust growth in 2023 Q4. In the case of inventories, the most recent evidence suggests that when these make a large positive contribution to growth in one quarter, the contribution of stockbuilding in the following quarter is often negative.[7] On balance, an overall assessment of the various indicators available for 2024 Q1 – such as the Banco de España Business Activity Survey (EBAE), social security registrations and Purchasing Managers' Indices – is compatible with quarter-on-quarter GDP growth slowing to 0.4% in the period.

Looking beyond Q1, GDP growth is expected to remain relatively stable, converging over the projection horizon towards rates consistent with the Spanish economy's growth potential. This outlook reflects the net impact on economic growth of multiple factors, of different strengths and effects and over varying time frames. For example, GDP growth over the coming quarters will benefit from factors such as the adverse impact of monetary policy tightening on activity fading away, projected population growth, the gradual recovery of the European and global economy and the larger roll-out of NGEU funds. On the other hand, however, it will be adversely impacted, inter alia, by the petering out of some of the tailwinds driving recent growth (such as significant pent-up demand for certain goods and services and the sharp correction of some negative supply shocks that weighed on activity in 2021 and 2022) and the persistence of considerable geopolitical tensions. All told, an overall assessment of these factors suggests that, in annual average terms, GDP growth will slow from 2.5% in 2023 to 1.9% in 2024 and 2025, before declining slightly to 1.7% in 2026 (see Table 3).

While net external demand and government consumption made a notable contribution to GDP growth in 2023, private consumption and investment will be the main drivers of Spanish economic activity in the years ahead (see Chart 2). In the coming quarters, household consumption, which did not return to pre-pandemic levels until end-2023, will be boosted by population growth, higher real incomes (associated with easing inflation rates), strong job creation and projected wage rises. Moreover, after presenting considerable weakness throughout 2023, gross fixed capital formation will increase over the projection horizon, underpinned by the galvanising effect expected from NGEU projects (whose roll-out should gain traction in 2024 and 2025) and by the waning of the adverse impact of cumulative monetary policy tightening. Nevertheless, investment will continue to be the demand component that takes longest to return to pre-pandemic levels. Net external demand will make virtually no contribution to GDP growth in 2024-2026, mainly due to imports recovering – in step with the growth of final demand and gross

7 For example, stockbuilding made a positive contribution to GDP growth of 1.1 pp in both 2021 Q4 and 2022 Q4. In the following quarter, the contribution of this component was -0.7 pp and -0.5 pp, respectively.

Table 3

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

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

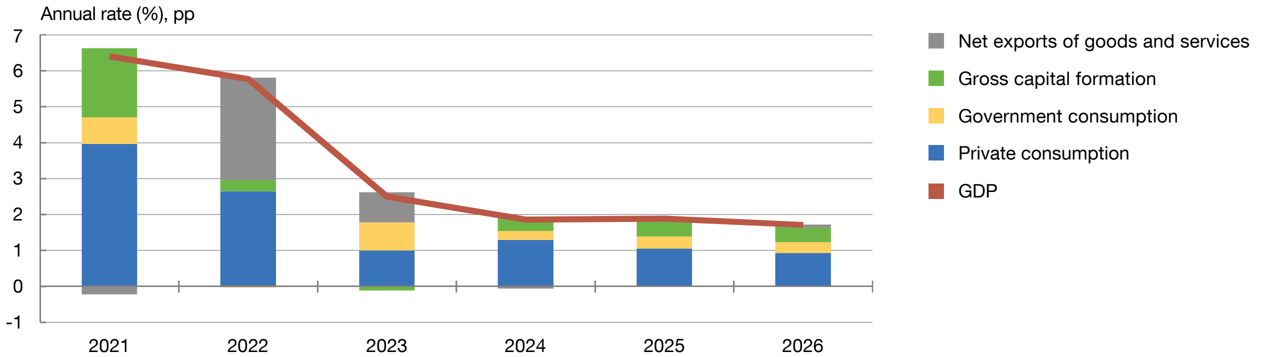
		March 2024 projections			December 2023 projections		
	2023	2024	2025	2026	2024	2025	2026
GDP	2.5	1.9	1.9	1.7	1.6	1.9	1.7
Private consumption	1.8	2.3	1.9	1.7	2.3	1.7	1.5
Government consumption	3.8	1.2	1.7	1.5	0.8	1.5	1.3
Gross fixed capital formation	0.6	0.4	2.7	1.9	2.7	2.7	1.8
Exports of goods and services	2.4	1.7	3.0	2.9	0.3	3.0	2.9
Imports of goods and services	0.3	2.1	3.4	3.0	1.3	3.0	2.7
Domestic demand (contribution to growth)	1.7	2.0	1.9	1.6	2.0	1.8	1.5
Net external demand (contribution to growth)	0.8	-0.1	0.0	0.1	-0.4	0.1	0.2
Nominal GDP	8.6	4.8	4.1	3.6	4.2	4.2	3.8
GDP deflator	5.9	2.9	2.2	1.9	2.6	2.3	2.1
HICP	3.4	2.7	1.9	1.7	3.3	2.0	1.9
HICP excluding energy and food	4.1	2.2	1.9	1.8	1.9	1.9	1.8
Employment (hours)	1.9	1.8	1.1	0.9	1.3	1.1	0.9
Unemployment rate (% of labour force). Annual average	12.1	11.6	11.5	11.3	11.7	11.4	11.3
Net lending (+)/net borrowing (-) of the nation (% of GDP)	3.6	3.4	3.5	3.6	2.9	3.0	3.0
General government net lending (+)/net borrowing (-) (% of GDP)	-3.8	-3.5	-3.5	-3.5	-3.4	-3.6	-3.6
General government debt (% of GDP)	107.7	106.5	107.2	108.4	106.3	107.2	108.4

SOURCES: Banco de España and INE.
NOTE: Latest QNA figure published: 2023 Q4.

a Projections cut-off date: 22 February 2024.

Chart 2

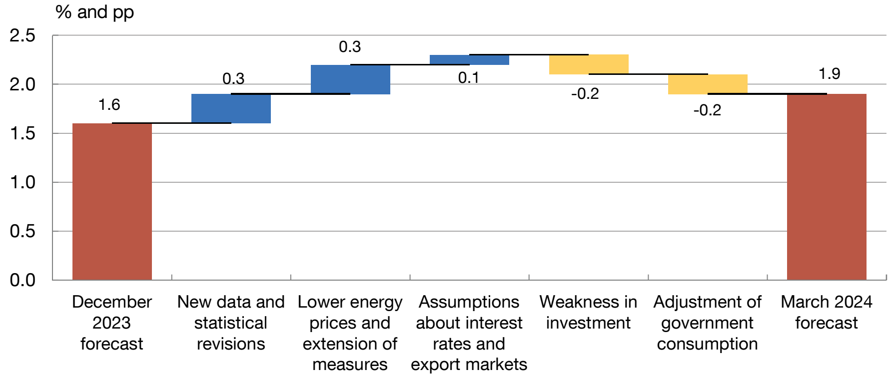
2.a GDP growth and contributions of main components



SOURCES: Banco de España and INE.

Chart 3

3.a Changes in the GDP growth forecast for 2024



SOURCES: INE and Banco de España.

fixed capital formation, which has a high import content – in a context in which exports of goods and services will also be relatively buoyant.

Compared with the December projections, GDP growth has been revised up in 2024 and is unchanged in 2025 and 2026. The average GDP growth rate for 2024 has been revised up by 0.3 pp to 1.9% (see Chart 3). This revision reflects the inclusion of the following elements, which operate in different directions:

— The new QNA data for 2023 Q4 – which present stronger than expected output growth – and the upward revisions to the GDP growth rates for the preceding two quarters have a positive carry-over effect on the average GDP growth rate of 0.3 pp for 2024.

— Other contributors to the upward revision to GDP growth for 2024 vis-à-vis December are the lower energy prices observed on the international markets in recent months, a more favourable outlook regarding the future course of such prices and the more gradual withdrawal of the measures deployed by the authorities to combat the effects of the inflationary episode.

— Based on the latest technical assumptions, the path of interest rates is now projected to be lower. This revision also gives a greater boost to economic activity over this year, by way of more favourable financing conditions for agents.[8]

— The weakness observed in gross fixed capital formation in recent quarters, along with firms' more negative outlook for 2024 Q1 compared with three months ago (according to

8 It should be noted that, for 2024, the favourable impact of lower interest rates on GDP growth more than offsets the slightly negative effect on output growth associated with the weaker momentum in Spanish export markets envisaged in this projection exercise.

EBAE data), will lead to investment being less robust in the more immediate future. This will push down the rate of GDP growth for 2024 compared with that projected in December.

— Strong government consumption in the last few months of 2023 meant that general government spending at year-end was significantly higher than envisaged in the December projections. This will result in less leeway for expansion in the coming quarters and, thus, slower GDP growth for 2024.

Turning to the labour market, employment is expected to lose some momentum over the projection horizon, resulting in a slight pick-up in productivity. Job creation in the final stretch of 2023 was higher than expected a few months ago – in keeping with the performance of activity – and could remain buoyant, as suggested by the indicators available for the first few months of 2024. Therefore, compared with the December projection exercise, expected employment growth has been revised up in 2024, but the deceleration projected for 2025 and 2026 remains unchanged. As a result, and despite the upward revision to GDP, apparent labour productivity will remain considerably weak in 2024, but is expected to rise slightly over the rest of the projection horizon. Meanwhile, the unemployment rate will continue to decline in the coming years, albeit at a slower pace than in previous years, owing to the expected moderation of job creation and the projected growth of the labour force, which, in line with figures for recent years, will be driven by strong immigration flows. As a result, the unemployment rate will hold at over 11% in 2026.

Prices and costs

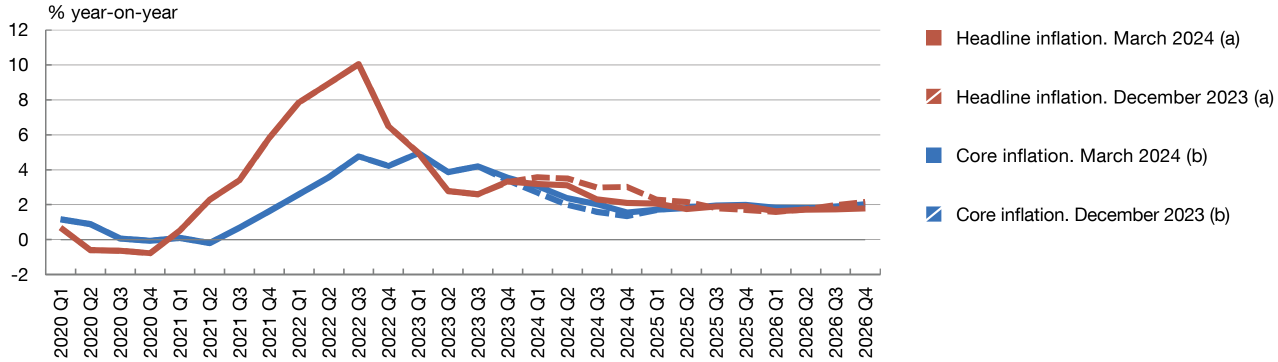
After rising slightly in January, headline inflation declined in February. Specifically, the year-on-year rate of change in the harmonised index of consumer prices (HICP) stood at 2.9% in February, compared with 3.5% in January and 3.3% in December. The higher inflation in January was primarily due to the impact of the partial reversal of some of the tax measures taken by the Government to mitigate the effects of rising inflation.[9] Nevertheless, this impact would have been significantly greater had the tax measures on energy prices been fully reversed, as was assumed in the December projection exercise. The slowdown in headline inflation in February was chiefly attributable to electricity prices being more contained, which more than offset the increase in fuel prices, following the declines recorded in previous months. In any event, compared with the December projection exercise, and after factoring in the impact of the partial reversal of the tax measures in January, the energy component appears to have surprised on the downside in recent months.

According to the more disaggregated data available to January, underlying inflation has held on a path of gradual deceleration in recent months, albeit at a slightly lower pace than expected in December, whereas food prices rose somewhat. Underlying inflation

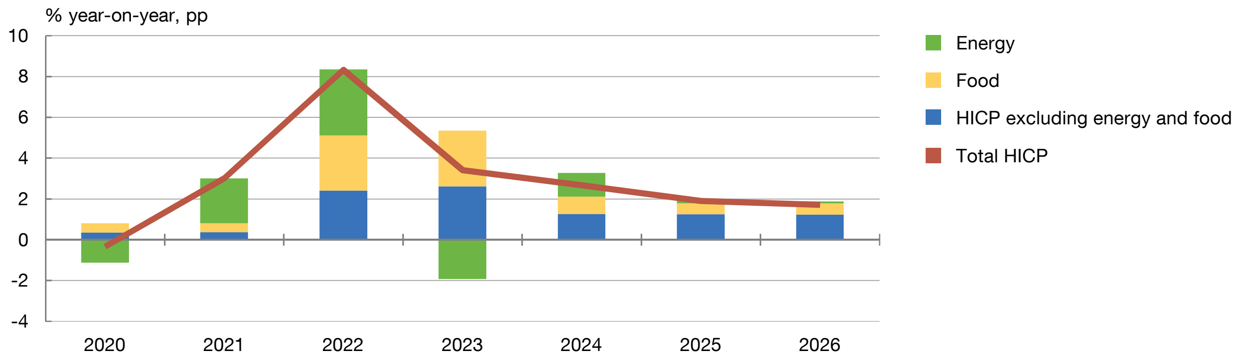
9 Specifically, the VAT rate on electricity and gas was increased from 5% to 10% on 1 January 2024, and the excise duty on electricity from 0.5% to 2.5%. These changes would have entailed an automatic rise in the January inflation rate of close to 0.3 pp.

Chart 4

4.a Headline and core 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.

declined by 0.3 pp in January to 3.2%, owing mainly to the loss of momentum in the prices of recreation, hospitality and tourism services and in those related to housing maintenance and repair. However, this moderation in underlying inflation was not as strong as expected. One noteworthy factor that may lie behind this surprise is clothing and footwear prices. Recent developments in these prices appear to be consistent with a more forceful than expected pass-through of past increases in producer prices, which seems to have been reflected, at least in part, by the smaller price discounts made during sales compared with previous years' estimates. Meanwhile, the higher growth rate of food prices was mainly attributable to base effects stemming from the VAT rate reduction for some foods in January 2023, as projected in December. However, the increase was slightly sharper than expected, owing to the downward stickiness of the price of certain foods whose production has been particularly affected by adverse weather conditions, such as fruit, vegetables and olive oil.

Inflation is expected to resume a downward path over the coming months (see Chart 4.a). This would reflect a gradual easing in food and core inflation, which should more than offset the increase in the contribution of the energy component. Indeed, the rate of change in the energy HICP, which stood at close to -9% in 2023 Q4, looks set to rise to around 2% at end-2024. Much of this increase would be associated with the above-mentioned gradual withdrawal of the tax measures.

Food inflation will continue to ease throughout the projection horizon (see Chart 4.b). The main driver behind this projected cooling of food inflation is the lower cost of several key production inputs, such as energy and fertilisers, with this decline also being reflected in food commodity prices. For its part, the reduced VAT rate on food has been extended to June 2024, which will help to contain food prices in the first half of the year but exert slight upward pressure in the second half.[10]

Meanwhile, core inflation will continue to slow over the course of this year and reach an average rate of around 2% in 2025-2026 (see Chart 4.a). The factors contributing to these developments over the coming quarters will include, inter alia, the impact on demand of the cumulative monetary tightening and the gradual pass-through to non-energy industrial goods and services of recent declines in energy prices. In addition, the public transport subsidies currently in force have been extended to the entirety of 2024, which will exert downward pressure on core inflation this year, but will have the opposite effect in 2025 when the measure is scheduled to expire.

In line with developments in recent quarters, no significant second-round effects on inflation are expected. In particular, developments in wage settlements are expected to remain in line with the fifth Employment and Collective Bargaining Agreement, with annual increases of around 3% over the projection horizon. However, compensation per employee will continue to rise at a somewhat faster pace than wage settlements, particularly in 2024, essentially due to a slightly positive wage drift. Meanwhile, profit margins are expected to remain relatively contained, such that they can accommodate the anticipated increases in unit labour costs (in a context in which compensation per employee continues to outpace productivity).

Considering all these developments, headline inflation will gradually ease from 3.4% in 2023 to 2.7% in 2024, 1.9% in 2025 and 1.7% in 2026. Core inflation, which in 2023 stood at 4.1% in annual average terms, will decline to 2.2% in 2024 and fall slightly further over the following two years.

Compared with the previous projections, headline inflation for 2024 has been revised down considerably. Specifically, the average headline inflation rate now projected for 2024 is 0.6 pp lower than envisaged in December. This revision essentially owes to the net impact of several factors pulling in opposite directions (see Chart 5.a):

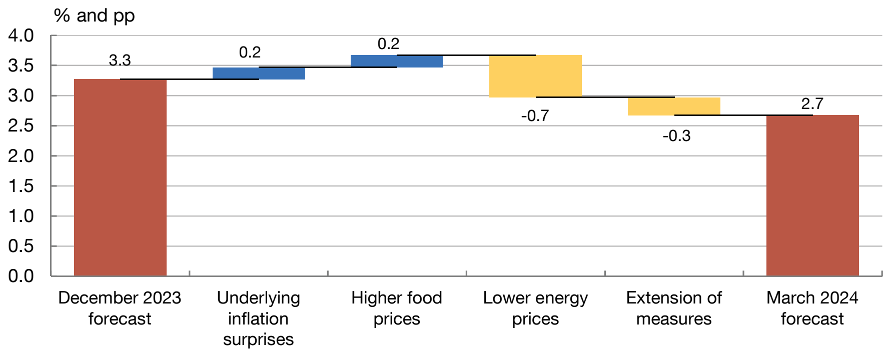
— The lower energy prices observed over the last few months and the current more favourable futures market expectations as to the course of such prices over the coming quarters result in a downward revision of 0.7 pp in average headline inflation for 2024.[11]

10 In line with the measures approved by the Government, it is assumed that in June 2024 the VAT rate on certain staple food products will return to 4% (from 0% at present) and that on other food products will revert to 10% (from 5% at present). This assumption was also included in the December projections.

11 The latest projection assumptions envisage lower energy prices throughout the horizon, which also entail a downward revision to the inflation rates projected for 2025 and 2026. However, for 2025, this downward revision is offset by the positive impact of the expiry, scheduled for that year, of the measures rolled out by the authorities to tackle the spike in inflation, which will remain in force in 2024.

Chart 5

5.a Changes in the inflation forecast for 2024



SOURCES: INE and Banco de España.

— The partial extension (not envisaged in the December projections) of some of the measures deployed by the authorities to mitigate the effects of the inflationary episode entails a downward revision of 0.3 pp to the average inflation rate projected for this year.

— The recent upward surprises in underlying and food inflation lead to a slight upward revision of both of these inflation paths, resulting in somewhat more persistent inflationary pressures in these goods and services than projected in December. As noted above, these surprises were essentially associated with more adverse weather conditions than expected and a stronger pass-through of past increases in clothing and footwear production costs. The new trajectories for underlying and food inflation each entail a 0.2 pp revision to the average headline inflation rate for 2024.

Main risks to these projections

The risks to the economic growth projections are on the downside, while the risks to the inflation projections are considered to be balanced.

As in previous projection exercises, the main sources of risk to this exercise are global geopolitical uncertainty and, in particular, a potential escalation in the ongoing conflicts in Ukraine and the Gaza Strip. Indeed, the flare-up of tensions in the Red Sea region over the last few months has triggered a sharp increase in shipping costs and driven up the indicators used to proxy the severity of global supply chain bottlenecks. However, with moderate global demand dynamics and no discernible signs of significant congestion in logistics networks or global supply chains, these shocks appear to be having a limited impact on inflation and activity for the time being.[12] That said, it is impossible to rule out a more adverse scenario in which the persistence or a potential escalation of these tensions gives rise to more adverse supply shocks that exert greater

12 Viani (2024).

downward pressure on activity and more upward pressure on inflation than envisaged in the baseline scenario of these projections. Indeed, according to the EBAE, roughly half of the Spanish industrial and trade firms surveyed reported having been affected by these tensions.

The impact of the cumulative monetary tightening on activity and prices is another significant source of uncertainty. The weakness of economic activity and the easing of inflation observed in the euro area in recent quarters – both of which have been more pronounced than expected – could indicate a stronger transmission of monetary policy than envisaged in these projections. Also pointing in this direction are the downward surprises in lending to the private sector, of which there have been several in the last few quarters. In any event, quantifying these effects is a complex task and caution should therefore be exercised when attempting to interpret the potential impact of monetary policy conduct on the main macro-financial aggregates. Such caution is particularly warranted when, as in the current scenario, multiple concurrent shocks and public policies are influencing developments in economic activity and prices. A data-dependent approach is therefore imperative to monitor these developments on an ongoing basis over the coming months.

Other significant sources of uncertainty surrounding the baseline scenario of these projections are on the domestic front and relate to potential second-round effects on inflation and the roll-out of NGEU funds. First, a faster than expected increase in wages and/or profit margins would entail a higher inflationary path than envisaged under the baseline scenario of these projections. For the time being, the pace of the moderation in inflation and the developments observed in profit margins and wages do not point in this direction. However, the possibility of stronger feedback loops between prices and wages and/or profit margins going forward cannot be ruled out entirely, particularly when compensation per employee is outpacing wage settlements and the labour market is showing considerable tightness.[13] In fact, underlying inflation in Spain has cooled less quickly than expected, and therefore caution should be exercised before assuming that the current inflationary episode is under control. Moreover, doubts persist regarding the pace of execution of the NGEU-related projects and their impact on activity. As has been noted, investment in Spain has surprised on the downside in recent quarters. This weakness, should it prove more persistent than expected, could weigh on activity and inflation over the projection horizon.

Lastly, the reactivation of the European fiscal rules (suspended since the onset of the pandemic) poses a considerable risk to the baseline scenario of these projections. Compliance with these rules will require the design and implementation of a medium-term fiscal consolidation plan that lays the foundations for a more pronounced correction of the structural public deficit than envisaged in these projections. The economic impact of this adjustment plan remains uncertain and will crucially depend on how it is designed. However, its implementation would likely result in lower momentum in activity over the projection horizon than envisaged in this projection exercise.

13 Ghomi, Hurtado and Montero (2024).