BANCO DE ESPAÑA
Eurosistema

ECONOMIC BULLETIN
2025/Q1

https://doi.org/10.53479/39321

11/03/2025

Macroeconomic projections and quarterly report on the Spanish economy. March 2025

Contents

EDITORIAL

Editorial

In recent months global economic activity has been unfolding amid growing uncertainty and geopolitical complexity. Most indices measuring international economic policy uncertainty and geopolitical and trade tensions have surged in recent months. This deterioration is largely associated with the various measures announced by the new US Administration (primarily concerning tariffs), the doubts about their possible macroeconomic and financial impact and the potential reactions from the authorities of other major world regions, like China and the European Union (EU).

Historical evidence suggests that such scenarios end up taking a toll on economic growth. Uncertainty together with geopolitical and/or trade tensions frequently cause households and firms to delay their spending and investment decisions, thereby slowing GDP growth. Moreover, trade and geopolitical tensions may also affect production by heightening supply risks and interfering with global value chains. As seen during some stages of the pandemic and Europe's energy crisis, these developments can be particularly disruptive.

Against this background, the lack of significant changes in global GDP growth in early 2025 with respect to end-2024 should be taken with caution… Some recent indicators, particularly for the United States, are starting to show signs of deteriorating economic sentiment and weakening consumption

… especially in a setting in which the global inflation moderation process is still ongoing… In recent months the pace of inflation has quickened in many of the world's major economies, and so have expectations about its future rise. For now, analysts view these increases, which are largely linked to energy price rises, as temporary. But they could ultimately be more persistent and therefore affect central banks' monetary policy outlooks.

… and where, despite some recent corrections, financial market valuations remain relatively high and risk premia contained. In recent weeks international financial markets have proved to be particularly sensitive to certain negative surprises in the macroeconomic data, developments in various geopolitical conflicts (particularly as regards a possible end to the war in Ukraine) and the numerous economic policy announcements (particularly concerning tariffs in the United States and the possibility of a greater fiscal expansion in the EU linked to defence spending). All this has sparked some volatility in the markets in recent times, despite which risk premia remain at relatively low levels.

That said, for the time being analysts' consensus baseline scenario still suggests that global GDP growth will remain relatively strong in the coming quarters and that the global disinflation process will continue. The risks to this baseline scenario are tilted to the downside in terms of growth and more balanced with regard to the inflation outlook, due to a confluence of factors affecting both supply and demand. In any event, the possibility of sharp corrections in financial asset valuations on international markets should not be ruled out. Were this to occur, it could have a very adverse impact on economic growth and agents' confidence.

In this uncertain and complex juncture, the Spanish economy has continued to surprise on the upside and to grow at a robust pace. Spanish GDP rose by 0.8% quarter-on-quarter in 2024 Q4, slightly more than expected in the Banco de España's December projection exercise. Also, the most recent data suggest that Spain's economic activity will keep growing at a rapid pace (between 0.6% and 0.7%) in 2025 Q1. This vigour stands in contrast to the lack of momentum observed in GDP in the euro area as a whole, which grew by only 0.2% in 2024 Q4, the same rate forecast for 2025 Q1 according to the latest European Central Bank projection exercise.

As a result of these dynamics, Spain's projected GDP growth for 2025 has been revised upwards by 0.2 pp with respect to the December projections (from 2.5% to 2.7%). This owes to the positive effect of the new GDP data published by the Spanish National Statistics Institute in late January and to the outlook for household income now being better than in December, which could have a positive effect on consumption.

Inflation for 2025 is revised upwards by 0.4 pp compared with the December projections, to 2.5%. This is mainly attributable to the rise in energy prices observed at the start of the year and to a higher future path for these prices than envisaged three months ago. Conversely, the extension of the public transport support measures to June 2025 (approved by the Government after the December projection exercise cut-off date) slightly offsets the upward revision to inflation in 2025.

In any event, these projections for the Spanish economy – as those for the world and European economies – are fraught with extraordinary uncertainty and subject to downside risks in terms of economic growth. It should be stressed that these forecasts do not explicitly incorporate the possible adverse impact on activity of the higher levels of uncertainty and geopolitical tensions observed globally in recent months. Neither do they include the increase in US tariffs on imports from Mexico, Canada and the EU, a matter surrounded by considerable uncertainty. This exercise also does not account for the possibility (which is being considered in the EU) of easing the fiscal rules to which the Member States are subject in order to appreciably increase government spending on defence.

Among other factors, it is important to keep a close eye on whether Spain's economic activity will be able to continue growing at a substantially faster pace than two of its main trading partners (France and Germany), as well as on private investment, whose path of recovery is particularly weak. In a setting in which the risks to the baseline scenario for inflation are slightly skewed to the upside, it is also important to analyse domestic inflationary pressures and, accordingly, the behaviour of labour costs and unit operating surpluses.

Figure 1

	2025	2026	2027
GDP	2.7% ↑ 0.2 pp	1.9% =	1.7% =
Inflation	2.5% ↑ 0.4 pp	1.7% =	2.4% =

SOURCE: Banco de España.

REPORT

1 Global economic activity has continued to grow at a robust rate, albeit with regional and sectoral differences

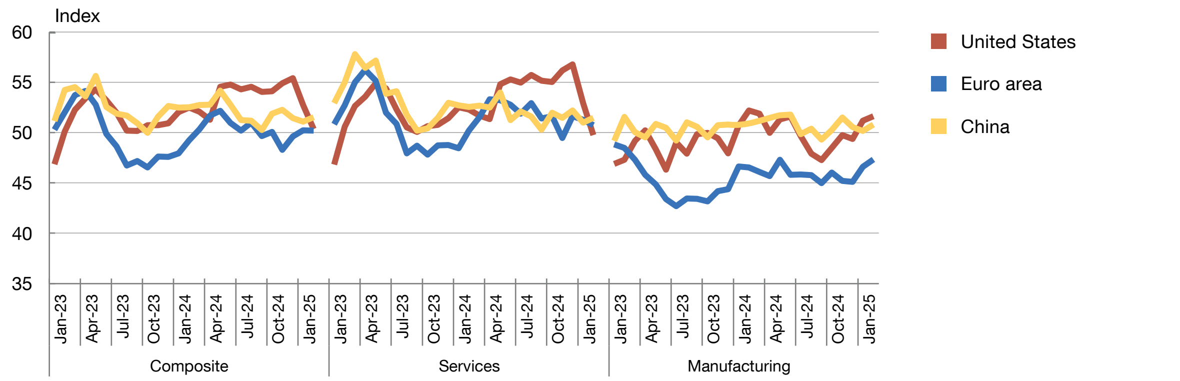
— Global GDP growth accelerated slightly in 2024 Q4, to 0.9% quarter-on-quarter. However, there continued to be significant differences across the main regions. Thus, in the United States, underpinned by private consumption, GDP expanded relatively strongly (by 0.6%, somewhat below expectations and less than the rate of 0.8% recorded in Q3). China's GDP growth exceeded forecasts (at a year-on-year rate of 5.4%), driven by the support measures deployed by the authorities in recent months. In contrast, growth continued to be modest in the euro area and surprised on the downside in some emerging economies.

— On the supply side, services remained stronger than manufacturing. That said, there have been some signs recently of weakness in services and incipient recovery in manufacturing (Chart 1a). Also, especially in the United States, some recent activity indicators appear to point to weaker consumption and a worsening of economic sentiment.

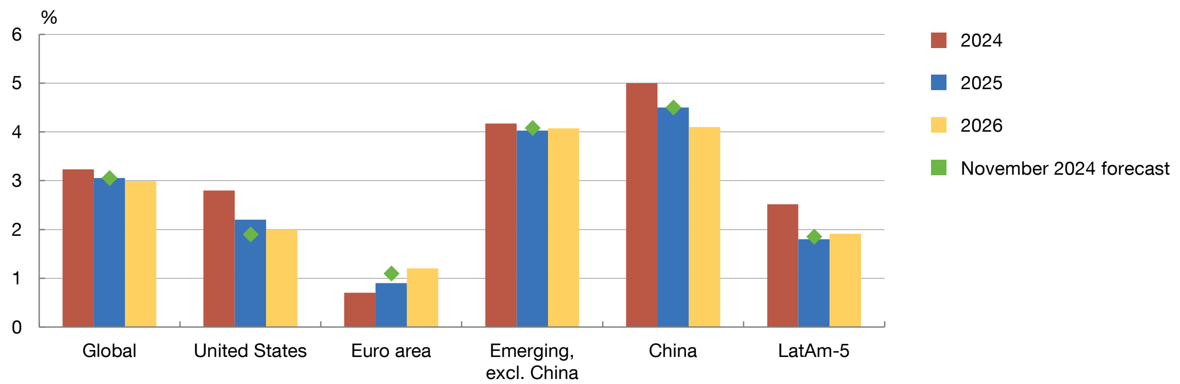
— In recent months, the professional forecasters' consensus for global growth in the next few quarters has barely changed. In particular, the expected global GDP growth rates for 2025 and 2026 continue to be similar to those recorded in 2024, which would be consistent with activity slowing somewhat in the United States and China (Chart 1.b).

Chart 1

1.a Purchasing managers' indices



1.b Consensus growth forecasts (a)



SOURCES: S&P Global and Consensus Economics.

a The February 2025 forecasts (bars) are compared with the November 2024 forecasts (diamonds). "LatAm-5" includes Mexico, Colombia, Peru, Chile and Brazil "Emerging excl. China" includes "LatAm-5", Argentina, India, Indonesia, Malaysia, Philippines, Thailand, Bulgaria, Hungary, Poland, Romania, Russia, Türkiye and Ukraine. Lastly, "Global" includes all the foregoing plus China, the United States, Canada, Japan, Norway, Sweden, Switzerland, the United Kingdom and the euro area.

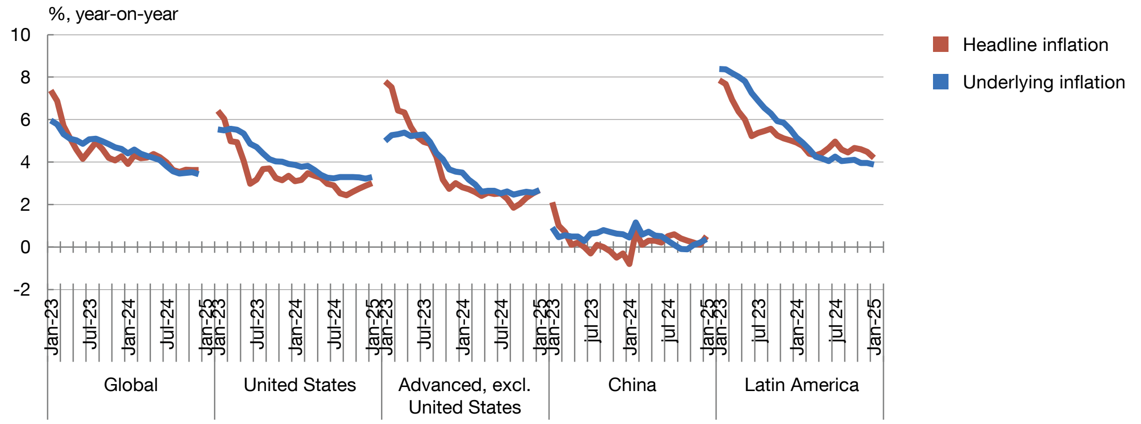
2 Signs that the global disinflation process is stuttering

— Since November, headline and underlying inflation have remained relatively steady at global level (Chart 2.a). This reflects two main factors: first, the continued notable downward stickiness of services inflation; and, second, an increase in late 2024 and early 2025 in energy prices, especially gas and oil prices, which has been partially reversed in recent weeks, partly as a consequence of various geopolitical developments (Chart 2.b).

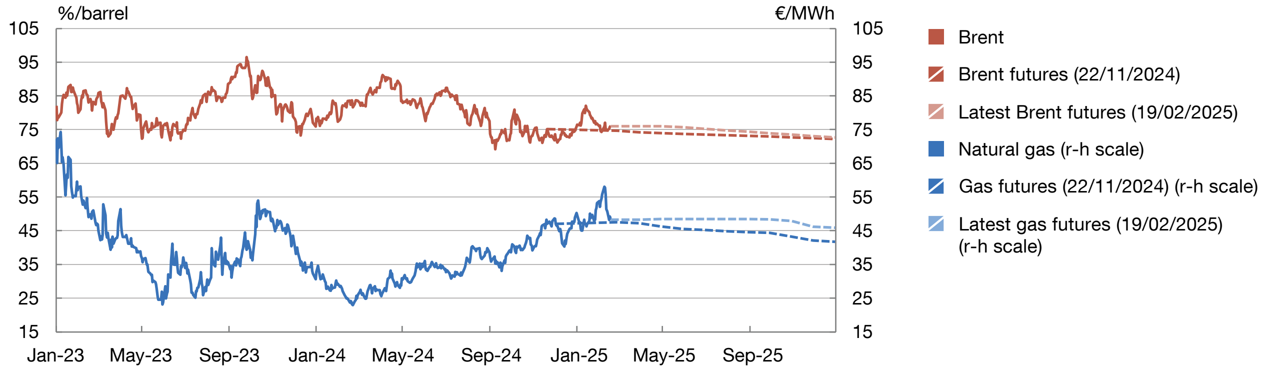
— As a result of these two factors, but also the possible impact of the trade and fiscal policy measures announced by the new US Administration, analysts' consensus forecasts for inflation have been revised upwards in recent months. This has been the case in the United States in particular, where, between November and February, the analysts' consensus forecast of average inflation in 2025 increased from 2.3% to 2.7%.

Chart 2

2.a Inflation



2.b Oil and gas prices and futures



SOURCES: National statistics and Refinitiv.

3 Uncertainty and trade and geopolitical tensions rise

— The international environment is extraordinarily complex on account of the heightened trade and geopolitical tensions combined with increasing uncertainty surrounding the economic policies in many countries considered to be systemic.

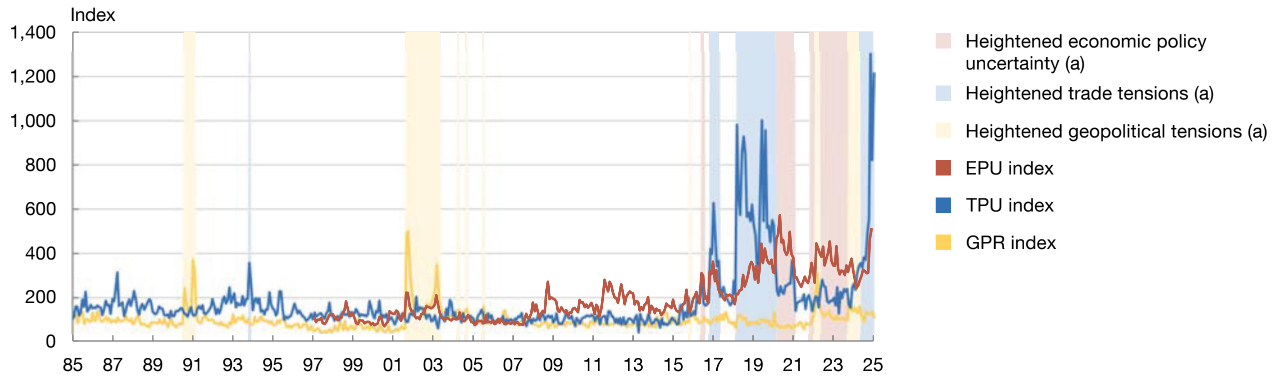
— The indices available to measure these factors reveal, on one hand, a recent marked escalation in trade tensions, which has been greater than that recorded during the first trade war between the United States and China (2017-2019) (Chart 3.a). On the other hand, there has been a notable rise in economic policy uncertainty, similar to that seen during the pandemic. For its part, geopolitical risk remains heightened, particularly when compared with the decades during which the greatest advances were made in the process of globalisation and the development of multilateralism in international decision-taking.

— The historical evidence suggests that an increase in uncertainty can have significant effects on economic activity if agents postpone their consumption and investment decisions, thereby reducing aggregate demand and GDP growth.[1] Moreover, the trade and geopolitical tensions may also affect output by amplifying supply risks and disrupting the operation of global value chains.

— The effects of uncertainty on inflation are less predictable and essentially depend on whether this adverse shock has a stronger effect on demand or supply. If an increase in uncertainty leads to a particularly sharp reduction in demand, this will tend to lower inflation. If, however, the strongest effects of uncertainty take the form of a reduction in supply (for example through value chain disruption or energy price increases), then this will tend to raise inflation.

Chart 3

3.a Historical developments in geopolitical and trade tensions, and in global economic policy uncertainty



SOURCES: GPR index, Caldara and Iacoviello (2022); TPU index, Caldera, Iacoviello, Molligo, Prestipino and Raffo (2020); EPU index, Baker, Bloom and Davis (2016).

a Blue (TPU index), red (EPU index) and yellow (GPR index) bands are used to show periods in which the level of the index exceeds its historical mean by more than one standard deviation. Latest data: February 2025 for the GPR and TPU indices; January 2025 for the global EPU index.

1 See, for example, Baker, Bloom and Davis (2016), Ghirelli, Pérez and Urtasun (2019), Caldara, and Iacoviello (2022), Alonso, Diakonova and Pérez (2024) and Caldara, Iacoviello, Molligo, Prestipino and Raffo (2020).

4 In recent months, monetary policies in the world's main economies have followed divergent paths, in line with differing outlooks for inflation and activity

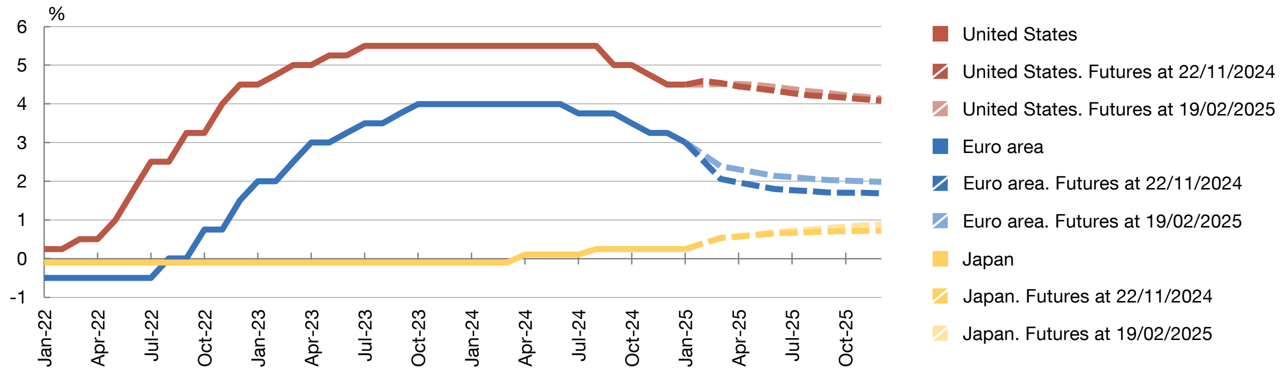
— In the advanced economies, in 2025 to date, there have been cuts in official interest rates in the euro area, the United Kingdom, Canada and Sweden, among others. In the United States, however, the Federal Reserve System decided in January to pause the rate cuts it had initiated in September 2024. The Bank of Japan, meanwhile, increased its official interest rates to 0.5%, their highest level since 2008.

— As regards the emerging economies, the central banks of most countries in Latin America (apart from Brazil) have reduced their official interest rates in recent months, while maintaining a restrictive monetary policy stance. China, meanwhile, has continued to ease its financing conditions as part of the stimulation measures adopted to address the slowdown in activity.

— Financial market expectations generally assume that monetary policies at global level will remain on divergent paths. Thus, the expected path of official US interest rates continues to suggest that monetary easing will be paused for most of 2025 (Chart 4.a) while, in the euro area, expectations are consistent with further rate cuts in the coming months. Lastly, the gradual tightening of monetary policy in Japan is expected to continue.

Chart 4

4.a Policy interest rates observed and futures (a)



SOURCES: Refinitiv Datastream, Banco de España and Federal Reserve.

a Interest rates priced in by the repective futures markets (30-day Federal Funds futures, euro area overnight index futures, Japanese overnight index futures).

5 Developments in long-term interest rates and stock indices have differed from one area to another

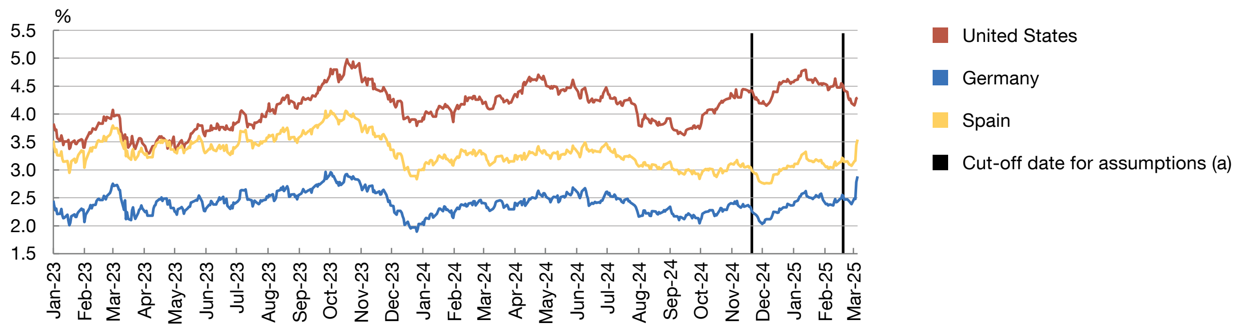
— The US 10-year sovereign bond yield rose until mid-January, when the publication of worse-than-expected macroeconomic data prompted a correction (Chart 5.a). In the euro area, 10-year government bond yields also followed an upward trajectory until mid-January, surging at the beginning of March following the announcement of public spending programmes to be accommodated by more flexible fiscal frameworks. The increases in yields during the quarter were greater in the case of the German Bund, leading to slightly narrower sovereign spreads.

— In recent weeks, stock indices in the United States have fallen, against a background of high uncertainty surrounding the implications of the new Administration's policies. Also, those securities most closely related to artificial intelligence have been adversely affected by the abrupt emergence of DeepSeek in late January. By contrast, European indices have been bullish (Chart 5.b), as a result, among other factors, of the high relative weight of banks in such indices, negotiations for a possible resolution of the conflict in Ukraine and, more recently, the possibility of growth in the European defence industry.

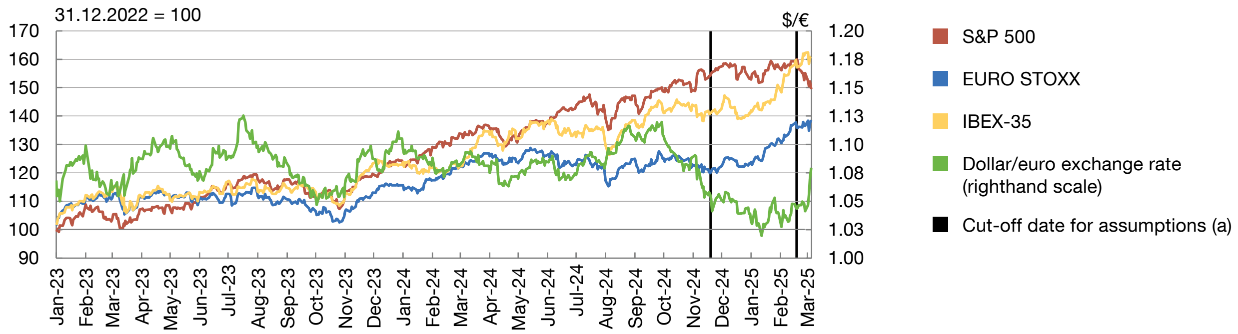
— On the currency markets, although the US dollar tended to appreciate in late 2024, it has been more volatile in 2025, depreciating markedly against the main international currencies at the beginning of March. Since the start of the year (up to early March), the euro has recovered by 3.9% against the US dollar and by 1.5% in nominal effective terms.

Chart 5

5.a 10-year sovereign bond yields



5.b Stock Market indices and exchange rate



SOURCE: LSEG Datastream. Latest figures for 6 March 2025.

a 21 November 2024 and 19 February 2025 for the December and March Banco de España projection exercises, respectively.

6 In the euro area, economic activity slowed significantly in 2024 Q4 ...

— According to Eurostat's latest estimate, GDP increased by 0.2% in 2024 Q4, down significantly from the rate recorded in the preceding quarter (0.4%). In terms of its composition, the positive contribution of consumption, especially private consumption, was partially offset by the negative contribution of inventories, while the contribution of net exports was insignificant.

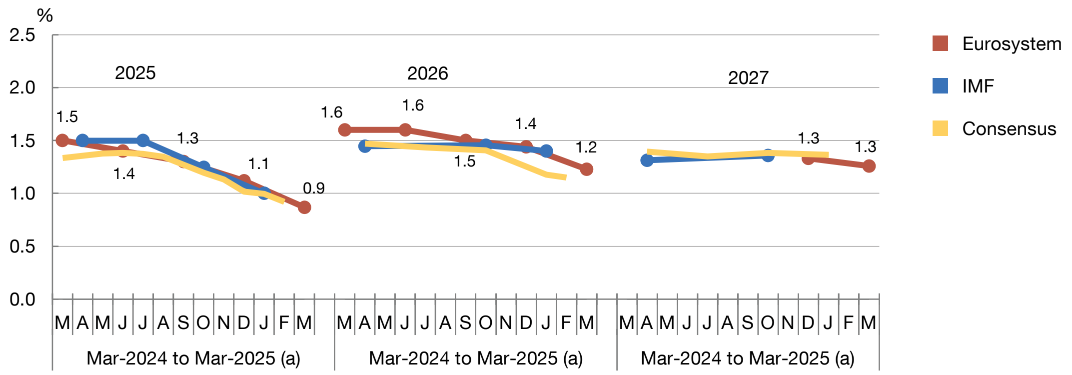
— The downward surprises in the region's three main economies (with GDP falling in Germany and France, and growing very moderately in Italy) contributed to this outcome, offsetting the upward surprises recorded, for example, in Spain and Portugal.

— The latest short-term economic indicators (such as the PMI) confirm the fragility of the current recovery over the coming quarters.

— In a setting of increasing uncertainty, the ECB's March projections exercise has revised down expected GDP growth by 0.2 pp in 2025 and 2026, to 0.9% and 1.2%, respectively (Chart 6.a), while maintaining the forecast for 2027 at 1.3%. The gradual recovery in activity projected in this exercise would mainly be based on a progressive improvement in real income and a certain degree of stability in the labour market. However, the risks to this pattern of growth appear to be on the downside, especially as a result of the current high level of uncertainty and significant trade and geopolitical tensions.

Chart 6

6.a Euro area GDP growth forecasts



SOURCES: IMF, Consensus Economics and Eurosystem.

a The letters refer to the month in which the corresponding report was published.

7 ... whereas, in recent months, inflationary pressures on energy have risen, while those on core inflation have fallen

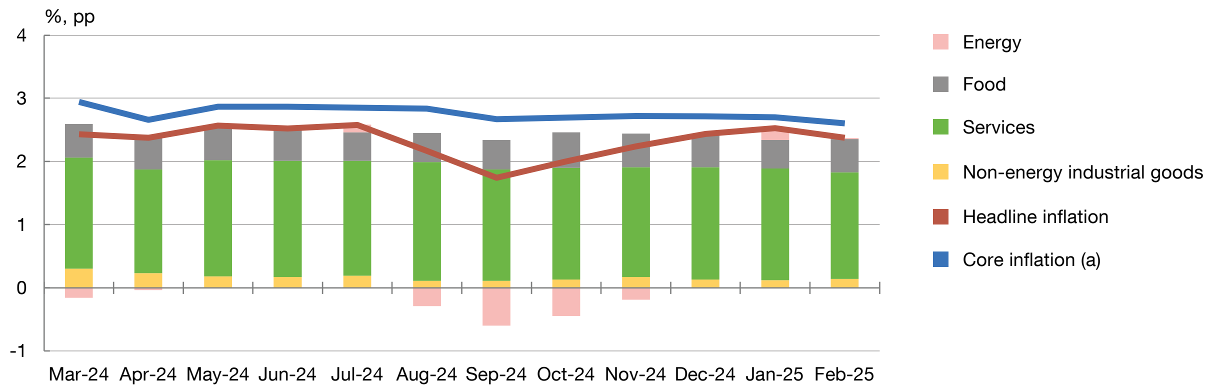
— On the HICP flash estimate, headline inflation in the euro area fell by 0.1 pp in February to 2.4% (Chart 7.a), reversing the upward trend followed since last September which was linked to the fading of certain base effects in the energy component.

— Core inflation dropped 0.1 pp in February to 2.6%. This variable has performed better in recent months mainly because of less pressure from services inflation which, despite its stickiness, eased by 0.2 pp in February to 3.7%, whereas non-energy industrial goods prices remained moderate.

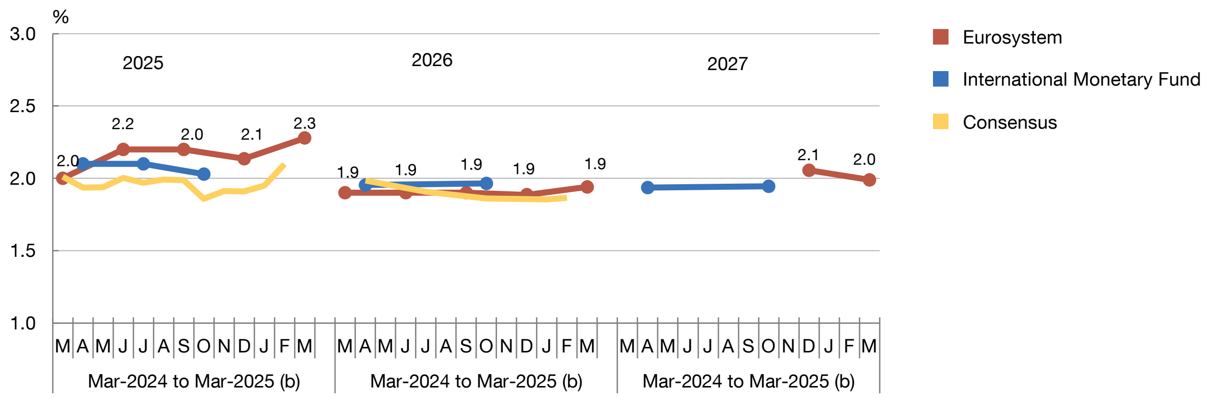
— Against this background, the Eurosystem's March projection exercise raised the headline inflation rate projected for 2025 by 0.2 pp to 2.3%, largely due to higher energy commodity prices. Subsequently, the exercise left the inflation rate projections for 2026 and 2027 virtually unchanged, at 1.9% and 2%, respectively (Chart 7.b).

Chart 7

7.a Euro area inflation and contribution of components



7.b Euro area inflation forecasts



SOURCES: IMF, Consensus Economics, Eurosystem and Eurostat.

a Headline HICP excluding energy and food.
b The letters refer to the month in which the corresponding forecast was published.

8 The ECB's monetary policy stance is becoming meaningfully less restrictive

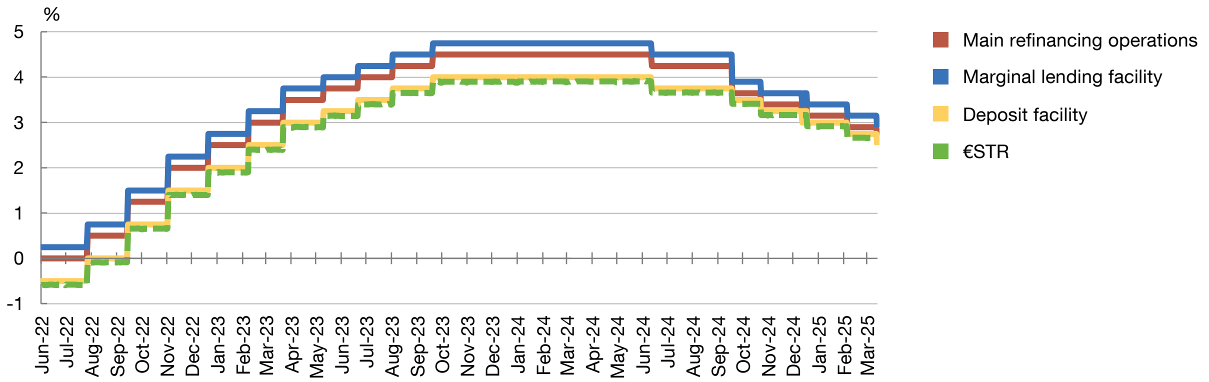
— At its March meeting the ECB Governing Council once again cut policy interest rates by 25 bp, bringing the deposit facility rate to 2.5% (Chart 8.a). This is the sixth reduction since June 2024, representing a cumulative cut of 150 bp in the deposit facility rate, the rate that determines the monetary policy stance in the euro area.

— This decision was based on an updated assessment of the inflation outlook, the dynamics of underlying inflation and the strength of monetary policy transmission. The disinflation process is on track and the ECB's latest projections are closely aligned with the previous inflation outlook. Most measures of underlying inflation suggest that inflation will settle around the target on a sustained basis. As for transmission, interest rate cuts are reducing the cost of new loans for firms and households and credit growth is rising. In any event, the previous interest rate hikes have continued to pass through to the outstanding balance of lending in the euro area as a whole and are slowing the easing of financing conditions.

— Looking ahead, the Governing Council will maintain a data-dependent and meeting-by-meeting approach, without pre-committing to any specific rate path, especially in the current context of heightened uncertainty.

Chart 8

8.a Key ECB interest rates and €STR



SOURCES: Banco de España and LSEG Datastream. Latest observation: 6 March 2025.
NOTE: The new interest rate level will take effect on 12 March.

9 The Spanish economy continued to grow robustly in 2024 Q4, spurred by domestic demand

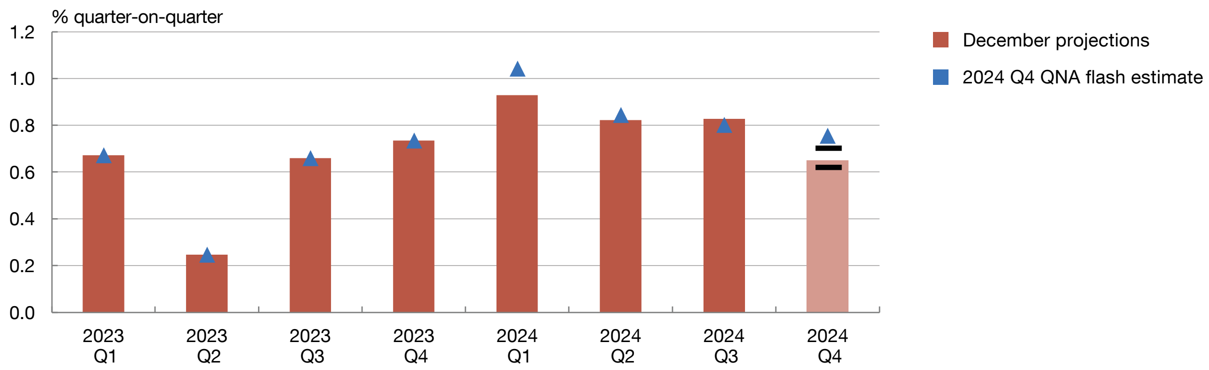
— According to the Quarterly National Accounts (QNA) flash estimate, GDP grew by 0.8% in 2024 Q4, the same rate as in the two previous quarters and slightly above the range of 0.6%-0.7% envisaged in the Banco de España's December projection exercise (Chart 9.a).

— This growth was underpinned by strong domestic demand, especially by high gross capital formation and private consumption, which together contributed 1.2 pp to the increase in GDP (Chart 9.b). By contrast, net external demand made a negative contribution of -0.4 pp to growth, owing to the higher than anticipated buoyancy of imports and the fall of 1.1% in goods exports.

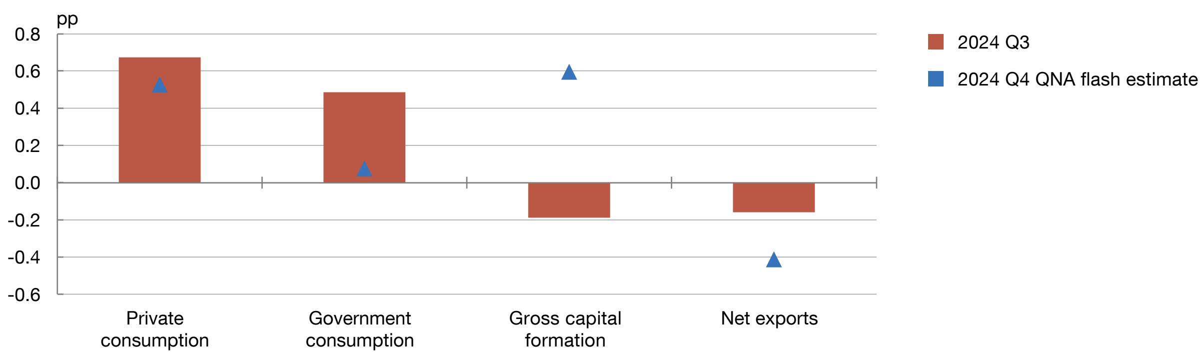
— On the supply side, all productive sectors – except agriculture, livestock breeding and fishing – grew in 2024 Q4. The slight acceleration of industrial activity and, within services, the buoyant performance of real estate activities; professional, scientific and technical activities; and public administration, education, health and social work activities were notable.

Chart 9

9.a GDP growth in Spain



9.b Contributions to GDP growth in Spain



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SOURCES: INE and Banco de España.

10 The latest short-term economic indicators suggest that economic activity in Spain will continue to grow at a high rate in 2025 Q1

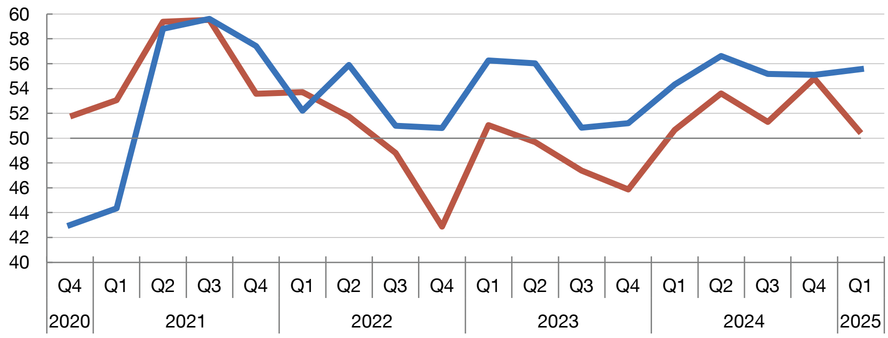
— The various indicators available, which provide partial, and as yet incomplete, information on activity in 2025 Q1, suggest that Spanish GDP could grow by between 0.6% and 0.7% quarter-on-quarter, only slightly lower than the growth rate in previous quarters.

— The indicators consistent with a slight loss of momentum in activity at the start of the year notably include the confidence indicators. In particular, although the average services PMI levels in January and February remained similar to those in 2024 Q4, both the manufacturing PMI and the composite PMI levels were lower (Chart 10.a).

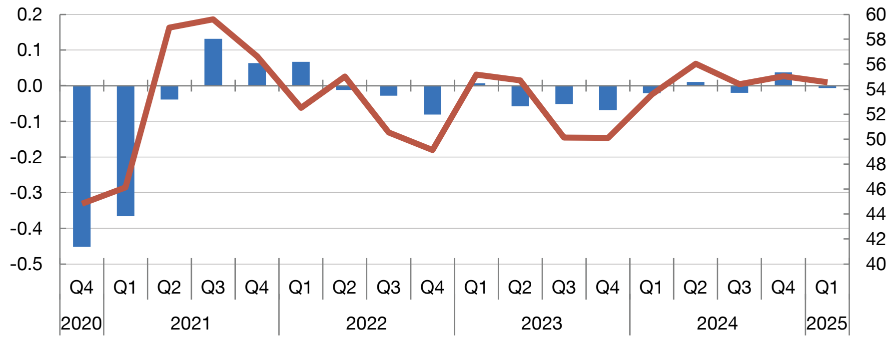
— The results of the latest edition of the EBAE suggest that Spanish firms' turnover remained practically unchanged on a seasonally adjusted basis in 2025 Q1, after picking up slightly at end-2024 (Chart 10.b).[2]

Chart 10

10.a PMIs (a)



10.b Quarterly change in turnover according to the EBAE, and in composite PMI



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

a The 2025 Q1 figure is the average for January and February.
a The qualitative responses from the EBAE are converted into a numerical scale as follows: significant decrease = -2; slight decrease = -1; unchanged = 0; slight increase = 1; significant increase = 2. Seasonally adjusted series.

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2 Fernández Cerezo and Izquierdo (2025).

11 Employment has continued to perform favourably, especially since the onset of the pandemic in the professional services branches

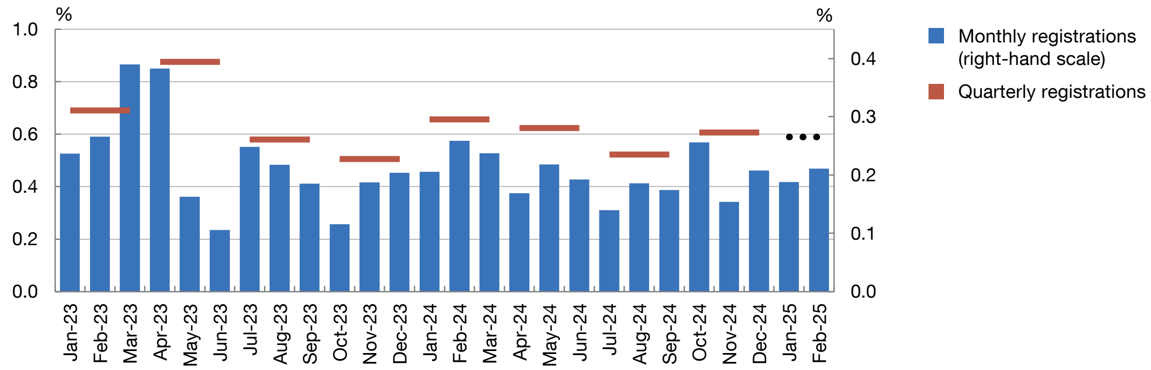
— In seasonally adjusted monthly terms, social security registrations increased by 0.2% in February (Chart 11.a), a similar figure to that seen in the two previous months. This suggests that employment performance in Q1 as a whole will be similar to that in 2024 Q4.

— Based on the average of the first two months of the year, social security registrations grew notably in sectors such as transport, construction, real estate activities, professional services and education.

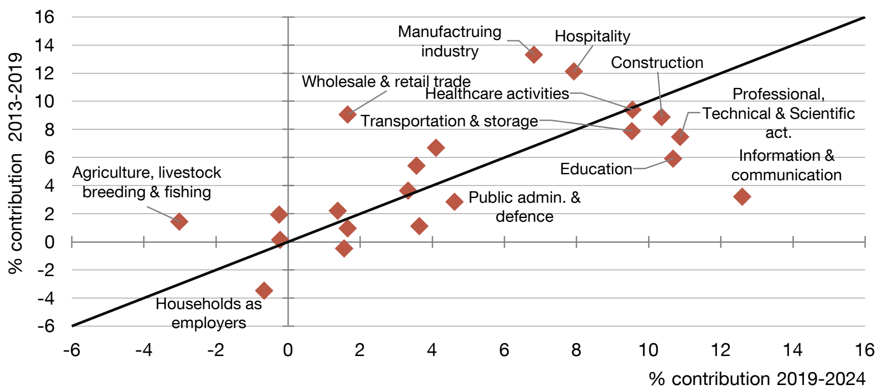
— Over a longer time frame, employment growth since the pre-pandemic period has been driven mainly by the information and communication, professional, technical and scientific activities, education and construction sectors. Overall, these sectors accounted for approximately 45% of total cumulative employment growth between end-2019 and end-2024 (Chart 11.b). This pattern of job creation contrasts with that observed between 2013 and 2019, when the increase in employment was concentrated more in manufacturing, hospitality and wholesale and retail trade.

Chart 11

11.a Total social security registrations. Monthly and quarterly rates (a)



11.b Relative contribution (in pp) to total employment growth (b)



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

a Seasonally adjusted monthly and quarterly rates. The 2025 Q1 rate has been calculated on the basis of the data for January and February only.
b Line: 45 degrees. The diamonds represent the relative contribution to growth in total employment, in percentage points, of each sector. The vertical axis shows the contributions for the period 2013 Q2 - 2019 Q4 and the horizontal axis shows the contributions for the period 2019 Q4 - 2024 Q4.

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12 The cost of credit has declined in recent months, boosting households' and firms' demand for financing[3]

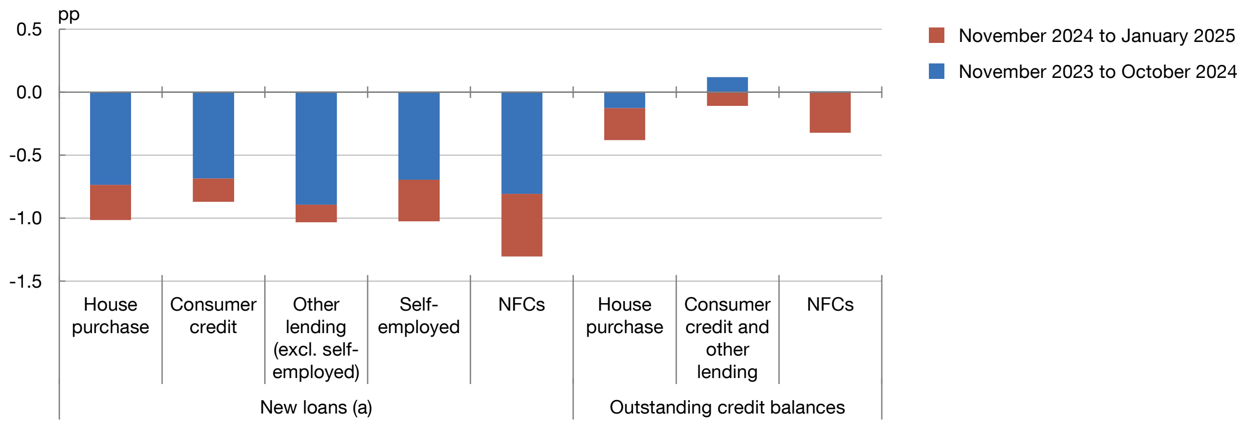
— Interest rates on new loans have continued to decrease gradually across all segments in recent months (Chart 12.a), a trend which is also beginning to be observed in the average cost of outstanding loans.

— According to the Bank Lending Survey, credit demand has continued to strengthen, while in the Survey on the Access to Finance of Enterprises firms reported that their access to bank financing had improved somewhat.

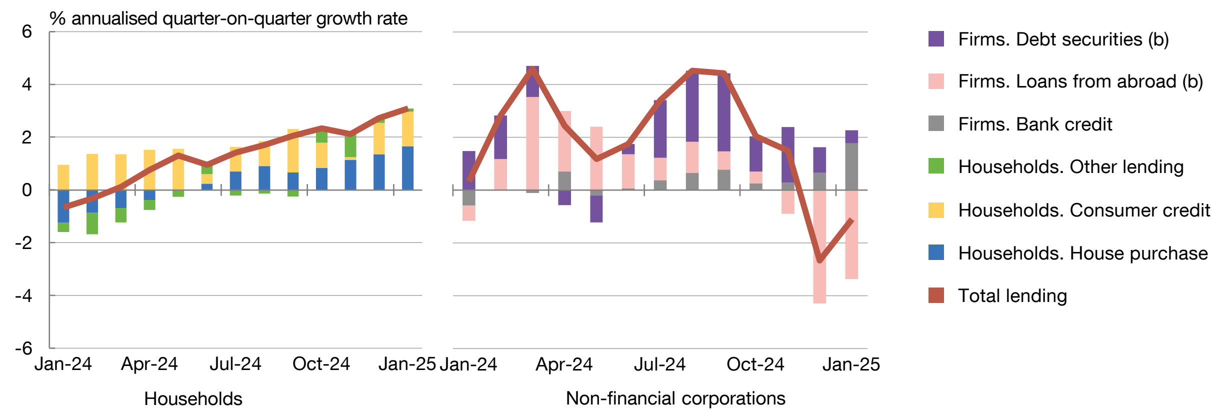
— Lending to households has continued to accelerate in recent months, with a growing contribution from housing mortgages (Chart 12.b). Conversely, financing to firms has fallen on account of the negative contribution of loans from abroad, a result of certain corporate groups' one-off transactions, while credit from resident banks has intensified the recovery that began in mid-2024.

Chart 12

12.a Change in the cost of credit during the monetary policy normalisation phase



12.b Lending to households and non-financial corporations (a)



SOURCE: Banco de España.

a Seasonally-adjusted data. Securitisation included.
b Securities issued abroad are excluded from loans from non-residents and are included in debt securities.

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3 For more details see the Report on the financial situation of households and firms. Second half of 2024.

13 Private consumption looks set to continue to grow strongly in early 2025, although at a somewhat lower rate than in previous quarters

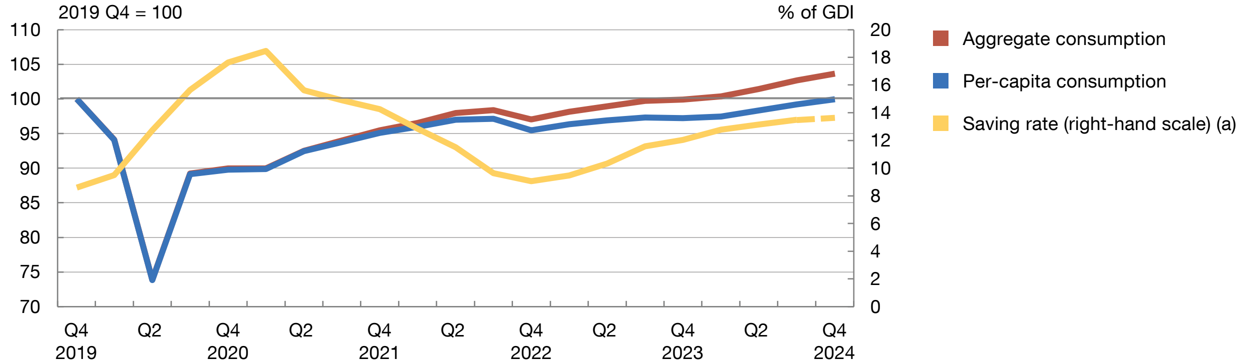
— Private consumption continued to grow robustly in 2024 Q4 with a quarter-on-quarter rate of 1%, which was very similar to that seen in the two preceding quarters. As a result, this component was 3.6 pp above its pre-pandemic level, although per capita consumption was just 0.1 pp below its level prior to the pandemic.

— In any case, this buoyant consumption, driven by strong household disposable income in 2024, has accompanied high saving rates that do not, as yet, show any signs of lowering (Chart 13.a).

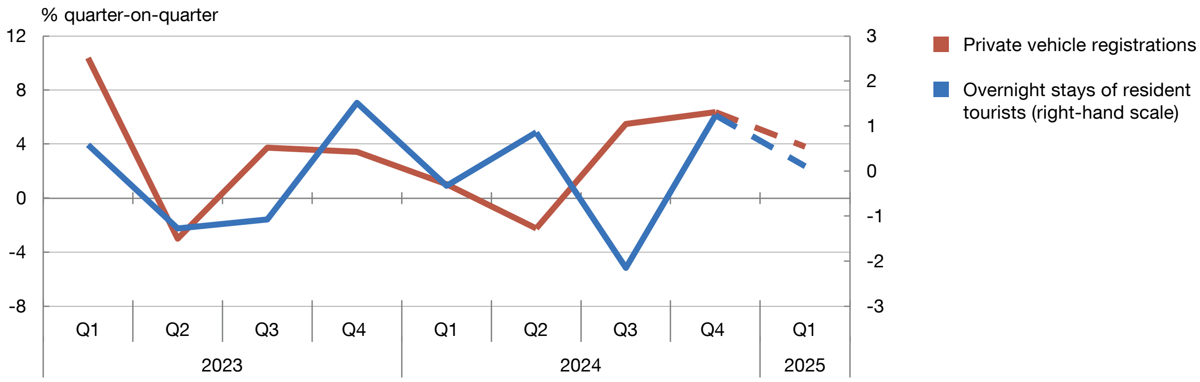
— The most recent short-term information available suggests that private consumption will remain notably buoyant in 2025 Q1, although its growth will ease relative to that seen in late 2024. This is also supported by the figures for private vehicle registrations and overnight stays in hotels by resident tourists. Furthermore, the household spending outlook reported in the ECB's Consumer Expectations Survey point to less dynamic consumption in the coming quarters, especially among households in the top income quintile.

Chart 13

13.a Aggregate consumption, per-capita consumption and saving rate of households and NPISHs



13.b Changes in common indicators of expenditure (b)



SOURCES: Asociación Española de Fabricantes de Automóviles y Camiones and INE.

a Four-quarter cumulative data. Since data are not yet available for 2024 Q4, the projection in this publication is used.
b The rate for 2024 Q1 has been calculated using data for January for overnight stays and the average of January-February for private vehicle registrations.

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14 Productive investment growth will likely slow in 2025 Q1, while residential investment will probably pick up somewhat

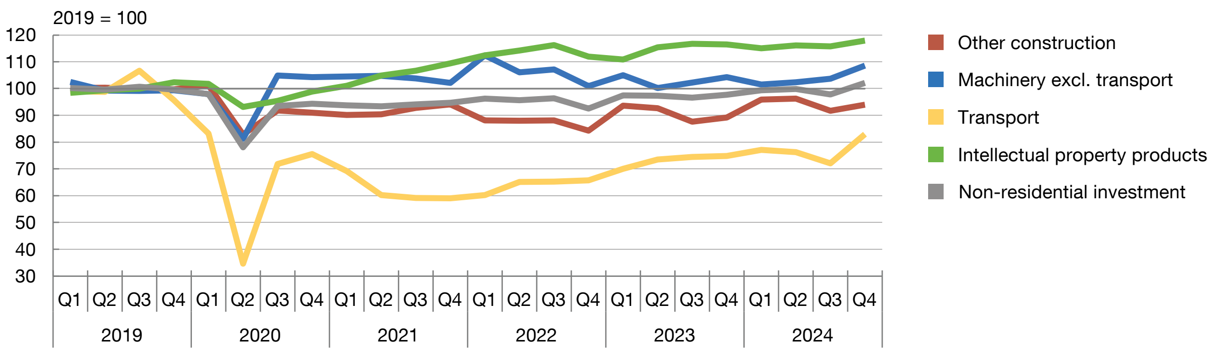
— In recent quarters, productive investment[4] has displayed considerable volatility. After a sharp contraction in 2024 Q3, all of its components surged in 2024 Q4 and posted an increase of 2.8% (Chart 14.a).

— In 2025 Q1, qualitative indicators point to productive investment recovering further, albeit more moderately. This is also supported by, for example, the capital goods PMI, which stood in contractionary territory for the first two months of 2025, following the positive data from late 2024, and the EBAE, which points to investment growth continuing for a fourth consecutive quarter, although at a slightly lower pace than in the previous quarter.

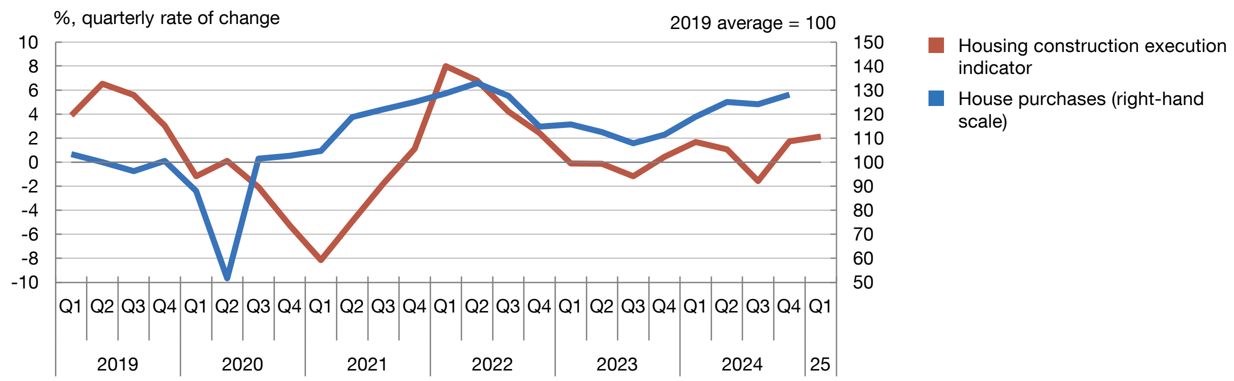
— Residential investment indicators remain favourable, including the construction starts and house sales indicators (Chart 14.b). In terms of prices, ongoing robust demand and limited supply continued to drive growth in house prices, with the year-on-year rise standing at 11.3% in late 2024.

Chart 14

14.a Recent performance of productive investment



14.b Main indicators of residential investment (a)



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

a For the housing construction execution indicator, the time frame considered is three months from issuance of the building permit to the construction start date and 18 months for the construction work. Seasonally adjusted series for house purchases.

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4 Productive investment is the sum of investment in machinery and equipment, intangibles and other construction, excluding residential investment.

15 The external sector's contribution to growth in 2025 Q1 appears to be slightly positive

— In 2024 Q4, the contribution of net external demand to GDP growth was negative (-0.4 pp), mainly owing to the momentum of imports, of both goods (+0.8%) and services (+3.6%). Sales abroad also slowed, with a fall in goods export (-1.1%), which more than offset the quickening of services exports (+2.3%).

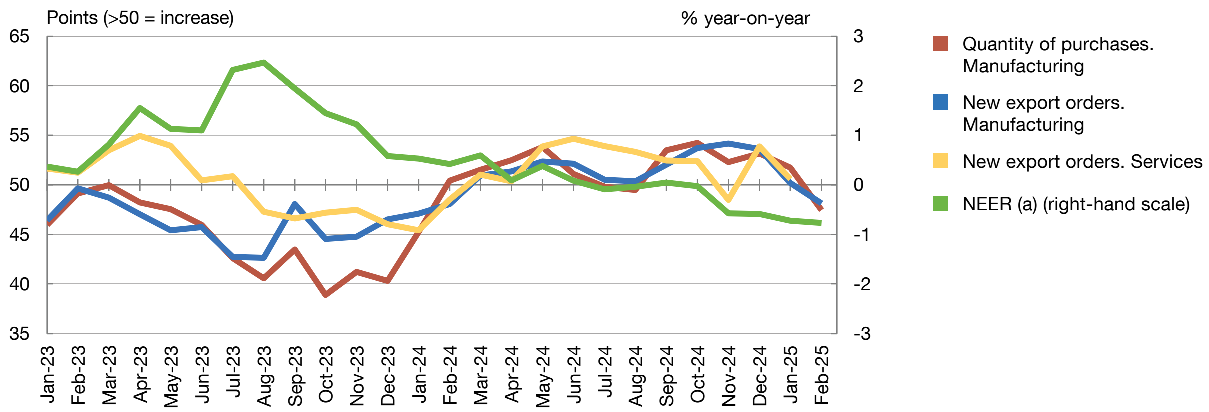
— For 2025 Q1, the short-term indicators available suggest a decline in goods trade flows abroad in recent months (Chart 15.a). This dynamic may, nevertheless, be countered by exports returning somewhat to normal following the negative and transitory impact of the flash floods in 2024 Q4 and the vigour expected in domestic demand.

— Given the nominal depreciation in the euro in the final stages of 2024, the growth rate of services exports is set to remain robust, although it will probably ease in Q1. For example, in terms of tourism services exports, the year-on-year growth in January in overnight stays by non-resident tourists (4.2%) was 0.5 pp lower than in 2024 Q4.

— In any case, the outlook for international trade flows is extraordinarily unclear, given the recent heightening of trade and geopolitical tensions globally and economic policy uncertainty, especially in the United States.

Chart 15

15. PMIs and NEER



SOURCES: S&P Global and ECB.

a Against euro area countries and a group of 18 countries comprising: Australia, Canada, Denmark, Hong Kong, Japan, Norway, Singapore, the Republic of Korea, Sweden, Switzerland, the United Kingdom, the United States, China, Czechia, Hungary, Poland, Bulgaria and Romania. Positive (negative) rates of change indicate losses (gains).

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16 In late 2024, government revenue remained remarkably strong, while the flash floods appear to have boosted government spending

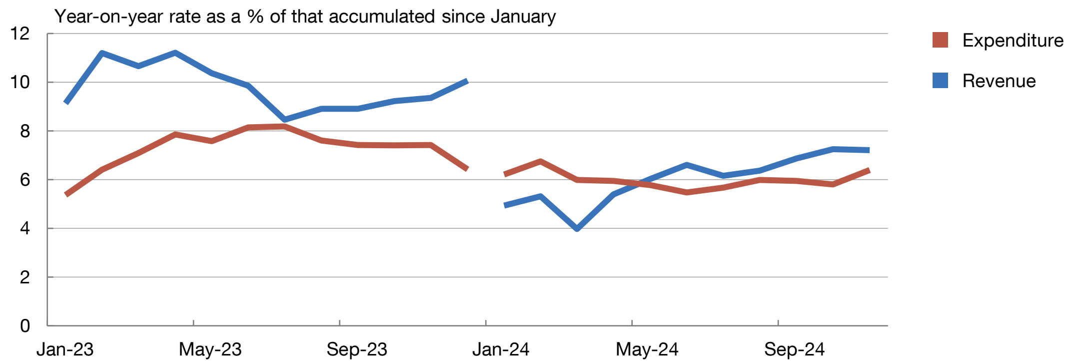
— On data to November, government revenue (excluding local government) rose by 7.2% year on year (Chart 16.a). This increase was the result of the recent buoyancy of activity and, in particular, of wages, along with the gradual rollback of tax cuts approved in response to the energy crisis. Partly owing to these developments, personal income tax receipts climbed by 8.5% year on year to November, while value-added tax (VAT) rose by 7.0%.

— For its part, government spending also appears to have increased significantly to November, by 6.4% year on year. A portion of this growth in spending stems from flash flood-related costs, which could reach around 0.3 pp of GDP in 2024. In any event, interest-related costs, social benefits and government consumption also rose notably year-on-year to November by 10.0%, 7.2% and 5.6%, respectively.

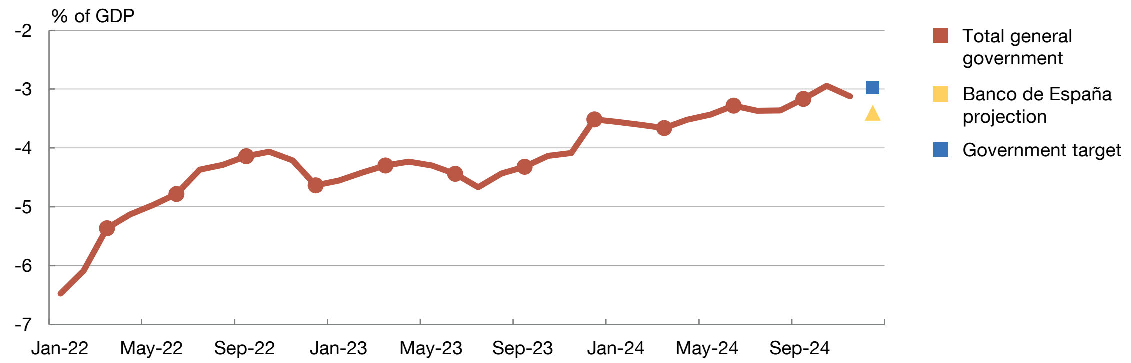
— Overall, the general government deficit is likely to stand at around 3.4% of GDP in 2024, partly on account of the extraordinary flash-flood related expenses and some court rulings against the Government (Chart 16.b).[5]

Chart 16

16.a Change in general government revenue and expenditure



16.b General government balance (a)



SOURCES: Banco de España, IGAE and 2025-2028 Medium-Term Fiscal and Structural Plan (October 2024).

a The dots correspond to the data for the overall general government sector, which the National Audit Office (IGAE) only publishes on a quarterly basis and with a longer time lag. The remaining monthly data are estimated drawing on information of the aggregate excluding local government.

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5 The European Excessive Deficit Procedure excludes one-off spending when estimating the general government balance.

17 Headline inflation has increased since October, fundamentally owing to rising energy prices

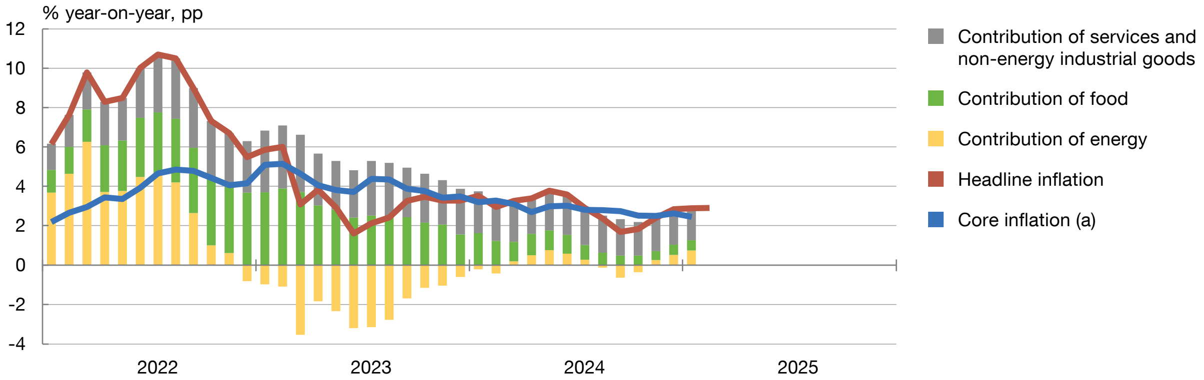
— Headline inflation rose to 2.9% in January and remained stable in February, slightly above expectations (Chart 17.a). This surprise reflected a faster-than-expected acceleration in the energy component, which was only partially offset by the positive developments in core inflation.

— On disaggregated data to January, changes in the energy component reflected January's rise in VAT on electricity as well as higher electricity and oil product prices, in line with the upturn in oil prices on world markets. The fall in food prices slowed owing to the upward trend of fresh food prices and the impact of the reversal in January of the VAT reduction on basic foods.

— Core inflation (HICP excluding energy and food) stood at 2.4% in January, slightly below what was expected. This more favourable behaviour is fundamentally a reflection of the impact on services inflation of the extension to June 2025 of the public transport discounts.[6] As for other services, noteworthy are the continued stickiness of prices in the hospitality and tourism sectors (which account for half of the services inflation) and in services with infrequent price adjustments, such as the insurance and education sectors (Chart 17.b). Lastly, the prices of non-energy industrial goods continued to slow, as they have done in recent months, reaching a year-on-year rate of 0% in January.

Chart 17

17.a Inflation in Spain: changes and contribution of components



SOURCES: Eurostat and Banco de España.

a Headline inflation, excluding energy and food.

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6 Following the approval of Royal Decree-Law 1/2025 of 28 January 2025. The December 2024 projections envisaged the public transport discounts ending in January 2025.

18 Negotiated wage settlements held at around 3%, although the increase in labour costs is greater owing to the persistence of a positive wage drift

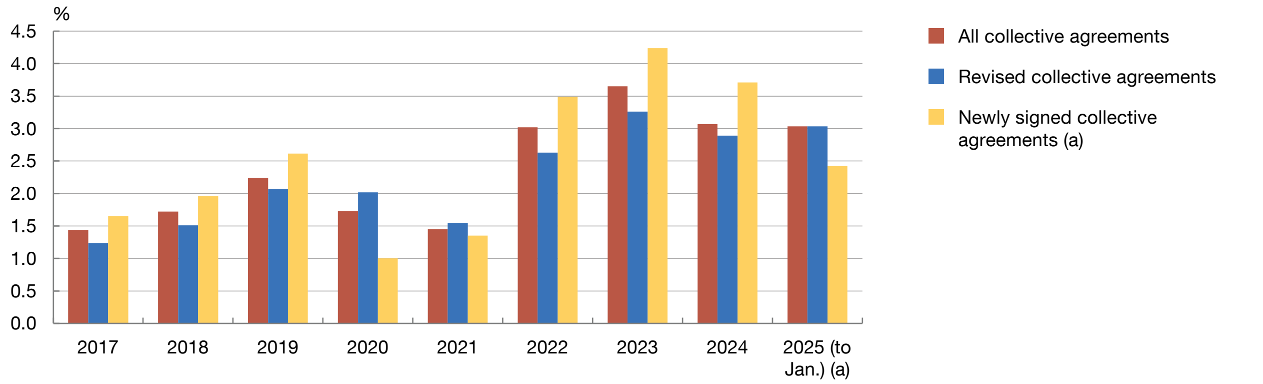
— On data to January, negotiated wage settlements for 2025 stood at 3%, in line with those signed for 2024 (3.1%) and the guidelines agreed in the fifth Employment and Collective Bargaining Agreement. Almost all wage-earners with agreements in force for 2025 (nearly 6 million workers) had wage settlements in previous years (Chart 18.a).

— Despite this easing in wage settlements, in 2024 compensation per employee in the market economy rose by 5.4%, which shows a largely cross-sector positive wage drift of close to 2 pp, and a small positive contribution from higher social security contributions.[7]

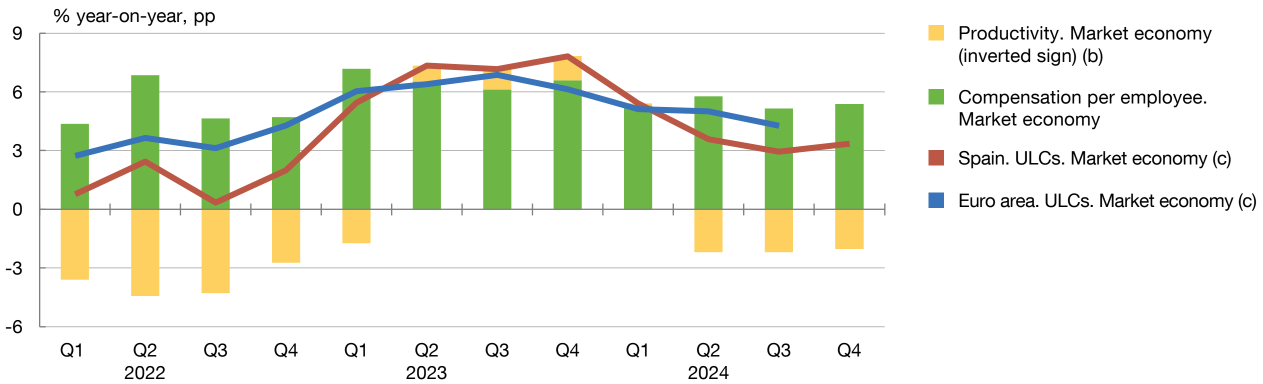
— In any event, the growth rate of unit labour costs (ULCs) has eased in Spain from 7.0% in 2023 to 3.8% in 2024. This slowdown is slightly sharper than the euro area average and has been bolstered by productivity gains (Chart 18.b).

Chart 18

18.a Wage settlements



18.b ULCs. Market economy. Changes and contributions



SOURCES: Ministerio de Trabajo y Economía Social and INE

a Newly signed agreements to January 2025 refer only to 12,122 workers (0.2% of employees with wage settlements for 2025).
b Productivity is defined as GVA divided by the total number of employees in a given sector.
c The change in ULCs can be proxied as the sum of the change in compensation per employee and the change in productivity (with an inverted sign). Therefore, a positive contribution of productivity in the chart is interpreted as the effect of a decline in productivity.

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7 This arose from the rise in the contribution of the intergenerational equity mechanism from 0.6% to 0.7%. A similar effect is also expected for 2025, when this figure increases to 0.8%.

19 The slowdown in ULCs and the relative stability of profit margins have helped to ease domestic inflationary pressures

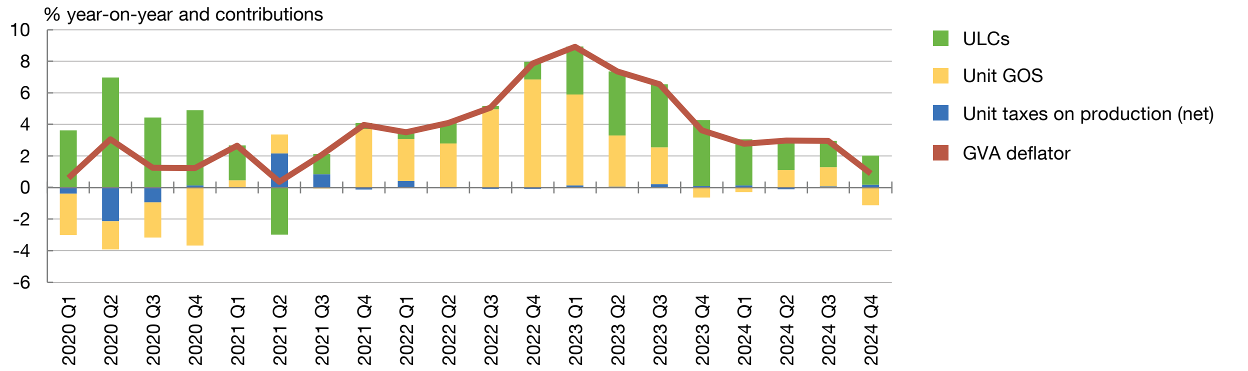
— The market economy value added deflator slowed its growth rate from 6.6% in 2023 to 2.4% in 2024. This reflects an easing in the growth rate of ULCs and a decline in the contribution of the unit gross operating surplus (GOS) (Chart 19.a).

— This notwithstanding, according to the QNA data), the ratio of GOS to gross value added (GVA) of the market economy stood slightly below its pre-pandemic level (Chart 19.b).

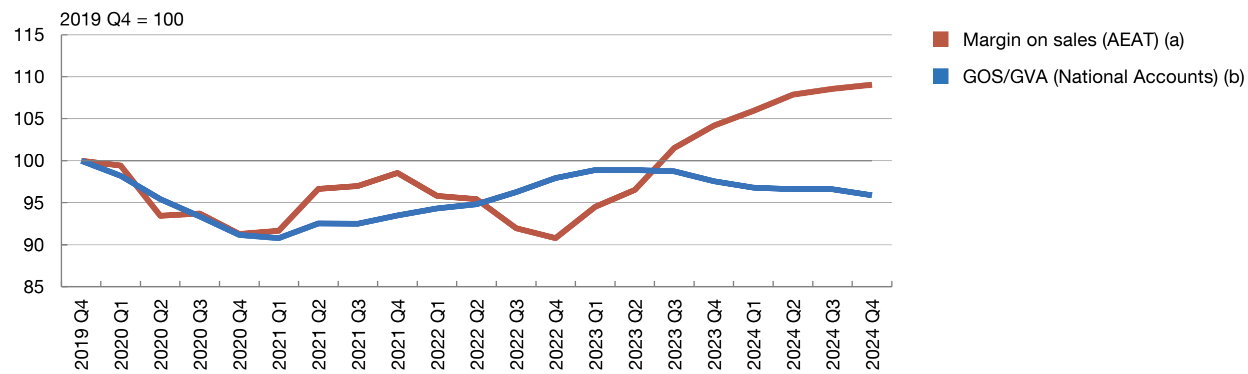
— According to data from the Spanish tax authorities (AEAT), the margin on sales, defined as the ratio of gross operating profit to turnover, has shown an upward trend in recent quarters (Chart 19.b).[8]

Chart 19

19.a Value added deflator. Market economy



19.b Changes in profit margins



SOURCES: Banco de España, INE and tax forms for VAT and withholdings on labour income and income from economic activities (AEAT).

a All firms excluding petroleum refining (NACE 19), wholesale of fuels (NACE 4671) and gas and electricity (NACE 35) sectors. Margin on sales is defined as the ratio of GOP to turnover. Four-quarter cumulative data, current population.
b Four-quarter average.

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8 For further details on the interpretation and recent performance of alternative measures that seek to approximate profit margins, see the Observatorio de Márgenes Empresariales website, a joint initiative of the Ministry of the Economy, Trade and Business, the tax authorities and the Banco de España.

MACROECONOMIC PROJECTIONS FOR THE SPANISH ECONOMY (2025-2027)

20 Main assumptions and considerations underlying the projections

— These projections are based on a series of technical assumptions regarding the future path of certain macroeconomic, financial and fiscal variables.[9] Overall, these assumptions now entail somewhat more unfavourable conditions for activity than those underlying the December projections.

- Based on futures markets, in the coming quarters oil and electricity prices are expected to stand above those envisaged in the previous projection exercise (Chart 20). Also, in the last three months oil prices have been higher, on average, than anticipated in December.
- Spain's export markets are still expected to recover over the period 2025-2027. However, in line with projected euro area activity developments, this recovery now appears to be weaker than was envisaged three months ago. (Table 1).
- The nominal exchange rate of the euro is now somewhat lower than in the previous projection exercise, both with respect to the US dollar and in effective terms (Table 1).
- As regards interest rates, the international financial markets point to higher short and long-term trajectories than anticipated in the previous projection exercise. This entails somewhat tighter financing conditions for households and firms in the current projection exercise (Table 1).

— Moreover, the latest Spanish GDP data for preceding quarters show that the starting point used to project the future paths of activity and prices has changed from that used in the previous projections. In particular, in the absence of other changes, the QNA flash estimate for 2024 Q4 automatically entails a higher starting point for GDP for the current projection exercise and a higher GDP growth rate for 2025.[10]

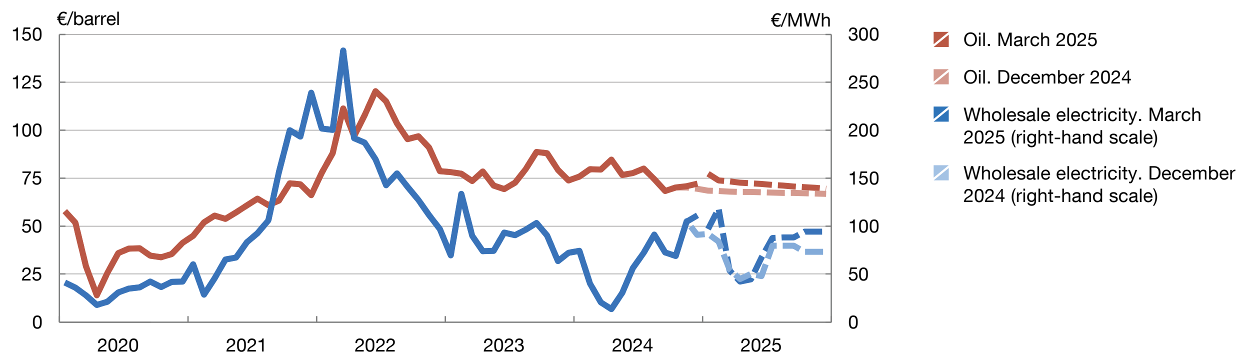
9 These projections incorporate the new information that has become available since the publication of the latest projections on 17 December. This includes, in particular, the QNA flash estimate for 2024 Q4 and the QNFAIS for 2024 Q3. The cut-off date for these projections is 21 February.

10 In addition, the INE has revised upwards the GDP growth rate for 2024 Q1, from 0.9% to 1%, meaning that growth in activity was greater for the whole of 2024.

20 Main assumptions and considerations underlying the projections (cont'd)

Chart 20

20.a Energy prices



SOURCES: OMIE and Reuters.

Table 1
International environment and monetary and financial conditions (a)

Annual rate of change (%), unless otherwise indicated

		March 2025 projections			Difference between the current projections and the December 24 projections (b)			
	2024	2025	2026	2027	2024	2025	2026	2027
Spain's export markets (c)	1.2	2.5	3.0	2.9	0.4	-0.2	-0.2	-0.1
Oil price in dollars/barrel (level)	82.0	74.9	70.8	69.2	0.2	3.1	0.7	-0.1
Wholesale electricity price in €/MWh (level)	62.9	80.8	65.6	58.3	1.6	11.5	2.1	1.5
Monetary and financial conditions								
Dollar/euro exchange rate (level)	1.1	1.0	1.0	1.0	0.00	-0.02	-0.02	-0.02
Nominal effective exchange rate against non-euro area countries (d) (2000 = 100)	116.0	112.2	112.2	112.2	-0.1	-2.1	-2.1	-2.1
Short-term interest rate (3-month EURIBOR; level) (e)	3.6	2.3	2.1	2.2	0.0	0.1	0.1	0.1
Long-term interest rate (10-year Spanish government bond yield; level) (e)	3.2	3.3	3.5	3.7	0.0	0.1	0.1	0.2

SOURCES: Banco de España and ECB.

a Cut-off date for assumptions: 19 February. 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 2025 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.

21 GDP growth is projected to slow down slightly over the coming quarters

— In 2024 Q4 Spanish GDP growth once again surprised on the upside, standing at 0.8% quarter-on-quarter and 3.5% year-on-year. The surprise is mainly explained by a greater-than-expected contribution of government consumption and investment to GDP growth, which was partly offset by a more negative contribution of the external sector than anticipated. Thus, the Spanish economy's GDP stood 7.6% above its pre-pandemic level, a 2.9 pp wider gap than in the euro area.

— The latest short-term indicators suggest that Spanish economic activity will continue to grow at a robust pace in 2025 Q1 (between 0.6% and 0.7% quarter-on-quarter), only slightly below that recorded in the previous quarters.

— Economic growth is projected to gradually slow down over the coming quarters, to rates more in line with the Spanish economy's potential growth, which will stand at just under 2% at the end of the projection horizon. Specifically, GDP growth is expected to decline from 3.2% in 2024 to 2.7% in 2025, 1.9% in 2026 and 1.7% in 2027 (Table 2).[11]

Table 2
Projections for the main macroeconomic aggregates of the Spanish economy (a)

Annual rate of change in volume terms (%) and % of GDP		March 2025 projections			December 2024 projections		
	2024	2025	2026	2027	2025	2026	2027
GDP	3.2	2.7	1.9	1.7	2.5	1.9	1.7
Private consumption	2.9	3.3	2.1	1.8	2.9	2.0	1.8
Government consumption	4.9	2.2	1.8	1.7	1.9	1.8	1.7
Gross capital formation	1.2	3.0	2.5	1.9	3.1	2.2	1.9
Exports of goods and services	2.9	2.9	2.9	2.9	3.0	3.2	2.9
Imports of goods and services	2.0	4.0	3.5	3.2	3.8	3.5	3.2
Domestic demand (contribution to growth)	2.8	2.9	2.0	1.7	2.6	1.9	1.7
Net external demand (contribution to growth)	0.4	-0.2	-0.1	0.0	-0.1	0.0	0.0
Nominal GDP	6.3	4.7	3.9	4.0	4.8	3.8	4.0
GDP deflator	3.0	2.0	1.9	2.2	2.2	1.8	2.2
HICP	2.9	2.5	1.7	2.4	2.1	1.7	2.4
HICP excluding energy and food	2.8	2.2	2.0	1.9	2.3	1.9	1.8
Employment (people)	2.2	1.9	1.2	1.0	1.6	1.1	1.0
Employment (hours)	1.9	1.7	1.2	1.0	1.3	1.1	1.0
Unemployment rate (% of the labour force). Annual average	11.3	10.5	10.0	9.5	10.8	10.4	9.9
Net lending (+) / net borrowing (-) of the nation (% of GDP)	4.1	3.8	3.7	3.1	4.2	4.2	3.6
General government net lending (+) / net borrowing (-) (% of GDP)	-3.4	-2.8	-2.6	-2.6	-2.9	-2.7	-2.7
General government debt (% of GDP)	101.8	101.3	101.6	101.0	102.6	102.5	101.8

SOURCES: Banco de España and INE.

a Projections cut-off date: 21 February 2025. Latest QNA figure published: 2024 Q4 flash estimate.

11 Under this scenario, the difference between real and potential GDP (the output gap) will be positive throughout the projection horizon, although it will gradually start to close from 2026.

22 In the years ahead economic growth will be underpinned by the buoyancy of domestic demand

— According to these projections, GDP growth in the period 2025-2027 will be driven by the buoyancy of domestic demand (Chart 22). In particular:

- Private consumption will be the main contributor to economic growth, due to the projected favourable developments in disposable income and employment, and the expected population increase.

- Gross capital formation – which, despite rebounding in 2024 Q4, surprised on the downside in the year as a whole and has been the least dynamic demand component since the pandemic – will increase its contribution to GDP growth in the coming months, in part as a reflection of the deployment of NGEU funds and improved financing conditions.

- Government consumption (which accounted for 39% and 27% of GDP growth in 2023 and 2024, respectively) is expected to moderate its contribution to activity growth in the years to come.

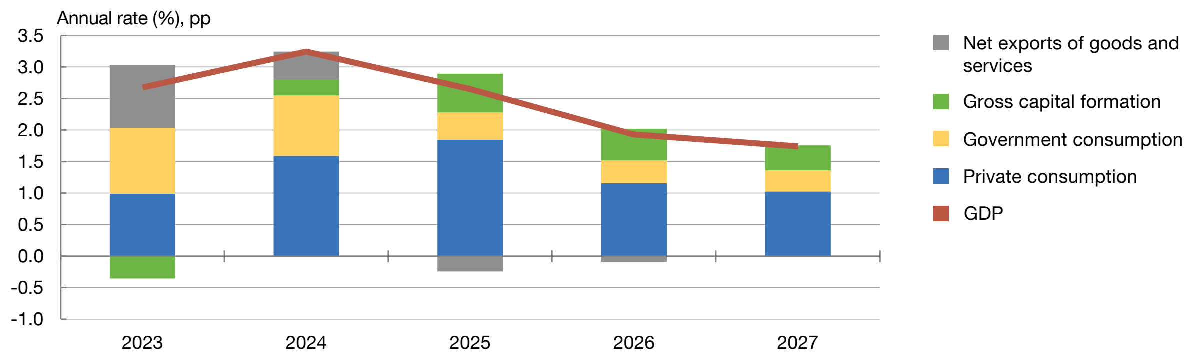
— By contrast, the contribution of net external demand to GDP growth will be slightly negative in the period 2025-2027 (Chart 22). Specifically,

- On the exports side, international tourist arrivals are expected to gradually slow down, yet maintain high growth rates over the coming years. Non-travel services exports, which surged after the pandemic, will also moderate somewhat their growth over the projection horizon. In contrast, goods exports are projected to recover in the future, in line with expected developments in Spain's external markets.

- Imports will gain traction over the coming quarters, in contrast to the stagnation they experienced in 2023 and 2024, owing to the greater-than-expected vigour of the investment and goods exports headings, which have a high import content.

Chart 22

22.a GDP growth and contributions of main components



SOURCES: Banco de España and INE.

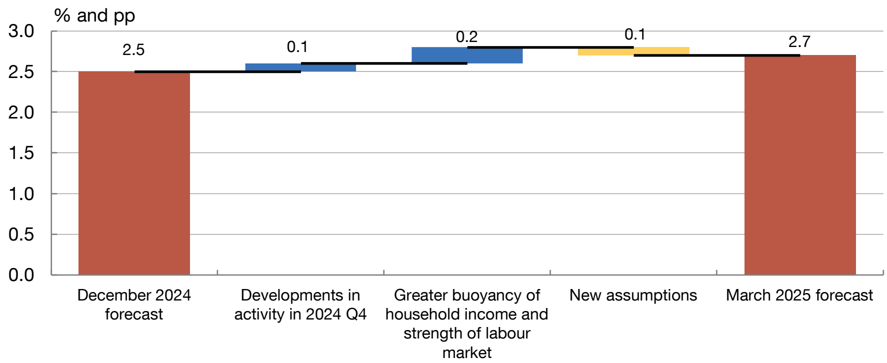
23 Compared with the December exercise, the GDP growth rate for 2025 has been revised up in the current projections, while the rates for 2026 and 2027 remain unchanged

— The activity growth rate projected for 2025 has been raised by 0.2 pp compared with the December projection exercise, from 2.5% to 2.7%, owing to the confluence of various opposing factors (Chart 23).

- First, the buoyancy of activity in 2024 Q4, higher than anticipated by the Banco de España in December, will automatically add 0.1 pp to the average year-on-year growth rate in 2025.
- Second, the vigour shown by employment, compensation per employee and households' gross disposable income in the last stretch of 2024 again surprised on the upside.[12] In light of these developments, the current projection exercise envisages a reassessment of household income expectations, which are now more favourable than in December, boosting private consumption and adding 0.2 pp to the average GDP growth rate for 2025.
- Third, the technical assumptions regarding future interest rate developments, energy prices and export markets underlying this projection exercise entail, conversely, slightly worse conditions for activity than those envisaged in the December projections, subtracting 0.1 pp from output growth in 2025.

Chart 23

23.a Changes in the GDP growth forecast for 2025



SOURCE: Banco de España.

12 For instance, according to the QNFAIS published in December, the gross disposable income of households and non-profit institutions serving households increased, on average, by 9.4% up to 2024 Q3, above the rate forecast in the December projection exercise. Also, according to the QNA flash estimate, compensation per employee in 2024 rose by 5.1%, exceeding the increase forecast three months ago.

24 As far as the labour market is concerned, job creation is expected to continue over the projection horizon, albeit less vigorously than in recent quarters

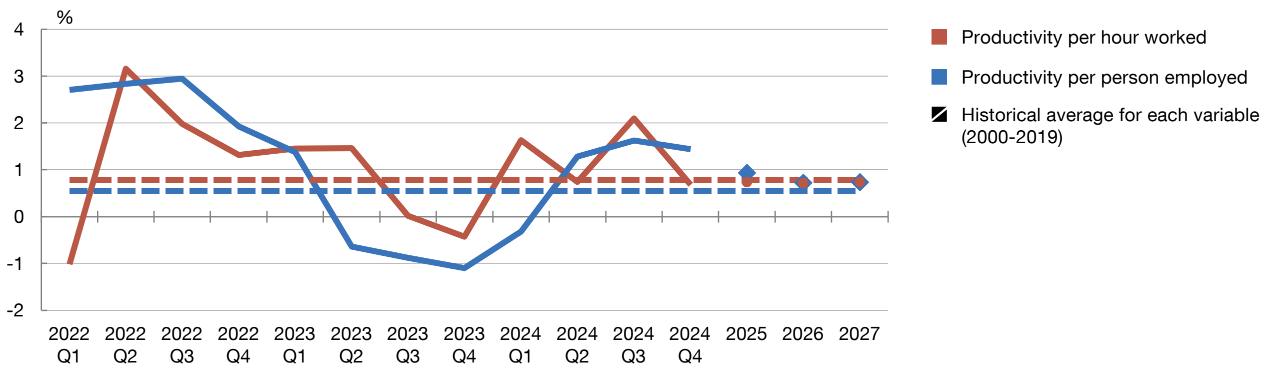
— Job creation will continue over the period 2025-2027, albeit at a slower pace, in line with recent quarters. In particular, compared with the 3% and 2.2% rises recorded in 2023 and 2024, respectively, employment (measured in terms of people employed) is expected to increase by 1.9% in 2025 before gradually slowing to around 1% in 2027 (Table 2).

— This employment growth rate forecast, below that projected for GDP, will lead to increased productivity per person employed over the next few years, growing at a slightly slower pace than in 2024, but above the rates recorded on average in the period 2000-2019. In addition, productivity per hour worked is expected to follow a similar pattern to that of productivity per person employed, also hovering around its historical average (Chart 24.a).

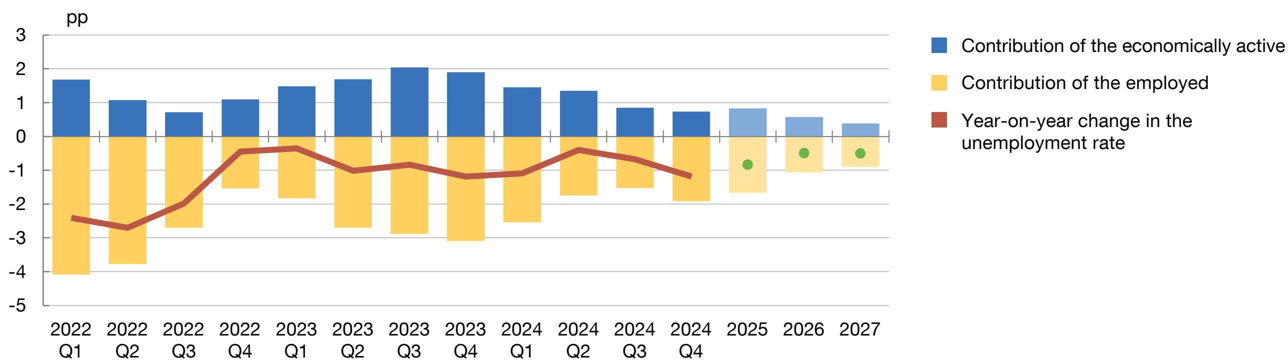
— The unemployment rate will continue to fall over the 2025-2027 horizon, albeit at a slower pace than in 2024. All against a backdrop of lower job creation and a somewhat slower increase in the labour force, which is highly influenced by the projected migratory flows (Chart 24.b). Overall, the unemployment rate will decline from 11.3% to 9.5% between 2024 and 2027.

Chart 24

24.a Productivity (year-on-year rate of change) (a)



24.b Unemployment rate (year-on-year change and contribution of the employed and economically active)



SOURCES: Banco de España and INE.

a Seasonally adjusted series.

25 On the public finances front the deficit is projected to fall from 3.4% of the expected GDP for 2024 to 2.8% in 2025 and 2.6% in 2026-2027

- The key changes in the fiscal assumptions with respect to the December projection exercise are the discontinuation of the temporary levy on energy utilities and the extension until June 2025 of the public transport subsidies.[13] All else being equal, the combined effect of these two developments increases the deficit in 2025 by 0.1% of GDP.

- Meanwhile, the expected impact of the measures rolled out in response to the October flash floods has not changed compared with the December exercise: 0.5% of GDP, spread over 2024 and 2025. The effect of these measures on the general government balance could be lower if their cost were to be partly covered by European funds.

- The expected trajectory of expenditure financed out of RRM funds also remains unchanged at just over 1% of GDP in 2025 and 2026.

- The new macroeconomic projections envisage stronger economic activity in real terms in 2024 and 2025 and a better performance of household income, which will result in higher tax collection. This effect would be partly offset by the upward revision of inflation in 2025 – which leads to a greater increase in pension expenditure in 2026 – and slightly higher interest rates throughout the projection horizon.

- Bearing all this in mind, the general government deficit – which could stand at around 3.4% of GDP at end-2024 – will fall to 2.8% in 2025 and 2.6% in 2026 and 2027, a downward revision of 0.1 pp per year compared with the December projections.

- The improved balance over the projection horizon continues to be largely driven by the discontinuation of the remaining temporary relief measures introduced in response to the energy crisis and the gradual elimination of the extraordinary expenses associated with various court decisions and the October flash floods.[14]

- Meanwhile, general government debt as a percentage of GDP will decrease from the 101.8% seen in 2024 to 101% in 2027. This downward resistance is explained by the impact of the RRM loans in 2025 and 2026, among other factors.[15]

- In terms of compliance with European fiscal rules, net primary expenditure is expected to grow by 4.5% in 2025, 4.1% in 2026 and 3.8% in 2027. These figures are 0.8 pp, 0.6 pp and 0.6 pp higher, respectively, than the maximum values established in the MTFSP (3.7% for 2025, 3.5% for 2026 and 3.2% for 2027). This deviation is higher than that estimated in the December projection exercise due to the impact, among other measures, of the extension of the public transport subsidy and the discontinuation of the levy on energy utilities, as well as, albeit to a lesser extent, the effect of changes in the macroeconomic variables, particularly higher pension expenditure arising from the upward revision to inflation in 2025.

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13 Royal Decree-Law 10/2024 extended to 2025 the temporary levy on energy utilities that was in force during 2023 and 2024, but it was repealed by the Spanish Parliament on 22 January. The extension of the public transport subsidy was established in Royal Decree-Law 1/2025 of 28 January 2025.

14 Together, these three factors would have accounted for 0.9 pp of the deficit in 2024. This figure falls to 0.4 pp in 2025 and to less than 0.1 pp in 2026-2027.

15 Assuming that around 50% of the total amount of available loans is absorbed, which amounts to 2.4 pp of GDP in cumulative terms over those two years.

26 In the coming months headline inflation is expected to embark on a downward path towards rates close to 2%

— In recent months headline inflation in Spain has climbed to 2.9% from the 1.8% recorded in October. This increase, envisaged in the December projection exercise, was somewhat sharper than anticipated, due to a higher acceleration in the energy component than predicted three months ago, which was partly offset by a somewhat more moderate than expected behaviour of core inflation.

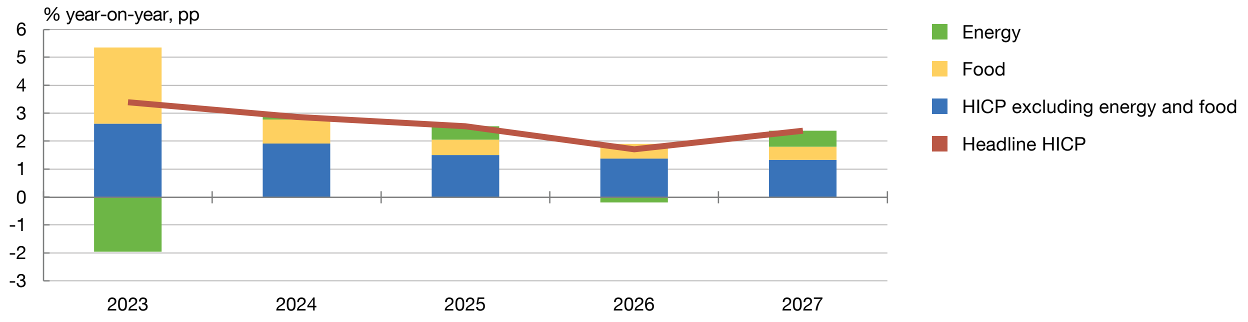
— In the upcoming quarters headline inflation is expected to decline to around 2%, such that the average rate of increase of the HICP will stand at 2.5% in 2025 – 0.4 pp less than in 2024 – and drop further to 1.7% in 2026, before rising again to 2.4% in 2027 (Chart 26).

— The energy component will be the main driver of the expected fluctuations in headline inflation over the projection horizon. Specifically, the contribution of this component to price growth is expected to gradually diminish until 2026, but to rise substantially in 2027 due to the planned implementation of a new EU-wide emissions trading system (EU ETS2).[16]

— Food consumer prices will grow increasingly less strongly over the period 2025-2027, in line with recent developments in producer prices for these goods and with food commodity prices projected by the futures markets. The projections also envisage a deceleration in core inflation in the coming years which would also help rein in headline inflation (Chart 26).

Chart 26

26.a Contributions to HICP growth, by component



SOURCES: Banco de España and INE.

16 This system will affect road transport, heating in homes and some industries not covered by the system currently in force (EU ETS1). For further details, see Banco de España (2024).

27 Core inflation will continue to moderate over the course of this year and is expected to stand on average at close to 2% in 2025-2027

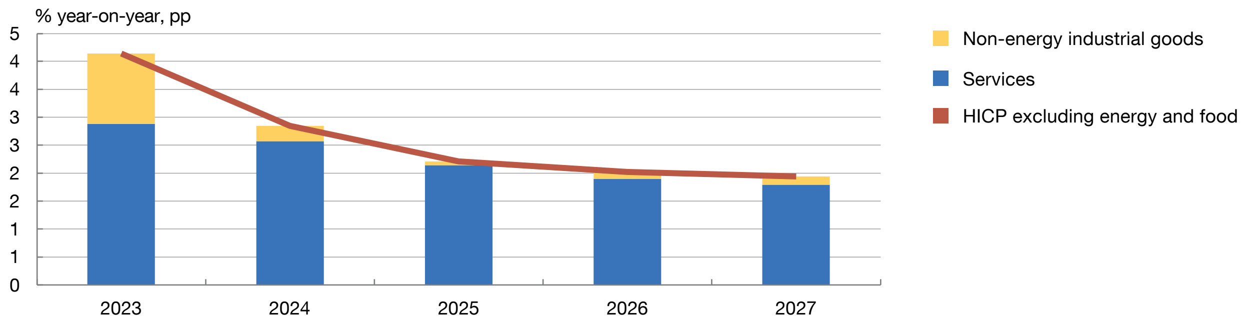
— In recent months core inflation has been somewhat more subdued than expected, although its components have surprised in opposite directions: non-energy industrial goods prices have slowed down more sharply than anticipated, while services inflation has remained more downwardly sticky than anticipated.[17]

— In the coming quarters core inflation will remain on a gentle slowdown path to rates close to 2%. In annual average terms, core inflation will ease from 2.8% in 2024 to 2.2% in 2025, 2% in 2026 and 1.9% in 2027 (Chart 28).

— The rise in services prices will gradually slow down over the projection horizon, from the 3.7% recorded in 2024 to rates slightly above 2%, in line with the persistence shown by this inflation component in recent months. Growth in non-energy industrial goods prices will remain subdued in the coming quarters (at around 0.5%), in line with recent developments and the expected path of producer prices for these types of goods.

Chart 27

27.a Contributions to growth in HICP excluding energy and food



SOURCES: Banco de España and INE.

17 In November and December there were small upward surprises in services inflation with respect to the December projection exercise. By contrast, in January services price growth was lower than projected. However, this latter development was due to the extension of public transport discounts, a measure that was not considered in the December projection exercise. According to Banco de España estimates, had public transport discounts not been extended, services inflation would have slightly surprised on the upside in January.

28 The current projections envisage an upward revision to the 2025 headline inflation rate, while the rates for 2026 and 2027 remain unchanged

— Compared with the December projection exercise, the expected headline inflation rate for 2025 is revised up by 0.4 pp, from 2.1% to 2.5% (Chart 29), driven by two factors acting in opposite directions:

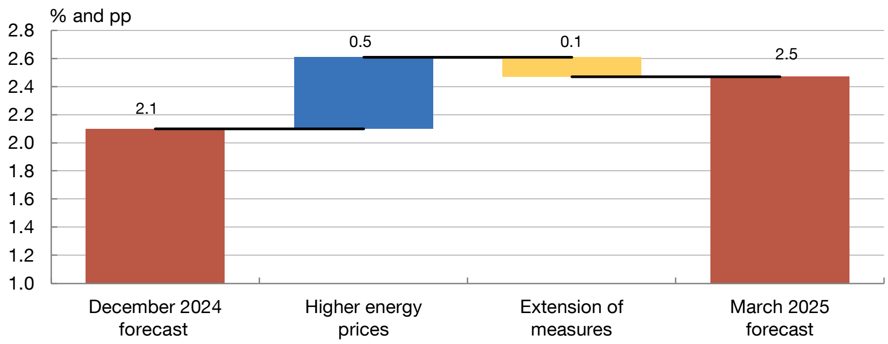
- First, the incorporation into the baseline scenario of the recent rise in energy prices and the new path for such prices determined by futures markets for the coming months entails an upward revision of 0.5 pp.

- Conversely, the extension of the public transport support measures to June 2025 (approved by the authorities after the December projection exercise cut-off date) leads to a downward revision of 0.1 pp.

— As regards the rest of the projection horizon, headline inflation rates remain unchanged for 2026 and 2027. However, the lack of changes in these rates masks a slight downward revision to energy inflation in those two years (due to the expected path for energy prices based on futures markets, which now predict a sharper slowdown in 2026 and 2027, from a higher starting point). This downward revision is offset by a slight upward revision to core inflation (driven by stronger expected wage income growth over the projection horizon and the upward base effect in the 2026 year-on-year rate associated with the extension of the public transport subsidies to June 2025).

Chart 28

28.a Changes in the inflation forecast for 2025



SOURCE: Banco de España.

29 The risks to the baseline scenario in these projections are to the downside for activity and to the upside for inflation

— The main external risk sources notably include the recent heightening of global uncertainty and geopolitical and trade tensions, which is partly due to the various economic policy measures announced by the new US Administration. Historical evidence shows that these tensions and growing uncertainty could have a significant adverse effect on activity. In this regard, it should be noted that this projection exercise does not include any increase in US tariffs on imports from Mexico, Canada and the European Union, an issue which is shrouded in significant uncertainty.

— Despite this and although there have been some corrections in international financial markets in recent weeks, valuations remain relatively high and risk premia tightly contained. This raises the possibility that there could be sharp correction episodes in these markets, particularly as the monetary policies of the world's major central banks show signs of divergence. Should these episodes materialise, they could also have a very adverse impact on economic growth and agents' confidence.

— Meanwhile, the Spanish economy has outperformed the euro area as a whole in recent quarters. According to the baseline scenario in these projections, this trend will continue in the coming years. However, the possibility that this decoupling between economic activity in Spain and the euro area (particularly France and Germany, two of Spain's main trading partners) will decrease in the future cannot be ruled out. If this were the case, for example because Spanish exports to the euro area were once again to respond to the activity of Spain's trading partners as they have historically in terms of magnitude, economic growth could be lower than projected.

— Some of the main internal sources of uncertainty have to do with public finances. In particular, following robust growth in 2023 and 2024, government consumption in 2025 could once again exceed expectations and slow down less than projected under the baseline scenario. Meanwhile, Europe is contemplating providing Member States with more fiscal room to considerably increase defence spending. This possible fiscal expansion is not envisaged in the baseline scenario.

— Lastly, the baseline scenario in these projections envisages relatively high growth rates for ULCs. Although they will decelerate compared with 2024, ULC growth will remain at around 2.5% on average over 2025-2027. These rates will not lead to greater internal inflationary pressures given that profit margins, calculated as the unit gross operating surplus (GOS), are expected to grow modestly (1.1% on average in 2025-2027). While this assumption is consistent with recent ULC and GOS developments, two alternative scenarios should still be considered. First, profit margins might increase more than anticipated (underpinned, for example, by the strong demand envisaged under the baseline scenario), which could lead to higher inflationary pressures and lower growth. Second, profit margins might remain subdued, as projected in the baseline scenario, but this could have a stronger-than-expected negative impact on private investment[18] (which has lagged behind significantly since the pandemic), thereby hindering activity growth.

18 For a preliminary analysis of the possible relationship between profit margins and investment, see Puente Díaz and Mulino Ríos (2024).

ACRONYMS AND ABBREVIATIONS

AEAT	Spanish tax revenue service
BLS	Bank Lending Survey
CES	Consumer Expectations Survey
EBAE	Banco de España Business Activity Survey
ECB	European Central Bank
ETS1	Emissions Trading System
ETS2	Emissions Trading System for buildings, road transport and small industry
EU	European Union
GDP	Gross domestic product
GOP	Gross operating profit
GOS	Gross operating surplus
GVA	Gross value added
HICP	Harmonised Index of Consumer Prices
IGAE	National Audit Office
IMF	International Monetary Fund
INE	National Statistics Institute
MTFSP	Medium-term fiscal structural plan
NEER	Nominal effective exchange rate
NGEU	NextGenerationEU
PMI	Purchasing Managers' Index
QNA	Quarterly National Accounts
QNFAIS	Quarterly Non-Financial Accounts of the Institutional Sectors
RRM	Recovery and Resilience Mechanism
SAFE	Survey on the Access to Finance of Enterprises
UCLs	Unit labour costs
VAT	Value added tax

bn	Billion
bp	Basis points
pp	Percentage points
H	Half
Q	Quarter