

## Annual Report: Digest

### The international environment

The global economy grew at a somewhat faster pace than expected in 2024, albeit with uneven developments across sectors and regions. This was consistent with a decrease in inflation rates, although the services component declined more gradually.

- The global economy grew by 3.3% in 2024, a slightly slower pace than in 2023 but higher than had been expected both at end-2023 and during much of 2024.
- Global growth was underpinned by expansion in the services sector, whereas manufacturing slowed, particularly in the advanced economies.
- Activity was also uneven by geographical area. Among the advanced economies, GDP growth was robust in the United States, more moderate in the euro area and slowed significantly in Japan. The growth in emerging market economies eased slightly, influenced by the slowdown in China. In Latin America economic activity grew at a similar pace to 2023.
- In 2024 headline and core inflation rates continued to ease gradually in the main geographical areas, although the latter declined at a more gradual pace, influenced by services prices.

In the euro area, economic activity began a smooth and gradual recovery in 2024, mirroring the sectoral heterogeneity observed in the global economy. At the same time, inflation continued to decline despite the stickiness of services inflation.

- Following the broad-based slackness in euro area economic activity during 2023, GDP in the region began to gradually recover in early 2024, recording 0.8% growth in the year as a whole, only slightly above the 0.5% observed in 2023.
- This modest acceleration in economic activity was mainly underpinned by growth in government expenditure and a positive performance from the external sector. On the supply side, there was a stark dichotomy between productive sectors during much of 2024, with persistent weakness in manufacturing contrasting with momentum in the services sector.
- The recovery in euro area economic activity during 2024 was uneven across countries. On the one hand, some central and northern European countries, such as Austria, Finland and Germany, experienced slight GDP contractions. Other economies, such as France, the Netherlands and Italy, recorded GDP growth rates of close to or below 1%. At the other extreme, some southern European countries, such as Spain, Greece and Portugal, recorded higher GDP growth rates.
- Euro area inflation remained on a decreasing path, declining from 2.9% in December 2023 to 2.4% in December 2024, shaped mainly by developments in the most volatile inflation components, in particular the strong moderation in food prices and the continued fall in energy prices.
- Core inflation also decreased, easing from 3.4% at December 2023 to 2.7% at December 2024. This was influenced by greater downward stickiness than expected in services inflation. By contrast, non-energy industrial goods prices moderated significantly.

In the final stretch of 2024 and early 2025 global economic activity unfolded against a backdrop of mounting economic policy uncertainty and heightened geopolitical and trade tensions.

- The marked rise in global uncertainty has largely been driven by the various measures announced/introduced by the new US Administration, which took office in January of this year. The measures related to tariff policy are particularly notable, especially the very significant and broad-based increase in tariffs on goods imported into the United States.
- The trade tensions escalated considerably on 2 April, when the United States announced its “reciprocal tariffs” on the rest of the world. Many of the affected countries, including the EU, responded with their own measures, while the tensions between China and the United States triggered a dramatic spiral of trade retaliations. All of which gave rise to sharp corrections and volatility on global financial markets.
- On 9 April the US Administration announced a 90-day suspension of the country-specific reciprocal tariffs for all nations except China, albeit maintaining the universal baseline tariff of 10%. This, together with other announcements on tariffs, has resulted in a slight de-escalation of trade tensions.
- Against this background, US economic growth slowed abruptly in 2025 Q1, and although activity remains robust in other major global regions such as China and the euro area, the risks to growth in the coming quarters are on the downside.
- As regards prices, recent data suggest no significant changes in the global disinflation process. However, there is considerable uncertainty over future inflation developments, which could display highly divergent paths across geographical areas.

The central banks of the main developed and emerging market economies tended to ease their monetary policy stances over the course of 2024, with some pausing the process in 2025, while the ECB has continued its rate cutting.

- As the gradual disinflation process took hold, a large number of central banks were able to ease their monetary policy during 2024, a trend that began somewhat earlier in the emerging market economies.
- In the euro area, the ECB followed a data-dependent approach. Having kept the deposit facility rate at 4% from September 2023, it began an easing cycle in June 2024, bringing the rate down to 3% at end-2024.
- In parallel, the ECB continued to reduce the size of the Eurosystem’s balance sheet in a gradual and predictable manner.
- In 2025 to date, the ECB has continued to lower its key policy rates (to 2.25% in April), whereas a growing number of central banks, including the US Federal Reserve, have paused the monetary easing process in a setting of heightened uncertainty surrounding the macro-financial, geopolitical and trade landscape and the future path of inflation.

Financial conditions in the euro area eased in 2024, in particular thanks to lower short-term interest rates, the depreciation of the euro and higher risky asset prices.

- After peaking in October 2023, interbank interest rates started to decline in the euro area as they incorporated expectations of the first key ECB interest rate cuts. Once the rate cuts started, the decline gained traction. Risk-free long-term interest rates also fell in the euro area in 2024, albeit very slightly.

- Long-term government bond yields in the euro area performed unevenly across countries. In Spain they decreased, seeing the sovereign spread against the German Bund narrow by almost 30 bp to 70 bp at end-2024.
- The euro depreciated slightly in nominal effective terms in 2024, highly influenced by a loss of value against the US dollar.
- Equity market valuations were generally bullish in 2024, with the IBEX 35 gaining 13.8%.

#### In early 2025 international financial markets began to correct some of these dynamics ...

- At the start of 2025, US stock prices and bond market yields had started to correct downwards in view of a possible cyclical downturn in US activity. In addition, the prices of firms most closely related to artificial intelligence were also negatively affected by the abrupt emergence in January of the new Chinese competitor DeepSeek.
- In the euro area, conversely, equity markets prolonged their upward path during 2025 Q1, supported by a possible resolution of the Ukraine and Middle East conflicts, and the boost to defence and infrastructure spending in the EU.

#### ... and the “reciprocal tariffs” announced by the US Government triggered an episode of severe global financial turmoil, which has been reversing in recent weeks.

- The size, scope and narrative of the tariffs announced by the United States on 2 April surprised the markets negatively, triggering sharp declines in stock market indices and driving up volatility and corporate credit risk premia globally.
- What set the April 2025 financial instability apart from previous episodes was that US government bonds and the US dollar did not act as safe-haven assets. Quite the opposite: US sovereign bond yields rose and the US dollar depreciated.
- The market instability started to subside on 9 April, after the US Administration announced a temporary pause on the implementation of some tariffs, and although financial valuations have largely reversed over the last few weeks, long-term yields and the exchange rate against the euro are yet to recover entirely.
- Some risky asset prices remain high from a historical perspective.

## The Spanish economy

The Spanish economy was notably buoyant in 2024, with GDP growth outpacing both the rest of the euro area and the projections available at the start of the year.

- In Spain, GDP grew by 3.2% in 2024, more than envisaged in the Banco de España's projections at the start of the year (1.9%) and than in the euro area as a whole (0.8%).
- The main factors behind this GDP growth were the upward surprises in government and private consumption and exports of travel and non-travel services, together with the positive carry-over effect stemming from the statistical revision of the growth rates for the second half of 2023.
- On the supply side, all sectors of activity posted strong growth, outpacing the rest of the euro area. This greater buoyancy was bolstered, among other factors, by a sharper reduction in the energy bill for industry, the continued geographical and seasonal diversification of tourism flows and Spain's increased capacity in terms of digital infrastructure, which appears to have boosted the performance of non-travel services sectors, in particular those with a higher technological content.
- On the demand side, both government and, especially, private consumption were the main support for activity in 2024 and explained the bulk of the gap between GDP growth in Spain and the euro area, while gross capital formation, together with goods exports, remains the demand component with the slowest recovery since the pandemic.
- One significant factor supporting the buoyancy of demand in Spain was the surge in the population which, driven by immigrant inflows, grew by 1% in 2024, compared with a rise of 0.4% in the euro area as a whole.
- In early 2025, the Spanish economy continued to grow at a robust rate, although this was slightly weaker than that observed in late 2024. Looking ahead, as in the global and European setting, the outlook for activity in Spain is subject to extraordinary uncertainty, resulting from a highly complex international environment.

Inflation continued to slow in Spain in 2024, in line with the forecasts at the start of the year, although services inflation was more persistent than expected.

- In 2024, inflation in Spain, as measured by the harmonised index of consumer prices, declined by 0.5 pp, to 2.9%, reflecting chiefly the slowdown in food prices compared with the upsurge in energy prices, which owed largely to the base effects stemming from lower electricity prices in 2023.
- Core inflation saw average growth of 2.8% in 2024, 1.3 pp less than in the previous year, mainly as a result of the sharp deceleration in non-energy industrial goods prices, in contrast to the greater downward stickiness observed in services inflation.
- The slowdown in inflation was in line with the forecasts available at the start of the year, as the downward surprises in food inflation were offset by services inflation proving more persistent than initially expected.
- Compensation per employee increased significantly again in 2024, surpassing both initial expectations and wage settlements, although productivity gains helped contain growth in unit labour costs.
- The first few months of 2025 saw no major shifts in inflation dynamics, as prices continued to moderate, although energy prices have been notably volatile.

Employment continued to grow at a robust pace in 2024 and early 2025, in a setting in which both the unemployment rate and the temporary employment ratio fell considerably.

- In 2024 and the early months of 2025 job creation was stronger in Spain than in the euro area, consistent with the more buoyant economic activity, with growth more marked in terms of persons employed than in terms of hours worked.
- In recent years job creation has been particularly concentrated among the immigrant population. Between end-2019 and end-2024, around 76% of all jobs created in Spain were filled by the foreign-born population, helping to meet the growing demand for labour in sectors facing greater difficulties filling their vacancies.
- The available indicators show that since end-2022 there has been a significant increase in the proportion of firms having difficulties finding labour, especially in hospitality and construction, although there is considerable uncertainty as to whether this is a result of the cyclical position of the economy or of a more structural skills mismatch.
- Another factor that is tightening the Spanish labour market is the increase in the percentage of the employed taking temporary sick leave, associated with circumstances such as poorer health in the wake of the pandemic, population ageing and the business cycle itself (historically there is a higher incidence of temporary sick leave in economic growth periods).
- The continued decline in the unemployment rate in Spain reflects the strong rate of job creation, which is outpacing the growth in the labour force, although the unemployment rate remains significantly above the euro area average, especially among young people.

Productivity indicators have performed better in Spain than in the rest of the euro area, both in 2024 and over the whole of the period 2019-24.

- The productivity gains achieved in Spain in recent years have narrowed the negative productivity gap built up with the euro area over past decades. However, the gap is still significant and narrowing it further is one of the major challenges facing the Spanish economy going forward.
- The recent productivity growth observed in Spain may be due to short-term and/or structural factors.
- The structural factors commonly identified as determinants of long-term productivity notably include innovation, human capital and institutional quality.
- In terms of innovation, Spain lags behind its European peers, although the available indicators suggest that the innovation gap has narrowed since the pandemic.
- Human capital has improved somewhat in the most recent period compared with other European countries, especially among the population groups with lower levels of education, based on the results of international standardised assessments of adult competencies.
- Lastly, the available indicators show that institutional quality – understood as the set of laws and regulations that govern socioeconomic relations – and in particular general government efficiency have declined somewhat since the start of the century.

The ECB's less restrictive monetary policy has lowered the cost of bank lending, boosting demand for loans among Spanish households and firms, whose debt ratios are close to their lowest levels in recent decades.

- The cost of new bank loans has fallen considerably, to stand at a level that, although higher in nominal terms compared with the period 2013-19, is somewhat lower when adjusted for expected inflation.

- The cumulative drop in the cost of financing in the current monetary policy normalisation phase has generally been somewhat more intense in Spain than in the euro area.
- In a highly dynamic economic setting in Spain, lower interest rates have boosted private sector loan demand, and households' outstanding mortgage stock began to increase in mid-2024, after two years of decline.
- Spanish households' and firms' debt ratios are close to their lowest levels in recent decades which, alongside other indicators, suggests that their financial vulnerability levels are low.
- The profitability of the Spanish banking system has continued to improve and solvency has risen slightly.

In a setting of robust public revenue and expenditure, both the budget deficit and the public debt-to-GDP ratio fell in 2024.

- The general government deficit declined by 0.3 pp in 2024, to 3.2% of GDP, mainly as a result of the economic cycle effect on public finances, the increase in tax revenue and the withdrawal of the temporary relief measures introduced in response to the energy crisis, albeit partially counteracted by the extraordinary spending associated with the October flash floods and certain court decisions.
- In 2024 the public debt ratio fell to 101.8% of GDP, owing chiefly to nominal GDP growth, although it is still 4.1 pp higher than its pre-pandemic level.
- Over a broader timescale, there have been some significant changes in the structure of public finances since the pandemic. Revenue has increased considerably, and the share of direct taxes and social security contributions has risen, while that of indirect taxation has declined. Spending has also expanded significantly, with notable increases in social benefits, government consumption and government investment.
- Government investment, a key lever for boosting medium and long-term growth, is still lower in terms of GDP in Spain than in the euro area. Moreover, most of the recent increase in this item has been underpinned by initiatives financed by temporary European funds.
- Looking ahead, the new Medium-Term Fiscal-Structural Plan sets out a framework for normalising public finances, but it misses the opportunity to undertake a rigorous planning of public finances in the medium term, especially given the favourable macroeconomic setting conducive to such a task.

The Spanish economy's net financing capacity rose once again in 2024, reaching its highest level since 1995, and the nation's net debtor position continued to decline.

- Spain's net lending rose by 0.4 pp of GDP in 2024, due primarily to a widening current account surplus.
- This was the result of the higher non-energy goods balance (continuing the favourable trend observed since 2012, which has been driven by competitiveness gains and export market diversification), marked growth in services exports and a slight decline in the energy deficit (owing to Spain's lower energy dependence vis-à-vis the rest of the world and the fall in energy prices).
- In part as a result of the current account surplus and GDP growth, in 2024 the negative net international investment position of the Spanish economy decreased to 44% of GDP, its lowest level since 2004.
- Nevertheless, this balance was still high compared with that of other European countries, and Spain's gross external debt as a percentage of GDP remained virtually unchanged in 2024.

## The Spanish economy: outlook and challenges for the future

In early 2025 consensus forecasts envisaged a relatively benign baseline scenario for global, European and Spanish economic activity, although there were some prominent downside risks to growth that have materialised in the wake of the latest trade and geopolitical developments.

- At global level, the baseline scenario envisaged mainly that world GDP would grow relatively robustly over the coming years, at above 3%. At the same time, the gradual disinflation process was expected to continue.
- In the euro area, the projections published by the European Central Bank in early March remained consistent with the expectation of a modest acceleration in economic activity in the region and of a gradual convergence of inflation towards the target rate of 2% (which is expected to be reached in 2026).
- Turning to the Spanish economy, the March Banco de España macroeconomic projections forecast a slightly lower output growth rate than that recorded in 2024, but one still above the Spanish economy's potential growth and that expected in most advanced economies. The March projections were also consistent with the continuation of the easing of inflationary pressures and the convergence of inflation rates towards 2% (which is expected to be reached in 2026).
- The latest economic, trade and geopolitical developments have seen some of the downside risks to growth materialise. As a result, the outlook for global economic activity for the coming quarters is now subject, even under the baseline scenario, to extraordinary uncertainty that stems from a set of particularly unclear factors.
- Estimating the possible macroeconomic impact of these factors is particularly complex, not only because some of their key details are unknown, but also because the channels through which they will impact economic activity are unclear.

Spain's trade with the United States is balanced and Spain has limited direct exposure, although some specific sectors are somewhat more exposed than others.

- Over the last decade, Spain's trade balance with the United States has run close to equilibrium. This is the result of a rising trade surplus in services (of over €10 billion in 2024) that is offset by a trade deficit in goods, which, since 2022, has increased considerably due to higher energy imports.
- The volume of Spain's external trade with the United States – measured as the trade-to-GDP ratio – is slightly above 4% of GDP, which is considerably lower than the ratio of other major euro area economies.
- The products most exported from Spain to the United States were: (i) machinery and transport equipment (27% of the total); (ii) other manufactured goods (26%); and (iii) chemicals and chemical products (19%).
- Furthermore, in terms of the share that exports to the United States account for in each sector's total exports, the sectors most exposed are non-metallic mineral products, machinery and equipment, electrical equipment and other transport equipment.
- Prominent among the goods imported from the United States were energy products, chemicals and chemical products and machinery and transport equipment.
- However, Spain's indirect exposure to the United States is greater because of the Spanish economy's integration with global value chains.
- In 2023, before the latest US trade policy developments, the average effective tariff borne by the Spanish economy on its exports to the United States was 3%.



- However, under the current tariff scenario, the average effective tariff on Spanish exports to the United States has risen to 12%.
- If the reciprocal tariffs that the US Administration announced on 2 April are ultimately implemented, the average effective tariff borne by the Spanish economy on its exports to that country would increase further still, to 18%.
- The ultimate impact of a tariff increase on the volume of exports by Spanish firms will depend, among other factors, on the price sensitivity of US demand for goods, on the ability of Spanish firms (and of those from the rest of the world) to adjust their margins and on the possibility of them finding alternative export markets to the United States or adapting their product range.
- It is important to note that, while the current tariff war is, for the time being, focused on goods, this does not mean that services activity will not be affected.

The rise in tariffs reduces global economic growth across all trade scenarios simulated.

- The higher the general tariff rates, the larger the impact which, therefore, is more negative under the countermeasure scenario.
- By geographical area, the negative impact is considerably stronger in the United States than in the other countries. The effects are more moderate in the euro area and Spain.
- They are significantly amplified if accompanied by a tightening of financial conditions or higher economic policy uncertainty.

In recent months, in an increasingly complex geopolitical context in which the United States appears to seek to scale down its role as the main guarantor of global security, the need for higher defence spending in the EU has become increasingly important to bolstering European security autonomy.

- At the same time, in response to these geopolitical concerns and the German economy's notable weakness in recent years, Germany's new coalition government has agreed on a significant fiscal impulse for the coming years that will focus on defence and infrastructure spending.
- In line with these developments at European level, the Spanish Government unveiled the Industrial and Technological Plan for Security and Defence on 22 April 2025. This plan's envelope amounts to approximately 0.6% of GDP, with the aim of reaching a defence spending-to-GDP ratio of 2% by 2025, in line with North Atlantic Treaty Organization criteria.
- The impact of these initiatives on activity and prices in the EU and Spain over the coming quarters will depend not only on actual additional expenditure, but also on a range of factors that are clouded by significant uncertainty.

Recent years have seen globalisation and the multilateral international system called into question, with potentially more acute adverse implications for the most open economies integrated with global value chains.

- Economic globalisation in recent decades has driven international trade and investment flows, as well as the dissemination of technology. This has not only fostered global economic growth, but also bolstered the development of emerging market economies.
- However, in recent years, various dynamics have emerged that seem to challenge this globalisation process and the system of international relations based on cooperation and multilateralism. This has potentially more



pronounced adverse implications for the EU and Spain, which are relatively open economies and are deeply integrated with global value chains.

- In recent years, there has been marked redirection of bilateral trade flows between various economies. This could intensify and become widespread in the future, depending on how the current tariff war develops.
- Doubts have arisen more recently regarding the pivotal role of the US dollar in the international monetary and financial system. Although it is unclear whether the dollar could cease to function as the anchor of this system in the short term, any abrupt change in this situation – or in the perception of economic agents about it – could pose significant risks to global financial stability.

In an extraordinarily complex economic and geopolitical setting, European policies should respond resolutely (on both the external and domestic fronts), with a clear goal in mind: to strengthen the unity of the European project, its institutional framework and the economy's competitiveness and resilience.

- On the external front, the EU must continue to defend a rules-based multilateral framework for global decision-making, while it reinforces its international alliances and diversifies its trade exposures.
- On the domestic front, the challenges are no less significant. Here the EU must rapidly implement an ambitious structural reform programme aiming to foster greater integration, dynamism, resilience and competitiveness among the European economies.
- The new European Commission has drawn up a multidisciplinary work programme to address many of the EU's structural challenges. It is essential that all the actors involved in driving this programme forward be ambitious, open-minded and pragmatic in order to achieve substantial improvements in the current European economic governance framework.

The Spanish economy has grown robustly in recent years and the outlook for the coming quarters, in an extremely uncertain global scenario, remains relatively favourable, although with clear downside risks to future activity growth.

- Against this backdrop, it is essential to understand, first, how much of Spanish economic activity's recent dynamics is attributable to purely conjunctural factors (and could therefore unravel in the future) and how much owes to truly structural changes (which have sustainably increased Spain's resilience and growth capacity).
- Second, despite recent progress, the Spanish economy still faces numerous extraordinarily important structural challenges. Some of these challenges have been well known for decades, such as those related to productivity and the labour market. Others affecting present and future developments in the Spanish economy, such as those linked to the housing market, migratory flows and the green transition, have gradually come to the fore in recent years.
- Third, given the rising current and expected pressures on government spending, fiscal policy must seize the opportunity provided by European funds and the robust growth pattern to devise, with an eye on the medium term, ways to simultaneously bolster the sustainability of public finances and improve their composition, ensuring that government revenue and expenditure contribute more positively to economic growth.