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THE SPANISH ECONOMY: OUTLOOK AND CHALLENGES FOR THE FUTURE

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Foreword by the Governor

José Luis Escrivá

The Banco de España *Annual Report* has been prepared and published at a time of extraordinary global complexity and uncertainty. The current environment is characterised by a convergence of intense geopolitical and trade tensions, significant unpredictability in the way the US Administration conducts its economic policy both domestically and internationally (including its tariff, fiscal and regulatory policies, its role in multilateral organisations and the institutional framework of its public administration and independent agencies), and a noticeable deterioration in the confidence levels of economic agents. All these factors play a crucial role in shaping global growth prospects and pose risks to the stability of the international financial system.

In contrast to the volatile and turbulent situation at the start of 2025, the global economy in 2024 fared relatively well, with growth rates exceeding expectations in some regions, against a backdrop of gradual disinflation and easing financial conditions. This new scenario presents significant challenges from an economic analysis perspective.

First, there remains considerable difficulty in determining whether the shocks being observed are structural or transitory, as well as understanding the specifics and scope of each economic measure. The analysis of the potential effects of the trade measures announced by the US Administration varies significantly depending on the scenarios considered. Second, the transmission of these shocks through financial and confidence channels is a source of potentially major uncertainty owing to the combination of various factors, such as the central role of the US dollar as a reserve currency, means

of payment and safe-haven asset, recent developments in some financial markets with high valuations, and especially the possible deterioration of international investors' confidence in the US economy. These issues, combined with the general uncertainty about the direction in which the global economy is heading, generate additional risks to global financing conditions and investment.

It should be noted that, unlike previous crises, the current environment is distinguished by a particularly diffuse and persistent form of uncertainty, which complicates both the identification of plausible adverse scenarios and the assignment of probabilities to such scenarios. Moreover, recent developments are not being immediately or clearly captured by the main conventional activity indicators, which makes it more difficult to interpret the economic cycle and assess the outlook for the economy and inflation. In this context, volatility has become a structural feature of financial markets.

In such uncertain times, the analysis of different scenarios becomes especially relevant. As a result, various simulations for the global economy have been conducted in this report, which, while not independent of each other, attempt to capture the main elements that characterise the current situation. These simulations suggest that an increase in tariffs would adversely affect global activity, particularly in the United States and, to a lesser extent, in the euro area and, particularly so, in Spain. However, should these trade tensions heighten owing to a deterioration in global financial conditions or uncertainty levels, the negative impact on GDP would increase.

Regarding inflation, the United States would experience a more adverse impact in the form of higher inflationary pressures, while in the euro area and Spain, such upward pressures would be more limited and could be offset by lower activity levels and trade diversion effects, which would shift some of the exports that other countries cease to send to the United States towards Spain and the euro area. Deflationary pressures would be more significant if the trade shock were amplified by the financial or the uncertainty channels, which would partially mitigate the inflation spike in the United States.

In any case, the ultimate impact of a tariff increase on export volumes will depend on multiple factors, such as the possibility of other countries implementing "reciprocal tariffs", trade agreements eventually made, the price sensitivity of US demand for goods, tariff policies' spreading to the services sector, the ability of firms from the rest of the world to adjust their margins and the possibility that these firms might find alternative export markets to the United States or restructure their product offerings.

Alongside the short or medium-term effects, the report examines, over a broader time scale, how some of the current risks can be considered as part of a deeper and more structural questioning of multilateralism in international relations and of globalisation, in order to assess the possible implications of these developments in the long term.

This uncertainty inevitably affects Europe, whose economic recovery and financial stability face substantial risks, not only because of its direct trade exposure to the United States, but also through indirect channels such as the European economy's integration into global value chains and the international financial market. In tandem with developments in international trade, major decisions are now being taken at European level, such as the review of the German fiscal framework and the strong boost to defence and infrastructure spending, the economic impact of which is not yet known.

While the measures represent an opportunity to strengthen the European Union's economic resilience, their short and medium-term effects need to be analysed in depth. Their impact will depend to a large extent on how they are designed and the degree of European coordination. Recent experience highlights the importance of common fiscal and financial governance frameworks that help maximise the aggregate benefits for the Union and prevent fragmentation of the Single Market.

As for the Spanish economy, 2024 ended with GDP growth of 3.2%, higher than expected at the start of the year, underpinned by strong private and government consumption, the positive contribution of net external demand – in particular, services exports – , and the significant increase in employment and the labour force, largely driven by net migration flows. The economy continued to perform well in early 2025, albeit at a somewhat more moderate pace. Inflation continued to slow in 2024, mainly due to the fall in food inflation and to a more subdued decline in underlying inflation.

At the same time, the private sector's financial position has gradually become stronger, with lower household and corporate debt ratios and the negative net international investment position of the Spanish economy remaining on a downward path. In parallel, the normalisation of monetary policy by the European Central Bank led to a gradual improvement in financing conditions and a steady recovery in the demand for credit. The outlook for the coming quarters, however, is contingent on global developments, with clear downside risks. Although the direct trade exposure to the United States is relatively low, the indirect exposure through global supply chains and financial and confidence channels is notable and must be closely monitored.

Meanwhile, the Spanish economy continues to face major structural challenges. The productivity gap relative to the euro area average has narrowed in recent years but remains significant. The persistence of a lower employment rate than that of our European partners limits the potential for growth and hampers convergence in terms of per capita income. These structural challenges require an ambitious reform programme that includes fostering business growth, enhancing the quality of the regulatory and institutional framework, strengthening the medium-term budgetary framework to afford greater credibility to efforts to bolster the sustainability of public finances, boosting investment in innovation and building up human capital, and improving the performance of active and passive labour market policies.

Against such a complex backdrop, this Annual Report aims to provide a comprehensive, well-sourced and useful analysis of recent economic developments in Spain and the European and international context and of the main challenges facing the Spanish economy in the years ahead. The possible effects of recent financial and international trade developments are also analysed, paying special attention to their potential impact on the Spanish economy.

In doing so, the Banco de España reaffirms its commitment to carrying out its institutional functions as a national central bank, in particular, producing economic reports and studies, and publishing statistics related to its functions, to provide independent, evidence-based analyses that contribute to more informed decision-making by public authorities, institutions and all economic agents.

José Luis Escrivá

Governor of the Banco de España

Foreword to the Annual Report 2024.

20 May 2025.

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.

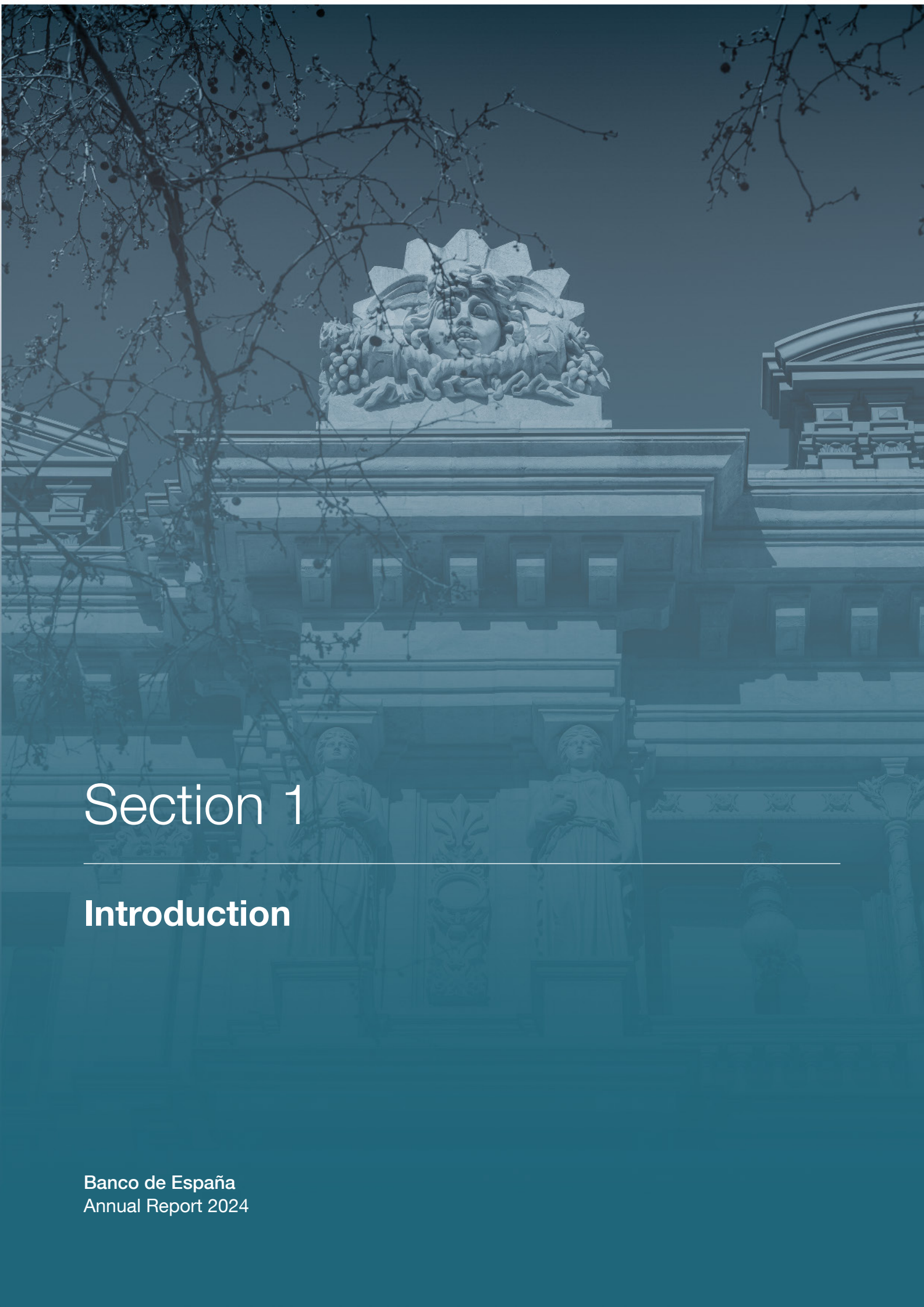
— The new European Commission has drawn up a multidisciplinary work programme to address many of the EU's structural challenges. It is essential that all the actors involved in driving this programme forward be ambitious, open-minded and pragmatic in order to achieve substantial improvements in the current 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.



Section 1

Introduction

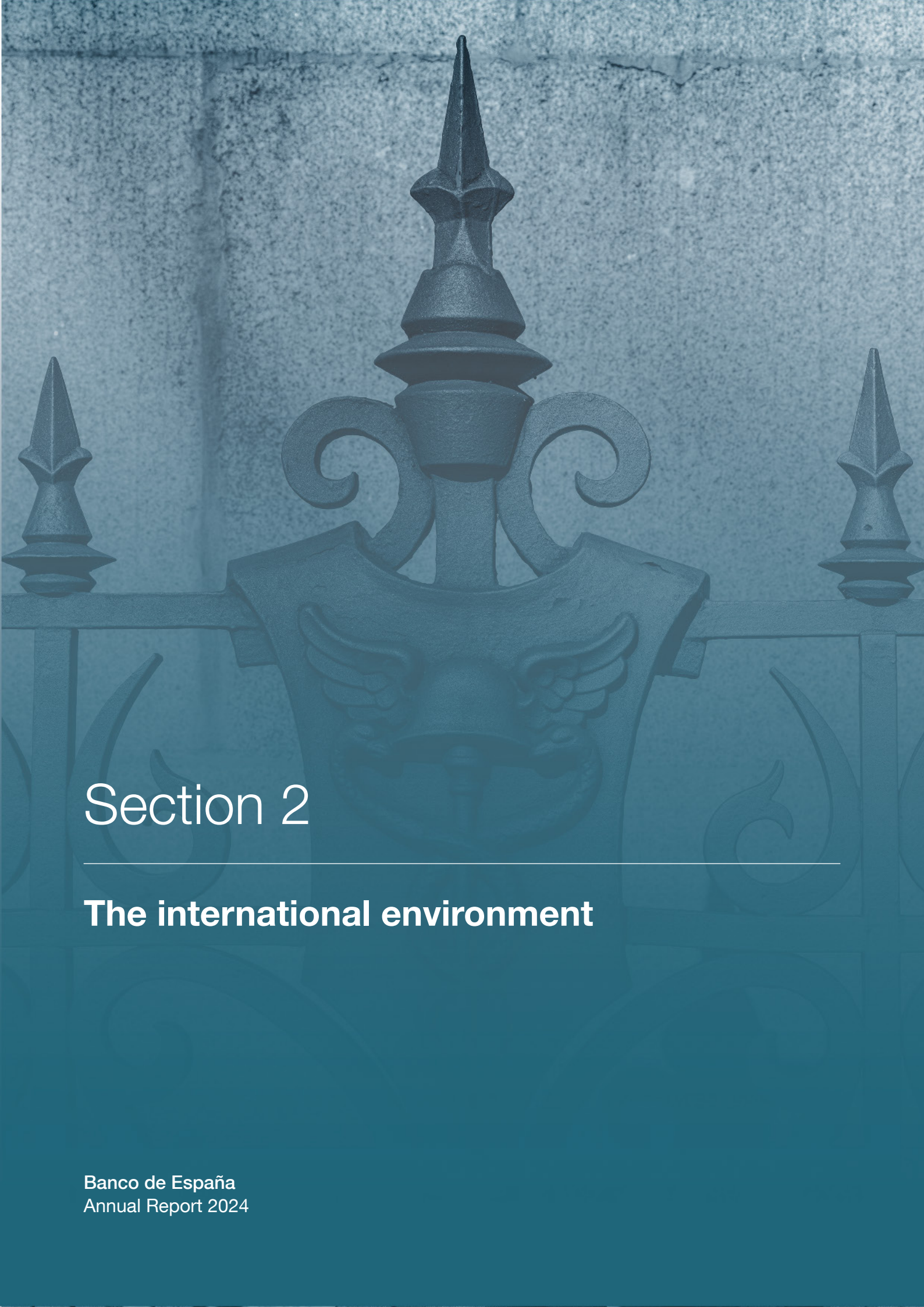
This *Annual Report* presents the most salient aspects of the developments in Spanish economic activity in 2024 and early 2025. It also describes the outlook for the coming quarters and considers the main structural challenges facing the Spanish economy that must be addressed in the coming years.

To do so, Section 2 of this report begins by describing the latest activity and price dynamics at global and European level. In addition, it documents the key factors behind developments in international financial markets and the monetary policy of the world's main central banks in recent months. Foremost among them are high economic policy uncertainty and renewed trade tensions, which have stemmed from some of the tariff initiatives implemented or announced by the new US Administration.

Section 3 focuses on the recent performance of the Spanish economy, which has remained notably buoyant and continues to grow at a considerably faster pace than the other main European economies. All this, while the gradual easing of inflationary pressures has continued – albeit with some ups and downs – and productivity, the labour market and the external sector, to highlight certain dimensions, have performed fairly favourably. By contrast, the recovery in private investment has remained relatively weak.

Lastly, Section 4 of this report is more forward-looking and considers the outlook for global, European and Spanish economic activity over the coming quarters. This outlook is extraordinarily uncertain and will mainly be determined by how the current trade tensions unfold and by how they affect financial markets and economic agents' confidence/certainty.

Against such a complex backdrop, with risks to projected global – and Spanish – growth tilted to the downside, Section 4 describes the main challenges that European and Spanish economic policy will have to address diligently and ambitiously over the coming years.



Section 2

The international environment

The global economy grew relatively robustly in 2024, against a backdrop marked by buoyant activity in the United States and a strong services sector. However, 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, largely associated with the various measures announced/introduced by the new US Administration.

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 (in these regions and globally) are tilted to the downside.

Looking at prices, inflationary pressure continued to ease globally during 2024 and the first few months of 2025. During certain periods, this moderation was highly influenced by energy price volatility and the continued downward stickiness of services inflation.

In any event, as with the outlook for activity, the inflation outlook remains highly uncertain, with the potential for highly divergent inflation dynamics across geographical regions over the coming quarters.

Against this backdrop, the central banks of the main developed and emerging market economies tended to ease their monetary policy stances in 2024, resulting in looser financing conditions. In recent months, however, a growing number of central banks have paused their monetary easing cycles, partly due to rising future inflation expectations.

Having initiated a cycle of monetary policy normalisation in June 2024, the European Central Bank (ECB) has lowered its deposit facility rate by 175 basis points (bp) to 2.25%. All following a data-dependent and meeting-by-meeting approach to decision-making, without pre-committing to a particular rate path.

Global financial markets performed relatively favourably over much of 2024 and early 2025. More recently, however, there has been considerable volatility, particularly in early April after the US Administration announced its “reciprocal tariffs”.

That announcement took markets by surprise and triggered a period of pronounced financial turbulence globally, during which, contrary to historical patterns, the dollar and US sovereign debt did not act as safe-haven assets. Although this turbulence and the corrections observed in many financial asset prices have partially reversed in recent weeks, global financial markets remain particularly vulnerable to potential adverse shocks in the coming months.

2.1 Activity and price dynamics

The global economy grew at a somewhat faster pace than expected in 2024, albeit with uneven developments across sectors and regions.

— The global economy grew by 3.3% in 2024, according to the April 2025 World Economic Outlook (WEO) published by the International Monetary Fund (IMF). This full-year 2024 growth rate was slightly down on 2023, but higher than had been expected both at end-2023 and during much of 2024 itself (Chart 2.1.a).

— Set against an improvement in household spending capacity – thanks to positive developments in real income – this growth was underpinned by activity growth in the services sector, whereas manufacturing activity slowed, particularly in the advanced economies.

— Activity developments were also uneven by geographic area.

- Looking at the advanced economies, there was notable momentum in the United States, where GDP grew by 2.8% (down from 2.9% in 2023), largely driven by private consumption which, in turn, was underpinned by a relatively positive labour market performance. Conversely, GDP growth was more moderate in the euro area (0.8%, compared with 0.5% in 2023), whereas in Japan it slowed significantly (to 0.1% from 1.5% in 2023).[1]

- The growth in emerging market economies eased slightly in 2024, influenced by the activity slowdown in China (from 5.4% to 5%), reflecting the protracted correction in the real estate sector and weak private consumption. In Latin America economic activity grew by 2.4%, a similar pace to 2023,[2] underpinned by positive data in Brazil (3.4%) and despite the slowdown in GDP growth in Mexico (from 3.3% in 2023 to 1.5% in 2024) and the 1.7% contraction in Argentina.

This was consistent with a decrease in inflation rates, albeit with the services component declining more gradually.

— In 2024 headline inflation rates continued to ease gradually in the main geographical areas (Chart 2.1.b). Thus, average global inflation stood at 3.6% in December 2024, well below the peak of September 2022 (8.8%) and also down on the 4.3% recorded at end-2023.

— Globally, core inflation declined at a more gradual pace, influenced by services prices, while the growth in goods prices eased markedly. The latter trend was likely shaped by, first, the near absence of supply problems, according to the index developed by the Banco de

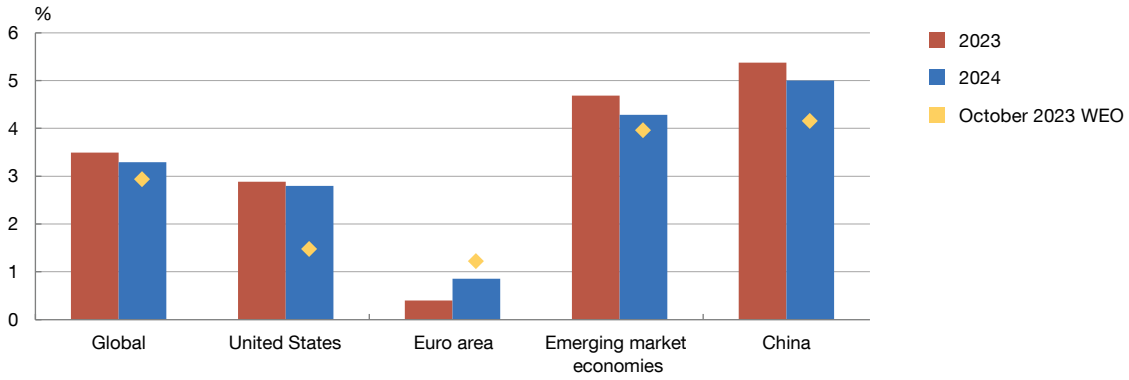
1 The growth rates for the euro area come from the series used in the Eurosystem projection exercise, which are adjusted for seasonal and calendar effects. The rates for other countries are those calculated by the IMF using unadjusted original series.

2 Banco de España (2025).

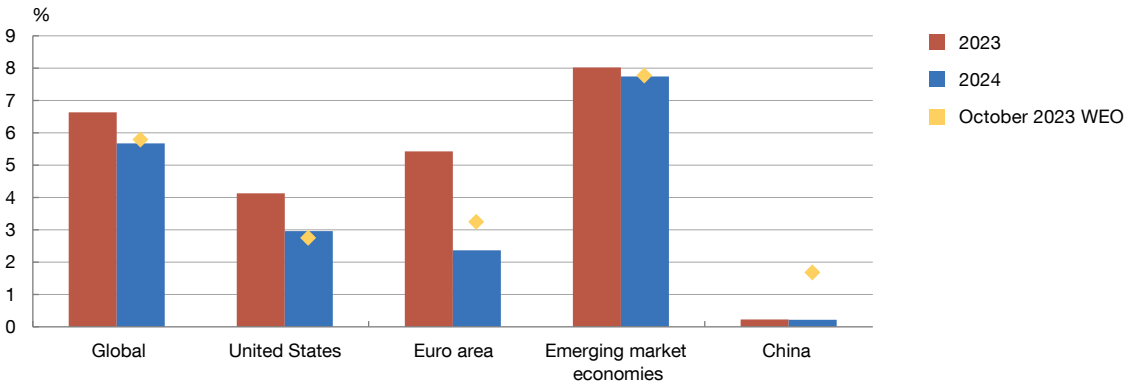
Chart 2.1

Global economic activity remained on a growth path in 2024, albeit with marked heterogeneity across geographical areas and sectors, while inflation continued to ease

2.1.a GDP growth



2.1.b inflation rates



SOURCE: IMF (WEO October 2023 and WEO April 2025).

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España[3] (Chart 2.2.a), and, second, commodity prices remaining contained (Chart 2.2.b), despite persistently high geopolitical tensions associated, for example, with the armed conflicts in the Middle East and Ukraine. For instance, Brent oil prices ended 2024 at around $70/barrel, reflecting both a slowdown in demand, primarily from China,[4] and strong supply.[5]

— By geographical area, and looking at the advanced economies, headline inflation in the United States, which peaked at 9.1% in June 2022, fell from 3.4% at end-2023 to 2.9% in December 2024, while core inflation was down from 3.9% in December 2023 to 3.2% in December 2024. Meanwhile, in Japan, where price pressures were significantly more subdued during the inflationary crisis, headline and core inflation stood at 3.6% and 2.4%,

3 For an analysis of the impact of the Red Sea crisis on bottlenecks, see Viani (2024). For more details about the bottlenecks index, see Burriel, Kataryniuk, Moreno and Viani (2024).

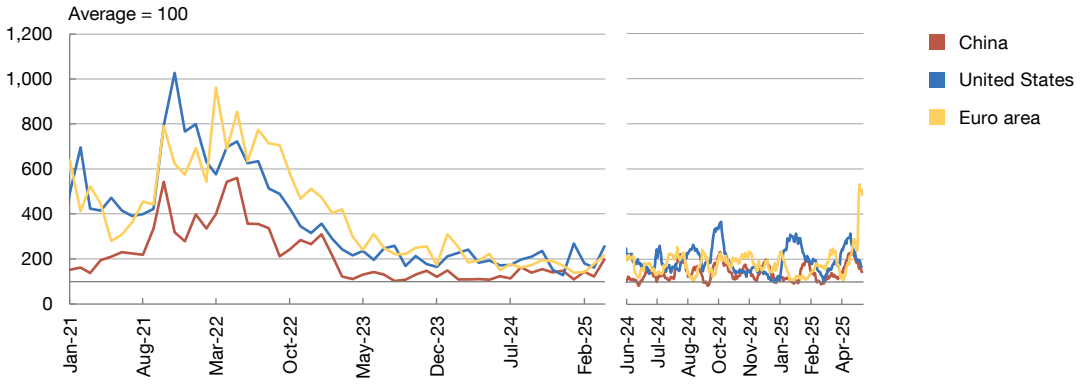
4 Alonso, Santabárbara and Suárez-Varela (2023).

5 Natural gas prices followed a rising trend over the year, reaching around €45/MWh in early 2025, albeit still well below the peak levels recorded following the outbreak of the war in Ukraine.

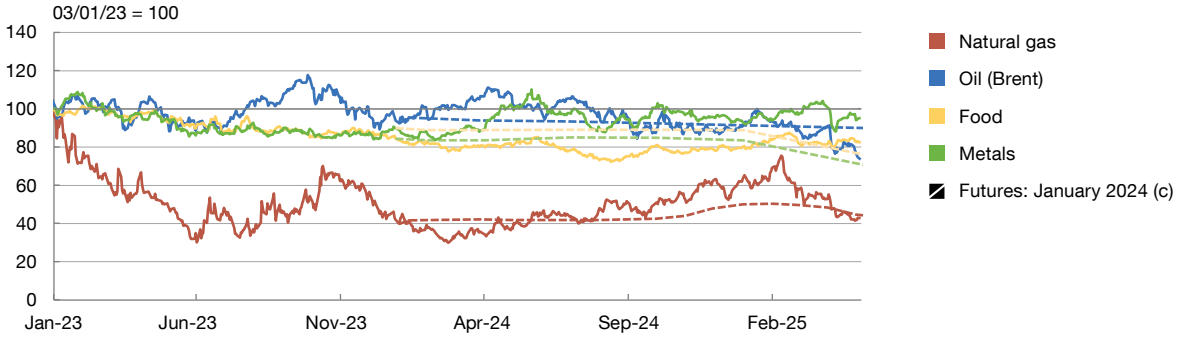
Chart 2.2

The activity growth and moderating global inflation rates came against a backdrop of relatively limited bottlenecks and subdued commodity prices

2.2.a Supply bottlenecks index (a)



2.2.b Gas, oil, food and metal prices (b)



SOURCES: Banco de España, drawing on Burriel, Kataryniuk, Moreno and Viani (2024) and LSEG Datastream.

a The supply bottlenecks index measures the proportion of newspaper articles that report on supply problems and is indexed to 100 for the period ending in December 2021. The euro area index is calculated as the average of the domestic German, French, Italian and Spanish indices. The latest data observed corresponds to the average for April 2025 (top panel) and 04/05/25 (bottom panel).
b Latest data observed: 05/05/25.
c The dotted lines indicate January 2024 futures for natural gas (brown), oil (blue), food (yellow) and metals (green).

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respectively, at end-2024. In emerging market economies, the average inflation rate in Latin America fell from 5% at end-2023 to 4.5% in December 2024. Price pressures in China remained highly muted, with headline inflation at 0.1% in December 2024 and core inflation at 0.4%, amid a protracted decline in producer 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. At the other end of the spectrum, persistently high uncertainty hindered a stronger recovery in private consumption, despite improvements in households' real income and a strong labour market, while private investment clearly declined. 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.

— Euro area inflation followed a pattern similar to that in other developed economies. Headline inflation remained on a decreasing path, sliding from 2.9% in December 2023 to 2.4% in December 2024, a decline shaped mainly by developments in the most volatile inflation components. These notably included a sharp moderation in food prices, whose rate of change fell from 6.1% to 2.6% in the same period, and the continued decline in energy prices, which fell at an average annual rate of 2.2% in 2024.

— Core inflation also decreased, easing from 3.4% at December 2023 to 2.7% at December 2024. This was influenced by services inflation, which showed greater downward stickiness than expected (partly due to relatively robust demand for services and still appreciable wage growth) and held broadly stable at around 4% throughout 2024. By contrast, non-energy industrial goods prices moderated significantly, from growth rates of over 2% at December 2023 to around 0.5% at end-2024, in line with, among other factors, the gradual easing of global value chain bottlenecks and the correction in energy input and commodity prices.

In the euro area, alongside the uneven developments across productive sectors, some cross-country heterogeneity was also evident in GDP growth and, to a lesser extent, inflation developments.

— The recovery in euro area economic activity during 2024 was uneven across countries, partly due to the aforementioned sectoral heterogeneity and the varying degree of productive specialisation among the countries (Chart 2.3.a).

— On the one hand, some central and northern European countries, such as Austria, Finland and Germany, where the industrial sector accounts for a relatively large share of the economy, experienced slight GDP contractions, partly due to the fall in productive investment. Other economies where investment showed a relatively modest performance were France, the Netherlands and Italy, which recorded GDP growth rates of close to or below 1%.

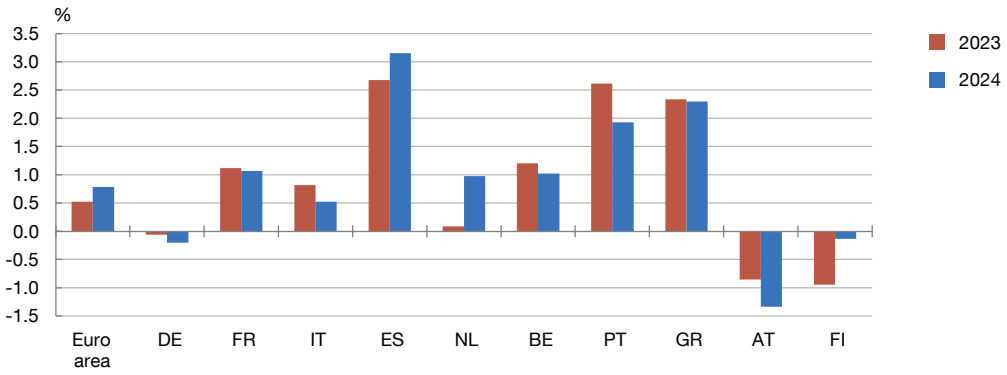
— On the other hand, some southern European countries recorded higher GDP growth rates, such as Spain (3.2%), Greece (2.3%) and Portugal (1.9%), which are more specialised in services related to trade, transport and tourism.

— In terms of inflation there was less cross-country heterogeneity: in 2024 most major euro area economies recorded average headline inflation rates of between 2.3% and 3%, with exceptions such as Italy, Ireland or Finland which had lower rates of around 1% (Chart 2.3.b).

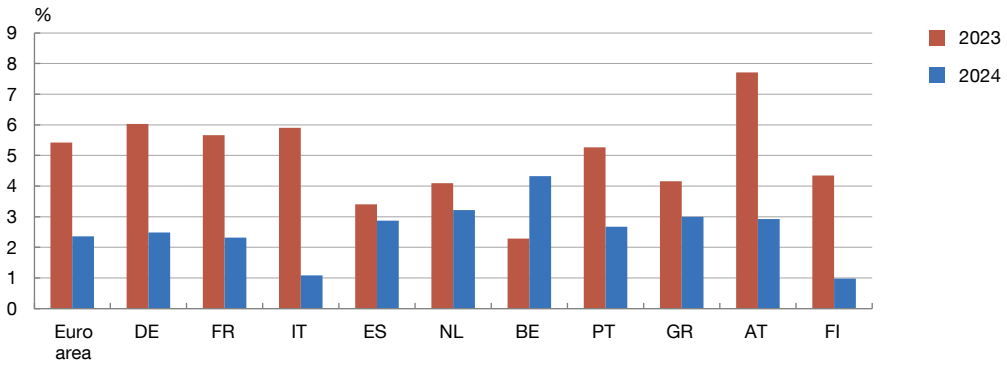
Chart 2.3

While the economic recovery in the euro area has exhibited cross-country heterogeneity, inflation showed less disparity and, with some exceptions, broadly declined

2.3.a GDP rates of change. Euro area



2.3.b Headline inflation rates. Euro area



SOURCE: Eurosystem.

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, largely associated with the various measures announced/introduced by the new US Administration.

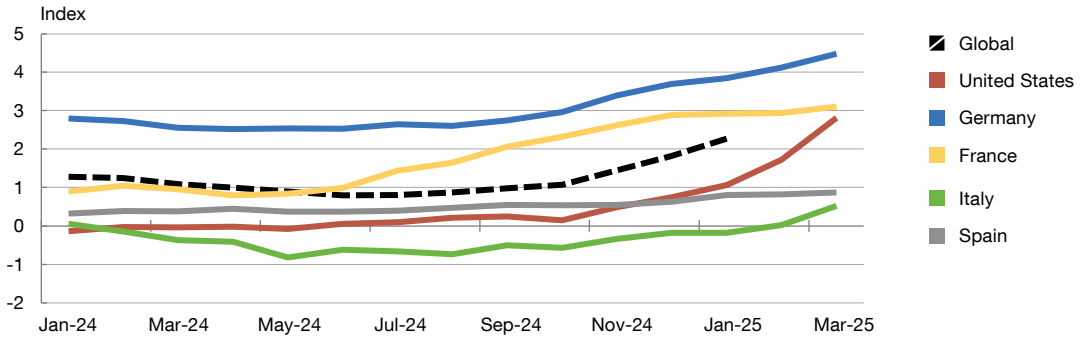
— Indeed, over recent months the traditional indicators of policy uncertainty, notably the Economic Policy Uncertainty (EPU) Index, have followed a clear rising path both globally and in several major world economies (Chart 2.4.a). At the same time, according to the Trade Policy Uncertainty (TPU) Index there has been an extraordinary uptick in uncertainty over global trade policies, while the Geopolitical Risk (GPR) Index shows a relatively high level of geopolitical risk by historical standards (Chart 2.4.b).

— Aside from a number of purely domestic factors affecting some of the world's largest economies in recent months, including political instability in France and snap elections in Germany, the rise in global uncertainty has largely been driven by the various measures

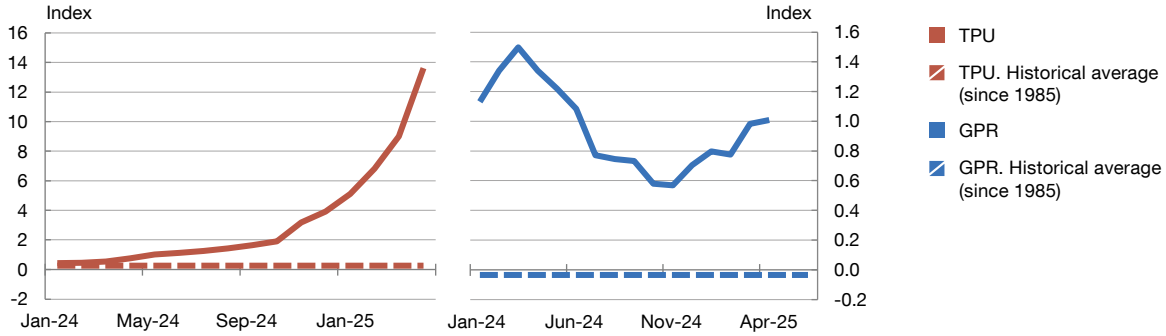
Chart 2.4

Economic policy uncertainty, in particular regarding trade policy, has increased markedly since end-2024

2.4.a EPU index (a)



2.4.b TPU index and GPR index



SOURCES: Baker, Bloom and Davis (2016); Caldara, Iacoviello, Molligo, Prestipino and Raffo (2020); Caldara and Iacoviello (2022).

a 6-month moving average, standardised series. Latest data available for the Global EPU Index: January 2025.

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announced/introduced by the new US Administration, which was elected in early November 2024 and took office in January of this year.

— Among these wide-ranging measures – affecting, for example, areas such as immigration, fiscal, regulatory, defence and foreign policy – those related to tariff policy stand out in particular. The new US Administration has announced, and in some cases implemented, a very significant and broad-based – by product and exporting country – increase in tariffs on goods imported into the United States. This tightening of US trade policy has unfolded in a number of stages (Table 2.1), with considerable back and forth (in some instances announced via social media posts), and has prompted several of the main economies affected, such as China, Canada and the European Union (EU), to announce or implement tariff increases on imports from the United States.

— A key moment in the course of this erratic US tariff policy came on 2 April, when the United States announced its "reciprocal tariffs" on the rest of the world (US Fair and Reciprocal Plan), marking a significant escalation in trade tensions. This initiative included a baseline tariff of

Table 2.1
Key events in the tariff conflict (a)

% and bp			Daily change in financial indicators				
Announcement	(b)	Date (c)	S&P 500 (%)	EURO STOXX (%)	EUR/USD (%)	US 10-year government bond (bp)	German 10-year government bond (bp)
US: additional 10% tariff on China	↗	1 Feb	-0.8	-1.2	-0.2	-1.2	-7.1
US: additional tariffs on Mexico and Canada	↗	1 Feb	-0.8	-1.2	-0.2	-1.2	-7.1
Canada: tariffs on US increased	↗	2 Feb	-0.8	-1.2	-0.2	-1.2	-7.1
US: tariffs on Mexico and Canada paused	↘	3 Feb	0.7	0.6	0.3	-2.2	0.6
China: additional tariff on US of up to 15%	↗	4 Feb	0.7	0.6	0.3	-2.2	0.6
US: tariffs on steel and aluminium increased	↗	10 Feb	0.7	0.6	-0.2	1.0	-1.6
Trump statement: possible tariffs on the EU	↗	27 Feb	-1.6	-0.9	-0.8	2.3	-2.6
US: additional 10% tariff on China	↗	3 Mar	-1.8	-2.6	1.1	-4.2	-1.2
China: additional 15% tariff on US	↗	3 Mar	-1.2	-2.6	1.3	4.9	-1.2
US: exemption of USMCA-compliant products from additional tariffs	↘	6 Mar	-1.8	0.7	-0.1	1.2	10.0
EU: reintroduces 2018 and 2020 additional tariffs on the US. Further retaliatory measures possible	↗	12 Mar	0.5	1.0	-0.3	4.0	1.7
US: 25% tariff on vehicles and vehicle parts	↗	26 Mar	-1.1	-1.0	-0.4	3.5	-0.4
US: baseline additional reciprocal tariff of 10%, with selective increases (20% for the EU; 34% for China)	↗	2 Apr	-4.8	-2.9	1.8	-13.3	-8.4
China: 34% retaliatory tariff on US	↗	4 Apr	-6.0	-4.8	-0.9	-3.8	-7.2
US: reciprocal tariff on China increased to 84%	↗	8 Apr	-1.6	2.6	0.5	8.7	-1.8
EU: retaliatory tariff on US confirmed	↗	9 Apr	9.5	-3.0	-0.1	3.0	-4.5
US: temporary pause on reciprocal tariffs above 10% (except for China)	↘	9 Apr	9.5	3.9	-0.1	3.0	0.4
China: reciprocal tariff on the US increased to 84%	↗	9 Apr	-3.5	3.9	2.3	9.9	0.4
US: reciprocal tariff on China increased to 125%	↗	9 Apr	-3.5	3.9	2.3	9.9	0.4
EU: retaliatory tariffs on US paused	↘	10 Apr	-3.5	3.9	2.3	9.9	0.4
China: retaliatory tariffs on US increased to 125%	↗	11 Apr	1.8	-0.3	1.4	6.5	-5.6
US: tariff exemption for certain electronic products	↘	11 Apr	1.8	2.6	1.4	6.5	-0.6
US and China: China exempts some electronic products from additional tariff and indicates potential negotiation	↘	23 and 24 Apr	3.7	2.5	-0.3	-8.8	0.1
US and China: stronger indications of potential negotiation	↘	2 May	1.5	2.1	0.0	9.2	8.0

SOURCES: Global Trade Alert, LSEG Datastream and Banco de España.

a This table includes information up to the cut-off date for this report (5 May 2025). Note that trade agreements have subsequently been entered into between the United States and the United Kingdom and between the United States and China.
b An up (down) arrow indicates a toughening (easing) of tariff measures.
c Dates refer to when the tariff measure was announced. For daily changes in asset prices, the reference points are the market close immediately before and after the announcement. These figures do not necessarily represent the impact of the measure and may reflect other factors.

10% for all countries (with the exception of Canada and Mexico) from 5 April, with around 60 countries facing additional specific tariffs of up to 50% from 9 April. For instance, the reciprocal tariffs amounted to 34% for China, 20% for the EU, 24% for Japan and 25% for South Korea.

— 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. As a consequence, international financial markets experienced sharp corrections and high volatility (see Section 2.2.2), contributing to the US Administration's decision to announce on 9 April a 90-day suspension of the country-specific reciprocal tariffs for all nations except China (which would face an additional reciprocal tariff), albeit maintaining the universal baseline tariff of 10%. In turn, on 10 April the EU announced a 90-day suspension of its 25% tariffs on a range of US products.

— Subsequent tariff announcements have followed (Table 2.1),[6] generally contributing to a slight de-escalation of trade tensions, while the 90-day negotiation remains ongoing. Despite this back and forth, it is important to note some of the main tariff measures currently in force, in addition to the baseline 10% tariff. In particular, since 12 March the United States has applied a tariff of 25% on imports of steel, aluminium and certain derivative steel and aluminium products, and since 3 April has applied a 25% tariff on vehicles (exempting the US content of such imports, which affects the bulk of vehicle imports from Mexico and Canada). In addition, a 25% tariff on imports of vehicle parts came into effect on 3 May, except for imports from Mexico and Canada under the United States-Mexico-Canada Agreement (USMCA). All of the above tariffs affect EU products, including those from Spain.

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 (in these regions and globally) are on the downside.

— In the United States, the national accounts advance estimate for 2025 Q1 showed a significant slowdown in activity, with quarter-on-quarter GDP growth declining from 0.6% in 2024 Q4 to a contraction of 0.1% in 2025 Q1. This slowdown appears primarily driven by a surge in imports, largely in anticipation of potential tariff hikes. However, other determinants include a weaker contribution from private consumption to GDP growth, which is consistent with the deterioration in consumer sentiment observed in recent months, as measured, for instance, by the University of Michigan Consumer Sentiment Index.

— In China, however, GDP grew by 5.4% year-on-year in 2025 Q1, unchanged from the previous quarter but above consensus forecasts. This relatively strong performance appears attributable to, among other aspects, the effect of the stimulus measures deployed by the Chinese authorities over 2024 and buoyant exports. The latter, as mentioned above, at least partly owes to a certain stockpiling effect (the frontloading of trade flows) ahead of a potential hike in US tariffs.

— Like in China, euro area economic activity also surprised to the upside in 2025 Q1. In particular, according to the initial data provided by Eurostat, euro area GDP accelerated its quarter-on-quarter growth, rising from 0.2% at end-2024 to 0.4% in 2025 Q1. By country, following a slight contraction in the preceding quarter, the region's two largest economies returned to positive

6 Note that after the cut-off date for this report trade agreements have been entered into between the United States and the United Kingdom and between the United States and China.

growth rates (0.2% in Germany and 0.1% in France). Activity also quickened in Italy, with growth reaching 0.3% in 2025 Q1, up by 0.1 percentage points (pp) on 2024 Q4.

— In any event, these recent dynamics are likely not yet fully reflecting the adverse impact on economic growth from the sharp increase in uncertainty in recent months. Indeed, historical evidence suggests that heightened uncertainty has a negative, albeit lagged, impact on households' and firms' spending and investment decisions, and thus on economic activity.[7] In this regard, the risks to global economic growth in the coming quarters are essentially skewed to the downside, although it is difficult to gauge their magnitude for the time being. This will depend, among other factors, on how current trade tensions are resolved, on international financial market developments and, in the case of the EU, on the potential macroeconomic impact of a possible significant increase in defence and infrastructure spending in the region (see Section 4.1).

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.

— In the final stretch of 2024 and early 2025 there were some signs of the downward trend of global headline inflation rates stuttering. This was mainly in response to the rise in energy prices during that period.

— More recently, however, energy (particularly oil) prices have fallen significantly, partly owing to the higher uncertainty and a worsening analysts' outlook for the future pace of global economic growth. For example, since 1 April – prior to the announcement of "reciprocal tariffs" by the United States – and until the cut-off date for this report, the price of Brent oil had dropped by 19% to $60/barrel.

— In line with these developments, the latest inflation data published in the main world regions are so far consistent with continued disinflation. Thus, for example, in the United States headline and core inflation stood at 2.4% and 2.8%, respectively, in March 2025, 0.5 pp and 0.4 pp lower than at end-2024. In the same vein, the April flash estimate of euro area inflation points to a headline inflation rate of 2.2%, unchanged from March, but 0.2 pp lower than in December. However, it should be noted that core inflation in the euro area surprised to the upside in April and rose by 0.3 pp to 2.7% (the same rate as in December last year). This was mainly due to an increase in services inflation to 3.9%, reversing part of the declines recorded in the opening months of the year.

— In any event, the outlook for the future path of inflation is extraordinarily uncertain. As with economic growth (discussed above), it will depend on developments in trade tensions,

7 In the case of the Spanish economy, for instance, historical irregularities suggest that an increase in uncertainty over global economic policies has a maximum adverse impact on the level of activity after around four quarters. This impact is especially pronounced in investment.

financial markets (in particular commodity prices and exchange rates), the possible emergence of bottlenecks in global production and supply chains, and economic agents' level of confidence/certainty. As discussed in Section 4.1, these developments are likely to have a very heterogeneous impact on inflationary pressures across regions worldwide, which the latest consensus forecasts already acknowledge.

2.2 Monetary policy and financial conditions

2.2.1 Monetary policy

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 exceptions.

— As the gradual disinflation process took hold, a large number of central banks were able to ease their monetary policies during 2024. For example, outside the euro area, the US Federal Reserve cut its policy rate by 100 bp between September and December 2024 (Chart 2.5).[8]

— In emerging market economies, where the monetary easing cycle tended to start earlier, central banks generally also decreased their policy rates over the course of 2024, especially in Latin America. The exception was Brazil, where in 2024 H2 the central bank raised its key interest rate by 175 bp in response to the pick-up in inflation rates.

The ECB initiated a monetary policy normalisation cycle in June 2024 and continued to reduce its balance sheet in a gradual and predictable manner (see **Box 1**).

— The improved inflation outlook in the euro area, the moderation of core inflation and the effective transmission of monetary policy enabled the ECB to start easing the level of monetary tightness in June 2024. This marked the end of a nine-month period, from September 2023, in which the deposit facility rate[9] was kept at 4%.

— Between June and December 2024, the ECB eased its monetary policy with four policy rate cuts, taking the deposit facility rate to 3%.

— In parallel, the ECB continued to reduce the size of the Eurosystem's balance sheet in a gradual and predictable manner – thus preventing any interference with the monetary policy stance – and introduced some changes to its operational framework.

In 2025 to date, the ECB has continued to lower its key policy rates, whereas a growing number of central banks have paused the monetary easing process.

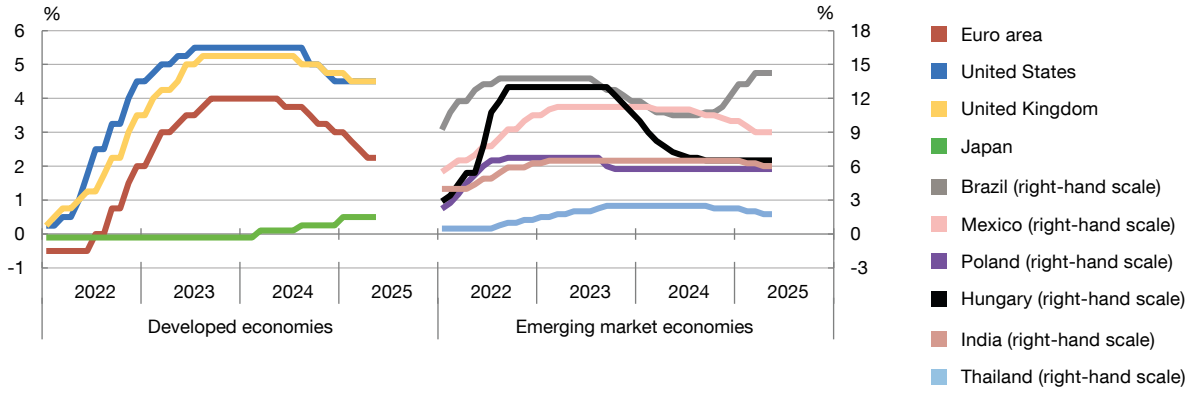
— In a setting of heightened uncertainty surrounding the macro-financial, geopolitical and trade landscape and the future path of inflation – with medium-term inflation expectations rising in some countries – an increasing number of central banks in advanced economies have recently paused the monetary easing process that had begun a few months ago. A

8 The exception to this trend was the Bank of Japan, which abandoned its zero rate policy and raised its benchmark interest rate in March and July 2024 to 0.25%.

9 This is the key interest rate that currently steers the ECB's monetary policy stance. See the Banco de España blogpost "Which ECB interest rate affects my loan or mortgage?", published on 25 October 2023.

Chart 2.5
Monetary policy eased over the course of 2024 in most of the main global economic areas

2.5.a Policy interest rates (a)



SOURCES: National central banks and LSEG.

a Monthly data at month-end (except for the latest observation, which is at 5 May).

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case in point is the US Federal Reserve (which paused its policy rate cutting in January), the Bank of England and the Bank of Sweden (which paused in March), and the Bank of Canada (which kept its interest rates unchanged in April). By contrast, other central banks, such as those of Switzerland and New Zealand, have continued to cut interest rates at their latest meetings.

— The ECB, for its part, cut its key interest rates by 25 bp at each of the three monetary policy meetings held in 2025 to date (in January, March and April), bringing the deposit facility rate to 2.25%. The cut agreed on 17 April took place against a background of progress in disinflation and increased downside risks to economic growth in the euro area amid escalating global trade tensions. At that meeting, the ECB Governing Council stressed its determination to ensure that euro area inflation stabilises sustainably at its 2% medium-term target, as well as the importance of following a data-dependent approach in which decisions are taken on a meeting-by-meeting basis, and without pre-committing to any particular rate path. The President of the ECB also pointed out the need to be ready and flexible to ensure an appropriate monetary policy stance.

— Looking to the coming months, international financial market prices anticipate some scope for a further decline in the key ECB interest rates, which could bring the deposit facility rate below 2% by the end of the year. In the same vein, at the cut-off date for this report, the financial markets are pricing in a scenario where the US Federal Reserve cuts its policy interest rates by 25 bp on around three occasions before the end of 2025.

— Among emerging market economies, there has also been some divergence in monetary policy decisions in recent months. Thus, while some central banks, especially in Latin

America, have kept their policy interest rates stable or paused their monetary policy easing cycles, others have either accelerated easing (such as Mexico) or intensified tightening (such as Brazil). In Türkiye, the central bank interrupted its monetary easing cycle in April and raised its interest rates by 350 bp (to 46%), amid depreciation pressures stemming from increased political instability.

2.2.2 Financial conditions in the euro area and international financial markets

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. Thus, the 3-month and 12-month EURIBOR decreased by 111 bp and 124 bp, respectively, in 2024, accumulating a fall of 172 bp and 202 bp between October 2023 and April 2025, to stand at 2.25% and 2.14% in average monthly terms.

— Risk-free long-term interest rates also declined in the euro area in 2024, albeit very slightly. Thus, the 10-year OIS rate stood at 2.2% at end-2024.

— Government debt yields in the euro area performed unevenly across countries. Spanish and Italian 10-year bond yields decreased by around 20 bp and 40 bp, respectively, to stand, on average, at 3.1% and 3.4% at December 2024. By contrast, the French bond yield rose by 40 bp, reflecting political instability and weak public finances in France. All told, the Spanish sovereign spread against the German Bund fell by almost 30 bp over 2024, standing around 70 bp at the end of the year.

— The euro depreciated slightly in nominal effective terms in 2024, shaped by its position against the US dollar, whose weight in the nominal effective exchange rate (NEER) is 16%. The depreciation of the euro against the dollar (6% in 2024) reflected different outlooks for activity and inflation in the United States and the euro area, which also affected the 2-year OIS spread between these two regions, which exceeded 200 bp in the final stretch of the year. The euro also recorded losses against the pound sterling (of 4.6%) and the yuan (of 3.4%), but appreciated overall against the currencies of Latin America and the Japanese yen.

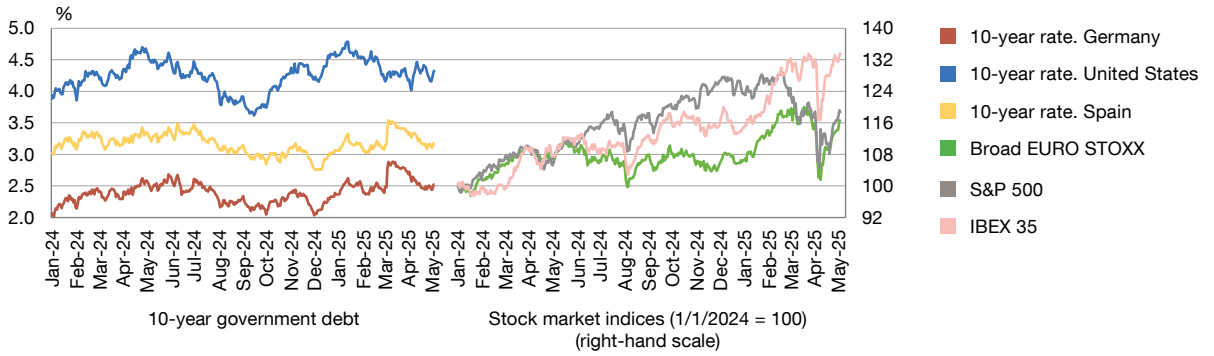
— Equity market valuations were generally bullish in 2024. In any event, the gains on stock market indices in Europe and Spain were lower than in the United States. Thus, the US S&P 500 index appreciated by 24% in 2024, outperforming the EURO STOXX (6.6%) and the IBEX 35 (13.8%).

In early 2025 international financial markets began to correct some of these dynamics (with a divergence between the United States and the euro area), influenced by the new US Administration's policies and developments in the current trade and geopolitical conflicts.

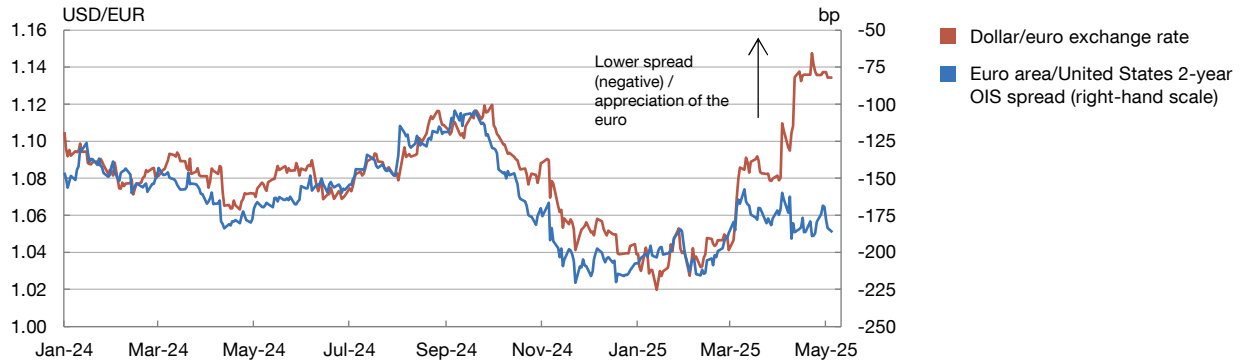
Chart 2.6

The trade war escalation in early April 2025 triggered an episode of strong global financial turmoil in which the dollar did not act as a safe-haven asset and depreciated

2.6.a Sovereign debt yields and stock market indices



2.6.b Interest rate spread between the euro area and the United States and bilateral exchange rate



SOURCES: Bloomberg and LSEG Datastream. Latest observation: 5 May 2025.

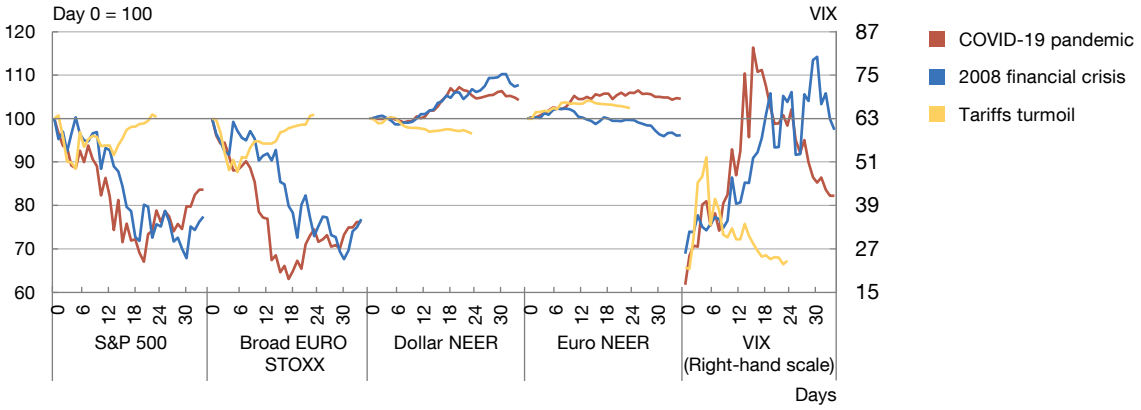
— At the start of 2025, prior to the announcement of "reciprocal tariffs" by the US government on 2 April, US stock prices and bond market yields had started to correct downwards in view of a possible cyclical downturn in US activity (Chart 2.6.a). In addition, the prices of firms most closely related to artificial intelligence were also negatively affected by the abrupt emergence in January of the new Chinese competitor DeepSeek.

— In the euro area, however, equity markets started the year by prolonging the upward path of late 2024, supported by a possible resolution of the Ukraine and Middle East conflicts, and expectations of a possible significant boost to defence spending in the EU – allowing countries greater flexibility under the new European fiscal framework – and to defence and infrastructure spending in Germany (see Section 4.1.4). Specifically, the announcement in Germany of a plan that includes reforming the constitutional "debt brake" led, in early March, to euro area long-term interest rates rising by around 40 bp, which also contributed to the euro's appreciation against the dollar since the beginning of the year (Chart 2.6.b).

Chart 2.7

The financial turmoil in April 2025 associated with the tariff war was intense but short-lived and, unlike in past periods of turmoil, the dollar depreciated

2.7.a Volatility, stock market indices and exchange rates during periods of financial market turmoil (a)



SOURCE: LSEG Datastream.

a Change in the VIX, S&P 500, broad EURO STOXX and the nominal effective exchange rate (NEER) for the dollar and the euro during 35 working days of the COVID-19 pandemic (from 21/2/2020 to 10/4/2020) and the 2008 financial crisis (from 12/9/2008 to 31/10/2008), and during 24 working days of the tariffs turmoil (from 1/4/2025 to 5/5/2025).

The announcement of "reciprocal tariffs" by the US Government on 2 April triggered an episode of severe global financial turmoil, which has been reversing in recent weeks but continues to leave financial markets exposed to potential adverse shocks in the coming months.

— As shown in Table 2.1, at the beginning of 2025 global financial markets were already highly sensitive to any tariff-related announcements, whether by the US Administration or by countries affected by increased tariffs on their exports to the United States.

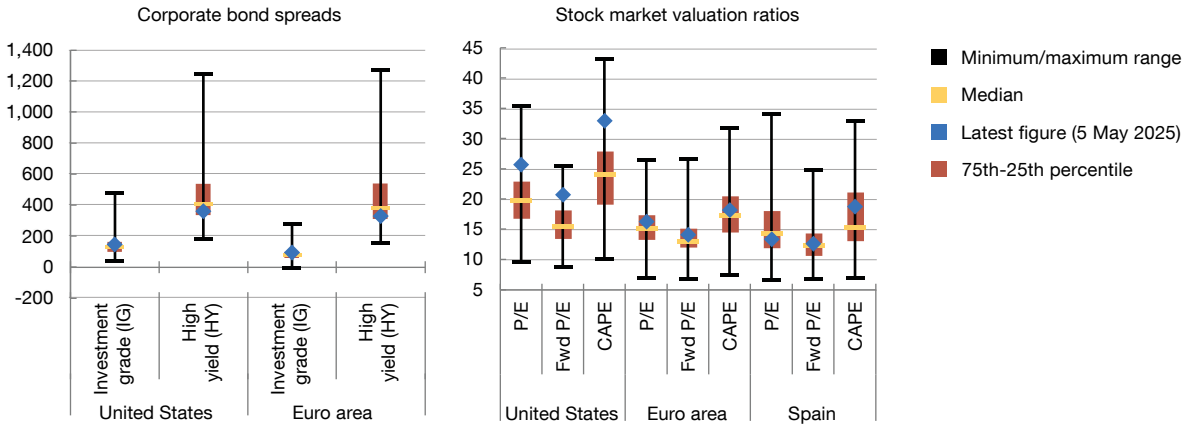
— However, the size, scope and narrative of the tariffs announced by the United States on 2 April surprised the markets negatively, triggering sharp declines in stock market indices and driving up volatility and corporate credit risk premia. The magnitude of these corrections was similar to that observed at some junctures of the COVID-19 pandemic in 2020 and the global financial crisis in 2008 (Chart 2.7). For instance, the S&P 500 index fell by almost 12% between 2 and 8 April, similar to the decline during the first week of the COVID-19 crisis.

— What set this episode of instability apart from previous ones was that US government bonds and the US dollar did not act as safe-haven assets. Quite the opposite: during this episode there was a marked increase in US sovereign bond yields and a depreciation of the US dollar. In the euro area, however, opposite movements were recorded as investors sought safe-haven assets, which also led to the appreciation of other traditional safe-haven assets such as gold.

— In any event, all these abrupt market corrections have been relatively short-lived over time. Indeed, the instability started to subside on 9 April, following the announcement by the US

Chart 2.8

High valuations persist in some segments of the fixed income and equity markets



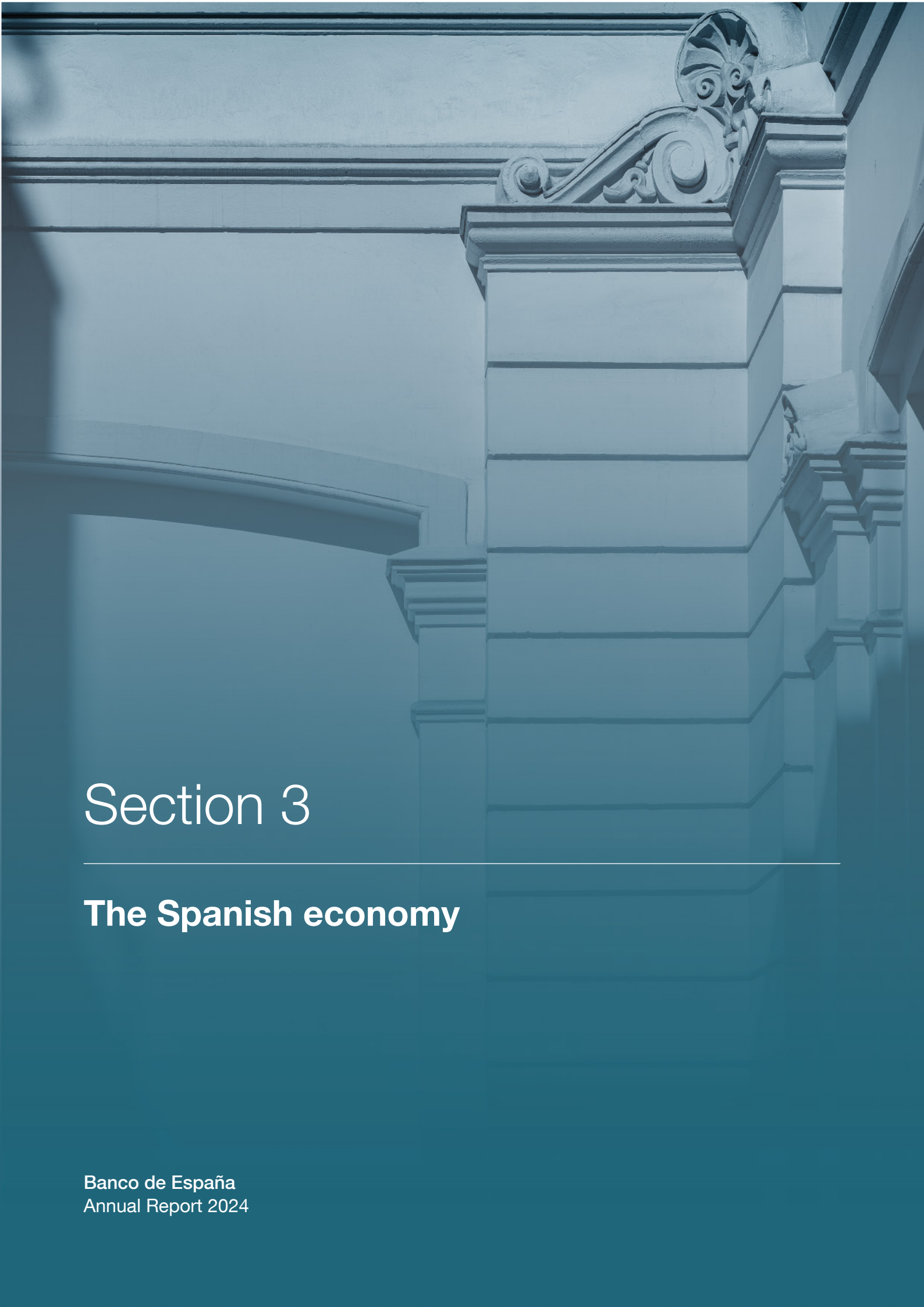
SOURCES: LSEG Data stream and Banco de España.

a Corporate spreads over the swap curve of the ICE Bank of America Merrill Lynch indices. Monthly series data since 1998.
b Drawing on monthly data of the stock market index series constructed by Datastream since 1985 for the euro area and the United States and since 1987 for Spain. The sample is somewhat smaller for Spain's CAPE ratio and the euro area Fwd P/E ratio. Ratios provided by Datastream, except for the CAPE (cyclically adjusted price-to-earnings) ratio which is calculated as the value of the stock market index in real terms (adjusted for CPI) divided by a 10-year moving average of the index firms' earnings in real terms. The P/E ratio and 1-year fwd P/E ratio capture the relationship between the stock price and earnings per share (observed or expected).

Administration that it would pause the implementation of some tariffs for a period of 90 days.

— However, in some cases the reversal of the recent shift in financial valuations remains incomplete. For instance, between 2 April and the cut-off date for this report (5 May), the yield on the US 10-year sovereign bond increased by 19 bp, while that on the German Bund fell by about 20 bp. In the same period, the euro has appreciated by 5% against the dollar, accumulating an appreciation of more than 9% so far this year. By contrast, the EURO STOXX and S&P 500 indices have recovered their levels prior to the onset of tensions.

— Finally, it is important to note that, following the sharp market corrections in early April and the partial reversal of these corrections in recent weeks, some risky asset prices remain high from a historical perspective. In particular, equity risk premia remain well below their historical average in both the United States and the euro area. Stock market valuation ratios, which relate firms' earnings to their stock prices, are well above their historical median in the United States (Chart 2.8). Corporate credit risk spreads in the high-yield segment have approached, but remain slightly short of, their historical median following the recent episode of turmoil.



Section 3

The Spanish economy

The Spanish economy was notably buoyant in 2024, surpassing the projections available at the start of the year and the average growth rate of the euro area. The salient factors underpinning GDP growth in Spain are strong public and private consumption – compared with relatively weak investment – and the positive contribution of net exports, which was shored up by the sound performance of travel and non-travel services exports.

By contrast, the floods that affected several Spanish provinces in late 2024 and took an extraordinary toll in terms of human lives, dampened – albeit in relatively limited terms – the buoyant activity in 2024 Q4, and exerted some upward pressure on public spending.

Other important factors for GDP growth in 2024 – and, more generally, in recent years – were the increase in population, stemming from strong net migration inflows, and employment growth, which has led to a protracted decline of the Spanish economy's high unemployment rate.

As for the labour market, in recent years job creation has been largely concentrated in the immigrant population, among workers with higher levels of education and, in terms of sectors, in services, some of which have high added value. At the same time, the labour market has shown growing signs of tightening: the percentage of firms reporting that labour shortages have restricted their activity has increased and the percentage of employed people on temporary sick leave has climbed sharply. The causes of the latter phenomenon should be analysed thoroughly.

Productivity growth also seems to have boosted GDP growth. For instance, in both 2024 and in the period 2019-24, the momentum of productivity was more marked in Spain than in other euro area countries, especially compared with France and Germany and regarding total factor productivity (TFP). Nonetheless, the negative productivity gap that has built up in recent decades between Spain's and other euro area economies, remains significant and narrowing this gap remains one of its major future challenges.

More recently, early in 2025, the Spanish economy has continued to grow at a robust – albeit slightly weaker – rate than in late 2024 and, looking ahead, it is expected to be subject to some downward risks in a highly complex international setting. In any event, employment dynamics at the beginning of this year remain relatively favourable.

Likewise, the normalisation of monetary policy by the European Central Bank (ECB) appears to have brought down the cost of bank credit somewhat – seemingly more sharply in Spain than in other euro area countries in recent quarters – which is driving a moderate recovery in the demand for credit. This has occurred in a scenario where household and corporate debt ratios have continued to decline, their financial vulnerability has remained relatively contained – according to various metrics – and where the Spanish economy's net lending capacity has risen to its highest level in recent history, at the same time as its negative net international investment position (IIP) has held on a downward path.

Turning to price developments, inflation continued to slow in Spain in 2024, mainly due to a decrease in food prices and, to a lesser degree, in underlying inflation, despite sharper than

expected downward stickiness in services prices. Compensation per employee rose significantly in 2024 – exceeding the forecasts available early in the year and the negotiated wage increases – although productivity improvements contributed to containing the growth of unit labour costs.

The first few months of 2025 saw no major shifts in price and wage dynamics compared with 2024, although energy prices have been notably volatile.

Moreover, the improvement in economic activity contributed to reducing the general government deficit in 2024 and the public debt-to-GDP ratio – although the latter remains high compared with the euro area as a whole. The structure of public finances in Spain has changed considerably since the pandemic: revenue from direct taxes and social security contributions has risen and expenditure, especially on social benefits, has climbed notably.

Looking ahead, the new Medium-Term Fiscal and Structural plan sets out a framework for normalising public finances, but it misses the opportunity of rigorously planning public finances in the medium term which would also benefit from the current robust growth of the Spanish economy. In an increasingly complex geopolitical context in which the United States appears to want to limit its role as the main guarantor of security, defence and the global order, public finances also face new challenges from the need for somewhat persistently higher spending on defence.

3.1 GDP growth

The Spanish economy was notably robust in 2024 compared with the projections available at the start of the year and with the rest of the euro area. This growth was underpinned, as in the two previous years, by a strong increase in the population.

— The pace of GDP growth in Spain quickened in 2024 to stand at an annual average of 3.2%, 0.5 percentage points (pp) up on 2023. By contrast, as mentioned earlier, the euro area's GDP grew by only 0.8% in 2024, slightly higher than the figure of 0.5% recorded in the previous year.

— GDP growth in Spain in 2024 was 1.3 pp higher than forecast by the Banco de España in March 2024. Behind this positive surprise lie the higher than expected buoyancy of public and private consumption, strong services exports and the statistical revision of GDP data for 2023. Meanwhile, after stripping out the effect of these statistical revisions, investment performed more weakly in 2024 than was initially projected (see Box 2).

— Against the backdrop of considerable job creation (see Section 3.3), the Spanish economy gained from significant population growth, thanks to high immigration inflows.[1] Specifically, Spain's resident population increased by 1% in 2024, compared with a rise of 0.4% in the euro area as a whole, which brought annual GDP per capita growth in Spain in 2024 to 2.2% (0.4% in the euro area).

— Finally, there was a slight slowdown in activity throughout 2024. In particular, the quarter-on-quarter growth rate moderated slightly from 1.0% in Q1 to 0.8% in Q2 and then to 0.7% in Q3 and Q4. The growth rate in the second half of 2024 was still relatively robust, taking into account the negative impact on activity of the flash floods in several Spanish provinces (especially in Valencia) during 2024 Q4 (see Box 3).

On the supply side, the remarkable buoyancy of all sectors of activity in 2024 was more pronounced than in the euro area as a whole, due to a wide range of factors.

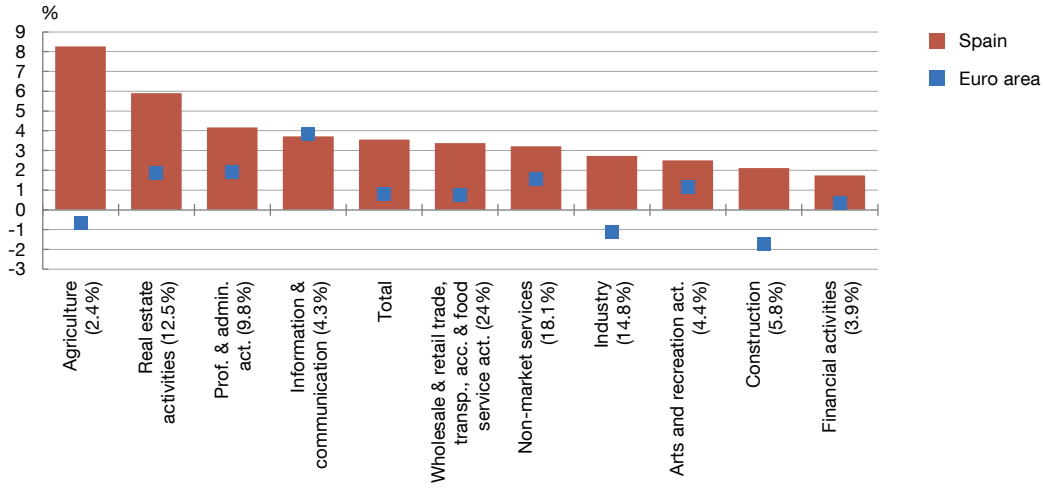
— In 2024 economic activity in Spain expanded across all sectors (Chart 3.1.a). For instance, the primary sector grew by 8.3%, which was significantly higher than in the euro area where it slipped by 0.7%. Growth in Spain in the industrial sector and in construction reached 2.7% and 2.1%, respectively, compared with the contraction of these two sectors in numerous countries in the euro area. Finally, the services sector grew by 3.7%, 2.2 pp more than in the euro area, driven by the strong momentum of real estate activities and of more knowledge-intensive sectors (such as professional, scientific and technical activities, and

1 In 2024, resident foreign nationals accounted almost exclusively for the increase of around 200,000 people in the working population; their labour-market participation amply offset the decline, of close to 180,000 people, in the number of working resident Spanish nationals.

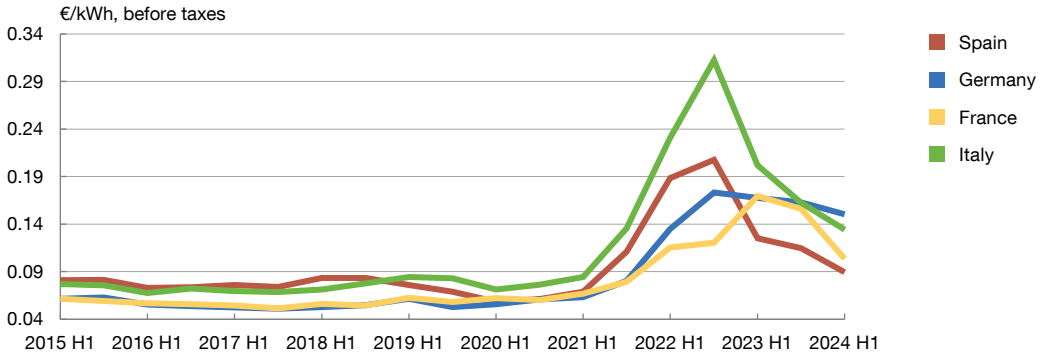
Chart 3.1

In 2024 economic activity in Spain expanded across all sectors

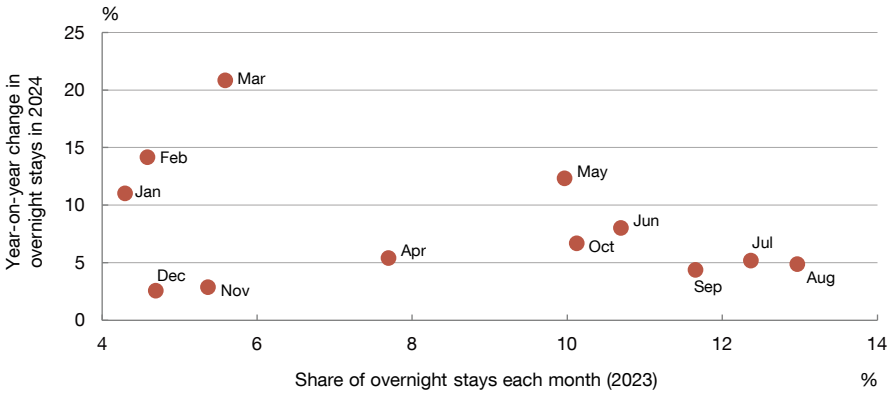
3.1.a Real GVA growth rate in 2024 (a)



3.1.b Electricity prices for industrial consumers



3.1.c Hotel overnight stays by foreigners in Spain



SOURCES: Eurostat and INE.

a In brackets, the share of gross value added (GVA) of each sector in 2023. The sectoral groupings shown in the chart are: agriculture; real estate activities; professional and administrative activities; information and communication; wholesale and retail trade, transportation and accommodation and food service activities; non-market services; industry; arts, entertainment and recreation; construction and financial activities.

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information and communication), as well as by the positive performance of tourism-related sectors.

— Several factors help to explain why the sectors of the Spanish economy outperformed those of other euro area economies.

  • First, Spanish industry has been bolstered by a sharper moderation of the energy bill from its highs in summer 2022 (Chart 3.1.b),[2] partly triggered by the roll-out of renewable energies,[3] and by the Spanish economy's lower exposure to the disruption caused by the war in Ukraine.

  • Second, tourism-related activities have been boosted by a growing diversification of these flows, both in terms of season and in source and destination, as well as by the increase in arrivals in high season months (Chart 3.1.c).

  • Lastly, in non-travel services, in a scenario where more services are being provided online globally, employment has surged in some sectors with a higher technological content such as programming, IT consultancy and information services (see Section 3.3), which could reflect Spain's increased capacity in terms of digital infrastructure.[4]

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.

— Household consumption, which rose at a rate of 2.8% in 2024, explained half of the increase in activity in that year, buoyed by population growth, lower interest rates and higher real income. However, amid persistently high interest rates and rising uncertainty, household consumption increased less than household income, which prompted a fresh rise in the saving rate. Although the saving rate is still lower than in the euro area, it was almost 5 pp higher than its pre-pandemic average (Chart 3.2.a).[5]

— Over a longer time frame, since 2019, the increase in aggregate household consumption has barely offset the demographic growth of the Spanish economy. For instance, at end-2024, consumption per capita barely reached its pre-pandemic level, unlike in the euro area where that level was exceeded by 1.4 pp (Chart 3.2.b).

— Government consumption was again strong in 2024 and grew at a rate of 4.1%, higher than that observed in the euro area, where it also showed remarkable vigour at 2.7%. Since late

2 According to Eurostat, electricity prices for industrial consumers in Spain in 2024 H1 were 16% higher than the pre-energy crisis levels, whereas in Germany these prices were 170% higher than that benchmark.

3 Quintana (2024).

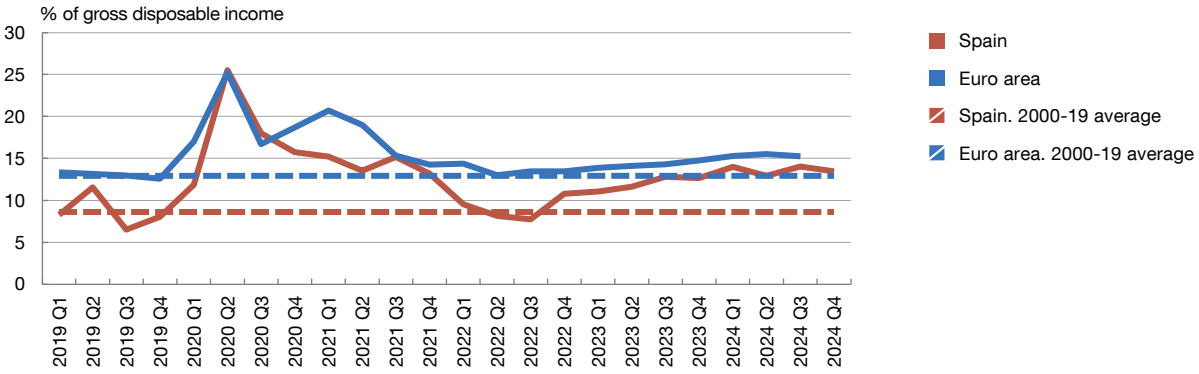
4 European Commission (2022).

5 Martínez-Carrascal (2025) and Basso y Gómez (2025).

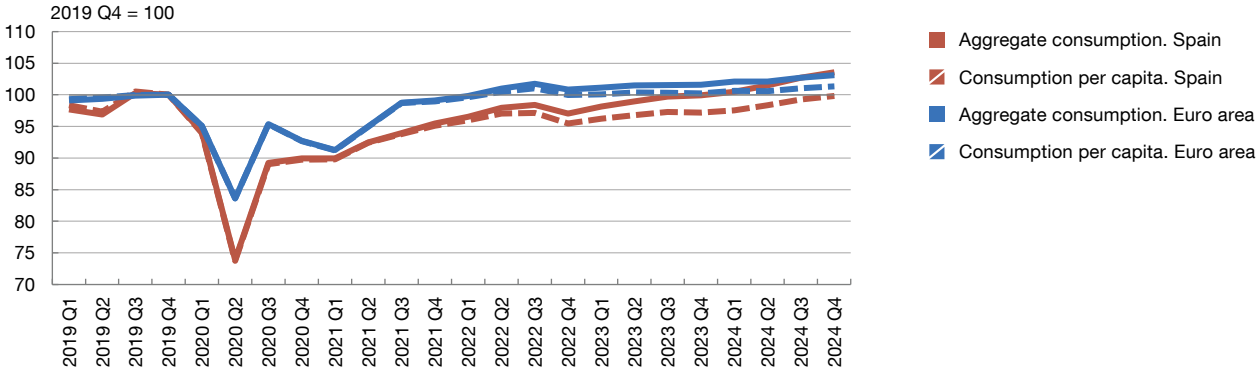
Chart 3.2

Although private consumption explained half the increase in activity in 2024, its aggregate growth since the pandemic has barely offset demographic growth

3.2.a Saving rate of households and non-profit institutions serving households. Spain and the euro area



3.2.b Consumption of households and non-profit institutions serving households. Spain and euro area



SOURCES: Eurostat and INE.

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2019, this demand component has become established as the main contributor to cumulative GDP growth, accounting for around half of output growth over this period.[6]

— Gross capital formation, together with goods exports, remains the demand component with the slowest recovery since the health crisis.[7] By component, investment in capital goods – and, in particular, in transport equipment – and in construction other than housing are weaker than in 2019, although they also increased more sharply in 2024. Residential investment grew modestly last year, by 1.7%. This increase was once again insufficient to meet greater needs for housing which have arisen in recent years as a result, among other reasons, of the higher number of households (see Box 4).

6 Fernández, Moral-Benito and Urtasun (2024).

7 Fernández Cerezo, Puente Díaz and Veiga Duarte (2025), Puente Díaz and Mulino Ríos (2024) and González-Simón, Jiménez-García and Martínez-Carrascal (2024).

Net external demand, buoyed by vigorous services exports, continued to contribute positively to the growth of activity in 2024, although its contribution eased following the highs recorded in the previous two years.

— Services exports grew very strongly (by 8.7%) in 2024 and were 37% higher at year-end than before the pandemic (Chart 3.3.a). This increase in services exports – the sharpest in the euro area, where this gap amounts to 18% – was underpinned by travel services exports (owing to higher inflows of foreign tourists and higher average spending by visitor) and by exports of other services. The latter intensified their upward trend of recent decades, which was also observed in other European countries, and accounted for a share of 7.6% of GDP in 2024, almost 3 pp up on 2000.

— Conversely, goods exports stagnated in 2024 after declining in the previous year. Compared with their pre-pandemic levels, these exports barely grew 2.2% and performed less favourably than in the euro area as a whole (growth of 5.2% relative to end-2019 levels) and, in particular, less favourably than in other southern European countries (such as Portugal, Italy and, especially, Greece) (Chart 3.3.b).

— Spain's imports in 2024 increased more slowly (2.4%) than its exports (3.1%) and final demand (3%). Thus, the elasticity of imports to final demand held at historically low levels, in keeping with the pattern observed worldwide. In the Spanish economy this could at least be partly explained by the restructuring of final demand towards components with a lower import content (such as private and government consumption) and by lower dependence on energy from abroad, prompted by the significant increase in renewable electricity generation capacity which has been observed in recent years in Spain.[8]

In early 2025, the Spanish economy continued to grow at a robust rate, although this was slightly weaker than that observed in late 2024 and, furthermore, it is expected to be subject to some downward risks in a highly complex international setting.

— According to Quarterly National Accounts (QNA) flash estimates, published on 29 April, the quarter-on-quarter GDP growth rate stood at 0.6% in 2025 Q1. This growth was slightly down on the 0.7% recorded in 2024 Q4 and stands at the lower end of the range (of between 0.6% and 0.7%) envisaged in the Banco de España's March projection exercise.

— Growth in 2025 Q1 was mainly supported by strong domestic demand (with a contribution of 0.4 pp to GDP growth) which, nevertheless, slowed significantly compared with the tail end of 2024, particularly in gross capital formation and, to a lesser extent, in private consumption.

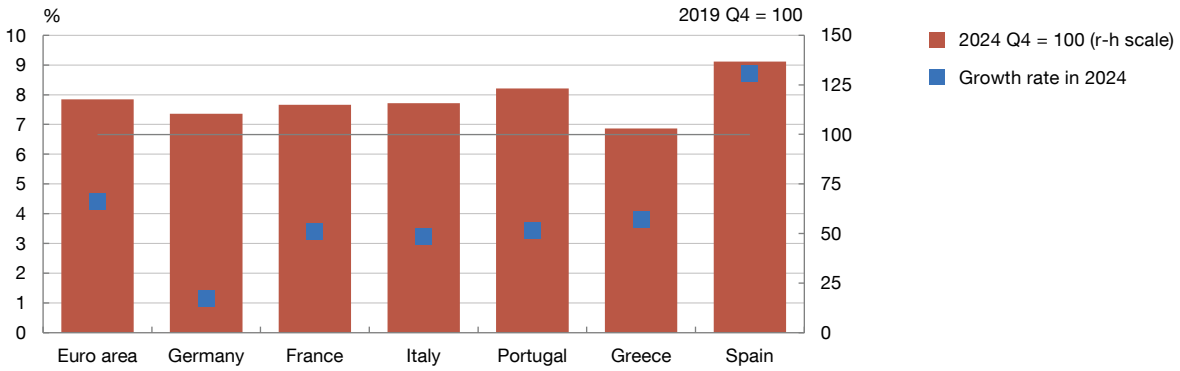
— The contribution of net exports to GDP growth (0.2 pp) quickened considerably compared with 2024 Q4, due to both stronger exports and weaker imports.

8 In particular, the share of wind and solar energy in total electricity generation increased from 26% in 2019 to over 40% in 2024. For an analysis of the impact of renewables on the wholesale price of electricity, see Quintana (2024).

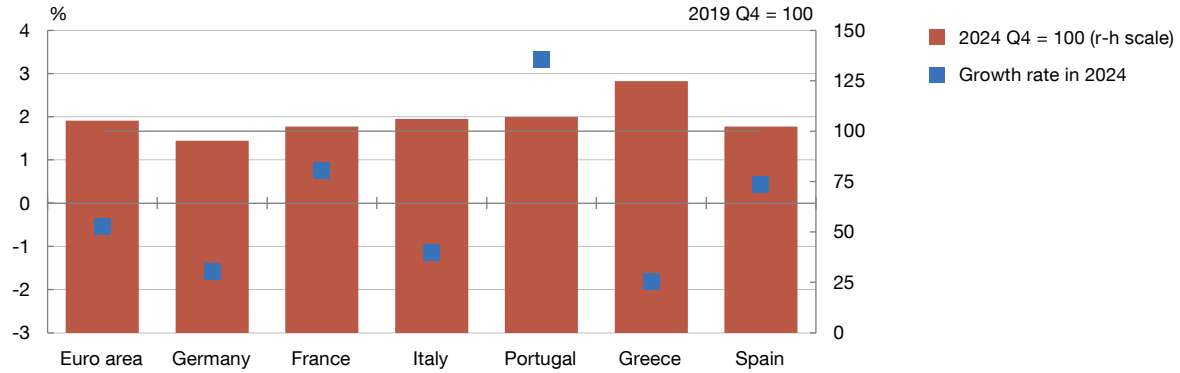
Chart 3.3

The increase in external demand was underpinned by strong growth in services exports, while goods exports were far less buoyant

3.3.a Services exports (a)



3.3.b Goods exports (a)



SOURCES: Eurostat and INE.

a In real terms.

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— In any event, as in the global and European setting, the outlook for activity in Spain is subject to extraordinary uncertainty, resulting from a highly complex environment, and downward risks to economic growth prevail (see Section 4.1).

3.2 Prices

Inflation in Spain continued to decelerate throughout 2024, mainly owing to lower food prices and, to a lesser extent, to the decline in underlying inflation.

— The harmonised index of consumer prices (HICP) rose by 2.9% in 2024, 0.5 pp less than in the previous year and 0.5 pp more than in the euro area overall. During the year inflation was strongly influenced by energy price developments. Accordingly, it accelerated slightly during 2024 H1, decelerated sharply in Q3 and then climbed from October, standing at just under 3% in December 2024 (Chart 3.4.a).

— The main driver of the slowdown in headline inflation in 2024 was the downward trend in the rate of change in food prices, which continued on its moderating path seen since early 2023, falling 4.6 pp in the year. This trend reflected the lower pressure on input costs, due to slowing domestic producer and import prices of food and beverages, in a setting less marked by adverse weather conditions for agriculture than the previous year.

— Energy consumer prices rose by 0.9% on average in 2024, in contrast to the sharp drop of 16.1% recorded in 2023. This increase was largely driven by the base effects stemming from lower electricity prices in 2023. Meanwhile, gas and oil product prices fell less than in the previous year, against the backdrop of a slowing rate of moderation of crude prices on the international markets.

— In 2024 inflation was also influenced by the phase-out of some of the government measures approved in response to the upturn in inflation that began in 2021. In particular, the gradual increase in the rates of VAT and other taxes on certain components of the consumption basket curbed the slowdown in the rate of growth of prices in 2024.[9]

— The slowdown in inflation was similar to that expected in the forecasts available at the start of the year. Specifically, the inflation rate forecast for the year in the Banco de España's March 2024 projection exercise was 2.7%, 0.2 pp less than the actual figure.[10] This difference is explained by two factors of opposite sign:

  • First, downside surprises in food inflation, mainly driven by the decision to extend the lower rate of VAT on some foods (from June) and by the lower price increases in certain unprocessed foods, such as fruit and vegetables.

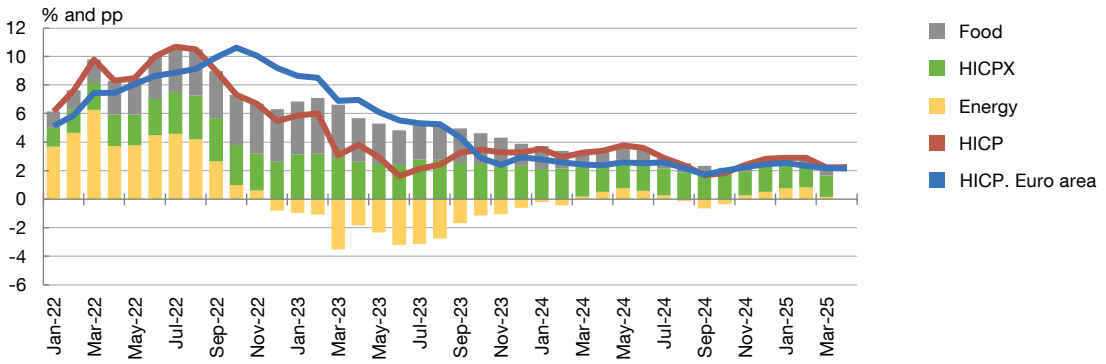
9 Specifically, VAT on gas was raised from 5% to 21% over the first few quarters of 2024, while VAT on electricity was dependent on wholesale market prices and stood at 21% from March to June and at 10% during the rest of the year, compared with 5% throughout 2023. In addition, the excise duty on electricity was phased back in, rising from 0.5% to 5.11%, along with VAT rates on certain foodstuffs as from July, while the transport subsidies were extended through to June 2025 (see Royal Decree Law 9/2024 of 23 December 2024).

10 Median inflation forecasts at that date stood at 2.9%.

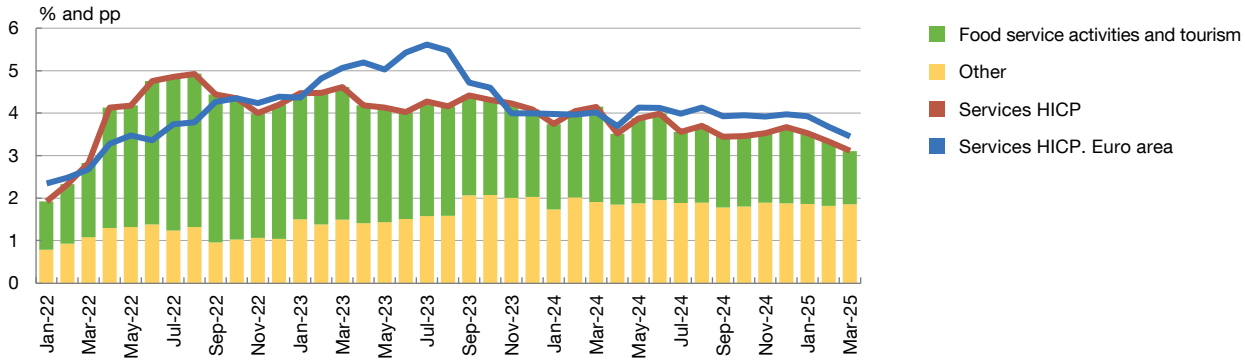
Chart 3.4

Inflation fell in Spain in 2024 owing to the decline in food inflation and, to a lesser extent, in underlying inflation, while energy prices made a positive contribution

3.4.a HICP: change and contributions. Year-on-year rate of change



3.4.b Services HICP: change and contributions. Year-on-year rate of change



SOURCES: Banco de España and Eurostat.

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- Second, upside surprises in services inflation, which was more persistent than expected, especially in tourism-related items (package holidays and hospitality) and some non-travel services (such as health insurance and transport).

— Spain's positive inflation differential (0.5 pp) with respect to the euro area overall in 2024 was due to the energy and food components. In particular, in the first part of the year the slowdown in food prices moderated in Spain compared with the euro area, but it subsequently intensified, so that in the closing months of the year annual food inflation was lower in Spain. Meanwhile, the upward trajectory of energy prices was more pronounced in Spain than in the euro area, owing to larger base effects in Spanish electricity prices and the unwinding of the government measures deployed in response to the upturn in inflation.

In 2024 underlying inflation continued to gradually decelerate as observed since early 2023, although services inflation remained more persistent.

— Core inflation – HICP inflation excluding energy and food (HICPX) – continued in 2024 on the downward path observed since March 2023, with average growth of 2.8%, the same as in the euro area overall and 1.3 pp less than in the previous year.

— Non-energy industrial goods inflation showed some volatility in 2024, although the annual average stood at 0.9%, 2.6 pp less than a year earlier. This was mainly because prices were contained at the initial stages of production and import of these goods.

— Services inflation, by contrast, was more persistent: after holding at around 4% in 2024 H1, it fell to around 3.6% in H2. This slight (slower than expected) deceleration in services prices was mainly in food service activities and tourism, while inflation in all other services displayed more downward stickiness (Chart 3.4.b). With increases in labour costs remaining high, the fact that services are relatively more dependent on labour input may be expected to have contributed, at least in part, to this greater downward stickiness in services prices. In any event, services inflation in 2024 was lower in Spain than in the euro area, where the rate of growth of services inflation fluctuated around 4% throughout the year.

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 (ULCs).

— Compensation per employee in the market economy grew by 5.4% on average in 2024, compared with 6.6% in 2023. This growth was significantly higher than the negotiated wage increases (3.3% at end-2024), thereby creating a wage drift of nearly 2 pp, which could be the result of some labour market tightness (see Section 3.3).

— Despite the sharp rise in compensation per employee, the pace of growth of ULCs continued to slow in 2024, in part due to productivity gains during the year. This contributed to a slight narrowing of Spain's positive gap in ULC growth vis-à-vis the rest of the euro area that has existed since 2019. Specifically, between 2019 Q4 and 2024 Q4, these costs rose by 23.1% in Spain and 20.5% in the euro area.[11]

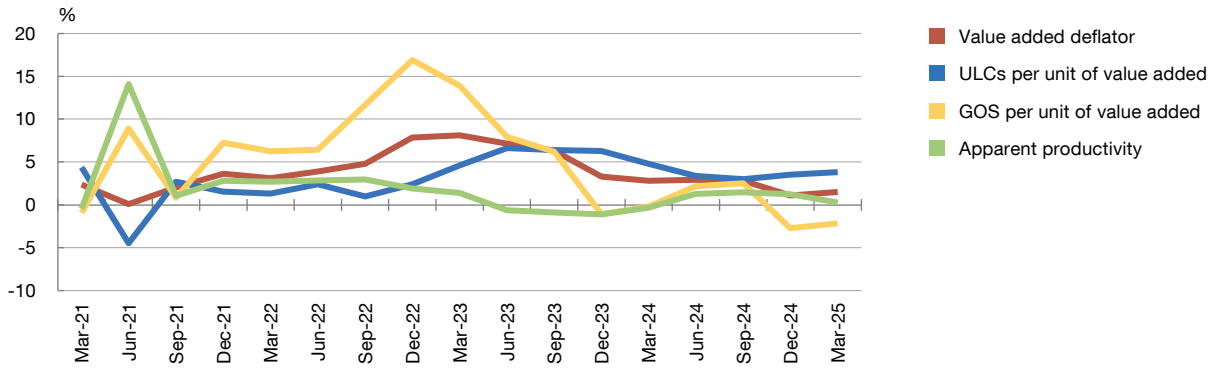
— For its part, the unit gross operating surplus (GOS) slowed in 2024, to an annual average growth rate below that of ULCs. As a result, the annual average growth rate of the GVA deflator declined by just over 4 pp in 2024, to 2.4% (Chart 3.5).

— Profit margins, measured as the GOS/GVA ratio available in the National Accounts, fell slightly (by 1.7%) over 2024. This decline was chiefly attributable to the construction and industry sectors, with margins remaining relatively stable in market services and agriculture. Meanwhile, the operating margin, proxied as the ratio of gross operating profit (GOP) to turnover, continued on the recovery path that began in 2023 and grew by 8.7%.

11 In the same period, the cumulative increase in the HICP in Spain (18.3%) was 2.2 pp lower than in the euro area (20.5%), while the gap in the producer price index (PPI) stood at 8.3 pp: 39% in Spain compared with 30.7% in the euro area.

Chart 3.5
Productivity growth helped contain the growth of ULCs, despite the significant rise in compensation per employee

3.5.a Value added deflator. Overall economy. Year-on-year rate of change



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SOURCES: Banco de España and Eurostat.

The first few months of 2025 saw no major shifts in price and wage dynamics, but energy prices have been notably volatile.

— On the latest information available,[12] headline inflation remained stable at 2.2% in March and April 2025, after decelerating from the rates of close to 3% recorded between December 2024 and February 2025.

— After climbing between October 2024 and February 2025, energy prices moderated in March to a year-on-year growth rate of 1.7%, down 6.9 pp on February. This slowdown was mainly attributable to the lower price of electricity and oil products.

— Meanwhile, underlying inflation eased slightly in early 2025, from 2.6% in December 2024 to 2.2% in March. This was in part due to the slowdown in services inflation, which stood at 3.1% year-on-year in March, down 0.6 pp on December. Prices in food service activities and tourism contributed 0.5 pp to this slowdown, after showing downward stickiness in the last few months of 2024. Extending the public transport discounts until June 2025 also helped contain services prices at the start of the year.

— Lastly, on data to March, negotiated wage settlements for 2025 stand at 3.3%, in line with those signed for 2024 and the guidelines agreed in the fifth Employment and Collective Bargaining Agreement (3% for 2025).[13] Moreover, on the QNA data published by the National Statistics Institute (INE) on 29 April, compensation per employee in the market economy grew by 4.9% year-on-year in 2025 Q1. This is just below the rate of 5.5% observed in 2024 Q4 and would be consistent with a slight deceleration in the wage drift.

12 March and April 2025 for the detailed information of the HICP and the headline HICP flash estimate, respectively.

13 By sector, the increases negotiated for construction and, primarily, services were larger than in 2024, but smaller in the case of industry and, especially, agriculture.

3.3 Labour market

Employment has continued to grow at a robust pace in 2024 and in the early months of 2025.

— The rate of increase in employment, measured in terms of people employed on QNA estimates, eased in 2024 to 2.1% which was higher than in the euro area as a whole (Chart 3.6.a).[14] According to the same source, in 2024 Q4 the number of persons employed in Spain reached a record high of 22 million, 6 pp above its end-2019 level.

— In terms of hours worked, employment growth throughout 2024 was somewhat lower, at 1.2% (Chart 3.6.a).[15] According to the National Accounts, the number of hours worked per employee decreased in 2024 for the second consecutive year, continuing its downward trajectory since the financial crisis. Aside from structural factors – linked, for example, to the increased weight of the services sector and of per capita income – this decline seems to partly reflect the impact of other more conjunctural factors – associated, for example, with the ongoing high incidence of temporary sick leave (see Box 5).

— According to the most recent data, strong job creation appears to have continued in early 2025. For instance, according to the LFS, in 2025 Q1 employment grew by 0.7% on a seasonally adjusted basis; just below the figure of 0.8% observed in 2024 Q4 but higher than the projection of 0.5% in Banco de España (2025).

In recent years, job creation was largely concentrated among the immigrant population, workers with higher levels of education and in the services sector.

— The particularly strong net inflows of migrants to Spain in recent years (see Box 6) have been essential in meeting the Spanish economy's growing demand for labour. Thus, between end-2019 and end-2024, around 76% of all jobs created in Spain were filled by the foreign-born population. These jobs were concentrated particularly in those sectors where, according to the Banco de España Business Activity Survey (EBAE), firms have had greater difficulties in finding labour (Chart 3.6.b).

— Between 2019 Q4 and 2024 Q4, annual average employment growth was higher in the services sector than in the manufacturing sector. Employment was particularly buoyant in the information and communication sector and, since end-2021, in the hospitality sector, one of those hit hardest during the pandemic (Chart 3.7.a).

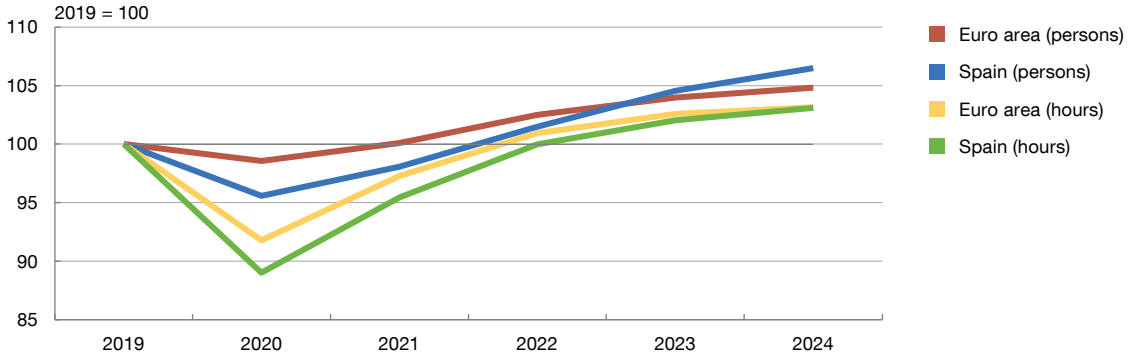
14 For a detailed analysis of employment developments in the Eurosystem, see Berson et al. (2024).

15 To facilitate international comparisons, Chart 3.6.a shows the hours worked according to the National Accounts. Spain's Ministry of Inclusion, Social Security and Migration has a measure of actual hours worked, which has performed more buoyantly since 2019 Q4 (and also during 2024) than the hours worked recorded in the National Accounts. The Ministry of Inclusion, Social Security and Migration's statistics combine information on the hours reported to Social Security and from the Estadística de Convenios Colectivos (Collective Agreement Statistics) and strip out hours not worked due to short-time work schemes, temporary sickness and other benefits. The National Accounts combine information from the Estadística Estructural de Empresas (Structural Business Statistics), the Spanish Labour Force Survey (EPA) and Social Security records, although the changes in their measure of hours closely follow that of hours in the Spanish Labour Force Survey (EPA).

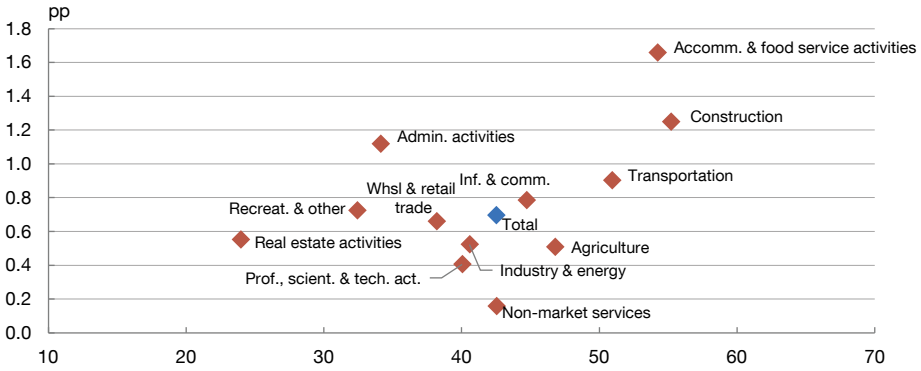
Chart 3.6

Employment has continued to grow robustly in 2024, at a faster pace than observed in the euro area as a whole

3.6.a Employment: number of persons employed and hours worked. Spain and the euro area



3.6.b Relationship between growth in foreign national social security registrations and perceived labour shortages (a)



SOURCES: Banco de España (on QNA data), Eurostat and Ministerio de Inclusión, Seguridad Social y Migraciones.

a The vertical axis shows the change in the share of foreign national social security registrations in total social security registrations in each sector between 2023 and 2024. The horizontal axis shows the percentage of EBAE respondent firms reporting labour shortages in 2023 Q4.

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— By level of education, employment growth since 2019 Q4 has been higher among individuals with university or technical qualifications, and below average among individuals with primary education – among whom employment did not increase in this period. This is consistent with changes in employment by job type, which show, for example, above-average annual growth among skilled workers and other technicians and scientists (Chart 3.7.b).

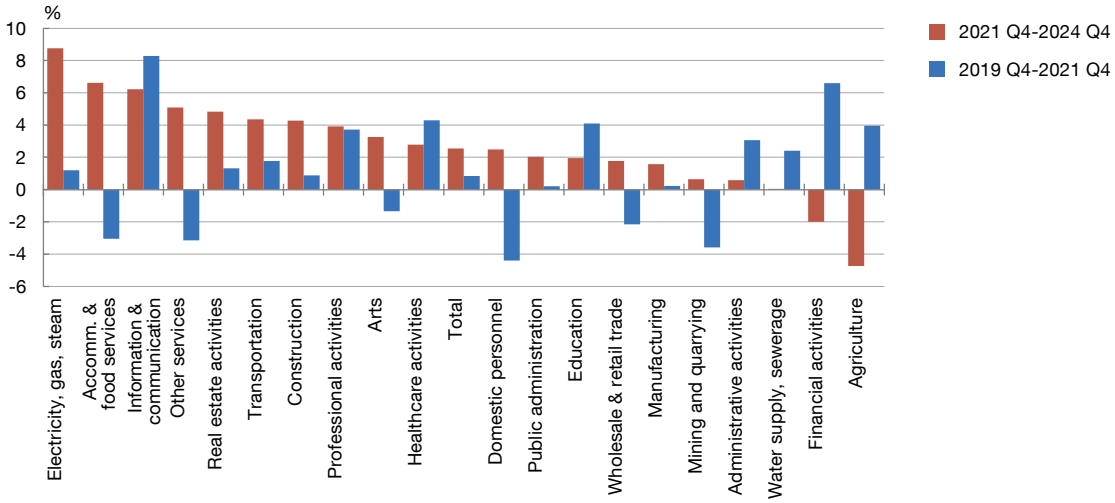
— Over a broader time scale, the pattern of job creation in Spain in recent years (2019-24) has differed notably from that in the period 2013-19. In particular, the sectors of information and communication, professional, scientific and technical activities, education and construction account for a significantly higher weight in this job creation process. Overall, these sectors represent approximately 45% of total cumulative employment growth between end-2019 and end-2024 (Chart 3.8).

— Moreover, according to the Spanish Labour Force Survey (LFS), the numbers employed in the public sector rose from 3.2 million in 2019 – in annual average terms – to 3.5 million in

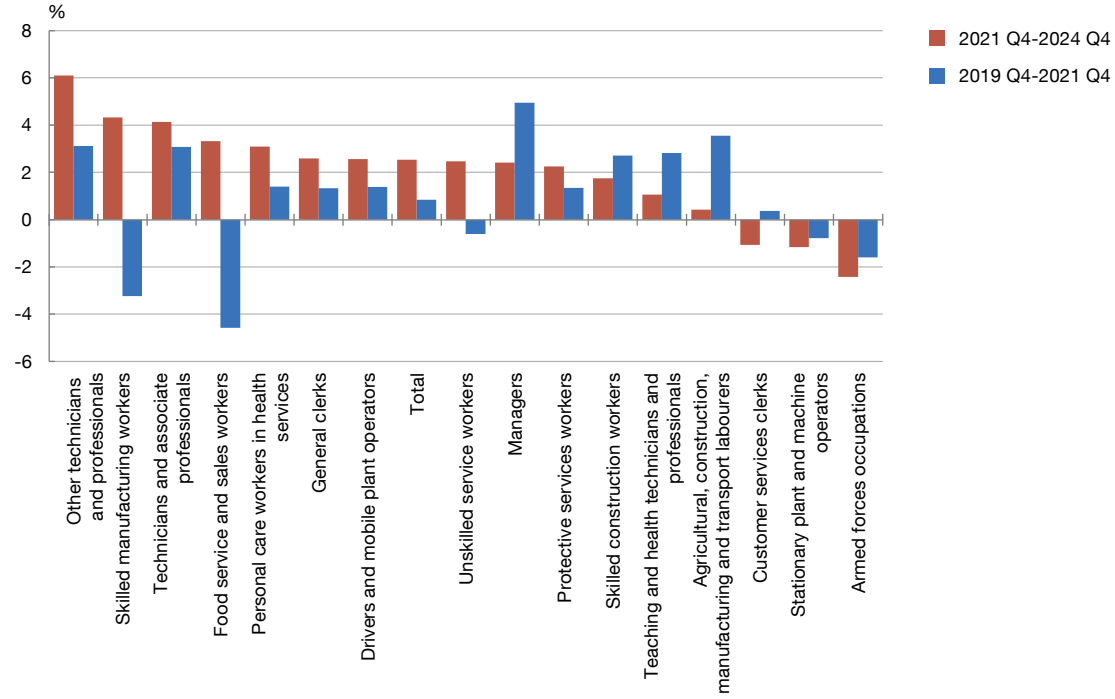
Chart 3.7

Post-pandemic employment growth was higher in the information and communication and transportation sectors, and lower in agriculture and financial activities

3.7.a Annual average employment growth rate by sector



3.7.b Annual average employment growth rate by occupation



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SOURCE: INE (Spanish Labour Force Survey, 2024).

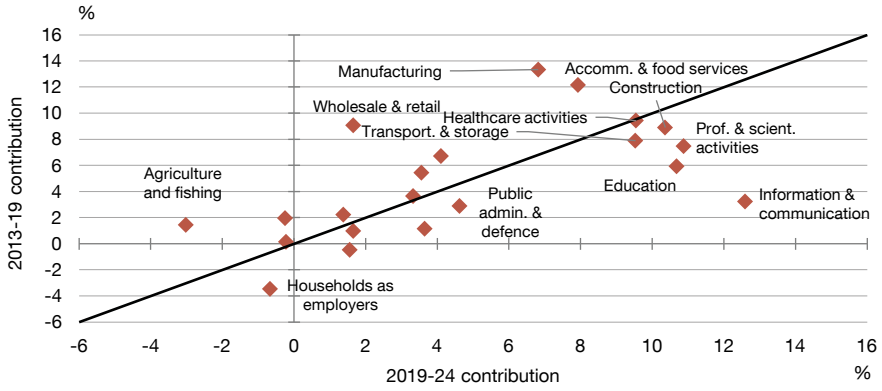
2024. This represents 18% of all employment growth over this period (1.87 million). However, the share of public employment in total employment in Spain has increased very slightly in recent years, from 16.3% in 2019 to 16.4% in 2024.

The unemployment rate has continued to decline, although it still varies considerably at regional level and remains significantly higher than the European Union (EU) average.

Chart 3.8

Since the pandemic, the pattern of job creation has differed from that observed in 2013-19

3.8.a Contribution, by sector, to total employment growth (a)



SOURCE: INE (Spanish Labour Force Survey).

a The solid line is the 45 degree diagonal. The diamonds represent each sector's relative contribution to growth in the total number of persons employed. The vertical axis shows the contributions for 2013 Q2-2019 Q4, and the horizontal axis, for 2019 Q4-2024 Q4.

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— The unemployment rate declined in Spain from 12.2% in 2023 to 11.3% in 2024 in annual average terms, coinciding with the surge in the labour force, which rose by 1.3% over 2024 spurred by the significant increase of 5.9% in the working-age foreign-born population.

— In 2024 Q4, the unemployment rate stood at 10.6% for Spain as a whole, but differed considerably by region, ranging from 6.6% in Navarre to 15.8% in Andalusia (Chart 3.9). Nevertheless, since the outbreak of the pandemic, the unemployment rate in Spain fell more sharply, precisely, in those regions that have traditionally had higher unemployment rates.[16]

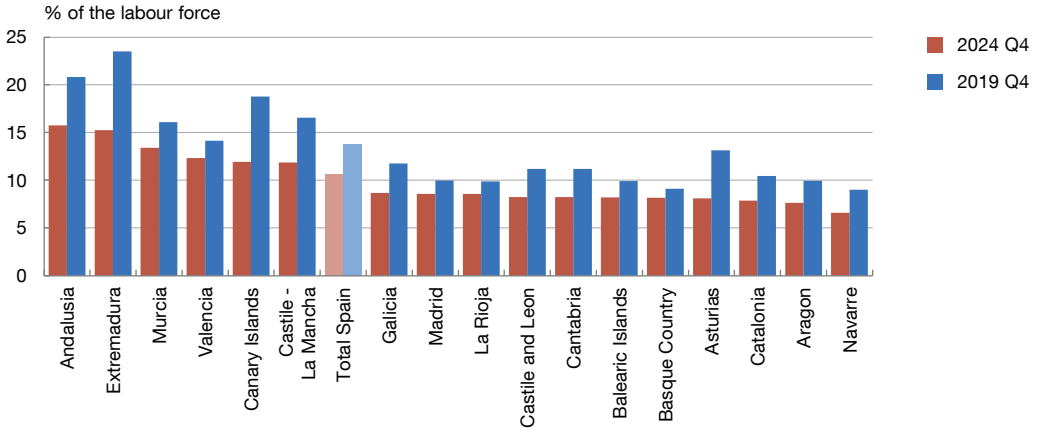
— More recently, in 2025 Q1 the unemployment rate rose to 11.4% of the labour force, although on a seasonally adjusted basis it stood at 10.8%, as in the previous quarter.

— Despite these relatively positive developments, the Spanish economy's unemployment rate remains about 5 pp higher than the EU average (Chart 3.10.a). This gap is particularly pronounced for young people, for whom the unemployment differential between Spain and the EU amounted to around 14 pp in 2021 and narrowed to 8.9 pp in 2024 (Chart 3.10.b).

There has been a reduction in the temporary employment ratio and in the aggregate labour turnover rate, although the latter and transitions from employment to unemployment are high compared to those of other EU countries.

16 Regional dispersion in unemployment rates in Spain is relatively high compared with other European countries. Thus, in 2024 the standard deviation of the unemployment rate across the nomenclature of territorial units for statistics - level 2 (NUTS-2) (a geographical unit corresponding to a region in Spain) reached 5.9% in Spain, around 3.5% in Italy and France and 0.8% in Germany.

Chart 3.9
The unemployment rate has declined more in those regions where it was relatively higher



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SOURCE: INE (Spanish Labour Force Survey).

— The decline of the temporary employment ratio, which began in 2022, continued, albeit at a slower pace than in previous years. This ratio averaged 15.9% in 2024 and is significantly higher in the public than in the private sector (28.8% and 12.6%, respectively). This reduction may have helped to sustain household spending.[17]

— However, there is still high labour turnover in the Spanish economy.[18] For instance, when labour turnover is measured using the ratio of the sum of total monthly social security registrations and deregistrations to the stock of registered employees, it produces an average of 1.1% for the period 2022-24, which is just below the average of 1.3% recorded in the period 2015-19 (Chart 3.11.a). In this regard, although turnover rates increased among both permanent workers (from 0.3% to 0.6%) and temporary workers (from 3.9% to 4.0%), the significant rise in the share of permanent workers – who have a lower turnover – triggered a decline in the aggregate labour turnover rate.[19]

— The higher turnover in permanent contracts since the entry into force of the labour market reform is the result of greater labour market employment inflows and outflows, especially of employees with permanent seasonal employment contracts. Specifically, the deregistration rate for these contracts has increased significantly compared with the period 2015-19. Thus, the deregistration rate for permanent seasonal contracts before the reform stood practically midway between that for other permanent contracts and that for temporary contracts.

17 Anghel, Barceló and Villanueva (2023) and Martínez-Carrascal (2023).

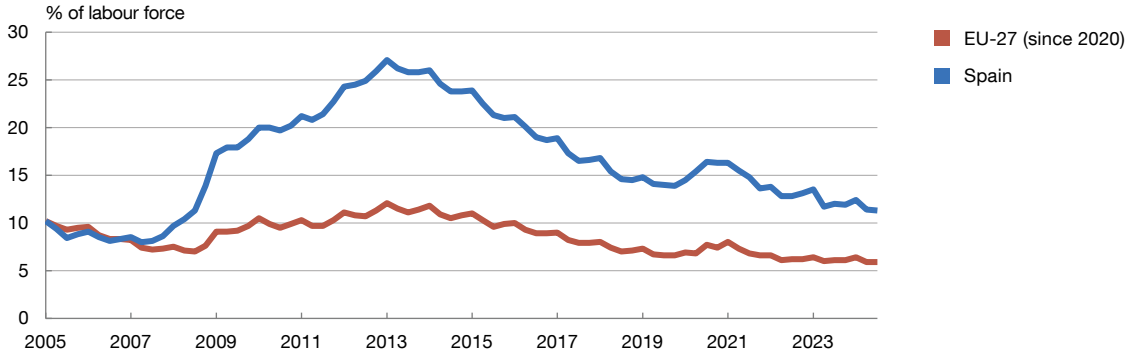
18 Royal Decree-Law 32/2021 introduced internal flexibility measures such as the RED Mechanism aimed at fostering stable labour relations and avoiding transitions to unemployment in the event of cyclical or sectoral crises.

19 Other measures also point to a reduction in turnover, such as the number of contracts signed. Thus, according to the National Public Employment Service, 1,681,500 initial contracts were signed in December 2021, while in December 2024 30% fewer contracts were signed (1,182,706). In addition, Annual Report 2023 of the Banco de España (Box 3.1, Chart 5) shows that contracts which started in March 2022 were more likely to be extended the first year they were in force than those which began in March 2017 and March 2018.

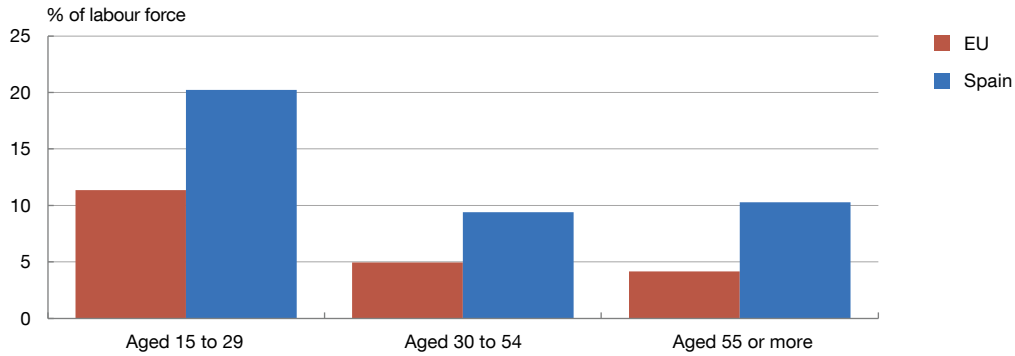
Chart 3.10

The unemployment rate has declined but remains above the EU average. This gap is more pronounced among young people

3.10.a Unemployment rate



3.10.b Unemployment rate by age group. 2024 average



SOURCE: INE (Spanish Labour Force Survey, 2024).

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However, since 2022 this rate has doubled, exceeding the rate for temporary contracts (Chart 3.11.b). As for permanent contracts as a whole, the increase in social security deregistrations is linked to dismissals – most of which are disciplinary – and to the end of the probation period.

— Moreover, drawing on the employment surveys harmonised in the Labour Force Survey, the magnitude of the flows between employment and unemployment can be compared internationally.[20] According to these sources, in Spain 2.8% of employees transitioned from employment to unemployment during 2024, which is 1 pp higher than in France and about 2 pp higher than in Germany and Italy (Chart 3.12.a).[21] The quarterly transitions from unemployment to employment affected 3.5% of those employed in Spain in 2024, 1.3 pp more than in France

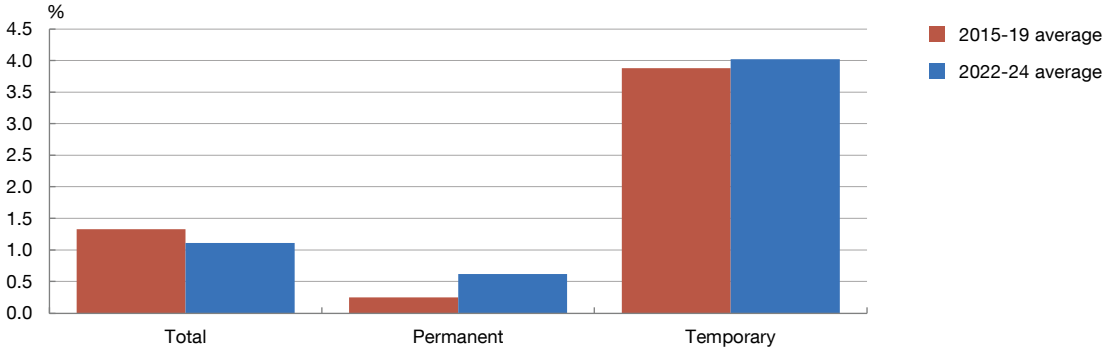
20 The results obtained with these surveys are not directly comparable to those obtained with social security data. First, because these surveys measure quarterly and not monthly transitions, as is the case of the social security data. Second, because the reference population is the entire employed population, and not only employees registered with social security.

21 Some of these differences may be associated with the different sectoral compositions of the economies concerned.

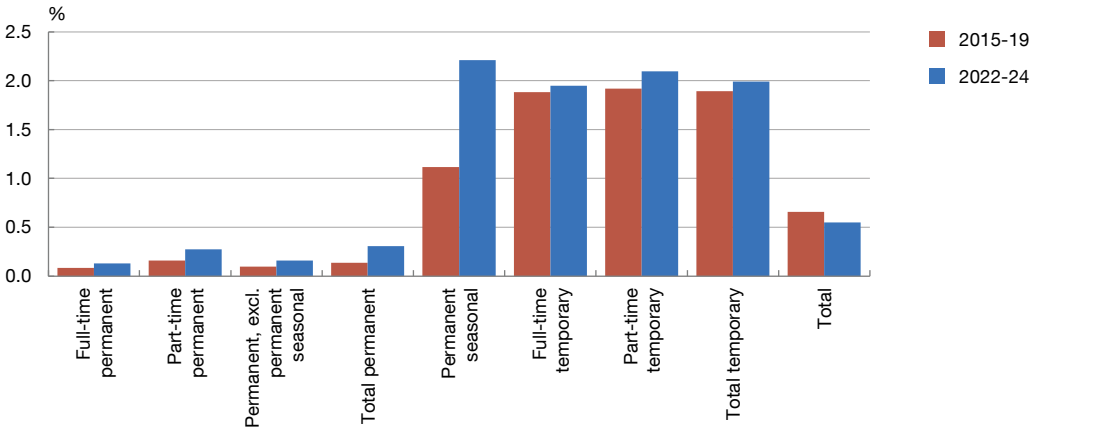
Chart 3.11

Labour turnover rates have declined overall since 2022 owing to the higher share of permanent contracts, but they have increased for each type of contract

3.11.a Aggregate turnover rate by contract type. Monthly average registrations and deregistrations as a share of total social security registrations



3.11.b Deregistration rate by contract type. Monthly average deregistrations as a share of total social security registrations



SOURCE: Tesorería General de la Seguridad Social.

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and 2.5 pp more than in Germany and Italy (Chart 3.12.b). When the flows between employment and unemployment are combined, the quarterly turnover rate in Spain reached 6.3% in 2024, 2.3 pp higher than in France and 4.4 pp higher than in Germany and Italy.

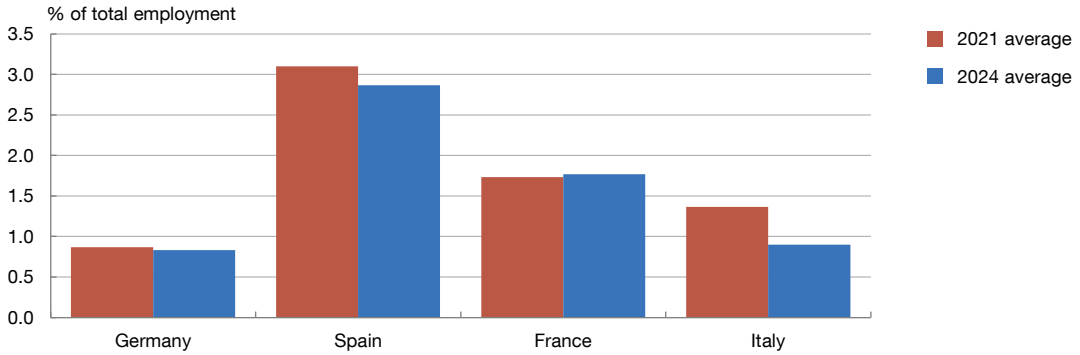
There is an increase in the percentage of companies reporting that labour shortages limit their activity. Further analysis is needed to determine whether this reflects the cyclical position of the economy or a skills mismatch.

— Since late 2022 both the regular surveys of the European Commission and the EBAE have shown significant growth in the percentage of companies reporting labour shortages. Thus, according to the EBAE, between 2021 and 2024, the percentage of companies stating that the dearth of employees restricted their activity increased from 10% to 43% (Chart 3.13.a). The shortage of workers is particularly pronounced in hospitality and construction, where 64% and 56% of companies, respectively, reported being affected by limited availability of labour.

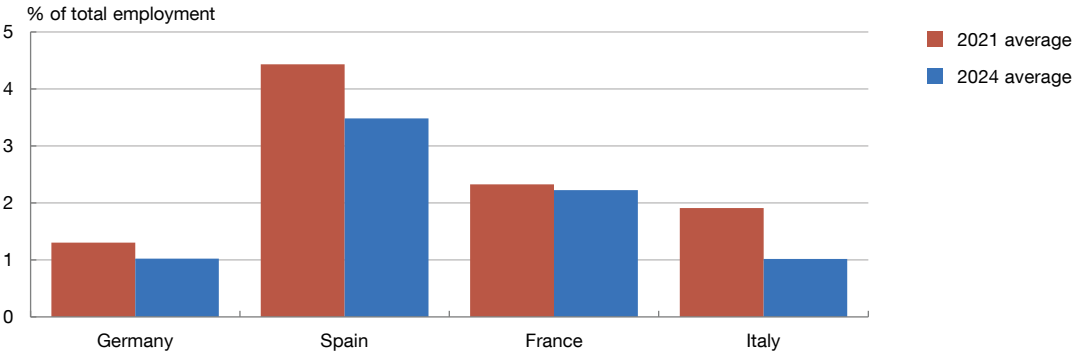
Chart 3.12

Job losses, as a percentage of total employment in Spain, were lower in 2024 than in 2021, albeit still higher than in other European countries

3.12.a Quarterly transitions from employment to unemployment



3.12.b Quarterly transitions from unemployment to employment



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SOURCE: Banco de España, drawing on Eurostat data.

— Labour needs can also be measured by the number of vacancies a company fails to fill.[22] According to Eurostat's Job Vacancies Statistics, the job vacancy rate in Spain was 0.9% in 2024 Q4, similar to that in 2023 and 0.2 pp higher than between 2018 and 2019. By sector, the problems were particularly marked in general government, information and communication, and professional, scientific and technical activities.

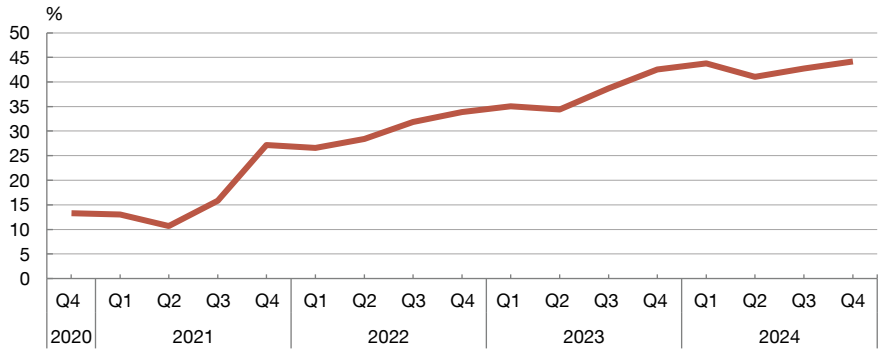
— Similarly, according to the Quarterly Labour Cost Survey, during 2023, 50% of companies that were unable to fill an active vacancy in the previous quarter mentioned the shortage of suitable staff as a limiting factor. This was very pronounced in sectors requiring relatively specialised skills (such as information and communication, and professional, scientific and

22 The statistical measurement of vacancies poses considerable challenges and, consequently, the available measures should be interpreted with caution. For example, for a vacancy to be considered as such, the company must have actively searched externally for a suitable person for the position. This may be easier to identify in some sectors, such as general government, than in others. In any case, there are pilot schemes to complement the available information on vacancies with that from job portals. In this regard, see, for example, Eurostat (2024).

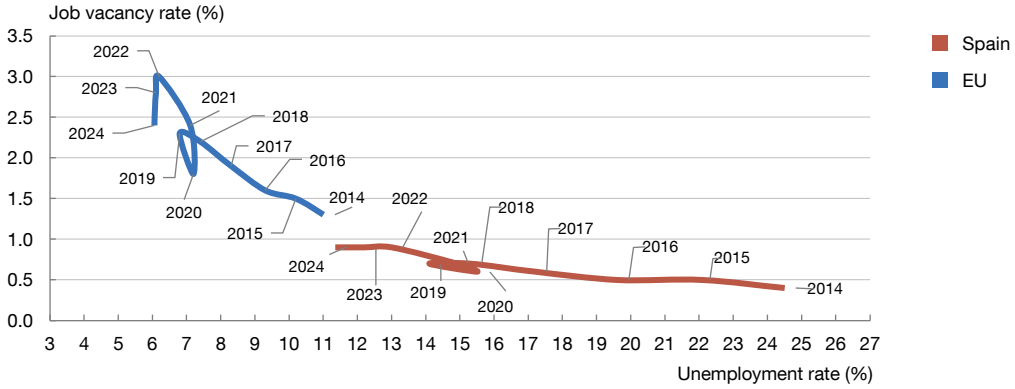
Chart 3.13

There is an increase in the number of firms whose activity is constrained by labour shortages

3.13.a Firms whose activity is constrained by labour shortages (a)



3.13.b The Beveridge curve (b)



SOURCES: Banco de España (EBAE) and Eurostat.

a Percentage of firms reporting an adverse or very adverse impact of labour shortages on their activity.
b The job vacancy rate is measured as the ratio of the number of job vacancies to the sum of the number of occupied posts and the number of job vacancies. The unemployment rate is the ratio of the unemployed population to the total labour force (aged 15-74). Data for 2024 are estimates based on the incomplete information available.

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technical activities), where more than 75% of companies reported a lack of skilled employees.

— A higher number of vacancies may be due to the fact that the job seekers' skills do not always coincide with those sought by companies, generating a mismatch in the labour market. It may also be attributable to cyclical factors: during an upturn, the number of firms creating new jobs increases but, at the same time, the minimum wage that the unemployed are willing to accept also rises, leading to an inverse relationship between the unemployment and vacancy rates (Chart 3.13.b).[23]

— New information, such as that from job portals, is required to diagnose the relative contribution of cyclical and structural factors to unemployment and vacancy dynamics.

23 Koenig, Manning and Petrongolo (2024).

Drawing on these portals' information on the characteristics of both job seekers (e.g. level of education and specialisation) and the jobs offered (e.g. skills needed for the job, duration of the vacancy and salary offered), it would be possible to identify which part of the dynamics are attributable to greater frictions between the skills required and those available, and which is attributable to different cyclical factors.

The increase in the percentage of employed persons taking temporary sick leave (up from 2.7% in 2019 to 4.4% in 2024) is another factor which has tightened the Spanish labour market.

— As detailed in Box 5 of this report, the percentage of employed people on temporary sick leave climbed relatively sharply between 2019 and 2024 in Spain compared to other European countries. This increase has been observed in all age groups and across all regions and sectors of activity.

— The analysis presented in Box 5 of the possible causes of this significant rise in temporary sick leave (which has a sizeable economic cost for companies and general government alike) suggests that it could largely be explained by workers' perceived deterioration in their health and the tighter labour market, to the extent that, historically, there is a positive correlation between buoyant economic activity and the percentage of workers on temporary sick leave.

3.4 Productivity

Measuring productivity is complex and involves, among other difficulties, quantifying output and inputs in real terms and choosing the most appropriate indicator according to the issue analysed.

— Measuring productivity, whether for a country, a sector of activity or a firm, requires very precise information, for example, on the quantities of products and services produced, and on the quantity, quality and intensity of use of the factors of production employed. In this respect, while significant progress has been made in recent years relating to the methodology and information available to quantify these variables, significant gaps remain, for example, in the measurement of real output (especially in the services industries) and in the availability of firm-level price deflators.

— Moreover, there are numerous productivity indicators whose usefulness depends on the issue analysed. For instance, GDP per worker is the most widely used productivity indicator and that most closely related to per capita income, while other complementary indicators serve to identify the sources of productivity growth. Productivity per hour worked is another measure that takes labour use intensity into account, while two other sources of economic growth are a higher quality labour force and improvements in the capital goods with which workers operate. Lastly, total factor productivity (TFP) measures the increase in the productive efficiency of all inputs combined (see Box 7).

Based on the various metrics available, Spain recorded higher productivity gains than the euro area overall in 2024 and over the 2019-24 period, especially in terms of TFP and compared with countries such as France or Germany.

— In 2024 productivity increased in the Spanish economy more than in the euro area, Germany and France, measured by worker or hour worked,[24] or in terms of capital or TFP[25] (Table 3.1).

— Moreover, since end-2019 all productivity measures have been more dynamic in Spain than in the euro area overall or in its two main economies (Table 3.1).[26]

— In any event, this improved productivity in the Spanish economy since the outbreak of the pandemic has closed only a relatively small part of the negative productivity gap existing since 1998 between Spain and the euro area, Germany and France (Chart 3.14).

24 See Manera, Navinés, Franconetti, Quetglas and Pérez-Montiel (2025) for an analysis of regional and sectoral heterogeneity in productivity per hour worked in Spain.

25 At the date of publication of this report, the latest available data for TFP correspond to 2024 Q3.

26 It should be noted that, in this same period, productivity per worker and per hour worked was higher in both Greece and Portugal than in Spain.

Table 3.1
Productivity measures. Spain and Europe (a)

%

		Productivity per worker	Productivity per hour worked	Productivity of capital	Total factor productivity (TFP)
Spain	1998-2019	0.0	0.4	-0.9	-0.3
	2020-2024	-0.3	1.2	0.9	0.8
	2024	1.4	2.1	2.5	2.2
Euro area (b)	1998-2019	0.4	0.7	0.0	0.3
	2020-2024	-0.2	0.1	-0.4	-0.4
	2024	-0.7	0.1	-0.5	0.9
Germany	1998-2019	0.5	1.1	0.4	0.8
	2020-2024	-0.6	0.1	-1.1	0.0
	2024	-1.3	-0.3	-1.7	1.6
France	1998-2019	0.8	0.9	0.1	0.6
	2020-2024	-0.1	-0.2	-1.0	-1.4
	2024	0.2	2.1	0.0	1.6

SOURCE: Comin, Quintana, Schmitz and Trigari (2025).

a Measures of value added by worker, hours worked and capital stock. TFP calculated as per Comin, Quintana, Schmitz and Trigari (2025). Annualised rates of growth by subperiods.
b Euro area: the averages for the four big European economies that make up approximately 80% of euro area GDP.

Spanish productivity growth and the narrowing of the negative productivity gap with other European countries since end-2019 may be due to short-term and/or structural factors.

— The short-term factors notably include all those associated with the cyclical behaviour of productivity and those stemming from the special characteristics of the present recovery, greatly influenced by the nature and intensity of the health crisis.

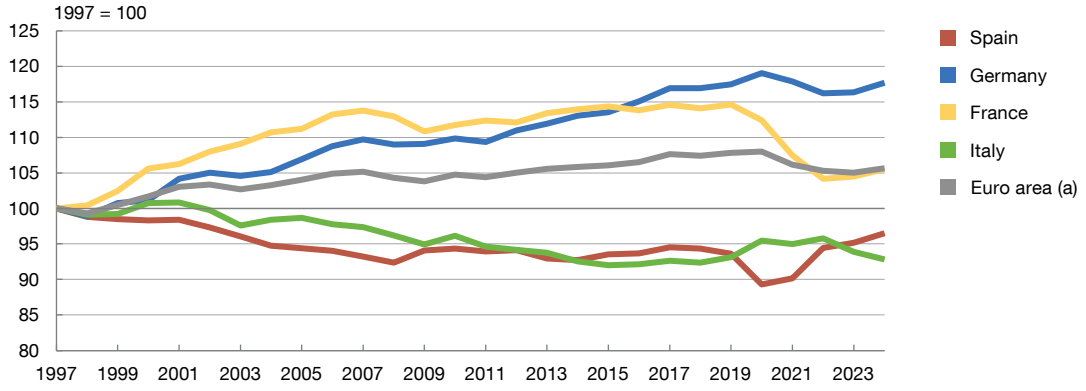
- First, insofar as firms were able to protect their employment relationships and their installed capacity during the most acute phase of the pandemic, supported by the measures introduced such as the short-term work schemes and public guarantees, the subsequent recovery may have prompted a more intensive use of both factors of production, driving up productivity indicators.

- Second, the reallocation of workers to more productive sectors, occupations and firms, which presumably accelerated after the pandemic, should have contributed to productivity growth, although it is still difficult to accurately quantify this contribution. In this respect, as mentioned above, since 2019 job creation appears to have been stronger in information and communication services, spurred by the heightened digitalisation of economic activity in the wake of the pandemic.[27]

27 Banco de España (2024a).

Chart 3.14
Spain has seen considerable growth in total factor productivity (TFP) since the pandemic, unlike the other major European economies

3.14.a TFP



SOURCE: Comin, Quintana, Schmitz and Trigari (2025). For more details, see Box 7.

a Euro area: the averages for the four big European economies that make up approximately 80% of euro area GDP.

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- Lastly, the exit of less productive firms and the entry of new, more productive, ones, which should have increased in the post-pandemic period, could also have boosted productivity, as has been documented in other advanced economies.[28]

— In any event, measuring the contribution that these short-term factors make to productivity growth relies on the availability of databases that provide a more complete picture of business dynamics and labour flows between firms.

— The structural factors commonly identified as determinants of long-term productivity notably include human capital, capital investment – especially in intangible assets such as R&D and innovation (R&D&I)[29] – and institutional quality. Although more and better data are needed to measure the impact of these factors on productivity and their interaction with structural trends related to population ageing and advances in artificial intelligence, some recent developments are presented below.

Innovation is the key determinant of long-term productivity growth[30] and is an area in which Spain trails other European countries.

— In terms of investment in R&D – one of the main drivers of innovation - Spain lags behind its main European partners. According to Eurostat, in 2023 R&D expenditure amounted to 1.5% of Spanish GDP, compared with 2.3% for the euro area. This difference stems mainly

28 Amundsen, Lafrance-Cooke and Leung (2025).

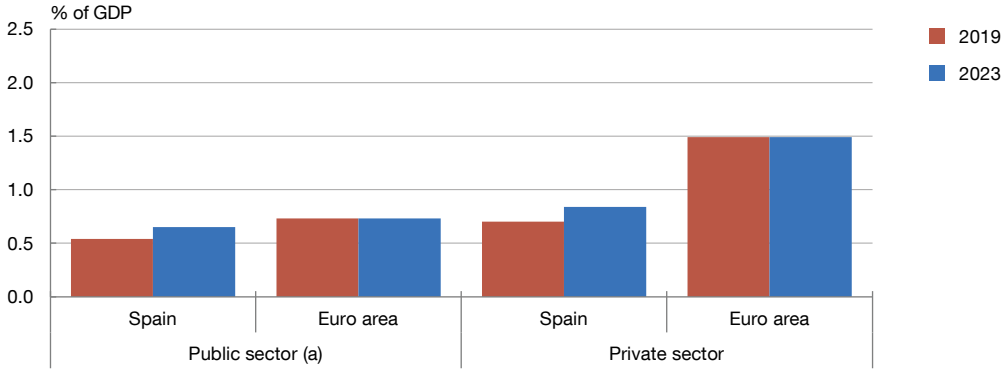
29 Although the TFP measure presented in this report considers the effects of changing labour composition and capital stock, improvements in workforce skillsets and investment in intangible assets may have additional positive effects on TFP associated with efficiency gains in the way firms combine their productive factors; for instance, linked to complementarities between human and technological capital. See, for example, Cuadrado, Moral-Benito and Solera (2020).

30 Romer (1986), Lucas (1988) and Aghion and Howitt (1992).

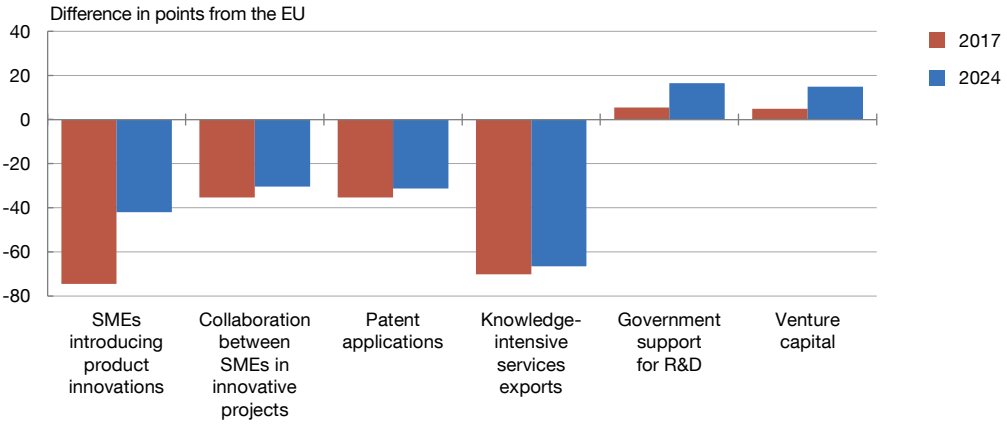
Chart 3.15

The Spanish economy's R&D&I investment gap has narrowed slightly since the pandemic, on the indicators available

3.15.a Public and private sector R&D investment in Spain and in the euro area in 2019 and 2023



3.15.b Relative improvement for Spain in some European Innovation Scoreboard dimensions (b)



SOURCES: Eurostat and European Innovation Scoreboard.

a Public spending on R&D includes spending by the Government and by universities.
b In each dimension, the composite index sets the EU average at 100 points. The chart depicts the difference between Spain and this reference. The indices are presented for 2024 but the latest available data may be earlier. See European Commission (2024a) for more details on the methodology used.

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from the private business sector, whose contribution accounted for 0.8% of GDP in Spain, compared with 1.5% in the euro area.[31] The shortfall was somewhat smaller – less than 0.1 pp – for the public sector and universities combined (Chart 3.15.a).

— As regards other innovation indicators, on the latest information from the European Commission's European Innovation Scoreboard,[32] in 2024[33] Spain ranked among the group

31 In this respect it should be noted that the main tax incentives for innovation in Spain take the form of corporate income tax deductions. Although the implicit subsidy these incentives entail is theoretically one of the highest in the OECD, in practice it is significantly lower owing to the existence of various administrative requirements and the corporate income tax mechanics. See Banco de España (2023).

32 This index aggregates data in several innovation-related dimensions: research, training, digitalisation, R&D expenditure and funding, knowledge flows, intellectual property and activity in high-tech sectors.

33 Note that 2024 is the year of publication of the European Innovation Scoreboard, although some of the underlying variables may refer to previous years depending on the data availability.

of moderate innovators in the EU. Specifically, the Spanish economy has an innovation shortfall compared with the EU overall that is particularly significant in five dimensions (Chart 3.15.b): (i) firms introducing product innovations; (ii) collaboration between SMEs in innovative projects; (iii) employment in innovative firms;[34] (iv) patent applications; and (v) knowledge-intensive services exports.[35]

Nevertheless, according to the available indicators, the Spanish economy's gap in terms of investment in R&D&I appears to have narrowed since the pandemic.

— Investment in R&D as a percentage of GDP rose in Spain from 1.2% in 2019 to 1.5% in 2023, while it held steady, at 2.3%, in the euro area overall. In the same period, R&D expenditure as a percentage of GDP grew in both the private and the public sector – albeit slightly more so in the private sector – in Spain, while remaining stable in both cases in the euro area overall (Chart 3.15.a).

— Some of the gaps between Spain and the EU in the innovative activities reflected in the European Innovation Scoreboard narrowed slightly between 2017 and 2024 (Chart 3.15.b). Indeed, the negative gap in terms of SMEs introducing product innovations narrowed significantly, as the percentage of Spanish SMEs doing so rose from 14% in 2018 to 17% in 2022, while the figure for the EU fell from 28% to 24%, according to the latest results from the Community Innovation Survey.

— The negative gap in terms of collaboration between innovative firms has also narrowed. Thus, the percentage of innovative SMEs collaborating with others increased in Spain from 7% in 2018 to 9% in 2022. However, this is still below the figure for the EU, which also rose (albeit to a lesser extent) over the same period, from 12.1% to 12.4%

— Likewise, the proportion of employment in innovative SMEs increased in Spain, from 39% in 2018 to 43% in 2022. It also rose in the EU overall, but less markedly, from 57% in 2018 to 58% in 2022.

— Regarding patent applications, Spain's negative gap with the EU also appears to have narrowed in recent years, although it remains significant. Specifically, according to the latest OECD data available, 1,415 patent applications were filed in 2021 in Spain per million GDP,[36] compared with 1,336 in 2017. This increase contrasts with the decrease observed in the EU overall, where patent applications fell from 4,328 per million GDP in 2017 to 3,838 in 2001.

34 Innovative firms are those that have introduced or improved the goods or services they provide or their production processes. The latter include areas as diverse as improvements in logistics, in the use of information and communications technology (ICT) or in organisational practices.

35 Knowledge-intensive services are insurance and pension services, financial services, intellectual property royalties, telecommunications, information technology, other business services, audiovisual services and services related to maritime, air and space transport.

36 In purchasing power standards (PPS).

— Knowledge-intensive services exports is another indicator that shows some convergence between Spain and the EU overall. On Eurostat data, in Spain these exports rose from 38.1% of total services exports in 2017 to 45.5% in 2023, while in the EU they held quite steady at higher levels, climbing from 66% of total services exports in 2017 to 68.8% in 2023.

Difficulties accessing funding pose a significant barrier for firms when it comes to innovating; in this dimension Spain has improved slightly since the pandemic compared with the EU overall.

— Information asymmetries make it difficult for smaller innovative firms[37] and start-ups that have no collateral or credit history to access funding. Moreover, compared with tangible capital, the very nature of innovative activities and intangible assets makes it harder to use them as collateral and this also limits access to bank financing.[38] These restrictions may limit business investment in innovative activities that could generate positive spill-over effects on economic productivity as a whole.

— Based on the available evidence, the productivity and welfare gains that could be obtained if these market failures were corrected appear to warrant the introduction of a range of economic policy initiatives to enhance access to finance for innovative activities.[39] In particular, public support and access to non-bank funding, such as venture capital, can play a key role in financing innovative activity.

— In this respect, according to the European Innovation Scoreboard indicators, Spain's relative position in terms of access to funding for innovative activities has improved in the post-pandemic period, especially in the field of public support (Chart 3.15.b).

  • First, between 2017 and 2023 public support for innovative activities in the form of tax concessions and transfers increased in Spain to slightly over 0.2% of GDP, while in the same period they held steady in the euro area overall at around 0.2%, according to OECD data.

  • Second, in the post-pandemic period, the share of venture capital financing has increased at a similar pace in Spain and in the euro area overall, climbing to just under 0.1% of GDP in both cases.

Human capital – which contributes to productivity gains, complementing investment in R&D&I – has also improved somewhat in the most recent period in Spain compared with other European countries, especially among the population groups with lower levels of education.

37 In this respect, the fact that small firms account for a larger share of the Spanish business sector appears to explain, at least in part, why Spain lags behind in innovation, as larger firms tend to have fewer difficulties accessing financing and more intense innovative activity. According to the Community Innovation Survey, 76% of Spanish firms with more than 250 employees conduct innovative activities, compared with 30% of firms with between 10 and 49 employees.

38 Dejuán, Menéndez and Mulino (2018) and Demmou and Guido (2021).

39 Bloom, Van Reenen and Williams (2019), Akcigit, Hanley and Stantcheva (2022), and Akcigit, Grigsby, Nicholas and Stantcheva (2022).

— The PIAAC (Programme for the International Assessment of Adult Competencies) database, developed by the OECD, compiles detailed information on the key competencies of the adult population in areas such as literacy, numeracy and adaptive problem solving. According to the latest results available, the negative gap in Spain for the adult population overall narrowed from 18 points in 2011-12 to 9 points in 2022-23.[40] For adults with lower levels of education this gap narrowed more sharply and even turned slightly positive (Chart 3.16.a). The decline in the early school leaving rate compared with past decades is understood to be a key factor behind this improvement.[41]

— Spain's early school leaving rate fell from 21.9% in 2014 to 13% in 2024 – although it was still 3.5 pp above the EU average in 2023 (the latest figure available) – and mostly affected students from disadvantaged backgrounds. In particular, the probability of young people dropping out of school if their mother has completed only primary education is 34%, 15 times higher than for young people whose mother has completed tertiary education (2.3%). In addition, the drop-out rate among young non-Spanish nationals (29.6%) is almost triple that of young Spanish nationals (10.4%).[42]

— The PIAAC data also show that the skills gap for groups with high levels of education has narrowed only very slightly compared with ten years ago (Chart 3.16.a). At least in part this may reflect shortcomings in the Spanish tertiary education system.

— An alternative way to analyse the competencies of tertiary students is to check how the labour market remunerates their studies. A recent Banco de España article estimates the private rate of return to tertiary studies compared with compulsory secondary education in Spain and other European countries.[43] Based on the results, there is some room for improvement in order for the estimated returns associated with all tertiary education specialisations in Spain and Italy to converge towards the higher estimated rates in Germany and France (Chart 3.16.b).[44]

Lastly, another structural determinant of productivity is institutional quality, understood as the set of laws and regulations that govern socioeconomic relations and, in particular, general government efficiency. In this respect, the available indicators show a decline in institutional quality in Spain since the start of the century.

— Institutional quality affects productivity through various channels, but essentially through its impact on the incentive to invest. For example, unstable institutions that generate uncertainty

40 PIAAC Cycle 2 was conducted between 2022 and 2023 and published in December 2024. The level of performance in PIAAC in the three areas assessed is expressed on a scale of 0 to 500 points (OECD, 2024).

41 Anghel, Cuadrado and Tagliati (2021).

42 For more information, see Ministerio de Educación, Formación Profesional y Deportes (2025).

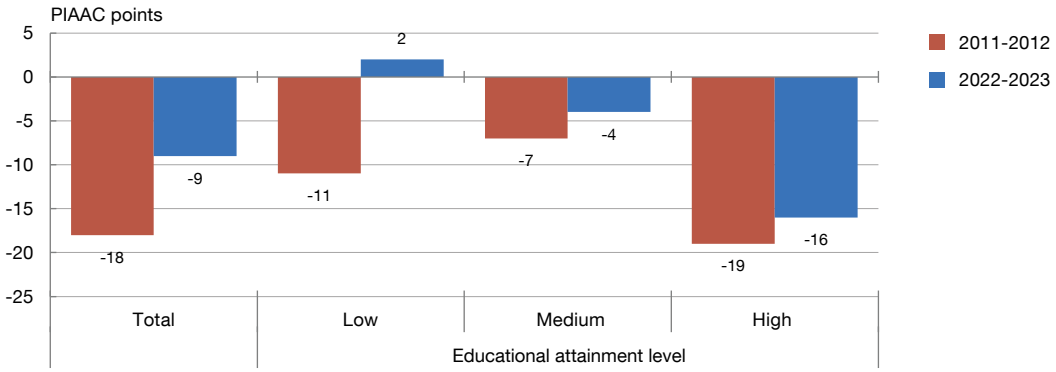
43 The rate of return associated with a specific level of education is calculated as the discount rate that equates the present value of the flow of a person's wage income to the present value of the costs of education and the opportunity costs. For more details, see Anghel and Lacuesta (2025).

44 In this respect, it would be desirable to encourage firms to cooperate with universities and research centres, to help university graduates enter the labour market. This is especially important in the case of STEM graduates (graduates in science, technology, engineering and mathematics), who account for a lower proportion of total graduates in Spain than in the euro area (Banco de España, 2023) and whose studies provide them with a smaller estimated return compared with their euro area peers.

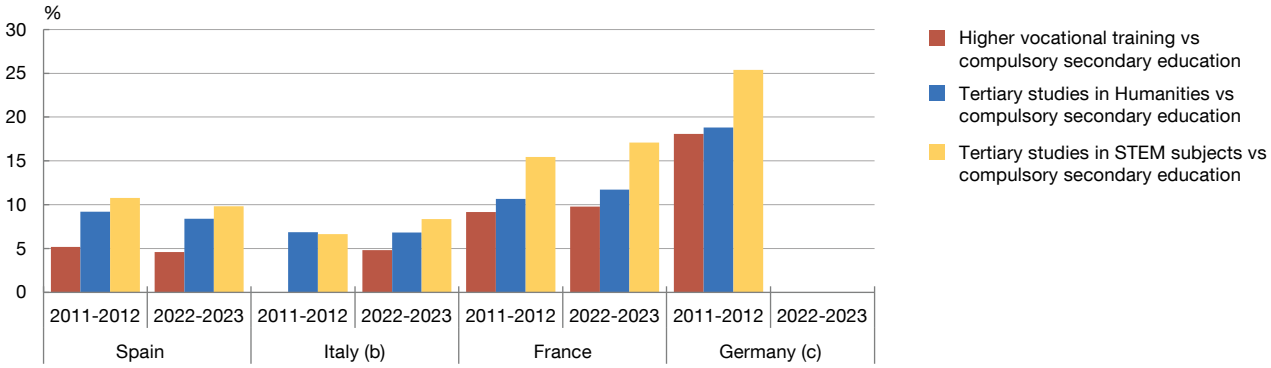
Chart 3.16

The recent improvement in competencies vis-à-vis other European countries is limited to the population with a lower level of education, which may be a contributing factor to the low return to tertiary education in Spain compared with France or Germany

3.16.a Mathematical competencies gap between Spain and the EU (a)



3.16.b Rate of return to education, by types of tertiary education



SOURCE: Banco de España, drawing on OECD microdata (PIAAC 2013 and PIAAC 2023).
NOTE: PIAAC 2013 refers to 2011-12 and PIAAC 2023 to 2022-23.

a EU includes the EU-27 countries that participated in the PIAAC survey. PIAAC 2013: Austria, Belgium, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Ireland, Italy, Netherlands, Poland, Slovakia, Sweden. PIAAC 2023: Austria, Belgium, Czech Republic, Denmark, Estonia, Finland, France, Germany, Hungary, Ireland, Italy, Poland, Portugal, Slovakia, Sweden.
b For Italy, there are insufficient observations available to accurately estimate the employment income of individuals with higher vocational training in PIAAC 2013.
c For Germany, there is no information available on individuals' wages in PIAAC 2023.

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and grant little protection to returns on investments will tend to discourage physical capital accumulation and limit potential productivity gains. The same applies, in terms of human capital accumulation, to labour market or education system institutions, for instance, that are not conducive to the generation of returns on human capital, either because they offer low labour supply incentives or because they fail to adequately remunerate professional qualifications.

— Although measuring institutional quality is subject to various difficulties, which advise a cautious interpretation of these measures, the available indicators show that Spain is not well placed in the international institutional quality rankings in this dimension. Moreover, since the mid-2000s institutional quality has deteriorated in Spain and this could affect its growth capacity going forward (see Box 8).

3.5 Financial conditions

In recent quarters, the ECB's less restrictive monetary policy has lowered the cost of bank lending, somewhat more sharply in Spain than in the euro area.

— Between end-2023 and March 2025, the latest data available, the cost of new bank loans to households for house purchase fell by 111 basis points (bp) to 2.8%, while the cost of new consumer loans dropped by 91 bp to 7.1% and the cost of new loans to firms fell by 152 bp to 3.6% (Chart 3.17.a).

— In lending for house purchase and lending to firms, current interest rates are respectively 0.5 pp and 1.1 pp higher than on average in the pre-pandemic period of economic growth (2013-19). By contrast, in consumer lending the current cost of new loans is almost 0.9 pp lower than in that period. In any event, adjusted for expected inflation,[45] interest rates on new lending are not currently higher than those observed in the period 2013-19.

— In comparative terms, the cumulative fall in the cost of financing in this monetary policy normalisation phase has generally been somewhat more intense in Spain than in the euro area. Thus, in the case of new bank loans for house purchase, consumer loans and loans to non-financial corporations, interest rates have tended to be lower in Spain than in the euro area.

— Interest rates on new time deposits have also fallen recently. Specifically, between December 2023 and March 2025, in cumulative terms, the interest rates on firms' time deposits fell by 137 bp to 2.2%, while those on households' time deposits dropped by 57 bp to 2%. Over the same period in the euro area the interest rates on households' time deposits fell more sharply, by 119 bp to 2.1%, while those on firms' time deposits dropped by 139 bp to 2.3%, similarly to the pattern observed in Spain (Chart 3.17.a).

Access to finance for households and firms appears to have improved.

— According to the bank lending survey, credit standards ceased to tighten in 2024, except for those for consumer credit and other lending which tightened slightly. In 2025 Q1, these standards remained unchanged in all segments and the banks surveyed expect them to remain unchanged in 2025 Q2 (Chart 3.17.b, left-hand panel).

— Meanwhile, according to the ECB's survey on the access to finance of enterprises (SAFE), Spanish firms – both SMEs and large companies – perceive an improvement in their access to bank financing in 2024, thanks to positive developments in their financial situation and banks' greater willingness to grant credit. This pattern continued in the first three months of 2025.

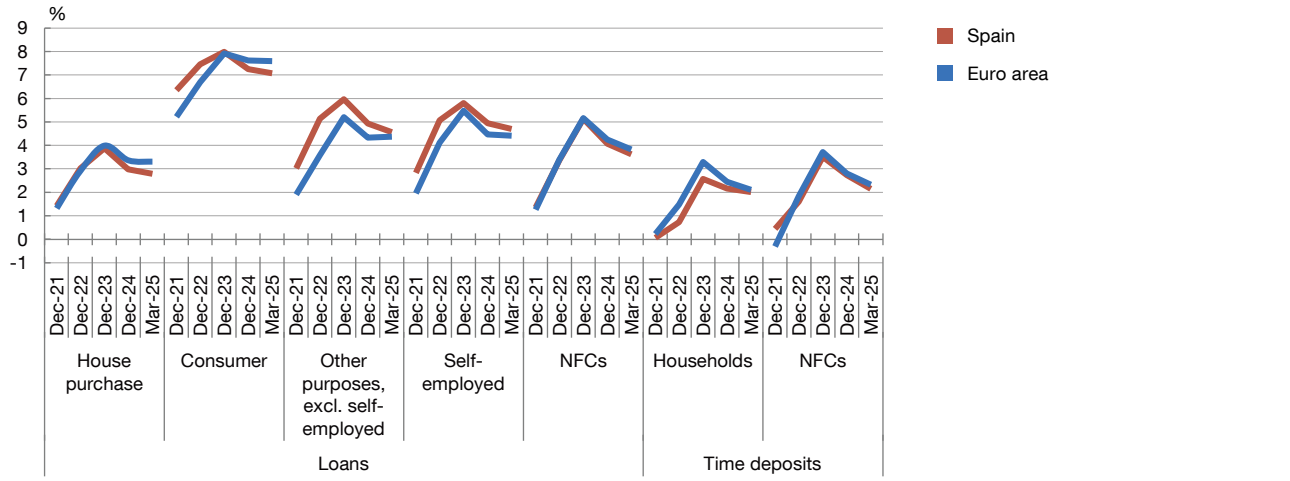
Cheaper financing has boosted both the demand for credit and the credit stock.

45 Interest rates adjusted for expected inflation are calculated using Consensus Forecast medium-term inflation expectations for each credit segment, calculated as a weighted average by loan volume.

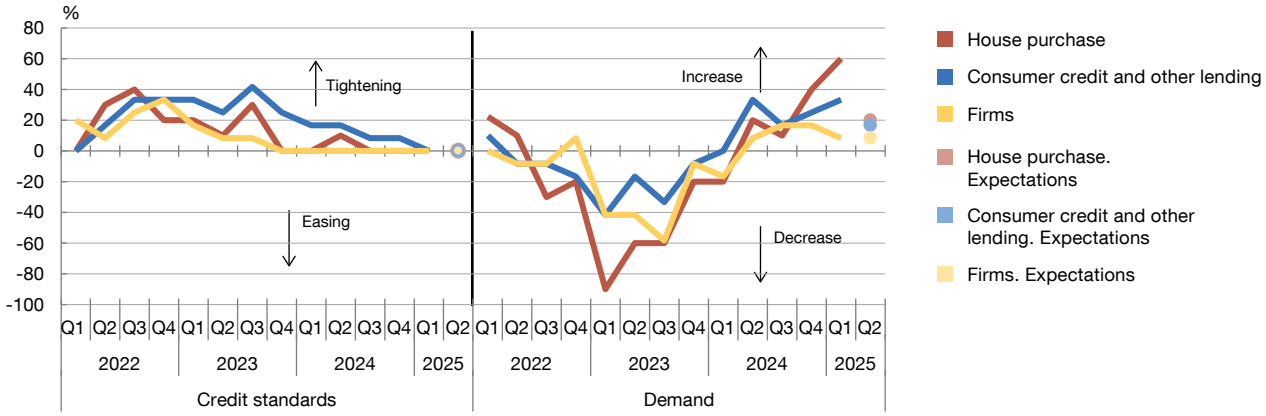
Chart 3.17

Lower bank interest rates boosted the demand for loans, while credit standards remained largely unchanged, except in the consumer credit segment

3.17.a Interest rate on new bank lending (a)



3.17.b Change in credit standards and loan demand in Spain (BLS) (b)



SOURCES: ECB and Banco de España.

a Narrowly defined effective rates (NDER), i.e. excluding related costs, such as repayment insurance premiums and fees, adjusted for seasonal and irregular components.
b Bank lending survey. Percentage of banks reporting a tightening (increase, in the case of demand) minus the percentage of banks reporting an easing (decrease, in the case of demand).

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— In a highly dynamic economic setting, lower interest rates have boosted loan demand across the board in recent quarters (Chart 3.17.b, right-hand panel).

— Against this backdrop, households' outstanding mortgage stock began to increase in mid-2024, after two years of decline, posting year-on-year growth of 1.5% in March 2025. This was due to the increase in new mortgages, which were almost 20% higher in 2024 than in 2023, and to the decrease in mortgage repayments, which fell by 12% during the same period.[46]

46 These figures have been corrected for renegotiations of previously granted loans, but they include other operations such as forbearance and subrogation.

— Consumer lending accelerated, with year-on-year growth of 8.6% in March 2025 in the amount outstanding, compared with 4.3% in December 2023. This growth was driven mainly by purchases of durable goods and, increasingly, of current goods.

— Lastly, the year-on-year decline in the stock of bank lending to firms came to a halt in October 2024, posting an increase of 1.7% in March 2025. Total lending to firms – which includes net debt issuance and loans received from abroad – was somewhat less robust, with growth of 1.3% year-on-year in March 2025, albeit with strong net debt issuance.

In any event, Spanish households' and firms' debt ratios have continued to fall and stand close to their lowest levels in recent decades, while the available indicators that seek to approximate their degree of financial vulnerability suggest that it is currently relatively contained.

— Firms' debt ratios fell by 2.5 pp in 2024 to 63.5% of GDP, their lowest level since 2001, and are 4 pp below the equivalent euro area ratio. However, the slight moderation in firms' gross operating surplus (GOS) in 2024 and the increase in debt drove up the debt-to-GOS ratio slightly, from 316% at end-2023 to 331%.

— The household debt ratio fell by 2.4 pp in 2024 to less than 44% of GDP. This is very close to the low recorded at the start of the century and some 8 pp below the equivalent euro area ratio.

— In this setting, in recent quarters the various indicators that approximate households' and firms' financial vulnerability have remained historically low. Thus, for example, the proportion of households allocating more than 70% of their income to essential expenditure[47] is estimated to have dropped to 15.2% in 2024, compared with an average of 17% since 2014. At the same time, the proportion of firms subject to high financial pressure stood at 14% in 2024, compared with an average of almost 17% between 2008 and 2023.

The profitability of the Spanish banking system[48] has continued to improve and solvency has risen moderately.

— The consolidated earnings of the Spanish banking sector in 2024 were 21% higher than in 2023. The main driver of this growth was the 9% increase in net interest income, although both fees and commissions – up almost 11% year-on-year – and gains on financial transactions – up 31% year-on-year – also made a positive contribution and offset the 2.5% rise in operating expenses (Chart 3.18.a). Although net interest margin, i.e. the spread between the average interest rates on financial assets and financial liabilities, boosted net interest income in 2024, lower policy rates are expected to reduce its contribution this year. However, these lower rates could also have a positive impact on net interest income through an increase in credit volume.

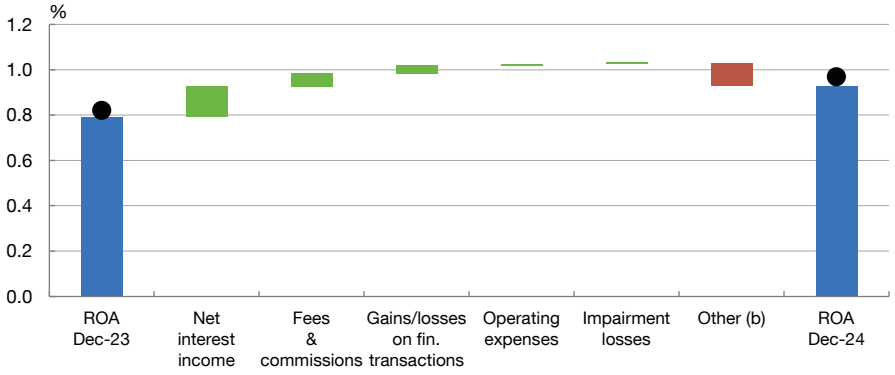
47 Essential expenditure includes debt servicing, food and utility bills and rental of the main residence.

48 For more details, see the *Financial Stability Report,* Spring 2025 (forthcoming).

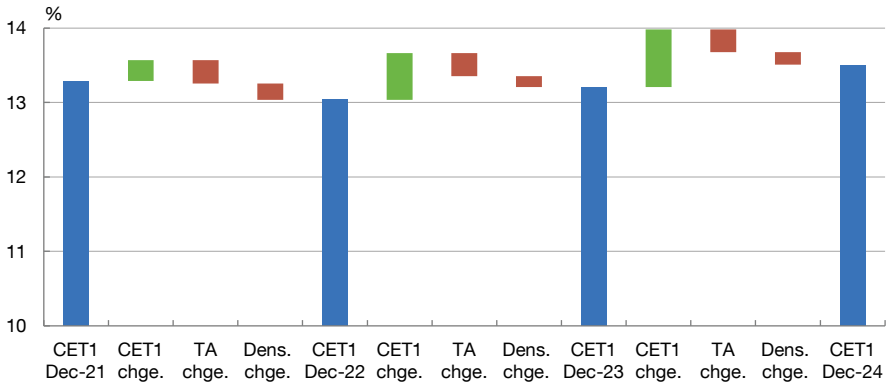
Chart 3.18

Spanish banks' profitability continued to improve in 2024 and the CET1 ratio rose by 30 bp

3.18.a Breakdown of the change in profit. Consolidated net profit as a percentage of average total assets (a)



3.18.b Breakdown of the change in the CET1 ratio between 2021 and 2024 (c). Consolidated data



SOURCE: Banco de España.

a The red (green) colour of the bars denotes a negative (positive) contribution of the corresponding item to the change in consolidated profit at December 2024 compared with December 2023. The black circles denote the return on assets (ROA) excluding the impact of the temporary levy on the banking sector.

b Includes, among other items, the temporary levy on the banking sector mentioned in note (a).

c The CET1 ratio is broken down into the change in CET1, total assets (TA) and density (Dens.), where density is calculated as the ratio of risk-weighted assets to total assets. Therefore, the CET1 ratio is calculated as CET1 to TA x Dens. The green (red) colour of the bars denotes positive (negative) contributions from components.

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— In 2024 impairment losses on balance sheet items rose by just 2% at consolidated level and fell by 12.5% in business in Spain, decreasing in both cases as a percentage of net operating income. In a similar vein, credit quality in Spain improved in 2024, leading to a decline in the non-performing loan (NPL) ratio of 0.2 pp (to 3.2%) and in the stage 2 ratio of 1.2 pp (to 6.4%) at December 2024.

— Against this backdrop, the solvency of the Spanish banking sector increased. The growth in Common Equity Tier 1 (CET1) capital lifted the CET1 ratio, which stood at 13.5% at December 2024, a year-on-year climb of 30 bp (Chart 3.18.b). The results of the latest available stress tests show that these solvency levels provide the Spanish banking sector

with significant aggregate resilience.[49] However, the current uncertain environment calls for proactive analysis of macro-financial risk developments by banks and supervisory bodies, together with cautious planning in the face of possible unexpected losses.

49 See the results of the 2023 EBA stress test exercise (EBA, 2023), the Banco de España's 2024 Forward Looking Exercise on Spanish Banks (FLESB) exercise (Banco de España, 2024e) and the stress test carried out by the IMF during the Financial System Assessment Program (FSAP) in Spain in 2024 (IMF, 2024).

3.6 Public finances

3.6.1 Public finances in 2024

Public revenue and expenditure grew markedly in 2024.

— Public revenue climbed by 7.1% in 2024, with tax revenue and social security contributions up 7.3%. Tax receipts were boosted by the tax base increases (which outpaced even nominal GDP),[50] the effect of fiscal drag on personal income tax[51] and the gradual withdrawal of the energy tax rebates, which was completed in early 2025. As a result, revenue from current taxes on income and wealth rose by 8.5% in 2024, while revenue from VAT and other taxes on products, production and imports grew by 6.9% and 7.1%, respectively. Revenue from social security contributions, meanwhile, rose by 6.7%.

— Spending increased by 6.2%, slightly less than revenue (Chart 3.19.a). Growth was especially strong in interest payments (9.2%), social benefits (6.8%, chiefly pensions and temporary sickness benefits) and government consumption (4.8%) which, as highlighted in Section 3.1 and Box 2, made a sizeable contribution to aggregate GDP growth in 2024.[52] Government investment, however, was much less buoyant and declined by 4.5%.

— It is important to note the extraordinary factors that affected government spending in 2024, including the significant disbursements by general government to households and firms associated with various court decisions.[53] Also, the measures adopted in response to the flash floods affecting several Spanish regions in late October entailed a cost of 0.35 pp of GDP in 2024. If these expenses are excluded, government spending in 2024 would have increased by around 2 pp less.

Consequently, the Spanish general government deficit decreased from 3.5% of GDP in 2023 to 3.2% in 2024 (2.8%, if the expenses associated with the flash floods are excluded).

— The decline in the deficit in 2024, equal to 0.3 pp of GDP, was the result of various factors operating in opposing directions.

  • The economic cycle effect on public finances (linked, for instance, to lower unemployment spending), the increase in tax revenue (associated with aspects such as the tax base increases and the fiscal drag) and the withdrawal of the temporary relief measures

50 Overall, the tax bases increased by 7.1% (0.9 pp more than nominal GDP), with marked growth in compensation of employees (7.7%), capital income and tourism expenditure.

51 See Box 2.1 of *Annual Report 2023* of the Banco de España, and Balladares and García Miralles (2024).

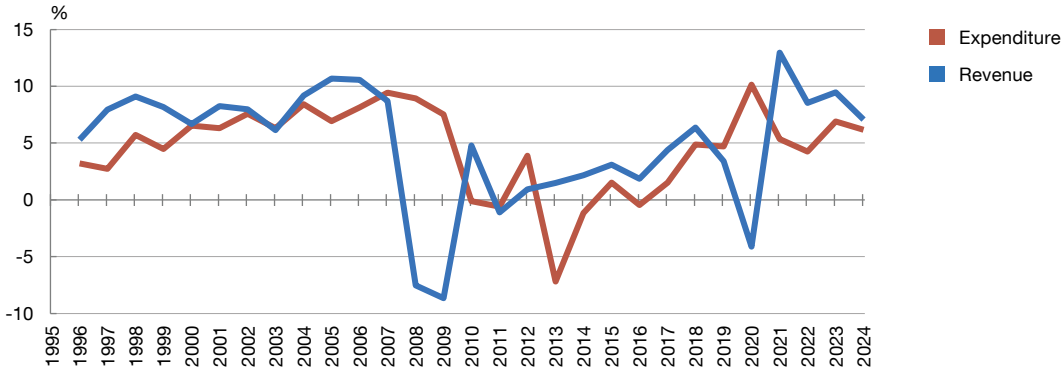
52 Since the outbreak of the pandemic, government consumption as a percentage of GDP has risen in real terms by 2.1 pp and now stands at 20.3%. This is 0.9 pp below the 2020 peak, but 0.1 pp above the previous high reached in 2011, in the wake of the global financial crisis and Spanish economic crisis.

53 In 2024, court decisions had a particularly significant impact in National Accounts terms (0.7 pp of GDP according to the National Audit Office), on both expenditure (0.5 pp) and revenue (0.2 pp).

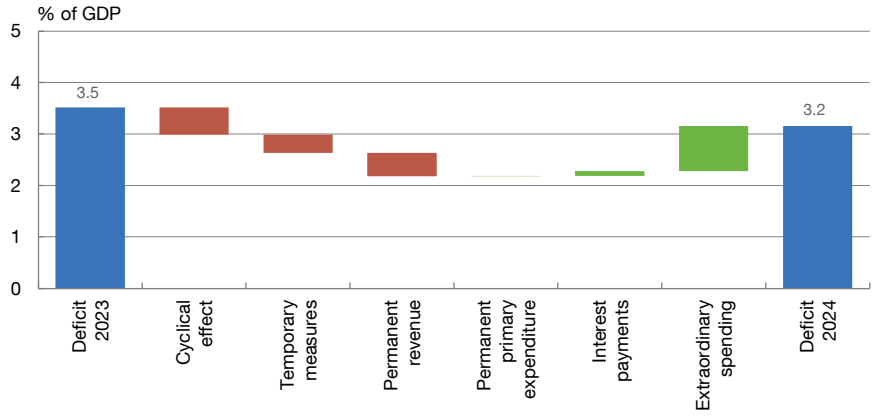
Chart 3.19

Public revenue and expenditure rose markedly in 2024, albeit at a slower pace than in 2023, and the general government deficit continued to fall, although it remains high

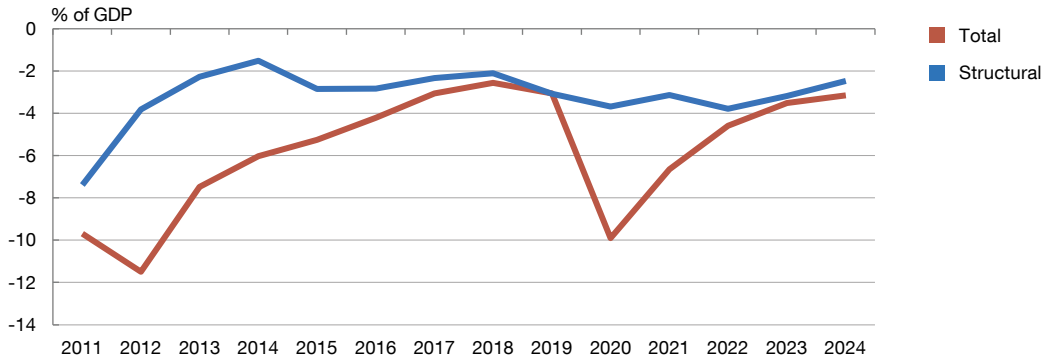
3.19.a Public finances. Year-on-year rate of change



3.19.b Change in the deficit in 2024 (a)



3.19.c General government deficit



SOURCES: IGAE, INE and Banco de España.

a Banco de España estimate.

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introduced in response to the energy crisis brought down the deficit by close to 1.3 pp of GDP (Chart 3.19.b).

- However, the volume of extraordinary spending described above (associated with the October flash floods and certain court decisions), together with the higher interest expense, drove the deficit up by 1.0 pp of GDP.

— Spain's budget shortfall is slightly larger than the 3.1% of GDP observed in 2024 for the euro area as a whole, where particularly sizeable shortfalls were reported by France, Austria and Belgium (5.8%, 4.7% and 4.5% of GDP, respectively).

— Although its estimate is subject to some uncertainty, the structural deficit is expected to remain around 3% of GDP (Chart 3.19.c). Taking into account debt interest payments equal to 2.4% of GDP in 2024, the Spanish general government's structural primary deficit is estimated to be around 0.2% of GDP.

Against this backdrop, Spain's public debt-to-GDP ratio fell from 105.1% in 2023 to 101.8% in 2024, but it remains one of the highest in the euro area.

— The public debt ratio declined in 2024 mainly on account of nominal GDP growth (Chart 3.20), but it is still 4.1 pp higher than its (pre-pandemic) end-2019 level.

— Moreover, the Spanish public debt ratio in 2024 was somewhat more than 14 pp above that of the euro area as a whole, with only Belgium (105%), France (113%), Italy (135%) and Greece (154%) reporting ratios above that of Spain.

3.6.2 Public revenue and expenditure in the wake of the pandemic

There have been some significant changes in the structure of public finances since the outbreak of the pandemic.[54] Revenue has increased considerably, and direct taxes and social security contributions have risen as a share of GDP.

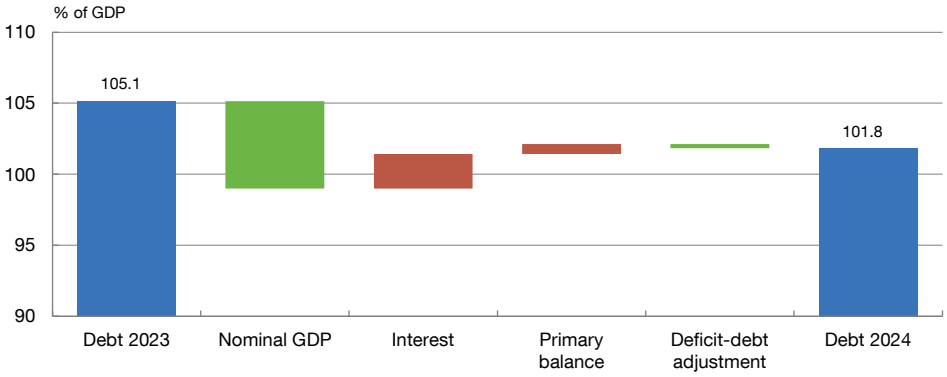
— Between 2019 and 2024, public revenue in Spain (excluding that linked to the European Recovery and Resilience Facility (RRF))[55] increased by 2.5 pp, in terms of GDP, to 41.5%, in contrast to the euro area average, where it remained virtually unchanged at 46.5%. Consequently, Spain's negative revenue gap with the euro area average has narrowed by 2.5 pp since the outbreak of the pandemic.

54 The overall general government deficit rose slightly (by 0.1 pp), to 3.2% of GDP between 2019 and 2024. This was attributable, on the one hand, to the increase in the central government deficit (by 1.4 pp, to 2.9% of GDP) and, on the other, to the improvement in the accounts of regional governments (deficit down by 0.5 pp, to 0.1% of GDP), local governments (surplus up by 0.1 pp, to 0.4% of GDP) and the social security fund (deficit down by 0.7 pp, to 0.5%).

55 In 2024, revenue arising from the RRF stood at around 0.8% of GDP.

Chart 3.20
The public debt-to-GDP ratio fell in 2024, mainly due to the positive impact of economic growth

3.20.a Change in the public debt-to-GDP ratio in 2024



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SOURCES: IGAE and Banco de España.

— The growth in public revenue in this period has been accompanied by an increase in the tax bases and, although this relationship weakened in 2021, it has recovered in subsequent years. Thus, in the period 2019-23 as a whole, almost all the increase in the public revenue-to-GDP ratio appears to owe to changes in the macroeconomic bases and the fiscal measures adopted.[56] As a result, the fiscal residuals (i.e. the part of tax revenue not explained by changes in the tax bases or in fiscal measures) would be virtually zero in cumulative terms. This trend appeared to continue in 2024, with marginally negative fiscal residuals being observed for the main taxes.

— The strong rise in public revenue in Spain has been primarily due to the growth in current taxes on income and wealth, which have risen in terms of GDP by just over 2 pp since 2019 (Chart 3.21.a). Specifically, in the case of current taxes on income, the increase has been concentrated in personal income tax, which rose by 1.3 pp in terms of GDP between 2019 and 2024. It is estimated that around 23% of this increase is attributable to employment and wage growth outpacing GDP, while the remaining 77% stems from the higher average effective tax rates as a result of the corresponding parameters not being fully updated, an effect known as fiscal drag (Balladares and García-Miralles, 2024).[57] This effect has been particularly pronounced in Spain compared with other euro area countries (García-Miralles et al., 2025).

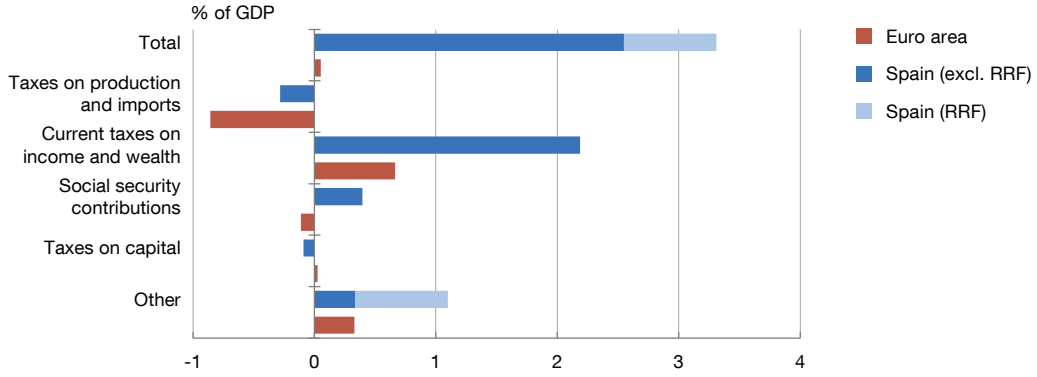
— Moreover, social security contributions as a proportion of GDP also rose, from 12.8% in 2019 to 13.2% in 2024, in contrast to the slight fall (of 0.1 pp) observed in the euro area

56 Fernández, Moral-Benito and Urtasun (2024).

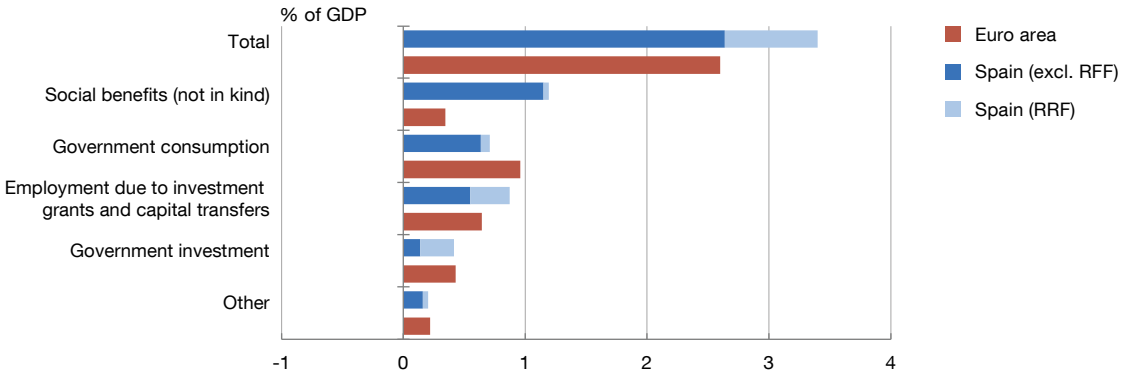
57 The explanatory power of the lack of a full update of the personal income tax parameters has increased compared with the estimates reported in Box 2.1 of *Annual Report 2023* of the Banco de España and in Balladares and García-Miralles (2024) which pointed to an impact of around 50%. This is mainly due to the revision of GDP for 2023, which gave rise to a smaller increase in the ratio of personal income tax to GDP in this period.

Chart 3.21
Both public revenue and expenditure have risen markedly since the pandemic (a)

3.21.a Public revenue. 2019-2024



3.21.b Public expenditure. 2019-2024



SOURCES: Eurostat and Banco de España.

a In the case of revenue, "Other" includes funds for investment grants and capital transfers, as well as other current revenue and transfers. In the case of expenditure, "Other" includes subsidies, effective interest paid and other current transfers and payments. This category also includes the adjustment corresponding to government consumption items not computed as expenditure.

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overall in the same period. As a result, social security contributions in Spain as a proportion of GDP were 0.3 pp higher than the euro area arithmetic mean.

— By contrast, both VAT and all other indirect taxes (including excise duties) have been more contained in recent years, slipping from 11.4% of GDP in 2019 to 11.1% in 2024.

— In consequence, the share of indirect taxation (which the economic literature usually considers to be less distortionary on activity)[58] in total tax revenue in Spain has fallen by 2.5 pp, from 29.3% in 2019 to 26.8% in 2024. In the same period, it also decreased for the

58 Indirect taxation has a smaller negative effect since, unlike direct taxation on labour or capital, it does not directly affect agents' work decisions and has a less negative effect on savings decisions. This is particularly visible when changes in indirect taxation are accompanied by transfers to the most vulnerable cohorts. For more detailed analyses of the potential gains to be obtained from reforms to increase the share of indirect taxation, see Correia (2010), Fuster (2022), Guner, Lopez-Daneri and Ventura (2023) and Macnamara, Pidkuyko and Rossi (2023).

euro area average, by 2 pp to 26.7%, a smaller decline than that observed in the Spanish economy.

Public spending, particularly on social benefits, has also risen considerably since end-2019.

— Between 2019 and 2024, the Spanish public spending-to-GDP ratio rose by 2.6 pp (3.4 pp if the RRF-related expenditure is included (Chart 3.21.b)), of which around 1.2 pp is attributable to the increase in social benefits not in kind.

— As mentioned above, another item that has stood out since the start of the pandemic is government consumption, whose increase appears to be largely associated with the higher spending on health and education. Thus, according to the functional classification of government spending, between 2019 and 2023, total spending on these items as a proportion of GDP increased by 0.5 pp and 0.2 pp, respectively, to 6.6% and 4.2%. By comparison, government spending on health and education accounts for 7.4% and 4.6% of GDP on average in the euro area.

— Government investment, a key lever for boosting medium and long-term growth according to the economic literature, has also seen notable increases in recent years. Specifically, in Spain its share in GDP rose by 0.4 pp between 2019 and 2024, to stand at 2.6%, while in the euro area it also increased by 0.4 pp, to 3.4%. However, it should be noted that, in the case of Spain, most of the increase in government investment is underpinned by initiatives financed by temporary European funds. When these funds are wound down, it will be essential to find a way to maintain current investment levels, as very significant challenges – for example, relating to the green and digital transitions – will remain.

3.6.3 The Medium-Term Fiscal-Structural Plan

The new Medium-Term Fiscal-Structural Plan (MTP) sets a framework for normalising public finances.

— The MTP submitted by the Spanish Government in mid-September 2024 was endorsed by the Council of the European Union on 21 January.

— This document is the cornerstone of the new European fiscal rules and sets out the fiscal stance for the coming years, based on a net expenditure path that is compatible with ensuring that public debt stays on a downward path over a medium-term horizon.[59]

59 The definition of the net expenditure path is based on growth in total nominal public expenditure, net of interest payments, cyclical elements of unemployment benefit expenditure and one-off and other temporary measures. Moreover, the expenditure financed with EU funds and the national expenditure that co-finances projects funded by the EU are excluded. Lastly, any increase in revenue obtained as a result of discretionary government measures is deducted from this adjusted growth in spending. Thus, assuming maximum growth in net expenditure, the Government will be able to spend more (less) than agreed if it introduces additional measures to raise (cut) revenue.

— This path replaces the targets for the size of the "structural" fiscal adjustment that were predominant under the previous rules framework, so as to curb the procyclical bias that has been seen in the past, enhance the transparency and monitoring of fiscal targets and facilitate improvements in the budget balance in periods of economic growth.

— The new framework sets a fiscal commitment for the upcoming four years, although the period for reaching the targets may be extended to up to seven years if it is underpinned by reforms and investments that improve the growth outlook and are aligned with the EU's common goals.

— In the case of Spain, the Government has requested this extension, based on the implementation of a set of reforms and investments that are linked mostly to the RRF.[60] In this respect, in the view of the European Commission, the main additional measures are promoting dual vocational training, facilitating the recognition of foreign professional qualifications and skills and improving the management of temporary disability benefits.

— The Spanish MTP commits to annual average growth of net (or primary) expenditure of 3% over the extended seven-year adjustment period (2025-31). According to the MTP projections and assumptions, this is compatible with the growth rate of primary expenditure gradually falling from 3.7% in 2025 to 3.0% in 2028 and 2.4% in 2031 (some recent changes to this path are described later in this section).

— In any event, the new European economic governance framework ensures flexibility (the control account), which allows for a deviation from the spending targets set in the fiscal plans. This control account will be used to record any future deviations from the MTP. The maximum deviation allowed (before any potential corrective or penalty measures are taken) is 0.3 pp of GDP annually and 0.6 pp on a cumulative basis from the start of the Plan.

The MTP misses the opportunity to undertake a rigorous planning of public finances over a medium-term horizon, nor does it take advantage of the current pattern of robust growth in the Spanish economy.

— The MTP does not include sufficient detail of the budgetary measures needed to reach the targets set, nor does it allow for a granular medium-term forecast of revenue and spending. These shortcomings in the design of the MTPs undermine their usefulness as a medium-term budgetary planning tool, a point that the Spanish Independent Authority for Fiscal Responsibility (AIReF) has also raised in its report on the Plan.[61]

— Furthermore, the fact that a significant part of the fiscal adjustment is scheduled for the latter years of the MTP means that it fails to take advantage of the opportunities presented by the current pattern of robust growth in the Spanish economy, in terms of mitigating the

60 Annex 6.3 of the MTP.

61 AIReF (2024).

possible adverse effects arising from this fiscal consolidation. Moreover, if the fiscal adjustment implemented in the early years of the MTP (when economic activity is expected to be considerably buoyant) were stronger than has been envisaged, it would lessen the uncertainty arising from the risk of potentially having to implement a procyclical fiscal adjustment at a later date.

In any event, there have been some significant fiscal developments in recent weeks (since publication of the MTP), in response to the extraordinarily complex and changing geopolitical scenario.

— First, in response to the tariff measures announced by the US Administration on 2 April (see Section 2.1), on 8 April the Spanish Government rolled out a Trade Response and Relaunch Plan. With funds of close to 0.9% of GDP, the plan has been designed to provide financing to firms that are more exposed or vulnerable to the US tariff hikes. Specifically, this plan provides for a guarantee facility through the Official Credit Institute to boost the activity of firms hit by the tariffs and extends the coverage offered by the Spanish official export credit company (Cesce) for export risks. The plan also redirects some pre-existing instruments (chiefly loans associated with the RRF), to provide financial support to firms.

— Second, on 22 April, the Spanish Government presented its Industrial and Technological Plan for Security and Defence, with funds of close to 0.6% of GDP. This plan is aimed at reaching the 2% of GDP target for defence spending by 2025, as per NATO criteria. To this end, the plan provides for various instruments, such as budgetary resources for the Special Modernisation Programmes for the Armed Forces, the availability of financial instruments to boost the defence industry, and spending to improve response capacities in climate emergencies. The bulk of the funding for this plan will come from reallocating unused appropriations in the 2023 State budget and redirecting RRF funds.

Taking these developments into account, on 30 April the Spanish Government published the ***2025 Annual Progress Report*** on the MTP, including the following noteworthy aspects:

— According to this Report, net primary expenditure grew by 4.1% in 2024, less than the 5.3% originally established in the MTP. This downward deviation from the MTP in 2024 provides scope for additional flexibility (of close to 0.5% of GDP), which could be used to offset a higher than envisaged increase in spending in the coming years, through the control account described above.

— For 2025, the *Annual Progress Report* envisages an upward deviation of around 0.4 pp in net expenditure growth from the MTP target (3.7%), which the Report attributes to the effort expected to be made to increase defence spending.

— Nevertheless, inasmuch as this deviation is within the limits established by the control account, compliance with the MTP in 2025 should not necessarily require activation of the escape clause provided by the European Commission. Unlike other countries that have

formally requested its activation (such as Germany, Belgium, Portugal and Greece), the Spanish Government has not yet taken a decision in this respect.

— Lastly, the general government deficit target for 2025 has been updated in the *Annual Progress Report,* to 2.8% (based on the extraordinary expenditure arising from the flash floods in October 2024). Meanwhile, public debt is projected to stand at 101.7% of GDP in 2025, 0.1 pp less than in 2024.

In March 2025, AIReF conducted its first assessment under the pension expenditure rule,[62] introduced in 2023.

— AIReF found that the projected pension expenditure, net of the approved revenue measures, does not exceed the threshold set out in this rule. The Government is therefore not required to submit to Parliament any measures to strengthen the financial sustainability of the pension system. In particular, according to the *Ageing Report,* projected pension expenditure in the period 2022-50, corrected for the latest observed data, amounts to 14.6% of GDP. Meanwhile, AIReF quantified the impact of the revenue measures approved since 2020 at 1.4% of GDP in that period.[63] Therefore, pension expenditure net of these measures stands at 13.2% of GDP, 0.1 pp below the threshold for non-compliance with the expenditure rule.

— In any event, along with its *Report on the Pension Expenditure Rule,* AIReF also published a *Second Opinion on the Long-Term Sustainability of General Government.* In this report, AIReF notes that pension system sustainability – measured not in terms of the expenditure rule stipulated in the latest pension reform, but in terms of the expenditure that the system will face in the coming decades – has not improved with respect to the first opinion published two years ago (AIReF, 2025).

— This is despite the fact that in 2024 pension expenditure amounted to 12.9% of GDP, around 1 pp below the level projected for that year by the *Ageing Report,* AIReF and the Ministry of Inclusion, Social Security and Migration a few quarters ago, owing primarily to the strength of economic activity. Another factor that also appears to be helping, at least in part, to contain expenditure is the increase in the share of retirements beyond the ordinary age. In particular, since the new incentives for late retirement came into force in 2022, the proportion of such retirements has almost doubled, to 9.3% of total new retirements in 2024 (around 34,000 people).[64]

62 The pension expenditure rule stipulates that, from 2025 and every three years, AIReF will verify whether the projected average pension expenditure in the period 2022-50 published in the *Ageing Report,* corrected for the revenue measures adopted from 2020, exceeds 13.3% of GDP. If it does, the Government is required to identify a set of measures to correct the gap, which should enter into force the year following AIReF's assessment. If no such measures are agreed, social security contributions will increase automatically.

63 With the following breakdown: Intergenerational Equity Mechanism: 0.4 pp of GDP; change in the maximum contribution base: 0.3 pp of GDP; additional solidarity contribution: 0.1 pp of GDP; reform of the contribution system for self-employed workers: 0.2 pp of GDP; transfers from the central government to Social Security to strengthen the public pension system: 0.3 pp of GDP; and increase of the minimum wage: 0.1 pp of GDP.

64 In 2025 to February, the effective retirement age was 65 and late retirements accounted for 11.3% of total retirements.

3.7 External balance

The Spanish economy's net financing capacity rose once again in 2024, to 4.2% of GDP, its highest level since 1995.

— Spain's net lending rose by 0.4 pp of GDP between 2023 and 2024, due primarily to a widening current account surplus,[65] which was in turn driven by a number of factors.

- First, the non-energy goods surplus increased slightly (to 0.2% of GDP), continuing a trend that, save a partial interruption in 2022, has been observed since 2012. This surplus has been driven by competitiveness gains and the diversification of Spain's export markets,[66] which has helped lessen the adverse impact that the weak economic activity in the country's main European trading partners has had on exports.

- Second, the services surplus rose by 0.1 pp, underpinned by marked growth in exports of travel services (aided, inter alia, by the diversification of tourism flows[67] observed since 2023) and of non-travel services.

- Lastly, the energy deficit declined slightly, as a result of Spain's lower energy dependence vis-à-vis the rest of the world and the fall in energy prices (Chart 3.22.a).

The recent increase in the Spanish economy's net financing capacity could be the result of a growing imbalance between saving and investment.

— In the Spanish economy, the savings built up by households and firms are sufficient to fund their levels of investment. In 2024 this translated into a lending capacity of 4.7% of GDP in the case of households and of 1.8% and 0.9% of GDP among financial and non-financial corporations, respectively. By contrast, the public sector has a net borrowing requirement equal to 3.2% of GDP.

— The increase in households' net lending capacity over a broader timescale is particularly noteworthy, rising as a percentage of GDP from 3% in 2023 to 4.7% in 2024, figures that are well above the pre-pandemic (2014-19) average of 1.2% of GDP. This strong growth in net lending capacity since the pre-pandemic period stems from the robust increase of 4.8 pp in household savings, while investment has risen by 1.3 pp.

— In line with these developments, the household saving rate as a percentage of gross disposable income rose from 12% in 2023 to 13.6% in 2024, again well above the average of 7.3% observed in the period 2014-19.

65 The capital account balance, which encompasses a large part of the funds received from the EU (primarily under the Next Generation EU (NGEU) programme), also improved, albeit less markedly. For an explanation of how these EU funds are recorded in the balance of payments and international investment position, see Banco de España (2022).

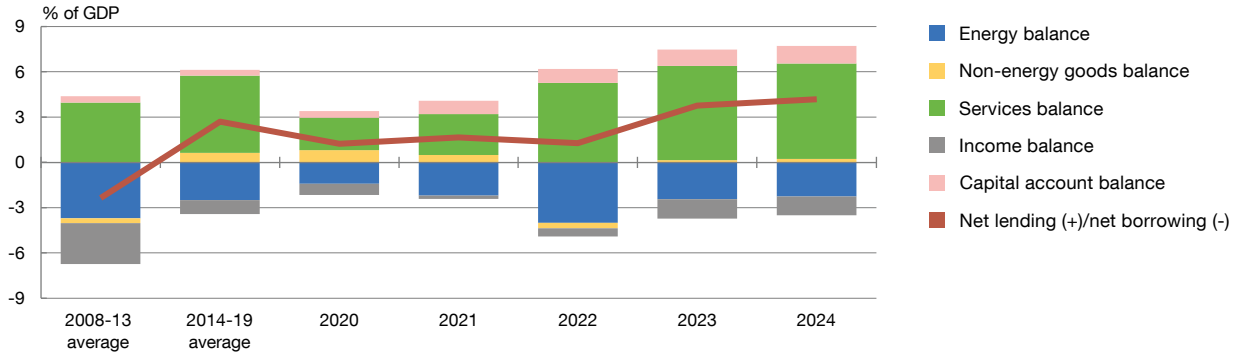
66 For more details on recent developments in Spanish goods exports, see García Esteban and Jiménez García (2024).

67 Jiménez-García and García Esteban (2024).

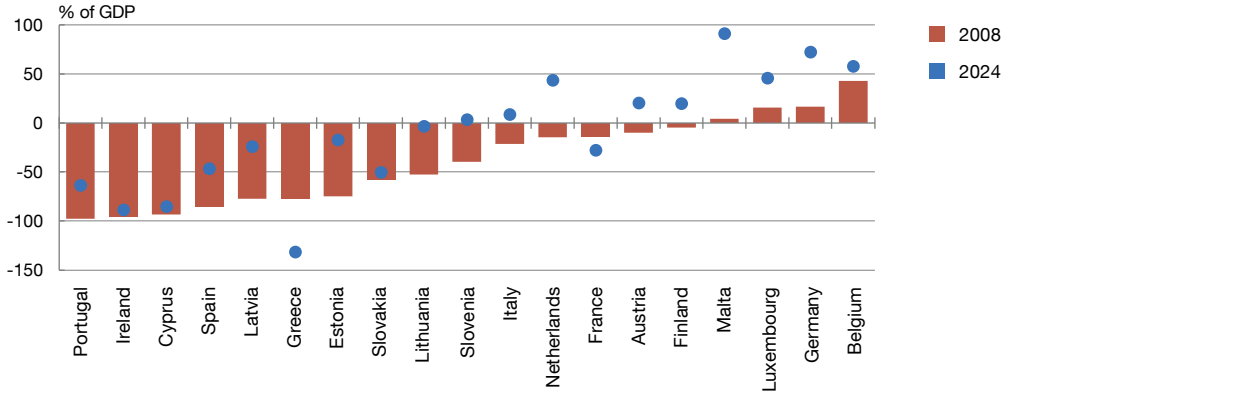
Chart 3.22

The Spanish economy's net lending capacity rose in 2024, while its negative net international investment position fell, although it remained relatively high

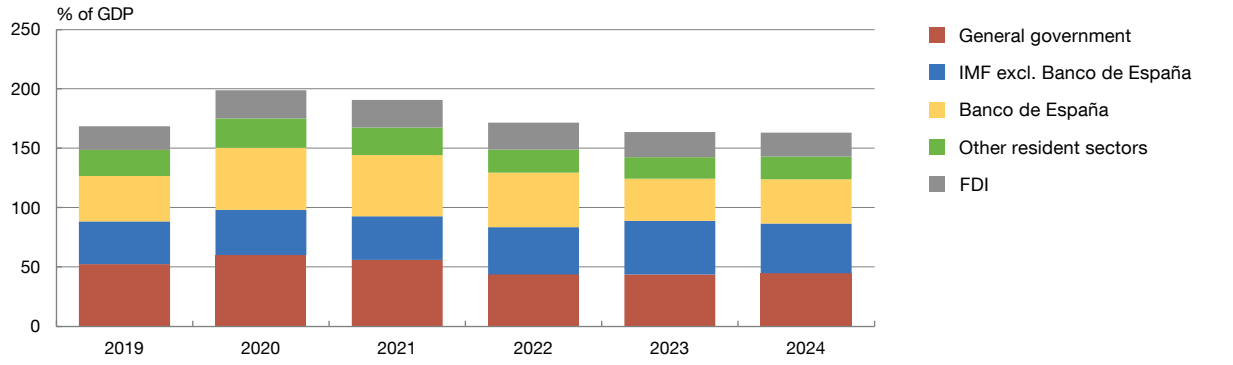
3.22.a Spain's net lending (+)/net borrowing (-)



3.22.b Positive (+)/negative (-) net international investment position



3.22.c Gross external debt of the Spanish economy



SOURCES: Banco de España, ECB and Eurostat.

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In 2024 the net international investment position (IIP) held on a downward path, while gross external debt as a percentage of GDP remained stable.

— In part as a result of the current account surplus and GDP growth, in 2024 the negative net IIP of the Spanish economy decreased by 7.3 pp in terms of GDP, to stand at 44%, its lowest level since 2004. Nevertheless, compared with other European countries, the Spanish economy continues to post a high negative net IIP (Chart 3.22.b).

— The net debtor position notably includes portfolio investment (equivalent to 22.7% of GDP) and foreign direct investment (FDI) (equivalent to 14.6% of GDP). By institutional sector, for the first time since the adoption of the euro, the resident sectors[68] other than monetary financial institutions had a net creditor position vis-à-vis the rest of the world in 2024, equivalent to 2.5% of GDP; this was in part due to the 2 pp increase in the creditor position of non-financial corporations and households. Conversely, general government and the Banco de España presented net debtor balances equivalent to 40.2% and 10.7% of GDP, respectively.

— Spain's gross external debt[69] as a percentage of GDP remained virtually unchanged in 2024, declining by just 0.6 pp to 163.1% (Chart 3.22.c). However, the vulnerability posed by the Spanish economy's high external debt is partially mitigated by the composition of these liabilities, as they mainly comprise liabilities to the public sector and the Banco de España (27.5% and 22.8%, respectively, of the total), which have a comparatively lower rollover risk than private sector liabilities, and liabilities issued on a long-term basis at a fixed interest rate and in euro, factors which reduce the rollover, interest rate and exchange rate risks, respectively.

Spain's FDI flows and stocks are relatively high as a percentage of GDP.

— FDI flows[70] into the Spanish economy were equivalent to 2.1% of the country's GDP on average in 2014-23, higher than the figures observed globally (1.9%) and in Germany, France and Italy (around 1%) in that period.

— As a result of these flows, Spain's inward FDI stock in 2023 verged on 60% of its GDP, well above the percentages observed in Germany (27%), France (33%) and Italy (21%). Consistent with this pattern, foreign multinationals account for a considerable share of Spain's productive system (Chart 3.23).

— The geographical composition of Spain's inward FDI stock has a relatively low exposure to geopolitical risks because, as with the other main euro area economies, the bulk (nearly half) of such investment comes from other EU countries.

68 Other resident sectors comprise financial corporations, non-financial corporations and households.

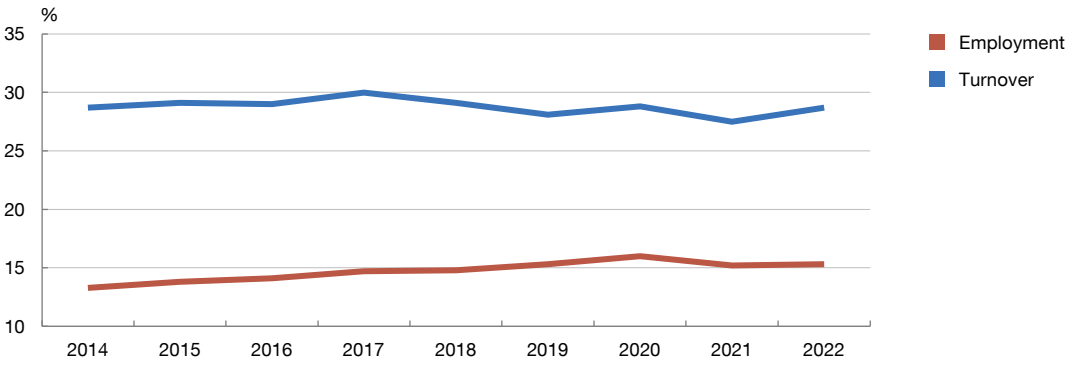
69 Gross external debt comprises all of a country's liabilities to the rest of the world that entail a future payment obligation. It therefore excludes equities (shares and other equity and investment fund shares or units), financial derivatives and gold bullion.

70 The data on inward and outward direct investment correspond to FDI under the directional principle, for which the latest data available refer to 2023. For more details on developments in Spain's FDI flows and stocks, see Andrino López, López Espinosa, Martín Machuca and Matos Celemín (2025).

Chart 3.23

The Spanish subsidiaries of foreign multinationals account for a considerable share of the employment and turnover of firms operating in Spain

3.23.a The share of subsidiaries of foreign multinationals in employment and turnover

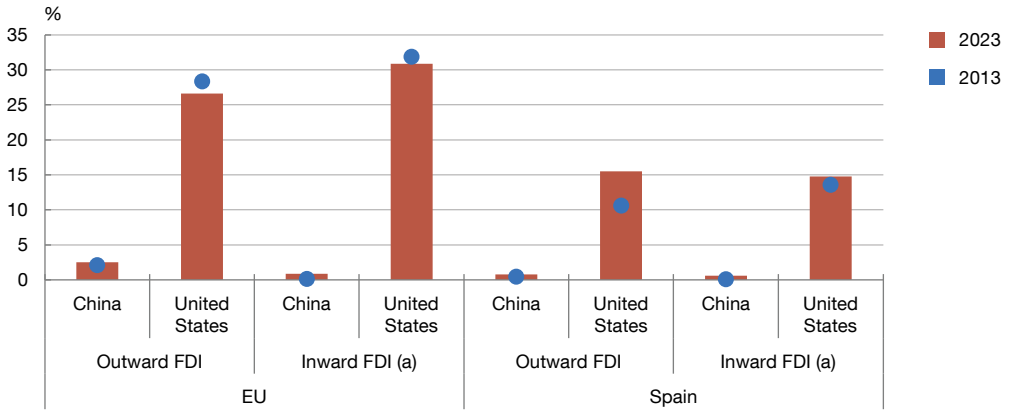


SOURCE: INE

Chart 3.24

FDI stocks in the EU and Spain

3.24.a Stock of inward and outward FDI of China and the United States



SOURCE: Eurostat.

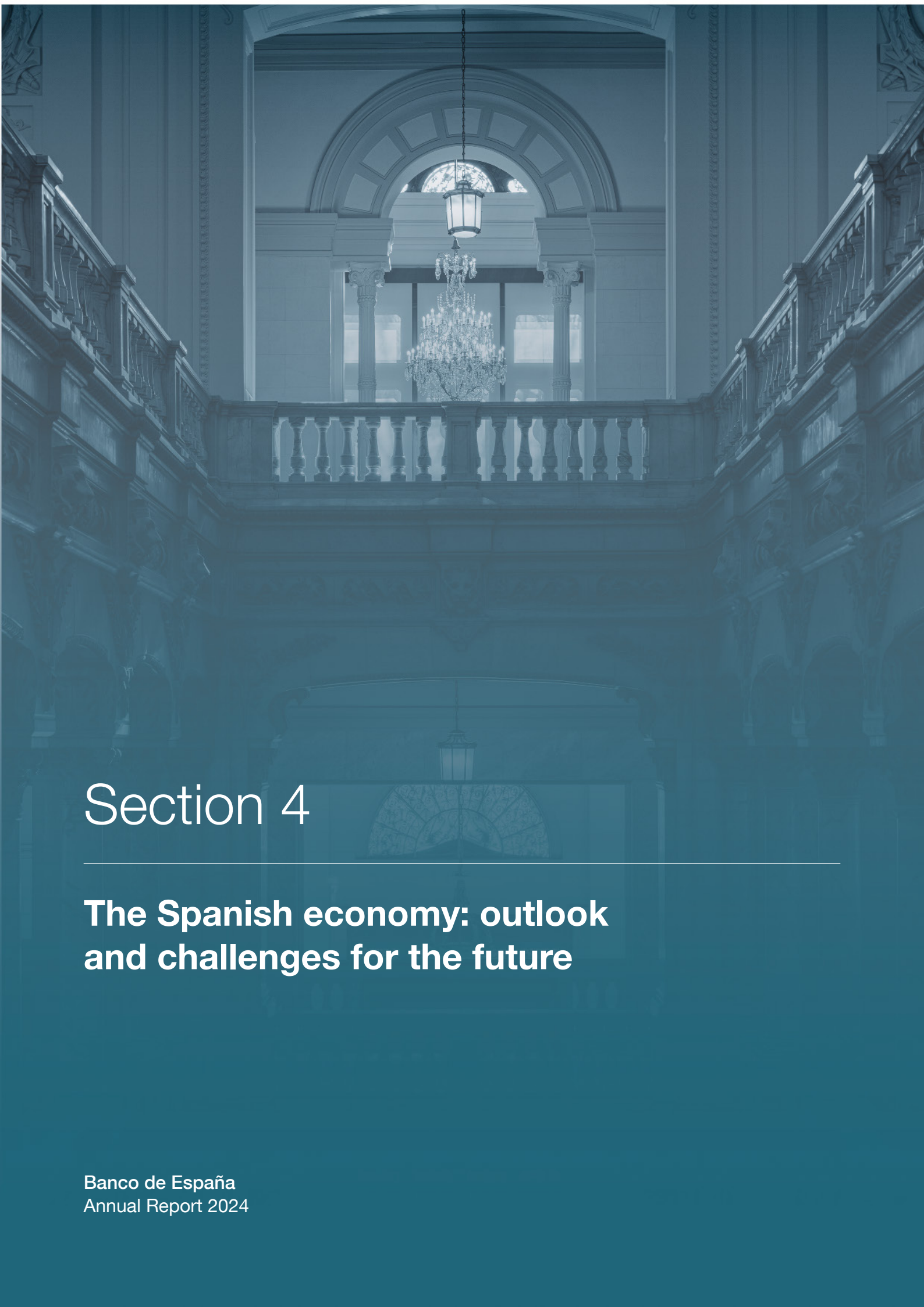
a The data on FDI from outside the EU are disaggregated by immediate investing country, since the data by ultimate investing country are not published. The data for Spain are disaggregated by ultimate investing country.

— In any event, the United States is the second largest investor in Spain, accounting for close to 15% of its FDI stock (Chart 3.24). This percentage is similar to the US share of the FDI stock in France, but smaller than its share in Germany (over 20% of the total stock).

— Direct investment by China is considerably smaller, fluctuating around 1% of the total, while Latin America accounts for around 8% of Spain's inward FDI stock, much more than in Italy (4%) and Germany and France (less than 1%).

Nevertheless, despite these relatively favourable developments overall, the future course of the different dimensions of the Spanish economy's external balance is subject to marked uncertainty, against an extraordinarily complex global trade and geopolitical backdrop (see Section 4.1).

— For instance, although the tariffs recently announced by the US Administration – which have largely been suspended for the time being – chiefly affect trade in non-energy goods (where Spain has a balanced account), trade in services (where Spain has a surplus vis-à-vis the United States) could also be affected. Specifically, one possible transmission channel would be if there were a reconfiguring of international tourist flows, where both Spain and the United States are highly significant global markets (see Section 4.1.2).



Section 4

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.

The latest economic, trade and geopolitical developments have seen some of those risks 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.

Specifically, this future outlook depends mainly on how the current trade tensions are resolved and how this affects the performance of the international financial markets and the degree of confidence with which economic agents make their spending and investment decisions.

In the current setting, understanding the Spanish economy's trade exposure to the United States – the country spearheading the changes in global tariffs – is key. In this respect, Spain's direct trade exposure to the United States is relatively low and Spain is less exposed than other European countries. However, it is somewhat more exposed when considering the indirect exposure channels resulting from the Spanish economy's integration with global value chains.

In addition, in such a complex environment with so many unknowns, envisaging the possible materialisation of different alternative hypothetical scenarios is essential. The simulations conducted by the Banco de España suggest that a potential tariff hike would adversely affect the level of global activity. This impact would be particularly high in the United States, but more subdued in the euro area and especially in Spain. However, if these trade tensions were amplified by a deterioration in global financial conditions or uncertainty levels, the negative impact on the Spanish and European economy's GDP would be higher.

These downside risks to Spanish and European economic activity could be mitigated somewhat if in the coming quarters defence and infrastructure spending in the European Union (EU) were to rise, like some recent initiatives have signalled. However, at present it is difficult to accurately quantify the size of such positive impact. It will be determined by a series of factors, including the actual additional expenditure made and its composition and import content, about which there is still considerable uncertainty.

In any event, looking further ahead, it is important to understand that some of the current risks can be considered as part of a deeper and more structural questioning of multilateralism in international relations and of globalisation, and to assess the possible implications of these developments in the long term. Specifically, any intensification of the doubts that have emerged recently over the protagonism of the US dollar in the international monetary and financial system could trigger significant risks to global financial stability.

In such a complex 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. In this respect,

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.

In addition to the European initiatives under way, there is still room for improvement in some very important dimensions. In particular, it would be important to implement in the EU a permanent common funding instrument, applying the lessons learned from the temporary NextGenerationEU (NGEU) programme. Such an instrument would make it possible to finance large-scale projects to provide public goods at European level, while simultaneously avoiding an excessive or uneven impact on national public finances and financing costs and a deterioration in the single market.

Turning to the Spanish economy, first it is essential to analyse how much of Spanish economic activity's – relatively buoyant – 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 the Spanish economy's resilience and growth capacity).

Second, it is necessary to take into account that, despite some notable headway recently, 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), while others, for example those linked to the housing market, migratory flows and climate change and the green transition, have gradually come to the fore in recent years.

In addition, amid growing pressures on the expenditure side, complying with the new European fiscal rules will require rigorous planning, with an eye on the medium term, to simultaneously bolster the sustainability of public finances and improve their composition, so that government budgets are more growth-friendly.

4.1 A highly complex and uncertain international environment

4.1.1 Main sources of risk at global level

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.

— At global level, the baseline scenario envisaged mainly that world GDP would grow relatively robustly over the coming years, in line with developments in 2024 and above 3%.[1] At the same time, inflationary pressures were expected to continue easing gradually over the projection horizon, converging somewhat more quickly towards target rates in the advanced economies – some of which would see inflation return to the target rate in 2025/2026 – than in the emerging market economies.

— With regard to the euro area, while the ECB staff macroeconomic projections published in early March revised down euro area GDP growth for the coming years and revised up inflation slightly, they remained consistent with the expectation of a modest acceleration in economic activity in the region – whose GDP growth would strengthen from 0.8% in 2024 to 1.2% in 2026 – and a gradual convergence of inflation towards the 2% target (which is expected to be reached by 2026).

— Turning to the Spanish economy, the March Banco de España macroeconomic projections revised up both the GDP growth rate forecast for 2025 (to 2.7%) and the average headline inflation rate expected in the year (to 2.5%). The projections therefore forecast a slightly lower output growth rate than that recorded in 2024 (3.2%), 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 disinflation that has taken place in Spain in recent years (from 3.4% in 2023 to 2.9% in 2024), and with 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 those risks 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.

— As detailed in Section 2, this future outlook mainly depends:

- on how the current trade tensions are resolved (with the reciprocal tariffs established by the United States on 2 April currently paused for 90 days, pending the bilateral negotiations with the affected countries);

1 See, for example, the International Monetary Fund's (IMF) *World Economic Outlook,* January 2025.

- on how this affects/interacts with the global financial markets, where, after the corrections and rallies of recent weeks, some risky assets still trade at relatively high prices (Chart 2.8); and

- on the degree of confidence with which economic agents make their spending and investment decisions, amid high levels of economic policy uncertainty in many systemic countries (Chart 2.4.a).

— From a European and Spanish perspective, another important factor that might affect GDP growth and inflation in the future is the potential boost in the coming quarters to defence spending in the EU and to defence and infrastructure spending in Germany. Details in this respect have yet to be fleshed out.

Estimating the possible macroeconomic impact of this set of 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. For example, with regard to trade, the following key aspects are unknown:

— First, given that the 90-day pause established following the announcement of the reciprocal tariffs by the United States is yet to end, the size, scope and duration of the tariffs that the United States could ultimately impose on its imports from the rest of the world are unknown. Similarly, the countermeasures that the countries potentially affected by these tariffs will end up implementing cannot at present be specified.

— Second, an escalation in the tariff war, which has so far focused on goods, ultimately affecting international trade in services cannot be ruled out. Furthermore, to date the tariff war has focused on the level of bilateral tariffs between the United States and other global economies. In this respect, of late there have not been any significant changes in bilateral trade policy between other third countries. However, these changes could arise, thereby considerably altering current international trade patterns. This could happen, for example, if some regional trade alliances become stronger or, conversely, if some countries raise their tariffs on third countries to prevent them from redirecting towards their economy the trade they no longer export to the United States.

— Third, the channel through which the trade war will ultimately have a bigger impact on activity and prices is unclear. In principle, a tariff hike represents a negative supply shock for the country imposing the tariffs – its imports become more expensive – and a negative demand shock for the countries bearing them. As a result, the academic literature suggests that the level of global economic activity could be adversely affected, while the impact on inflation is less clear and uneven across countries, depending, among other factors, on exchange rates and mark-ups . But this is only one of the channels through which tariffs can impact activity. As witnessed in early April, this shock can also be transmitted, particularly forcefully, through a deterioration in agents' confidence or in the markets and financial conditions (see Section 2.2.2). If this were the case, the decline in activity could be greater and the deflationary pressures associated with this shock would increase. Conversely, the

possibility that the tariff hikes may trigger shocks in global production and supply chains cannot be ruled out. In this case, as occurred in some phases of the COVID-19 pandemic, inflationary pressures could be greater.

The following sections cast some light on the potential macroeconomic impacts:

— Section 4.1.2 describes the Spanish economy's trade exposure to the United States, the country spearheading the changes in global tariffs.

— In such a complex setting with so many uncertainties, Section 4.1.3 simulates, using various general equilibrium models, the possible response of the global, European and Spanish economy to various hypothetical scenarios involving different tariff, global financial market and uncertainty developments.

— Meanwhile, Section 4.1.4 considers the possibility of higher defence and infrastructure spending in the EU and the main factors that could affect its potential macroeconomic impact.

— Lastly, looking further ahead, Section 4.1.5 addresses the extent to which some of the current risks can be considered as part of a deeper and more structural questioning of multilateralism in international relations and globalisation, and the possible implications of these developments in the long term.

4.1.2 Degree of exposure of the Spanish economy to the US tariffs

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 (Chart 4.1.a). 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.

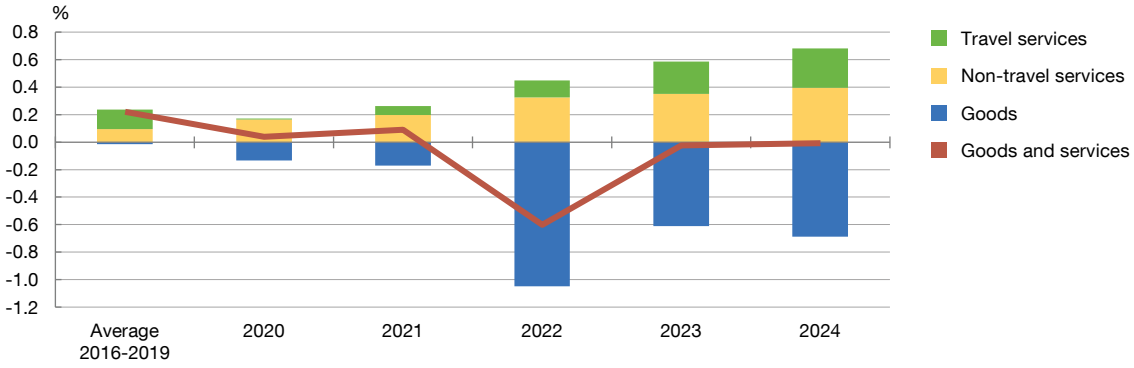
— In any event, the volume of Spain's external trade with the United States – measured as the trade-to-GDP ratio – is slightly above 4% of GDP, which is considerably lower than that of the other big euro area economies, such as Germany (above 7%) and Italy (over 5%). These countries also run a sizeable trade surplus with the US economy, particularly in trade in goods.

— According to the Customs and Excise Department's external trade data, in 2024 the products most exported from Spain to the United States were: (i) machinery and transport equipment (27% of total exports to the United States, above all electronic appliances and devices); (ii) other manufactured goods (26%); and (iii) chemicals and chemical products (19%, above all pharmaceuticals and essential oils). In addition, some food products also

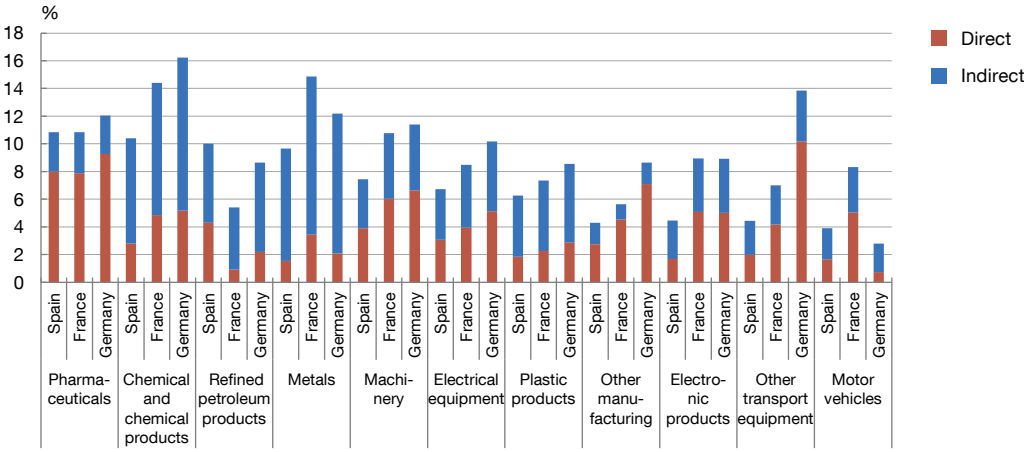
Chart 4.1

Over the last decade Spain's balance of trade with the United States has been close to equilibrium, running a goods deficit and a services surplus

4.1.a Spain's recent balance of trade with the United States



4.1.b Value added exported to different countries, by manufacturing sector (a)



SOURCES: Banco de España, ECB and Eurostat-Figaro.

a Only sectors whose direct and indirect exposure exceeds 8% are depicted. Direct exposure shows direct exports to the United States as a percentage of each sector's total output. The sum of direct and indirect exposure shows the percentage of gross value added of each sector involved in the direct exports of the sector itself, in addition to the supply of intermediate goods to other firms exporting to the United States.

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accounted for a relatively sizeable share of total exports, such as olive oil (just over 5%) and wine (close to 2%).

— 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: (i) non-metallic mineral products (where just over 12% of exports are to the United States); (ii) machinery and equipment (10%); (iii) electrical equipment (8.5%); and (iv) other transport equipment (almost 8%).

— Prominent among the goods imported from the United States were: (i) energy products (which accounted for 33% of total imports from the United States in 2024, most notably oil and natural gas); (ii) chemicals and chemical products (29%, mainly pharmaceuticals); and

(iii) machinery and transport equipment (19%, in particular, airplanes and other aircraft, parts and accessories, and non-electric motors and machinery).

However, Spain's indirect exposure to the United States is greater because of the Spanish economy's integration with global value chains.

— Because of its global value chain integration, the Spanish economy is indirectly exposed to demand from the US economy through Spanish exports of intermediate goods (e.g. car parts) to other countries, which later become part of the final products that such countries export to the United States.

— This indirect channel increases the Spanish economy's exposure to the United States particularly significantly for some industrial sectors. In particular, the Spanish industries whose value added is most exposed to US demand are those linked to the pharmaceutical, chemical, petroleum and metal sectors. (Chart 4.1.b). In any event, these exposures are considerably lower than those of other big euro area countries and the European economy as a whole.

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%.

— The average effective tariff borne by a country on its exports to the United States depends, first, on the tariffs in force for each specific product and, second, on the volume this country exports to the United States of each of these products. In other words, it is the result of multiplying the tariff on each product by the proportion of such product in the country's total exports to the United States.

— Thus, while the US Administration imposes a single tariff (per product) on all European exports, the average effective tariff borne by each EU Member State will vary on the basis of the sectoral composition of its exports to the United States.

— In 2023 the average effective tariff on Spanish exports to the United States was 3% (Chart 4.2.a), higher than that borne by the main European economies. This is because the most important sectors for Spanish exports to the United States included some, such as vehicles, ceramic products and chemicals and chemical products,[2] that bear particularly high tariffs (12.5%, 8.2% and 5.1%, respectively). By contrast, the sectoral composition of German exports mainly comprised four sectors[3] whose tariffs ranged from 0% to 2%. It should also be noted that, in the case of the motor vehicle sector, the average effective tariff imposed on Spain (12.5%) was far higher than that imposed on Germany (2.2%), as most Spanish exports to the United States are related to a specific category of small vehicles (light trucks), which bear a tariff of 25%, well above the 2.5% tariff imposed on passenger vehicles in 2023.

2 These categories amounted to 15% of Spanish exports to the United States in 2023.
3 These categories amounted to 70% of German exports to the United States in 2023.

However, under the current tariff scenario, the average effective tariff on Spanish exports to the United States has risen to 12%.

— The average effective tariff borne by the main world economies on their exports to the United States is calculated by considering: (i) a universal tariff of 10% on most products (with exemptions for some products, such as pharmaceuticals and electronics, published in Annex II to the Executive Order on reciprocal tariffs); (ii) tariffs of 25% on aluminium and steel, and on cars and car parts; and (iii) various exemptions affecting Canada and Mexico.[4]

— In this case, the average effective tariff on Spanish exports to the United States is 12% (Chart 4.2.a). The product categories that make the biggest contribution to this tariff increase are machinery, mechanical appliances, electrical appliances and vehicles (Chart 4.3).

— Under this scenario, Germany is the most affected among the main euro area countries: 29% of its exports to the United States are subject to a tariff increase of over 10 percentage points (pp) (Chart 4.2.b). This is due to vehicles and machinery predominating in its imports to the United States.[5] Meanwhile, countries like Ireland, whose exports to the United States include many pharmaceutical products, which are exempted from the current tariffs, are for the time being seeing a lower rise in the effective tariff.

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%.

— As detailed in Section 2.1, under such scenario, all EU Member States would face a specific tariff of 20%, 10 pp more than under the previous scenario.

— As a result, the average effective tariff borne by the Spanish economy would rise to 18% (Chart 4.2.a). Among the four main euro area economies, which would bear a higher average effective tariff than the euro area average, Germany would see a smaller rise in tariffs under this scenario. This is because vehicles and auto parts, which are already subject to a 25% tariff, account for a greater share of its exports.

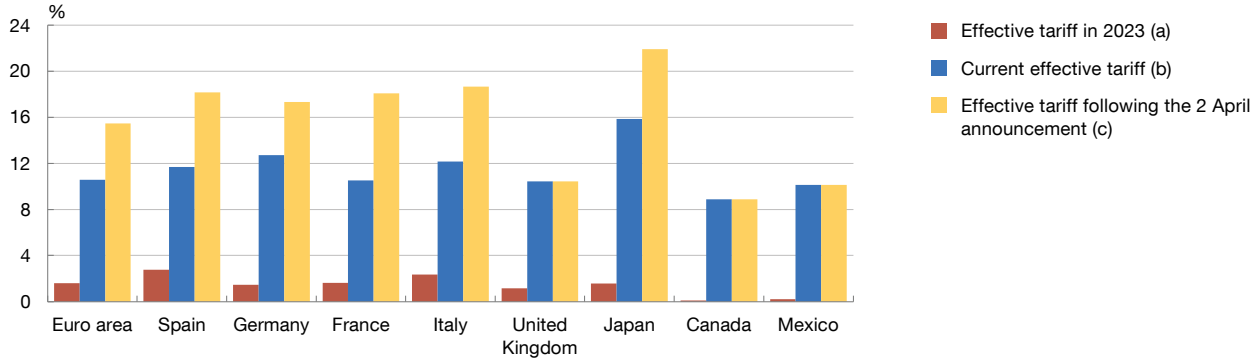
— While not depicted in Chart 4.2.a, it is important to highlight that, in all the cases envisaged above, China would be the world economy with the highest average effective tariff on its exports to the United States. This tariff stood at 10% in 2023, but following the latest announcements by the US Administration, it is expected to increase to over 120%.

4 Except for steel and aluminium, trade that qualifies for application of the United States-Mexico-Canada Agreement (USMCA) is exempt. Canadian exports of energy and potash and Mexican exports of potash are subject to a reduced tariff. The products published in Annex II to the Executive Order on reciprocal tariffs, such as some pharmaceutical products and electronic products, are exempt. There is a 25% tariff on all other products.

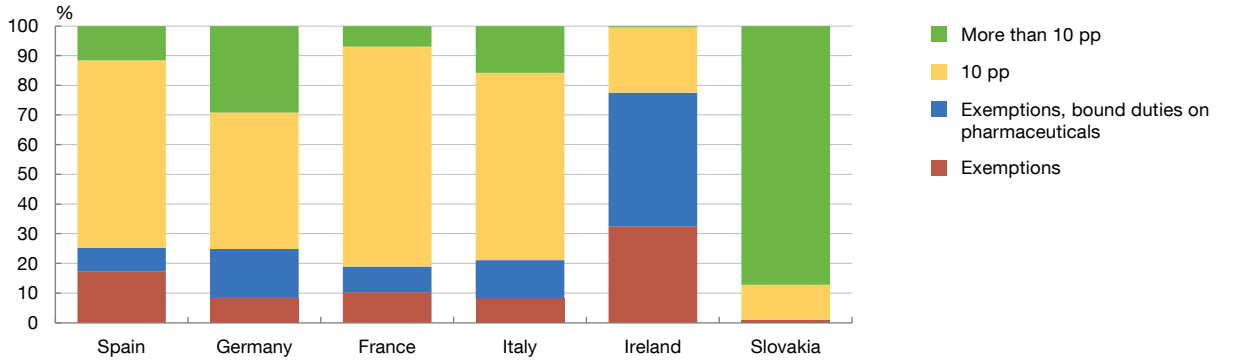
5 These sectors account for 23% and 21%, respectively, of German exports to the United States and are currently subject to tariff hikes of 21 pp and 12 pp.

Chart 4.2
Average effective tariffs

4.2.a Tariffs applied to the euro area and other economies



4.2.b Share of exports to the United States affected by different hikes to the current tariffs



SOURCES: CEPII-BACI, WTO, US Trade Census and Banco de España.

a Effective tariff level in force in 2023.
b Current tariff level, calculated assuming: (i) a universal tariff of 10% on most products (with exemptions for some products, such as pharmaceuticals and electronics, published in Annex II to the Executive Order on reciprocal tariffs); (ii) tariffs of 25% on aluminium and steel, and on cars and car parts; and (iii) various exemptions affecting Canada and Mexico (exemptions for trade flows qualifying under the USMCA, except for steel and aluminium; tariffs of 10% on energy and potash from Canada and on potash from Mexico; exemptions for products in Annex II to the Executive Order on reciprocal tariffs, such as pharmaceuticals and electronics; other products are subject to a 25% tariff).
c Tariff level in the event the reciprocal tariffs announced on 2 April are activated.

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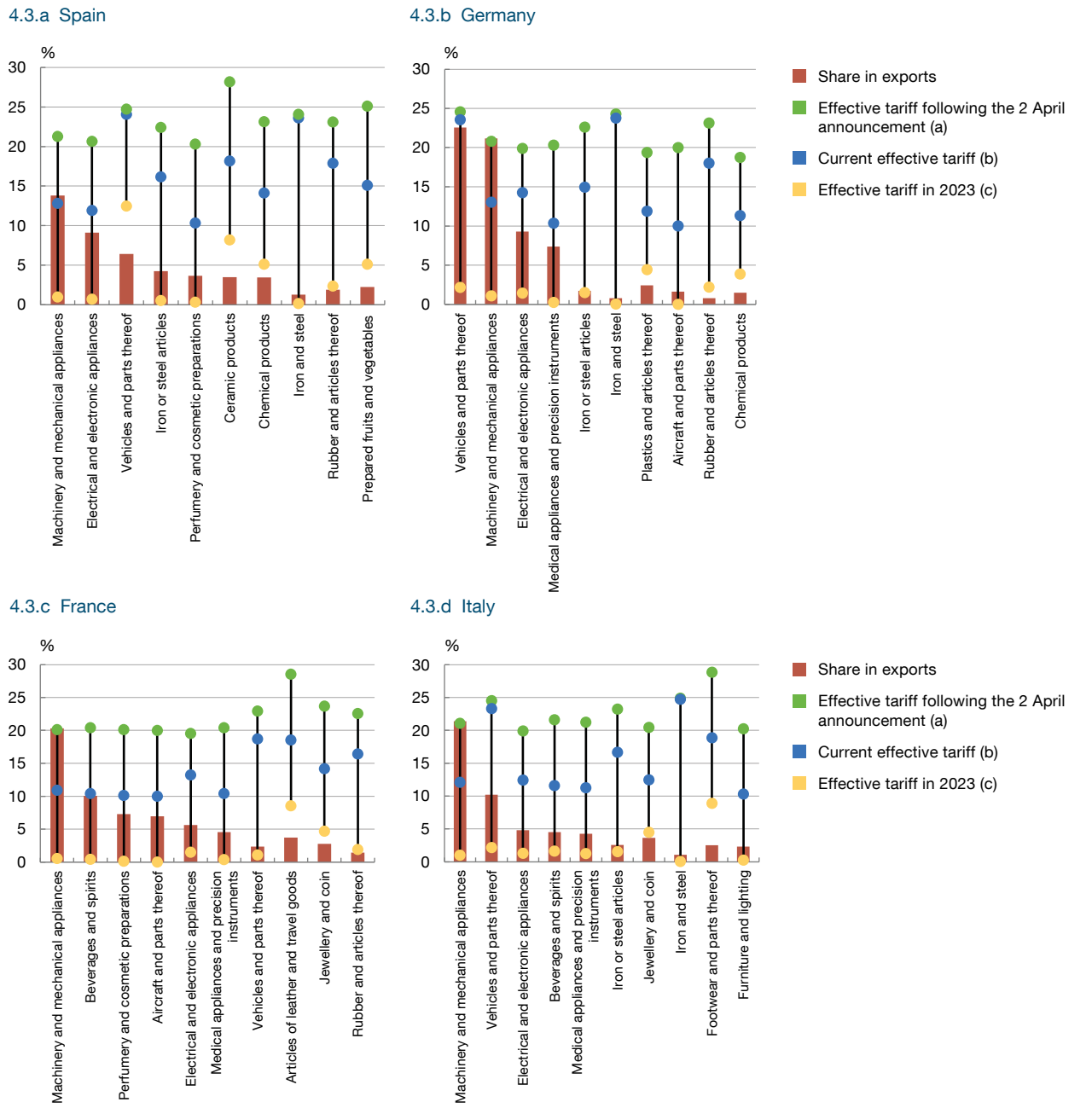
In any event, the ultimate impact of a tariff increase on the volume of exports by Spanish firms will depend, among other factors, on the price sensitivity of US demand for goods, on the ability of Spanish firms (and of those from the rest of the world) to adjust their margins and on the possibility of them finding alternative export markets to the United States or adapting their product range.

— With regard to the price elasticity of demand, the academic literature suggests that it is relatively low for products with high value added or more differentiated products, which are therefore more difficult to substitute.[6] In this respect, Rauch (1999) categorises products in international trade by their degree of differentiation. According to this categorisation, the products most exported by Spain to the United States include some differentiated products,

6 See, for example, Fontagné, Guimbard and Orefice (2022) and Soderbery (2018).

Chart 4.3

Products making the biggest contribution to the change in tariffs



SOURCES: CEPII-BACI, WTO, US Trade Census and Banco de España.

a Tariff level in the event the reciprocal tariffs announced on 2 April are activated.
b Current tariff level, calculated assuming: (i) a universal tariff of 10% on most products (with exemptions for some products, such as pharmaceuticals and electronics, published in Annex II to the Executive Order on reciprocal tariffs); (ii) tariffs of 25% on aluminium and steel, and on cars and car parts; and (iii) various exemptions affecting Canada and Mexico (exemptions for trade flows qualifying under the USMCA, except for steel and aluminium; tariffs of 10% on energy and potash from Canada and on potash from Mexico; exemptions for products in Annex II to the Executive Order on reciprocal tariffs, such as pharmaceuticals and electronics; other products are subject to a 25% tariff).
c Effective tariff level in force in 2023.

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such as pharmaceutical products and electronic appliances, but also other products that are more easily substituted, such as wine and olive oil. However, there are differences within each product. For example, in the case of olive oil, the elasticity is higher for those exporters whose competitive strategy is price-based.

— Firms' ability to adjust their margins will also foreseeably vary considerably across firm type, sector and product. In any event, a Banco de España Working Paper (Gutiérrez and Martín Machuca, 2021) analysing the elasticity of nominal Spanish exports to changes in tariffs in the period 1995-2019 highlights that, on average, the negative impact of higher tariffs on nominal sales is mainly concentrated on the amount exported and not on the price.[7]

— Meanwhile, some studies suggest that exporting firms generally have considerable capacity to adapt to higher tariffs. For instance, Gutiérrez, Lacuesta and Martín-Machuca (2024) study the impact of Brexit on Spanish firms' trade flows, finding that those more exposed to the British market managed almost full trade diversion for exports, mostly to other European countries. In the same vein, Minondo (2023) and Gutiérrez (2023) also observe that Spanish firms demonstrated high adaptability in response to the tariffs that the United States imposed on the EU between October 2019 and March 2021, by making adjustments to the products supplied.

Lastly, 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.

— Indeed, even if no tariffs are applied to international trade in services, a tariff hike for goods will also probably affect the level of activity in services sectors (see Section 4.1.3). This is because the services content of manufacturing exports is significant. In particular, according to the latest information available in the Organisation for Economic Co-operation and Development's Trade in Value Added database, the national services content of Spanish manufacturing exports amounted to just over 20% in 2020 (compared with just over 25% for euro area manufacturing exports), while the foreign services content accounted for almost 15% (5 pp more than in the euro area).

— Meanwhile, recent events could also affect the tourism sector, where Spain records a wide trade surplus both with the rest of the world and with the United States[8] (4.2% and 0.3%[9] of GDP, respectively, in 2024).

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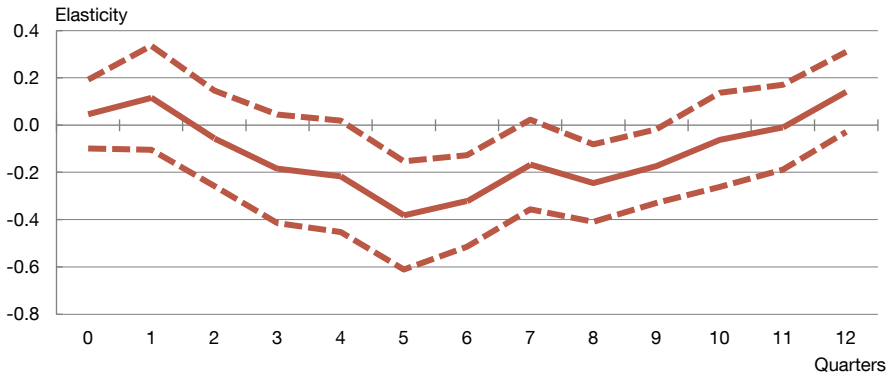
7 In the same vein, various studies show that in response to tariffs, exporting firms' prices do not tend to undergo significant changes. See, for example, Amiti, Redding and Weinstein (2019) and Fajgelbaum, Goldberg, Kennedy and Khandelwal (2020). However, Cavallo, Gopinath, Neiman and Tang (2021) analyse the impact of tariffs imposed by China in 2018 and find that US exporting firms did in fact respond by adjusting their prices. This adjustment is attributable to the tariffs targeting undifferentiated products.

8 According to the Inbound Tourism Survey (Frontur) and the Tourism Expenditure Survey (Egatur), in 2024 over 4 million US tourists visited Spain (the highest figure since 1999, making the United States the main non-European country providing tourists for Spain). Moreover, US tourists' average expenditure per person and average stay in Spain are higher and longer than those of the average tourist in Spain.

9 Spain's trade surplus in non-travel services with the United States is even greater (0.4%) (Chart 4.1.a). According to balance of payments data, non-travel services accounted for 68% of the total services exported to the United States in 2024. Business services accounted for almost 40% of non-travel services exports to the United States, followed by telecommunication and IT services (23% of the total) and transport services (10% of the total).

Chart 4.4
Tourism flows to Spain are influenced by exchange rate dynamics

4.4.a Response of overnight stays in hotels by foreign tourists in Spain to an appreciation of the exchange rate (a)



SOURCES: ECB and Banco de España.

a Impact of a 1% appreciation of the exchange rate against the US dollar. Local Projections methodology with 90% confidence bands.

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- First, insofar as such events may ultimately have an adverse impact on world economic activity (see Section 4.1.3) and, therefore, on global demand for travel services.

- Second, because, as a result mainly of the current tariff war, the euro has appreciated considerably against the US dollar recently (7.5% in the year to date), and also in nominal effective terms (2% in the same period). This could represent a slight loss of competitiveness for the Spanish tourism sector, which would adversely affect foreign tourist arrivals to Spain or their level of expenditure during their stay. Indeed, the empirical evidence suggests that an appreciation of the euro tends to have a negative impact, albeit with a lag of approximately a year and a half, on the volume of overnight stays at hotels by foreign tourists in Spain. This impact is particularly acute in the case of US tourists (Chart 4.4).

4.1.3 Macroeconomic impact of different hypothetical trade scenarios

This section tentatively illustrates the potential impact that different hypothetical trade scenarios might have on GDP and inflation in the United States, the euro area, Spain and China.

— Two multi-country general equilibrium models are used to do this:

- the National Institute Global Econometric Model (NiGEM), which includes most of the planet's economies, but lacks a sectoral breakdown, and

- the Banco de España's multi-sectoral model,[10] which considers a smaller number of countries or blocs (specifically, eight countries/regions in the exercises described below),

10 Aguilar, Domínguez-Díaz, Gallegos and Quintana (2025).

but with a detailed sectoral breakdown, allowing the role played by intermediate consumption and production chains to be incorporated into the analysis.

— Four alternative trade scenarios are considered:[11]

- Scenario 1 ("Universal 10%" scenario): a 10% tariff is placed on all US goods imports from the rest of the world, except those related to energy products. This scenario does not differ significantly from the circumstances prevailing at the cut-off date for this report (apart from the 145% tariff on Chinese exports to the United States), during the 90-day suspension period of the "reciprocal tariffs" announced on 2 April.

- Scenario 2 ("2 April" scenario): this scenario considers the "reciprocal tariffs" announced by the US Administration on 2 April. Thus, for example, tariffs are set at 54% for imports from China, 20% for those from the EU and around 50% for those from the rest of South-East Asia. Note that, under this scenario, European/Spanish exports lose a considerable part of their competitiveness in the US market relative to domestic producers but become more competitive relative to Chinese and South-East Asian exporters, who face higher reciprocal tariffs.

- Scenario 3 ("With countermeasures" scenario): on top of Scenario 2, it is assumed that, in response to the tariffs imposed by the United States, all economies raise their tariffs on US exports symmetrically.

- Scenario 4 ("US-China trade war" scenario): added to Scenario 3 is an escalation in the tariff war between the United States and China, resulting in a 145% reciprocal tariff between these two economies only.

— In addition, two alternative scenarios are simulated separately using NiGEM, specifically a sharp increase in uncertainty and a marked deterioration in global financial conditions, as occurred in the first half of April.[12] Both these factors may amplify the adverse impact of the trade war on activity.

- "Financial amplification channel" scenario: calibrated on the basis of the increase observed between 2 and 8 April in sovereign debt yields and corporate spreads, and the losses recorded in the main stock indexes over the same period. As mentioned in Section 2.2.2, the tightening of financial conditions during this episode of turbulence was more pronounced in the United States than in other advanced and emerging market economies.

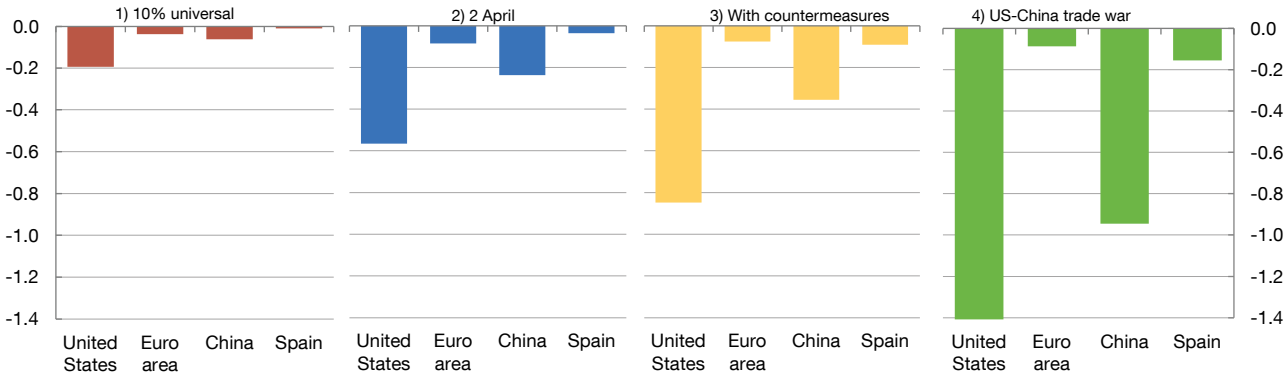
11 These alternative scenarios depart from a baseline scenario under which (i) tariffs remain at their pre-March 2025 level, (ii) financial conditions do not tighten and (iii) economic agents do not change their consumption or investment decisions in response to growing uncertainty.

12 These amplification scenarios are formulated independently. In reality, however, the financial channel and the confidence/uncertainty channel are frequently interrelated. Thus, an increase in uncertainty not only affects economic agents' consumption and investment decisions but also tends to cause a financial market reaction. Likewise, a negative financial shock on the capital markets may adversely affect economic agents' confidence and their consumption and investment decisions.

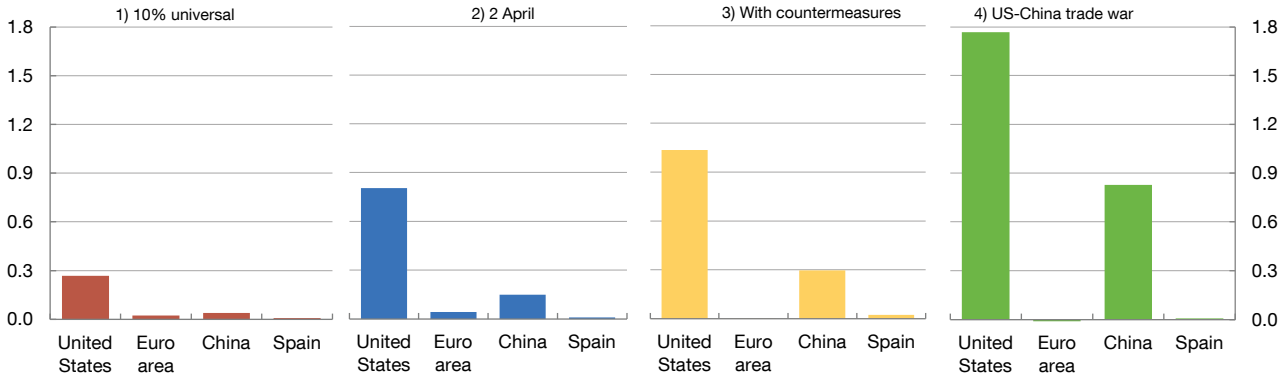
Chart 4.5

The increase in tariffs significantly reduces growth and drives up inflation in the United States and China, albeit less so in the latter. The effect on Spain and the euro area is much smaller (a)

4.5.a Impact on GDP (percentage deviation from baseline)



4.5.b Impact on inflation rate (percentage deviation from baseline)



SOURCE: Banco de España, using NiGEM and the multi-sectoral model (Aguilar, Domínguez-Díaz, Gallegos and Quintana, 2025).

a The impact on GDP and inflation is the average of the impact of the two models considered during the three years following the tariff hike announcement.

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- "Uncertainty amplification channel" scenario: calibrated on the basis of the increase observed in April in the economic policy uncertainty index in the United States and in Europe.

The following conclusions can be drawn from these simulations.

— Under the four trade scenarios considered, the tariff increase puts downward pressure on global economic activity (Chart 4.5.a).[13] Generally, the higher the level of tariffs the greater the pressure. Thus, all else being equal, the adverse impact is larger when the countries affected by US tariffs retaliate.

— The negative impact on activity of the trade war is significantly greater in the United States than in the other economies considered, except in the event of a trade war between the

13 The charts show the average impact of the two models considered during the first three years following approval of the tariffs.

United States and China, in which case China also experiences a significant GDP contraction. In contrast, the impact on euro area and Spanish GDP is relatively limited under Scenarios 1-4.

— The imposition of tariffs by the United States leads to a decline in US imports and, given their size, in world trade. In particular, under the "2 April" scenario, this factor would explain around half of the deterioration in the euro area's trade balance and one-third of that in Spain's. At the same time, the models show a shift in trade between countries outside the United States. Thus, exports from Spain and the euro area to China slow, while European imports from China increase, partly as a result of the depreciation of the renminbi against the euro.

— In any case, for Spain and the euro area, the negative impact on GDP of a tightening in financial conditions or increase in uncertainty, caused (as at the beginning of April) by a trade war escalation, would be greater than the decline in activity caused by the tariff increase, when this shock is transmitted solely through the trade channel (Charts 4.5.a and 4.6.a). This result highlights the importance of shock amplification channels operating through financial markets or economic agents' confidence/certainty.

— Turning to prices, the United States again suffers a more negative impact under the four trade scenarios considered, in the form of higher inflationary pressures (Chart 4.5.b). In the euro area and Spain, by contrast, these upward pressures (mainly stemming from depreciation of the euro)[14] are relatively limited. This is essentially a consequence of two factors that lead to downward pressure on prices: the lower levels of activity and trade diversion effects, which shift some of the exports that other countries cease to make to the United States towards Spain and the euro area.

— In any event, when the trade shock is amplified through the financial or the uncertainty channel, deflationary pressures dominate in the euro area and in the Spanish economy, while the rise in inflation is partially mitigated in the United States and China (Chart 4.6.b).

From a more disaggregated perspective, the increase in US tariffs affects each country's economic sectors differently, through direct, indirect and general equilibrium channels.

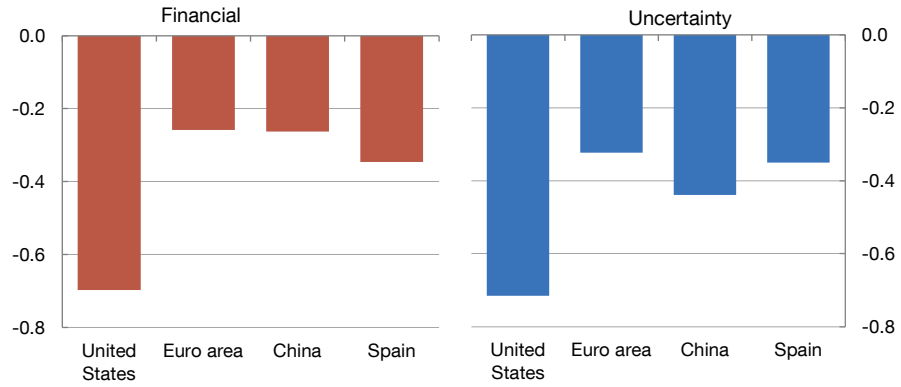
— Multi-sectoral models that explicitly incorporate the production of intermediate goods make it possible to distinguish between the direct effects (on exports to the United States), the indirect effects (reflecting second round effects, through production chains, stemming from the fall in US demand) and the general equilibrium effects (which include the economic effects following the relative price adjustment).

14 Although depreciation of the euro is a result common to all the trade channel simulations and in line with the historical regularities observed in other financial turbulence episodes, it should be noted that one of the most unusual aspects of the recent episode of international financial market turbulence (following the announcement by the United States of reciprocal tariffs), was the depreciation of the dollar against the world's main currencies. This would essentially reflect the operation of the financial/confidence amplification channels, which are also discussed in this section.

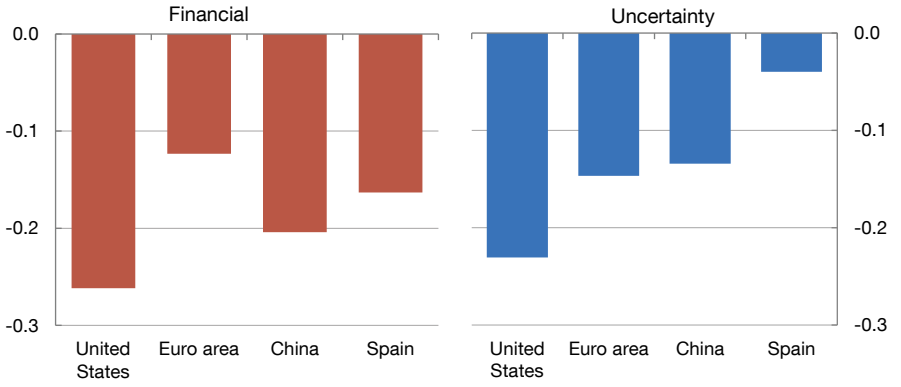
Chart 4.6

The financial and uncertainty channels significantly reduce GDP and inflation in all countries (a)

4.6.a Impact on GDP (percentage deviation from the baseline)



4.6.b Impact on the inflation rate (percentage deviation from the baseline)



SOURCE: Banco de España, using NiGEM.

a The impact on GDP and inflation is the average of the impact during the three years following the tariff hike announcement.

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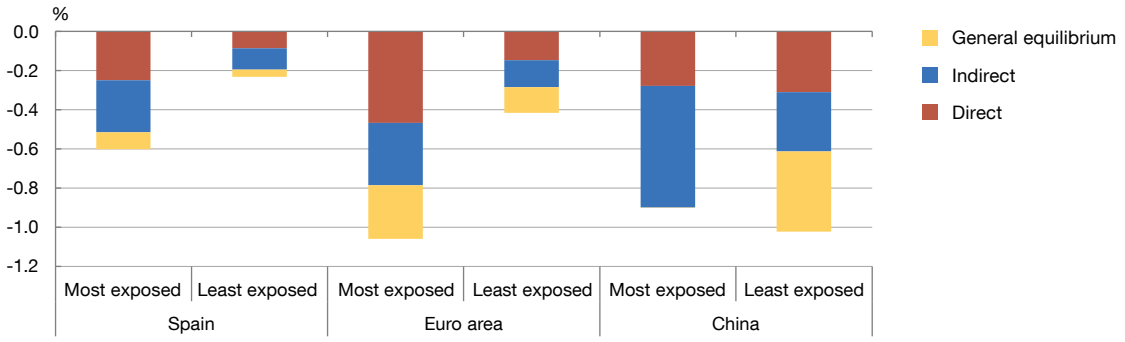
— The simulations performed with these models confirm, in line with Section 4.1.2, that the sectors most affected under the "2 April scenario" are pharmaceuticals (with falls in output of 3% in the euro area and 1.5% in Spain), chemicals (with falls of 0.9% in the euro area and 0.5% in Spain) and basic metals (with falls of 0.8% in the euro area and 0.5% in Spain).

— These sectors, which suffer the greatest direct effects, reduce their demand for domestic inputs and for those produced in third countries, thus spreading the economic impact of tariffs along production chains. This indirect channel has a larger impact on sectors located at the initial stages of the production chain, such as basic metals, as they are more exposed to changes in the demand for inputs from other sectors (Chart 4.7). Conversely, this amplifying effect tends to be smaller in sectors at the end of the production chain, such as pharmaceuticals. In the services sector, the industries most exposed to indirect channels operating through value chains are those that provide intermediate services for goods exports, i.e. those whose value added is incorporated into such exports. This is the case, for example, of transport and professional services.

Chart 4.7

Under the 2 April scenario, industrial output would be unevenly affected depending on each industrial sector's degree of exposure, with greater falls in the euro area and in China than in Spain (a)

4.7.a Fall in output in different industrial sectors, by transmission channel



SOURCE: Banco de España.

a The most exposed industrial sectors are: chemicals and chemical products, pharmaceuticals, basic metals, electrical equipment and machinery. All the other industrial sectors are included within the least exposed sectors.

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— The general equilibrium effects, which reflect the consequences of price adjustments, also affect different productive sectors asymmetrically. In general, the impact of these general equilibrium effects on a particular sector depends, among other factors, on its relative position in value chains, its degree of international exposure and its ability to adjust prices/margins.

4.1.4 Higher defence and infrastructure spending in the European Union: factors that could shape its macroeconomic impact

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 security, defence and global order, the need for higher defence spending in the EU has become increasingly important to bolstering European security autonomy.

— Examples of this include EU-wide initiatives, such as the Permanent Structured Cooperation projects, the European Defence Fund, the European Defence Industry Reinforcement through common Procurement Act, the European Defence Industrial Strategy and, more recently, the ReArm Europe Plan/Readiness 2030. The primary aim of all of these is to enhance the EU's military capabilities and strengthen the European defence industry.

— This latter plan is mainly implemented by temporarily relaxing the fiscal rules framework to accommodate an increase in defence spending, which, according to the European Commission, could create nearly €650 billion of fiscal space over four years. It also functions via a new European loan instrument, dubbed Security Action for Europe (SAFE), with a financing capacity of up to €150 billion.

— At the cut-off date for this report, 16 Member States have decided to make a formal request to the European Commission to activate the national escape clause to accommodate the increased defence spending: Belgium, Bulgaria, Czech Republic, Denmark, Germany, Estonia, Greece, Croatia, Latvia, Lithuania, Hungary, Poland, Portugal, Slovenia, Slovakia and Finland. Of the other main EU economies, France and Italy have announced that they may decline to activate this clause, while Spain and the Netherlands have not yet reached a definitive decision.

— Moreover, aside from the aforementioned initiatives, discussions are currently under way on alternative financing proposals. These include the introduction of special investment vehicles for joint acquisitions, mixed grant and loan mechanisms similar to the NGEU programme, and the creation of a European Defence Mechanism. This new European institution, inspired by the European Stability Mechanism, would promote strategic investments, leverage economies of scale and build a single European market for the defence industry.[15]

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.

— Specifically, the agreement introduces a partial reform of the "debt brake" (a constitutional rule in Germany that limits the federal government's annual borrowing to 0.35% of GDP), exempting from it all defence spending above 1% of GDP. In addition, it lifts the borrowing restriction for the regions (Länder), raising their limit in line with the federal government's ratio.

— Furthermore, a special fund of €500 billion is created that will last twelve years and is intended to modernise infrastructure and productive capital. A portion of the fund, up to €100 billion, is ring-fenced for projects related to the green transition.

In line with these developments at the European level, the Spanish Government presented 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.

— As highlighted in Section 3.6.3, this plan includes changing the budget appropriations envisaged in the 2023 State Budget and reallocating funds initially assigned to the Recovery and Resilience Facility to finance various security and defence-related projects.

— Specifically, the funds associated with this plan (around €10,471 million) will be allocated to: (i) improving the working conditions, training and equipment of the armed forces; (ii)

15 Wolff, Steinbach and Zettelmeyer (2025).

developing and acquiring new telecommunications and cyber security technologies; (iii) manufacturing or purchasing new defence and deterrence instruments; (iv) bolstering the armed forces to handle emergencies and natural disasters; and (v) enhancing the security conditions of peace missions currently undertaken by Spain abroad.

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.

— Regarding defence spending, the academic literature suggests that increased military expenditure could have a multiplier effect on GDP growth, ranging between 0.6 and 1.5 over a horizon of two to four years,[16] while its impact on consumer goods and services inflation would be relatively limited. This is especially so if the fiscal impulse is more concentrated on government investment, which has a greater positive impact on supply in relative terms.

— However, this same literature indicates that these impacts are heavily influenced by, among other factors, the timing of the expenditure, how it is financed and its composition and import content. Specifically, the impact of increased defence spending on activity would be more positive when there is some underutilised productive capacity in the economy – which can be redirected towards new production needs without creating bottlenecks elsewhere – and when it is financed with debt, largely allocated to domestically produced goods and services and concentrated on research and development.[17] In this regard, it is noteworthy that government spending on defence in the EU and Spain allocates more resources to personnel costs compared to other global powers, with less going to research and development investment (Chart 4.8).

— In any case, as well as the volume and composition of defence spending that could take place in the EU in the years ahead, another key factor from the standpoint of its efficiency and potential impact is the degree of European coordination achieved in in all related matters (e.g. its provision, financing and planning). This is particularly relevant given defence and security are considered to be a public good in Europe.[18]

— Two aspects of the increased public spending in Germany are worth noting. First, the size of the announced fiscal impulse, if fully implemented, would be considerable. For instance, the infrastructure fund alone would provide an annual boost of nearly 1% of GDP each year. This initiative could, therefore, have a noticeable upward impact on activity and prices in Germany and the euro area as a whole. However, once again, the range of possible fiscal multipliers associated with this increased spending is very broad and largely depends on the same factors mentioned above for defence spending. For example, Alloza, Burriel and

16 See, for example, Antolín-Díaz and Surico (2022), Nakamura and Steinsson (2014), Ramey (2011) and Ramey and Zubairy (2018).

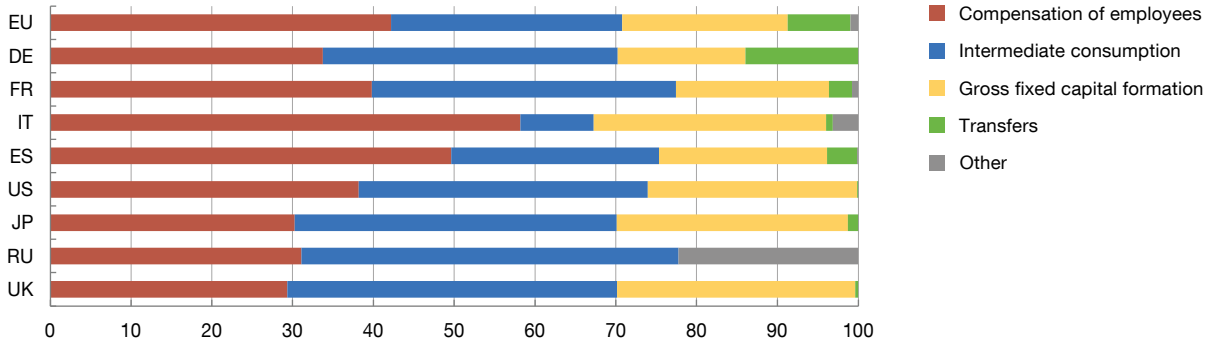
17 See, for example, Dupor and Guerrero (2017) or Box 16, "EU public goods and Military spending", in Ioannou, Pérez et al. (2023).

18 López Vicente, Rodríguez Vives and Rojas (2024).

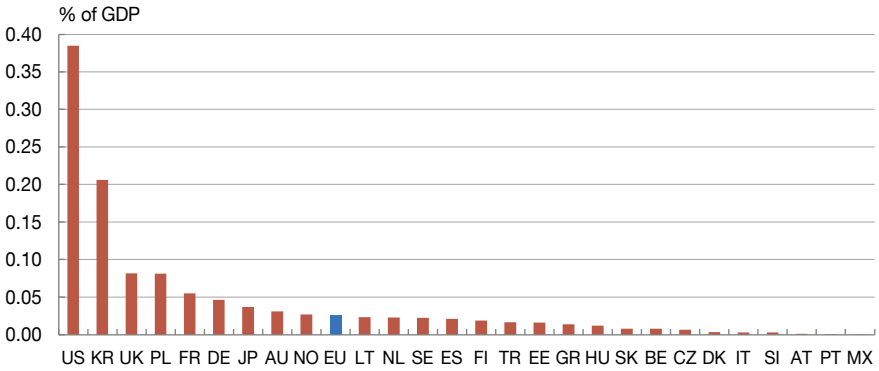
Chart 4.8

Classification of defence spending, by expenditure category

4.8.a Government spending on defence, by heading (a)



4.8.b Budgeted government spending on defence R&D (b)



SOURCE: Banco de España, drawing on Eurostat, IMF and OECD data.

a The data in the chart refer to 2023, except for Russia (2019) and the United Kingdom (2022). "Transfers" includes capital transfers and other current transfers. "Other" refers to the other accounting headings and, for Russia, also includes investment and transfers.
b The data in the chart refer to 2023, except for the United Kingdom (2022).

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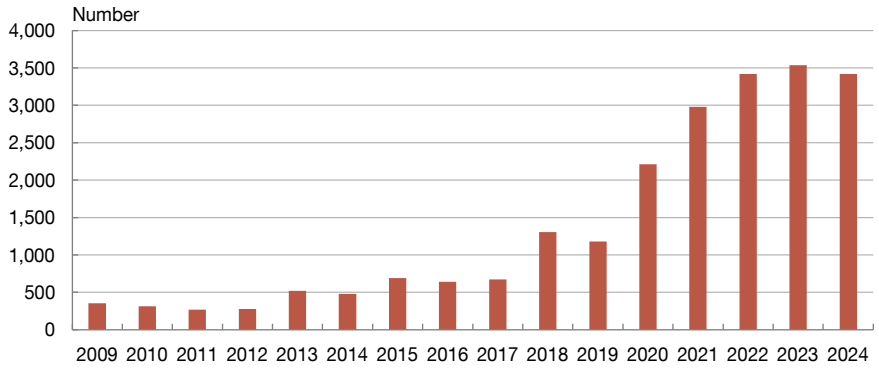
Pérez (2019) estimate that the multiplier effect on the GDP of the main euro area economies of a fiscal impulse in Germany (the spillover effect) would range from 0.2 to 0.6 over one to three years.

— Secondly, it is noteworthy that when this fiscal plan was announced in Germany, there was an increase in the yield of German sovereign debt (although the prices of credit default swaps remained relatively stable)[19] and in the cost of debt for other European countries (see Section 2.2.2), which could mitigate the positive spillover effects on growth of the fiscal stimulus. Furthermore, given the central role that German bonds play in European debt markets, a substantial increase in supply could potentially affect the functioning of these markets themselves.

19 Petroulakis and Saidi (2025).

Chart 4.9
Trade and investment restrictions

4.9.a Number of new measures



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SOURCE: Global Trade Alert.

4.1.5 Potential long-term implications of the current international context

The globalisation of economic activity around the world 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.[20] 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 ...

— First, economic and food security considerations, along with security and defence ones, have increasingly influenced economic policy decisions, especially since the pandemic. This has led many governments to adopt measures aimed at reducing trade dependencies, promoting domestic production of goods considered "strategic" and imposing stricter controls on foreign direct investment inflows (Chart 4.9).[21] While these public interventions can be justified on strategic grounds in certain cases, they could also lead to unintended adverse effects. Such actions have the potential to reshape global trade and financial flows in the medium and long term and may introduce significant distortions in both international and domestic economic activity.

— Second, the shifting economic power of different countries and regions around the globe in recent decades[22] is bringing forth new multilateral structures as alternatives to those of the "Bretton Woods" system. This shift is also giving rise to questions surrounding the governance rules and decision-making processes within these structures. An example is

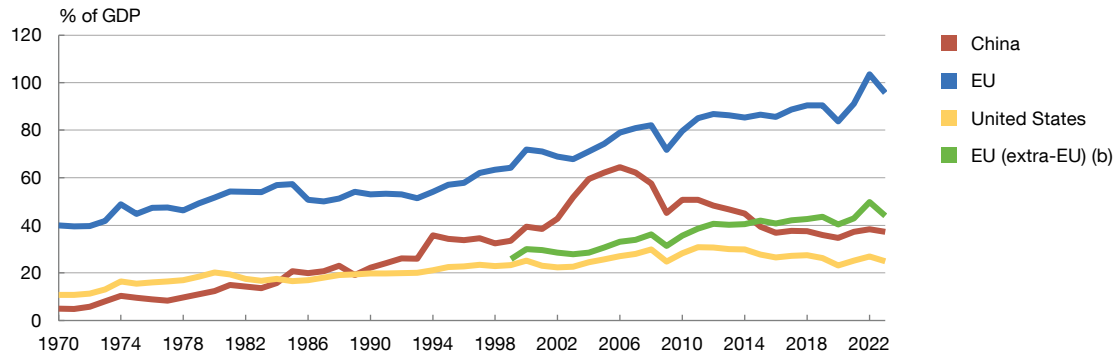
20 See, for example, Wolf (2005) and Bhagwati (2005).

21 Ioannou, Pérez et al. (2023) and Attinassi, Mancini et al. (2024).

22 According to IMF data, as measured in purchasing power parity, emerging market and developing economies have grown from a third of global GDP in 1990 to above 60% in 2024.

Chart 4.10
Trade openness of the main economies

4.10.a Trade openness (a)



SOURCES: World Bank and Eurostat.

a Calculated as the sum of exports and imports of goods and services as a percentage of GDP.
b Calculated as the sum of exports and imports of goods and services as a percentage of EU GDP vis-à-vis extra-EU countries.

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the BRICS association, which came into being as a result of the rise of new global players, such as China and India, and is driving a transition to a more multipolar economic system.

— Furthermore, there is increasing questioning of the rule-based multilateral system even within major advanced economies. One factor potentially driving this phenomenon is the perception among large segments of society that income and wealth inequality has significantly increased within these economies, despite the substantial reduction in inequality seen worldwide.[23] According to some narratives, this perceived increase is partly attributed to globalisation and the industrial outsourcing processes it entailed. Reflecting these trends, there is diminished support for multilateral integration and increased political fragmentation and polarisation within advanced countries, including some in the euro area (see Box 9).

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

— The EU economies, including Spain, are highly interconnected with the rest of the world through trade, financial and migratory flows, making them particularly vulnerable to commercial and geopolitical disruptions. In fact, the EU's trade openness surpasses that of other major global economies, such as the United States or China (Chart 4.10). In addition, the share of exports and imports in the EU's GDP has steadily increased since the global financial crisis, while it has slowed in the United States and significantly declined in China (the latter owing to its partial economic reorientation towards its domestic market).

23 Lang and Tavares (2023).

— While the European internal market helps mitigate EU countries' vulnerability to abrupt trade flow disruptions (given that a significant portion of Member States' external trade is conducted among themselves) they still have significant trade dependencies with the rest of the world, particularly with the United States and China (Chart 4.11). Regarding China, for example, the following should be noted.

- While China's share in EU imports of technologically advanced products (a set of goods produced by high-tech industries, such as semiconductors, information technology-related goods and pharmaceuticals) has not fallen appreciably in recent years, that of the United States has (Chart 4.12).

- Similarly, since 2017 China's share in EU imports of technological goods linked to the green transition have grown significantly, while its share in US imports has held virtually stable (Chart 4.12).

- There are limited possibilities for trade diversification of the "critical and strategic" raw materials (a group of minerals characterised by their significant economic value and the fact that reserves are concentrated in a small number of exporting countries). China is the largest global exporter of 34 of 51 resources of this type and is sometimes the only source of them.[24]

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.

— At the aggregate level, despite geopolitical and trade tensions in recent years, there has been no significant decrease in the degree of global trade integration. For instance, between 2017 and 2023, global trade openness (measured by the ratio of total trade flows to global GDP) remained relatively stable (Chart 4.13). It is noteworthy that global trade in services, which grew at a similar pace to that of goods at the beginning of the century, has accelerated over the last decade and is now increasing faster.[25]

— Nonetheless, there are major realignments of the bilateral trade flows between some of the world's largest economies.

- A clear example is the marked decline in China's share of US goods imports since the trade war between the two countries during President Trump's first term (Chart 4.14), a decline that, as yet, has not spread to trade flows between China and the EU.

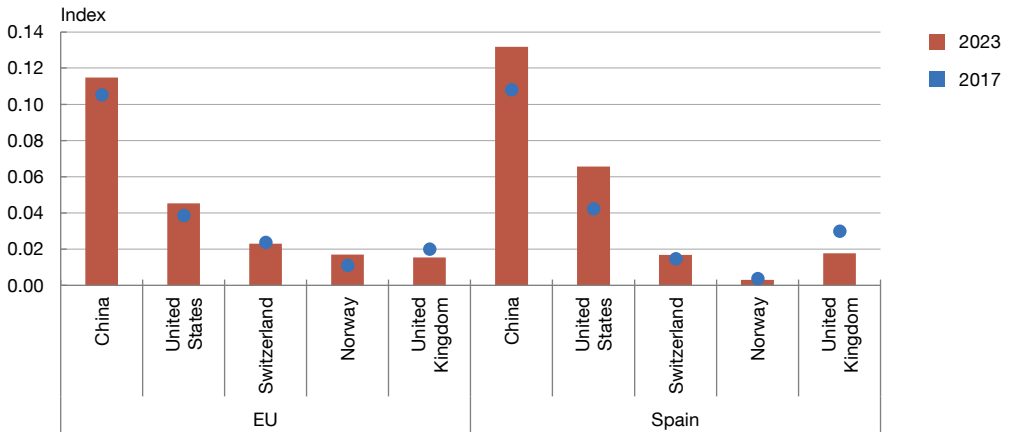
24 European Commission (2023).

25 This acceleration comes amid the liberalisation of services trade through the development of the General Agreement on Trade in Services, established in 1995 by the World Trade Organization (WTO), and other bilateral agreements, as well as the sector's deregulation. Furthermore, technological changes, such as automation and digitalisation, have facilitated the expansion of e-commerce, global platforms and the offshoring of professional and financial services.

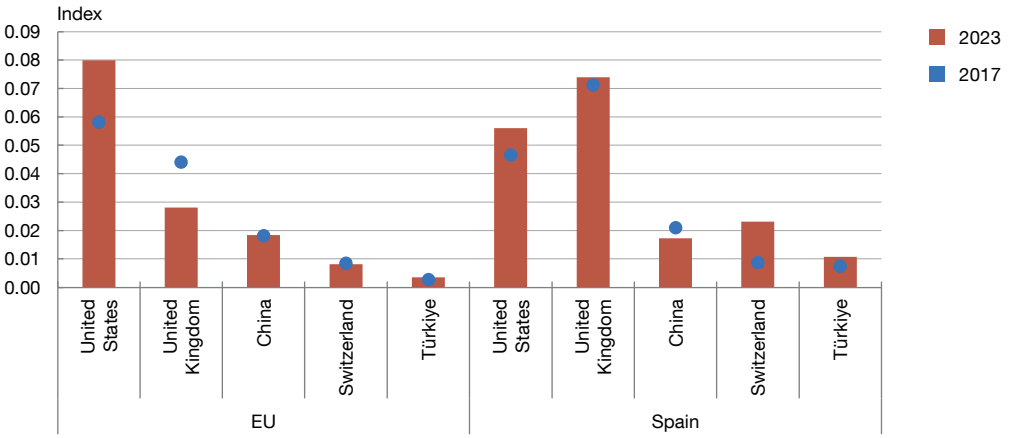
Chart 4.11

Bilateral concentration of trade flows of goods

4.11.a Concentration of imports (a)



4.11.b Concentration of exports



SOURCE: Banco de España drawing on CEPII-BACI data.

a For each product, identified using the six-digit HS classification, the concentration of extra-EU imports (exports) is measured using the Herfindahl-Hirschman index as the sum of the squares of the product's market shares in all its destination markets. Higher index values denote more concentrated imports (exports). Concentration indices at product level are aggregated at importing (exporting) country level, weighted by the value of imports (exports) of each product as a share of the country's total imports (exports). Lastly, the concentration index is decomposed bilaterally, allocating each product to the biggest supplier (destination market). Intuitively, high bilateral concentration values suggest that the trade partner in question is the biggest supplier (destination market) for many of the imported (exported) products of a country, that imports (exports) of such products are highly concentrated in the supplier (destination market) and that such products account for a significant share of the country's imports (exports). For more details see Balteanu et al. (2025).

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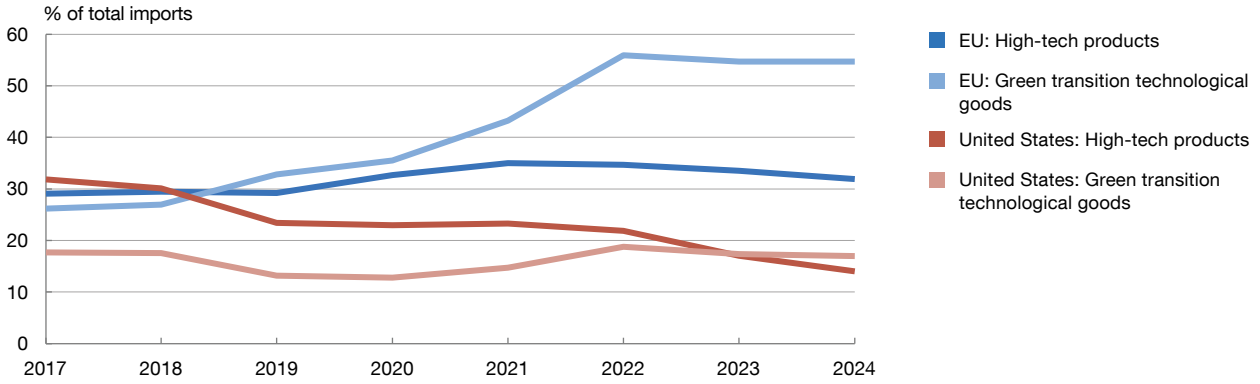
- Another example is the sharp drop in European imports of energy products from Russia owing to Russia's invasion of Ukraine and the sanctions imposed by the EU in response (Charts 4.15.a and 4.15.b).

- The United Kingdom's exit from the EU is a further instance of how such geopolitical disruptions can significantly alter the composition and magnitude of international trade flows. Springford (2024) suggests that had UK goods exports to the EU grown in line with those of the Member States since end-2020, they would have been 27% higher in

Chart 4.12
Share of imports from China in total imports of green-tech and high-tech products

4.12.a Share of imports from China in total imports: green-tech and high-tech products (a)



SOURCE: Banco de España drawing on Eurostat data.

a High-tech products and technological products for the green transition are identified based on the classification in Balteanu et al. (2025).

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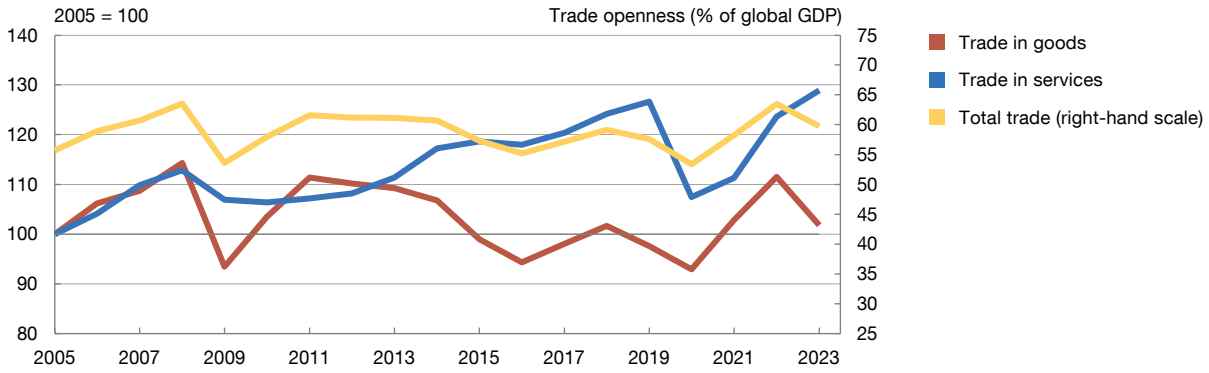
Chart 4.13
Global trade in goods and services (2005-2023)

4.13.a Global trade and global GDP



SOURCES: Federal Reserve Bank of St. Louis and UNCTAD.
NOTE: Trade in goods and trade in services are the sum of world exports as a percentage of GDP. Trade openness is the sum of trade in goods and trade in services.

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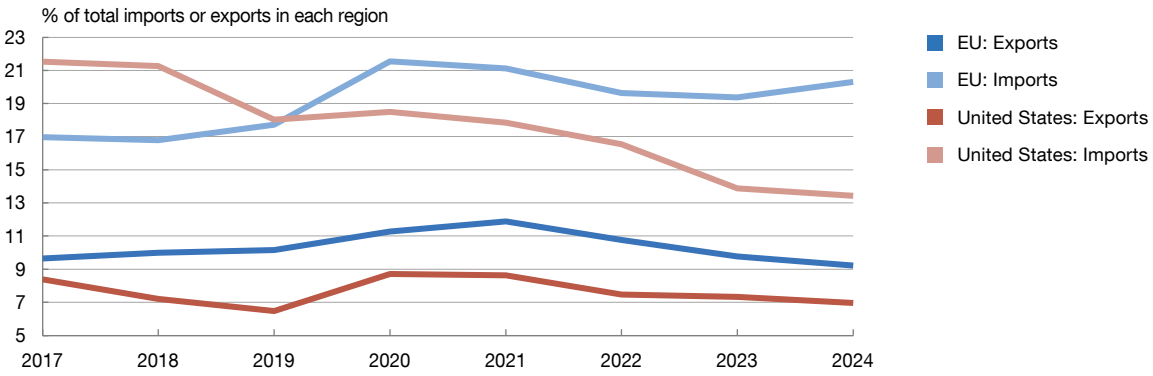
2023 Q3.[26] Additionally, if, during the same period, British exports of services had grown in line with those of similar advanced economies, they would have been 11% above the levels recorded. In contrast to these counterfactual trends, the UK's exports to the EU have significantly declined since Brexit.

26 Other studies confirm the negative impact on UK trade in goods with the EU, such as Lewis and Tolva (2024), who estimate a drop of 17%.

Chart 4.14
US and EU trade with China

4.14.a Share of US and EU trade flows with China (a)



SOURCES: Trade Data Monitor and Eurostat.

a For the EU, the shares are expressed as a percentage of extra-EU trade flows.

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— This recomposition and fragmentation of international trade flows is likely to ramp up significantly in the future should some of the risk scenarios that can be discerned in the current environment of high tariff tensions materialise. In particular, in the medium term, in response to higher and highly heterogeneous tariffs between countries, goods trade flows would suffer and the aforementioned trends in trade redirection, increased regionalisation and reduced complexity of value chains would intensify. All of this will foreseeably have a notable negative impact on global economic activity and simultaneously exert greater inflationary pressures in the medium term, while reducing the global economy's resilience to adverse shocks.

Furthermore, doubts have arisen more recently regarding the pivotal role of the US dollar in the international monetary and financial system at present. 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.

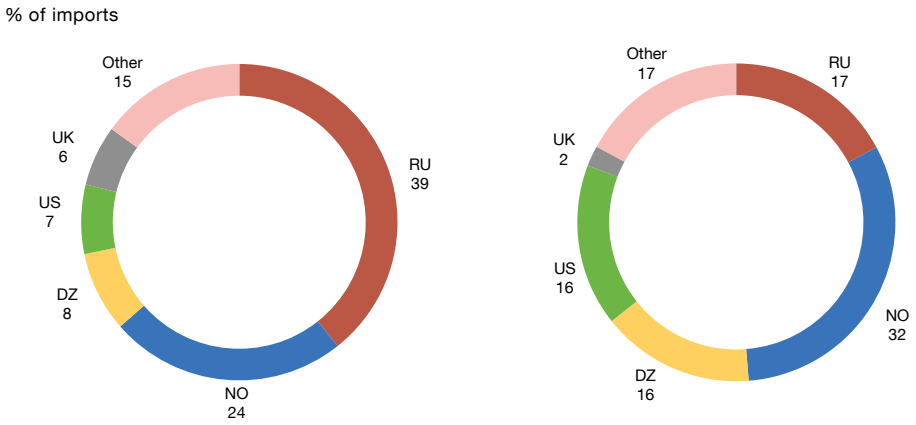
— Under the current international monetary and financial system, which emerged from the Bretton Woods conference, the dollar serves as the global reserve currency. This role was further strengthened when the gold standard and the fixed exchange rate system were abandoned in the early 1970s. In this context, although the economic and commercial sway of the United States has fallen in recent decades and the international role of other alternative reserve currencies has increased (partly owing to efforts to internationalise the Chinese renminbi), the dollar has scarcely seen its extraordinary leadership in global trade and finance diminish (Chart 4.16).[27]

27 While the United States accounts for approximately 25% of global GDP and 11% of world trade, the dollar holds a 50% share of global trade invoicing, 57% of international reserves and 88% of global financial transactions.

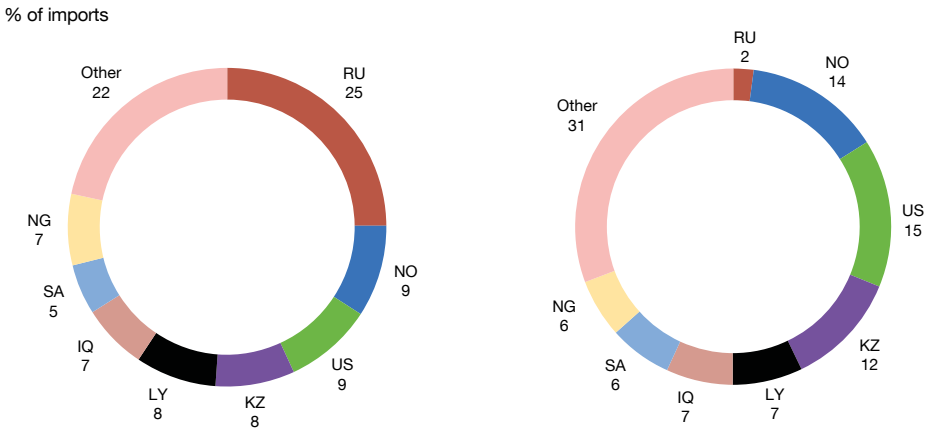
Chart 4.15

Main suppliers of natural gas and oil to the EU in 2021 and 2024 Q4

4.15.a Main suppliers of natural gas to the EU in 2021 and 2024 Q4



4.15.b Main suppliers of crude petroleum oils to the EU in 2021 and 2024 Q4



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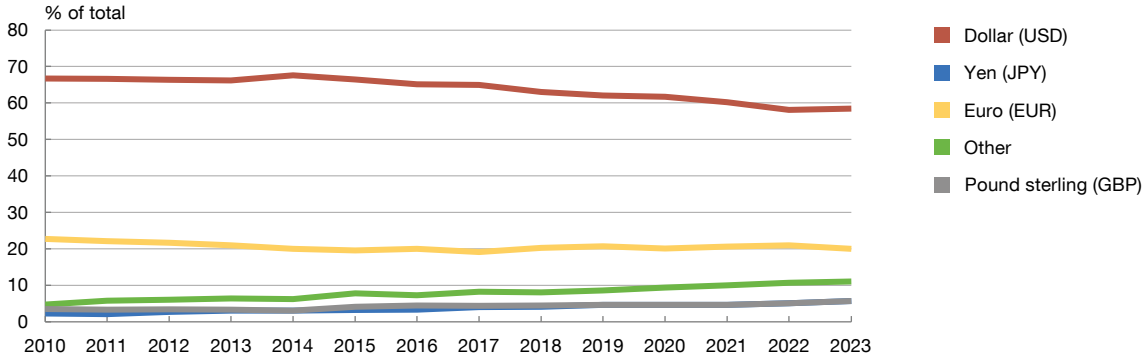
SOURCE: Banco de España drawing on data from the European Commission.

— The dollar's position as a global reserve currency results in a high and structural demand for dollars from private agents and the government sector globally. Among other implications, this strong demand for dollars for financial reasons leads to a higher valuation of the dollar against other international currencies,[28] allows the United States to finance its borrowing at a lower cost on the capital markets and, unlike other world economies, prevents a high and growing external deficit from translating into a weaker dollar in the future (or if not entirely prevented, to a much lesser extent than is usual in other countries).

— Additionally, the dollar has historically served as a safe-haven currency during times of instability, a role supported by the size and traditional stability of the US economy.

28 All else being equal, a strong dollar makes imports cheaper and exports more expensive, tipping the balance of trade towards a deficit with the rest of the world.

Chart 4.16
International reserves by currency



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SOURCE: ECB.

— However, during the financial turmoil that began on 2 April 2025 following the announcement of potential tariff hikes by the US Administration, the dollar did not fulfil its usual role as a safe-haven asset. On the contrary, it depreciated significantly (see Section 2.2.2). This occurred in a context where, for some time, there have been efforts to reduce the dollar's value without compromising its role as a reserve currency or increasing the financing costs for the United States.[29]

— If the current tensions in international trade and geopolitical relations were to escalate and seriously call into question the dollar's role as a global reserve currency, the international financial system could suffer significantly (given that, at present, there are no alternative assets that could fulfil the role played by dollar-denominated assets) through multiple channels (for example, through potentially large capital outflows from the United States, among other impacts).[30] Undoubtedly, this would also have a notable adverse impact on the real economy, both in the United States and globally.

29 In particular, the initiative known as the Mar-a-Lago Accord stands out. This was proposed in November 2024 by Stephen Miran (current Chair of the US Council of Economic Advisers) in the article "A User's Guide to Restructuring the Global Trading System". The proposal includes a series of measures to correct the dollar's valuation and the US trade deficit, serving as a complement to the imposition of tariffs.

30 In June 2024 foreign holdings of US securities stood at $30.9 trillion, representing 33% of US government bonds, 27% of US corporate debt and 18% of US equities. See "Foreign Portfolio Holdings of U.S. Securities", US Department of the Treasury, April 2025.

4.2 The role of European policies

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.

— The outbreak of the COVID-19 pandemic and the war in Ukraine – two adverse shocks of an unprecedented nature and scale in many decades – evidenced that a key aspect of the economic policy response (beyond the measures deployed domestically by the various national authorities) was to move decisively towards a stronger and more united Europe, using new instruments such as the NGEU, SURE and REPowerEU programmes.

— At the current juncture, amid heightened uncertainty over economic policies and geopolitical and trade tensions, and with major challenges ahead (such as the green and digital transitions), the European policy response must continue to stay on the same course and remain highly ambitious.

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.

— The EU must continue to play a central role globally in defending an open rules-based multilateral framework. From its creation, the EU has been a driving force behind global trade and financial openness, which has, moreover, proven to be highly beneficial for it. A significant setback in this global integration of flows of goods, services and people, owing to a range of geopolitical considerations, would jeopardise the mutual benefits and the increase in the economy's potential growth achieved in recent decades.

— At the same time, the EU should strengthen and diversify its international alliances and exposures to increase its strategic autonomy. Some recent steps in this direction, which should remain a priority, include, for instance, the modernisation of the bilateral trade agreements entered into with Mexico in January 2025 and Chile in September 2024.[31] Also, the negotiations for the EU-Mercosur agreement (a customs union comprising Argentina, Brazil, Paraguay, Uruguay and Bolivia), were successfully finalised in December 2024. This agreement, if ratified, would create a free-trade area for over 700 million people and could lead to an appreciable increase in trade flows between the two areas.[32] Among other aspects, it could also help to reduce many European economies' heavy dependence on

31 See the agreements entered into with Mexico and with Chile. In addition, the EU is currently involved in a negotiation process with India to try to reach a free-trade agreement.

32 See, for example, Timini and Viani (2022) and Berganza, Campos, Estevadeordal, Talvi and Timini (2025).

China in the sourcing of various critical raw materials, of which the Mercosur countries are major producers.

On the domestic front, the challenges are significant. Here the EU must rapidly implement an ambitious agenda of structural reforms aiming to foster greater integration, dynamism, resilience and competitiveness among the European economies.[33] The EU should press forward in the following areas, among others:

— Full integration of the Single Market in its various facets. Among other factors, this integration is limited by burdensome regulations and red tape, which are not only excessive and could be simplified, but are also often fragmented across borders. A larger and less fragmented market would help European firms reach an optimal scale to successfully compete globally.

— Greater coordination among the various European policies and between these and national policies, reinforcing European public investment programmes. All this with the aim of helping to achieve, as efficiently as possible, the common goals and ensure the proper functioning of the Single Market – in particular, with rules on non-distorting State aid.

— Improved channelling of aggregate savings in the EU towards private investment projects, through both bank financing – for instance, revitalising the securitisation market with the creation of a European securitisation platform – and the capital markets (see Box 10). This is particularly important in key areas with significant investment requirements, such as infrastructure, energy and defence, where public investment can only cover a small portion of the existing needs. In this connection, a well-known shortcoming of the EU's economic environment is European firms' heavy dependence on bank financing and the small role played by venture capital in the development of innovative firms and start-ups, which are essential to boost new technologies and increase productivity.

— Holistic review and, if necessary, streamlining, of the banking system's regulatory and supervisory framework. In general, it is believed that the regulatory framework for the banking industry in Europe may be overly complex. This puts a strain on the supervisory function, hampers financial institutions' operation and could fragment the market. Without reducing the regulatory requirements that ensure the financial stability and strength of the banking system (an asset which must be protected), an in-depth assessment should be carried out to try to identify whether the current regulatory and supervisory framework can be simplified and made more stable, predictable and efficient.[34]

— A digital euro. In view of the growing digitalisation of economic activity and the use of money, it is essential for the Eurosystem to develop a digital currency. A digital euro would provide Europeans with a trustworthy and secure digital payment system (as it is backed by

33 See Letta (2024) and Draghi (2024) for a detailed description of many of the shortcomings that have hampered Europe's economy in recent decades.

34 Escrivá (2025).

a central bank) and would help to fulfil the goal of reinforcing the area's strategic autonomy (see Box 11).

The new European Commission has drawn up a multidisciplinary work agenda to address many of the EU's (external and internal) structural challenges. It is essential for all the actors involved in pushing this programme forward to be ambitious, open-minded and pragmatic in order to achieve substantial improvements in the current European economic governance framework.

— Over the last few months the Commission has drawn up an extensive work agenda based on relatively comprehensive analyses, such as those in Letta (2024) and Draghi (2024), and on a broad-based consensus on the main shortcomings that have hampered Europe's economy in recent decades.

— Many of the initiatives proposed by the Commission are part of the Competitiveness Compass, a strategic roadmap for addressing the factors hindering productivity growth in Europe. It establishes a general framework that prioritises three areas for action:

  • First, closing the productivity and innovation gap with other global powers, creating adequate market conditions with initiatives such as the EU Start-up and Scale-up strategy, and others aimed at specific sectors, such as artificial intelligence (AI). Following the development of supercomputers for conducting scientific experiments, AI factories are now being set up to conduct experiments for industrial purposes. There will be seven of these in Europe, one of which will be in Spain, at the Barcelona Supercomputing Center. The next step is to develop computing power for industrial applications, for example through the recently launched InvestAI initiative, to build at least four AI gigafactories in Europe.

  • Second, pressing forward in digitalisation and decarbonisation and fostering competitiveness, with the implementation of the Digital Compass and the Green Deal Industrial Plan to create an environment conducive to industrial innovation and clean technology. In this regard, the Commission's initiative introducing a Carbon Border Adjustment Mechanism would also help set a fair price for carbon emissions and accelerate the green transition.

  • Third, within the framework of the Economic Security Strategy, the European Commission plans to press ahead with its open strategic autonomy agenda. The aim is to enhance economic security and reduce external dependencies by protecting and diversifying supply chains, strengthening trade cooperation regarding technologies and essential raw materials for decarbonisation, and developing Europe's defence industry through a coordinated strategy between Member States. With regard to the latter, the Commission has recently published the *White Paper for European Defence,* which describes its strategy for boosting and funding Member States' defence capacities.

— In addition, the strategy identifies certain tools to facilitate action in those areas, such as significantly reducing burdensome administrative and regulatory procedures and single

market barriers, strengthening private financing, and improving European and domestic policy coordination. These tools are used in many initiatives, including most notably the first Omnibus Package for regulatory simplification, the Single Market Strategy, the proposed Savings and Investments Union (which, among other actions, integrates the Capital Markets Union and the Banking Union) and the Important Projects of Common European Interest programme.

— Irrespective of the foregoing initiatives, it is important to highlight that there is still room for improvement in some important dimensions. In particular, given the limited fiscal space of many European countries and the public investment needs in common areas such as defence, energy infrastructure and the green transition, and the support needed for certain industries considered strategic, it would be important to implement in the EU a permanent common funding instrument, applying the lessons learned from the temporary NGEU programme. Such an instrument would make it possible to finance large-scale projects to provide public goods at the European level, while simultaneously avoiding an excessive or uneven impact on national public finances and financing costs, and a deterioration of the single market.

4.3 Main challenges facing the Spanish economy

The Spanish economy has followed a robust growth profile in recent years (Section 3) 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 (Section 4.1).

— At end-2024 the Spanish economy's GDP stood 7.6% above its pre-pandemic level, a 2.9 pp wider gap than in the euro area.

— One of the factors that have contributed to the greater recent strength of economic activity in Spain, which has been relatively broad-based, is the very significant population increase (3.7% in cumulative terms in the period 2019-2024, well above the 1.5% observed in the euro area). Given the shrinking native population (which has fallen by 1.5% in the last five years), this population growth has been driven almost exclusively by particularly strong net migration flows to Spain.

— These migration flows, which cannot be interpreted as a purely exogenous phenomenon to the Spanish economy (see Box 6), have been key for meeting the growing demands of the Spanish labour market and raising the Spanish economy's growth capacity. In any event, taking into account this greater population increase in Spain, Spanish GDP per capita is estimated to have grown by 3.7% since end-2019, 0.3 pp more than the euro area average.

— Other factors that help to explain the greater dynamism of Spanish economic activity in recent years compared with the euro area include, for example,

- The greater relative importance of NGEU funds in Spain, which has resulted in notable growth in public investment, but not private investment.
- Public consumption growth, which, in cumulative terms, raised GDP growth by 3.6%, compared with 2.5% in the euro area.
- Spain's lower relative exposure to the war in Ukraine, especially on the energy front (partly given the Spanish economy's regasification capacity and the recent increase in the share of renewable energies in Spain's energy mix).
- The global process following the pandemic whereby economic activity – and households' consumption basket – has shifted from manufacturing to services, in which the Spanish economy has some significant comparative advantages that are not just limited to the tourism sector (for example, its high connectivity levels, which exceed the European average).

— Nevertheless, it should be noted that these factors are not unique to the Spanish economy and that they have also contributed to economic growth in other southern European

economies where services account for a notable share of the productive system. For example, since end-2019 Portugal and Greece have grown more than Spain in absolute terms (8.9% and 10.6%, respectively, compared with 7.6% in Spain) and, especially, in per capita terms (5.4% and 12.6%, respectively, compared with 3.7% in Spain),[35] showing similar or even more favourable productivity and manufacturing dynamics.[36]

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).

— Given the current situation, marked by very significant and diverse global shocks (see Section 4.1) and by numerous changes in European and Spanish economic policies (see Section 4.2), answering this question is extraordinarily complex and will require more time. This is especially the case when it comes to identifying true causal effects, rather than mere correlations, given also that the effects of many of these developments and policies take time to fully filter through to economic activity and that they interact with economic activity differently during upturns and downturns.

— In this regard, from a domestic perspective, it is essential to continue the ongoing and rigorous assessment of the various policies implemented in many areas by the Spanish authorities in recent years, most of which fall under the Recovery, Transformation and Resilience Plan agreed with the European authorities.

— To this end, it would be desirable to expedite some of the initiatives currently under way[37] aimed at granting the research community access to a larger volume of the exceptionally rich granular information stemming from the merger of various government-owned databases.

— Moreover, while the creation of bodies such as the National Productivity Board and the Institute for the Evaluation of Public Policies can be considered steps in the right direction, their effectiveness will depend on the independence and professional competence of their members, as well as on the resources available to them to carry out rigorous analyses. In this respect, the allocation of insufficient budgetary resources for newly established bodies and the persistence of excessive budgetary constraints affecting other, more consolidated independent bodies may seriously hinder the proper performance of their tasks.

35 Since end-2019 GDP has also increased more sharply in other southern European countries (such as Slovenia or Croatia) and in other major euro area economies (such as the Netherlands) than in Spain.

36 For example, compared to pre-pandemic levels, in 2024 goods exports had grown by barely 1.2% in Spain, compared to 7% in Portugal and 24% in Greece. Conversely, exports of services, which have increased by 37% in Spain over the last five years, have grown by 23% in Portugal and 3% in Greece.

37 Notable among these initiatives is the data laboratory ES_DATALAB, which seeks to contribute to the advancement of research by allowing those conducting it to jointly access the databases of the participating institutions, in an environment that guarantees data confidentiality. The ability to cross-match the participating institutions' databases maximises these data's value for research development. The institutions participating in this project are the National Statistics Institute (INE), the Spanish tax authorities, the State Secretariat for Social Security and Pensions, the Social Security General Treasury, the National Social Security Institute, the Social Marine Institute, the Social Security IT Department, the National Public Employment Service and the Banco de España.

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...

— Since the outbreak of the pandemic, productivity (see Section 3.4) and employment (see Section 3.3) in Spain have performed above the euro area average and better than in some of the main countries in the region, such as France and Germany. Nevertheless, from a broader time perspective, there are still considerable gaps with the euro area in both dimensions.

— For example, in terms of productivity per hour worked, Spain's cumulative negative gap since 1998 relative to the euro area, Germany and France has barely narrowed from 25 pp, 34 pp and 36 pp, respectively, in 2019, to 24 pp, 33 pp and 32 pp in 2024.

— Similarly, in 2024 Q4, the employment rate for the population aged 15-64 was still 4.2 pp lower in Spain than in the euro area as a whole (66.4% compared with 70.6%). All this in a context where:

  • despite the significant reduction in the temporary employment ratio in recent years, job turnover and transitions from employment to unemployment remain high in Spain compared with other European countries,

  • the coexistence of labour shortages at firms and a still relatively high unemployment rate suggest that unemployment in Spain has a notable structural component, and

  • temporary sick leave (see Box 5) has increased notably in recent times, with considerable adverse implications for general government and firms from both an economic and an operational perspective.

— On the productivity side, it would be desirable to build on policies which, inter alia, (i) promote firm growth, (ii) facilitate the reallocation of productive resources across sectors and firms, (iii) foster the attraction and retention of human capital, (iv) boost private investment – especially in a situation like the current one, where this item's performance is notably weak – and, in particular, more innovative activities by harnessing the potential of new technologies, and (v) improve the efficiency of public administrations and the quality of the current regulatory and institutional framework (see Box 8).

— Similarly, on the labour market side, in a context in which, in addition to the green transition, the technological and demographic changes currently under way will lead to major shifts in the sectoral and occupational structure of employment, it is essential to improve Spain's active and passive labour market policies, which have several significant shortcomings compared with those deployed in other European economies. [38] In particular, passive labour

38 For example, over a broad time horizon and compared with other countries, in Spain the degree of coverage/protection of the unemployed through passive policies has been relatively low, while the replacement rate of unemployment benefits has been relatively high. In addition, both the extent to which the unemployed participate in active policies and the amounts spent on such policies are low in Spain, compared with other European countries, when set against the unemployment rate. For further details, see Chapter 3 of the Banco de España *Annual Report 2023.*

market policies must simultaneously provide an adequate level of protection for the unemployed and sufficient incentives for them to return to employment. In order to increase workers' employability, it is also vital to strengthen both the formal education system and back-to-work and vocational training (especially dual vocational training).

— As already mentioned, in recent years the authorities have introduced a range of very diverse measures aimed at boosting productivity growth and improving the functioning of the labour market in the Spanish economy.[39] A rigorous and holistic assessment of the effects of these regulations is still pending.

... while other challenges that shape present and future economic developments in Spain have become increasingly prominent in recent years. These include, for example, those linked to the housing market,...

— As discussed in detail in Chapter 4 of the Banco de España *Annual Report 2023,* in recent years certain population groups have been facing growing housing affordability problems in specific geographical areas in Spain, entailing significant adverse social and economic effects.

— In 2024, despite some modest progress on the supply side, demand for housing continued to grow at a faster pace than supply, contributing to a lack of noticeable improvements in house price dynamics and affordability indicators in recent months (see Box 4).

— If they are not decisively and holistically addressed, housing market imbalances (which show little sign of significantly decreasing in the short term) could become a clear supply-side bottleneck for the Spanish economy and a major social problem.

— All this, in a context where:

- although it has recently declined, income inequality remains high in Spain from a European standpoint,[40]
- net wealth inequality has increased appreciably in recent decades, albeit from relatively low levels,[41] and

39 Some of the most important measures approved are, for example, the draft Law on Industry and Strategic Autonomy, the reform of the Insolvency Law, the Plan for the Digitalisation of SMEs (2021-2025), the labour market reform, the Create and Grow Law, the Startups Law, the "Régimen 20" proposal, the Vocational Training Law, the Employment Law and Royal Decree-Law 2/2024, which introduced several amendments to the unemployment assistance benefit.

40 On the latest information available, in 2023 Spanish inequality in terms of households' disposable income was at its lowest since 2007, partly thanks to the strength of employment, the rise in the minimum wage and the introduction of the minimum income scheme. However, this level of inequality is relatively high within the euro area, behind only that of Latvia, Lithuania and Estonia, with inequality measured as the ratio between the 90th percentile and the 10th percentile of annual household disposable income (European Survey of Living Conditions, 2023).

41 According to the Banco de España's Survey of Household Finances (EFF), in 2002 the wealthiest 10% of Spanish households held 42.9% of total wealth, a percentage that rose to 53.6% in 2022. In any event, as documented in Chapter 2 of the Banco de España *Annual Report 2023,* according to the World Inequality Report 2022, the concentration of wealth in the wealthiest 10% of households in Spain is still 22 pp below the world average.

- moreover, from an intergenerational perspective, in recent years income and wealth have grown faster among the oldest population groups than in the youngest ones.[42]

... migration flows,...

— The challenges linked to the high migration flows into Spain have gained prominence in recent years. As already mentioned, these flows have made it possible to significantly raise the Spanish economy's growth capacity and mitigate, at least partially, the rapid ageing of the Spanish population.[43]

— At end-2024 foreign-born individuals were estimated to account for 19.1% of Spain's total resident population (5.7 pp more than in 2011), and this percentage is expected to continue increasing significantly in the coming decades.

— The economic and social consequences of immigration depend, among other factors, on the composition of these flows (for example, by age, educational attainment and country of origin)[44] and on the ability of the destination countries to integrate them into society and their labour market.

— In this respect, it would be desirable, first, to analyse how the process of integrating and assimilating new flows of immigrants into Spain is taking place, and to identify whether there is room for improvement in public policies to facilitate this process, although important reforms have been made in this area recently.

  - It should be noted that according to the MIPEX index, in 2019 barriers to immigration in Spain were less restrictive than in the EU on average. In particular, immigrants to Spain had better relative access to health services, permanent residence and family reunification. Conversely, the general policy for obtaining citizenship was more stringent. Some recent papers propose that this latter aspect can expedite immigrants' integration into the labour market, by allowing them to quickly transition to more productive and advantageous job opportunities.[45]

  - In any event, given that Spain's migration policies have undergone major changes since 2019 (for example, through the amendments made to the Regulation on Foreign Nationals in both 2022 and 2024) these aspects need to be rigorously reassessed.

42 According to the EFF, the median wealth of households in the over-74 age group went from being 1.3 times higher than that of the population aged 35-44 in 2011 to being 2.9 times higher at end-2022. In the Eurosystem as a whole, according to the Household Finance and Consumption Survey, the wealth of the over-74s was 1.4 times higher than that of 35 to 44-year-olds in 2010 and 1.6 times higher in 2021. This increase was particularly noteworthy in Germany, Finland, France and Spain, but not in Italy.

43 By way of illustration, in Spain, birth rates continued to decline in the period 2000-2023 (from 9.8 births per 1000 inhabitants to 6.6), longevity continued to increase (life expectancy at birth jumped from 79.3 to 83.8) and the average age of the population continued to rise (from 39.5 to 44.4). For more details on the scale of the population ageing process in Spain, and on its myriad far-reaching implications for economic activity as a whole, see Chapter 4 of the Banco de España *Annual Report 2018* and Chapter 3 of the Banco de España *Annual Report 2023.*

44 For a comparative analysis of the composition of recent migration flows to Spain and to other European countries, see Cuadrado, Gómez and Sastre (2024).

45 See Domenella (2025), which shows that delays in the acquisition of citizenship have long-lasting negative effects on the labour income of immigrants, caused by both lower wages and lower employment rates (fewer days worked).

— At the same time, it would also be advisable to study the extent to which the catalogue of difficult-to-cover occupations is efficiently achieving its goal of attracting immigrants in their countries of origin based on the Spanish labour market's unmet needs. Fully implementing the changes made to this catalogue following the 2022 reform should ensure it adequately reflects the sectors in need of foreign workers. In this respect, there is evidence that, in France, making this catalogue more flexible reduced labour market rigidities in certain sectors and boosted firms' productivity.[46]

— Lastly, as shown in Chapter 3 of the IMF's April 2025 World Economic Outlook, the tightening of migration policies in one country may have appreciable spillover effects on migratory movements towards other countries. The extent to which the recently adopted changes to migration policies in the United States (which has a large presence of Latin American immigrants) could affect the scale and composition of migrant flows to Spain in the future will therefore need to be analysed.

... and climate change and the green transition.

— The fight against climate change and the transition towards a more sustainable economy are two of the most significant challenges facing the Spanish society. Even so, in 2024 global temperatures hit a new record, exceeding 1.5 °C above pre-industrial levels, and CO_2 emissions reached an all-time high worldwide.

— This highlights the urgency of diligently adopting ambitious mitigation and adaptation measures at global, European and Spanish level to reduce our vulnerability to climate change and ensure sustainable development.

— However, timely and proper compliance with the global environmental targets agreed in recent years (which was already in doubt a few months ago)[47] could be further compromised by the wavering commitment recently shown by some governments and companies. In particular, at the beginning of 2025 the new US Administration began the process of withdrawing from the Paris Agreement, a situation reminiscent of what happened between 2020 and 2021.

— In any event, as pointed out by various studies[48] and shown by the tragic aftermath of the flash floods that affected several Spanish provinces in late 2024 (see Box 3), Spain is particularly exposed to the physical risks associated with global warming and the risk of more frequent and severe weather events (which, moreover, may be very different in nature and include, for example, floods, droughts, heatwaves and forest fires).

— It would therefore be desirable for Spain, together with its European partners, to continue making quick and efficient strides in the green transition. In this regard, it should be noted

46 Signorelli (2020).

47 See, for example, the reports from the World Meteorological Organisation and the Global Carbon Project.

48 See, for example, the European Commission's ninth report on economic, social and territorial cohesion which uses the JRC Peseta V model.

that the update to the National Energy and Climate Plan 2023-2030, published in late September 2024, sets out a number of very ambitious targets for 2030.[49] While positive steps are being taken to achieve these objectives, the challenge remains daunting.[50]

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.

— Despite the progress made in recent years (see Sections 3.6.1 and 3.6.2), Spain's fiscal position is still characterised by a notable structural imbalance and a high debt ratio. In this regard, although the established fiscal objectives have been achieved in the short term, complying with them in the medium and long term under the new European fiscal framework (see Section 3.6.3) continues to be crucial for the Spanish economy. To this end, the investments and reforms submitted to the European Commission in order to extend the Medium-Term Fiscal-Structural Plan adjustment period need to be rigorously implemented and evaluated.

— At the same time, amid the recent significant narrowing of the government revenue gap in Spain relative to the EU average,[51] public spending has come under increasing pressure, which is more structural than conjunctural. This pressure stems from both social spending (especially pensions) and other items that are essential for the digital and green transitions (investment and spending on education) and to address the challenges associated with a significant shift in the global geopolitical landscape (defence spending). This is coupled with the upward pressure on health expenditure due to population ageing and the deterioration in health in recent years.

— In this context, building safety buffers that enable fiscal policy to respond efficiently and counter-cyclically to potential future adverse shocks while addressing the growing spending pressures is a significant challenge. Tackling it requires designing and communicating a medium-term planning exercise that provides certainty to economic agents, not only about the sustainability of public finances, but also about the expected future path of government revenue and expenditure.

— As part of this exercise, a comprehensive review of all government expenditure and revenue items should be carried out to assess whether they jointly achieve their objectives as effectively and efficiently as possible. A useful starting point for this analysis on the revenue

49 Among others, cutting greenhouse gas (GHG) emissions by 32% from 1990 levels, raising the share of renewable energies to 48% of final energy consumption and 81% of electricity generation, improving energy efficiency to scale down final consumption by 44% and reducing energy dependency to 50%.

50 According to the INE's Quarterly Air Emission Accounts, in 2024 GHG emissions in Spain were 0.8% lower than in 2023 and were still at around the same levels as in 1990. At the same time, according to the latest data from Red Eléctrica Española, renewables generated 56% of the Spanish electricity mix in 2024, 5 pp up on 2023.

51 In 2019 the ratio of government revenue to GDP was 7.5 pp lower in Spain than in the euro area. In 2024, however, this negative gap had narrowed to 4 pp.

side is the White Paper on Tax Reform presented in March 2022 and, on the expenditure side, the various parts of the Independent Authority for Fiscal Responsibility's (AIReF) Spending Review.

— Other general elements or principles that can help guide this analysis would be the following:[52]

- In times of limited fiscal headroom, it is essential for the measures rolled out, whether on the expenditure side or the revenue side, to be carefully targeted, which was not the case for many of the measures implemented by the Spanish and European authorities in response to the energy crisis.[53]

- In a highly decentralised country like Spain, the medium-term planning and comprehensive review of government expenditure and revenue that this analysis requires should actively involve all tiers of general government and be based on a broad economic, political and social consensus.

- In this regard, as also pointed out by AIReF, it would be advisable for the fiscal authorities to take advantage of the transposition of the new European fiscal framework into national legislation to unify the various frameworks that constrain the actions of Spanish public administrations (the national expenditure rule, that stemming from the European framework and the pension expenditure rule) in order to improve their consistency and ensure simultaneous compliance.

52 For other, more specific public revenue and expenditure recommendations, see Chapter 2 of the Banco de España *Annual Report 2023.*

53 See, for example, García-Miralles (2023) and Amores et al. (2023).

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Box 1

THE EUROPEAN CENTRAL BANK'S MONETARY POLICY IN 2024 AND 2025 TO DATE, AND ITS MACROECONOMIC IMPACT

The global inflationary episode that began in 2021 triggered a cycle of extraordinary monetary tightening by the main central banks.[1] Between July 2022 and September 2023, the European Central Bank (ECB) raised the euro area deposit facility rate[2] from -0.5% – the level at which it had held since September 2019 – to 4%.

As a result of the ECB's resolute response, and despite headline inflation in the euro area surging to more than 10% in October and November 2022 (10.6% and 10.1%, respectively), economic agents' medium-term inflation expectations remained anchored at around the 2% target rate. This proved crucial to euro area inflation starting to moderate, once some of the negative supply shocks that had contributed to the initial uptick in inflation began to fade.[3] For example, at end-2023 headline inflation declined to 2.9% and underlying inflation, which had peaked at 5.7% in March that year, fell to 3.4%.

This easing in inflationary pressures – which continued throughout 2024 H1 – prompted the ECB to cut its key interest rates by 25 basis points (bp) at its June 2024 meeting and to start gradually moderating its restrictive monetary policy stance (Figure 1).

In recent quarters, this moderation has been consistent with the euro area inflation's gradual convergence towards its medium-term target of 2% (see Section 2.1). Indeed, in this period, the ECB has maintained a data-dependent approach and has adopted its interest rate decisions meeting by meeting, based on its assessment of the inflation outlook in light of incoming economic and financial data, the dynamics of underlying inflation and the strength of monetary policy transmission. All this without pre-committing to a particular rate path.

Thus, between June 2024 and March 2025 the ECB lowered the deposit facility rate by 150 bp to 2.5% (Chart 1).

At the same time, over the last few quarters the ECB has pressed ahead with normalising the Eurosystem's balance sheet, a process that began in 2022. This measured and predictable reduction in the balance sheet has been underpinned by the early repayment and maturing of targeted longer-term refinancing operations (TLTROs) and, increasingly, by maturities in the monetary policy asset portfolio (Chart 2).

For instance, reinvestments under the Asset Purchase Programme (APP) were discontinued as of July 2023. The size of the Pandemic Emergency Purchase Programme (PEPP) portfolio decreased at a pace of €7.5 billion per month in 2024 H2, and reinvestments came to an end in early 2025.

As a result, by April 2025 the Eurosystem's balance sheet had declined by almost 30% from its mid-2022 peak. Similarly, excess liquidity decreased by almost 40% in the same period, although the level of bank reserves remained abundant.

In March 2024 the ECB made a series of changes to the operational framework for implementing monetary policy to ensure that it remains appropriate as the Eurosystem balance sheet normalises. In particular, the changes will affect how central bank liquidity will be provided in the context of a gradual reduction of excess liquidity in the banking system, even if it will remain significant over the coming years.[4]

Latest European Central Bank decisions

Since early April the escalation in global trade tensions and their impact on global financial markets (see Section 2.2.2) have constituted an extraordinary shock, significantly distorting the global macro-financial and geopolitical landscape and complicating the ECB's monetary policy conduct.

As discussed in Section 4.1 of this report, there is currently considerable uncertainty regarding (i) the size and scope of the tariffs that will prevail over the coming quarters between the major global economies, and (ii) the main channels of transmission (supply-side vs demand-side channels) through which these trade measures could impact global economic activity going forward, which

1 Banco de España. (2023). "Chapter 3.The current episode of price pressures in the euro area, the monetary policy response and its effects". In Banco de España, *Annual Report 2022,* pp. 140-180. https://repositorio.bde.es/handle/123456789/29664

2 The deposit facility rate is currently the key rate used to steer the monetary policy stance in the euro area.

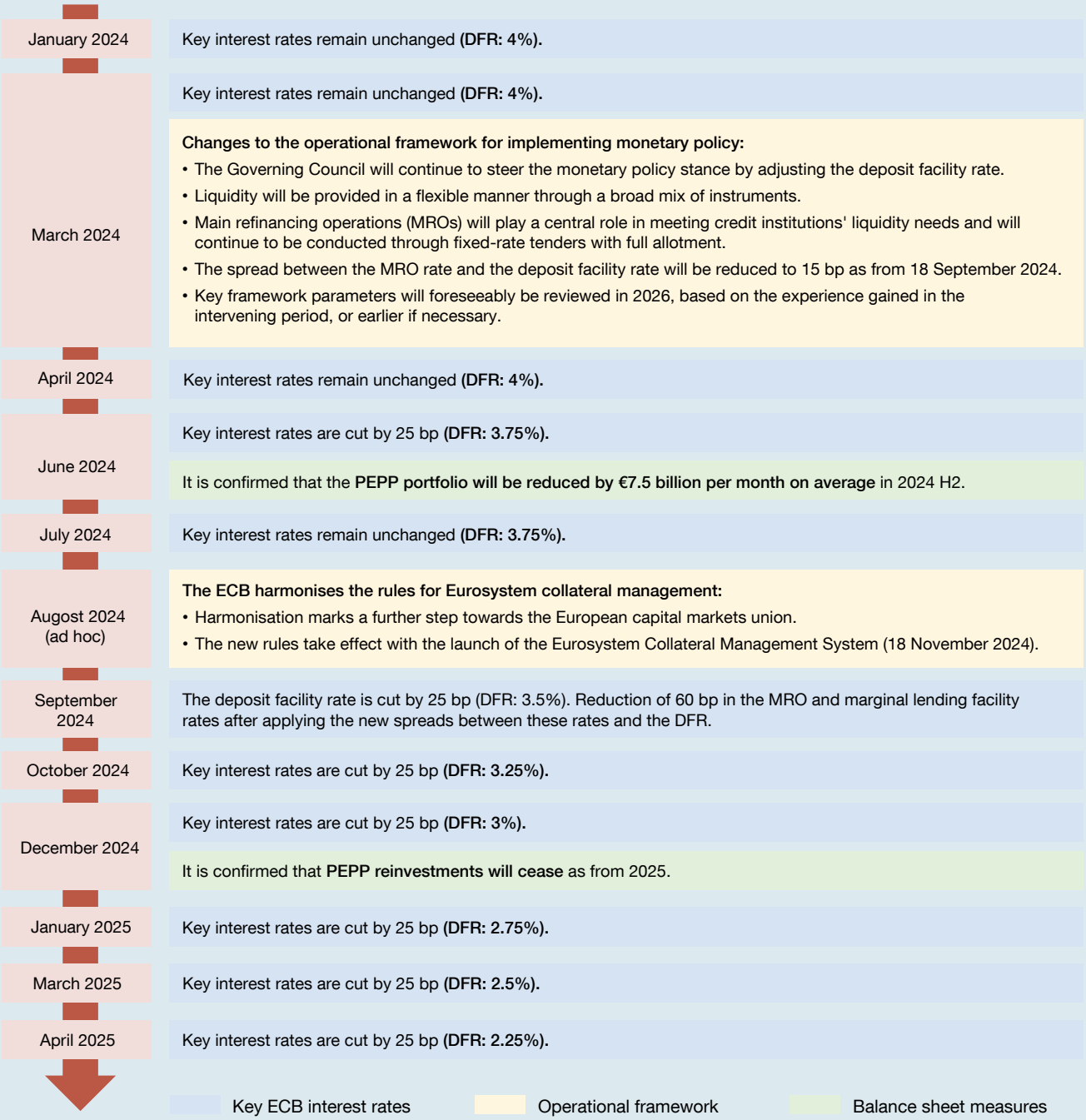
3 For example, through the moderation of energy prices and easing of the supply bottlenecks that had for some time hampered the functioning of global production and supply chains.

4 The ECB also narrowed the spread between the main refinancing rate and the deposit facility rate from 50 bp to 15 bp to limit the potential scope for volatility in money market rates, a decision that had no implications for its monetary policy stance and came into effect in September 2024.

Box 1

THE EUROPEAN CENTRAL BANK'S MONETARY POLICY IN 2024 AND 2025 TO DATE, AND ITS MACROECONOMIC IMPACT (cont'd)

Figure 1
Monetary policy measures and other measures adopted by the ECB since 2024



SOURCE: Banco de España.
NOTE: "DFR" refers to the deposit facility rate and "PEPP" to the Pandemic Emergency Purchase Programme. During the period under review, the ECB has also extended and rolled over swap and repo lines with non-euro area central banks to meet possible euro liquidity needs. Moreover, in April 2024 the ECB confirmed that the remuneration ceiling for euro area government deposits was set at the euro short-term rate (€STR) minus 20 bp, and adjusted the remuneration of other non-monetary policy deposits, so that the limited amount of non-monetary policy deposits not yet aligned to this uniform rate are aligned accordingly.

Box 1

THE EUROPEAN CENTRAL BANK'S MONETARY POLICY IN 2024 AND 2025 TO DATE, AND ITS MACROECONOMIC IMPACT (cont'd)

largely depends on the (uncertain) response of financial markets and economic agents to those measures.

According to the economic literature, the monetary policy response could differ depending on which are the dominant transmission channels: supply-side channels (reducing growth but raising inflationary pressures) or demand-side channels (dampening both activity and prices).

Against this background, the ECB Governing Council agreed at its 17 April meeting to cut its key interest rates by a further 25 bp, putting the deposit facility rate at 2.25%.

Chart 1
Deposit facility rate, EURIBOR and market expectations (a)

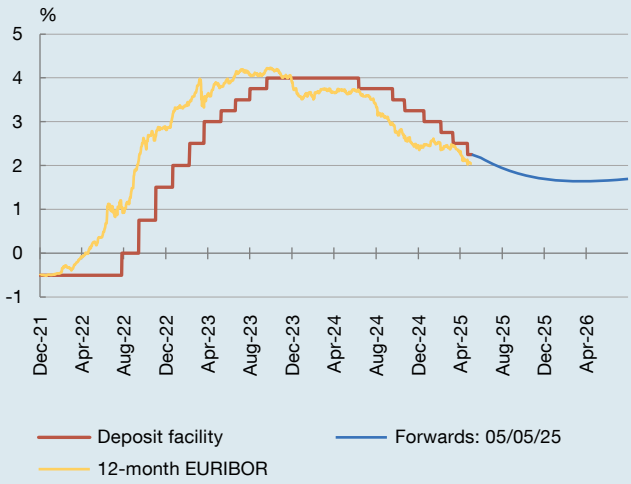


Chart 2
Eurosystem balance sheet and excess reserves (b)

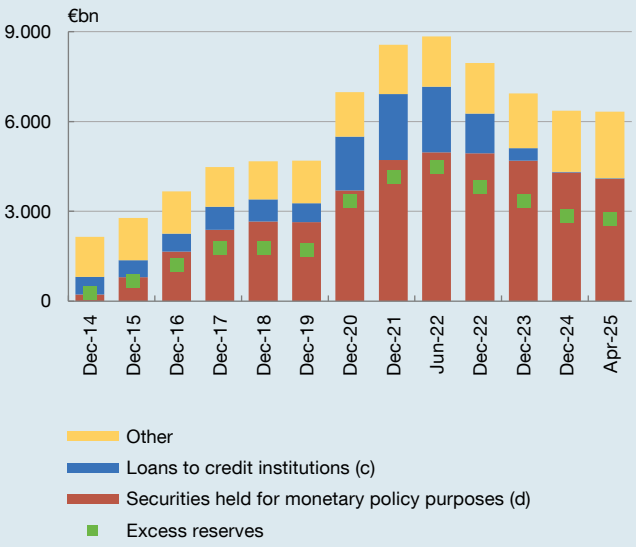
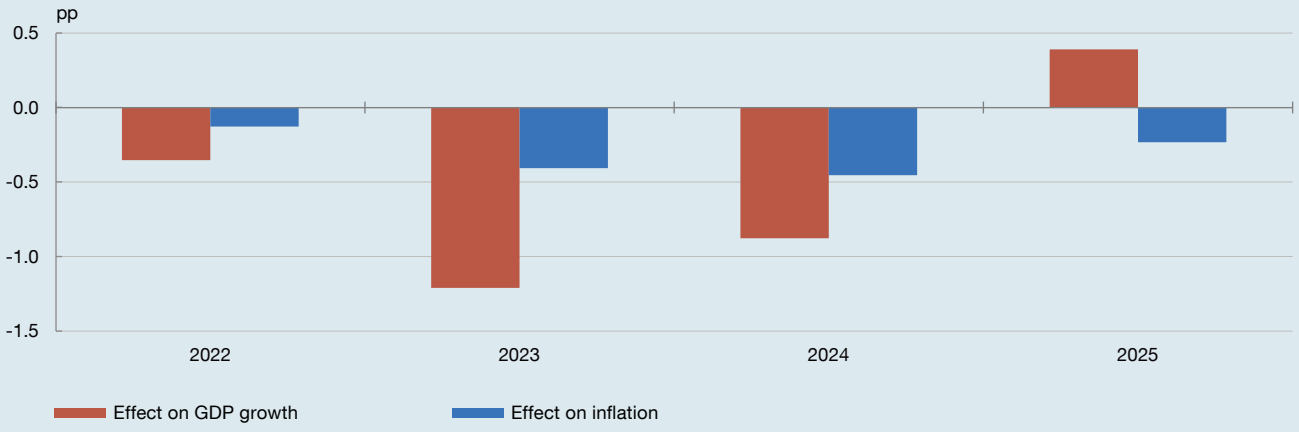


Chart 3
Estimated impact of the ECB's monetary policy tightening since 2021 on GDP and inflation in Spain (e)



SOURCES: ECB, Banco de España and LSEG Datastream.

a Instantaneous forwards estimated based on market data on OIS rates at different maturities using the Svensson (1994) parametric model and adding the spread between the policy rate and the overnight interest rate at the estimation date.
b Year-end data, except for June 2022 (which captures the peak level of 23 June 2022) and the latest available figure (April 2025).
c Includes main refinancing operations, longer-term refinancing operations and the marginal lending facility.
d ECB purchase programmes: SMP, CBPP3, ABSPP, PSPP, CSPP and PEPP.
e Estimated using the MTBE.

Box 1
THE EUROPEAN CENTRAL BANK'S MONETARY POLICY IN 2024 AND 2025 TO DATE, AND ITS MACROECONOMIC IMPACT (cont'd)

In any event, as underlined by the ECB President in her post-meeting press conference, readiness and agility are key attributes to ensure an appropriate response to new developments. Now more than ever it is important to maintain a data-dependent approach, with decisions made meeting-by-meeting and without pre-committing to a particular rate path.

Macroeconomic impact of the European Central Bank's monetary policy

The remainder of this box examines how the ECB's monetary policy since 2021, described above, appears to have impacted GDP and inflation in the Spanish economy in recent years.[5]

This exercise is an update of that presented in Section 4.4 of Chapter 3 of the Banco de España *Annual Report 2022.* It consists of introducing into the Quarterly Macroeconometric Model of the Banco de España (MTBE, by its Spanish abbreviation)[6] shocks to interest rates, household income, exchange rates and stock prices. These shocks are calibrated to capture the effects of the changes in ECB monetary policy between December 2021 and March 2025.

Based on these shocks, the MTBE generates a counterfactual scenario in which the different channels included in the model whereby monetary policy affects the economy (the intertemporal substitution effect, the exchange rate effect, the wealth effect, the income effect and the trade channel with the rest of the euro area) act in line with the empirical regularities historically observed in Spain, in a general equilibrium setting.[7]

In relation to these channels, as discussed in Chapter 3 of the Banco de España *Annual Report 2022,* the transmission of monetary policy decisions to economic activity and inflation takes place in two stages. The first stage affects financial conditions and becomes evident relatively quickly. In fact, this stage begins somewhat before monetary policy decisions are made, to the extent that financial asset prices reflect investor expectations about potential future changes in monetary policy. For instance, interbank market rates and bond yields at different horizons partly reflect investor expectations about the future path of policy rates.

In the second stage, changes in financial conditions impact real activity and, ultimately, consumer prices and inflation. These effects typically appear with something of a lag, which can be as long as two years.[8]

Taking into account these channels and stages, the simulations conducted using the MTBE (which, as with any model that only partially captures highly complex economic dynamics, should be treated with caution) suggest that the contractionary effects of the monetary tightening deployed by the ECB in recent years reduced Spanish GDP growth by around 1 percentage point (pp) both in 2023 and 2024 (Chart 3). In 2025, conversely, the net effect on Spain's economic activity would be slightly positive thanks to the recent monetary easing.

Meanwhile, the ECB's monetary policy appears to have reduced the average annual inflation rate in Spain by approximately 0.5 pp in 2023 and 2024. In line with historical regularities, this policy is also likely to be mitigating inflationary pressures this year, albeit to a lesser extent.

One striking aspect of this disinflation episode – in Spain, the euro area and other advanced economies alike – is that the "sacrifice ratio" (i.e. the cost in terms of reduced GDP resulting from efforts to lower inflation through monetary tightening) is relatively low compared with the historical regularities and consensus expectations.[9, 10]

5 For a similar exercise conducted for the euro area as a whole using multiple models, see Philip R. Lane. (2024). *The 2021-2022 inflation surges and the monetary policy response through the lens of macroeconomic models.* European Central Bank. https://www.ecb.europa.eu/press/key/date/2024/html/ecb.sp241118_1~2c31ddbaa8.en.html

6 The latest release of the MTBE is used. See Pablo Aguilar, Corinna Ghirelli and Samuel Hurtado. (2025). "MTBE v2025: New version of the Quarterly Model of the Banco de España". Documentos Ocasionales, Banco de España. Forthcoming.

7 The exercise only partially captures the positive impact (for economic activity and price stability in the medium term) that the ECB's monetary policy tightening between 2022 and 2023 had in keeping medium-term inflation expectations anchored at around 2%.

8 For example, see Philip R. Lane. (2022). *The transmission of monetary policy.* https://www.ecb.europa.eu/press/key/date/2022/html/ecb.sp221011~5062b44330.en.html

9 Corinna Ghirelli, Javier J. Pérez and Daniel Santabárbara. (2025). "Inflation and growth forecast errors and the sacrifice ratio of monetary policy in the euro area". Documentos de Trabajo, 2516, Banco de España. https://repositorio.bde.es/handle/123456789/39441

10 Deutsche Bundesbank. (2024). ("The global disinflation process and its costs". *Monthly Report - July 2024"),* whose estimation data end in 2023 Q4. https://publikationen.bundesbank.de/publikationen-en/reports-studies/monthly-reports/monthly-report-july-2024-935476?article=the-global-disinflation-process-and-its-costs-935482.

Box 1

THE EUROPEAN CENTRAL BANK'S MONETARY POLICY IN 2024 AND 2025 TO DATE, AND ITS MACROECONOMIC IMPACT (cont'd)

Two possible factors behind this lower sacrifice ratio in Spain and the euro area stand out: (i) the fact that medium-term inflation expectations remained anchored at the ECB's target of 2% throughout the inflationary episode, and (ii) the increased frequency of price adjustments by firms during that period, which may have steepened the Phillips curve.[11]

11 For evidence concerning the frequency of price adjustments, see, for example, Eduardo Gutiérrez Chacón and Pau Roldán Blanco. (2024). "The inflationary spike in Spain between 2021 and 2023: evidence from micro data". *Economic Bulletin - Banco de España,* 2024/Q1, 05. https://doi.org/10.53479/36135. See also Alberto Cavallo, Francesco Lippi and Ken Miyahara. (2023). "Large Shocks Travel Fast". CEPR Discussion Paper Series, 18413, Centre for Economic Policy Research. https://cepr.org/system/files/publication-files/DP18413.pdf

Box 2

QUANTIFYING THE DETERMINANTS OF THE SURPRISES IN THE GDP GROWTH FORECAST FOR 2024

In 2024 Spanish GDP grew at an annual average rate of 3.2%, well above the rate projected by both the Banco de España and the analysts' consensus in early 2024 (Chart 1). This box analyses the various determinants of the 1.3 percentage point (pp) difference between the annual average growth rate projected for 2024 in the Banco de España's March 2024 projection exercise[1] (1.9%) and the growth rate ultimately recorded (3.2%). Specifically, the contributions of the different components of domestic and external demand to the surprises in GDP growth are quantified, stripping out the effect of statistical revisions.

Chart 1
Changes in projections for 2024 over the course of the year. GDP rates of change (a)

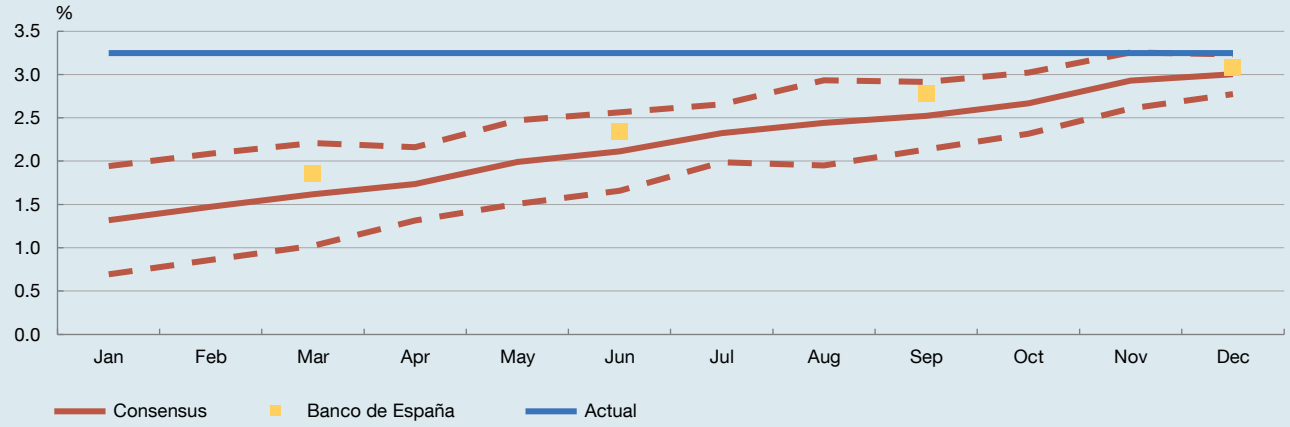
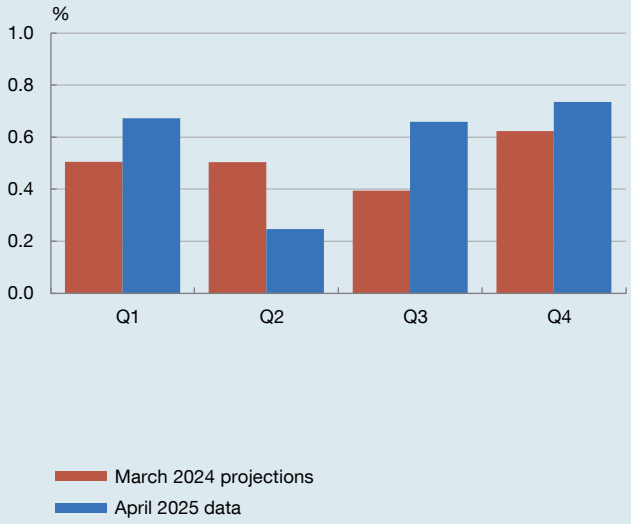
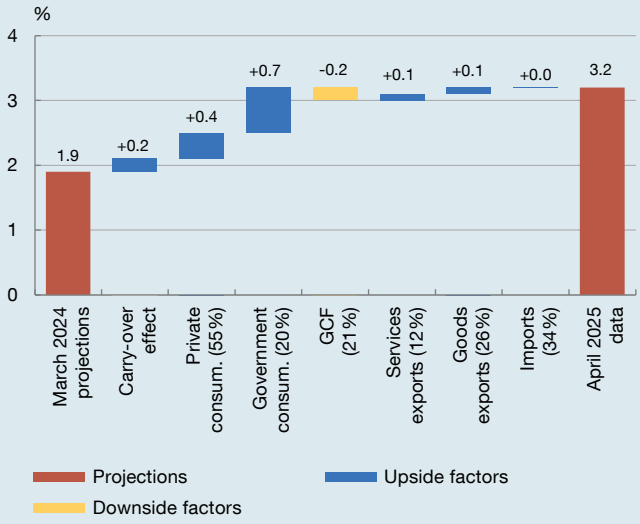


Chart 2
Determinants of revisions to the 2024 GDP growth rate

2.a Quarterly GDP growth in 2023



2.b Revision vis-à-vis March 2024 macroeconomic projections (b)



SOURCES: Banco de España, Consensus Economics and INE.

a The dotted lines represent the maximum and minimum among the institutions comprising the Consensus panel.
b The weight of each component in 2023 GDP is shown in brackets.

1 The March projections are considered as they were the first where complete information for 2023 was available.

Box 2
QUANTIFYING THE DETERMINANTS OF THE SURPRISES IN THE GDP GROWTH FORECAST FOR 2024 (cont'd)

First, some of the difference between the annual average GDP growth rate currently available for 2024 and the rate forecast in March 2024 owes to revisions to the quarterly GDP growth rates for 2023 that became known after the March 2024 projection exercise had concluded.[2] The impact of these revisions on GDP growth in 2024, known as the "carry-over effect", depends not only on the corrected average growth rate for 2023 but also the quarterly profile of growth over that year.[3]

According to the latest information available, in 2023 GDP grew at an average pace of 2.7%, versus the 2.5% envisaged on the information available in March 2024. In addition, the quarter-on-quarter growth rates in the final two quarters of 2023 were also revised up significantly (Chart 2.a).

As a result of these revisions, even if the quarter-on-quarter growth rates in 2024 had matched the March forecasts, GDP growth would have been 0.2 pp higher than anticipated at the start of the year (Chart 2.b).

Second, stripping out the effect of these statistical revisions, some components of domestic demand did not perform as expected.

In 2024 as a whole, private consumption was stronger than initially anticipated. Among the various factors behind this surprise, two in particular should be noted.

- First, stronger than expected growth in real disposable income (4.5% versus the 1.5% projected early in the year). In employment income, the surprise is mainly attributable to the growth in compensation per employee (5% versus 3.9% forecast), since employment was in line with forecasts (up 2.2% versus 2.1% envisaged in March). Meanwhile, non-labour income grew substantially, and far more than initially projected (11.2% versus 1.6% expected early in the year).
- Second, consumption was once again underpinned by the population, which grew by 1% (0.4 pp more than forecast in March).

All told, the stronger private consumption than envisaged in March explains around 0.4 pp of the higher GDP growth in 2024 (Chart 2.b). This positive surprise happened for the second year in a row: according to estimates in the *Annual Report 2023,* private consumption contributed 0.2 pp to the GDP surprise in 2023.[4]

Government consumption in 2024 also outpaced early-year forecasts. The surprise partly[5] owed to the nominal increase in government consumption, which, while broad-based across components, was particularly marked in consumption of fixed capital, intermediate consumption and transfers in kind.

As a result of these developments, the upward deviation in government consumption explains around 0.7 pp of the surprise in GDP growth in 2024 (Chart 2.b). It is worth noting that strong government consumption contributed similarly to the GDP growth surprise in 2023.

Conversely, investment was less robust than expected over the course of 2024 (stripping out the effect of the statistical revisions to 2023 data). Several factors could explain this negative surprise in investment, which has occurred repeatedly since the outbreak of the pandemic.

First, according to the results of the Banco de España Business Activity Survey (EBAE by its Spanish acronym) for 2024 Q2,[6] the main obstacles to investment are economic policy uncertainty, the outsourcing of production processes (which reduces the investment activity of firms that outsource) and business regulation (and the associated red tape).

Second, regarding the use of NextGenerationEU funds, despite the EBAE results indicating a relatively high degree of additivity, up to 24% of firms report that they

2 José Luis Fernández, Enrique Moral-Benito and Alberto Urtasun. (2024). "An overview of the Spanish economy's performance since the pandemic following the revision of national accounts: a European comparison". *Economic Bulletin - Banco de España,* 2024/Q4, 05. https://doi.org/10.53479/38878

3 Specifically, higher growth rates in the second half of the year have a larger impact on activity in the following year. For more details, see José González Mínguez and Carmen Martínez Carrascal. (2019). "The relationship between average annual and quarter-on-quarter GDP growth rates: implications for projections and macroeconomic analysis". *Economic Bulletin - Banco de España,* 3/2019, Analytical Articles. https://repositorio.bde.es/handle/123456789/10782

4 Banco de España (2024). "Box 1.1. Quantifying the determinants of the surprises in the GDP growth forecast for 2023". In Banco de España, *Annual Report 2023,* pp. 84-87. https://doi.org/10.53479/36513

5 Another factor behind the upward surprise in real government consumption growth in 2024 was the smaller rise in the government consumption deflator (2.2 pp less than expected at the start of the year).

6 Alejandro Fernández Cerezo, Sergio Puente Diaz and Rubén Veiga Duarte. (2025). "Weak business investment in Spain following the pandemic: an analysis based on the EBAE". *Economic Bulletin - Banco de España,* 2025/Q1, 02. https://doi.org/10.53479/38999

Box 2
QUANTIFYING THE DETERMINANTS OF THE SURPRISES IN THE GDP GROWTH FORECAST FOR 2024 (cont'd)

would have implemented the investments even without the support of the NGEU programme. This implies that private productive investment may have increased by less than initially expected, since some of it would have happened even without these funds.

Overall, the sluggishness of investment is estimated to have held back GDP growth in 2024 by around 0.2 pp compared with the early-year forecasts. This downside surprise in investment was also seen in the 2023 GDP growth projections.

Third, with regard to external demand, exports of services grew more robustly in 2024 than expected. The strong momentum in this heading owed mainly to exports of travel services, buoyed by the ongoing diversification of destinations across Spain's regions and a higher number of foreign tourists during the low season months.

In any event, exports of non-travel services have also exhibited considerable strength, amid competitiveness gains and more effective use of Spain's digital infrastructure. All told, the growth in services exports explains around 0.1 pp of the positive surprise in the 2024 GDP growth rate (Chart 2.b).

In sum, aside from the positive carry-over effect resulting from the statistical revisions of the growth rates for the last two quarters of 2023, the Spanish economy's higher than expected GDP growth in 2024 owed primarily, and in this order, to the upward surprises in government consumption, private consumption and exports of services. Conversely, investment was weaker than initially expected.

Lastly, by way of conclusion, it is worth noting that this surprise in activity developments has only very partially fed through to other variables of interest.[7]

First, inflation performed in line with expectations (see Section 3.2). Specifically, lower food inflation offset the upward surprise in services inflation (partly driven by a strong performance in tourism, which likely generated additional price pressure for tourism-related activities).

Second, the unemployment rate stood at 11.3% in 2024, compared with 11.6% expected in March 2024. The divergence between the positive GDP surprise and the scant unemployment surprise owes mainly to the stronger than expected increase in apparent labour productivity (0.9% in 2024).

7 For a description of the various factors that have shaped the budget deficit in Spain in 2024, see Section 3.6 of this report.

Box 3

THE ECONOMIC IMPACT OF THE FLASH FLOODS

On 29 October 2024, Spain was hit by a "cut-off low", a meteorological phenomenon that caused severe flash floods in several regions, particularly in Valencia province.

This extreme weather event led to a significant loss of human life and caused substantial economic damage.[1] The damage affected not only public infrastructure but also a huge number of firms and individuals, resulting in significant disruption to mobility and economic and social activities in the affected areas.

Areas affected

Royal Decree-Law 6/2024 of 5 November 2024 adopting urgent measures in response to the damage caused by the flash floods identified 74 municipalities in Valencia plus the districts to the south of the city of Valencia as the most affected areas. Three municipalities outside Valencia were also included: Alhaurín de la Torre (Málaga), Letur (Albacete) and Mira (Cuenca).

Together, these municipalities account for around 2% of the Spanish population, total employment and firms (and a slightly higher share – 2.7% – of industrial sector firms).

The Banco de España's response

Since the first day after the catastrophe hit, the Banco de España has taken diligent action to attempt to identify, in real time, the multiple adverse impacts of the flash floods and work on mitigating them as much as possible. In particular, the Banco de España has taken action in several different areas.

First, as part of its responsibility to oversee the functioning of the payment system, it implemented daily monitoring of payments and deposits, as well as cash withdrawals from ATMs and transactions at point-of-sale terminals in the affected areas. This continuous vigilance ensured that the payment system operated smoothly and that people's access to their money was not disrupted.

Similarly, the Banco de España introduced a more streamlined process for exchanging banknotes damaged by the floods, enabling credit institutions to deposit damaged notes worth over €13.4 million at its Valencia branch.

Second, since the onset of the disaster and in the scope of its microprudential and macroprudential functions, the Banco de España has monitored the credit exposure of Spanish banks to the affected areas and how that exposure has developed.

In this regard, it is noteworthy that, according to data at end-September 2024,[2] banks operating in Spain had exposure of approximately €27.5 billion in the affected municipalities[3] (2.2% of the financial system's total exposure), of which €17.4 billion corresponded to households (2.5% of the total exposure to households) and just over €10 billion to non-financial corporations (NFCs) (1.7% of the total exposure to NFCs). So far, the Banco de España's monitoring of these credit exposures suggests that there have been no significant variations in the months following the disaster (Chart 1).

Third, in terms of economic situation analysis, the Banco de España has been performing continuous and real-time monitoring of multiple high-frequency indicators to attempt to quantify the impact of the flash floods on the economy as a whole and on the financial system, thereby contributing to the preparation of the aid packages deployed by the authorities.

In this monitoring, special attention has been paid to bottlenecks and supply chain disruptions caused by the floods and changes in employment in the affected areas and, in particular, the number of short-time work schemes (ERTE by their Spanish initials) approved, which eventually affected more than 30,000 workers. Additionally, the Banco de España Business Activity Survey (EBAE, by its Spanish acronym) was used to gauge the expectations of firms in Valencia province regarding turnover and employment.

Support measures rolled out by the authorities

The severity of the emergency caused by the flash floods required an exceptional level of operations and

1 According to the scientific community, climate change is contributing to the frequency of such extreme weather events increasing. This trend is expected to continue globally in the coming years. See Intergovernmental Panel on Climate Change. (2023). *Climate Change 2023.* https://www.ipcc.ch/report/ar6/syr/downloads/report/IPCC_AR6_SYR_SPM.pdf.

2 September 2024, the month before the floods, is taken as the baseline for starting point exposures.

3 For this analysis, the monetary volume of loans granted by any bank operating in Spain is considered. The affected areas are classified based on the postcodes of the municipalities listed in Royal Decree-Law 6/2024. The approach taken is intended to include any potential affected borrower. An operation is deemed to have been affected by the flash floods if any counterparty belongs to one of the postcodes of the locations considered affected or if a property located in one of the affected areas serves as mortgage collateral for the loan or credit in question.

Box 3
THE ECONOMIC IMPACT OF THE FLASH FLOODS (cont'd)

considerable mobilisation of resources. These measures, which are mostly set out in Royal Decree-Laws 6/2024 and 7/2024, notably included suspending interest and principal repayments and creating guarantee facilities

Chart 1
Financial institutions' credit exposure remained stable in the municipalities affected by the flooding (a) (b)

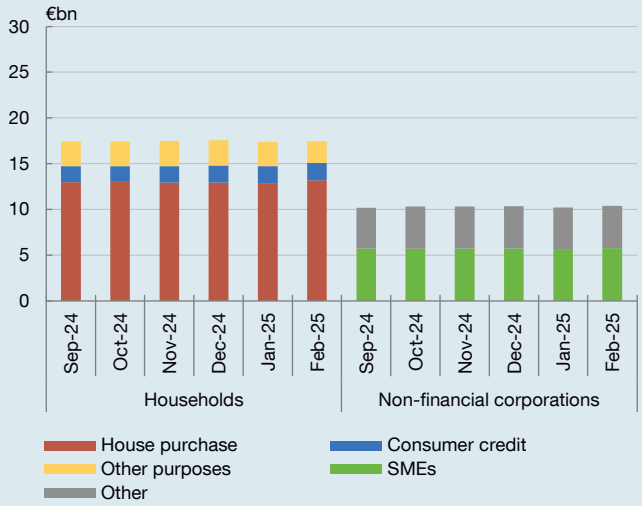


Chart 2
The flooding caused the supply bottlenecks index to rise, similar to the impact of Hurricane Katrina in the United States in 2005, although the index dropped significantly after the first fortnight

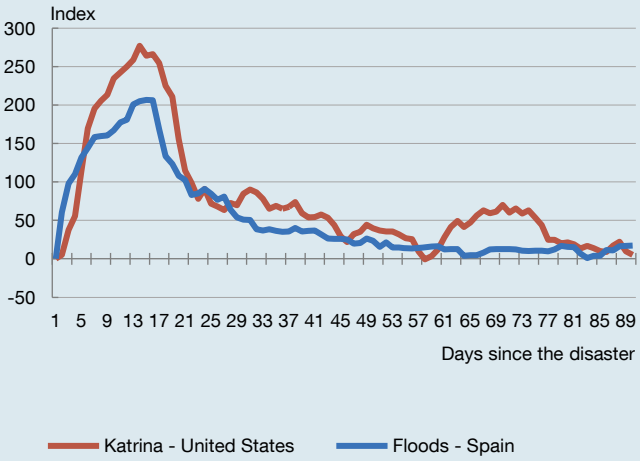


Chart 3
Employment in Valencia province has shown similar performance as in the previous 12 months, following the small disparity that appeared in November 2024

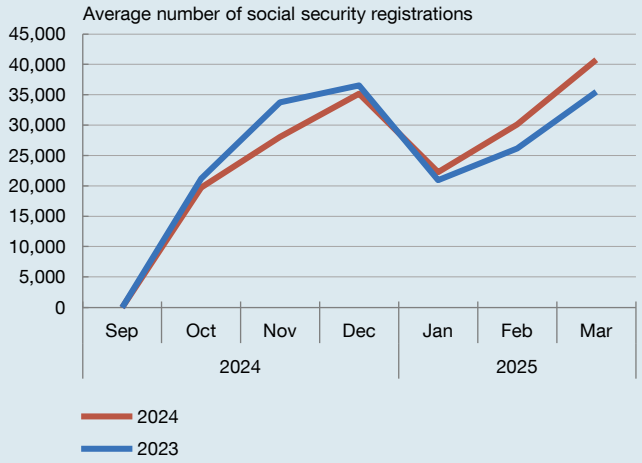
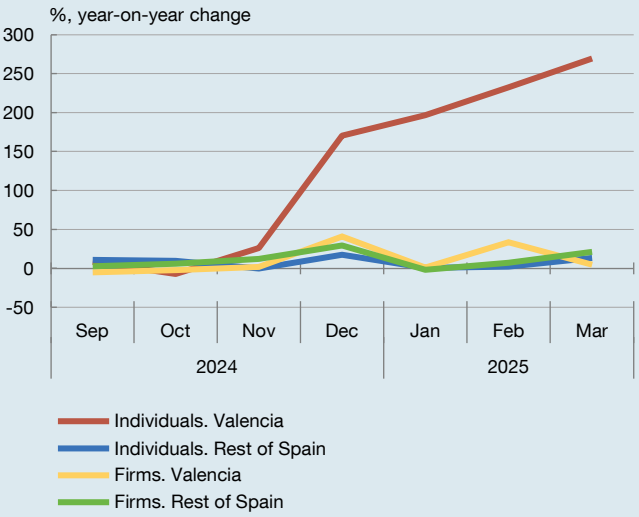


Chart 4
The uptick in vehicle registrations in Valencia after the flooding reflects the rebound effect of the replacement of damaged capital



SOURCES: Banco de España, Ministerio de Inclusión, Seguridad Social y Migraciones and Asociación Española de Fabricantes de Automóviles y Camiones.

a The exposure is shown in billions of euro in the areas affected by the flooding. The household sector includes individuals, sole traders, neighbourhood associations and other households (excluding non-profit institutions serving households) with loans that reside in the affected areas or if a property located in one of the affected areas serves as collateral for the loan or credit in question. The non-financial corporations category encompasses all non-financial firms with loans or real estate collateral in the affected areas.
b Other purposes of lending to households includes all loans to sole traders.

Box 3
THE ECONOMIC IMPACT OF THE FLASH FLOODS (cont'd)

managed by the Official Credit Institute (ICO, by its Spanish initials).[4] Direct aid and tax benefits for households and firms were also approved, in addition to compensation from the national insurance compensation consortium (Consorcio de Compensación de Seguros (CCS)).[5]

Overall, it is estimated that the increase in public spending linked to these aid packages amounts to around 0.5 percentage points (pp) of GDP, split between 2024 and 2025. In the 2024 public finances position, the costs linked to the flooding attributed to that year amount to 0.35 pp of GDP. The impact on Spanish public finances may be mitigated to the extent that a portion of the expenses is set to be covered by European funds.

Overall economic impact

Based on all available information and the analysis of past similar disasters, the Banco de España's December 2024 macroeconomic projections incorporated a negative impact caused by the flash floods of between 0.1 pp and 0.2 pp on the quarter-on-quarter GDP growth rate in 2024 Q4.[6]

Nevertheless, based on the historical evidence available for similar events, this adverse impact was expected to be transitory and, provided the support measures for affected households and firms are rolled out swiftly and effectively, reversed in 2025 H1.[7]

In this regard, in the weeks following the disaster, various real-time indicators appear consistent with this forecast of a predominantly temporary impact of the flash floods. They even point to a somewhat earlier recovery than initially expected – although much work remains to be done for a full recovery in the affected areas.

One of the key indicators pointing in this direction is the supply bottlenecks index[8] which, after a sharp initial spike in the first 15 days similar to that observed in the United States after Hurricane Katrina in 2005, then decreased considerably (Chart 2).

Another significant indicator is social security registrations, which have recently shown a pattern similar to 12 months earlier in Valencia province, after the small disparity that appeared in November 2024 (Chart 3).

Lastly, vehicle registrations are a useful indicator of the rebound effect entailed by the replacement of capital damaged by the flash floods. Vehicle registrations by private individuals have picked up strongly in Valencia province in recent months, in contrast to their more contained change in the rest of the country (Chart 4).

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4 By March 2025, more than 31,300 applications for moratoria had been submitted, of which 95% had already been approved. Furthermore, by late April 2025, 2,679 guarantees had been formalised, with a total of €610 million.

5 By April 2025, more than 246,000 applications had been registered, amounting to approximately €2.8 billion. Comparing this with other extraordinary disasters managed by the CCS vividly illustrates the exceptional nature and magnitude of this emergency. For example, cumulative payments are eight times higher than the total payments resulting from the volcano eruption in La Palma, while the total number of payments is two and a half times higher than that for the Lorca earthquake and the La Palma eruption combined.

6 All of this is in addition to the losses incurred in the stock of capital and wealth in the affected areas. According to the Valencian Institute of Economic Research, such losses could amount to more than €17 billion.

7 There is a consensus in the literature that natural disasters, such as floods, have significant negative impacts on GDP in the short term, but negative long-term effects are not observed. This is owing to the fiscal stimulus from support measures and increased spending on capital replacement and durable goods by households and firms. See Eduardo Cavallo and Ilan Noy. (2010). "The Economics of Natural Disasters: A Survey". IDB Working Paper Series, IDB-WP-124, Inter-American Development Bank. https://doi.org/10.18235/0010924; Tamim Bayoumi, Saad N. Quayyum and Sibabrata Das. (2021). "Growth at Risk from Natural Disasters". IMF Working Papers, WP/21/234, International Monetary Fund. https://doi.org/10.5089/9781513597652.001; and Sehrish Usman, Guzmán González-Torres Fernández and Miles Parker. (2024). "Going NUTS: the regional impact of extreme climate events over the medium term". ECB Working Paper Series, 3002, European Central Bank. https://www.ecb.europa.eu/pub/pdf/scpwps/ecb.wp3002~a77b495fa8.en.pdf.

8 Constructed using the methodology described in Pablo Burriel, Iván Kataryniuk, Carlos Moreno Pérez and Francesca Viani. (2024). "A New Supply Bottlenecks Index Based on Newspaper Data". *International Journal of Central Banking,* 20(2), pp. 17-69. https://www.ijcb.org/journal/ijcb24q2a2.pdf.

Box 4
RECENT HOUSING MARKET DYNAMICS

The Banco de España conducted a comprehensive analysis of the housing market in Chapter 4 of its *Annual Report 2023,* which was later supplemented by two additional papers that extended and updated it.[1] This box documents recent developments in the main indicators of activity in the Spanish housing market.

1 **Developments in housing demand.** Housing demand remains robust, driven by demographic growth, purchases by non-residents and a favourable macroeconomic environment.

- **Demographic growth.** Potential demand for housing increased as a result of high migratory flows. Spain's resident population grew notably in 2024 (0.9%) and has increased by nearly 2.7 million in cumulative terms since 2016. Amid the gradual decline in residents born in Spain, this increase owes to the arrival of new foreign-born residents.[2] This demographic growth is greater in cities, where the population has tended to concentrate over the last decade.[3]
- **Net household formation.** Demographic dynamics have driven demand for both rented and owner-occupied housing through the formation of new households. Provisional figures indicate that in 2024 the number of households rose by 180,000. As a percentage of total households, this represents a 0.9% increase,[4] below the figures for 2022 and 2023, but higher than the annual average increase observed in the period 2013-21. Specifically, in the period 2022-23, the number of households increased by 245,000 (1.3%) per year on average, compared with 80,000 between 2013 and 2021.
- **Demand from non-residents.** House purchases by non-residents play a significant role in the strength of demand, although this varies across regions. Around 60,000 houses were purchased annually by non-residents since 2022, with these transactions accounting for 8.4% of total purchases in 2024. This proportion is higher in tourist areas, such as the islands and the Mediterranean coast, due to the high demand for second homes from non-residents.[5] In the overall housing stock more than 500,000 homes are owned by foreign-born non-residents, representing 2% of the total. This figure can be as high as 11% and 8.5% in the provinces of Alicante and Málaga, respectively. In addition, tourist rentals exert further demand pressure in tourist areas and the centres of large cities. The available estimates suggest that the number of tourist dwellings increased by 50,000 units on average in 2024, compared with 2023.[6]
- **Macroeconomic context.** Housing demand in 2024 was underpinned by significant growth in employment (2.2%) and per capita real gross disposable income (3.5%). Moreover, households' net worth has improved, conditions for accessing mortgage lending have eased and interest rates have gradually decreased,[7] all of which contribute to boosting demand for home ownership.

2 **Residential real estate supply indicators.** Residential real estate supply indicators showed signs of greater

1 See Andrés Lajer Barón, David López-Rodríguez and Lucio San Juan. (2024). "El mercado de la vivienda residencial en España: evolución reciente y comparación internacional". Documentos Ocasionales, 2433, Banco de España. https://doi.org/10.53479/37873, and Dmitry Khametshin, David López-Rodríguez and Luis Pérez García. (2024). "El mercado del alquiler de vivienda residencial en España: evolución reciente, determinantes e indicadores de esfuerzo". Documentos Ocasionales, 2432, Banco de España. https://doi.org/10.53479/37872

2 Foreign-born residents are estimated to have grown by around 540,000 in 2024 and by around 3.5 million since 2016, compared with a fall in Spanish-born residents of around 85,000 in 2024 and 800,000 since 2016. See INE. (2025). *Continuous Population Statistics.* https://www.ine.es/dyngs/INEbase/en/operacion.htm?c=Estadistica_C&cid=1254736177095&menu=ultiDatos&idp=1254735572981

3 For more details, see Banco de España. (2021). "Chapter 4. The spatial distribution of population in Spain and its economic consequences". In Banco de España, *Annual Report 2020,* pp. 249-284. https://repositorio.bde.es/handle/123456789/16610. See also Banco de España. (2024). "Chapter 4. The Spanish housing market: recent changes, risks and affordability problems". In Banco de España, *Annual Report 2023,* pp. 110-113. https://repositorio.bde.es/handle/123456789/36494

4 INE. (2025). *Continuous Population Statistics.* https://www.ine.es/dyngs/INEbase/en/operacion.htm?c=Estadistica_C&cid=1254736177095&menu=ultiDatos&idp=1254735572981

5 For example, these ratios are 35.5% in the province of Alicante, 28.5% in Málaga, 26% in the Balearic Islands and 22% in Santa Cruz de Tenerife.

6 INE. (2025). *Experimental statistics. Measurement of the Number of Tourist Dwellings in Spain and their Capacity.* https://www.ine.es/en/ experimental/viv_turistica/experimental_viv_turistica.htm?L=1

7 Keeping real interest rates on mortgages for house purchase at historically low values.

Box 4
RECENT HOUSING MARKET DYNAMICS (cont'd)

momentum in 2024, even though quantitatively the increases were relatively modest and their impact in terms of boosting housing supply will materialise in the coming years.

- **New housing.** In 2024 building permits were issued for around 127,500 new dwellings, up 16.7% on the previous year. This increase was driven by a rise in the construction of flats (20%), with single-family homes experiencing lower growth (5%). The single-family home segment, which increased significantly after 2021, still accounts for around 20% of new builds and uses up more of the land available for construction. Within around two years this growth in activity is expected to lead to an increase in housing completions, which stood at around 100,000 in 2024.
- **Employment and residential investment.** Employment in real estate and construction increased in 2024 to 8.2% of total employment (7.5% in the euro area) and residential investment stood at 5.8% of GDP, in line with that of the euro area. This increase in real estate activity could be constrained by the relative shortage of skilled labour for housing construction.[8]
- **Housing rehabilitation.** Rehabilitation permits were issued for around 24,000 dwellings in 2024, up 7.3% on the previous year. However, these figures are significantly below the annual targets set in the Spanish Recovery, Transformation and Resilience Plan (300,000 dwellings per year until 2030).
- **Government-subsidised housing.** The supply of government-subsidised housing has also gathered momentum, although the starting levels are low. For example, the number of government-subsidised housing units officially certified as such, promoted through State and regional housing plans, increased by 5,500 in 2024, to roughly 14,500 dwellings. In addition, government-subsidised housing starts, which will be completed over the next two years, grew by around 11,500 units in 2024, to approximately 24,000 dwellings.
- **Land and productive capacity.** The availability of urban land for construction is essential to increase housing supply. The available information to 2024 suggests that in recent years there have been no large urban developments at any of the various stages of land development that have boosted the production of build-ready land in large cities.[9] At the same time, the construction and housing development sector is dominated by highly-leveraged small and medium-sized enterprises with limited recourse to own funds to finance new housing developments. Moreover, industrialised construction appears to have little penetration in Spain, against a backdrop of declining productivity – measured, for example, by total factor productivity (Chart 1) – and a shrinking skilled labour pool in the construction sector.
- **Residential rental supply.** The rental housing stock grew strongly boosted by an increase in market rentals of more than one million dwellings over the last decade. This growth was underpinned by a substantial increase in supply based on investments by individuals, in contrast to the decrease in the market share accounted for by institutional investors and public administrations. For example, in 2023 (the latest available figure), the stock of market-price rental housing owned by natural persons increased by more than 90,000 dwellings, the highest figure since 2019, but below the annual average increase in 2014-19 (130,000 units).[10] This increase in investment took place in a context where the non-risk-adjusted gross returns on private residential investment by individuals exceeded gross returns on alternative financial assets (such as shares, bonds and deposits).[11]
- **Non-residential rental supply.** Housing supply for alternative uses (such as seasonal, room or tourist

8 According to the Banco de España Business Activity Survey (EBAE), in 2024 55% of firms in the construction sector reported that labour shortages were a limiting factor for their activity.

9 The data on urban land and its development status from the Urban Information System (Sistema de Información Urbana) can be used to analyse how these developments unfold.

10 The public administrations own around 300,000 rental housing units and corporations own around 210,000.

11 Gross returns on residential investment in real terms were 8.5% per year between 2015 and 2022, according to the calculations in Dmitry Khametshin, David López-Rodríguez and Luis Pérez. (2024). "El mercado del alquiler de vivienda residencial en España: evolución reciente, determinantes e indicadores de esfuerzo". Documentos Ocasionales, 2432, Banco de España. https://doi.org/10.53479/37872

Box 4

RECENT HOUSING MARKET DYNAMICS (cont'd)

Chart 1
Change in total factor productivity (TFP)

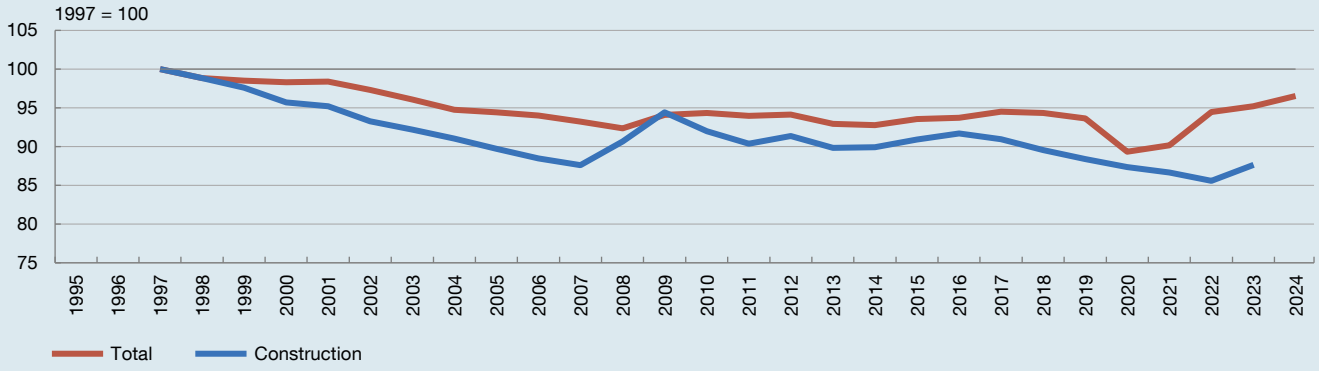


Chart 2
Maximum capacity of the housing stock in 2024 to absorb residential demand (a)

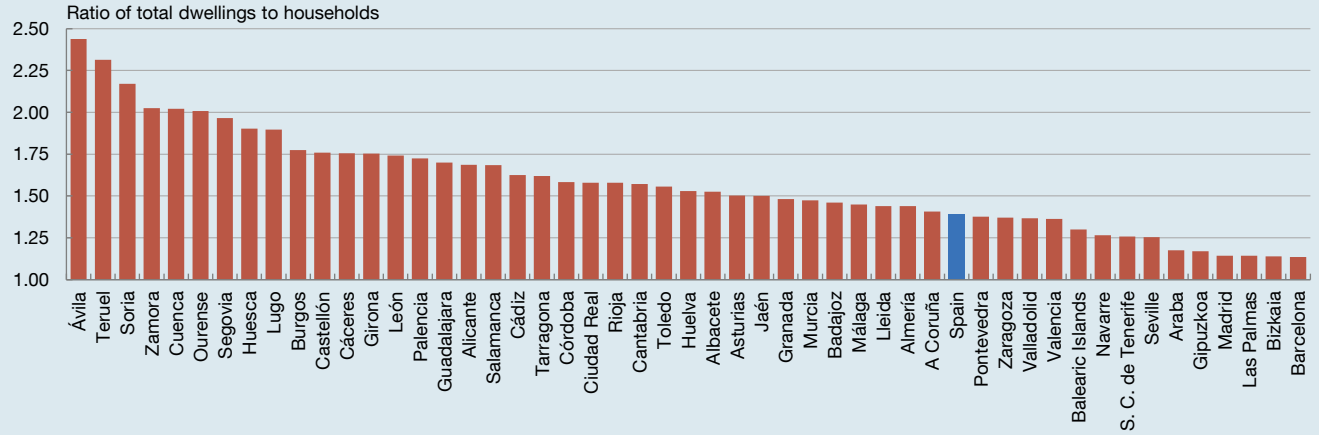
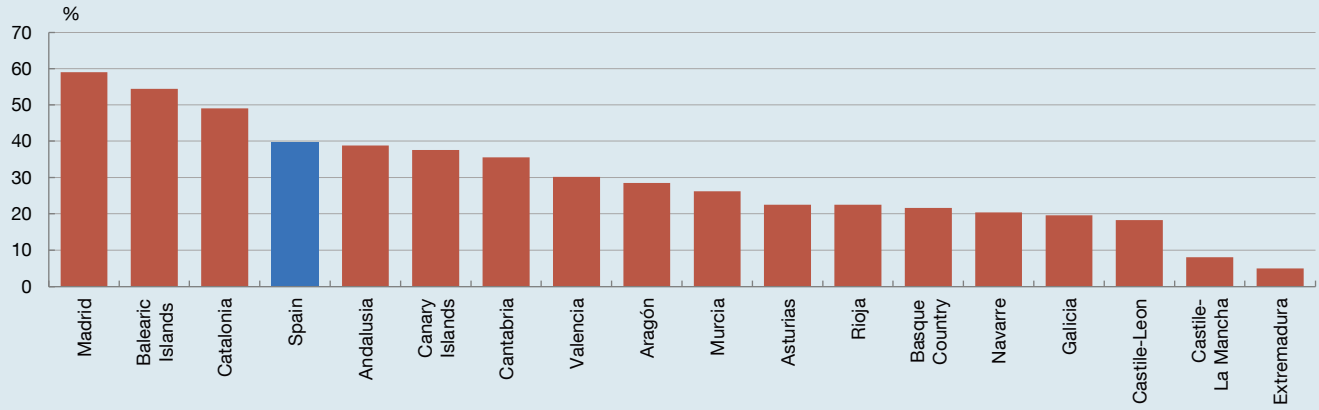


Chart 3
Real house price growth between 2014 and 2024, by region (b)



SOURCES: Comin, Quintana, Schmitz and Trigari (2025) and Banco de España drawing on data from Catastro, Ministerio de Transportes y Movilidad Sostenible and INE.

a Provincial housing stock figures are estimates for 2024. The figures for households are the provisional number of households resident in each province at 1 January 2025 published in the Continuous Population Statistics.
b Average price growth between 2014 Q1 and 2024 Q4. Nominal prices are deflated using the quarterly average of the consumer price index by region.

Box 4
RECENT HOUSING MARKET DYNAMICS (cont'd)

rentals) continued to trend upward in 2024.[12] The increase in these categories could limit residential rental supply growth against a backdrop of subdued public and private institutional investment in the rental housing market.

3 **Mismatch between housing supply and demand developments.** Stronger growth in housing demand than in housing supply is fuelling the rise in house prices and increasing the supply shortfall in properties for sale and rent.

- **House purchases.** House purchases grew strongly in 2024 (by 12%, to around 715,000). This growth was underpinned by the notable buoyancy in the second-hand market, which accounts for almost 90% of transactions.
- **New housing shortfall.** Housing supply growth, measured as the number of new housing completions in the recent period, has lagged behind the strong growth in residential demand, proxied by net household creation. For example, the cumulative differential between these two aggregates between 2022 and 2024 ranged between 400,000 and 450,000 housing units. The mismatch is particularly significant in five provinces (Madrid, Barcelona, Valencia, Alicante and Malaga), which account for just over 50% of this gap.[13] This suggests that in these areas a significant number of houses are being repurposed for residential use (for example, second and vacant homes) and that properties are being converted from tertiary to residential use.
- **The housing stock.** Available non-residential houses in Spain as a whole currently account for 39% of total households.[14] However, this housing availability is highly heterogeneous across provinces (Chart 2). For example, the proportion of existing dwellings that could be used to potentially increase the number of resident households is significantly more limited in provinces with high demographic pressure, such as Barcelona (13.2%) and Madrid (14.3%). In these provinces, if all second homes, homes with alternative uses (tourist and seasonal rentals) and, to a lesser extent, other vacant homes were mobilised to bring the current housing stock to its maximum capacity, it would be able to accommodate 310,000 additional households in Barcelona and 390,000 in Madrid.[15] The residential housing shortage is also observed in the Basque provinces and Las Palmas, and contrasts with the excess housing capacity relative to the number of households in Spain's inland provinces. Meanwhile, potential residential housing ratios are also high in the Mediterranean coastal provinces and the islands, although in these areas second homes owned by residents and non-residents and tourist rentals play a large role. When tourist dwellings and houses owned by non-residents are taken into account, residential housing capacity decreases by over 50% in the Balearic Islands and the Canary islands, 40% in Malaga and 35% in Alicante.[16]
- **House prices.** The persistent mismatch between the growth of supply and demand helps to support rising house prices. The year-on-year growth rate of average real house prices in Spain increased to 8.7% in 2024 Q4, bringing the cumulative rise in real house prices to 39.8% since the low recorded at the end of the real estate market correction in 2014 Q1. In this period, real prices of new housing increased at a higher rate (62.1%) than those of existing housing (36.4%). In addition, there is significant geographical heterogeneity in these price developments. For example, real house prices rose most in cumulative terms in regions with the highest growth in economic activity and

12 Studies based on data from property websites suggest that the number of advertisements for seasonal and room rentals has risen, particularly in large cities and tourist areas, and that these types of rentals have increased among younger people. The estimated increase in tourist dwellings and their geographical distribution can be found in INE. (2025). *Experimental statistics. Measurement of the Number of Tourist Dwellings in Spain and their Capacity.* https://www.ine.es/en/experimental/viv_turistica/experimental_viv_turistica.htm?L=1

13 Andrés Lajer Barón, David López-Rodríguez and Lucio San Juan. (2024). "El mercado de la vivienda residencial en España: evolución reciente y comparación internacional". Documentos Ocasionales, 2433, Banco de España. https://doi.org/10.53479/37873

14 This calculation does not take into account the state and livability of these houses, which is not known.

15 The latest available estimate of the number of vacant homes, based on 2020 data, stands at close to four million. However, many of these dwellings are in areas with low population growth and only 400,000 of them were in municipalities with a population of more than 250,000. INE. (2023). *Population and Housing Censuses 2021.* https://www.ine.es/en/prensa/censo_2021_jun_en.pdf

16 In Spain as a whole, these dwellings represent 11.5% of the potential residential housing capacity.

Box 4
RECENT HOUSING MARKET DYNAMICS (cont'd)

tourism where the population tends to concentrate in cities (Chart 3).

- **Rental prices.** Based on the data available, the average cost of real rent per square metre for rented housing stock in the common fiscal territory (i.e. all Spanish regions excluding the Basque Country and Navarre) climbed by 12.5% in cumulative terms between its low in 2015 and 2023. This growth varies considerably by geographical area, with higher increases in large cities and tourist areas, where the mismatch between supply and demand is greater.[17] Furthermore, the prices in new rental contracts point to future surges in the average cost of rent. For example, the estimated entry prices of the rental market indicate significant buoyancy in 2022-23, with year-on-year growth of more than 10% in the real prices of new contracts.[18] Similarly, the flash indicators for 2024 and 2025 Q1, based on asking rental prices on the main property portals, also indicate that rents grew strongly by around 10% in nominal terms.
- **Mortgage lending.** Recourse to mortgages to finance house purchases increased in 2024, against a backdrop of falling borrowing costs, in line with the looser monetary policy stance. Thus, the cost of financing of new loans to households for house purchase declined progressively over 2024 by an average of 95 basis points (bp) year-on-year at end-2024. These developments in financing conditions contributed to a significant rise in the number of new residential mortgages in 2024 (24.6%) and of new mortgages for house purchase (17.6%).
- **Purpose of mortgages for house purchase.** In 2024, most mortgages granted by financial institutions operating in Spain to households for house purchase were intended for the purchase of their principal residence (86.5% of the total). In particular, 73% of the total were for first-time purchase of a principal residence and 13.5% related to households which moved or changed the mortgage loan on their principal residence. Among the other purposes of taking out a mortgage, buy to rent accounted for 1% of the total and other purchases, for example, buying a second home, represented 12.5%.[19]
- **Financing of real estate and construction activity.** The stock of bank credit for real estate and construction activity climbed modestly (by 0.7%) in 2024. In addition, real estate market analysts indicate that alternative financing via investment funds spurred growth in 2024 in segments expected to have high returns in residential housing development.[20]
- **Credit standards.** The buoyant housing market and patterns of borrowing and lending in real estate in 2024 are not linked to laxer credit conditions. Specifically, there have been no warning signs about the situation of the mortgage market or the credit standards of security for loans, which are stringent by historical standards.[21] For example, the loan-to-price (LTP) ratio was similar to previous years: it averaged 76.5% and stood at less than 80% for nearly 60% of loans for house purchase. At the same time, no significant changes were observed in the loan-to-income (LTI) ratio and loan-service-to-income (LSTI) ratio indicating an easing of lending standards for households with new mortgages.

4 **Housing affordability difficulties:** the imbalance between supply and demand in residential housing

17 For example, real average rents per square metre increased between 2015 and 2023 by 35.9% in Valencia, 28.8% in Málaga, 27.3% in Palma and by around 25% in Alicante and Castellón de la Plana.

18 Calculations based on information on the annual average rent per square metre provided by the Spanish tax authorities (AEAT) for the rented property stock owned by individuals; the rental CPI, which approximates updated prices of contracts in force; and the available data indicating that newly signed contracts account for between 25% and 30% of total contracts during this period.

19 These amounts increase, respectively, to 1.1% and 15.5% when mortgages for house purchases granted to sole proprietors and corporations are also included. Consequently, around 83.5% of these transactions in 2024 were linked to the purchase of a principal residence, in line with the average observed in the period 2016-24.

20 This growth was noted, for example, in the report prepared by EY Spain in The Living Property Telescope 2024.

21 Historical comparisons of lending standards generally started in 2004, when granular information became available for performing this analysis. A more detailed analysis of these standards can be found in Banco de España. (2024). Financial Stability Report. Autumn 2024. https://https://doi.org/10.53479/37958

Box 4
RECENT HOUSING MARKET DYNAMICS (cont'd)

contributes to the worsening of housing affordability indicators which is sharper among young people and in those geographical areas where economic activity is concentrated.

- **Housing affordability indicators.** The aggregate indicator which approximates house purchase affordability, measured in terms of the years of gross annual income required by a median household to buy an average housing unit, stood at 7.2 at end-2024.[22] This ratio is in line with the average affordability of the last three years and that recorded on average in 2024. However, the current cycle shows considerable differences across geographical areas. For example, the housing affordability indicator for renting households is higher in those provinces where economic activity and tourism are concentrated. In these provinces, in 2022 the house price-to-income ratio stood at more than nine years of gross annual income in city centres and among lower-income groups (such as households below 35 years of age or foreign-born households).[23]

- **Housing affordability and mortgage lending.** The improvements in affordability based on household income growth and looser financial conditions in 2024 were constrained by the increase in house prices (Chart 4). The difficulties of financing a house purchase with a mortgage appear to be even greater among those groups living in rented properties. For example, approximately three-quarters of renting households do not have sufficient savings to cover the initial costs of buying an average house in the municipality where they reside or their mortgage repayment would exceed the recommended ceiling of 35% of net household income.[24] These figures are estimated to be higher in the larger metropolitan areas of Barcelona and Madrid where demand for residential housing among households without access to a mortgage has seemingly shifted to the rental market.

- **Housing affordability for young people.** Although in recent years the real average wages of young people have increased faster than those of other employees, the cumulative growth in real house purchase prices and rents has been even higher (Chart 5).[25] At the same time, despite recent improvements in their employment status, in 2024 the employment rate for young people under 30 was still low (43.2%) and the unemployment and part-time employment rates for them were still high (20.2% and 25.3%, respectively, compared with 11.3% and 13.6% for the whole economy). Young people's employment status makes it difficult for them to obtain a mortgage and to rent a property. These housing affordability difficulties could help to explain why young people are leaving home at a later age than they used to before 2008,[26] and the fall in the relative weight of house purchases by buyers aged between 18 and 30, which has declined from 24.5% in 2007 to 10.4% in 2024.[27] Likewise, these housing affordability problems are reflected in the growing intergenerational inequalities in the accumulation of wealth and the increasing importance of family members donating and transferring property free of charge in wealthier households.

- **Affordability indicators in the rental market.** Renting is growing among lower-income households and is predominant among young people and the foreign-born population.[28] These households spend

22 The changes in this indicator and the methodology used to calculate it can be found in the Summary indicators of the real estate market.

23 These affordability indicators are obtained by combining household gross income and geographical location data for 2022 taken from the Household Panel (INE and AEAT, Fiscal Studies Institute), average house prices calculated on the basis of property sales microdata provided by the Colegio de Registradores (Association of Registrars), and housing tenure data provided by the AEAT.

24 Banco de España. (2024). "Chapter 4. The Spanish housing market: recent changes, risks and affordability problems". In Banco de España, Annual Report 2023, pp. 210-264. https://repositorio.bde.es/handle/123456789/36494

25 The estimated year-on-year growth rate of real prices for new rental contracts, which is particularly important for young people wanting to leave the family home, was around 10% over the last four years.

26 In 2023, 65.6% of young people between the age of 18 and 34 were living in the family home. This ratio stands 16 pp above the EU27 and has increased by 13 pp since 2008, which is the biggest rise among the large European economies.

27 Calculations provided by the Consejo General del Notariado (General Council of Notaries). (2025). Centro de Información Estadística del Notariado.

28 A total of 73% of households whose head is under 30 and 84% of households comprising non-EU27 nationals resided in private-market and low-cost housing (including rent-free accommodation) in 2024. This share stands at 26.4% for the total economy. See INE. (2025). Encuesta de condiciones de vida. https://www.ine.es/dyngs/INEbase/es/operacion.htm?c=Estadistica_C&cid=1254736176807&menu=resultados&idp=1254735976608

Box 4
RECENT HOUSING MARKET DYNAMICS (cont'd)

a greater proportion of their income on rent, although the relatively limited supply drives this indicator for all renting households. For example, the proportion of household gross income earmarked for private-market rent was higher in Spain than the total median proportion and by income percentile relative to the EU27 and the large European economies in 2022.[29] These ratios are elevated for the median renting household across most of Spain, although they are even higher in provinces popular with tourists and large cities, where households on average have to spend between 25% and 30% of gross income on rent. They give rise to persistent overburdening and social vulnerability, particularly among households living in rented properties.[30]

5 **The challenge of housing affordability and public policies.** The imbalances in the residential housing market are in line with those diagnosed in Chapter 4 of the Banco de España Annual Report 2023. Thus, the economic policy recommendations in that report remain valid in the current setting.

Accordingly, the measures adopted should include a long time frame and they should be designed together by the various tiers of general government responsible for housing. In particular, the priority for mitigating the current housing affordability problems would be to adopt measures to increase the housing supply, especially in the rental segment.

The most effective economic policy measures to increase housing supply include the following: (i)

Chart 4
House purchase affordability for buyers with mortgage financing (a) (b)

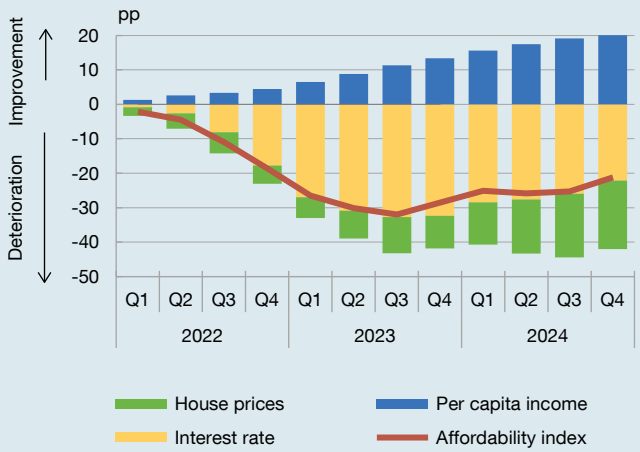
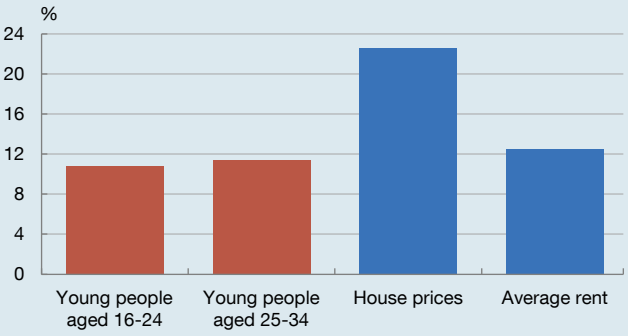


Chart 5
Cumulative growth of wages and real estate prices in real terms between 2015 and 2023 (c)



SOURCE: Banco de España drawing on data from INE, Colegio de Registradores and Servicio de Estudios Tributarios y Estadísticas de la AEAT.

a Index calculated following the methodology used in the Home Ownership Affordability Monitor (HOAM) Index of the Federal Reserve Bank of Atlanta. The change in the index and its components is expressed in percentage points of the change in their respective logarithms. The level of the index in 2021 Q4 is 100.
b House prices are measured with the INE's House Price Index, per capita income is the ratio of seasonally adjusted gross disposable income to population and the interest rate is the cost of new loans to households for house purchase.
c Wage growth is calculated based on the monthly gross average wages of workers' main job by age group in the Spanish Labour Force Survey (LFS); house price growth relates to growth in the House Price Index and the increase in rents relates to income per square metre for the average housing stock leased according to AEAT data. The nominal values are deflated using the annual average of the CPI.

29 Eurostat. (2024). EU statistics on income and living conditions [Dataset]. https://ec.europa.eu/eurostat/web/microdata/european-union-statistics-on-income-and-living-conditions

30 Eurostat (2024) considers that households are overburdened when they spend more than 40% of their gross income on housing, including utility costs. Households at risk of poverty or social exclusion are defined as those whose income does not exceed 60% of the median equivalised income after social transfers.

Box 4
RECENT HOUSING MARKET DYNAMICS (cont'd)

creating a stable regulatory and contractual framework to ensure legal certainty in the housing market; (ii) encouraging public and private sector collaboration to sustainably increase the stock of affordable rental housing; (iii) reducing administrative and regulatory friction in the production of land for development and housing construction; (iv) lowering housing production costs by promoting industrialised construction; and (v) designing new public insurance programmes and rental income compensation schemes for landlords.

These actions could be more effective where they are accompanied by measures in areas such as urban transport policy – which increases the potential supply of housing – and structural reforms to improve the purchasing power of lower-income households.

Box 5

A PRELIMINARY ANALYSIS OF THE INCREASE IN TEMPORARY SICK LEAVE IN SPAIN

Since the pandemic, the percentage of workers on temporary sick leave (TSL) has risen, from 2.7% in 2019 to 4.4% in 2024 (Chart 1.a)[1] on Spanish Labour Force Survey (LFS) data. Although TSL has also increased in other European countries, in 2023 it was higher in Spain (4.1%) than in France (3.6%), Germany (3.1%) and Italy (1.3%) (Chart 1.b).

As Table 1 shows, the pre-pandemic incidence of TSL in Spain was higher among women (3.3%, compared with 2.2% for men), Spanish nationals (2.9%, compared with 1.7% for the foreign population) and older workers (5%, more than double the figure for younger workers).

Over the past five years there has been a widespread increase in TSL across all population groups. It has risen by around 1.5 percentage points (pp) among men and by around 2 pp among women, and by age group, by 2.5 pp among those over 55, by 1.6 pp in the 30-54 age group, and by 1.1 pp among those under 30 years. The increase has been higher among Spanish workers (1.8 pp) than among foreign nationals (1.4 pp).

Considering other characteristics, such as sector of activity or region of residence, a fairly widespread increase in TSL is also observed, albeit with some nuances. For instance, between 2019 and 2023 TSL declined in extractive industries and energy supply activities, but it rose in agriculture, manufacturing, construction, wholesale and retail trade and transport, and increased sharply in water supply and sanitation (Chart 2.a).

By region, the Basque Country, Galicia, Cantabria and Murcia recorded the highest growth, well above that observed in Asturias, Madrid and, especially, Navarre (Chart 2.b).

The reasons for this increase in TSL are complex and multidimensional and are still under discussion. But it is widespread across personal characteristics, sector of activity and region, which suggests that there are common factors that are affecting all workers in a relatively similar way.

These potential factors include, first and foremost, health and demographics, such as the post-pandemic deterioration in health and population ageing (insofar as health tends to deteriorate with age).

Other possible causes not strictly related to the deterioration in workers' health include the business cycle itself (as historically the incidence of TSL tends to increase in periods of economic expansion), greater congestion in health services (which delays both healing and the return to work) and potential shifts in desired working hours or working conditions.[2]

Accurately measuring the contribution of each of these factors is extremely complex and would require a level of data granularity – both nationally and internationally – that is currently not available. The rest of this box tentatively explores the qualitative importance of some of the above-mentioned factors as explanations for this increase in TSL in Spain.

As regards how the health status of the population has evolved, the healthcare barometer of the *Centro de Investigaciones Sociológicas* (CIS, by its Spanish initials) shows that, between 2019 and July 2024, the percentage of people who reported having a chronic health problem rose by more than 17 pp. This pattern was observed across all the age brackets considered.

Meanwhile, the Survey of Health, Ageing and Retirement in Europe (SHARE) data point to marked differences in health status in Spain by gender, level of education and employment status from the age of 50, with women, people with a lower level of education and those outside the labour market all showing greater health deterioration. Among the over-50s, the probability of those who are in good health transitioning to poor health in the next wave of the survey is around 10%. For those already in poor health, the probability of remaining in poor health is at least 60 pp higher.[3] Consequently, poor health appears to be persistent, and health-impairing factors, such as the pandemic, could have very long-lasting consequences.[4]

1 Defined as the percentage of the employed who did not work in the reference week on account of illness, accident or temporary sickness, as a proportion of all persons employed.

2 See, for instance, R. Jason Faberman, Andreas I. Mueller and Ayşegül Şahin. (2022). "Has the Willingness to Work fallen during the Covid Pandemic?". *Labour Economics,* 79, 102275. https://doi.org/10.1016/j.labeco.2022.102275. The authors find that most demographic groups would like to see a widespread reduction in working hours, which they link to the impact of the pandemic on workers' lifestyle preferences.

3 Moreover, both women and people with a lower level of education are relatively more likely to fall into poor health in the future. See Laura Crespo, Angela Denis and Juan Francisco Jimeno. (2023). "The health status of the retirement-age population: a first approach". *Economic Bulletin – Banco de España,* 2023/Q4, 04. https://doi.org/10.53479/34892

4 Samuel Hurtado and Mario Izquierdo. (2023). "Economic effects of a possible prolonged deterioration in the general health of the Spanish population". *Economic Bulletin – Banco de España,* 2023/Q1, 20. https://doi.org/10.53479/29818

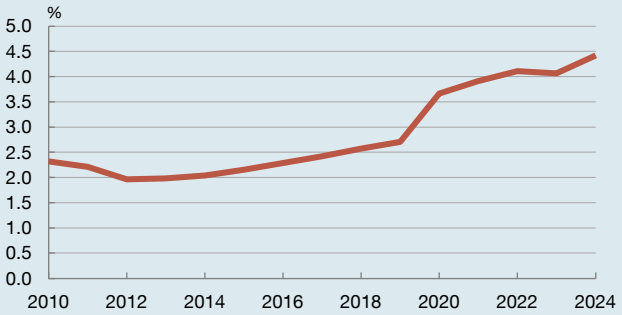
Box 5

A PRELIMINARY ANALYSIS OF THE INCREASE IN TEMPORARY SICK LEAVE IN SPAIN (cont'd)

As Chart 3.a shows, if the health status of the working-age population is proxied by the percentage of employed people reporting a chronic health problem, there is a clear positive correlation between this variable and TSL, especially in the post-pandemic period. This correlation holds if other health indicators are used, such as the percentage of the working-

Chart 1
In 2023, 4.1% of the employed were on temporary sick leave (TSL) in the reference week, one of the highest figures in the EU

1.a Percentage of the employed on TSL in Spain



1.b Percentage of the employed on TSL

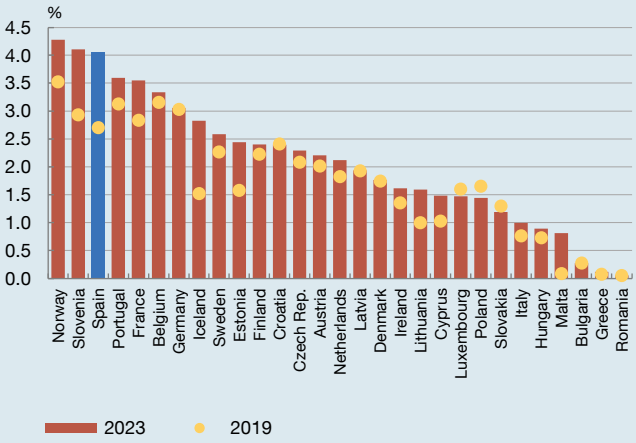
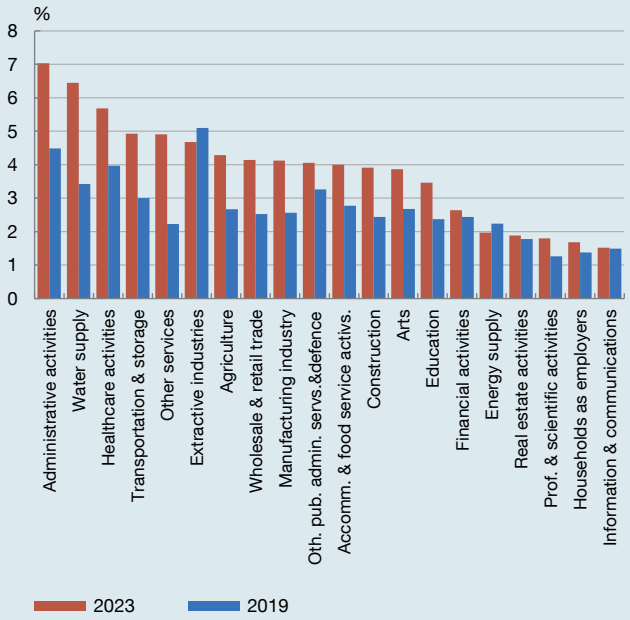
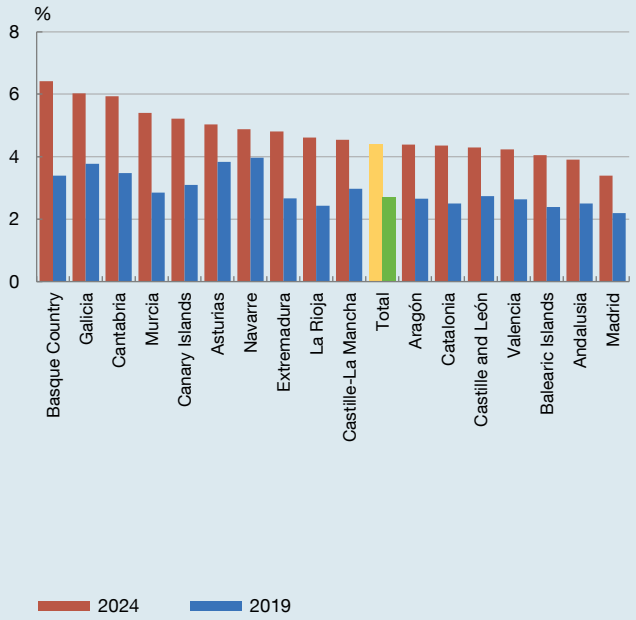


Chart 2
The incidence of TSL increased in all sectors of activity and across all Spanish regions and was most intense in administrative activities, water supply and health care and in northern Spain

2.a Percentage of the employed on TSL by sector of activity



2.b Percentage of the employed on TSL by region



SOURCES: Banco de España, drawing on data from the EU-SILC, the Labour Force Survey (Eurostat) and the Spanish Labour Force Survey (INE). See Arregui and Montero (2025).

Box 5
A PRELIMINARY ANALYSIS OF THE INCREASE IN TEMPORARY SICK LEAVE IN SPAIN (cont'd)

age population who report their health status as "fair" or "poor", or the frequency of primary care visits.[5]

Chart 3.b depicts how TSL and the unemployment rate (inverted scale) have evolved and illustrates the tight correlation between the two variables.

The increase in TSL has various economic implications, with negative effects for firms and for general government. From a fiscal perspective, the cost of TSL payments has risen sharply (by 78.5%) since 2019 and currently stands at just over €15 billion,[6] verging on 1% of GDP.

In comparative terms, this level of expenditure is among the highest in the European Union – alongside that of the Netherlands, Germany or Sweden where it amounted to between 1.5% and 2% of GDP in 2022 – and it has also seen one of the largest increases since 2019.[7] Thus, on comparable data to 2022, expenditure in Spain rose by around 0.3 pp of GDP, similar to the increase in the Netherlands, Sweden or Slovenia, whereas in other economies, such as France or Italy, this expenditure ratio held relatively stable over the same period.

For firms, TSL has both a direct cost, relating to the sums paid to absent workers, and an indirect cost, linked to the workforce restructuring they may need to make to continue their activity.

The Quarterly Labour Costs Survey (ETCL, by its Spanish initials) provides information on the payments firms make to workers on TSL, and the possible supplements.[8] These payments can be combined with LFS employee data to approximate the total direct cost. Specifically, it is estimated that the direct cost for firms has risen by 62%, from around €2,840 million in 2019 to some €4,613 million in 2024.[9]

In view of this sharp increase in expenditure, along with the worsening health status indicators and growing health system congestion, the social security authorities have implemented a series of measures to control spending

Table 1
Proportion of the employed on TSL

%	2019	2024
Men	2.2	3.7
Women	3.3	5.2
Age group		
16-29	1.1	2.3
30-44	2.2	3.8
45-54	2.7	4.3
55+	5.0	7.0
Nationality		
Spanish	2.9	4.7
Dual nationality	2.3	4.2
Foreign	1.7	3.2

SOURCE: Banco de España (Arregui and Montero, 2025), drawing on Spanish Labour Force Survey data (INE).

5 The frequency of primary care visits is the number of patients visiting primary care services as a proportion of the total population covered by the primary care health system.

6 These figures relate to non-professional contingencies. Including payments for professional contingencies the total is €16.48 billion.

7 José María Arregui and José Manuel Montero. (2025). Banco de España. Forthcoming.

8 This cost consists of the sums paid between day 4 and day 15 of the leave (60% of the regulatory base wage), plus possible supplements (potentially including payment from day 1 if so established in the applicable collective agreement or voluntarily decided by the employer) and the corresponding social security contributions.

9 This calculation excludes employees in agriculture, forestry and fisheries, so the estimated increase would be a lower bound.

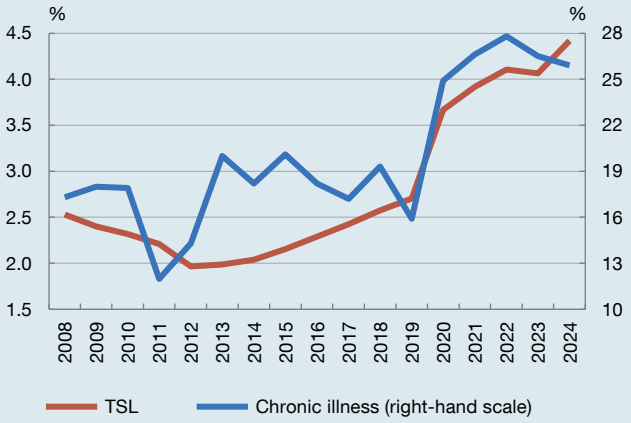
Box 5
A PRELIMINARY ANALYSIS OF THE INCREASE IN TEMPORARY SICK LEAVE IN SPAIN (cont'd)

and strengthen health services. These measures notably include renewing the bilateral agreements between the National Social Security Institute (INSS, by its Spanish initials) and the Spanish regions[10] for control of TSL (2025-28). In addition, cooperation agreements on non-professional contingencies are to be signed between the above-mentioned institutions and the mutual insurance companies that collaborate with the social security authorities, aimed at improving workers' health and ensuring that TSL is not prolonged unnecessarily in the case of traumatology/orthopaedic injuries. To this end, mutual insurance companies will be allowed to provide all diagnostic tests and medical treatments considered necessary.

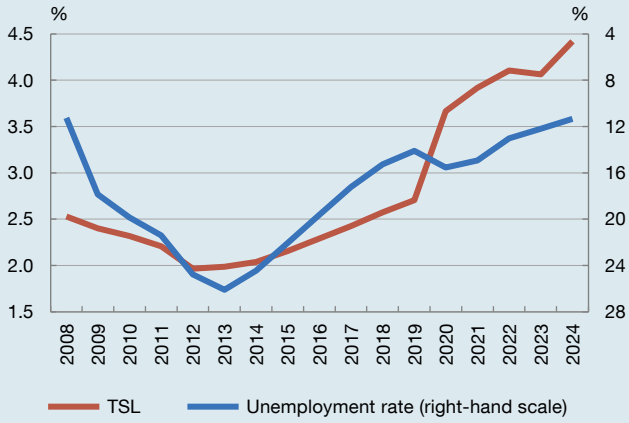
Future analysis of this question will seek to ascertain to what extent these various initiatives can help to mitigate the recent increase in TSL in Spain.

Chart 3
Health status and the cyclical position could explain a large part of the recent increase in absence from work

3.a Percentage of the employed on TSL and those with chronic health problems



3.b Percentage of the employed on TSL and the unemployment rate



SOURCES: Banco de España, drawing on data from the EU-SILC, the Labour Force Survey (Eurostat) and the Spanish Labour Force Survey (INE). See Arregui and Montero (2025).

10 Excluding Navarre and the Basque Country and including the National Institute of Health Management (INGS, by its Spanish initials).

Box 6

MIGRATORY FLOWS TO SPAIN IN RECENT YEARS: MAGNITUDE AND KEY DETERMINANTS

The immigrant population in Spain has increased significantly in recent years, especially since the end of the pandemic. In 2023, the net balance of immigrants stood at 642,000. Although this figure is high, it is lower than that recorded a year earlier (727,000) (Chart 1.a). For 2024, a preliminary estimate based on the partial information available indicates a net inflow of between 550,000 and 650,000 persons.

All told, according to the Continuous Population Survey, in the period 2009-2024 the share of foreign-born residents in Spain increased by 5.6 percentage points (pp) to 19.1% of the total population. During the same period, the share of working-age foreign-born individuals (between age 16 and 67) rose by 5.6 pp, to 22.3% of the total working-age population resident in Spain.

Thus, foreign-born residents in Spain are reaching a share in the total population similar to that in other countries that have traditionally been large recipients of immigrants (Chart 1.b).

To understand the causes underlying these migratory flows,[1] the economic literature usually distinguishes between pull and push factors.

Pull factors are linked to the socio-economic situation of the destination country. These include, for instance, better job opportunities, higher income prospects, flexible immigration policies and an established network of compatriots already living in the destination country who can help the new immigrants settle rapidly.

Push factors, however, are linked to the socio-economic situation of the country of origin. Noteworthy among these are, for example, the level of political instability, the occurrence of natural disasters or food crises and, in general, any aspects that can influence the current and future economic situation of the country of origin.

Chart 1
Net external migration (a)

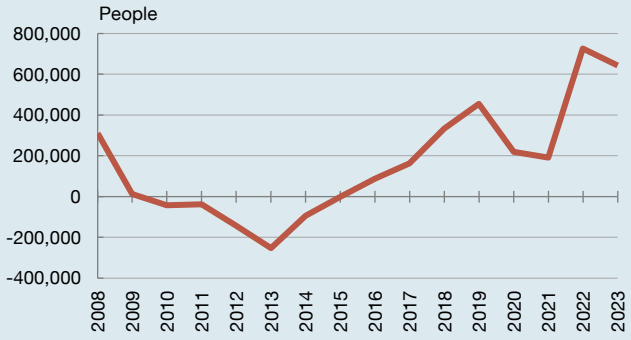
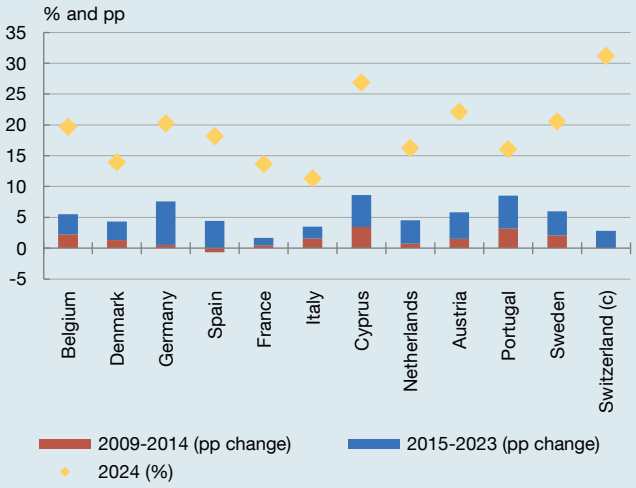


Chart 2
Proportion of immigrant population (b)



SOURCES: INE (migration statistics) and Eurostat.

a Net external migration is comprised of the number of foreigners who become residents in Spain and the number of persons who leave Spain to take up residence abroad.
b Immigrant population is defined by country of birth.
c No data are available for the period 2009-2014.

1 Beyond the size of these flows, a recent paper by the Banco de España shows that those arriving in Spain in recent years are older and have a higher education level than those who arrived in previous waves. Pilar Cuadrado, Ángel Luis Gómez and Teresa Sastre. (2024). "Comparing the characteristics of migratory flows to Spain and other European Union countries". *Economic Bulletin - Banco de España,* 2024/Q3, 06. https://doi.org/10.53479/37432

Box 6

MIGRATORY FLOWS TO SPAIN IN RECENT YEARS: MAGNITUDE AND KEY DETERMINANTS (cont'd)

The relative importance of the push and pull factors can be analysed by adapting the methodology proposed by Amiti and Weinstein[2] to separate the portion of bilateral migrant flows determined solely by factors related to the country of origin from that determined only by factors specific to the destination country.

Chart 3
Breakdown of migratory flows to Spain into push and pull factors (a)

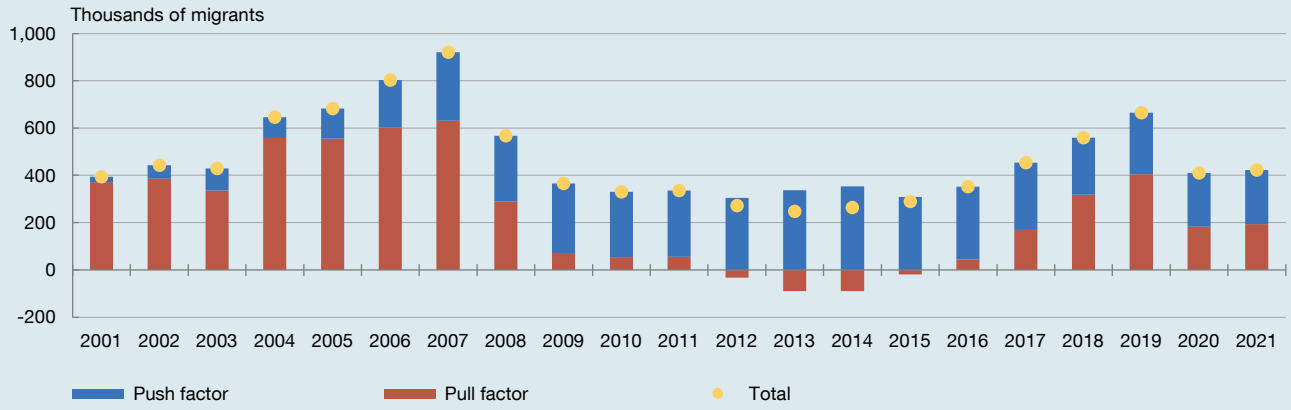


Chart 4
Impact of pull factors on inflows (b) (c)

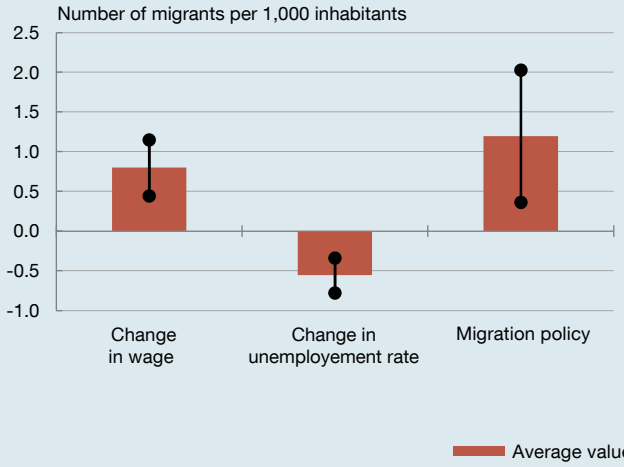
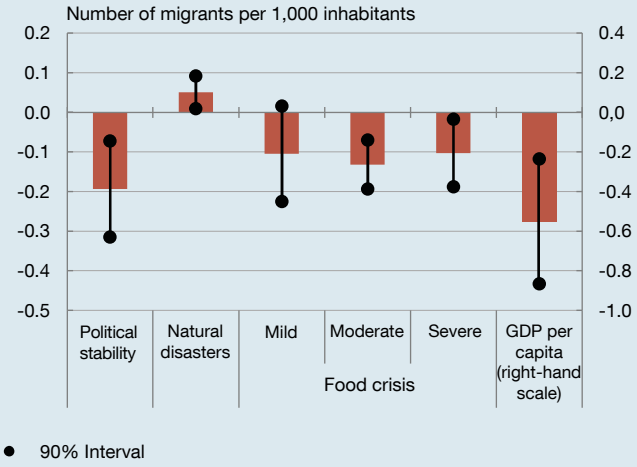
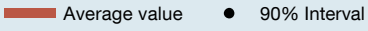


Chart 5
Impact of push factors on outflows (b) (c)





SOURCES: OECD, Banca d'Italia and Banco de España.

a Amiti and Weinstein (2013, 2018).
b Estimates based on regressions with fixed country and time effects for the pull component in migratory inflows and for the push component in outflows. The explanatory variables are standardised and one-period lagged.
c Including information from 34 countries receiving migrants, mainly advanced economies, and around 200 countries of origin of migrants arriving in OECD countries. The data on migratory flows are not harmonised, reflecting each country's criteria in their population and migration statistics (OECD (2024). "Statistical annex". In OECD, *International Migration Outlook 2024).*

2 These authors break down the growth of bank lending to firms into the parts which relate to demand shocks specific to firm borrowers and to bank loan supply shocks, using individual data disaggregated at a bilateral bank-firm level and applying a series of statistical assumptions and "additivity restrictions". See Mary Amiti and David E. Weinstein. (2013). "How much do idiosyncratic bank shocks affect investment? Evidence from matched bank-firm loan data". NBER Working Paper Series, 18890, National Bureau of Economic Research. https://doi.org/10.3386/w18890, and Mary Amiti and David E. Weinstein. (2018). "How much do idiosyncratic bank shocks affect investment? Evidence from matched bank-firm loan data". *Journal of Political Economy,* 126(2), pp. 525-587. https://doi.org/10.1086/696272

Box 6

MIGRATORY FLOWS TO SPAIN IN RECENT YEARS: MAGNITUDE AND KEY DETERMINANTS (cont'd)

A recent Banco de España study[3] suggests that, except in the period preceding the global financial crisis, the push factors (linked to the countries of origin) have historically played a greater role in migrant inflows to Spain than the pull factors (associated with the Spanish economy). However, in the recent rise in immigration observed in Spain, pull factors have gained relative importance (Chart 2.a). This indicates that immigrant inflows to Spain – generally considered exogenous items in demographic analyses and projections, as well as in many economic models – are also influenced by characteristics specific to the country's economy.

To understand what aspects or conditions in the countries of origin and destination affect inflows to the advanced economies, an analysis was conducted using panel data.[4] The results of this exercise suggest that the main pull factors driving recent migratory flows to Spain include a lower unemployment rate, average wage increases and changes in Spain's migratory policies, which have fostered better social and employment integration (Chart 2.b).

In any event, the determinants specific to the countries of origin still have an important effect on migratory flows. As mentioned above, these push factors include most notably political instability and per capita income (Chart 2.c).

3 Teresa Sastre, Marta Suárez-Varela, Pilar Cuadrado and Enrica Di Stefano. (2025). "Factores que influyen sobre los flujos migratorios hacia España y otras economías avanzadas". *Boletín Económico - Banco de España.* 2025/T2, 08. https://doi.org/10.53479/39845. This study applies the Amiti-Weinstein decomposition to annual bilateral migrant flows. Further, panel data for a large number of countries are analysed to identify the aspects or conditions of the countries of origin or destination that influence migrant inflows and outflows.

4 Two panel regressions are conducted: the first one to explain the pull component in inflows to advanced economies and the second one to explain the push component in outflows from about 200 countries. In the first case, the explanatory variables relate to the characteristics of countries receiving migrants, while in the second, the explanatory variables are related to specific aspects of the countries of origin. The regressions include fixed country and time effects.

Box 7

TOTAL FACTOR PRODUCTIVITY IN SPAIN: MEASUREMENT AND RECENT DEVELOPMENTS

Total factor productivity (TFP) is a key determinant of the economy's long-term growth and cyclical behaviour and, given its importance, is among the variables most analysed within the research community.

However, any empirical analysis of TFP and its determinants must first address the challenge posed by its measurement, a complex task not least because, unlike turnover or wages, TFP is not directly observable.

The most widely used measure of TFP growth is the "Solow residual",[1] which represents the difference between a country's output growth and the growth in the weighted sum of observable inputs (such as capital stock and hours worked). This residual therefore encompasses elements as diverse as a country's institutional quality (see Box 8), firms' organisational and management capacity, innovative capacity and other intangibles that add value to firms' output.

The Banco de España has used this measure, with series estimated by Eurostat, in various analyses and reports.[2] But such measurements rest on a number of simplifying assumptions that, for various reasons, do not reflect the evidence available. First, they consider only the change in the aggregate number of hours worked, without factoring in changes in the composition of the labour force attributable to differences in skill levels. Second, the estimates assume perfect competition in the product markets, ignoring potential business profits and the bias these may introduce to the weight of capital stock in output. Lastly, standard TFP measures do not capture changes in factor utilisation (i.e. the intensity with which inputs are used), which may result in positive spurious correlation between changes in output and changes in productivity over different phases of the cycle.

In this setting, a recent Banco de España study[3] presents a new estimate of TFP growth for European economies, which relaxes the three above-mentioned assumptions. Specifically, it estimates annual industry-level and aggregate TFP growth series, based on assumptions that are more in line with the empirical evidence than the other TFP measures available. It also provides, for the first time, quarterly TFP series for the major European economies, which has the added advantage of making available up-to-date information on how TFP is evolving in different European countries with a relatively short time-lag.[4]

These new series entail various adjustments to the standard estimates (including the Eurostat estimates). First, they consider changes in the working week of different groups of workers (differentiated by education, age and gender) and of types of capital, estimating different output elasticities to each type of labour and capital.[5]

Second, these series also relax the perfect competition assumption considered in standard measurements and allow for profits. To this end, the use cost of capital is estimated for each sector of activity, which makes it possible to calculate profits in each sector and, therefore, to adjust the cost share of each factor. Thus, positive profits imply a lower output elasticity to capital and a higher output elasticity to labour.[6]

Lastly, the new series also consider cyclical changes in factor utilisation,[7] by adjusting the Solow residual using

1 Robert M. Solow. (1956). "A Contribution to the Theory of Economic Growth". *The Quarterly Journal of Economics,* 70(1), pp. 65-94. https://doi.org/10.2307/1884513

2 Banco de España. (2020). "Chapter 5. Challenges for the Spanish economy in the post-pandemic scenario". In Banco de España, *Annual Report 2019,* pp. 159-216. https://repositorio.bde.es/handle/123456789/13778

3 Diego Comin, Javier Quintana, Tom Schmitz and Antonella Trigari. (2025). "Revisiting Productivity Dynamics in Europe: A New Measure of Utilization-Adjusted TFP Growth". *Journal of the European Economic Association,* jvaf003. https://doi.org/10.1093/jeea/jvaf003

4 This means that the TFP series can be updated when the quarterly National Accounts data are published (generally with a lag of only one quarter), rather than when the annual series are published (usually with a lag of over a year). The new series will be updated regularly and made available to the public on the Banco de España's website: https://www.bde.es/wbe/en/areas-actuacion/analisis-e-investigacion/recursos/europrod-ua.html.

5 This type of adjustment is already included in some TFP growth series, such as the EUKLEMS series (F. Bontadini, C. Corrado, J. Haskel, M. Iommi and C. Jona-Lasinio. (2023). "Sources of growth and productivity trends: methods and main measurement challenges". EUKLEMS & INTANProd: industry productivity accounts with intangibles. (https://euklems-intanprod-llee.luiss.it/wp-content/uploads/2023/02/EUKLEMS_INTANProd_D2.3.1.pdf) for European economies and the U.S. Bureau of Labor Statistics' series for the United States (https://www.bls.gov/news.release/prod3.toc.htm).

6 Standard measures of the Solow residual calculate the use cost of capital as a residual, by subtracting labour costs and input costs from total turnover (all of which are easily observable in the data). However, where positive profits exist, the value of turnover exceeds the value of costs and, therefore, this approach overestimates the weight of capital in total costs.

7 Fernald (2014) ("A Quarterly, Utilization-Adjusted Series on Total Factor Productivity". Working Paper Series, 2012-19, Federal Reserve Bank of San Francisco. https://doi.org/10.24148/wp2012-19) estimates utilisation-adjusted productivity series for the United States, using the number of hours per worker as a proxy for the utilisation rate. However, given the characteristics of European labour markets, Comin, Quintana, Schmitz and Trigari (2025) ("Revisiting Productivity Dynamics in Europe: A New Measure of Utilization-Adjusted TFP Growth". *Journal of the European Economic Association,* jvaf003. https://doi.org/10.1093/jeea/jvaf003) argue that this variable is not a well-suited proxy for Europe or, specifically, for Spain.

Box 7

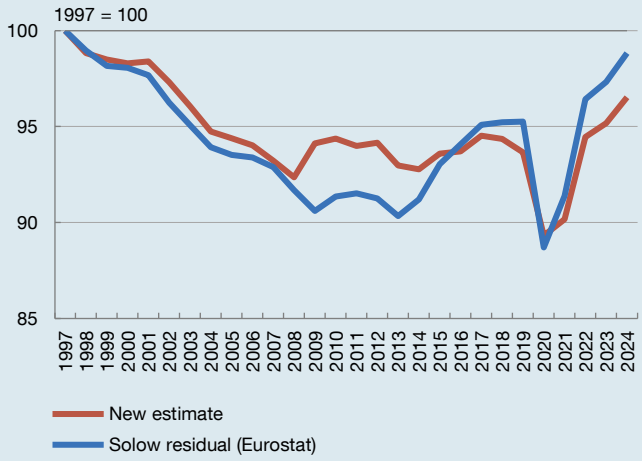
TOTAL FACTOR PRODUCTIVITY IN SPAIN: MEASUREMENT AND RECENT DEVELOPMENTS (cont'd)

information obtained from capacity utilisation surveys of firms operating in different sectors.[8]

Chart 1.a shows TFP in the Spanish economy estimated under the new methodology, compared with the series estimated by Eurostat using the standard method.[9] According to the results obtained, although the two series yield relatively similar estimates over a long-term horizon, there are marked differences in cyclical behaviour. The new TFP series are less volatile and have lower correlation with cyclical GDP fluctuations than those normally used

Chart 1
New estimates of TFP

1.a New TFP series under Comin, Quintana, Schmitz and Trigari (2025) and Solow residual (a)



1.b Contribution of the various adjustments to the differences between series (b)

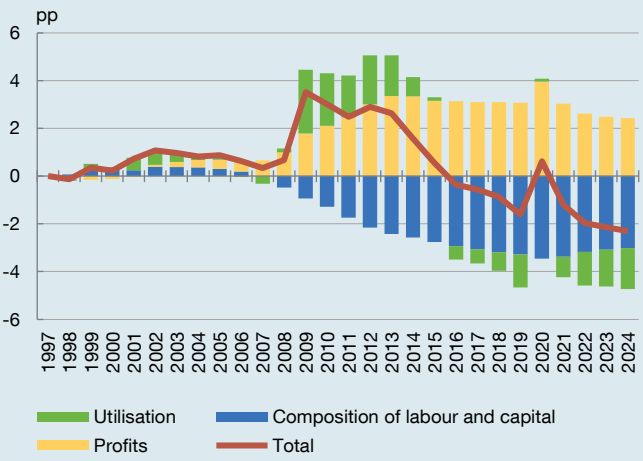
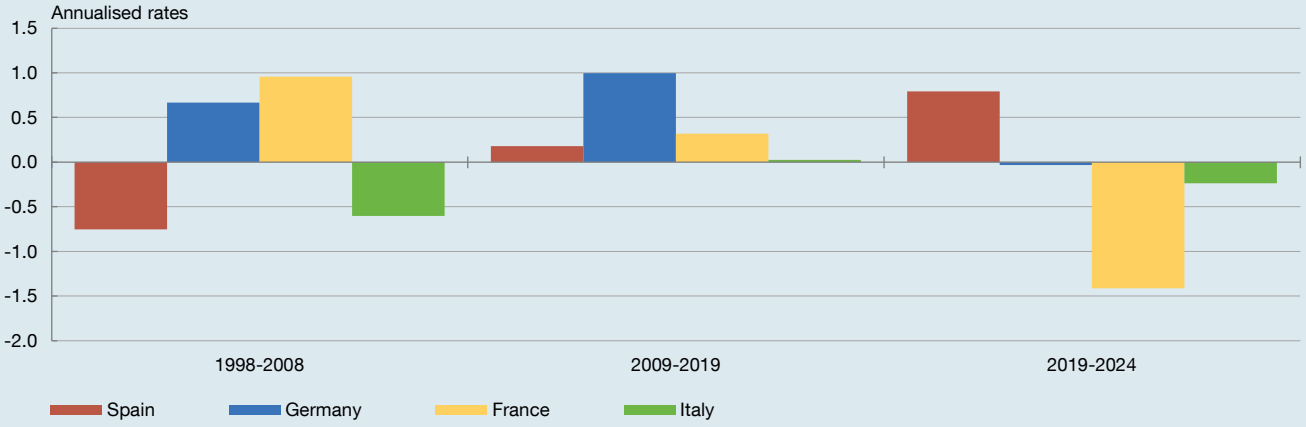


Chart 2
TFP growth in large European economies by period



SOURCES: Comin, Quintana, Schmitz and Trigari (2025) and Eurostat.

a TFP series for Spain estimated under the methodology in Comin, Quintana, Schmitz and Trigari (2025) and Solow residual estimated under the Eurostat methodology.
b Contribution, in percentage points, of each adjustment to the differences between the new TFP series and the Solow residual estimated under the

8 More specifically, it considers a regression where the dependent variable is the change in the composition- and profit-adjusted Solow residual and the independent variable is the change in the factor utilisation rate, implemented through demand shock variables to remove any possible endogeneity. The residual of this regression is the measure of TFP adjusted for composition, profits and utilisation.

9 To facilitate the comparison, both series are presented under the Eurostat method, applied to the market economy excluding agriculture and mining. The new series runs to 2024 (not currently available in the series published by Eurostat).

Box 7
TOTAL FACTOR PRODUCTIVITY IN SPAIN: MEASUREMENT AND RECENT DEVELOPMENTS (cont'd)

(such as the Eurostat series). The new series' lower cyclicality appears to be in line with what would be expected of a measurement of true technological progress.

Chart 1.b shows the contribution of each of the three adjustments described above to the differences between the two series. First, the new methodology considers changes in the composition of inputs (labour and capital) and enables them to be distinguished from changes in TFP (i.e. from the efficiency with which these inputs are combined). Specifically, this adjustment entails a secular reduction in TFP growth in Spain, particularly in the years after the real estate crisis, by separating changes in TFP from the changes in output owing to the relative increase in hours worked per skilled worker.[10]

Second, the adjustments for changes in capacity utilisation and profits play a more relevant role in the cyclical behaviour of TFP. The main differences occur when correcting for changes in capacity utilisation levels. During recessions, a considerable part of the fall in firms' output stems from lower capacity utilisation, which subsequently recovers during periods of growth. Measures that do not include this margin of adjustment will therefore tend to create a spurious correlation between changes in GDP and TFP, ascribing to changes in productivity what in reality are changes in factor utilisation.

For its part, the profit adjustment reduces the cost share of capital and increases that of other inputs (such as labour). Measures that do not include this adjustment therefore tend to overestimate the level of output that may be expected at times when the relative level of capital stock outpaces the number of hours worked. Given that in a recession the number of hours worked falls more sharply than capital stock, standard measures tend to overestimate the decrease in TFP in those periods and, in turn, to overestimate its growth during the recovery, again creating a spurious relationship between this variable and GDP growth.

In sum, the new TFP estimates improve on the measures currently used in various ways. First, they isolate secular changes in the composition and quality of inputs and provide a closer estimate of the efficiency with which they are combined in the economy. Second, the new measure is less volatile and yields a lower correlation between changes in TFP and in GDP, which is to be expected of a variable that truly captures technological change.

According to the new estimates, since 1998 TFP has performed less well in the Spanish economy than in other large European economies, such as Germany and France, but there are clear differences across time periods.

In this regard, Chart 2 shows the annual TFP growth rates by period. As can be seen, productivity in the Spanish economy underperformed in the period 1998-2008, when high economic growth was based on increases in the workforce and investment, but TFP declined on average by 0.8% per annum. TFP performed poorly across all sectors of the Spanish economy, but it was also hampered by a sectoral specialisation in industries with particularly low productivity levels. In comparison, TFP in Germany and France saw annual average growth of 0.7% and 1%, respectively, in the same period.

In the decade following the financial crisis, although the decrease observed in the previous cycle came to a halt, Spain saw no substantial increase in TFP, with the growth rate averaging around 0.2% per annum. In comparison, annual average TFP growth stood at 0.3% and 1% in France and Germany, respectively.

Since the pandemic, however, Spain has been the only large European economy that has seen significant TFP growth.[11] Although this improvement is still difficult to accurately quantify, it appears to be in part associated with a slight shift in activity towards certain services sectors with higher relative productivity (see Sections 3.1 and 3.3).

This better performance of TFP in Spain in recent years has helped narrow, but not fully close, the productivity gap vis-à-vis the other large European economies. Specifically, after widening by 17 percentage points (pp) between 1998 and 2019, the gap with the average of the other three large European economies had only narrowed to 10 pp by 2024.

10 It is, however, important to note that the measure of TFP is still a GDP residual that cannot be explained by directly observable factors. The advantage of including additional adjustments (such as changes in the composition of the labour force) is that it cleans up the residual and yields a measure that more closely reflects true technological or organisational changes or efficiency gains. Consequently, the new TFP measures do not imply changes in GDP levels, but instead provide more accurate information on the factors behind such changes.

11 The latest data available are for 2024 Q3.

Box 8
INSTITUTIONAL QUALITY AND PRODUCTIVITY

There is consensus in the economic literature about the positive association between institutional quality and the levels and rates of productivity growth. Institutional quality refers to the effectiveness of the rules and systems that societies establish to govern political, social and economic relationships. Institutions are the constraints that humans have created to control interactions between individuals and groups, establishing a structure that determines the incentives and constraints for economic agents.[1]

Various types of mechanism underpin this positive association between institutional quality indicators and productivity growth levels and rates.

First, better institutions help to boost investor confidence by providing a more stable and predictable legal framework to foster innovation and lower transaction costs.[2]

Second, higher quality institutions are often associated with lower levels of corruption, enabling a more efficient allocation of public and private resources.[3]

Third, more efficient bureaucracy can make it quicker and less costly to set up, launch and run a business, thereby fostering business investment.[4]

Fourth, institutions can have an impact on innovation and on the winners and losers from technological change. Indeed, the literature available indicates that higher institutional quality encourages both the creation of new technologies (invention and innovation) and their adoption and efficient use.[5]

Lastly, institutional quality can affect economic decision-making not only via the aforementioned effects, but also through economic agents' perception of the institutions. For instance, any corruption perceived by economic agents, whether justified or otherwise, can have similar adverse effects on their economic decisions as actual corruption.[6]

Measuring institutional quality is complex and typically relies on value judgements regarding the relevance of its multiple dimensions. Commonly used institutional quality indicators include the World Bank's Worldwide Governance Indicators, essentially based on surveys of businesses and households on how they perceive various aspects of the functioning of the public and private sectors in around 200 countries, and the V-Dem Institute's V-Dem Dataset, which measures the functioning of democracy in a country.

Complementary to these indicators, a recent Banco de España study[7] uses a dataset comprising 32 developed Organisation for Economic Co-operation and Development (OECD) member countries, a broad selection of institutional variables and a principal component analysis to build institutional quality indicators to explore the differences between countries with similar development levels to Spain.

Two exercises are conducted. First, an institutional quality indicator (IND1) is constructed using the sample of OECD countries with similar development levels to Spain and all the institutional quality variables available. A second indicator (IND2) is then constructed taking European Union (EU) countries only and institutional quality variables pertaining exclusively to government effectiveness, the quality of laws and other regulations and the independence of public institutions.

The period under review is 2000-2021. The data used were compiled by the Quality of Government Institute at Gothenburg University. The initial dataset comprises 1,126 variables, 306 of which measure various aspects related to institutional quality. After analysing the variables, the study was narrowed to 74 that offer sufficient

1 Douglass C. North. (1990). *Institutions, Institutional Change, and Economic Performance.* Cambridge University Press. https://doi.org/10.1017/CBO9780511808678

2 Gilbert Cette, Jimmy Lopez, Jacques Mairesse and Giuseppe Nicoletti. (2024). "Trust, Intangible Assets, and Productivity". NBER Working Paper Series, 32513, National Bureau of Economic Research. https://www.nber.org/system/files/working_papers/w32513/w32513.pdf

3 Manuel García-Santana, Enrique Moral-Benito, Josep Pijoan-Mas and Roberto Ramos. (2020). "Growing like Spain: 1995-2007". *International Economic Review,* 61(1), pp. 383-416. https://doi.org/10.1111/iere.12427

4 Balázs Égert. (2016). "Regulation, Institutions, and Productivity: New Macroeconomic Evidence from OECD Countries". *American Economic Review,* 106(5), pp. 109-113. https://www.aeaweb.org/articles?id=10.1257/aer.p20161026

5 Daron Acemoglu. (2025). "Institutions, technology and prosperity". NBER Working Paper Series, 33442, National Bureau of Economic Research. https://www.nber.org/system/files/working_papers/w33442/w33442.pdf

6 Nicholas Charron. (2015). "Do corruption measures have a perception problem? Assessing the relationship between experiences and perceptions of corruption among citizens and experts". *European Political Science Review,* 8(1), pp. 147-171. https://doi.org/10.1017/S1755773914000447

7 Juan F. Jimeno and Carlos Sanz. (2025). "Institutions and Macroeconomic Performance". Documentos de Trabajo, Banco de España. Forthcoming.

Box 8
INSTITUTIONAL QUALITY AND PRODUCTIVITY (cont'd)

information by country and over time, along with adequate variability in the data.

The information provided by these 74 variables is synthesised using a principal component analysis and the first principal component of this exercise is used as institutional quality index IND1.

Table 1 shows the ten variables with the highest weight in IND1. The variables with the highest weighting relate to issues such as the state's capacity to manage public affairs and public perceptions about the prevalence of corruption in all its forms.

The second indicator (IND2) – capturing differences in government effectiveness, the quality of legislation and the independence of public institutions within the EU – is constructed using an approach similar to that for IND1 but limiting the sample to EU countries and selecting just ten variables relating to those three dimensions of institutional quality (Table 2).[8]

The results place Spain in an intermediate position, albeit below the average, among the countries analysed (Chart 1).

For instance, in 2020[9] the leading countries in institutional quality according to the IND1 indicator were Denmark, New Zealand and Norway. Spain ranks 19th out of the 32 countries considered, with a similar level to France and ahead of Italy and Portugal, but behind Germany.

Similarly, in the 2020 ranking according to the IND2 indicator, Denmark, Finland and Luxembourg held the top positions, while Spain stood below the average with institutional quality levels close to those of Portugal, the Czech Republic and Lithuania.

Looking at the time profile of these measures of institutional quality, between the first decade of this century (2000-2010) and the second (2011-2021) both deteriorated, on average, somewhat more markedly in Spain than in most of the other countries analysed (Chart 2).[10]

Specifically, of the 32 countries considered Spain recorded the fifth largest drop in the IND1 indicator, with only Hungary, Poland, the United States and Iceland posting larger declines in recent years. The same applies to the IND2 indicator: Spain, along with Greece and Hungary, is among the three countries experiencing the largest decrease.

These measures of institutional quality are positively correlated with levels of productivity and GDP per capita, both between countries and over time. For example, Chart 3 and 4 illustrate the correlation between IND1 and IND2 and levels of productivity and GDP per capita in 2019, respectively.[11]

Additionally, to examine the impact of institutional quality on productivity growth, the authors estimate the usual convergence equations found in the economic growth literature, which also take into account that productivity growth depends on its initial level. In particular, the following specification is estimated:

$$\Delta \ln y_{ct} = \alpha_c + \delta_t + \beta \ln y_{c,t-5} + \gamma CI_{c,t-5} + \varepsilon_{ct},$$

where c indicates the country; t (2005, 2010, 2015, 2019) indicates the year; α_c and δ_t are country and year fixed effects; $\Delta \ln y_{ct}$ is productivity growth between year t-5 and year t; $y_{c,t-5}$ is the TFP in year t-5; and CI is the institutional quality in year t-5.

Table 3 shows the results for each of the two institutional quality indicators constructed. A positive correlation is observed between institutional quality and productivity growth, such that an improvement in institutional quality is associated with subsequent higher productivity growth.

The coefficient of the IND1 indicator is statistically significant at the 10% level and indicates that an improvement of one standard deviation in the initial institutional quality is associated with 3.4% higher cumulative productivity growth over the following five years.

The estimated impacts are even larger for the IND2 indicator. Specifically, an increase of one standard deviation in the initial institutional quality is associated with 9.6% higher cumulative productivity growth over the

8 The correlation between IND1 and IND2 is 0.9. The correlations of IND1 and IND2 with the World Bank's Government Effectiveness Index are 0.85 and 0.96, respectively. The variance explained by the principal components used to build IND1 and the IND2 is 3% and 72%, respectively. The difference owes to IND1 considering a much larger set of variables to select the principal component than IND2.

9 The latest year for which information is available for the United States.

10 The variables that account for the majority of this deterioration are, in the case of IND1, those associated with control of corruption, voice and accountability and the rule of law. In the case of IND2 they are the variables relating to the rule of law, political stability and regulatory quality.

11 The data refer to 2019, the latest year with data available for the measure of productivity used here. Productivity refers to total factor productivity (TFP) at purchasing power parity according to the Penn World Tables.

Box 8
INSTITUTIONAL QUALITY AND PRODUCTIVITY (cont'd)

Table 1
Variables with the highest weight in the IND1 institutional quality index

	IND1		
Variable	Weight	Correlation	Source and description
Control of corruption, estimation	0.192	0.911	Worldwide Governance Indicators. Measures perceptions of corruption, defined as the exercise of public power for private gain. The aspects gauged vary from how often irregular additional payments are required to get things done, through to the effect of corruption on the business environment and widespread corruption in politics.
Voice and accountability, estimation	0.191	0.907	Worldwide Governance Indicators. Includes indicators for aspects such as the political process, civil liberties and political rights, as well as media freedom. These indicators assess citizen participation in selecting the government and the media's role in holding authorities to account.
Basic state capacity, loads based on PCA	0.190	0.899	"Leviathan's Latent Dimensions: Measuring State Capacity for Comparative Political Research" (Hanson and Sigman, 2021). Based on three dimensions: extractive capacity, coercive capacity and administrative capacity. The authors use Bayesian latent variable analysis to assess state capacity drawing on indicators related to these dimensions.
Political corruption index	-0.187	-0.887	V-Dem Dataset. On a scale from 0 to 1, with higher values indicating more corruption. Includes six different types of corruption across the executive, legislative and judicial sectors, differentiating between bribery and embezzlement, and between corruption at the highest levels of the executive and in the public sector in general.
Legal system and property rights (panel data)	0.187	0.886	Economic Freedom of the World (Fraser Institute). On a scale from 0 to 10, where 0 denotes "no judicial independence", "no protection of intellectual property", "military interference in rule of law" and "no integrity of the legal system", and 10 denotes "high judicial independence", "reliable legal framework", "protection of intellectual property", "absence of military interference in rule of law" and "integrity of the legal system".
Rule of law, estimation	0.186	0.881	Worldwide Governance Indicators. Includes indicators that measure confidence in and adherence to the rules of society, such as perceptions of crime, the legal system's efficiency and predictability and the enforceability of contracts. These indicators assess the success of a society in creating an environment with fair and predictable rules and in protecting property rights.
Public sector corrupt exchanges	0.184	0.872	V-Dem Dataset. Measures how routinely public sector employees grant favours in exchange for bribes or other material inducements. The scale ranges from extremely common corrupt exchanges to hardly ever.
Legislature corrupt activities indicator	0.183	0.869	V-Dem Dataset. Measures whether legislators abuse their position for financial gain. The scale ranges from common corrupt activities to hardly ever.
Bayesian Corruption Index (BCI)	-0.183	-0.868	Bayesian Corruption Index (Sherppa, Ghent University). Measures corruption levels, with values between 0 (no corruption) to 100 (maximum corruption). In contrast to the PCI and Worldwide Governance Indicators, where a higher figure means a lower level of corruption, the Bayesian Corruption Index uses an absolute scale: 0 indicates there is no corruption at all and 100 indicates that corruption is as bad as it can get.
Public sector theft	0.182	0.861	V-Dem Dataset. Measures how often public sector employees steal, embezzle or misappropriate public funds or other state resources for personal or family use. The scale ranges from constant theft to hardly ever.

SOURCE: Jimeno and Sanz (2025).

Box 8
INSTITUTIONAL QUALITY AND PRODUCTIVITY (cont'd)

Table 2
Variables with the highest weight in the IND2 institutional quality index

	IND2		
Variable	Weight	Correlation	Source and description
Rule of law, estimation	0.359	0.964	Worldwide Governance Indicators. Includes indicators that measure confidence in and adherence to the rules of society, such as perceptions of crime, the legal system's efficiency and predictability and the enforceability of contracts. These indicators assess the success of a society in creating an environment with fair and predictable rules and in protecting property rights.
Government effectiveness, estimation	0.358	0.960	Worldwide Governance Indicators. Combines in a single group responses on the quality of the provision of public services, bureaucratic quality, the competence of civil servants, the independence of the civil service from political pressures and the credibility of the government's commitment to policies. The index primarily focuses on the "inputs" required for the government to formulate and implement sound policies and deliver public goods.
Legal system and property rights (panel data)	0.355	0.952	Economic Freedom of the World (Fraser Institute). On a scale from 0 to 10, where 0 denotes "no judicial independence", "no protection of intellectual property", "military interference in rule of law" and "no integrity of the legal system", and 10 denotes "high judicial independence", "reliable legal framework", "protection of intellectual property", "absence of military interference in rule of law" and "integrity of the legal system".
Regulatory quality, estimation	0.347	0.930	Worldwide Governance Indicators. Includes indicators reflecting the impact of market-unfriendly policies, such as price controls or unsound banking supervision, along with perceptions of the burdens caused by excessive regulation in areas such as foreign trade and business development.
Voice and accountability, estimation	0.346	0.927	Worldwide Governance Indicators. Includes indicators for aspects such as the political process, civil liberties and political rights, as well as media freedom. These indicators assess citizen participation in selecting the government and the media's role in holding authorities to account.
Governance quality indicator	0.342	0.917	International Country Risk Guide (ICRG) - The PRS Group. Measures the quality of governance, assessing corruption, the rule of law and bureaucratic quality. Higher values indicate better quality governance. Corruption is gauged in terms of bribery and nepotism, rule of law in terms of the impartiality of the legal system, and bureaucratic quality in terms if its capacity to operate without political interference.
Basic state capacity, loads based on PCA	0.310	0.831	"Leviathan's Latent Dimensions: Measuring State Capacity for Comparative Political Research" (Hanson and Sigman, 2021). Based on three dimensions: extractive capacity, coercive capacity and administrative capacity. The authors use Bayesian latent variable analysis to assess state capacity drawing on indicators related to these dimensions.
Credit, labour and business regulation (panel data)	0.260	0.698	Economic Freedom of the World (Fraser Institute). On a scale from 0 to 10, where 0 indicates low private bank participation, a high rate of foreign bank licence rejections and government control of interest rates, while 10 indicates strong private bank participation, a low rate of foreign bank licence rejections and interest rates determined by the market.
Political stability and absence of violence/terrorism, estimation	0.228	0.611	Worldwide Governance Indicators. Measures perceptions of the likelihood of political instability and/or politically motivated violence, including terrorism.
Freedom to trade internationally (panel data)	0.211	0.567	Economic Freedom of the World (Fraser Institute). On a scale from 0 to 10, where 0 indicates high taxes on international trade, slow import/export processes, small trade sectors, exchange rate controls and capital controls, while 10 indicates the absence of specific taxes on international trade, quick import/export processes, large trade sectors, the absence of black-market exchange rates and the absence of capital controls.

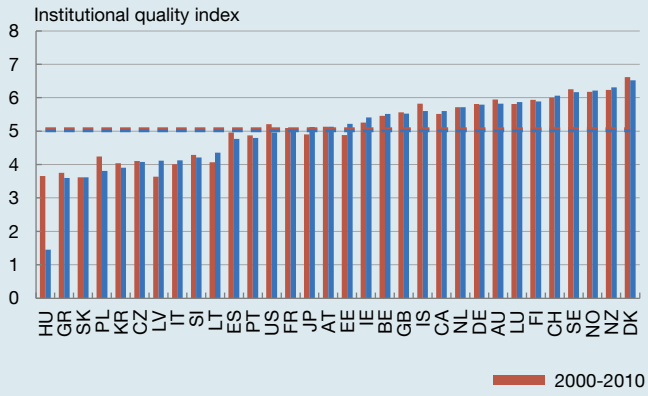
SOURCE: Jimeno and Sanz (2025).

Box 8

INSTITUTIONAL QUALITY AND PRODUCTIVITY (cont'd)

Chart 1
Time profile of the institutional quality indicators

1.a Time profile of IND1



1.b Time profile of IND2

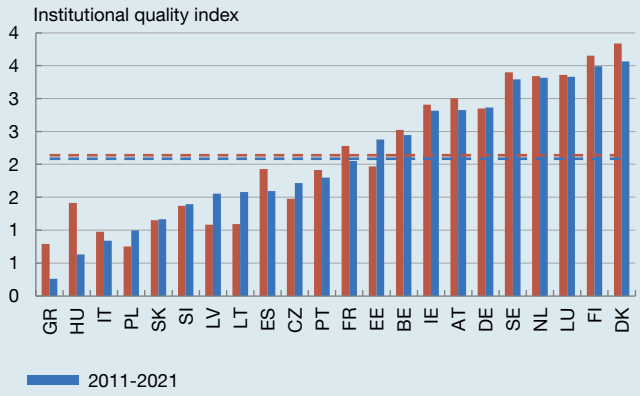


Chart 2
Time profile of the institutional quality indicators

2.a IND1. Difference between decades (2000-2010 vs. 2011-2021)

2.b IND2. Difference between decades (2000-2010 vs. 2011-2021)

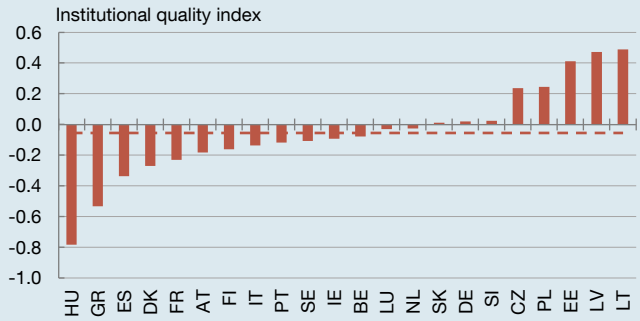
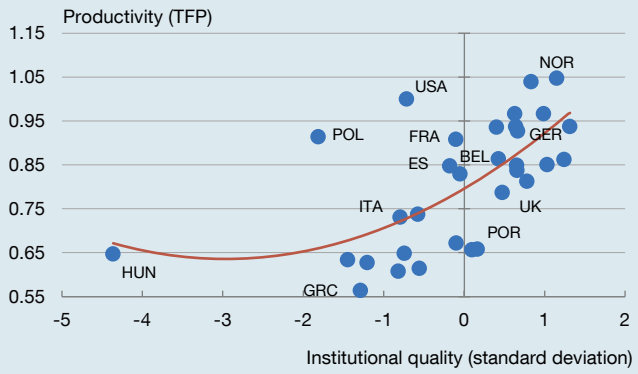
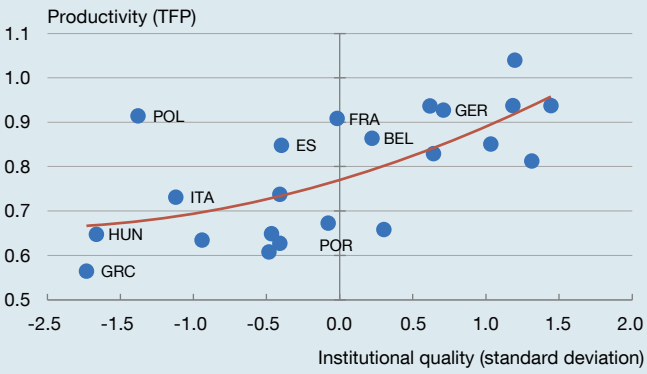


Chart 3
Correlation between institutional quality and productivity

3.a IND1



3.b IND2



SOURCE: Jimeno and Sanz (2025).

Box 8
INSTITUTIONAL QUALITY AND PRODUCTIVITY (cont'd)

subsequent five years, with this coefficient being statistically significant at the 1% level.

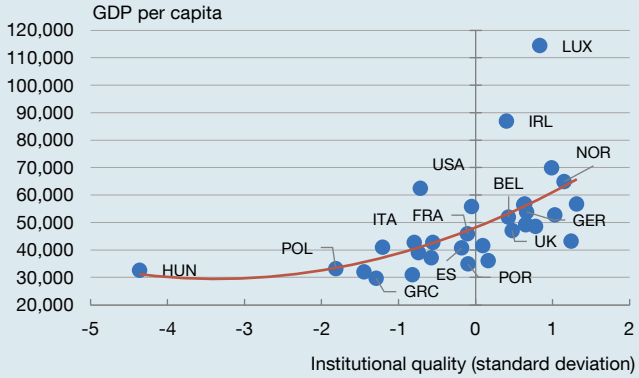
These results suggest that the productivity gains from enhancing institutional quality could be substantial. While the results do not necessarily demonstrate causal effects of institutional quality, they do offer some empirical evidence to support the hypothesis of a positive relationship between improvements in institutional quality and productivity growth.

If the above effects were causal and Spain's institutional quality were to match Denmark's according to the IND1 indicator, productivity growth in Spain over the subsequent five years could increase by 5.5% (were institutional quality the only determinant of productivity). This would suggest an increase in the average annual growth rate of TFP during that period of 1.1 percentage points (pp).

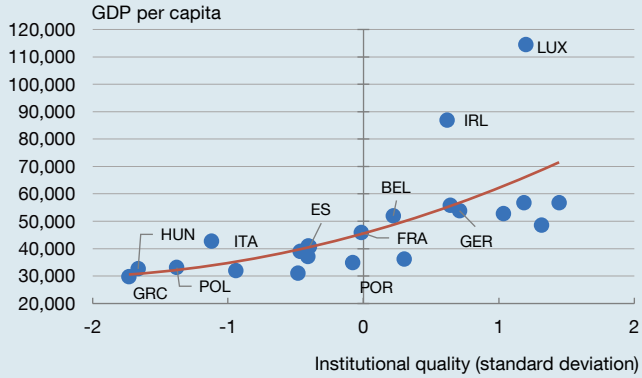
Conducting the same exercise with the IND2 indicator suggests that productivity growth in Spain over the next five years could be 19% higher, implying an increase in the average annual TFP growth rate during that period of 3.8 pp.

Chart 4
Correlation between institutional quality and GDP per capita

4.a IND1



4.b IND2



SOURCE: Jimeno and Sanz (2025).

Table 3
Effect of institutional quality on productivity convergence equations (a)

	IND1	IND2
	(1)	(2)
Initial productivity	-0.59***	-0.80***
	(0.088)	(0.14)
Initial institutional quality	0.034*	0.096***
	(0.018)	(0.032)
N	128	88

SOURCE: Jimeno and Sanz (2025).

a Robust standard errors in parentheses. Asterisks denote the significance level of the parameters. *** 1% ** 5% * 10%.

Box 9

A MEASURE OF THE DEGREE OF POLITICAL POLARISATION IN THE MAIN EURO AREA COUNTRIES

Political polarisation can be defined as a significant widening of the ideological divide between different political parties or their voters.[1]

According to the specialised literature,[2] polarisation tends to intensify partisan conflict and weaken cooperation between the different political actors, which can lead to legislative gridlock given the difficulty in reaching consensus on key issues of general and economic policy. This can delay necessary reforms, give rise to inefficient public spending and heighten uncertainty about economic stability.

Polarisation can also lead to frequent changes in economic policy, reducing predictability in the business environment, inhibiting investment and inducing volatility in the financial markets.

Furthermore, polarisation tends to distort the public's perception of the economic situation, affecting consumer confidence levels and spending decisions. It can also harm diplomatic relations and the stability of international relations in the countries concerned.

Political polarisation can be measured in various ways, depending on whether the focus is placed on the political elites or on the public at large, and on whether texts, surveys or other types of data are used. For example, Gentzkow, Shapiro and Taddy (2019)[3] extract a polarisation index by using text analysis on parliamentary speeches. Mason (2015)[4] and Iyengar, Sood and Lelkes (2012)[5] draw on opinion surveys, such as the Eurobarometer, to measure ideological perception. Bakshy, Messing and Adamic (2015)[6] use economic and social metrics, such as the Gini coefficient, residential segregation or social media analysis, to assess fragmentation in social interaction. These tools allow for comprehensive analysis of institutional, social and economic polarisation.

Although polarisation has been widely studied in the United States, there are no robust indicators for Europe to quantify and monitor political polarisation in the region and to assess its implications.

It is against this backdrop that this box presents polarisation indicators for Germany, France, Italy and Spain, developed according to the text-based methodology used by Azzimonti (2013)[7] for the United States. The Factiva database and its advanced search tools are used to systematically retrieve relevant newspaper articles. For each country, its main newspapers are selected, a dictionary of terms relating to polarisation and public policies is defined, and the number of newspaper articles containing references to both categories are counted. Lastly, the index is normalised by dividing this value by the total number of articles published in a given period, thus allowing for consistent comparison over time and between countries.

The results of this exercise are presented in Chart 1, which shows a steady rise in political polarisation in the four countries analysed, albeit following different trajectories in each case. In France, polarisation has gone from being a sporadic phenomenon to becoming a structural feature of the political landscape, growing continuously since 2010 without any signs of levelling off. The same is true in Italy, where polarisation has been on the rise since 2014.

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1 The discussion and indicators presented in this box are based on Marina Diakonova, Corinna Ghirelli and Javier J. Pérez. (2025). "Political polarization in Europe". Forthcoming.

2 Marina Azzimonti, Marco Battaglini and Stephen Coate. (2016). "The costs and benefits of balanced budget rules: Lessons from a political economy model of fiscal policy". *Journal of Public Economics,* 136, pp. 45-61. https://doi.org/10.1016/j.jpubeco.2016.03.001; Marina Azzimonti, Laura Karpuska and Gabriel Mihalache. (2020). "Bargaining over taxes and entitlements". NBER Working Paper Series, 30044, National Bureau of Economic Research. https://doi.org/10.3386/w30044; Marina Azzimonti, and Nirvana Mitra. (2023). "Sovereign default and tax-smoothing in the shadow of corruption and institutional weakness". NBER Working Paper Series, 31943, National Bureau of Economic Research. https://doi.org/10.3386/w31943; William Ginn and Jamel Saadaoui. (2025). "Divided We Fall: The Hidden Costs of Political Polarization on Macroeconomic Performance". https://dx.doi.org/10.2139/ssrn.5119306

3 Matthew Gentzkow, Jesse M. Shapiro and Matt Taddy. (2019). "Measuring Group Differences in High-Dimensional Choices: Method and Application to Congressional Speech". *Econometrica,* 87(4), pp. 1307-1340. https://doi.org/10.3982/ECTA16566

4 Lilliana Mason. (2015). "'I Disrespectfully Agree': The Differential Effects of Partisan Sorting on Social and Issue Polarization". *American Journal of Political Science,* 59(1), pp. 128-145. https://doi.org/10.1111/ajps.12089

5 Shanto Iyengar, Gaurav Sood and Yphtach Lelkes. (2012). "Affect, Not Ideology: A Social Identity Perspective on Polarization". *Public Opinion Quarterly,* 76(3), pp. 405-431. https://doi.org/10.1093/poq/nfs038

6 Eytan Bakshy, Solomon Messing and Lada A. Adamic. (2015). "Exposure to ideologically diverse news and opinion on Facebook". *Science,* 348(6239), pp. 1130-1132. https://doi.org/10.1126/science.aaa1160

7 Marina Azzimonti. (2013). "The Political Polarization Index". Working Paper, 13-41, Federal Reserve Bank of Philadelphia. http://dx.doi.org/10.2139/ssrn.2343139

Box 9

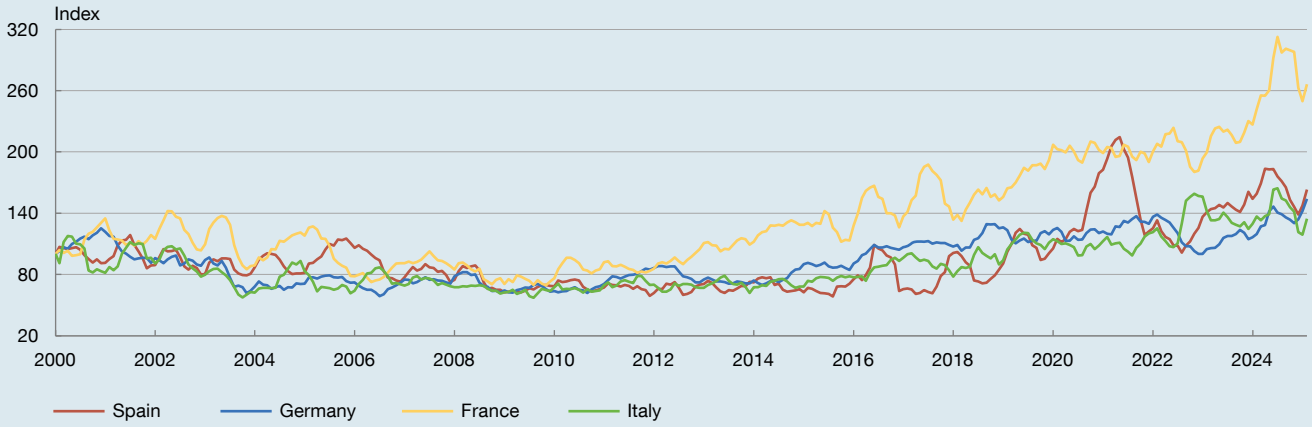
A MEASURE OF THE DEGREE OF POLITICAL POLARISATION IN THE MAIN EURO AREA COUNTRIES (cont'd)

In Germany, after declining in the first decade of this century, polarisation began to rise again from 2010 on, amid the euro area sovereign debt crisis, and has increased further in recent years.

In Spain, this measure of polarisation underwent the most significant change after 2015, rising steadily until 2021,[8] when it declined temporarily. However, polarisation levels have been on the rise again since 2022.

In all cases, the current levels of polarisation are considerably higher than two decades ago, suggesting a profound transformation in the political dynamics of these countries. For the reasons given at the beginning of this box, the increase in polarisation is a cause for concern and should be constantly monitored, both to assess the scale of the problem and also to understand its multiple implications and, potentially, to look at strategies to mitigate its effects on political and economic stability in Europe.

Chart 1
Changes in political polarisation indices in euro area countries (a)



SOURCE: For details of the methodology used, see Diakonova, Ghirelli and Pérez (2025).

a The series are monthly and shown as a six-month moving average.

8 The increase in the polarisation index in Spain between 2020 and 2021 is due to a combination of factors, including the political tensions triggered by the handling of the COVID-19 crisis and the motion of no confidence passed in the Spanish Parliament.

Box 10

THE EUROPEAN UNION'S PRIORITIES IN THE FIELD OF CAPITAL MARKETS

Europe is growing, but slowly and with weak productivity gains, losing share in the global economy. The European Union's (EU) negative gap in GDP to the United States nearly doubled between 2002 and 2023, expanding from -17% to -30% (Draghi, 2024).[1, 2] The European economy's weak performance is linked to a persistent deficit in productive investment in new technologies and innovation. To reactivate its growth and ensure its autonomy and continued prosperity in an increasingly adverse external context, Europe must close the investment and innovation gap with its major global competitors (the United States and China). This requires the implementation of an ambitious and coordinated agenda including structural actions across multiple areas. The financing of private investment is one of the main aspects requiring attention.

The banking sector is a fundamental pillar of the EU's financial system. Bank loans represent 92% of the total debt of European firms and will remain crucial in financing the required boost to private investment. However, the nature of the banking business, which is subject to strict prudential regulation, means that bank lending alone cannot finance all the necessary investments. Financing very long-term projects, or those involving high risk and uncertainty, such as firms emerging in the new technology sector, can and should be undertaken by the capital markets, which are a better fit for such projects. European companies have been increasing their market financing with debt issuances, which now account for 8% of their total debt, but this figure remains well below that of other regions such as the United States, where it stands at 39%.

In short, to significantly boost the financing of private investment, Europe needs to further develop its capital markets, equipping them with the liquidity and scale necessary to take on a new wave of investing. To achieve this, it must make effective progress towards the capital markets union. This is not a new objective for the EU – two action plans have been launched in recent years – but it has proven difficult to achieve. The new initiative of the European Commission, the savings and investment union (SIU), which brings together the capital markets union and the banking union under one plan, aims to avoid the mistakes of previous attempts. Its clearly defined objective is to improve the channelling of European savings towards the financing of productive investment. The proposed SIU calls for combined action at the EU and Member State level to strengthen capital markets through several lines of action[3] and advocates the completion of the banking union.

Venture capital

One of the priorities identified in the SIU is to facilitate access to financing for technological and innovative firms early on in their development, creating an ecosystem that allows them to grow and scale up within the European market. Against this backdrop, developing the venture capital market is fundamental since it is the main way to finance innovative projects in strategic sectors, such as technology and the energy transition. The financing gap in this segment remains considerable, as European early-stage investment markets are approximately six times smaller than their US counterparts and are concentrated in a few countries (Germany, France and Sweden).[4]

In the early stages of innovation, government backing plays an important complementary role as a way of sharing risks. To maximise its impact, venture capital funds must have incentives to take advantage of the opportunities arising from this public support. Agile investment instruments that accurately put a value on projects' financial and technological aspects are also required to leverage the potential of European funds for co-investment and to attract private capital. These instruments must be complemented by measures that reduce regulatory barriers.

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1 For an overview of the Draghi Report, see Pilar L'Hotellerie-Fallois. (2024). "The Draghi report: a plan for the economic future of Europe". Banco de España blog, 2 December 2024. https://www.bde.es/wbe/en/noticias-eventos/blog/el-informe-draghi-un-plan-para-el-futuro-economico-de-europa.html.

2 Data at constant 2015 prices.

3 Areas of action: (i) develop investment instruments that channel retail savings into capital markets and incentivise the participation of institutional investors, such as pension funds and insurers; (ii) facilitate access to financing for European firms, paying special attention to innovative firms and start-ups, eliminating regulatory and tax barriers; (iii) promote European-level integration of trading and settlement infrastructures and facilitate cross-border activity of asset managers; and (iv) move towards efficient market supervision.

4 Sweden has the deepest capital market in the EU, with a stock market capitalisation equivalent to 170% of its GDP, compared to the EU average of 60%. A key factor has been the integration of its stock exchange into Nasdaq Europe (a regional platform that operates the markets of Sweden, Finland, Denmark and Iceland) and the implementation of a dual model, which combines a main market with a more flexible growth segment – the Nasdaq First North Growth Market – that makes it easier for small and medium-sized enterprises to access market financing.

Box 10
THE EUROPEAN UNION'S PRIORITIES IN THE FIELD OF CAPITAL MARKETS (cont'd)

It is also necessary to expand the financing options available to support these firms in subsequent growth stages, either by creating specific stock market segments that support their access to public equity markets or by promoting secondary private capital markets. The participation of institutional investors (pension funds and insurers) in these types of markets is also essential to achieve the required liquidity and create a financial ecosystem conducive to innovation.

Securitisations

Another key piece of the SIU is the revitalisation of the securitisation market. Securitisation is a way for banks to transfer credit risk from their balance sheets to other investors outside the banking system, such as insurance companies and asset managers. This favours proper risk management and frees up capital for new loans.

The current regulatory framework for securitisations has benefitted the market and the financial system significantly.[5] Since this framework has been in place, the securitisation market has performed well, with a moderately upward trend in recent years, driven mainly by the greater share of synthetic securitisations. However, the market has developed more gradually than expected and the volume of issuances in Europe remains low. According to the Draghi report, the annual volume of issuances in Europe stood at 0.3% of GDP in 2022, compared with 4% of GDP in the United States. Even considering the particularities of both markets, such as the role of state agencies in the United States[6] and that of covered bonds in Europe,[7] the difference between the two regions is considerable.

Within the SIU framework, the European Commission plans to launch a legislative proposal in 2025 Q2 to introduce greater proportionality in and simplify transparency requirements for originating banks and due diligence requirements for investors. Additionally, it will propose adjustments to the prudential capital requirements for banks and insurers, all of which should help to stimulate this market. It is essential to strike a balance between promoting market activity and ensuring financial stability. In the medium to long term, consideration is being given to establishing a pan-European securitisation platform to facilitate the issuance of standardised securitised bonds, thereby enhancing liquidity and market depth.

5 Regulation 2017/2402 introduced new transparency, due diligence and risk retention requirements and also created simpler, more transparent and standardised (STS) securitisations.

6 In the US securitisation market, a significant portion of securitisations are guaranteed by state agencies such as Fannie Mae or Freddie Mac.

7 Covered bonds are debt instruments issued by a credit institution that are backed by a pool of mortgage loans or public sector debt, giving investors a preferential right in case of default. They constitute a highly significant source of financing for European credit institutions.

Box 11

BUILDING A DIGITAL EURO

Safe and efficient payments are a pre-condition for the economy to function properly. Payment systems and instruments are both strategic and critical. In recent decades, against a backdrop of growing globalisation and digitalisation, this strategic dimension has become ever more important.

Central banks play an essential role in the world of payments. They provide the settlement asset and the unit of account on which all other payment instruments are based, namely central bank money. And they guarantee the public good embodied by the proper functioning of payments.

This activity is organised around two areas: retail payments, which are traditionally identified with cash, and wholesale payments (i.e. between financial institutions), which are channelled through the central bank. In both cases, digitalisation and the recent geostrategic turbulence pose significant challenges.

As Chart 1 shows, cash is losing ground in day-to-day payments, on account of the digitalisation of the economy and e-commerce, where the use of cash is not possible.

Cards and other digital transactions crucially depend on a small number of non-European companies. For instance, 72% of card payments in Europe are channelled through international non-European brands.

These trends can erode the trust base that cash and the central bank provide to the payment ecosystem, and they exacerbate the euro area's strategic dependence.

In consequence, in 2020 the Eurosystem started to reflect on the desirability of adapting cash to the digital age. This culminated in the digital euro project, which aims to take the necessary steps to be ready to distribute a digital euro if it is finally deemed necessary.

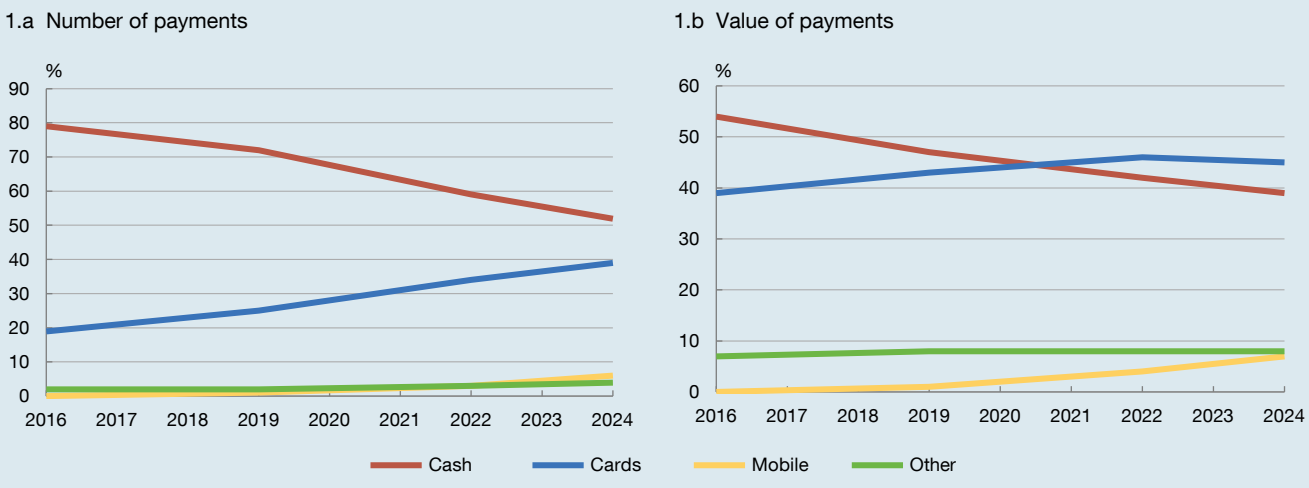
The digital euro would co-exist with other private means of payment as just another alternative, accessible to all euro area citizens at all times and in all places. Like cash, it would be a safe, fast, reliable and easy-to-use means of payment that could be used in a multitude of situations: in store, online or for peer-to-peer payments (Figure 1). And like cash, it too would be free to use for all consumers.

A digital euro would strengthen European identity and help deepen the integration of the single market, providing for the private initiatives under way – which to date have lacked momentum – a new impulse for the creation of a pan-European retail payment solution.

Considerable progress has been made in the technical preparation of the digital euro. The main design features and technical specifications have been established. For instance, it would be distributed through intermediaries, so supervised private providers would act as a gateway to this new means of payment, providing an added safeguard.

The digital euro would even work in places where there is no internet connection or limited connectivity (offline mode) and would not necessarily require a bank account.

Chart 1
Percentage of point-of-sale payments. Euro area



SOURCE: ECB (2024).

Box 11
BUILDING A DIGITAL EURO (cont'd)

In addition, special care is being taken in its design to ensure that people with disabilities, functional limitations or limited digital skills and other vulnerable groups are not excluded.

To give shape to all these elements, the Eurosystem has carried out numerous technical experiments and tests and is in constant contact with market stakeholders and civil society representatives and organisations. Privacy is one of the key points addressed in these fora.

The technical configuration of the digital euro will ensure that the central bank stores only the information needed to settle transactions and detect fraud patterns or money laundering schemes. In no case will it store or have access to personal data, thus guaranteeing user privacy, an issue that is especially important for end users.

The digital euro requires that a legal framework be established to regulate its operation. The European co-legislators (the European Council and the European Parliament) are working on a proposal for a regulation. The Eurosystem collaborates in this process, providing technical assistance and support.

In parallel, the Eurosystem continues to make progress on other essential aspects of the project, such as finalising the digital euro scheme rulebook and selecting providers to develop the necessary platform and infrastructures. The Banco de España aspires to play an important role in this regard.

The Eurosystem is also defining an objective and transparent methodology for calibrating the holding limits, i.e. the maximum amount of digital euro that users may hold in their wallets. This is an essential mechanism, included in the proposed legislation, to safeguard financial stability and the effective transmission of monetary policy impulses by preventing disruptive deposit outflows.

Lastly, on the wholesale side (relating to the large-value payments that support financial market operations), the Eurosystem has also launched a work stream aimed at preserving the role of central bank money as the main settlement asset.

In this case, the challenge posed by digitalisation is not the issuance of a new asset (the wholesale euro has been digital since its inception), but how to adapt the infrastructures that support these payments. It is a matter of finding an appropriate response to recent developments such as asset tokenisation and the use of distributed ledger technologies (DLT) whose market presence, albeit still limited, is growing significantly.

To this end, the Eurosystem central banks – both collectively and individually – have launched initiatives to draw up and, where appropriate, deploy concrete solutions to ensure interoperability between private DLT-based platforms and TARGET services.

In 2024, under the leadership of the European Central Bank (ECB) and with the participation of market

Figure 1
Use cases of different means of payment

	Cash		Domestic payment schemes (cards or direct debit)		International payment schemes (cards or direct debit)		Digital euro	
	Domestic	Euro area	Domestic	Euro area	Domestic	Euro area	Domestic	Euro area
Peer-to-peer payments (P2P)	✓ (a)	✓ (a)	Some	✗	✗	✗	✓	✓
In store	✓	✓	Some	✗	✓ (b)	✓ (b)	✓	✓
E-commerce	✗	✗	Some	✗	✓ (b)	✓ (b)	✓	✓

SOURCE: ECB (2024).

a Exclusively for proximity payments (save when sent by post).
b Subject to acceptance.

Box 11
BUILDING A DIGITAL EURO (cont'd)

stakeholders, a programme of exploratory work on new technologies was developed, enabling a wide variety of use cases and interoperability solutions to be tested.

The results of this exploratory work led the ECB's Governing Council to decide, in February this year, to intensify its efforts in this area, taking a two-track approach. First, by developing a safe and efficient platform for settling DLT-based transactions through a link with TARGET services. Second, by exploring a more integrated long-term solution for this same purpose. The aim is to support the use of innovative technologies in financial market infrastructures, to enable them to modernise without compromising on safety.

The Banco de España has been party to this effort and has completed its own programme of exploratory work on wholesale digital tokens. This initiative was developed in collaboration with external parties and has allowed it to conduct a variety of experiments in a simulated environment. As a result, it has broadened its knowledge of the opportunities, limitations and challenges that these technologies may pose in terms of efficiency, safety, transparency and other relevant dimensions.

INDEX OF PHOTOGRAPHS

The Banco de España publishes various types of documents providing information on its activity (economic reports, statistics, research papers, etc.), which can be consulted in the Institutional Repository at https://repositorio.bde.es/.

Most of these documents are available in PDF format and can be downloaded free of charge from the Banco de España website at http://www.bde.es/webbde/en/secciones/informes/.

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ACRONYMS AND ABBREVIATIONS

AEAT	State tax revenue service
AIReF	Independent Authority for Fiscal Responsibility
AMCESFI	Spanish Macroprudential Authority
APP	Asset Purchase Programme
BCBS	Basel Committee on Banking Supervision
BE	Banco de España
BIS	Bank for International Settlements
BLS	Bank Lending Survey
CBQ	Central Balance Sheet Data Office Quarterly Survey
CBSO	Central Balance Sheet Data Office
CCR	Central Credit Register
CCyB	Countercyclical capital buffer
CNE	Spanish National Accounts
CNMV	National Securities Market Commission
CPI	Consumer Price Index
DFR	Deposit facility rate
DGS	Deposit guarantee scheme
EBA	European Banking Authority
EBAE	Banco de España Business Activity Survey
ECB	European Central Bank
EFF	Spanish Survey of Household Finances
EFSF	European Financial Stability Facility
EIB	European Investment Bank
EONIA	Euro Overnight Index Average
EPA	Spanish Labour Force Survey
ERTE	Job retention and short-time work schemes
ESCB	European System of Central Banks
ESM	European Stability Mechanism
ESRB	European Systemic Risk Board
€STR	Euro short-term rate
ETS	Emissions trading system
EURIBOR	Euro Interbank Offered Rate
EUROSTAT	Statistical Office of the European Communities
FASE	Financial Accounts of the Spanish Economy
FDI	Foreign direct investment
FSB	Financial Stability Board
GDI	Gross disposable income
GDP	Gross domestic product
GFCF	Gross fixed capital formation
GHG	Greenhouse gas
GOP	Gross operating profit
GOS	Gross operating surplus
GVA	Gross value added
HICP	Harmonised Index of Consumer Prices
ICO	Official Credit Institute
IEA	International Energy Agency
IGAE	National Audit Office
IIP	International Investment Position
IMF	International Monetary Fund
INE	National Statistics Institute
IRENA	International Renewable Energy Agency
LTP	Loan-to-price ratio
MCVL	Social security administrative labour records
MREL	Minimum requirement for own funds and eligible liabilities
MTBE	Quarterly Model of the Banco de España
NCBs	National central banks
NDCs	Nationally determined contributions
NDER	Narrowly defined effective rate
NFCs	Non-financial corporations
NGEU	Next Generation EU
NGFS	Network for Greening the Financial System
NPISHs	Non-profit institutions serving households
NPLs	Non-performing loans
OECD	Organisation for Economic Co-operation and Development
OIS	Overnight index swap
PELTROs	Pandemic emergency longer-term refinancing operations
PEPP	Pandemic Emergency Purchase Programme
PIAAC	Programme for the International Assessment of Adult Competencies
PMI	Purchasing Managers' Index
PPP	Purchasing power parity
QNA	Quarterly National Accounts
R&D&I	Research, development and innovation
REACT EU	Recovery Assistance for Cohesion and the Territories of Europe
RRF	Recovery and Resilience Facility
RTRP	Recovery, Transformation and Resilience Plan
SAFE	ECB Survey on the Access to Finance of Enterprises
SGP	Stability and Growth Pact
SMA	Survey of Monetary Analysts (ECB)
SMEs	Small and medium-sized enterprises
SPF	Survey of Professional Forecasters (ECB)
SRB	Single Resolution Board
SRM	Single Resolution Mechanism
SSM	Single Supervisory Mechanism
TFP	Total factor productivity
TPI	Transmission Protection Instrument
TLTROs	Targeted longer-term refinancing operations
ULCs	Unit labour costs
UNEF	Spanish Solar Photovoltaic Association
VAT	Value Added Tax
WIPO	World Intellectual Property Organization
WTO	World Trade Organization

COUNTRIES AND CURRENCIES

In accordance with the protocol order, the EU Member States are listed using the alphabetical order of the country names in the national languages.

BE	Belgium	EUR (euro)
BG	Bulgaria	BGN (Bulgarian lev)
CZ	Czech Republic	CZK (Czech koruna)
DK	Denmark	DKK (Danish krone)
DE	Germany	EUR (euro)
EE	Estonia	EUR (euro)
IE	Ireland	EUR (euro)
GR	Greece	EUR (euro)
ES	Spain	EUR (euro)
FR	France	EUR (euro)
IT	Italy	EUR (euro)
HR	Croatia	EUR (euro)
CY	Cyprus	EUR (euro)
LV	Latvia	EUR (euro)
LT	Lithuania	EUR (euro)
LU	Luxembourg	EUR (euro)
HU	Hungary	HUF (Hungarian forint)
MT	Malta	EUR (euro)
NL	Netherlands	EUR (euro)
AT	Austria	EUR (euro)
PL	Poland	PLN (Polish zloty)
PT	Portugal	EUR (euro)
RO	Romania	RON (New Romanian leu)
SI	Slovenia	EUR (euro)
SK	Slovakia	EUR (euro)
FI	Finland	EUR (euro)
SE	Sweden	SEK (Swedish krona)
UK	United Kingdom	GBP (Pound sterling)
JP	Japan	JPY (Japanese yen)
US	United States	USD (US dollar)

CONVENTIONS USED

M1	Notes and coins held by the public + sight deposits
M2	M1 + deposits redeemable at notice of up to three months + deposits with an agreed maturity of up to two years
M3	M2 + repos + shares in money market funds and money market instruments + debt securities issued with an agreed maturity of up to two years
Q1, Q4	Calendar quarters
H1, H2	Calendar half-years
bn	Billions (10^9)
m	Millions
bp	Basis points
pp	Percentage points
...	Not available
—	Nil, non-existence of the event considered or insignificance of changes when expressed as rates of growth
0.0	Less than half the final digit shown in the series