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.

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