Independent Authority for Fiscal Responsibility

Report

27th March 2018

Report on the Macroeconomic Forecasts in the 2018 Draft General State Budgets

The mission of AIReF, the Independent Authority for Fiscal Responsibility, is to ensure strict compliance with the principles of budgetary stability and financial sustainability contained in article 135 of the Spanish Constitution.

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Executive Summary

The Independent Authority for Fiscal Responsibility (AIReF), on the basis of exogenous assumptions and defined policies, endorses the Government's macroeconomic forecast. The AIReF deems the Government's macroeconomic scenario accompanying the 2018 Draft General State Budgets to be prudent overall.

The forecasts underlying the 2018 Draft General State Budget (GSB) contain a significant upward revision of the projected growth for 2018 in October (from 2.3% to 2.7%), in line with the main analysts and institutions following the Spanish economy. The most recent short-term data available at the start of the first quarter of 2018 show signs of acceleration for the Spanish economy. The upward correction at the aggregate level is supported by the greater dynamism of the main trade partners, alongside a less intense than expected materialisation of the institutional uncertainty shock, with its impact essentially limited to October. In addition to these factors, the potential impact of the expansive fiscal policy measures envisaged in the 2018 GSB, could result in greater household disposable income and, therefore, greater consumer demand. In relation to this, since the October publication of the Report on the Macroeconomic Forecasts in the 2018 Draft Budgetary Plan (DBP), expectations regarding the Spanish economy have improved, leading to upward revisions in the 2018 growth forecasts.

The 2018 growth forecast is considered prudent and its composition is considered plausible, notably including both public and private consumption trends. Domestic demand continues to be the main driver of growth in 2018, mainly due to positive trends in investment, both productive and in construction. Private consumption is at the bottom of both the panellists' forecasts and when compared with the AIReF's internal models. It could exceed the forecast in the central scenario, taking into account the budgetary measures included in the GSB, the sound financial position of households and the improved climate of trust in the improving labour market. The external sector is consolidating its moderate positive contribution, confirming the changing growth pattern of the Spanish economy with respect to the previous cycle. Finally, the private consumption forecast has been revised upwards in light of the new measures included in the GSB, but lies outside the interquartile range of private forecasts, which is especially relevant in light of the bias previously identified in this item in the ex-post analysis. When compared with the AIReF models, the official forecast is within the 2018 forecast range, near the middle.

The basic assumptions on the external environment that support the macroeconomic scenario of the 2018 Draft GSB are considered feasible, with fairly balanced risks. On the one hand, in the short term, there could be an acceleration of growth of the main trade partners. On the other hand, in the medium term, there are risk factors that stem from a correction in the prices of the financial assets that were overvalued due to excessive market exposure to accommodative monetary conditions that have suppressed interest rate differentials. In addition, the

implementation of protectionist policies by some of the major players in global trade, along with geopolitical tensions in oil-producing countries, are also risks to consider beyond 2018.

At the domestic level, the worst scenarios that could have emerged in October as a result of the institutional crisis in Catalonia seem to have dissipated. The Spanish economy as a whole has behaved better than expected at the start of the year, aided by the moderation in political and institutional uncertainty. In the case of Catalonia, sustained growth is expected for 2018, although less dynamic than what was forecasted last October. Since then, growth differential with respect to the rest of Spain expected for 2018 has turned from positive to negative rates. Despite the observed rapid normalisation, it is not possible to rule out new episodes of friction that would have a significant impact on the economy in Catalonia.

For its part, the ex-post analysis of forecasts for previous years does not identify any substantial bias for the 2014-2017 period, although it shows widespread deterioration in forecast accuracy. Large unjustified biases were identified in the public consumption forecast for 2015-2017. In the case of the forecasts for the following year, during the 2014-2017 period the proportion of large biases increased from 20% in 2014 to 70% in 2017. Of these, biases unjustified by an ex-post result have grown steadily from zero to 44%.

On the basis of its analysis, the AIReF deems the progress made by the Government concerning transparency and the dissemination of information to be limited. In this regard, the AIReF reiterates two recommendations made to the Ministry of Economy, Industry and Competitiveness (MINEICO) in previous reports. First, to accompany the macroeconomic outlook with a "no policy change" scenario, and a separate quantification of the economic impact of the adopted or envisaged measures, in order to better understand the forecasts and specify the connection between the macroeconomic outlook and the budgetary scenario at all times. Second, to adopt and publish the measures needed to correct the important biases observed in the public consumption autumn forecasts.