



Independent Authority
for Fiscal Responsibility

Report 4/18

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Report on the Macroeconomic Forecasts of the 2018-2021 Stability Programme Update (SPU)

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) endorses the Government's macroeconomic forecasts included in the 2018-2021 Stability Programme Update. AIReF considers the Government's macroeconomic scenario to be prudent overall, taking into account the exogenous assumptions and defined policies. As we move forward in the projection horizon, the valuation changes from prudent to likely.

The basic assumptions underlying the macroeconomic scenario accompanying the 2018-2021 Stability Programme Update are considered feasible. Regarding the previous 2017-2020 Stability Programme Update (2017-2020 SPU), the external assumptions made by the Government have been revised favourably in most cases. Global growth has been revised upward, in particular for the main trading partners in the euro zone, in line with the forecasts of the main international organisations. The Government expects this momentum to be partially offset by the expected strengthening of the euro. The biggest revision has been made in its expectations about the evolution of oil prices, in line with information from the futures markets. Its expected growth will have a direct impact in terms of higher inflation and containment of domestic demand. Finally, the assumptions related to the long-term yield curve are considered prudent, maintaining a positive differential with respect to the market expectations inherent to the *forward* curve.

The composition of growth for 2018-2021 is considered plausible, although the contained evolution of domestic demand in the short term should be noted. The expected path for the 2018-2021 period is based on domestic demand as the main source of growth, mainly based on the positive evolution of investment, both productive and in construction. Expected growth for private consumption is considered prudent, especially in the short term, in comparison with both AIReF's internal models and the forecasts of the main analysts following the Spanish economy. Private consumption could, therefore, evolve above what was expected in the official scenario, and especially taking into account that the policy measures envisaged for 2018 and 2019 will result in greater household disposable income. The prudence in the private consumption forecasts hinders the contribution of domestic demand and, consequently, the GDP path. The public consumption forecast has been revised upwards significantly since the 2017-2020 SPU and is in line with AIReF's internal models. Finally, the Government expects a consolidation of the external sector's positive contribution to growth, confirming a balanced growth pattern. AIReF's analysis deemed this scenario to be feasible, although it is expected that the positive contribution of external demand will be residual towards the end of the period.

The official risk scenario is considered to be balanced in the short term, while in the medium term downside surprises may materialise. In the short term, global growth could remain robust, in line with what was observed in 2017, in a context of favourable financial conditions. On the other hand, increasing risks are identified in the medium term. The progressive withdrawal of monetary stimuli and its impact on real interest rates, the implementation of protectionist policies by some of the major world trade players, along with geopolitical tensions in the Middle East, are also risks to consider beyond 2018. At the European level, the departure of the United Kingdom from the European Union may have negative consequences on trade flows and financial flows, as well as on the evolution of tourism. So far, the impact has been smaller than expected, although the completion of the exit agreement could clarify the potential effects for both the British economy and its major European partners.

In the domestic sphere, AIReF considers that short-term risks are contained, although the impact of a continued scenario of uncertainty could manifest itself in the medium and long term. As stated in the Report on the macroeconomic outlook of the 2018 Draft General State Budget, the worst scenarios associated with the increase in uncertainty in Catalonia seem to have been ruled out. This moderation in uncertainty has contributed to the improvement in short-term forecasts. However, an uncertainty scenario becoming chronic could lead to a downward risk in the medium term, mainly if it ends up affecting the investment decisions of economic agents.

The impact on GDP of the measures advanced by the Government is considered feasible. For the first time, and in response to a recommendation made by AIReF, the Government has submitted a “no policy change” macroeconomic scenario to AIReF, accompanying the official outlook. This allows for an assessment of the impact of the measures adopted, as well as their transmission channels. AIReF’s assessment based on its internal models is in line with the growth impact presented in the 2018-2021 SPU, both in real terms and in nominal terms.

However, there are not enough elements for a complete assessment of the consistency between the macroeconomic outlook and the budgetary forecasts. When assessing the macroeconomic outlook, AIReF does not have information on the forecasts for any fiscal variables beyond public consumption. This lack of information prevents a complete and exhaustive analysis of the connection between the macroeconomic outlook and the budgetary scenario.

AIReF’s ex-post analysis does not identify any significant bias in the forecasts during the 2014-2017 period. The ex-post analysis of previous years’ forecasts does not identify any large, unjustified and repeated biases in the forecasts for any of the variables analysed in the last four years, although it should be noted that large and unjustified biases are identified in the public consumption forecast for the 2015-2017

period. In addition, forecast accuracy has decreased in recent years, with large and unjustified biases for private consumption, exports and imports during 2017.

AIReF views the publication of the “no policy change” macroeconomic scenario by the Government positively, although there are areas where greater transparency is necessary. The publication of the “no policy change” scenario (although not for the entire forecast horizon, since it does not include 2020 and 2021) responds to a reiterated recommendation issued by AIReF and represents important progress in terms of transparency. However, AIReF reiterates two best practice suggestions to achieve greater transparency. First, it is necessary to integrate the key elements of the forecasts into a simplified framework of National Accounts, so that it is possible to establish the relationship between economic activity, demand and employment, on the one hand, and income flows and financing needs on the other. Second, it is necessary to expand the information on the methodologies, assumptions and relevant parameters underlying the forecasts, in line with the provisions of Directive 2011/85 on national budgetary frameworks and of article 29 of the Organic Law on Budgetary Stability and Financial Sustainability.

AIReF has conducted its analysis based on the macroeconomic scenario and information on policy measures sent by the Ministry of Economy, Industry and Competitiveness on 18 April. In view of the possibility of that additional measures not foreseen at the date cut-off date or in the report on the 2018 Draft General State Budgets, AIReF will update its diagnosis on compliance with the stability target in its Report on the Stability Programme of 10 May.

The President of AIReF

A handwritten signature in black ink, appearing to read 'JL Escrivá', with a horizontal line underneath.

José Luis Escrivá