



REPORT ON THE MACROECONOMIC FORECASTS IN THE DRAFT GENERAL STATE BUDGETS FOR 2019

REPORT 2/19



Autoridad Independiente
de Responsabilidad Fiscal

The Independent Authority for Fiscal Responsibility (AIReF, for its acronym in Spanish) was created with the mission of ensuring strict compliance with the principles of budgetary stability and financial sustainability set out in article 135 of the Spanish Constitution.

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EXECUTIVE SUMMARY

The Independent Authority for Fiscal Responsibility (AIReF) endorses the forecasts of the Government's macroeconomic scenario included in the Draft General State Budgets (GSB) for 2019. AIReF assesses as prudent the Government's macroeconomic scenario, based on the exogenous assumptions and the defined policies.

The assumptions that reflect the risks stemming from the external environment are considered plausible. The basic assumptions regarding the main partners growth, oil price evolution and interest rates expectations, underlying the macroeconomic scenario of the GSB for 2019, are considered plausible overall, in light of the latest forecasts from international agencies and market trends.

The upward revision of 0.1% in the euro area growth for both 2018 and 2019 with respect to the Draft Budgetary Plan (DBP) could be optimistic, taking into account the downward revision of growth, both global and of the euro zone, contained in the latest forecasts from international agencies such as the European Central Bank and the European Commission.

Oil price expectations are revised markedly downward, reflecting the recent trend in the crude oil price and falling below international agencies' forecasts, but above the expectations of the futures markets.

Finally, long-term interest-rate assumptions are considered prudent, maintaining a positive differential with respect to the market expectations inherent to the forward yield curve.

Growth composition is considered reasonable, supported by a contribution of domestic demand in line with the two previous years, but with a slightly negative contribution from the external sector. Although somewhat more contained than in 2018, expected activity growth by AIReF for 2019 will continue to be supported by domestic demand, whose dynamism will be driven mainly by the favourable evolution of investment, both productive and in construction. The downward revision of the external sector contribution, largely conditioned by the negative surprises from the latest quarterly data, is also in line with AIReF's internal forecasting models.

From the analysis of the policy measures included in the GSB for 2019, AIReF estimates a neutral impact on economic growth, with some minor adjustments in relation to the DBP due to an implementation delay or a change in their

scope. In a previous report, AIReF made its own estimate of the macroeconomic impact of the different measures included in the 2019. A comparison of the relevant macroeconomic measures included then with those presented in the GSB for 2019 reveals minimal differences.

In line with its budgetary assessment, the impact of the measures that will take effect in the middle of the year is adjusted downwards, essentially the new taxes ("Tobin tax" and "Google tax") and the increase in the Hydrocarbons tax.

There have been two main changes in the evaluation of the measures related to Social Security whose macroeconomic impact is neutralised. On the one hand, the Special Regime of Self-Employed Workers (RETA) was excluded from the increase in the minimum contribution bases. On the other hand, the mandatory nature of the contribution for professional contingencies among the self-employed was extended and the minimum rate of contribution for Occupational Accidents was increased. These minor changes have been transferred to the macroeconomic scenario through various channels: greater job creation and, consequently, a higher private consumption, a slight upward revision in productive investment and a less dynamic evolution of prices.

In the short term, risks are identified arising from a lower world growth and the main trading partners of the Spanish economy. A lower world growth would imply a lower contribution of external demand. In the short term, there are two main sources of risk, both on the external side. On the one hand, the intensification of protectionist tensions, associated with lower growth in some of the main players in world trade such as China, may cause an additional drop in world trade and, with that, in Spanish exports. On the other hand, at European level, there are specific risks linked to Brexit and the situation in Italy. The departure of the United Kingdom from the European Union, initially scheduled for March 2019, is at one of the most sensitive moments since the referendum in 2016, due to the British Parliament's rejection of the agreement negotiated between the Government of the United Kingdom and the European Union. To this, we must add the uncertainty in the markets linked to the political and institutional evolution in Italy. Both risks deserve special attention and monitoring due to their possible short-term impact.

In order to make more transparent and efficient the endorsement process of the macroeconomic scenario, AIReF recommends to the Government to regulate the flow and schedule the exchange of information through a formal agreement or Memorandum of Understanding. This is in line with the usual practices in neighbouring countries in order to optimize the interaction and information flow between the Government and the National Independent Fiscal Institution.

In addition, AIReF reiterates two suggestions for best practice to the Government. First, integrate the key elements of the forecasts into a simplified framework of National Accounts, establishing a relationship between economic activity, demand and expenditure, on the one hand, and income flows and financing needs on the other. Second, 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 (LOEPySF).