

PRESS RELEASE
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AIReF ENDORSES THE GOVERNMENT'S MACROECONOMIC SCENARIO BUT WARNS OF DOWNSIDE RISKS

- **AIReF's endorsement is a preliminary assessment limited to the draft macroeconomic scenario of the 2020-2021 Stability Programme. Following receipt of this Programme, AIReF will publish its report over the coming week, with detail of its own macroeconomic and budgetary scenarios**
- **The macroeconomic forecasts are considered feasible assuming the Government's hypotheses on the duration and intensity of the pandemic are accurate and subject to the available information on the measures taken**
- **AIReF does not rule out worse scenarios, primarily derived from the intensity of the projected recovery in the second half of 2020 and in 2021. These downside risks are associated with the possibility that more adverse epidemiological scenarios will arise or more persistent damage to the productive capacity of the economy and employment will be sustained**
- **Despite close collaboration with the government, AIReF considers it necessary to have more detailed information in order to assess the internal consistency of the macroeconomic scenario and its correlation with the fiscal scenario**

Yesterday, the Independent Authority for Fiscal Responsibility (AIReF) endorsed the Government's Economic Forecasts, included in its draft macroeconomic scenario that will accompany the 2020-2021 Stability Programme Update (SPU). AIReF considers the macroeconomic scenario that the Government sent on 28 April to be reasonable against a backdrop of great economic uncertainty. However, AIReF also warns of downside risks relating to the possibility of more adverse epidemiological scenarios or more persistent damage to the productive capacity of the economy and employment that would hamper the recovery



projected for the second half of 2020 and 2021. The endorsement is made under the assumptions that the Government's hypotheses on the evolution of the pandemic are accurate, and that the macroeconomic policy measures considered are those that are currently approved. This endorsement is solely limited to the macroeconomic scenario. The full report on the SPU will be published next week.

AIReF indicates that the high uncertainty caused by COVID-19 has led the European Commission to allow information requirements to be significantly simplified. The draft macroeconomic scenario sent to AIReF uses this flexibility and limits the time frame to two years (2020-2021). The set of variables provided has also been reduced. In particular, the information received does not include the economy's cyclical situation, which is difficult to estimate in the present circumstances, or institutional sector accounts.

In addition, AIReF states that it has not received sufficient detail on the macroeconomic and budgetary impact of the Government's measures to deal with the crisis. Despite the fact that the Government has facilitated information exchange in the preparation of its macroeconomic scenario, AIReF has not received the fiscal scenario nor details of the evaluation of the adopted measures and how these affect the macroeconomic scenario. This makes it difficult to assess the consistency of macroeconomic scenarios with no policy changes and with new measures, as well as to assess the consistency between the macro and fiscal scenario.

Considering the available information and assuming that the Government's estimations of the intensity and duration of the pandemic are correct, AIReF considers the macroeconomic scenario to be feasible. The government's macroeconomic scenario falls within the range of the forecasts made by AIReF itself and those of other public and private agencies. In addition, AIReF believes that the decrease in domestic demand and employment caused by social distancing measures and the paralysis of some economic activities, along with a fall in exports against the backdrop of a global recession, are reasonably reflected in this scenario.

However, the institution makes it clear that more adverse scenarios arising from the intense recovery ahead cannot be ruled out. AIReF identifies downside risks that relate to the possibility that more adverse epidemiological scenarios will arise or that more persistent damage to the economy and employment's productive capacity will be sustained that will make the recovery predicted for the second half of 2020 and for 2021 more difficult.

In particular, the relative specialisation of the Spanish economy in service activities most affected by social distancing measures, the continued high level of temporary contracts on the labour market and the relatively greater presence of small businesses, which are more exposed to financial restrictions than larger firms, could complicate recovery. In addition, the resurgence of tensions in financial and sovereign debt markets that have been previously contained by the actions of the monetary authorities at the European level cannot be ruled out. The balance of risks may change if there are medical advances that reduce the risk of the coronavirus to public health.



Recommendations

While the information flexibility allowed this year by the European Commission is understandable, AIReF stressed the importance of systematising information exchange and adding more detail to the assumptions and hypotheses that have been incorporated into the Government's macroeconomic scenario design. More specifically, it is more desirable than ever to have more detail on the no-change-policy scenario as this would allow to assess more accurately the measures taken to deal with the crisis. Likewise, it is essential to accompany the macroeconomic scenario with the fiscal scenario, so that consistency between the two is ensured.

AIReF therefore reiterates its recommendation to the Government to include a fiscal scenario and no-change policy framework that detail and quantify the impact of the measures taken or expected and their transfer to the final macroeconomic framework in the information provided to AIReF in order for it to issue the reports referred to in article 14.1 of Organic Law 6/2013. In addition, it also reiterates its recommendation to regulate the flow and schedule of information exchange between the Government and the *Institución Fiscal Independiente Nacional* (National Independent Fiscal Institution) through a convention or "memorandum of understanding", in line with the customary practices of surrounding countries.

AIReF's economic scenarios

In order to issue this endorsement, AIReF has developed its own economic scenarios that will be included in the report on the Stability Programme, which will be published in the week beginning 4th May, along with an evaluation of the budgetary information. Against the backdrop of the extreme uncertainty caused by the COVID-19 pandemic, it is particularly difficult to assess the probabilities of specific scenarios.

It is difficult to determine the duration of the health crisis and the degree to which it will be possible for economic activity to go back to normal once the pandemic is controlled. In addition, there is a lack of sufficient indicators to define its economic impact, as well as a lack of information on some specific aspects such as the effect of instruments to make labour relations and *expedientes de regulación temporal de empleo* (temporary redundancy plans - ERTES) more flexible, which is essential in determining the crisis's impact on the labour market.

For this reason, AIReF has decided to adapt its analysis framework and has developed its own economic scenarios based on different assumptions on the evolution of the pandemic and the speed of recovery. These scenarios and the evaluation of the budgetary information that should be included in the SPU is included in the report on the Stability Programme, which will be published in the week of 4-9 May.