

AIReF ENDORSES THE GOVERNMENT'S MACROECONOMIC FORECASTS, BUT WARNS OF SIGNIFICANT DOWNSIDE RISKS

- **AIReF notes that the Government's nominal growth estimate is in the central range of the probability intervals of its scenario. However, it perceives downside risks in the real growth forecast by the Government for 2023, of 2.1%, compared with the 1.5% estimated by AIReF**
- **Among the risks, it points to the deterioration of the advanced economies, a higher gas price than that assumed by the Government, the escalation of geopolitical tensions, the difficulties of the European economies to manage the energy crisis and the deterioration in the purchasing power and confidence of Spanish households**
- **AIReF considers the Government's price forecasts, which place the GDP deflator at 3.8% in 2023, compared with the 4.3% estimated by AIReF, to be reasonable**
- **The institution estimates a lower impact of the RTRP than the Government estimates**
- **AIReF makes a new recommendation for the Ministry of Economic Affairs to consult AIReF on the Report on the Economic Situation which serves as the basis for the General Government (GG) budget**
- **It reiterates the need for information on budgetary and fiscal measures included in the macroeconomic scenario, as well as the need for the endorsement process to be regulated by means of a memorandum of understanding**

The Independent Authority for Fiscal Responsibility (AIReF) endorses the macroeconomic scenario that accompanies the 2023 General State Budget (GSB), considering that both the GDP growth path and the inflation forecasts are feasible, although there are significant downside risks in the former. The Government's scenario forecasts real GDP growth of 4.4% in 2022 and 2.1% in 2023, compared with 1.5% forecast by AIReF for next year. In the area of prices, the Government forecasts a slight reduction in the GDP deflator in 2023 to 3.8%, compared with the 4% expected for 2022, in a scenario of a sharp deceleration of the private consumption deflator. AIReF, for its part, estimates a GDP deflator of 4.3% in 2023.

AIReF highlights that the purpose of this report is to verify that the budgetary scenario is based on realistic macroeconomic forecasts. For this purpose, the relevant variables are not only real growth, its composition or employment, but also variables expressed in nominal terms. In particular, tax revenues are correlated with the evolution of different components of GDP in current terms with an elasticity that in the last two years is well above the historical average. In addition, some spending items, such as pensions, are indexed to inflation.

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The slowdown in GDP forecast by the Government for 2023 is based on a lower contribution of the external balance to growth, which, after contributing 2.9 points in 2022, would have a negative contribution in 2023 (-0.3 points). This behaviour would be partially offset by the evolution of domestic demand, which would contribute 2.4 points in 2023 compared with 1.5 points in 2022, due to the expansion of gross fixed capital formation, especially in construction. Private consumption would maintain moderate growth rates in both years. In this scenario, there would be a stagnation of full-time equivalent employment, while the unemployment rate would stand at 12.2% of the active population in 2023 - compared with the 12.8% that the Government expects on average for 2022. As regards prices, the Government's scenario forecasts a slight reduction in the GDP deflator in 2023 to 3.8%, compared with the 4% expected for 2022, in a scenario of a sharp deceleration of the private consumption deflator.

According to AIReF, downward risks to government-estimated growth prevail in 2023. Its estimates of real growth lie in the upper range of the probability intervals estimated on the basis of AIReF's forecast scenarios, while the estimates of the GDP deflator are in the central range. AIReF will publish its full forecasts in the Report on the 2023 Budget scheduled for October. These forecasts suggest real growth of 1.5% for 2023 and an increase in the GDP deflator of 4.3%. AIReF also notes that the Government's forecasts are above the average of the most recent estimates made by the main analysts.

Among the risks, AIReF points to the worsening outlook for growth in the major advanced economies and higher gas prices than those considered in the technical assumptions of the Government's scenario. In this regard, it explains that the assumptions about the growth of the European economies in the Government's scenario come from the forecasting exercise that the European Central Bank (ECB) performed before the cut-off in Russian gas supplies took place. Since then, the energy crisis has led to a major deterioration in the United States, China and all European economies. The downward revisions are significant in Germany, which is important given the country's close interrelations with the other European economies and its weight in relation to Spanish exports.

In addition, AIReF highlights the escalation of geopolitical tensions with Russia and the difficulties of the European economies to manage the energy crisis. These pose additional risks to the growth forecast in the Government's scenario and in that of AIReF itself. In its opinion, there is a great deal of uncertainty about whether European economies will be able to find alternative energy sources to Russian gas at reasonable prices and whether energy-saving measures will be effective.

At a domestic level, AIReF states that the deterioration in the purchasing power of households and confidence is another source of downside risks. In the first half of 2022, there was a contraction in the real compensation per employee of close to 6%, thus exceeding the contraction recorded in the fourth quarter of 2012, of 5.2%. In addition, there is a rapid tightening of financing conditions. This, combined with the deterioration in their confidence - which stands at levels similar to those observed in the months of strict lockdown at the beginning of the pandemic - could lead to a greater increase in savings than that considered in the Government's scenario.

In the area of prices, AIReF considers that the Government's forecasts seem reasonable since the base effects on energy and the prospects of a slowdown in global demand

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mean that inflation is expected to fall in 2023. Furthermore, high inflation rates have led to a rapid tightening of monetary policy worldwide in order to avoid a de-anchoring of expectations and to avoid wage and price spirals. In addition, measures have been taken by the Government and other countries to limit the rise in energy prices. This supports the slowdown in inflation that the Government expects. However, the persistence of high inflation rates raises the risk that companies and households will try to recover their margins and their purchasing power.

Compared with the Government's scenario, AIReF estimates a lower impact on economic growth associated with the Recovery, Transformation and Resilience Plan (RTRP). The estimates presented recently by the Ministry of Economic Affairs and Digital Transformation suggest that, overall, the increases in GDP as a result of the RTRP would stand at 0.7 points in 2021, 1.9 points in 2022 and 2.8 points in 2023, compared with a scenario without the Plan. In contrast, AIReF estimates that in 2021 the impact would have been practically zero due to the delay in the materialisation of the investments, while it estimates an impact of 0.8 points in 2022 and 2 points in 2023 on the level of GDP compared with a non-Plan scenario.

In view of the above, AIReF estimates that the Government's macroeconomic scenario is achievable. It lies within the confidence bands estimated by AIReF, although it must be taken into account that these bands prepared with statistical criteria do not reflect that the main sources of uncertainty currently existing pose downside risks around the growth expected by the Government and by AIReF itself for 2023. The risks are more balanced as regards prices.

Recommendations

In this context, AIReF makes a new recommendation that the Ministry of Economic Affairs and Digital Transformation should consult AIReF on the Report on the Economic Situation which it prepares and which serves as a basis for setting the budgetary stability and public debt targets that constitute the first step in the preparation of the draft General Government budget. This report, which is prepared around June or July, contains an estimate of the multi-year economic scenario that serves as the basis for the preparation of the GSB and which many public authorities take as a starting point for the preparation of their own macroeconomic and budgetary scenarios. Therefore, AIReF should be able to issue an opinion since two or three months later it has to endorse the macroeconomic scenario after the budgets have already been prepared.

In addition, AIReF reiterates to the Ministries of Economic Affairs and Digital Transformation and of Finance and Civil Service the need to have appropriate information on the budgetary and fiscal measures incorporated into the macroeconomic scenario in order to increase the rigour of the endorsement process. It also reiterates to the Ministry of Economic Affairs and Digital Transformation the need for the process of endorsing the macroeconomic forecasts to be regulated by an agreement between the parties, as most EU countries do, in order to agree on the necessary procedures, deadlines and exchanges of information during the process of endorsing the macroeconomic forecasts.