

EVALUATION OF AIR^eF's MACROECONOMIC AND FISCAL FORECASTS 2023

TECHNICAL DOCUMENT 2/24

Executive Summary

September 13th, 2024



Independent Authority
for Fiscal Responsibility



The Independent Authority for Fiscal Responsibility (AIReF) was created with the mission of ensuring strict compliance with the principles of budgetary stability and financial sustainability enshrined in Article 135 of the Spanish Constitution.

Contact AIReF:

C/José Abascal, 2, 2º planta. 28003 Madrid, Tel. +34 910 100 599

Email: Info@airef.es.

Web: www.airef.es

This documentation may be used and reproduced in whole or in part, provided that its source is quoted as AIReF.

Date of publication: September 13th, 2024

EXECUTIVE SUMMARY

By publishing this technical document, the Independent Authority for Fiscal Responsibility, A.A.I. (AIReF) maintains its commitment to analysing the quality of the macroeconomic and fiscal forecasts it has been making since 2015, incorporating the fiscal year 2023 into the study. Due to their nature, under normal circumstances, forecasts are subject to great uncertainty, which has been extraordinarily accentuated in recent years as a result of the pandemic and the outbreak of the war in Ukraine and other geopolitical tensions. In this highly shifting context, the analysis of forecast errors becomes even more important as it makes it possible to identify macroeconomic aggregates where AIReF's forecasts may be less accurate and remedy potential biases and weaknesses in the estimate process. This transparency exercise is in line with AIReF's core values and places it on par with other independent fiscal institutions that already perform this type of exercise. This is in response to one of the OECD's main recommendations and to the content of AIReF's Strategic Plan 2020-2026.

Macroeconomic forecasts

Forecasts of GDP growth, employment and inflation form the basis for the projections of public revenue and expenditure that are incorporated into budgetary plans. Unrealistic macroeconomic forecasts make it difficult to plan the budgetary process, comply with fiscal rules and, in short, ensure medium- and short-term fiscal discipline.

Accordingly, EU Regulation 473/2013 establishes that the macroeconomic forecasts that serve as the basis for drawing up budgetary plans and stability programmes must be produced or endorsed by independent fiscal institutions, such as AIReF. Directive 2011/85/EU also establishes that the macroeconomic and budgetary forecasts contained in budgetary plans should be subject to

regular evaluations to improve their quality and determine the potential existence of systematic biases.

In this regard, AIRcF regularly includes in its reports an evaluation of the Government's forecasts on the basis of a methodology developed for this purpose (see Report 21/22). Furthermore, in order to increase transparency, AIRcF also carries out an ex-post evaluation of its own forecasts, which are the basis for analysing the degree of compliance with the Government's scenarios and, in the case of macroeconomic forecasts, to endorse them.

This evaluation exercise of AIRcF's macroeconomic forecasts is undertaken using two approaches:

1. A short-term focus on analysing the magnitude of the forecast error made in 2023 with regard to the first estimate of the Spanish National Accounts for the year published by the National Statistics Institute (INE) in March 2024 and the factors underlying this error. The Spanish economy maintained a very dynamic performance beyond what was anticipated. As a reference, the forecasts made in October 2022, which serve as a basis for the preparation of the General State Budget (GSB) for 2023, the positive surprises were led by private and particularly public consumption, while investment once again showed more restrained performance. On the foreign trade side, although exports performed as expected, imports, as a result of the negative surprises in investment, grew at a notably lower rate than expected. From the perspective of the factors contributing to explaining this forecast error, the statistical revisions corresponding to 2022 stand out. Both the new Spanish National Accounts information corresponding to 2022, published throughout 2023, and the revisions of the quarterly profiles of the aggregates of the Quarterly Spanish National Accounts, as a result of the new revision policy implemented since January 2023 for this summary statistic, had a major impact on the forecast errors throughout 2023. The improvement in the quality of economic forecasts must be enhanced in terms of the explanatory factors underlying these revisions, and in this regard, the INE is urged to provide the National Accounts Department with the means to achieve effective compliance with the recommendations of the technical working group on the use of the sources of circumstantial information underlying the main macroeconomic indicators in the context of the pandemic.
2. The medium-term approach is made with a longer time perspective on the basis of a range of statistics that are commonly used to evaluate the quality of forecasts, following the methodological approach of Technical Document 2/2022 of February 18th, 2022. The purpose is to analyse the magnitude of errors and the potential existence of biases and their persistence. The main conclusions drawn are as follows:

- a. The incorporation of the year 2023 entails hardly any changes to the statistical quality measures in AIReF's forecasts. The measures continue to be satisfactory in terms of efficiency, accuracy and lack of bias.
- b. AIReF's GDP forecasts for the current year continue to be the most accurate, in terms of mean squared error, of all the agencies considered. In the case of expenditure, a negative bias continues to be observed. This pessimistic bias, both for the forecasts for the current year and for the one-year forecasts, has been slightly exacerbated by the latest forecasts. In general, this bias is common to all the agencies analysed.
- c. As has been the case in recent fiscal years of forecast evaluation, statistically significant biases can be seen in some demand aggregates for one-year forecasts. However, it can be seen that the mean squared errors are decreasing or starting to decrease after reaching historical highs due to the outbreak of COVID-19. This indicates that improvements in the accuracy of the estimates are taking place despite continuing high levels of uncertainty. For next year's forecasts, a high contribution of investment to the forecast error continues to be observed, which is associated with the delays in the execution of the RTRP compared with AIReF's initial expectations.
- d. There is still no persistence in the errors, except in gross fixed capital formation at one year, where overestimates at one year tend to be accompanied by overestimates for the following year. This persistence is also linked to the full implementation assumptions of the RTRP used by AIReF.
- e. Compared with other institutions, there are still no significant differences between the biases and the accuracy of the forecasts of the different institutions and AIReF. AIReF continues to forecast GDP growth in the current year with greater certainty, but it is less accurate in forecasting the evolution of the foreign sector in the current year and of gross fixed capital formation.

Fiscal forecasts

The inclusion of 2023 in the analysis confirms the absence of significant biases in AIReF's fiscal forecasts over the whole period. AIReF's deficit forecasts were, on average, 0.2 points higher than the actual deficit. In the initial forecasts, AIReF forecast a lower fiscal balance as the extension of the measures was unknown. In contrast, it then went on to forecast a deficit almost 0.5 points higher than the one finally achieved. This deviation can be mainly explained by a higher forecast for expenditure, primarily relating to the Central Government in expenditure related to the measures and capital expenditure associated with military investment and court rulings. For its part, the Government maintained the same

reference rate of 3.9% of GDP throughout the period, 0.3 points above the value finally observed.

The revenue and expenditure forecasts were strongly affected by the denominator effect. The updating of the nominal GDP series and the macroeconomic forecasts entailed a correction of the level of revenue and expenditure of around 1.5 points of GDP. In terms of millions of euros, AIReF's revenue forecasts were around the flash estimate figure. In contrast, AIReF forecast a higher amount of expenditure that did not finally materialise.

AIReF continues to work on improving the areas identified as having the greatest weaknesses. In this regard, it is worth highlighting the new RTRP monitoring tool that AIReF has developed, although the limited availability of information on the impact of the plan in national accounting terms for the revenue and expenditure of the General Government is beyond AIReF's scope. This improvement in the monitoring of the RTRP will make it possible to reduce errors in headings such as gross capital formation. Furthermore, as from the start of 2024, improvements have been introduced to the Corporate Income Tax forecasting methods, breaking down the level of analysis with separate projections on the tax bases of the instalment payments by type of company and method of calculating the tax liability. Despite these improvements, it should be stressed that it is impossible to anticipate the impact on the forecasts of unannounced measures, due to their discretionary nature.