Tomorrow's Affairs
Analysis of today
Assessment of tomorrow

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Spain's inflation problem is domestic

Spain's inflation difference with the euro area is not only an imported shock. It is the predictable outcome of expansionary public spending, a politicised energy mix, regulatory constraints on domestic supply and a tax system that monetises rising prices.

For years, the Spanish government has argued that inflation was imported, transitory and already defeated, and that this was "the government that has best controlled inflation".

However, the evidence points in the opposite direction. Spain has seen sixteen consecutive months of consumer price inflation above the euro area average, sharply higher food and housing costs, and a private sector operating under rising cost pressure.

Spain's excess inflation relative to the euro area is a domestic policy outcome. Expanding public spending faster than private-sector money demand is monetary expansion by another route, even without a national central bank.

On top of that, interventionist regulation, a rising tax burden and the cumulative pressure on farming, livestock, industry and business reduce the economy's capacity to expand supply and competition, which is the only durable way to contain prices.

Thus, the result is a 41% increase in food prices since June 2018, a rise of more than 27% in housing and basic services, and net real wages down by around 3.5%. The public sector is the main beneficiary. By refusing to index income tax to inflation, the state captures a growing share of nominal income, while nominal GDP growth flattens the debt and deficit ratios through the denominator.

The comparison with the previous administration is relevant. In 2015, Pedro Sánchez told Mariano Rajoy in Parliament that "the prices that depend on you have not stopped rising" and that gas and electricity bills had increased.

Cumulative inflation under Sánchez is more than four and a half times higher than under Rajoy, and the administered and energy-linked prices he referred to have risen more than three times as fast and, more importantly, well above the euro area average.

Not an energy-only phenomenon

The flash estimate released by Spain's National Statistics Institute (INE) on 28 August 2026 showed annual CPI inflation at 4.3%, seven-tenths of a point above July and the highest rate since February 2023. The harmonised index (HICP) rose to 4.5%, six-tenths higher. As such, monthly price increases have now accumulated for seven consecutive months.

This is not an energy-only phenomenon. In July, both headline and core inflation rose. Transport prices increased 6.2% year on year and housing 5.7%, according to the INE. In the August flash estimate, harmonised core inflation rose again, to 3.2%. When the core index accelerates, the explanation lies in domestic supply constraints, regulatory costs and taxation, not in an external shock.

> With August at 4.5% against a euro area rate close to 2.9%, the sixteenth month is effectively confirmed

In July, Spain's HICP inflation stood at 3.9% compared with 2.9% in the euro area, a full percentage point of differential and the highest rate among the large euro economies, above Germany (2.8%), Italy (2.9%) and France (2.4%). With the August flash estimate at 4.5% in Spain, the gap is set to widen further.

The official INE series shows fifteen consecutive months, from May 2025 to July 2026, with Spanish inflation above the euro area average. With August at 4.5% against a euro area rate close to 2.9%, the sixteenth month is effectively confirmed.

A persistent differential of this kind is a competitiveness problem, not a statistical accident, as the euro area faces the same external shocks, the same oil price and the same monetary policy.

The differential reflects a policy framework that raises the cost of food, housing and energy by design, restricts domestic supply through taxation and regulation, and treats rising prices as a revenue mechanism.

The mechanism is fiscal drag

Between June 2018, when the current administration took office, and July 2026, cumulative CPI inflation reached 26.4% according to INE's own calculator. Adding the 0.7% monthly increase recorded in August, the cumulative figure now exceeds 27%. In purchasing power terms, €100 saved in 2018 is worth less than €79 today.

Wages have not compensated for that loss. The OECD estimates that the purchasing power of Spanish wages has fallen by two percentage points since 2021, compared with an average gain of one point across advanced economies.

Real wages remain around 2% below their first-quarter 2021 level, and once the higher tax burden is included, the decline exceeds 3.5%. With collectively agreed increases running close to 3% against inflation above 4% and rising taxes, 2026 will be another year of falling real net disposable income.

> The European Commission's Annual Report on Taxation 2026 confirms that Spain recorded the largest increase in the tax burden in the European Union

While household purchasing power declines, tax revenue is at a record high. Tax receipts reached €148.9 billion in the first half of 2026, up 10.4% year on year, an additional €14.1 billion, with personal income tax revenue up 10.6% and VAT up 8.4%.

The mechanism is fiscal drag. Income tax brackets, personal allowances and deductions are not adjusted to inflation, so a wage that rises in nominal terms while falling in real terms is taxed at a higher effective rate.

This is a tax increase that was never legislated or voted on, and it is regressive in practice, as it weighs most heavily on middle- and lower-income employees.

Without any adjustment to the tax system, the average effective tax rate on wages increased from 15.5% in 2019 to 17.5% in 2025, and cumulative CPI inflation from 2020 to 2025 was 23.5%.

The European Commission's Annual Report on Taxation 2026 confirms that Spain recorded the largest increase in the tax burden in the European Union over the past decade, 2.9 percentage points of GDP, of which more than 2.5 points came from taxes on labour.

Constrained by regulation and taxation

The Spanish differential with the euro area has identifiable causes, and most of them are domestic or European policy decisions. A substantial part of the increase in consumer electricity costs is structural and regulatory.

From penalties on firm backup capacity, a politicised generation mix, punitive taxation of nuclear generation and the permanent cost of the reinforced system-operation mode adopted after the 2025 blackout feed directly into Spanish regulated tariffs and the Spanish CPI, not into the German or French ones.

The current energy problem is not crude oil supply but refining capacity, and that capacity has been destroyed by policy.

Europe closed four refineries in a single year, some 400,000 barrels per day of domestic capacity, increasing import dependence at a time when global refining margins have moved to record levels.

Taxing and regulating European refining out of existence does not reduce diesel consumption; it makes it more expensive and shifts the emissions elsewhere. Diesel and petrol in Spain already carry more than 45% of the final price in taxes.

The solution is not another temporary decree of tax rebates timed to the political calendar - Daniel Lacalle

The same applies to food. Diesel is an essential input for farming and freight, and its price feeds through the entire food chain.

Farmers and livestock producers have spent years protesting against compliance requirements, shrinking margins and a presumptive tax regime for agricultural income that ignores the cost escalation of recent years. When domestic productive capacity is eroded, the adjustment comes through prices.

Inflation is always a monetary and fiscal phenomenon. More currency units directed towards rising public spending, combined with domestic supply that is constrained by regulation and taxation. Prices rise because the public sector needs them to rise.

The balance of this cycle is clear. Cumulative inflation above 27%, sixteen months of inflation above the euro area average, net real wages below their 2019 level, falling real net household income and record tax revenues extracted without a single legislated rate increase. Households pay twice, at the supermarket and on their payslip.

The solution is not another temporary decree of tax rebates timed to the political calendar. It is to adjust the tax system to real inflation, remove the artificial tax layer on energy, dismantle the regulatory burden that constrains supply, stop destroying refining and agricultural capacity, and cut the structural public spending that requires higher taxes and higher inflation every year. Everything else will only mean impoverishment presented as success.