9. SPAIN

Job creation returns as the recovery firms

The economic recovery is forecast to get firmer over 2014-15, backed by improved confidence and a further easing of financing conditions. After having turned positive at the end of last year, employment growth is expected to increase gradually, while unit labour costs continue to moderate. Unemployment is set to decline but will remain high. The budget deficit is set to narrow in 2014 but government debt is still expected to rise.

The mild economic recovery in Spain is expected to gain momentum amidst improved confidence and further relaxation of financial conditions, as declining risk premia and better financing conditions for the sovereign and for banks are gradually passed on to final borrowers. Yet, financing conditions remain onerous for smaller borrowers, such as SMEs. The adjustment of imbalances progresses, but high levels of debt are expected to continue to weigh on growth.

Towards more balanced growth

GDP expanded by 0.2% q-o-q in the last quarter of 2013. The rate of activity is expected to accelerate during 2014, leading to an average GDP growth rate of 1.1% for the year as a whole. The positive contribution to growth from the external sector is expected to narrow progressively over the forecast horizon, while domestic demand takes over as the main growth driver. As a result, and under the customary no-policy-change assumption, the projected GDP growth for 2015 is 2.1%.

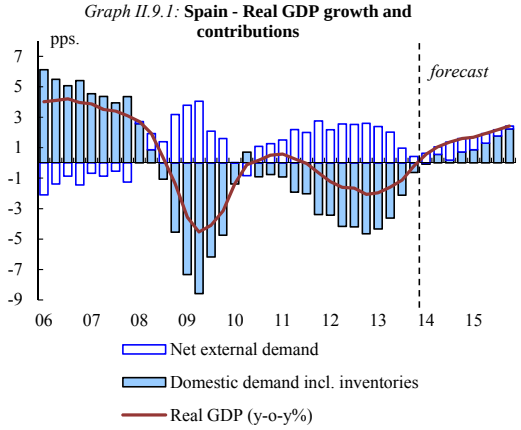
Private consumption is forecast to accelerate progressively, backed by positive employment growth and growing real gross disposable income, also supported by very low inflation. The household saving rate is projected to increase marginally as household continue to deleverage.

The improved economic prospects and the rebound in exports are expected to underpin investment in equipment. By contrast, the adjustment in construction is set to continue. In particular, residential investment is expected to keep contracting in 2014 as leading indicators remain weak.

Despite a deceleration in the second half of 2013, exports are set to remain robust, backed by ongoing improvements in price and non-price competitiveness and healthy growth of Spain's main export markets. At the same time, imports are forecast to accelerate in line with final demand and the high import content of equipment investment and exports. The current-account surplus is forecast to widen to 1.6% of GDP and net lending to around 2.2% of GDP in 2015.

Inflation is projected to remain very low at 0.1% and 0.8% on average for 2014 and 2015, respectively, due to sluggish demand and the fall in energy prices.

Graph II.9.1: **Spain - Real GDP growth and contributions**



Employment set to expand

Having peaked at 27.2% in the first quarter of 2013, the unemployment rate retreated to 26% at the end of 2013, [16] mainly due to the decline in the labour force, whereas employment kept falling until the third quarter. However, the process of job destruction bottomed out in the last quarter of 2013 and employment is expected to grow faster in 2014, prompting a moderate fall in unemployment.

Although productivity is expected to decelerate in 2014, wage moderation should allow for some further decline in nominal unit labour costs and competitiveness gains over the whole forecast period.

(16) This figure is obtained with the previous methodology. According to the new methodology, the unemployment rate was 25.7% in the same period.

Downside risks to the growth forecast are mainly related to the external sector. Growth could be negatively affected if emerging market economies, particularly those in Latin America, were to slow down more than expected. A positive surprise could arise if financing conditions improved faster than expected, as this would boost domestic demand.

Output recovery to aid ongoing deficit reductions

Final data for 2013 showed that fiscal consolidation continued last year, but at a more moderate pace than in 2012. Net of bank recapitalisation costs (about 0.5% of GDP), the general government deficit reached 6.6% of GDP for the full year.

The impact of the 2014 budget measures and an improving macroeconomic outlook are expected to reduce the deficit to 5.6% of GDP in 2014, mostly thanks to lower expenditure. With the debt stock increasing, interest payments are expected to rise further, despite lower interest rates. Social transfers should decelerate in 2014, thanks to falling unemployment and the change in the pension indexation formula. Two recent developments are expected to have a deficit-increasing impact of about 0.1% of GDP in 2014. First, the decision by the European Court of Justice to consider illegal the special tax levied by the regions during ten years known as the "*céntimo sanitario*" could lead to successful legal claims for reimbursement. Second, the low flat social security payments on new permanent employment contracts, which came into effect in February 2014 and companies can access until the end of the year.

Assuming no change in policy, the headline deficit is expected to widen to 6.1% of GDP in 2015. This projection assumes that some tax measures announced by the authorities as temporary will expire by the end of 2014.

The structural deficit is estimated to be at 2.8% and 2.4% of GDP in 2013 and 2014, respectively before rising to 3.4% in 2015. Large public deficits and low nominal GDP growth are projected to push the general government gross debt above 100% of GDP in 2014 and close to 104% of GDP in 2015.

Table II.9.1:

Main features of country forecast - SPAIN

	2012			Annual percentage change					
	bn EUR	Curr. prices	% GDP	94-09	2010	2011	2012	2013	2014	2015
GDP		1029.3	100.0	2.9	-0.2	0.1	-1.6	**-1.2**	**1.1**	**2.1**
Private Consumption		610.6	59.3	2.7	0.2	-1.2	-2.8	**-2.1**	**1.3**	**1.6**
Public Consumption		207.7	20.2	4.0	1.5	-0.5	-4.8	**-2.3**	**-0.8**	**-0.7**
Gross fixed capital formation		197.5	19.2	3.6	-5.5	-5.4	-7.0	**-5.1**	**-1.4**	**4.2**
of which: equipment		60.7	5.9	4.3	5.0	5.5	-3.9	**2.2**	**6.5**	**8.2**
Exports (goods and services)		336.0	32.6	5.8	11.7	7.6	2.1	**4.9**	**5.5**	**6.7**
Imports (goods and services)		328.3	31.9	6.7	9.3	-0.1	-5.7	**0.4**	**3.4**	**5.8**
GNI (GDP deflator)		1017.3	98.8	2.8	0.4	-0.7	-0.8	**-0.8**	**0.9**	**1.8**
Contribution to GDP growth:		Domestic demand		3.2	-0.9	-2.0	-4.1	**-2.6**	**0.4**	**1.5**
		Inventories		0.0	0.3	-0.1	0.0	**0.0**	**0.0**	**0.0**
		Net exports		-0.3	0.4	2.1	2.5	**1.5**	**0.8**	**0.5**
Employment				2.0	-2.3	-2.2	-4.8	**-3.4**	**0.4**	**1.2**
Unemployment rate (a)				13.7	20.1	21.7	25.0	**26.4**	**25.5**	**24.0**
Compensation of employees / f.t.e.				3.5	0.4	1.3	0.2	**0.7**	**0.2**	**0.3**
Unit labour costs whole economy				2.8	-1.7	-1.0	-3.0	**-1.6**	**-0.5**	**-0.5**
Real unit labour cost				-0.5	-1.8	-1.0	-3.0	**-2.2**	**-0.8**	**-1.3**
Saving rate of households (b)				-	13.9	12.7	10.4	**10.4**	**10.4**	**10.5**
GDP deflator				3.4	0.1	0.0	0.0	**0.6**	**0.3**	**0.7**
Harmonised index of consumer prices				3.0	2.0	3.1	2.4	**1.5**	**0.1**	**0.8**
Terms of trade goods				0.4	-2.3	-3.5	-2.3	**0.5**	**0.6**	**-0.1**
Trade balance (c)				-5.3	-4.6	-4.2	-2.5	**-1.2**	**-0.6**	**-0.6**
Current-account balance (c)				-4.3	-4.4	-4.0	-1.2	**0.8**	**1.4**	**1.5**
Net lending (+) or borrowing (-) vis-a-vis ROW (c)				-3.4	-3.8	-3.5	-0.6	**1.5**	**2.0**	**2.1**
General government balance (c)				-	-9.6	-9.6	-10.6	**-7.1**	**-5.6**	**-6.1**
Cyclically-adjusted budget balance (c)				-	-7.1	-6.8	-7.1	**-3.3**	**-2.4**	**-3.9**
Structural budget balance (c)				-	-7.1	-6.5	-4.1	**-2.8**	**-2.4**	**-3.4**
General government gross debt (c)				53.7	61.7	70.5	85.9	**93.9**	**100.2**	**103.8**

(a) Eurostat definition. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.