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SPAIN: MACRO FISCAL ASSESSMENT

AN ANALYSIS OF THE FEBRUARY 2010 UPDATE OF THE STABILITY PROGRAMME

The Stability and Growth Pact requires each EU Member State to present an annual update of its medium-term fiscal programme, called 'stability programme' for countries that have adopted the euro as their currency and 'convergence programme' for those that have not. The most recent update of Spain's stability programme was submitted on 1 February 2010.

The attached technical analysis of the programme prepared by the staff and under the responsibility of the Directorate-General for Economic and Financial Affairs (DG ECFIN) of the European Commission, was finalised on 12 March 2010. Comments should be sent to Mateo Capó Servera, Pedro Cardoso or Manuel Palazuelos Martinez (Mateo.Capo@ec.europa.eu, Pedro.Cardoso@ec.europa.eu, Manuel.Palazuelos-Martinez@ec.europa.eu). The main aim of the analysis is to assess the realism of the budgetary strategy presented in the programme as well as its compliance with the requirements of the Stability and Growth Pact. However, the analysis also looks at the overall macro-economic performance of the country and highlights relevant policy challenges.

The analysis takes into account (i) the Commission services' autumn 2009 forecast, (ii) the code of conduct ("Specifications on the implementation of the Stability and Growth Pact and guidelines on the format and content of stability and convergence programmes", endorsed by the ECOFIN Council of 10 November 2009) and (iii) the commonly agreed methodology for the estimation of potential output and cyclically-adjusted balances.

Based on this analysis, the European Commission adopted a recommendation for a Council opinion on the programme on 17 March 2010. The ECOFIN Council is expected to discuss the opinion on the programme on 16 April 2010.

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All these documents, as well as the provisions of the Stability and Growth Pact, can be found on the following website:

http://ec.europa.eu/economy_finance/sgp/index_en.htm

TABLE OF CONTENTS

1. INTRODUCTION

This document assesses the February 2010 update of Spain's stability programme, which was submitted on 1 February 2010 and covers the period 2009-2013.[1] The programme builds on the 2010 Budget Law. It was approved by the government but it does not provide information on its status vis-à-vis the Parliament.

This assessment is structured as follows. Section 2 discusses the key challenges for public finances in Spain. Section 3 assesses the plausibility of the macroeconomic scenario underpinning the public finance projections of the stability programme against the background of the Commission services' economic forecasts.[2] Section 4 analyses budgetary implementation in the year 2009, the budgetary plans for 2010 and the medium-term budgetary strategy. It also assesses risks attached to the budgetary targets. Section 5 reviews recent debt developments and medium-term prospects, as well as the long-term sustainability of public finances. Section 6 discusses institutional features of public finances. Finally, Section 7 concludes with an overall assessment of the programme. The annex provides a detailed assessment of compliance with the code of conduct, including an overview of the summary tables from the programme.

[1] The English language version was submitted on 25 February 2010.

[2] This assessment uses the Commission services' 2009 autumn forecast, as published on 3 November 2009, as a benchmark. However, more recent information that has become available has also been taken into account to assess the risks to the programme scenarios.

Table 1. Comparison of key macroeconomic and budgetary projections

		2008	2009	2010	2011	2012	2013
Real GDP (% change)	**SP Feb 2010**	**0.9**	**-3.6**	**-0.3**	**1.8**	**2.9**	**3.1**
	COM Nov 2009	0.9	-3.7	-0.8	1.0	n.a.	n.a.
	SP Jan 2009	*1.2*	*-1.6*	*1.2*	*2.6*	*n.a.*	*n.a.*
HICP inflation (%)	**SP Feb 2010**	**n.a.**	**n.a.**	**n.a.**	**n.a.**	**n.a.**	**n.a.**
	COM Nov 2009	4.1	-0.4	0.8	2.0	n.a.	n.a.
	SP Jan 2009	*n.a.*	*n.a.*	*n.a.*	*n.a.*	*n.a.*	*n.a.*
Output gap[1] (% of potential GDP)	**SP Feb 2010**	**0.6**	**-3.5**	**-4.4**	**-3.2**	**-1.6**	**-0.2**
	COM Nov 2009[2]	0.8	-2.8	-3.6	-2.6	n.a.	n.a.
	SP Jan 2009	*0.8*	*-2.3*	*-3.4*	*n.a.*	*n.a.*	*n.a.*
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	**SP Feb 2010**	**-9.1**	**-4.9**	**-4.2**	**-3.8**	**-3.6**	**-3.5**
	COM Nov 2009	-9.1	-4.5	-3.7	-3.3	n.a.	n.a.
	SP Jan 2009	*-9.2*	*-6.6*	*-5.8*	*-5.4*	*n.a.*	*n.a.*
General government revenue (% of GDP)	**SP Feb 2010**	**37.0**	**34.6**	**35.7**	**36.7**	**37.5**	**38.3**
	COM Nov 2009	37.0	34.0	35.6	36.0	n.a.	n.a.
	SP Jan 2009	*37.0*	*37.5*	*38.3*	*38.7*	*n.a.*	*n.a.*
General government expenditure (% of GDP)	**SP Feb 2010**	**41.1**	**46.1**	**45.5**	**44.2**	**42.8**	**41.3**
	COM Nov 2009	41.1	45.2	45.6	45.3	n.a.	n.a.
	SP Jan 2009	*40.4*	*43.3*	*43.1*	*42.6*	*n.a.*	*n.a.*
General government balance (% of GDP)	**SP Feb 2010**	**-4.1**	**-11.4**	**-9.8**	**-7.5**	**-5.3**	**-3.0**
	COM Nov 2009	-4.1	-11.2	-10.1	-9.3	n.a.	n.a.
	SP Jan 2009	*-3.4*	*-6.2*	*-5.7*	*n.a.*	*n.a.*	*n.a.*
Primary balance (% of GDP)	**SP Feb 2010**	**-2.5**	**-9.6**	**-7.7**	**-4.9**	**-2.3**	**0.1**
	COM Nov 2009	-2.5	-9.4	-7.6	-6.3	n.a.	n.a.
	SP Jan 2009	*-1.9*	*-4.1*	*-2.9*	*-1.9*	*n.a.*	*n.a*
Cyclically-adjusted balance[1] (% of GDP)	**SP Feb 2010**	**-4.3**	**-9.9**	**-7.9**	**-6.1**	**-4.6**	**-2.9**
	COM Nov 2009	-4.4	-10.0	-8.5	-8.1	n.a.	n.a.
	SP Jan 2009	*-3.7*	*-5.2*	*-4.2*	*n.a.*	*n.a.*	*n.a.*
Structural balance[3] (% of GDP)	**SP Feb 2010**	**-4.3**	**-9.9**	**-7.9**	**-6.1**	**-4.6**	**-2.9**
	COM Nov 2009	-4.1	-9.3	-8.5	-8.1	n.a.	n.a.
	SP Jan 2009	*-3.3*	*-4.6*	*-4.2*	*n.a.*	*n.a.*	*n.a.*
Government gross debt (% of GDP)	**SP Feb 2010**	**39.7**	**55.2**	**65.9**	**71.9**	**74.3**	**74.1**
	COM Nov 2009	39.7	54.3	66.3	74.0	n.a.	n.a.
	SP Jan 2009	*39.5*	*47.3*	*51.6*	*53.7*	*n.a.*	*n.a.*

Notes:

[1]Output gaps and cyclically-adjusted balances from the programmes as recalculated by Commission services on the basis of the information in the programmes.

[2]Based on estimated potential growth of 1.6%, -0.1%, 0.0% and 0.0% respectively in the period 2008-2011.

[3]Cyclically-adjusted balance excluding one-off and other temporary measures. One-off and other temporary measures are n.a. according to the most recent programme and -0.3% of GDP in 2008 and -0.7% of GDP in 2009 in the Commission services' autumn 2009 forecast.

Source :

Stability programme (SP); Commission services' autumn 2009 forecasts (COM); Commission services' calculations.

2. KEY CHALLENGES IN THE ECONOMIC DOWNTURN AND THE POLICY RESPONSE

This section describes recent economic and budgetary developments for Spain, which form the background against which the current programme assessment should be viewed, and outlines the key challenges to be addressed by future economic policies.

Before the onset of the current crisis, the Spanish economy recorded high growth rates for more than a decade, higher than the euro area average and in excess of potential GDP. On the back of a strong and broad-based domestic demand expansion, GDP growth averaged over 3½% per year between 1995 and 2007. That was accompanied by strong job creation and fast population growth thanks to large immigration flows.

This GDP growth record was accompanied by the accumulation of imbalances, which can be traced back to the regime changes brought about by EMU accession and continued against the backdrop of low interest rates and loose credit conditions observed over most of the decade. First, deeper external financing opportunities paved the way for a significant credit expansion to finance domestic demand and accumulation of debt by both households and corporations. Second, such a credit impulse widened the gap between domestic investment and savings, which had a counterpart in growing external deficits since the late nineties, and especially since 2004. Third, the structure of domestic spending itself changed, notably with an increasing weight of the housing sector. Fourth, the overheating of the economy resulted in inflation in excess of the euro area (EA) average, and against a backdrop of subdued productivity growth, cost competitiveness deteriorated.[3] In addition, asset prices, notably real estate, boomed.

Already in early 2007, when the credit impulse was fading out with rising interest rates, a slow correction of the imbalances described above started taking place, especially with the housing sector showing the first signs of a fading boom. The international financial crisis in late 2007, and especially as of the middle of 2008, accelerated and deepened that adjustment, which quickly spread to household consumption and other investment items. A later slump in world trade in end 2008 aggravated the situation by hurting the possibilities of growing through exports even if Spain does not seem to be a very open economy (at least when compared with the average of EA countries).

After the marked slowdown of economic activity in the course of 2008, GDP declined by 3.6% in 2009 reflecting the aggravation of the adverse developments recorded earlier on. Notably, domestic demand fell sharply, with household consumption falling by some 5% and investment shrinking by 15%. On the external side, both exports and imports plunged, but the latter much more than the former, such that, in net terms, trade no longer acted as a drag on GDP growth and in fact posted a contribution of almost 3 percentage points to GDP growth. The downturn has led to dramatic employment losses and sky-rocketing unemployment rates, which came close to 19% in the final quarter of 2009, up from lows of some 8% in 2007.

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[3] Nevertheless, Spanish exporters seem to have largely been able to maintain external market shares until a few years ago. For a deeper discussion of competitiveness and trade developments in Spain over this decade, see C. Martinez Mongay and L.A. Maza Lasierra "Competitiveness and growth in EMU: The role of the external sector in the adjustment of the Spanish economy", European Economy, Economic Paper 355, January 2009.

The crisis has led to the narrowing of some of the imbalances pointed out above. First, the credit boom ended and indebtedness levels of both households and corporations fell slightly in 2009. Yet their ratios to GDP have not declined due to a declining GDP in nominal terms. Second, the rebalancing of GDP growth away from domestic demand has taken place, with shrinking investment and falling consumption. Third, the external deficit has declined from a peak of 9½% of GDP in 2007 to less than 5% of GDP in 2009 on account of a sharp import retrenchment. Fourth, inflation has receded and was slightly below the EA average in 2009 as a whole. At the same time, whereas wage growth has remained above the EA average, measured productivity has increased significantly reflecting large employment losses concentrated on low-productivity sectors, notably construction and some services, such that labour costs have grown much less than the in rest of the EA. Asset prices, including real estate, have also fallen.

The crisis is taking a heavy toll on Spanish public finances. Fiscal outturns have changed abruptly after a period of gradual improvements in the fiscal balance from large deficits in the nineties to surpluses between 2005 and 2007 and a continued fall of the government debt ratio. Those pre-crisis outcomes can be ascribed to a tax-friendly backdrop with high GDP growth and rising asset prices, falling interest burden and some expenditure containment in earlier years. Yet, already in 2008, the fiscal position was buffeted by the crisis, and reflecting also discretionary stimulus measures, the government deficit exceeded 3% of GDP. On the basis of this deficit outturn, an EDP was opened in March 2009. The most recent step in this procedure was the issuance by the Council of a revised recommendation under Article 126(7) of the Treaty on the functioning of the European Union in December 2009, whereby Spain is called to end its excessive deficit situation by 2013 (see Box 1 for more details).

Besides the sharp economic downturn, fiscal developments reflect also a policy response that until recently was overall characterised by an accommodative stance with the adoption of various stimulus measures. In 2009, they amounted to around 2¼% of GDP – apparently the largest discretionary stimulus in the EA – comprising measures on both the revenue and expenditure side (notably investment), mostly of a temporary nature. On top of this, the Spanish authorities adopted in late 2008 a range of measures to support the financial sector, such as increases in bank deposit guarantees, provision of guarantees for bank's new funding operations and schemes for the acquisition of financial assets by the government. However and overall, the domestic banking sector has coped well with the turmoil recorded up to now without major government intervention.

More recently, and against the deterioration of the fiscal outlook, some fiscal consolidation measures, mostly on the revenue side, were announced in the course of 2009. Furthermore, in late January 2010, the Spanish authorities announced a consolidation package for the period 2010-2103, which has been considered in the current programme update.

All in all, the Spanish economy is facing various challenges. In particular, the gap between income and spending, as reflected in the external imbalance, has to narrow further. That has to go hand in hand with the continuation of rebalancing GDP growth drivers towards the external sector and a further move away from domestic demand components. However, that will require gains in competitiveness. In addition, the shallow recovery expected in external markets hampers the margin for the re-balancing of GDP growth towards exports, also because the share of exports on Spain's GDP is not very high, which means there is a low basis to grow from. Finally, the service of the large stock of (net) external liabilities creates an element of rigidity for the narrowing of the external deficit, notably as interest rates are bound to edge up sooner or later.

Indeed, the current juncture is the result of not just adverse cyclical developments and external shocks but also of structural elements such as an oversized housing sector, a vulnerable financial position of private agents due to high debt levels calling for deleveraging, and subdued apparent productivity growth.[4] All these aspects require considerable efforts to be overcome and the adjustment is likely to be lengthy and hamper economic activity. In this respect, efforts to boost potential GDP growth by supporting the resilience of the supply side seem also necessary in the light of the productivity gap of Spain vis-à-vis the EA average. This can also benefit from gains in competitiveness achieved by overcoming the eroded cost position by means of appropriate cost policies, i.e., contained price and wage growth relative to trading partners. Last but not least, the very high unemployment rates make sustainable job creation an undeniable key policy challenge.

Finally, the fiscal challenges are huge. If up to now the large government deficits have cushioned the sharp private sector retrenchment, there is no room for continuing to do so without further compromising fiscal sustainability. The quickly changed outlook for the Spanish economy seriously hampers the fiscal prospects. First, the asset boom is over and buoyant tax proceeds associated with it are gone. Second, the recovery of economic activity, and in particular of domestic demand, is likely to be shallow and consequently to give little relief to tax revenue.[5] Third, the foreseeable pace of economic activity cannot sustain the dynamism of public spending recorded over this decade. In addition, even if departing from a comfortable position, public debt is rising quickly with high deficits and low GDP growth. Finally, population ageing will put additional pressure on Spanish public finances in coming decades due to higher age-related expenditure.

[4] This weak productivity reflected to some extent the growing weight of low-productivity activities like construction and some services; it might have been less notorious in sectors more open and subject to competition from abroad.

[5] For more on tax revenue developments before the current crisis see C. Martinez Mongay, L. A. Maza Lasierra and J. Yaniz Igal (2007), ‘Asset booms and tax receipts: The case of Spain, 1995–2006’, *European Economy — Economic Papers*, No. 293, Economic and Financial Affairs DG, European Commission, November.

3. MACROECONOMIC OUTLOOK

Against the background of the current macroeconomic situation and the main policy challenges set out in the previous section, this section makes an assessment of the plausibility of the macroeconomic scenario underpinning the public finance projections of the programme.

The programme's macroeconomic outlook projects GDP to contract by 0.3% in volume terms in 2010 after having declined by 3.6% in 2009. The recovery is foreseen to take place in 2011 and beyond with real GDP growth rates of 1.8% in 2011 and some 3% in both 2012 and 2013 (see Table 2).[6]

Domestic demand is projected to be the main driver of economic activity, shrinking further in 2010 and recovering rapidly thereafter. In particular, investment is foreseen to show a very marked V-shape profile with a further sink in 2010 expected to be followed by stagnation in 2011 and notorious expansions in 2012 and 2013 by some 6% in the latter year. According to the programme, corporate investment alone could expand by an average of some 9% in 2012-2013 (government investment declines with fiscal consolidation efforts over the programme period). Private consumption swings in the same direction in a more muted way, attaining growth rates of 3¼% in the outer years, benefiting from a decline in household savings after the peak of some 19% of disposable income recorded in 2009. Government consumption is set to grow somewhat in 2010 but to slightly recede in subsequent years reflecting fiscal consolidation. Exports are assumed to accelerate over the entire period; while imports would fall further in 2010 and grow afterwards reflecting brisk domestic demand. All in all, the external sector is set to post net contributions to GDP growth but by a declining margin over the programme period.

The cyclical conditions implied by the update (as measured by the output gap recalculated by the Commission services based on the information provided in the programme following the commonly agreed methodology) are expected to deteriorate further in 2010 and to gradually improve thereafter. In particular, after the positive readings for the years up to 2008, the output gap is forecast to fall further in 2010, reaching -4½% of GDP, and to narrow afterwards up to the point of essentially closing by the programme horizon as actual GDP growth is assumed to constantly grow in excess of potential GDP growth (averaging 1¼% in 2011-2013 implied by the programme).[7]

[6] The update's external assumptions are based on the Commission services autumn 2009 forecast. Some variables assume the EA values and are not Spain-specific (e.g., long-term interest rate or growth of relevant foreign markets) with the former being slightly more benign than the latter.

[7] The estimates for potential GDP growth presented in the programme are higher than those of the Commission forecast mainly due to a higher contribution of the employment factor.

Table 2: Comparison of macroeconomic developments and forecasts

	2009		2010		2011		2012	2013
	COM	SP	COM	SP	COM	SP	SP	SP
Real GDP (% change)	-3.7	-3.6	-0.8	-0.3	1.0	1.8	2.9	3.1
Private consumption (% change)	-5.2	-5.0	-0.5	-0.1	0.9	2.5	3.3	3.3
Gross fixed capital formation (% change)	-15.6	-15.7	-8.4	-6.5	-1.3	0.3	4.2	5.9
Exports of goods and services (% change)	-13.0	-12.4	1.3	2.8	3.3	5.2	6.9	7.4
Imports of goods and services (% change)	-20.0	-18.7	-2.7	-1.3	2.2	3.7	5.8	6.8
Contributions to real GDP growth:								
- Final domestic demand	-6.6	-6.4	-1.9	-1.4	0.7	1.4	2.6	3.0
- Change in inventories	-0.1	0.0	0.1	0.0	0.0	0.0	0.0	0.0
- Net exports	3.0	2.8	1.0	1.1	0.3	0.4	0.3	0.1
Output gap[1]	-2.8	-3.5	-3.6	-4.4	-2.6	-3.2	-1.6	-0.2
Employment (% change)	-6.6	-6.7	-2.3	-1.9	-0.4	0.7	1.9	2.3
Unemployment rate (%)	17.9	18.0	20.0	19.0	20.5	18.4	17.0	15.5
Labour productivity (% change)	3.1	3.2	1.5	1.6	1.4	1.1	1.0	0.9
HICP inflation (%)	-0.4	n.a.	0.8	n.a.	2.0	n.a.	n.a.	n.a.
GDP deflator (% change)	0.1	0.2	0.5	0.5	1.4	1.5	2.0	2.0
Comp. of employees (per head, % change)	3.7	3.9	2.2	1.0	2.5	1.5	1.8	1.9
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	-4.5	-4.9	-3.7	-4.2	-3.3	-3.8	-3.6	-3.5

<u>Note</u>:

[1]In percent of potential GDP, with potential GDP growth according to the programme as recalculated by Commission services.

<u>Source</u> *:*

Commission services' autumn 2009 forecasts (COM); Stability programme (SP).

The programme's GDP prospects exceed those of the Commission services autumn 2009 forecast and do so by an increasing margin: the latter projects GDP to shrink by 0.8% in 2010 and to expand by 1% in 2011.[8] In addition, the programme's GDP growth projections for 2011 and beyond contrast visibly with the stagnation in potential GDP growth for the period 2010-2011 estimated in the Commission autumn forecast. Looking at the individual domestic and external demand components, it can be observed that the projections of the programme update exceed those of the Commission forecast for every single item barring government consumption.

The programme envisages further declines of the external deficit but by lower margins than in 2009, with the deficit reaching 3½% of GDP by 2012-2013 driven by a reduction in the goods and services deficit. That outlook is slightly milder than the one in the Commission services' autumn 2009 forecast. In terms of sector composition, and in sharp contrast with the years prior to the current crisis, the bulk of the savings deficit is now accounted for by the government. The programme expects the private sector to remain a net lender for the rest of the programme period but by a declining margin after the peak of 2009.

According to the update, additional job losses in 2010 will be followed by brisk employment creation with the unemployment rate going from a peak of 19% in 2010 to 15½% by 2013. The programme expects employment creation to account for over three fifths of GDP growth in the period 2011-2013 and labour productivity for the rest. A marked slowdown in wages is assumed, with wage growth going from a peak of some 5% in 2008 to a low of 1% in 2010, before slowly rebounding to approach 2% in the

[8] The Commission services February 2010 interim forecast projects GDP to fall by -0.6% in real terms in 2010.

outer years. This outlook differs from the Commission forecast scenario as the latter foresees more intense job destruction in 2010 and 2011 and less marked wage moderation, but with the aggregate wage bill being essentially identical in both scenarios. According to the update, unit labour costs will fall in 2010 and grow little afterwards, which is more muted than in the Commission outlook. The programme scenario for labour costs implies, first, unit labour costs growing below the EA average and, second, gains in unit profit margins over the programme period.

Inflationary pressures are assumed to remain contained over the programme period, with price growth approaching 2% by 2013 from below, which is broadly in line with the patterns foreseen in the Commission services' autumn 2009 forecast for the years 2010 and 2011.[9] Yet it is worth bearing in mind that the latter assumes a larger slack in activity, which is more likely to dampen pressures on prices. In other words, the programme's muted inflation outlook might not be consistent with the envisaged acceleration of demand. The update's scenario implies some small falls in wages in real terms and an inflation path that is consistent with the ECB's objective for price stability over the entire programme period. That means that the inflation differential vis-à-vis the EA would not persist in the coming years and that competitiveness would not suffer through this channel.

The programme seems to implicitly regard the ongoing crisis as an episode with strong cyclical elements and not so much as a turning point in the growth pattern. It suggests that the damages of the current crisis that has affected Spain and all its trade partners will soon disappear. In fact, the update expects already in 2012 a GDP growth pattern that shares various similarities with the one recorded until 2007 and briefly described in the previous section of this assessment. In more detail, GDP growth is assumed to soon reach a plateau of some 3% on the back of a buoyant private domestic demand, reinforced now by an export strength, and would be accompanied by solid employment creation.

Assessed against currently available information[10], this scenario appears to be based on slightly favourable macroeconomic assumptions for 2010 and on markedly favourable assumptions thereafter. Notably, the assumed quick recovery of economic activity seems difficult to attain with the optimism being particularly notorious at the level of domestic demand. More specifically, household income and thereby consumption prospects may be more affected than assumed by very high unemployment, tight credit conditions and possibly adverse wealth effects (for instance, related to falling housing prices). The backdrop is also marked by high debt levels and rising interest rates and burden over the medium-term.[11] On the investment side, bleak demand prospects and pressure to deleverage and improve balance sheets do not bode well, with investment being bound to

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[9] Since the programme does not provide data on HICP, this assessment is based on the private consumption deflator. Increases in indirect taxation in Spain may hike inflation in 2010 and 2011. However, that should not harm exports price competitiveness.

[10] The assessment notably takes into account the Commission services' autumn 2009 forecast, but also other information that has become available since then, especially the Commission services' February 2010 interim forecast.

[11] In particular, the update's projections for consumption are more benign than the evolution of both wages in real terms and employment would suggest. As mentioned before, that entails a visible reduction in saving rates from the relatively very high figure in 2009. No big help to disposable income can be expected from transfers from the government (net of taxes and contributions paid) believing on the programme's plans for these items.

further reflect the downsizing of the housing sector, which can be regarded as having a strong permanent nature given the unsustainable pre-crisis activity levels. All this is assumed to happen in times of marked fiscal consolidation. In addition, significant and sustained improvements in the external position might be difficult to achieve in times of slowly recovering world trade without a strong improvement in Spanish exporters' competitive position even if Spain's prices and especially wage levels are still below the EA average. To sum up, against the present juncture characterised by the correction of a number of macroeconomic imbalances, subdued GDP growth for some years is a distinctive possibility.

4. GENERAL GOVERNMENT BALANCE

This section consists of four parts. The first three parts discuss the budgetary implementation in the year 2009, the budgetary plans for 2010 and the medium-term budgetary strategy in the programme. The final part analyses the risks attached to the budgetary targets.

4.1. Budgetary implementation in 2009

According to the update of the stability programme, the public deficit is expected to reach 11.4% of GDP in 2009, which is markedly worse than the deficit of 3.4% of GDP registered in 2008. This significant deterioration of 8 pps. of GDP reflects the sharp worsening of the economic situation, which has resulted in a less tax-rich economic activity, as well as the impact of automatic stabilisers and a number of some discretionary fiscal measures, both on the revenue and expenditure sides. The Spanish authorities have responded vigorously to the economic and financial crisis, in line with the European Economic Recovery Plan, by adopting discretionary measures that amount to 2¼% of GDP in 2009, and are expected to be largely reversed in 2010. This response aimed at stimulating the economy and stabilising the banking sector, covering the financial market and the real economy through fiscal stimulus and structural measures mainly directed at supporting the investment activity, household purchasing power, and businesses. All this has resulted in a large public deficit in 2009 that leaves Spain without any further fiscal space.

Table 3 compares the projected outcome for the general government balance, revenue and expenditure (as a percentage of GDP) in 2009 as presented in the new stability programme with the targets from the previous update of the programme. Differences between outcome and targets (excluding the impact of an unanticipated GDP developments which may have affected the ratio, referred to as the ‘denominator effect’) are decomposed in the impact of a different starting position (i.e. the outcome of 2008 may also have been different from what was anticipated in the previous programme update) and the impact of differences in the revenue / expenditure growth rate from the planned growth rates[12].

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[12] Mathematically, the difference in the revenue ratio in Table 3 can be expressed as:

$$\rho^o - \rho^p = \underbrace{\frac{1+r^p}{1+g^p}\Delta\rho_{-1}}_{\text{Base effect}} + \underbrace{\frac{\rho^o_{-1}}{(1+g^o)(1+g^p)}\Delta r}_{\text{Revenue growth effect}} - \underbrace{\frac{\rho^o_{-1}}{(1+g^o)(1+g^p)}\Delta g}_{\text{Denominator effect}} + \underbrace{\frac{\rho^o_{-1}\left(r^o g^p - r^p g^o\right)}{(1+g^o)(1+g^p)}}_{\text{Residual}}$$

where r is the growth rate of revenue and g is the growth rate of GDP. The subscript -1 refers to the previous year’s value. Superscripts o and p refer to the outcome and the planned value respectively. Similar for the expenditure ratio.

Table 3: Budgetary implementation in 2009

	2008		2009	
	Planned SP Jan 2009	Outcome SP Feb 2010	Planned SP Jan 2009	Outcome SP Feb 2010
Government balance (% of GDP)	-3.4	-4.1	-6.2	-11.4
Difference compared to target [1]	-0.7		-5.2	
Difference excluding denominator effect [1,2]			**-5.6**	
Of which: due to a different starting position end 2008			-0.8	
due to different revenue / expenditure growth in 2009			-4.7	
p.m. Residual [3]			-0.1	
p.m. Nominal GDP growth (planned and outcome)			*0.0*	*-3.4*
Revenue (% of GDP)	37.0	37.0	37.5	34.6
Revenue surprise compared to target [1]	0.0		-2.9	
Revenue surprise excluding denominator effect [1,2]			**-4.2**	
Of which: due to a different starting position end 2008			0.0	
due to different revenue growth in 2009			-4.2	
p.m. Residual [3]			0.0	
p.m. Revenue growth rate (planned and outcome)			*1.4*	*-9.7*
Expenditure (% of GDP)	40.4	41.1	43.3	46.1
Expenditure surprise compared to target [1]	-0.7		-2.8	
Expenditure surprise excluding denominator effect [1,2]			**-1.4**	
Of which: due to different starting position end 2008			-0.8	
due to different expenditure growth rate in 2009			-0.5	
p.m. Residual [3]			-0.1	
p.m. Expenditure growth rate (planned and outcome)			7.2	8.4

Notes:

[1] A positive number implies that the outcome was better (in terms of government balance) than planned.

[2] The denominator effect captures the mechanical effect that, if GDP turns out higher than planned, the ratio of revenue or expenditure to GDP will fall because of a higher denominator. Although the denominator effect can be very significant for revenue and expenditure separately, on the balance they usually largely cancel against each other.

[3] The decomposition leaves a small residual that cannot be assigned to the previous components. The residual is generally small, except in some cases where planned and actual growth rates of revenue, expenditure and GDP differ significantly.

Source: *Commission services*

The 2009 general government deficit, projected at 11.4% of GDP in this update, is also markedly worse than the deficit of 6.2% of GDP projected in the stability programme update of January 2009. The negative difference between both, excluding the denominator effect, would be of around 5.6 pp of GDP. Spain's fiscal outlook worsened visibly in the course of 2009 reflecting the sharper-than-expected fall in economic activity (a real GDP decline of -3.6% instead of -1.6% according to the stability programme updates of 2010 and 2009 respectively). This abrupt economic downturn has significantly reduced the tax intensity of the economy and sharply increased social protection needs.

According to the 2010 update, total revenue (adjusted for the denominator effect) is estimated to have fallen by 4.2 pps. of GDP more than anticipated in the 2009 programme, driven by a sharper contraction of revenues from indirect (-1.5 pps. of GDP) and particularly direct taxes (-2 pps. of GDP). Revenue includes one-off measures amounting to around ¾% of GDP. Revenue developments have turned out sharply worse than expected, reflecting the combined result of a sharper-than-expected fall in nominal GDP, of an even stronger shrinking of the tax-rich domestic demand and of a rather high sensitivity of tax proceeds to the falls in all major tax bases such as nominal GDP, private consumption or asset transactions. All in all, tax proceeds are reflecting the fall in activity in a much stronger way than average tax elasticities would have suggested. As for total expenditure, it should increase by 1.4 pps. of GDP more than expected in the 2009 programme, driven by higher growth of primary expenditure. Automatic stabilisers have been let to work fully, implying a substantial increase in social expenditure and a significant decrease in tax revenue. Moreover, the fiscal stimulus included expenditure measures, such as the Local Investment Fund (0.8% of GDP), aimed at funding infrastructure investment, or the so-called 'Fondo para la dinamización de la Economía y el Empleo' (0.3% of GDP), a fund to stimulate the economy and employment targeting the stimulus of spending in areas considered to be strategic and with a high impact on employment creation.

Box 1: The excessive deficit procedure (EDP) for Spain

On 27 April 2009, the Council adopted a decision stating that Spain had an excessive deficit in accordance with Article 104(6) of the Treaty establishing the European Community (TEC). At the same time, the Council addressed a recommendation under Article 104(7) TEC specifying that the excessive deficit had to be corrected by 2012. On 2 December 2009, the Council, following a recommendation by the Commission, considered that action had been taken in accordance with the recommendations, but unexpected adverse economic events with major unfavourable consequences for government finances had occurred after the adoption of the recommendation, and issued new recommendations under Article 126(7) of the Treaty on the Functioning of the European Union (TFEU) to correct the deficit by 2013.

In particular, Spain was recommended to implement the significant deficit reducing measures in 2010 planned in the draft 2010 Budget Law; ensure an average annual fiscal effort of above 1,5 % of GDP over the period 2010-2013, which should also contribute to halting the rapid rise of the government gross debt ratio, specify the measures that are necessary to achieve the correction of the excessive deficit by 2013, cyclical conditions permitting and accelerate the reduction of the deficit if economic or budgetary conditions turn out better than currently expected. The Council established the deadline of 2 June 2010 for the Spanish government to take effective action to implement the deficit reducing measures in 2010 planned in the draft 2010 Budget Law and to outline in some detail the consolidation strategy that will be necessary to progress towards the correction of the excessive deficit. In addition, the Council called on the Spanish authorities to report on progress made in the implementation of these recommendations in a separate chapter in the updates of the stability programmes which will be prepared between 2010 and 2013.

4.2. The programme's budgetary strategy for 2010

According to the programme, the target for the general government deficit in 2010 stands at 9.8 % of GDP, which is markedly higher than the deficit of 8.1% of GDP projected in the 2010 Budget. This deterioration by 1.7 pp of GDP would be reflecting mostly a base effect from 2009, which registered a deficit 2 pp of GDP higher than forecasted in the 2010 budget, reflecting the sharp worsening of the budgetary situation in 2009. Due to a less favourable growth scenario and a more prudent assessment of measures on the revenue side, in the autumn 2009 Commission forecast the deficit is projected to reach 10.1% of GDP in 2010. This year 2010 will surely mark nonetheless the start of fiscal consolidation in Spain. According to the commission services' autumn 2009 forecast – after assessing the draft 2010 budget law – the general government deficit is projected to represent 10.1% of GDP in 2010. In structural terms, the government balance would improve by around ¾% of GDP next year against the backdrop of a rising interest burden and subdued economic growth.

The 2010 Budget Law includes a number of discretionary measures on both the revenue and expenditure side. The deficit reduction to 9.8% of GDP in 2010 is mainly driven by an increase in total revenues by 1½ pps of GDP, whereas total expenditures are projected to decrease by ¼ pps. of GDP, on the back of a reduction in current expenditures, mostly due to containment of public consumption and a reduction in public investment. The 2010 deficit forecast, as described in more detail below, incorporates deficit-reducing discretionary fiscal measures from the draft 2010 Budget Law, which according to the programme and taken at face value would amount to a total slightly over 1¾% of GDP in line with the Council Recommendation under Article 126(7) of 2 December 2009. This recommendation implies a correction in the average annual fiscal effort of at least 1¾% of GDP over the period 2010-2013.

Concerning revenue, the budget includes inter alia hikes in VAT rates as of July 2010 (with the normal rate going up to 18% from 16% and the reduced one to 8% from 7%), the withdrawal of a tax withholdings' reduction, an increase in taxes on savings and the additional impact of the hikes in taxes on alcohol and tobacco introduced in mid 2009. These revenue-increasing discretionary measures included in the 2010 Budget Law are expected to partially compensate the loss of revenues associated with the downturn, such as lower social contributions due to shrinking employment, and composition effects. Indeed, public finances in Spain are likely to face a relatively long period of subdued tax revenues, reflecting also a less tax-friendly growth composition associated with the fading out of the asset boom.

Table 4. Main budgetary measures for 2010

Revenue measures[1]	Expenditure measures[2]
• Increase in VAT rates (0.5% of GDP) • Increase in excise taxes (0.3% of GDP) • Withdrawal of a personal income tax credit of 400 euro (0.4% of GDP) • Increase in the saving taxation (0.1% of GDP) • Reduction in the corporate tax of SMEs (-0.1% of GDP)	• National Fund for Employment and Local Sustainability (0.5% of GDP) • Reduction in current expenditure (up to 0.8% of GDP)

Notes:

[1] Estimated impact on general government revenue
[2] Estimated impact on general government expenditure

Source: Commission services and 2010 Budget Law

On the expenditure side, the new Budget includes the National Fund for Employment and Local Sustainability, which includes almost ½% of GDP (€ 5 billions) of investment by local government, essentially extending into 2010 a similar stimulus measure originally adopted only for 2009 in the context of the EERP. The new temporary fund, adopted in October 2009, has a fixed budget and it will pursue the objectives of fostering employment and increasing public investment at local government level by financing newly-planned projects in certain strategic fields. This higher investment by local government of ½% of GDP is expected to be more that compensated by savings in current expenditure. Other expenditure measures in 2010 include a new temporary unemployment benefit of slightly over 420 euros for unemployed who have lost their eligibility to unemployment benefits. Furthermore, the 2010 Budget Law deficit target reflects the withdrawal of a large number of temporary stimulus measures implemented in 2008 (mainly comprising public investment and tax reductions), some in the context of the EERP. In parallel, spending moderation is expected to come from lower updates of wages and pensions in 2010 than those recorded in recent years.

In addition to the measures included in the 2010 Budget, consolidation is expected to be reinforced by the so-called draft 'Immediate Action Plan' for 2010, which will basically affect the Central Government Budget and will result in a reduction of 0.5% of GDP with respect to the planned expenditure in the 2010 budget. It will imply a reduction in the allocation to the Contingency Fund and a drop in public sector hiring in 2010 to 10% of the replacement rate and a halt in the recruitment of new temporary personnel. In addition, spending allocations to real investments, capital and current transfers and operating expenses will also be frozen.

This fiscal consolidation in 2010 seems feasible, if the announced measures are fully implemented. The fiscal stance will therefore be restrictive, with an improvement of 2 pps. in the structural balance, i.e. the cyclically-adjusted balance net of one-off and other temporary measures, in 2010 in relation to the previous year.

4.3. The programme’s medium-term budgetary strategy

This section describes the medium-term budgetary strategy outlined in the programme - and how it compares with the one in the previous update - as well as the composition of the budgetary adjustment, including the broad measures envisaged.

The budgetary strategy outlined in the February 2010 update of the stability programme of Spain, which covers the period 2009-2013, aims at gradually reducing the government deficit to 3% of GDP, the reference value, at the end of the programme period (2013), in line with the Council Recommendation under Article 126(7) of 2 December 2009. According to the programme, the medium-term budgetary objective (MTO) remains at a balanced position over the cycle, but it is not expected to be met within the programme period. The update projects the public deficit at 9.8% of GDP in 2010 and it is mainly driven by an increase in total revenue by about 1 pp of GDP, whereas total expenditure is expected to decrease by over ½ pps. of GDP, on the back of a reduction in current expenditure. After 2010, the update includes targets of a deficit of 7.5%, 5.3% and 3% of GDP for 2011, 2012 and 2013 respectively.

According to the Commission services’ autumn 2009 forecast, the government deficit is projected at 11.2% of GDP in 2009 and at 10.1% of GDP in 2010. On the basis of unchanged policies, and with GDP growing already by 1% in volume terms, the deficit is expected to decline to 9.3% of GDP in 2011. In structural terms, this would represent deficits of around 9¼% and 8½% and 8% of GDP in 2009, 2010 and 2011 respectively.

Consolidation in the outer years is expected to be strongly supported by the so-called draft Austerity Plan 2011-2013 and the Framework Agreements, containing a range of new measures to reduce expenditure. The main proposals included in this package intend to (i) practically freeze the public sector hiring process and sharply contain wage increases, (ii) reduce permanently intermediate consumption, transfers and other expenses by 1% GDP, (iii) decrease gross fixed capital formation by 0.9% of GDP, and (iv) cut subsidies by 0.5% of GDP. The Austerity Plan 2011-2013 and the Framework Agreements still need to be approved and specified in greater detail during the coming year.

Table 5: Composition of the budgetary adjustment

(% of GDP)	2008	2009		2010		2011		2012	2013	Change: 2009-2013
	COM	COM	SP	COM	SP	COM[1]	SP	SP	SP	SP
Revenue	**37.0**	**34.0**	**34.6**	**35.6**	**35.7**	**36.0**	**36.7**	**37.5**	**38.3**	**3.7**
of which:										
- Taxes on production and imports	9.9	7.6	8.3	8.8	9.1	9.1	9.5	9.8	10.1	1.8
- Current taxes on income, wealth, etc.	10.8	10.0	9.5	10.4	10.0	10.6	10.3	10.6	11.0	1.5
- Social contributions	13.1	13.3	13.5	13.4	13.6	13.4	13.7	13.7	13.7	0.2
- Other (residual)	3.2	3.0	3.3	3.0	3.0	3.0	3.2	3.4	3.5	0.2
Expenditure	**41.1**	**45.2**	**46.1**	**45.6**	**45.5**	**45.3**	**44.2**	**42.8**	**41.3**	**-4.8**
of which:										
- Primary expenditure	39.5	43.4	44.2	43.2	43.3	42.3	41.6	39.9	38.2	-6.0
of which:										
Compensation of employees	10.8	11.8	11.9	12.2	11.9	12.2	11.3	10.7	10.0	-1.9
Intermediate consumption	5.5	6.0	6.1	6.1	6.2	6.1	5.9	5.5	5.1	-1.0
Social payments	15.0	17.2	17.4	17.3	18.3	16.8	18.3	17.9	17.5	0.1
Subsidies	1.1	1.1	1.1	1.1	0.7	1.1	0.6	0.6	0.6	-0.5
Gross fixed capital formation	3.8	4.7	4.8	3.9	4.1	3.5	3.4	3.1	2.9	-1.9
Other (residual)	3.2	2.7	2.9	2.7	2.2	2.7	2.1	2.0	2.1	-0.8
- Interest expenditure	1.6	1.8	1.9	2.5	2.2	2.9	2.6	2.9	3.1	1.2
General government balance (GGB)	**-4.1**	**-11.2**	**-11.4**	**-10.1**	**-9.8**	**-9.3**	**-7.5**	**-5.3**	**-3.0**	**8.4**
Primary balance	**-2.5**	**-9.4**	**-9.6**	**-7.6**	**-7.7**	**-6.3**	**-4.9**	**-2.3**	**0.1**	**9.7**
One-off and other temporary measures	-0.3	-0.7	-	0.0	-	0.0	-	-	-	n.a.
GGB excl. one-offs	**-3.8**	**-10.5**	**n.a.**	**-10.1**	**n.a.**	**-9.3**	**n.a.**	**n.a.**	**n.a.**	**n.a.**
Output gap[2]	0.8	-2.8	-3.5	-3.6	-4.4	-2.6	-3.2	-1.6	-0.2	3.3
Cyclically-adjusted balance[2]	-4.4	-10.0	-9.9	-8.5	-7.9	-8.1	-6.1	-4.6	-2.9	7.0
Structural balance[3]	**-4.1**	**-9.3**	**-9.9**	**-8.5**	**-7.9**	**-8.1**	**-6.1**	**-4.6**	**-2.9**	**7.0**
Change in structural balance		*-5.1*	*-5.8*	*0.7*	*2.0*	*0.4*	*1.8*	*1.5*	*1.7*	
Structural primary balance[3]	-2.6	-7.5	-8.0	-6.1	-5.7	-5.2	-3.5	-1.7	0.2	8.2
Change in structural primary balance		*-4.9*	*-5.4*	*1.4*	*2.3*	*0.9*	*2.2*	*1.8*	*1.9*	

Notes:

[1]On a no-policy-change basis.

[2]Output gap (in % of potential GDP) and cyclically-adjusted balance according to the programme as recalculated by Commission services on the basis of the information in the programme.

[3]Structural (primary) balance = cyclically-adjusted (primary) balance excluding one-off and other temporary measures.

Source :

Stability programme (SP); Commission services' autumn 2009 forecasts (COM); Commission services' calculations

Both the primary balance and the structural balance calculated according to the commonly agreed methodology are expected to improve by around 2 pps. in 2010 in relation to the previous year. In structural terms, the fiscal plans contained in the programme would imply a fiscal contraction in 2010 and the outer years.

Box 2: The medium-term objective (MTO) for Spain

As noted in the Code of Conduct[13], the MTO aims to (a) provide a safety margin with respect to the 3% of GDP deficit limit; (b) ensure rapid progress towards fiscal sustainability; and (c) allow room for budgetary manoeuvre, in particular taking into account the needs for public investment. The MTO is defined in cyclically adjusted terms, net of one-off and other temporary measures. On 7 July 2009, the ECOFIN Council took note of a new methodology for setting MTOs, ensuring that implicit liabilities (costs related to ageing populations, in particular projected healthcare and pension expenditure) are also accounted for.

Specifically, the country-specific MTOs should take into account three components: (i) the debt-stabilising balance for a debt ratio equal to the (60% of GDP) reference value (dependent on long-term potential growth), implying room for budgetary manoeuvre for Member States with relatively low debt; (ii) a supplementary debt-reduction effort for Member States with a debt ratio in excess of the (60% of GDP) reference value, implying rapid progress towards it; and (iii) a fraction of the adjustment needed to cover the present value of the future increase in age-related government expenditure. This implies a partial frontloading of the budgetary cost of ageing irrespective of the current level of debt. In addition to these criteria, MTOs should provide a safety margin with respect to the 3% of GDP deficit reference value and, for euro area and ERM II Member States, in any case not exceed a deficit of 1% of GDP.

As communicated by the authorities, the MTO of Spain is a balanced position over the cycle. In view of the new methodology and given the most recent projections and debt level, the MTO more than adequately reflects the objectives of the Pact.

4.4. Risk assessment

This section discusses the plausibility of the programme's budgetary projections by analysing various risk factors. For the period until 2011, Table 5 (above) compares the detailed revenue and expenditure projections in the Commission services' autumn 2009 forecast, which are derived under a no-policy change scenario, with those in the updated programme. However, although the assessment uses the Commission services' forecast as a benchmark, it also takes explicitly into account all available information about more recent developments.

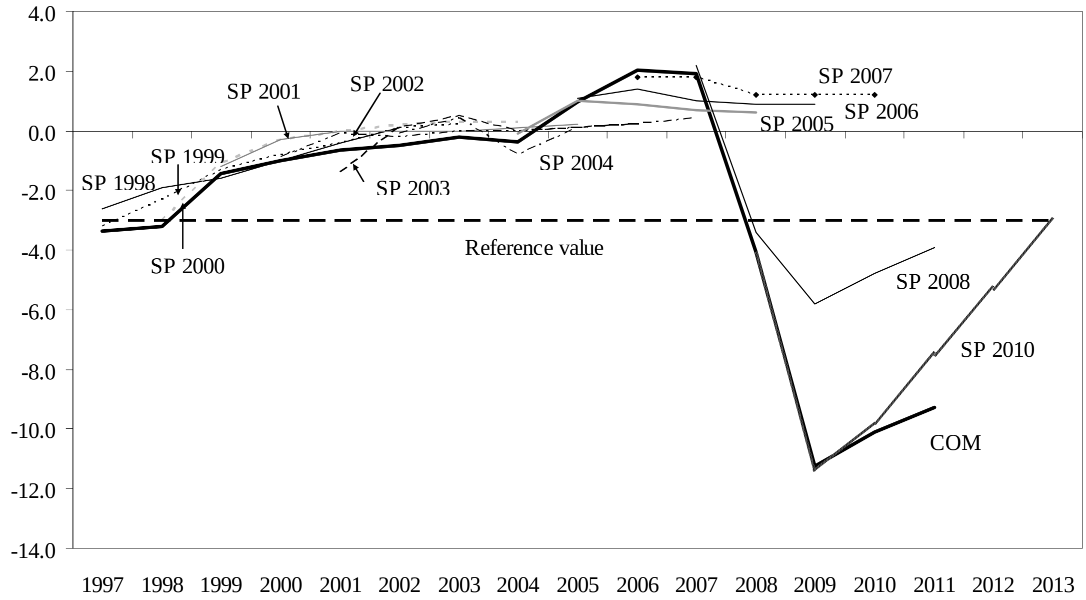
The budgetary targets are subject to downside risks throughout the programme period. The risks to the budgetary projections in the programme appear subject to minor downside risks in 2010, but more important ones for the year 2011 and beyond. Besides the discretionary corrective efforts, the improvement in the government balance up to a deficit of 3% of GDP in 2013 is already assumed to profit from a gradual but continued upswing in economic activity. In this context, the most relevant downside risks stem mostly from the macro-economic scenario presented for the period after 2010. While the projection included in the update is only very slightly favourable in 2010, with growth attaining -0.3% of GDP, it is markedly optimistic thereafter. In this context, the revenue performance in the outer years of the programme might be difficult to attain, in particular given the high elasticities implied for 2012 and 2013. Therefore, the budgetary outcomes presented in the update are subject to downside risks, since a more contained path for economic activity than the one envisaged by the authorities is likely, particularly for

[13] "Specifications on the implementation of the Stability and Growth Pact and guidelines on the format and content of stability and convergence programmes", endorsed by the ECOFIN Council on 10 November 2009, available at: http://ec.europa.eu/economy_finance/sgp/legal_texts/index_en.htm

2011 and 2012, would provide less relief to public finances than expected in the programme.

Moreover, there is a downside risk associated to the uncertainty surrounding the consolidation measures, particularly post 2010, which are still proposals and they will need to be approved and specified further.

Figure 1: Government balance projections in successive programmes (% of GDP)



<u>Source</u>: Commission services' autumn 2009 forecast (COM) and successive stability programmes

5. Government debt and long-term sustainability

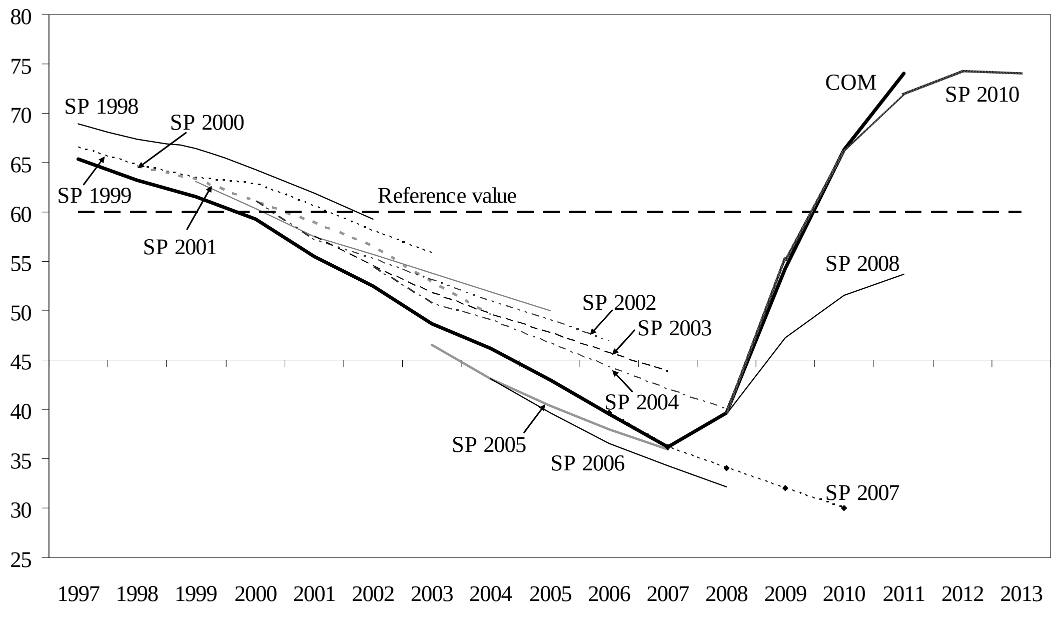
This section is in two parts. A first part describes recent debt developments and medium-term prospects, including risks to the outlook presented in the programme. A second part takes a longer-term perspective with the aim of assessing the long-term sustainability of public finances.

5.1. Recent debt developments and medium-term prospects

5.1.1. Debt projections in the programme

Government gross debt is estimated at 55.2% of GDP in 2009, significantly up from 39.7% in the year before. Apart from the sizeable increase in the deficit and the decline in GDP growth, a significant stock-flow adjustment reflecting primarily bank rescue operations and credit support contributed to the rise in the debt ratio. The debt ratio is projected to increase by a further 19 pps. over the programme period, and is expected to reach 74.3% of GDP in 2012, mainly driven by continued high government deficits. A slight decrease to 74.1% of GDP is foreseen by 2013.

Figure 2: Debt projections in successive programmes (% of GDP)



Source: Commission services' autumn 2009 forecast (COM) and successive stability programmes

According to figures contained in the 2010 update of the programme, the accumulation of primary deficits will be the main factor driving debt, contributing by 7.7, 4.9 and 2.3 points of GDP to the surge in the debt ratio in 2010, 2011 and 2012 respectively, while rising interest expenditure is expected to contribute by 2.1, 2.6 and 3.0 points of GDP in those years. In addition to the rise in the deficit and the decline in GDP growth, the effect of nominal GDP growth will increase it by 0.2 points in 2010, whereas it will reduce it by 1.1 and 2.0 of GDP in 2011 and 2012 respectively.

Table 6: Debt dynamics

(% of GDP)	average 2003-07	2008	2009		2010		2011		2012	2013
			COM	SP	COM	SP	COM	SP	SP	SP
Gross debt ratio[1]	**42.7**	**39.7**	**54.3**	**55.2**	**66.3**	**65.9**	**74.0**	**71.9**	**74.3**	**74.1**
Change in the ratio	-3.3	3.5	14.6	15.5	12.0	10.7	7.7	6.0	2.4	-0.2
Contributions [2] :										
1. Primary balance	**-2.8**	**2.5**	**9.4**	**9.6**	**7.6**	**7.7**	**6.3**	**4.9**	**2.3**	**-0.1**
2. "Snow-ball" effect	**-1.3**	**0.4**	**3.3**	**3.2**	**2.6**	**2.0**	**1.4**	**0.5**	**-0.3**	**-0.5**
Of which:										
Interest expenditure	1.9	1.6	1.8	1.8	2.5	2.1	2.9	2.6	3.0	3.1
Growth effect	-1.5	-0.3	1.5	1.5	0.5	0.2	-0.6	-1.1	-2.0	-2.2
Inflation effect	-1.7	-0.9	0.0	-0.1	-0.3	-0.3	-0.9	-0.9	-1.3	-1.4
3. Stock-flow adjustment	**0.8**	**0.7**	**1.8**	**2.7**	**1.8**	**1.0**	**0.0**	**0.6**	**0.5**	**0.5**
Of which:										
Cash/accruals diff.	-0.6	-0.6		n.a.		n.a.		n.a.	n.a.	n.a.
Acc. financial assets	1.5	1.3		n.a.		n.a.		n.a.	n.a.	n.a.
Privatisation	0.0	0.0		n.a.		n.a.		n.a.	n.a.	n.a.
Val. effect & residual	0.0	0.0		n.a.		n.a.		n.a.	n.a.	n.a.

Notes:

[1]End of period.

[2]The snow-ball effect captures the impact of interest expenditure on accumulated debt, as well as the impact of real GDP growth and inflation on the debt ratio (through the denominator). The stock-flow adjustment includes differences in cash and accrual accounting, accumulation of financial assets and valuation and other residual effects.

Source :

Stability programme (SP); Commission services' autumn 2009 forecasts (COM); Commission services' calculations

5.1.2. Assessment

The debt projection in the programme is only slightly more favourable than the latest forecast of the European Commission for 2009 and 2010, while in 2011 the discrepancy widens to 2.1 pps. The economic downturn, which has significantly reduced the tax intensity of the economy and sharply increased social protection needs, has led to both rapidly falling revenue-to-GDP and rising expenditure-to-GDP ratios, resulting in turn in a sharp deterioration of the public deficit and consequently of public debt.

The evolution of the debt ratio could be less favourable than projected in the update, given the risks to the macroeconomic scenario and the budgetary targets, and to a lesser extent, the uncertainty about the impact of the guarantees granted in the context of the financial rescue package. However, the increase in debt linked to the measures taken in support of the financial sector would be reversed if the support scheme and the financial operations linked to it are successful.

In addition, the Spanish authorities adopted a range of measures to stabilise the financial sector, which have or may have an impact on the debt to GDP ratio. This includes the FROB (Fund for the Orderly Restructuring of Banks) was created in June 2009 and was endowed with an initial capital of 9 billion Euros (9% of GDP), with the goal of providing capital to deposit institutions undergoing mergers, restructuring or in cases of liquidation. Moreover, support to credit lines to firms, especially for SMEs, or to re-finance mortgages of financially-troubled households was put in place. There have been numerous credit lines to provide liquidity to business either set up or enlarged in 2009 and often renewed for 2010, managed by the Official Credit Institute (ICO), which target in particular SMEs. Finally, the Spanish authorities created in December 2009 the Sustainable Economy Fund 2010-2011, which is a capitalisation fund with a budget of up to 20 billion euro in 2010 and 2011. It will be managed by ICO, which will contribute with 10 billion euro, while private financial institutions will provide the other 10 billion. The Fund's aim will be to provide funding to private sector investment projects that contribute to technological innovation and development, ICT, the knowledge-based society, energy saving and efficiency, environmental preservation and improvement, the development of social and health services, and business internationalisation.

5.2. Long-term debt projections and the sustainability of public finances

This section presents sustainability indicators based on the long-term age-related government spending as projected by the Member States and the EPC in 2009 according to an agreed methodology[14].

Table 7 shows that age-related spending is projected to rise by 8.3 percentage points of GDP between 2010 and 2060, clearly above the EU average (4.6 pps.). Sustainability indicators for two scenarios are presented in Table 8. 'The 2009 scenario' is based on a no-policy-change assumption and the 2009 structural primary balance as a starting year, while 'the programme scenario' takes into account the consolidation planned in the programme up to 2012 and is based on the projected 2012 structural primary balance as a starting position. Including the increase of age-related expenditure and assuming that the structural primary balance remained at its 2009 level, the sustainability gap (S2)[15] would amount to 15.3% of GDP; about 6 percentage points more than in last year's assessment. This is due to a lower estimated structural primary balance in the starting year, while the rise in age-related expenditure is actually slightly lower in the 2009 projection than in the previous one. The starting budgetary position is not sufficient to stabilize the debt ratio over the long-term and entails a risk of unsustainable public finances even before considering the long-term budgetary impact of ageing.

While the "2009 scenario" reflects the strong weakening of the budgetary position in view of the current economic crisis, the "programme scenario" foresees a significant improvement in the budgetary position with a return to a positive territory in the structural primary balance in 2013 and consequently shows a considerably smaller sustainability gap. If the budgetary consolidation planned in the programme was achieved, risks to long-term sustainability of public finances would be mitigated.

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[14] Economic Policy Committee and the European Commission (2009), '2009 Ageing Report: Economic and budgetary projections for the EU-27 Member States (2008-60)', *European Economy* No. 2/2009. European Commission (2009), 'Sustainability Report 2009, European Economy No. 9/2009. European Commission (2008), 'Public finances in EMU – 2008', *European Economy* No. 4/2008..

[15] The S2 indicator is defined as the change in the current level of the structural primary balance required to make sure that the discounted value of future structural primary balances (including the path of property income) covers the current level of debt.

Table 7: Long-term age-related expenditure: main projections

(% of GDP)	**2007**	**2010**	**2020**	**2030**	**2040**	**2060**	**Change 2010-60**
Total age-related spending	**19.3**	**20.0**	**20.7**	**22.4**	**25.3**	**28.3**	**8.3**
- Pensions	8.4	8.9	9.5	10.8	13.2	15.1	6.2
- Healthcare	5.5	5.6	5.9	6.3	6.8	7.2	1.6
- Long-term care	0.5	0.7	0.9	1.0	1.1	1.4	0.7
- Education and unemployment benefits	4.8	4.8	4.5	4.3	4.1	4.6	-0.2
Property income received	1.0	1.0	0.8	0.7	0.7	0.6	-0.3

Source: Economic Policy Committee and Commission services.

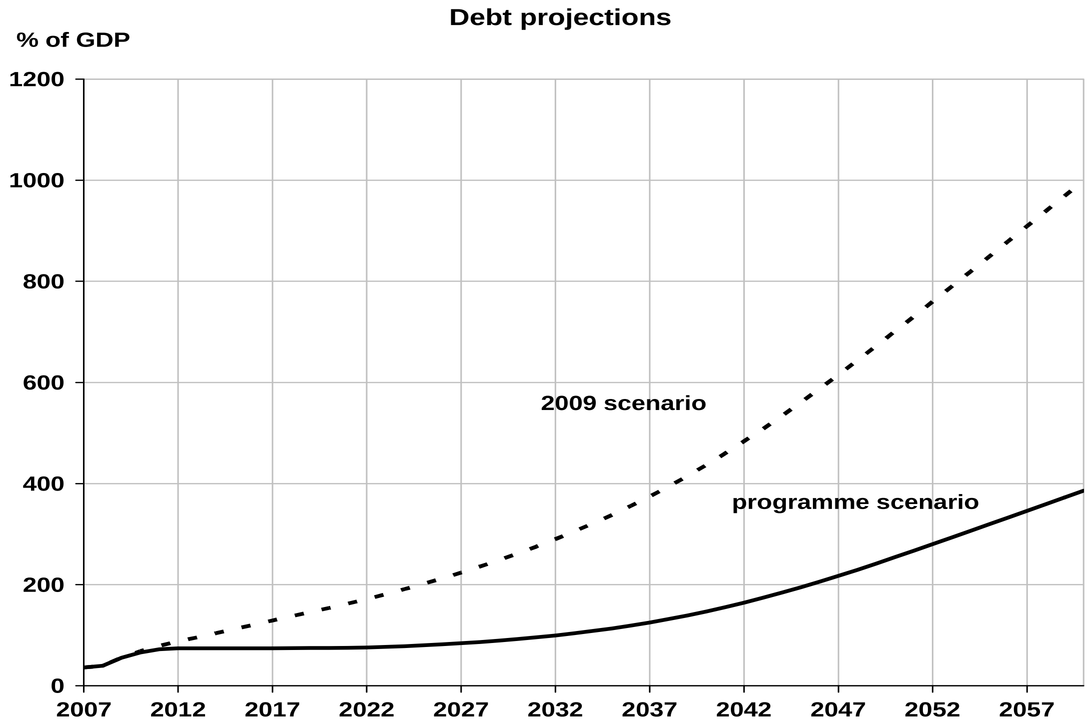
Table 8: Sustainability indicators and the required primary balance

	2009 scenario			**Programme scenario**		
	S1	**S2**	**RPB**	**S1**	**S2**	**RPB**
Value	13.5	15.3	6.9	4.7	6.8	6.7
of which:						
Initial budgetary position (IBP)	9.4	9.6	-	0.9	1.1	-
Debt requirement in 2060 (DR)	0.5	-	-	0.2	-	-
Long-term change in the primary balance (LTC)	3.6	5.7	-	3.6	5.7	-

Source: Commission services.

Based on the assumptions used in the projection of age-related expenditure and the calculation of the sustainability indicators, Figure 3 displays the projected debt-to-GDP ratio over the long-term.

Figure 3: Long-term projections for the government debt ratio



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Note: Being a mechanical, partial-equilibrium analysis, the long-term debt projections are bound to show highly accentuated profiles. As a consequence, the projected evolution of debt levels should not be seen as a forecast similar to the Commission services' short-term forecasts, but as an indication of the risks faced by Member States.

Source: Commission services.

Based on the alternative assumptions of economic developments presented in the Commission services' autumn 2009 forecast publication[16], Figure 4 shows projected medium-term trajectory of the debt-to-GDP ratio. The projected debt trajectories show somewhat differing debt paths under the two sets of assumptions. When account is taken on most recent economic developments, the debt developments seem to be slightly more favourable than under the long-term baseline calculations. According to the programme scenario, the debt level would start to decrease after peaking in 2013 at the level of about 74% of GDP[17]. According to the 2009 scenarios, the debt levels would be on an increasing trend under both set of assumptions.

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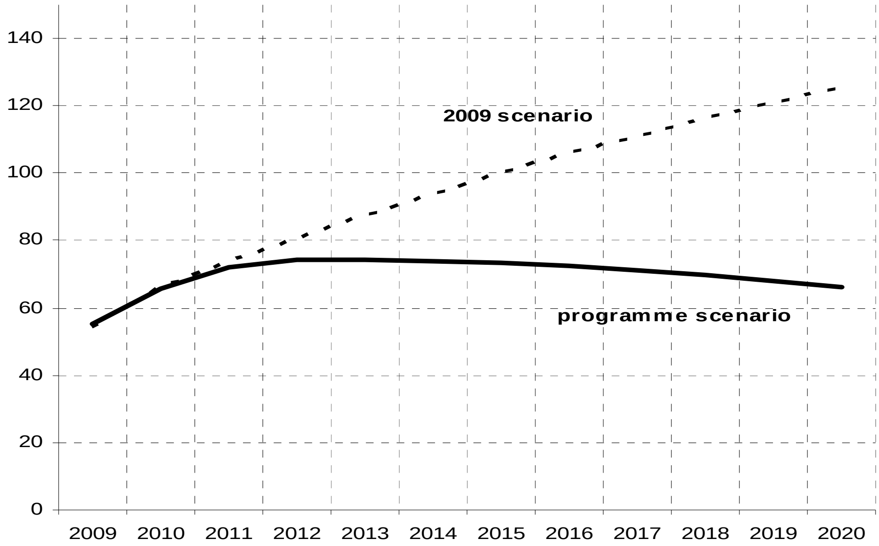
16 Section 3.5 in European Commission (2009), 'European Economic Forecast – autumn 2009', European Economy No. 10/2009

17 The projected decrease in the debt ratio is due also to the assumption of the tax ratio to return beyond the programm horizon to pre-crisis levels. Without this assumption the debt ratio would continue to rise.

Figure 4: Medium-term projections for the government debt ratio



Source: Commission services.

5.2.1. Additional factors

For an overall assessment of the sustainability of public finances, other relevant factors are taken into account (Table 9). The fact that the structural primary balance is forecast to remain highly negative for a number of years weighs on the risk of the long-term sustainability of public finances. Overall, additional factors do not change the assessment of the long-term sustainability risk.

Table 9: Additional factors for the assessment of long-term sustainability risks.

	Impact on risk
Debt and pension assets	na
Decline in structural balance until 2011 in COM Autumn 2009 forecast	-
Alternative projection of cost of ageing	na
Strong decline in benefit ratio	na
High tax burden	na
Difference between S1 and S2	na

Note: '-': factor tends to increase the risk to sustainability, '+': factor tends to decrease the risk to sustainability.

'na': not applicable.

Alternative projections are often presented in the programmes, whose assumptions often diverge from the common method. Projections currently discussed in the Economic Policy Committee but not yet published, are for the time being also considered "unofficial".

An explanation on these factors can be found in chapter V of: European Commission (2009), Sustainability Report 2009, European Economy No. 9/2009.

Source: Commission services.

5.2.2. Assessment

The long-term budgetary impact of ageing is well above the EU average, mainly as a result of a very high increase in pension expenditure as a share of GDP over the coming decades. The budgetary position in 2009, as estimated in the programme, which is significantly worse than the starting position of the previous programme, compounds the budgetary impact of population ageing on the sustainability gap. Reducing the primary deficit over the medium term, as already foreseen in the programme, and a further pension reform aimed at curbing the substantial increase in age-related expenditures would contribute to reducing the high risks to the sustainability of public finances.

The current level of gross debt is above the Treaty reference value. Medium-term debt projections until 2020 that take account of more recent economic developments and projections on the potential growth show that the budgetary development envisaged in the programme, taken at face value, would limit the increase in the debt ratio to the level of about 74% of GDP in 2013 and thereafter decrease the ratio in the medium term.

6. FISCAL FRAMEWORK AND QUALITY OF PUBLIC FINANCES

This section is subdivided into two elements: the fiscal framework and the quality of public finances in a broader sense.

6.1. Fiscal framework

Although the medium-term budgetary framework has been instrumental in promoting multiannual fiscal planning and shows an overall good track record, the latter has worsened since 2008. The existing domestic framework had been strengthened with the reform of the Budgetary Stability Act in 2007, which introduced the principle of budgetary stability over the cycle. This allowed objectives to be established on the basis of the cyclical situation. However, in 2009 exceptionally regional and local administrations were allowed to present higher deficits than initially foreseen within the framework. No further reforms to this framework are planned.

In October 2009, the government agreed with the Autonomous Communities fiscal deficits limits for the period 2010-2012 ranging from 2.5% of GDP in 2010 to 1.3% in 2012. However, according to the programme, these deficit limits have been pushed further (3.2% of GDP in 2010, 4.2% in 2011), partly due to the delayed effect of the return of transfers to the central government.

A recent reform of the Law governing the financing system of Autonomous Communities has increased the amounts of State tax revenues handed over to them. Specifically, the share of Central government's revenues from direct taxes and indirect taxes of the Autonomous Communities increased from 33%-35% to 50%. In the case of some specials taxes, the share increased from 40% to 58%.

6.2. Quality of public finances

The programme highlights the importance of the quality of public finances as a key element of the exit strategy in Spain. In this regard, the government has launched different initiatives aiming at improving the cost efficiency and the effectiveness of government expenditure as well as changing structural features of tax system. These initiatives have been announced or implemented in the framework of the 2010 Budget Law, the government's Strategy for a Sustainable Economy, which includes a draft Law for Sustainable Economy, and the Framework Agreement on the sustainability of public finances, which will be discussed with Autonomous Communities.

The 2010 Budget Law aims at mitigating the negative effects of the crisis, laying the foundations of a fiscal consolidation and focusing on productive expenditures in a context of economic austerity. To achieve these objectives, the 2010 Budget Law reduced total expenditures by 4%, compared with last year, while public investment in infrastructures and R&D fell by much less (1.4% both). By contrast, expenditure in education increased by 3.5%. This evolution of productive expenditures contrasts with the significant increases observed in recent years. Accumulated expenditure on R&D&i, education and infrastructure, increased in 2004-2008 by 168%, 92% and 33%, respectively. Although according to the programme the share in the GDP of productive expenditures is at historical highs, a comparison with other Member States shows that their weight in GDP remains relatively low.

A Law on Sustainable Economy, currently under discussion, is set to increase the focus of public expenditure on productive areas through the implementation of two new funds. The State Fund for Employment and Local Sustainability, endowed with 5 billion euro in 2010, aims at financing, amongst other, the development of scientific and technological parks and improving coverage and access to new generation telecommunication networks. The Fund for a Sustainable Economy, endowed with 20 billion euros in the period 2010-2011 and co-financed by private financial entities, is set to provide capital investment to the private sector on projects contributing to innovation and technological development, ICT technologies, knowledge society, etc. In addition, a plan for the setting up a special working group has recently been presented to promote efficiency aspects of expenditure projects in ministries and public organisations.

The 2010 Budget Law also introduced some changes to the structural features of the Spanish tax system: the elimination of a tax credit on earned income through a personal income tax credit of up to 400 euro per taxpayer (except for low income taxpayers); an increased progressivity of saving tax system; a temporary reduction of taxes on SMEs that favours employment; and an increase on VAT rates. The draft Law on Sustainable Economy is set to introduce additional measures in that respect, such as the abolition of the tax deduction to main house purchasing (except for low revenue taxpayers) starting from 2011, new fiscal incentives to invest in R&D, a reduction in the cost of patents and a plan for fighting tax evasion.

7. OVERALL ASSESSMENT

Taking into account risks attached to the budgetary targets discussed above, this section assesses the appropriateness of the fiscal strategy in relation to the Council Recommendations under Article 126(7) of 2 December 2009 with a view to correcting the excessive deficit and the budgetary objectives of the Stability and Growth Pact, against the background of the current economic situation, the debt and long-term sustainability position of the country, and the institutional features of its public finances.

The overall conclusion is that the current crisis is severely impacting Spanish public finances, with a very high deficit estimated for 2009 and a rapidly-rising government debt ratio. The budgetary strategy to bring the deficit below 3% of GDP is broadly appropriate in view of the Art. 126(7) recommendations, although consolidation measures still need to be approved and specified further, particularly after 2010. The stability programme update aims at achieving this sizeable fiscal consolidation on the back of expenditure containment throughout the programme period and some hoped-for revenue in the outer years. Fiscal consolidation is essential, as mounting fiscal deficits and debt can damage sustained economic growth in the medium term. In addition, improving long-term fiscal sustainability should be a priority also in the light of the projected high rise in age-related public expenditure.

The budgetary targets are subject to downside risks throughout the programme period. The most relevant risks stem from the macro-economic scenario presented for the period after 2010. The favourable macroeconomic assumptions may imply a lower contribution of economic growth to fiscal consolidation than envisaged in the programme. Therefore, achieving the ambitious consolidation path may require additional efforts, notably in the light of the markedly favourable macroeconomic assumptions and the subsequent risk of a lower-than-assumed contribution of economic growth to fiscal consolidation, and the revenue performance in the outer years of the programme that might be difficult to attain. At the same time, the adjustment path is not fully backed up with concrete measures for the years beyond 2010. The adjustment path post-2010 therefore needs to be spelled out in greater detail in terms of the concrete measures to be adopted. A functioning budgetary framework, including the regulation of the relations between the different levels of the general government sector, is an essential instrument to support the achievement of the ambitious consolidation plans against a setting of high fiscal decentralisation. In addition, fostering the quality of public finances is important also with a view to underpinning a smooth adjustment of the economy in the light of the macroeconomic imbalances it is faced with, notably by lifting potential GDP, fostering employment creation, boosting competitiveness and further narrowing the external imbalance.

In any case, 2010 marks the start of a sizeable fiscal consolidation programme in Spain, which targets implies an annual average effort targeted for this period 2010-2013 in line with the Art. 126(7) recommendation. The restrictive budgetary stance attached to this scenario from 2010 seems appropriate, in particular taking into account the country's complete lack of fiscal space.

Overall, taking into account the risks, the budgetary strategy is broadly consistent with the Council recommendations, although it needs to be backed up by fully specified measures after 2010, and it may need to be reinforced in case the aforementioned risks do materialise.

ANNEX. COMPLIANCE WITH THE FORMAT AND CONTENT REQUIREMENTS FOR STABILITY AND CONVERGENCE PROGRAMMES

This annex provides an assessment of whether the programme respects the requirements of Section II of the code of conduct (guidelines on the format and content), notably as far as (i) the model structure (Annex 1 of the code of conduct); (ii) the formal data provisions (Annex 2 of the code of conduct); and (iii) other information requirements is concerned. It also assesses to what extent Country followed up on the Council's recommendation to report on progress made in the correction of the excessive deficit, in a separate chapter of the programme.

(i) Model structure

The February 2010 update of stability programme follows the model structure in Annex 1 of the code of conduct.

(ii) Data requirements

The tables on the following pages show the data presented in the February 2010 update of stability programme, following the structure of the tables in Annex 2 of the code of conduct. Compulsory data are in bold, missing data are indicated with grey-shading.

As far as data requirements are concerned, the numbering and presentation of the tables are not fully following the structure of the tables in Annex 2 of the code of conduct. Specifically, the update does not provide information on the following items:

In Table 1b, the HICP (albeit it is optional); in Table 1c, the definition of unemployment rate is unclear as there is no footnote explaining that whether it follows the Eurostat's harmonised definition; in Table 1c, Labour productivity, hours worked; in Table 1d, the ESA 95 references are missing; in Table 2, one-off and other temporary measures; Table 3 is missing; Table 4, SFA components, liquid financial assets and net financial debt; Table 5, ESA 95 references are missing, as well as one-off and other temporary measures; Table 6, ESA 95 references are missing; Table 7, interest expenditure, details on total revenue, details on pension reserved fund assets, real GDP growth (potential GDP growth is shown instead), participation rates are presented for age category 15-64 instead of 20-64.

The tables on the following pages show the data presented in the February 2010 update of stability programme, following the structure of the tables in Annex 2 of the code of conduct. Compulsory data are in bold, missing data are indicated with grey-shading.

(iii) Separate chapter on progress made in the correction of the excessive deficit

In its recommendations under Article 126(7) of 2 December 2009 recommendations with a view to bring the excessive deficit situation to an end, the Council also invited Spain to report on progress made in the implementation of the Council's recommendations in a separate chapter in the updates of the stability programmes. The update does not provide a separate chapter on progress made in the correction of the excessive deficit. Spain therefore only partly complied with this recommendation.

(iv) Other information requirements

The table below provides a summary assessment of the adherence to the other information requirements in the code of conduct.

* * *

The SCP…	Yes	No	Comments
a. Involvement of parliament			
… mentions status vis-à-vis national parliament.			
… indicates whether Council opinion on previous programme has been presented to national parliament.			

The SCP…	Yes	No	Comments
b. Economic outlook			
… (for euro area and ERM II Member States) uses "common external assumptions" on main extra-EU variables.	X		
… explains significant divergences with Commission services' forecasts[1].			Not applicable
… bears out possible upside/downside risks to economic outlook.	X		
… analyses outlook for sectoral balances and, especially for countries with high external deficit, external balance.	X		
c. Monetary/exchange rate policy			
… (CP only) presents medium-term monetary policy objectives and their relationship to price and exchange rate stability.			Not applicable
d. Budgetary strategy			
… presents budgetary targets for general government balance in relation to MTO and projected path for debt ratio.		X	
… (in case new government has taken office) shows continuity with respect to budgetary targets endorsed by Council.			Not applicable
… (when applicable) explains reasons for deviations from previous targets and, in case of substantial deviations, whether measures are taken to rectify situation (+ provides information on them).		X	
… backs budgetary targets by indication of broad measures necessary to achieve them and analyses their quantitative effects on balance.	X		
… specifies state of implementation of measures.		X	
e. "Major structural reforms"			
… (if MTO not yet reached or temporary deviation is planned from MTO) includes comprehensive information on economic and budgetary effects of possible 'major structural reforms' over time.		X	
… includes quantitative cost-benefit analysis of short-term costs and long-term benefits of reforms.		X	
f. Sensitivity analysis			
… includes comprehensive sensitivity analyses and/or develops alternative scenarios showing impact on balance and debt of: a) changes in main economic assumptions b) different interest rate assumptions c) (for CP only) different exchange rate assumptions d) if common external assumptions are not used, changes in assumptions for main extra-EU variables.	X		
… (in case of "major structural reforms") analyses how changes in assumptions would affect budget and potential growth.			Just information on the impact potential GDP growth of some measures is provided
g. Broad economic policy guidelines			
… provides information on consistency with broad economic policy guidelines of budgetary objectives and measures to achieve them.			
h. Quality of public finances			
… describes measures to improve quality of public finances, both revenue and expenditure sides.	X		
i. Long-term sustainability			
… outlines strategies to ensure sustainability.	X		
… includes common budgetary projections by the AWG and all necessary additional information (esp. new relevant information).	X		
j. Other information (optional)			
… includes information on implementation of existing national budgetary rules and on other institutional features of public finances.	X		

Notes: SCP = stability/convergence programme; CP = convergence programme

[1]To the extent possible, bearing in mind the typically short time period between the publication of the Commission services' autumn forecast and the submission of the programme.

Source:
Commission services

Tables from Annex 2 of the code of conduct

Table 1a. Macroeconomic prospects

	ESA Code	2008	2008	2009	2010	2011	2012	2013
		Level	rate of change	rate of change	rate of change	rate of change	rate of change	rate of change
1. Real GDP	B1*g	*127.6*	0.9	-3.6	-0.3	1.8	2.9	3.1
2. Nominal GDP	B1*g	*1088.5*	3.4	-3.4	0.2	3.3	4.9	5.2
Components of real GDP								
3. Private consumption expenditure	P.3	*127.1*	-0.6	-5.0	-0.1	2.5	3.3	3.3
4. Government consumption expenditure	P.3	*148.5*	5.5	5.2	1.2	-0.4	-1.1	-1.4
5. Gross fixed capital formation	P.51	*138.3*	-4.4	-15.7	-6.5	0.3	4.2	5.9
6. Changes in inventories and net acquisition of valuables (% of GDP)	P.52 + P.53	*134.4*	0.5	0.5	0.5	0.4	0.4	0.4
7. Exports of goods and services	P.6	*132.6*	-1.0	-12.4	2.8	5.2	6.9	7.4
8. Imports of goods and services	P.7	*153.9*	-4.9	-18.7	-1.3	3.7	5.8	6.8
Contributions to real GDP growth								
9. Final domestic demand		-	-0.7	-6.4	-1.4	1.4	2.6	3.0
10. Changes in inventories and net acquisition of valuables	P.52 + P.53	-	0.1	0.0	0.0	0.0	0.0	0.0
11. External balance of goods and services	B.11	-	1.4	2.8	1.1	0.4	0.3	0.1

Table 1b. Price developments

	ESA Code	2008	2008	2009	2010	2011	2012	2013
		Level	rate of change	rate of change	rate of change	rate of change	rate of change	rate of change
1. GDP deflator		*135.4*	2.5	0.2	0.5	1.5	2.0	2.0
2. Private consumption deflator		*130.3*	3.7	-0.5	1.4	1.8	2.0	2.0
3. HICP[1]		*n.a.*	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
4. Public consumption deflator		*131.2*	3.5	1.7	0.8	0.5	1.0	1.0
5. Investment deflator		*139.4*	1.5	-3.3	-0.8	1.0	2.0	2.2
6. Export price deflator (goods and services)		*119.1*	3.0	-2.1	1.5	1.8	2.1	2.3
7. Import price deflator (goods and services)		*113.2*	4.7	-5.3	2.6	1.3	1.5	1.7

[1] Optional for stability programmes.

Table 1c. Labour market developments

	ESA Code	2008 Level	2008 rate of change	2009 rate of change	2010 rate of change	2011 rate of change	2012 rate of change	2013 rate of change
1. Employment, persons[1]		*20.5*	n.a.	-6.7	-1.9	0.7	1.9	2.3
2. Employment, hours worked[2]		*n.a.*	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
3. Unemployment rate (%)[3]		*11.3*	11.3	18.0	19.0	18.4	17.0	15.5
4. Labour productivity, persons[4]		*39.2*	n.a.	3.2	1.6	1.1	1.0	0.9
5. Labour productivity, hours worked[5]		*n.a.*	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
6. Compensation of employees	D.1	*n.a.*	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
7. Compensation per employee		*32.2*	5.2	3.9	1.0	1.5	1.8	1.9

[1]Occupied population, domestic concept national accounts definition.

[2]National accounts definition.

[3]Harmonised definition, Eurostat; levels.

[4]Real GDP per person employed.

[5]Real GDP per hour worked.

Table 1d. Sectoral balances

% of GDP	ESA Code	2008	2009	2010	2011	2012	2013
1. Net lending/borrowing vis-à-vis the rest of the world	B.9	-9.1	-4.9	-4.2	-3.8	-3.6	-3.5
of which :							
- Balance on goods and services		-5.9	-2.3	-1.5	-1.1	-0.7	-0.4
- Balance of primary incomes and transfers		-3.7	-3.2	-3.3	-3.3	-3.5	-3.5
- Capital account		0.5	0.5	0.7	0.7	0.5	0.4
2. Net lending/borrowing of the private sector	B.9	-5.0	6.5	5.6	3.7	1.7	-0.5
3. Net lending/borrowing of general government	EDP B.9	-4.1	-11.4	-9.8	-7.5	-5.3	-3.0
4. Statistical discrepancy		-	optional	optional	optional	optional	optional

Table 2. General government budgetary prospects

	ESA Code	2008 Level	2008 % of GDP	2009 % of GDP	2010 % of GDP	2011 % of GDP	2012 % of GDP	2013 % of GDP
Net lending (EDP B.9) by sub-sector								
1. General government	S.13	*-44260*	-4.1	-11.4	-9.8	-7.5	-5.3	-3.0
2. Central government	S.1311	*-30500*	-2.8	-9.5	-6.2	-2.5	-3.8	-1.9
3. State government	S.1312	*-16992*	-1.6	-2.2	-3.2	-4.2	-1.5	-1.1
4. Local government	S.1313	*-5230*	-0.5	-0.5	-0.7	-1.0	-0.3	-0.2
5. Social security funds	S.1314	*8462*	0.8	0.8	0.2	0.2	0.2	0.2
General government (S13)								
6. Total revenue	TR	*402677*	37.0	34.6	35.7	36.7	37.5	38.3
7. Total expenditure	TE[1]	*446937*	41.1	46.1	45.5	44.2	42.8	41.3
8. Net lending/borrowing	EDP B.9	*-44260*	-4.1	-11.4	-9.8	-7.5	-5.3	-3.0
9. Interest expenditure	EDP D.41	*17229*	1.6	1.9	2.2	2.6	2.9	3.1
10. Primary balance[2]		*-27031*	-2.5	-9.6	-7.7	-4.9	-2.3	0.1
11. One-off and other temporary measures[3]		-	-	-	-	-	-	-
Selected components of revenue								
12. Total taxes (12=12a+12b+12c)		*229802*	21.1	18.2	19.5	20.3	20.9	21.6
12a. Taxes on production and imports	D.2	*107641*	9.9	8.3	9.1	9.5	9.8	10.1
12b. Current taxes on income, wealth, etc	D.5	*117483*	10.8	9.5	10.0	10.3	10.6	11.0
12c. Capital taxes	D.91	*4678*	0.4	0.5	0.5	0.5	0.5	0.5
13. Social contributions	D.61	*143043*	13.1	13.5	13.6	13.7	13.7	13.7
14. Property income	D.4	*11223*	1.0	1.1	1.2	1.2	1.1	1.1
15. Other[4]		*18609*	1.7	1.8	1.5	1.6	1.7	1.9
16=6. Total revenue	TR	*402677*	37.0	34.6	35.7	36.7	37.5	38.3
p.m.: Tax burden (D.2+D.5+D.61+D.91-D.995)[5]		360318.0	33.1	30.4	31.5	32.5	33.4	34.2
Selected components of expenditure								
17. Compensation of employees + intermediate consumption	D.1+P.2	*177470*	**16.3**	**18.0**	**18.1**	**17.3**	**16.2**	**15.1**
17a. Compensation of employees	D.1	*117641*	10.8	11.9	11.9	11.3	10.7	10.0
17b. Intermediate consumption	P.2	*59829*	5.5	6.1	6.2	5.9	5.5	5.1
18. Social payments (18=18a+18b)		*163636*	15.0	17.4	18.3	18.3	17.9	17.5
18a. Social transfers in kind supplied via market producers	D.6311, D.63121, D.63131	*28176*	2.6	2.9	3.0	3.0	3.0	3.0
18b. Social transfers other than in kind	D.62	*135460*	12.4	14.5	15.3	15.3	15.0	14.5
19=9. Interest expenditure	EDP D.41	*17229*	1.6	1.9	2.2	2.6	2.9	3.1
20. Subsidies	D.3	*11687*	1.1	1.1	0.7	0.6	0.6	0.6
21. Gross fixed capital formation	P.51	*41642*	3.8	4.8	4.1	3.4	3.1	2.9
22. Other[6]		*35273*	3.2	2.9	2.2	2.1	2.0	2.1
23=7. Total expenditure	TE[1]	*446937*	41.1	46.1	45.5	44.2	42.8	41.3
p.m.: Government consumption (nominal)	P.3	*211095*	19.4	21.5	21.9	21.2	20.2	19.1

[1]Adjusted for the net flow of swap-related flows, so that TR-TE=EDP B.9.

[2]The primary balance is calculated as (EDP B.9, item 8) plus (EDP D.41, item 9).

[3]A plus sign means deficit-reducing one-off measures.

[4] P.11+P.12+P.131+D.39+D.7+D.9 (other than D.91).

[5]Including those collected by the EU and including an adjustment for uncollected taxes and social contributions (D.995), if appropriate.

[6] D.29+D4 (other than D.41)+ D.5+D.7+D.9+P.52+P.53+K.2+D.8.

Table 3. General government expenditure by function

% of GDP	COFOG Code	2007	2012
1. General public services	1	n.a	n.a
2. Defence	2	n.a	n.a
3. Public order and safety	3	n.a	n.a
4. Economic affairs	4	n.a	n.a
5. Environmental protection	5	n.a	n.a
6. Housing and community amenities	6	n.a	n.a
7. Health	7	n.a	n.a
8. Recreation, culture and religion	8	n.a	n.a
9. Education	9	n.a	n.a
10. Social protection	10	n.a	n.a
11. Total expenditure (=item 7=23 in Table 2)	TE[1]	n.a	n.a

[1]Adjusted for the net flow of swap-related flows, so that TR-TE=EDP B.9.

Table 4. General government debt developments

% of GDP	ESA Code	2008	2009	2010	2011	2012
1. Gross debt[1]		39.7	55.2	65.9	71.9	74.3
2. Change in gross debt ratio		3.5	15.5	10.8	5.9	2.4
Contributions to changes in gross debt						
3. Primary balance[2]		2.5	9.6	7.7	4.9	2.3
4. Interest expenditure[3]	EDP D.41	1.6	1.9	2.2	2.6	2.9
5. Stock-flow adjustment		0.7	2.6	1.0	0.5	0.5
of which:						
- Differences between cash and accruals[4]		n.a.	n.a.	n.a.	n.a.	n.a.
- Net accumulation of financial assets[5]		n.a.	n.a.	n.a.	n.a.	n.a.
of which:						
- privatisation proceeds		n.a.	n.a.	n.a.	n.a.	n.a.
- Valuation effects and other[6]		n.a.	n.a.	n.a.	n.a.	n.a.
p.m.: Implicit interest rate on debt[7]		4.5	4.6	4.0	4.1	4.3
Other relevant variables						
6. Liquid financial assets[8]		n.a.	n.a.	n.a.	n.a.	n.a.
7. Net financial debt (7=1-6)		n.a.	n.a.	n.a.	n.a.	n.a.

[1]As defined in Regulation 3605/93 (not an ESA concept).

[2]Cf. item 10 in Table 2.

[3]Cf. item 9 in Table 2.

[4]The differences concerning interest expenditure, other expenditure and revenue could be distinguished when relevant.

[5]Liquid assets, assets on third countries, government controlled enterprises and the difference between quoted and non-quoted assets could be distinguished when relevant.

[6]Changes due to exchange rate movements, and operation in secondary market could be distinguished when relevant.

[7]Proxied by interest expenditure divided by the debt level of the previous year.

[8]AF1, AF2, AF3 (consolidated at market value), AF5 (if quoted in stock exchange; including mutual fund shares).

Table 5. Cyclical developments

% of GDP	ESA Code	2008	2009	2010	2011	2012	2013
1. Real GDP growth (%)		0.9	-3.6	-0.3	1.8	2.9	3.1
2. Net lending of general government	EDP B.9	-4.1	-11.4	-9.8	-7.5	-5.3	-3.0
3. Interest expenditure	EDP D.41	1.6	1.9	2.2	2.6	2.9	3.1
4. One-off and other temporary measures[1]		n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
5. Potential GDP growth (%)		2.1	1.6	0.6	0.9	1.1	1.6
contributions:							
- labour		0.3	0.1	-0.2	0.1	0.2	0.4
- capital		1.4	0.9	0.2	0.2	0.3	0.4
- total factor productivity		0.4	0.5	0.6	0.7	0.7	0.8
6. Output gap		2.1	-3.2	-4.1	-3.2	-1.6	-0.1
7. Cyclical budgetary component		0.9	-1.4	-1.7	-1.4	-0.7	0.0
8. Cyclically-adjusted balance (2 - 7)		-5.0	-10.0	-8.1	-6.1	-4.6	-2.9
9. Cyclically-adjusted primary balance (8 + 3)		-3.4	-8.1	-5.9	-3.5	-1.7	0.1
10. Structural balance (8 - 4)		n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

[1]A plus sign means deficit-reducing one-off measures.

Table 6. Divergence from previous update

	ESA Code	2008	2009	2010	2011	2012	2013
Real GDP growth (%)							
Previous update		n.a.	-1.6	1.2	2.6	n.a.	n.a.
Current update		n.a.	-3.6	-0.3	1.8	n.a.	n.a.
Difference		n.a.	-2.0	-1.5	-0.8	n.a.	n.a.
General government net lending (% of GDP)	EDP B.9						
Previous update		n.a.	-5.8	-4.8	-3.9	n.a.	n.a.
Current update		n.a.	-11.4	-9.8	-7.5	n.a.	n.a.
Difference		n.a.	-5.6	-5.0	-3.6	n.a.	n.a.
General government gross debt (% of GDP)							
Previous update		n.a.	47.3	51.6	53.7	n.a.	n.a.
Current update		n.a.	55.2	65.9	71.9	n.a.	n.a.
Difference		n.a.	7.9	14.3	18.2	n.a.	n.a.

Table 7. Long-term sustainability of public finances

% of GDP	2007	2010	2020	2030	2040	2050
Total expenditure	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Of which: age-related expenditures	19.2	20.0	20.7	22.4	25.2	28.3
Pension expenditure	8.4	8.9	9.5	10.8	13.2	15.5
Social security pension	7.6	8.1	8.7	10.0	12.5	14.8
Old-age and early pensions	5.0	5.5	6.0	7.1	9.4	11.8
Other pensions (disability, survivors)	2.5	2.7	2.6	2.8	3.1	3.1
Occupational pensions (if in general government)	0.8	0.8	0.9	0.9	0.8	0.6
Health care	5.5	5.6	5.9	6.3	6.8	7.1
Long-term care *(this was earlier included in the*	0.5	0.7	0.9	1.0	1.1	1.3
Education expenditure	3.5	3.4	3.5	3.4	3.2	3.5
Other age-related expenditures	1.3	1.4	0.9	0.9	0.9	0.9
Interest expenditure	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Total revenue	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Of which: property income	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Of which : from pensions contributions (or social contributions if appropriate)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Pension reserve fund assets	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Of which : consolidated public pension fund assets (assets other than government liabilities)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Assumptions						
Labour productivity growth	1.0	0.8	2.7	1.9	1.7	1.7
Real GDP growth	3.7	2.9	3.4	1.8	0.9	1.1
Participation rate males (aged 20-64)[1]	81.5	82.0	81.5	81.0	81.3	81.9
Participation rates females (aged 20-64)[1]	61.5	64.3	69.6	71.5	72.9	73.2
Total participation rates (aged 20-64)[1]	71.6	73.3	75.7	76.4	77.2	77.6
Unemployment rate	8.3	8.8	6.2	6.2	6.2	6.2
Population aged 65+ over total population[2]	24.2	24.4	27.4	34.3	46.4	58.7

[1]Aged 15-64.

[2]Population aged 65+ over population aged 15-64

Table 8. Basic assumptions

	2008	2009	2010	2011	2012	2013
Short-term interest rate[1] (annual average)	4.6	1.3	1.5	2.5	2.8	3.0
Long-term interest rate (annual average)	4.3	3.2	3.5	3.8	4.0	4.2
USD/€ exchange rate (annual average) (euro area and ERM II countries)	1.47	1.39	1.48	1.48	1.48	1.48
Nominal effective exchange rate	4.4	2.7	1.6	0.0	0.0	0.0
(for countries not in euro area or ERM II) exchange rate vis-à-vis the € (annual average)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
World excluding EU, GDP growth	3.8	-0.4	3.8	4.1	4.4	4.5
EU GDP growth	0.8	-4.1	0.7	1.6	1.7	1.8
Growth of relevant foreign markets	2.2	-12.8	2.1	4.0	5.4	5.5
World import volumes, excluding EU	4.6	-12.6	4.6	5.0	6.2	6.7
Oil prices (Brent, USD/barrel)	98.5	61.3	76.5	80.5	80.5	80.5

[1]If necessary, purely technical assumptions.