6. SPAIN

Growth set on a moderating path after a long expansion

Growth forecasts have been revised downward due to both data revisions and a weaker growth momentum amid increased uncertainty. Private consumption is expected to recover slightly over the forecast horizon but provide only a moderate impulse to growth. Net exports are set to decelerate while remaining supportive to growth. Employment creation is also expected to slow down, but unemployment should continue to fall. In the absence of a budget for 2020, the deficit reduction is projected to slow further.

A downgraded outlook due to data revisions and weaker growth momentum

Revised national accounts up to 2019-Q2 show that growth in recent quarters has been lower than previously estimated, mainly as a result of lower private consumption. This implies a lower growth momentum, and points to weaker domestic demand going forward due to a lower propensity to consume than previously expected. Soft and hard indicators also point to a lower growth trajectory going forward amid increased uncertainty.

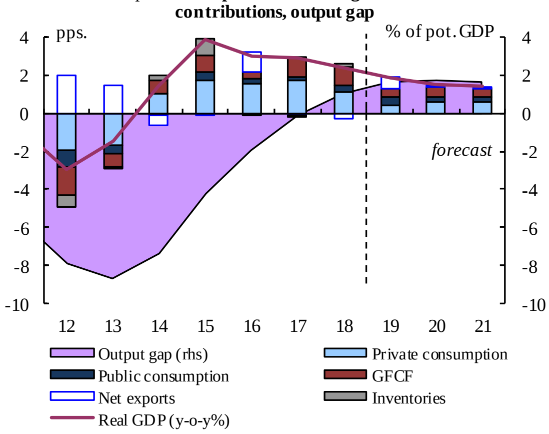
As a consequence, the growth forecast for this year has been revised down to 1.9%, 0.4 pps. lower than in the summer. Half of this difference is due to historical data revisions, while the other half is due to a weaker outlook for 2019H2. For 2020, growth is now forecast at 1.5% (also 0.4 pps. lower than in the summer) and at 1.4% in 2021. Risks to the outlook are on the downside in a context of elevated uncertainty, and relate to both external and domestic risks, such as global trade tensions and households' precautionary savings behaviour.

Domestic demand to grow modestly, but net exports to make a positive contribution

In recent quarters, private consumption has been growing at its slowest pace since 2014. Consumption of durable goods has been particularly weak. This has been taking place in a context of increasing real wage growth, resulting in a sharp increase in the saving rate. This may indicate that households are increasing their level of precautionary savings amid growing uncertainty.

Private consumption growth is expected to recover slightly as households' financial position improves and some of the temporary factors limiting car sales gradually fade away. Still, consumption is expected to grow below real disposable income over the forecast horizon, resulting in a continued recovery in the household saving rate.

Graph II.6.1: **Spain - Real GDP growth and contributions, output gap**



Investment is expected to decelerate over the forecast horizon. Weakness in the manufacturing sector since mid-2018 has had an adverse impact on equipment investment growth, which is expected to bottom out this year. It should then recover slightly over the forecast horizon, in line with final demand. Construction investment is expected to decelerate, both for residential and non-residential construction, as the economic cycle matures.

The unusually low import growth reported in recent quarters, partly reflecting weak demand for durable and investment goods, is set to result in a large positive contribution of net exports to growth this year. The import intensity of final demand is expected to gradually increase as demand for durable and capital goods recovers, resulting in higher import growth going forward. Exports are forecast to continue growing moderately, amid trade tensions and weak global growth. As a result, the contribution of net exports to growth is expected to diminish but remain positive.

Unemployment to continue falling, inflation set to increase gradually

The labour market started to lose traction in 2019-Q3, in line with the cyclical slowdown. Job creation is expected to continue but weaken, especially in 2020 and 2021. Still, the unemployment rate is set to continue falling, to below 13% in 2021, the lowest since 2008. Wage growth is expected to peak in 2019, and remain dynamic and higher than inflation in 2020 and 2021. As productivity growth is set to turn positive next year, unit labour costs should rise more slowly after peaking in 2019. Due to oil price developments, HICP inflation is forecast to decline to 0.9% this year, before increasing gradually to 1.4% in 2021, due to base effects from energy prices and a gradual increase in core inflation.

Budget deficit reduction to slow further

After decreasing by 0.5 pps. to 2.5% of GDP in 2018, the general government deficit is expected to continue declining, albeit at a slower pace. Despite the moderation in economic growth, revenues are expected to grow at a relatively rapid pace in 2019, helped by buoyant social contributions and personal income taxes. This rise in revenues should more than offset significant increases in expenditure, related to compensation of employees and social transfers, in particular pensions. This should lead the general government deficit to narrow to 2.3% of GDP for the full year.

In the absence of a 2020 budget bill, the deficit is projected to decline further to 2.2% of GDP in 2020. This projection includes the wage increase for public employees stipulated for 2018-20 in agreement with the trade unions and an annual pension revaluation in line with inflation. At the same time, it incorporates only some of the potential savings identified in the spending reviews published by AIReF which, if fully implemented, could help lowering the deficit from 2020 onwards. Assuming no change in policy, the headline deficit is set to decline to 2.1% of GDP in 2021. Downside risks are related to the materialisation of contingent liabilities, such as the guarantee call under the banking asset protection scheme.

Spain's structural deficit is projected to increase slightly and reach 3¼ in in 2020, before improving marginally in 2021. The debt-to-GDP ratio is expected to decrease gradually to 96.0% by 2021. This decline will be driven by nominal GDP growth and falling interest expenditure, while the primary balance is likely to remain broadly unchanged around zero.

Table II.6.1:

Main features of country forecast - SPAIN

	2018		Annual percentage change						
	bn EUR Curr. prices	**% GDP**	**00-15**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**
GDP	1202.2	100.0	1.6	3.0	2.9	2.4	**1.9**	**1.5**	**1.4**
Private Consumption	700.8	58.3	1.3	2.7	3.0	1.8	**0.8**	**1.0**	**1.0**
Public Consumption	223.8	18.6	2.9	1.0	1.0	1.9	**2.0**	**1.5**	**1.4**
Gross fixed capital formation	233.6	19.4	0.3	2.4	5.9	5.3	**2.5**	**2.5**	**2.1**
of which: equipment	75.6	6.3	1.0	1.8	8.5	5.7	**1.9**	**2.3**	**2.1**
Exports (goods and services)	422.2	35.1	3.5	5.4	5.6	2.2	**2.0**	**2.3**	**2.4**
Imports (goods and services)	389.5	32.4	2.5	2.6	6.6	3.3	**0.5**	**2.0**	**2.4**
GNI (GDP deflator)	1204.9	100.2	1.7	3.3	2.6	2.6	**1.9**	**1.5**	**1.4**
Contribution to GDP growth: Domestic demand			1.4	2.2	3.0	2.4	**1.3**	**1.3**	**1.3**
Inventories			0.0	-0.2	0.0	0.2	**0.0**	**0.0**	**0.0**
Net exports			0.2	1.0	-0.1	-0.3	**0.6**	**0.2**	**0.1**
Employment			0.5	2.8	2.8	2.5	**2.2**	**1.0**	**0.8**
Unemployment rate (a)			15.7	19.6	17.2	15.3	**13.9**	**13.3**	**12.8**
Compensation of employees / f.t.e.			2.7	-0.6	0.7	1.0	**2.4**	**2.2**	**2.1**
Unit labour costs whole economy			1.6	-0.8	0.7	1.2	**2.7**	**1.7**	**1.5**
Real unit labour cost			-0.5	-1.1	-0.7	0.1	**1.3**	**0.3**	**0.1**
Saving rate of households (b)			8.6	7.1	5.5	5.9	**7.8**	**8.6**	**8.9**
GDP deflator			2.1	0.3	1.4	1.1	**1.4**	**1.4**	**1.4**
Harmonised index of consumer prices			2.4	-0.3	2.0	1.7	**0.9**	**1.1**	**1.4**
Terms of trade goods			-0.1	0.1	-0.8	-2.2	**0.0**	**-0.2**	**-0.2**
Trade balance (goods) (c)			-5.2	-1.3	-1.9	-2.4	**-1.9**	**-1.7**	**-1.7**
Current-account balance (c)			-3.8	3.2	2.7	1.9	**2.4**	**2.5**	**2.6**
Net lending (+) or borrowing (-) vis-a-vis ROW (c)			-3.2	3.4	2.9	2.4	**2.9**	**3.1**	**3.1**
General government balance (c)			-3.8	-4.3	-3.0	-2.5	**-2.3**	**-2.2**	**-2.1**
Cyclically-adjusted budget balance (d)			-3.1	-3.2	-2.9	-3.2	**-3.3**	**-3.2**	**-3.0**
Structural budget balance (d)			-	-3.2	-2.9	-2.9	**-3.1**	**-3.2**	**-3.0**
General government gross debt (c)			61.2	99.2	98.6	97.6	**96.7**	**96.6**	**96.0**

(a) as % of total labour force. (b) gross saving divided by adjusted gross disposable income. (c) as a % of GDP. (d) as a % of potential GDP.