Summary for non-specialists
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Macroeconomic Imbalances – Spain 2013

On 28 November 2012, the European Commission presented its second Alert Mechanism Report (AMR-2013) in accordance with the Regulation (EU) No. 1176/2011 on the prevention and correction of macroeconomic imbalances. The AMR serves as an initial screening device to identify Member States that warrant further in depth analysis into whether imbalances exist or risk emerging. According to Article 5 of Regulation No. 1176/2011, these country-specific "in-depth reviews" should examine the nature, origin and severity of macroeconomic developments in the Member State concerned, which constitute, or could lead to, imbalances. On the basis of this analysis, the Commission concludes whether it considers that an imbalance exists or not, and if so whether it is excessive or not, and what type of follow-up it will recommend to the Council to address to the Member State.

The 2013 in-depth reviews (for Belgium, Bulgaria, Denmark, Spain, France, Italy, Hungary, Malta, the Netherlands, Slovenia, Finland, Sweden and the United Kingdom) were published on 10 April 2013 together with a Commission communication summarising the results. On the basis of the analysis in the In-depth review the Commission concluded that:

SPAIN is *experiencing excessive macroeconomic imbalances. Although adjustment is taking place, the magnitude of the necessary correction requires continuous strong policy action.* In particular, very high domestic and external debt levels continue to pose risks for growth and financial stability. The decisive policy action at the EU level and by Spain has resulted in a visible adjustment of flows, reduction in financing costs and a reduction of immediate risks. However, developments over the last year, including further contraction in economic activity, soaring unemployment, and the need for public support for the recapitalisation of a number of banks, have exposed the vulnerabilities represented by those imbalances for growth, employment, public finances and financial stability.

More specifically, Spain has been affected by large and closely interconnected external and internal imbalances. Strong capital inflows during the boom years contributed to the accumulation of large net external liabilities and spurred a large housing and construction bubble. After this bubble burst, the exposure of the banking sector to doubtful real estate and construction assets endangered financial stability. These risks to the banking sector are being effectively addressed through the financial sector assistance programme and the recapitalisation and restructuring of the most affected banks and the strengthening of the regulatory and supervisory framework[1].

[1] See the Commission, services' reports on the financial assistance programme to recapitalise financial institutions in Spain, *European Economy-Occasional Papers*, 118, 121, 126 and 130.

The adjustment of external imbalances is on-going but not completed yet, as Spain needs to move towards a persistent current account surplus to reduce its stock of net external liabilities: currently part of the improvement in the current account balance and cost competitiveness may be driven by cyclical factors. The adjustment of private sector balance-sheets is advancing, but will continue to pose a challenge for economic growth and the fiscal outlook over the medium term. The housing market has not stabilised yet. Rigidities in product and labour markets contribute to high and rising unemployment, and more generally hinder the adjustment of the economy. All in all, vulnerabilities to possible real and financial shocks remain elevated, and with them the possibility of negative spill overs on the rest of the euro area. These challenges require continued action in the areas of product and service markets, labour market, financial sector, and public finances.

In addition, significant revenue shortfalls linked to the rebalancing of the economy, higher social expenditure and costs of bank recapitalisation have led to a substantial pressure of government deficits and a steeply rising government debt. A sustainable correction of the excessive budget deficit in the medium-term requires simultaneous progress on correcting macroeconomic imbalances, supported by further structural reforms to boost growth and employment creation and to reduce structural rigidities that hamper the adjustment.