Summary for non-specialists
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Macroeconomic Imbalances

Spain 2014

On 13 November 2013, the European Commission presented its third Alert Mechanism Report (AMR) 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, presented on 5 March 2014, the Commission will conclude 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 2014 in-depth reviews (for Belgium, Bulgaria, Germany, Denmark, Ireland, Spain, France, Croatia, Italy, Luxembourg, Hungary, Malta, Netherlands, Slovenia, Sweden, Finland and the United Kingdom) were published on 5 March 2014 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 *macroeconomic imbalances which require specific monitoring and decisive policy action*. In several dimensions, the adjustment of the imbalances identified last year as excessive has clearly advanced and the return to positive growth has reduced risks. Yet, the magnitude and inter-related nature of the imbalances, in particular high domestic and external debt levels, mean that risks are still present. The Commission will continue a specific monitoring of the policies recommended by the Council to Spain in the context of the European Semester, and will regularly report to the Council and the Euro Group. This monitoring will rely on post-programme surveillance.

More specifically, the adjustment has been supported by decisive policy actions at the EU level and by Spain. In particular, the recapitalisation and restructuring of weaker banks have dispelled systemic concerns about the financial sector and allowed a smooth ending of the financial assistance programme at the beginning of 2014. The current account has turned into surplus, as a result of a combination of import compression and strong exports, supported by competiveness gains. The housing market has approached stabilisation. Employment destruction appears to be coming to an end. On the policy front, the comprehensive agenda of structural reforms outlined in the 2013 NRP is mostly completed from legislative point of view, and attention is shifting to a challenging implementation phase. These positive developments have led to a strong return of confidence, manifest in the fall in market risk premia, the return of foreign capital inflows and the rise in business and consumer confidence.

Yet, the adjustment is far from complete and vulnerabilities persist. More specifically, the very high stock of private and public debt, both domestic and external, continues to pose risks for growth and financial stability. Despite its recent contraction, unemployment remains at alarming levels. The re-orientation of the productive system towards exporting sectors and the recovery in international competitiveness will have to be maintained to reduce the very large stock of external liabilities and the burden that it causes in terms of negative flow of incomes towards the rest of the world. The adjustment of private sector balance-sheets is advancing, but high unemployment and falling incomes have limited the pace of deleveraging of households. Non-financial corporations have reduced debt at a somewhat more sustained pace. Going forward, the challenge is ensuring that deleveraging will go hand in hand with positive credit flows to financially healthy borrowers. Removing hindrances in the functioning of the product and financial markets and efficient insolvency procedures could reduce the drag on growth from deleveraging. In the labour market, building on the positive effects of recent reforms on internal flexibility and wage settings, additional reforms could be envisaged. Finally, significant revenue shortfalls, higher social expenditure and costs of bank recapitalisation have led to a substantial pressure on government deficits and a steep rise in government debt to high levels. The 2013 fiscal deficit target might have been missed, although the improving macroeconomic prospects should allow Spain to meet the 2014 headline target. Ensuring a reduction in government debt in the medium-term will require sustained fiscal efforts.