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**Assessment of the 2018 Stability Programme for
Spain**

(Note prepared by DG ECFIN staff)

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1. INTRODUCTION

On 30 April 2018, Spain submitted its 2018 Stability Programme, covering the period 2018-2021. The government approved the programme on 27 April.¹

Spain is currently subject to the corrective arm of the Stability and Growth Pact (SGP). The Council opened the Excessive Deficit Procedure (EDP) for Spain on 27 April 2009. On 8 August 2016, the Council gave notice to Spain to correct the excessive deficit by 2018. The year following the durable correction of the excessive deficit, Spain would become subject to the preventive arm of the SGP and should ensure sufficient progress towards its medium-term budgetary objective (MTO). As the debt ratio in 2018, at 97.6% of GDP, is projected to exceed the Treaty 60%-of-GDP reference value and as Spain was already in EDP on the date that the Six Pack amendments to the SGP were adopted (8 November 2011), Spain would also become subject to the transitional arrangements as regards compliance with the debt criterion. During the three years following the correction of the excessive deficit (transitional debt rule), it should ensure sufficient progress towards compliance.

This document complements the Country Report published on 7 March 2018 and updates it with the information included in the Stability Programme.⁽²⁾

Section 2 presents the macroeconomic outlook underlying the Stability Programme and provides an assessment based on the Commission 2018 spring forecast. The following section presents the recent and planned budgetary developments, according to the Stability Programme. In particular, it provides an overview of the medium-term budgetary plans, an assessment of the measures underpinning the programme and a risk analysis of the budgetary plans based on the Commission forecast. Section 4 assesses compliance with the rules of the SGP, including on the basis of the Commission forecast. Section 5 provides an overview of long-term sustainability risks and Section 6 of recent developments and plans regarding the fiscal framework. Section 7 provides a summary.

2. MACROECONOMIC DEVELOPMENTS

The Stability Programme forecasts robust growth to continue until 2021, albeit at a decelerating pace. After having reached 3.1% in 2017, annual real GDP growth in Spain is projected to decrease to 2.7% in 2018 and 2.4% in 2019, before levelling off at 2.3% in 2020-2021. The main contributor to GDP growth over the 2018-2021 period is projected to be domestic demand, and in particular private consumption, which is expected to be supported by strong job creation. Investment is projected to decline slightly in 2018 and 2019, before stabilizing in 2020-2021, despite declining final demand. Net exports are expected to increase their contribution to growth this year, mainly on account of declining import growth, and then reduce it until 2020 and stabilize thereafter. Compared to the no-policy-change 2018 Draft Budgetary Plan (DBP) submitted in October 2017, the growth forecast in the Stability Programme is higher for 2018, by 0.4 percentage point. The upward revision is attributed both to decreased uncertainty surrounding the situation in Catalonia and the positive impact on

¹ The Stability Programme was submitted in Spanish language only.

² The 2018 Stability Programme was submitted together with the updated 2018 DBP, with identical macroeconomic and budgetary projections for 2018.

domestic demand of the fiscal measures put forward in the 2018 Stability Programme (estimated at 0.2 percentage point. in 2018 and of 0.1 percentage point. in 2019).

Compared to the Commission 2018 spring forecast, the Stability Programme projects lower real GDP growth in 2018 (by 0.2 pps) and the same in 2019. However, the Stability Programme projects a higher GDP deflator growth, and, therefore, nominal GDP growth is projected to be broadly similar in the two forecasts in 2018 and slightly higher in the Stability Programme in 2019. The Commission forecast also incorporates a positive impact on domestic demand from the fiscal measures contained in the Stability Programme in 2018 and 2019, though of a smaller magnitude, given that the Commission forecast includes a smaller set of measures. Divergences in the composition of growth are larger in 2018 than in 2019. Despite the Stability Programme projecting higher wage and employment growth, it projects lower consumption growth than the Commission forecast, especially in 2018. This is the main reason behind the lower growth rate in the Stability Programme in 2018. At the same time, the Stability Programme forecasts higher investment (especially in 2019) and a slightly larger contribution of net exports to growth (on account of lower import growth) than the Commission forecast in both years. For the outer years of the programme (2020 and 2021), growth at 2.3% in the Stability Programme appears somewhat favourable, especially in light of the positive output gap.

Both macroeconomic scenarios imply a closing and subsequent reversal of the negative output gap over the programme period. However, based on the Commission forecast, the output gap is projected to increase faster than based on the Stability Programme, mainly owing to higher and faster increasing potential growth in the latter.

Overall, the macroeconomic projections underpinning the Stability Programme appear plausible in 2018 and 2019 when compared with the Commission 2018 spring forecast and somewhat favourable for 2020 and 2021. They were endorsed on 28 of April 2018 by Spain's independent fiscal institution (AIReF) (see section 6).³

³ Available at:
<http://www.airef.es/documents/42901/763147/2018+04+27+Resumen+Ejecutivo+Informe+APE+2018-2021.pdf/f754d9b8-8d1a-4a48-86f5-6eb029e03abf>

Table 1: Comparison of macroeconomic developments and forecasts

	2017		2018		2019		2020	2021
	COM	SP	COM	SP	COM	SP	SP	SP
Real GDP (% change)	3.1	3.1	2.9	2.7	2.4	2.4	2.3	2.3
Private consumption (% change)	2.4	2.4	2.3	2.0	1.9	1.8	1.7	1.7
Gross fixed capital formation (% change)	5.0	5.0	4.6	4.7	3.9	4.4	4.3	4.3
Exports of goods and services (% change)	5.0	5.0	5.0	4.8	4.7	4.6	4.4	4.2
Imports of goods and services (% change)	4.7	4.7	4.7	4.1	4.5	4.2	4.0	4.0
<i>Contributions to real GDP growth:</i>								
- Final domestic demand	2.7	2.7	2.6	2.3	2.2	2.2	2.1	2.1
- Change in inventories	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0
- Net exports	0.3	0.3	0.2	0.4	0.2	0.3	0.2	0.2
Output gap ¹	-0.2	-0.2	1.4	1.1	2.3	1.6	2.2	2.5
Employment (% change)	2.6	2.6	2.4	2.6	2.1	2.3	2.2	2.0
Unemployment rate (%)	17.2	17.2	15.3	15.5	13.8	13.8	12.3	11.0
Labour productivity (% change)	0.2	0.2	0.2	0.2	0.1	0.1	0.2	0.3
HICP inflation (%)	2.0		1.4		1.4			
GDP deflator (% change)	1.0	1.0	1.4	1.5	1.6	1.8	1.9	1.9
Comp. of employees (per head, % change)	0.1	0.1	1.1	1.2	1.6	1.5	1.8	1.9
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	2.0	2.0	1.7	1.9	1.9	1.8	1.7	1.5
<i>Note:</i>								
¹ In % of potential GDP, with potential GDP growth recalculated by Commission services on the basis of the programme scenario using the commonly agreed methodology.								
<i>Source:</i>								
Commission 2018 spring forecast (COM); Stability Programme (SP).								

3. RECENT AND PLANNED BUDGETARY DEVELOPMENTS

3.1. Deficit developments in 2017 and 2018

Driven by the cyclical improvement of the economy, lower interest expenditure and a slight increase in the tax burden, the general government headline deficit shrank from 4.5% of GDP in 2016 to 3.1% of GDP in 2017, in line with the headline deficit target required by the Council notice of August 2016. Although the deficit ratio came in as anticipated in the no-policy-change DBP submitted in October 2017, both the revenue and expenditure ratios turned out 0.2 percentage point lower, at 38.9% and 40.0% of GDP, respectively. In the 2017 Stability Programme, which also had a deficit forecast of 3.1% of GDP, both revenue and expenditure ratios were forecast to be about ½% of GDP higher, with taxes on production and imports as well as interest and other expenditure being particularly over-estimated (by around 0.2 % of GDP each).

For 2018, the Stability Programme shows the general government deficit narrowing to 2.2% of GDP, reflecting the continued cyclical upswing. The projection includes the measures in the draft 2018 budget bill presented to parliament in early April, in particular the tax cut for low-income earners and a 3% increase in the lowest pensions. It also includes some additional

measures regarding pensions that have been agreed in the course of the budget discussions in parliament, in particular a general revaluation of pensions by 1.6% to compensate for CPI inflation (see section 3.3). The deficit reduction in 2018 is driven by a 0.4 percentage point increase in the revenue ratio, which reaches 38.3% of GDP, and a decrease in the expenditure ratio from 41.0% of GDP to 40.5% of GDP. While the latter is again driven by compensation of employees (−0.3 percentage point), interest expenditure (−0.2 percentage point) and social transfers (−0.1 percentage point) growing slower than nominal GDP (but above potential), revenue is boosted by an increase in the ratio of taxes on income and wealth (+0.2 percentage point) as well as social contributions (+0.1 percentage point).

More in detail, the Stability Programme expects compensation per employee to grow only slightly faster than expected inflation in 2018. While the projection includes the impact of the agreed wage hike of 1.75% for public sector workers, it implicitly assumes very little public employment growth in 2018, despite the strong increase recorded in the second half of 2017 creating a strong carry-over effect into 2018. Data for the first quarter of 2018 published after the cut-off date of the Commission forecast also show public employment growing strongly in early 2018.⁴ Social transfers are pushed up by higher pensions, but their increase is held back by falling unemployment benefits. Partly offsetting these reductions, the public investment ratio is expected to increase by 0.2% of GDP also because the Stability Programme assumes that the government will take over the infrastructure of distressed toll motorway companies for an amount of about 0.15% of GDP, a share of which is recorded as one-off gross fixed capital formation and the remaining one as capital transfers.

3.2. Medium-term strategy and targets

The medium-term budgetary strategy put forward in the Stability Programme aims at further reducing the general government deficit after 2018 so as to keep the debt ratio on a declining path and thereby strengthen fiscal sustainability. After the correction of the excessive deficit, the programme targets a general government deficit of 1.3% of GDP and 0.5% of GDP in 2019 and 2020, respectively, before reaching a surplus of 0.1% of GDP in 2021. This would correspond to a reduction of the structural deficit by around 0.4% of GDP in the first three years covered by the programme and by 0.6% of GDP in the fourth year, based on the structural balance as recalculated by the Commission on the basis of the information in the programme according to the commonly agreed methodology (henceforth "recalculated structural balance"). The programme confirms the medium-term budgetary objective (MTO) of Spain to be a balanced budget in structural terms, but the Stability Programme only foresees the MTO to be reached in 2024, i.e. beyond the time horizon of the Stability Programme.

According to the programme, the central government is planned to contribute most to the headline deficit reduction (by a cumulative 1.9% of GDP over the four years covered by the programme), followed by the social security sector (by 1.5 percentage points) and regional governments (by 0.3 percentage point), while the local government surplus of 0.6% of GDP in 2017 is projected to disappear.

⁴ The Labour Force Survey (INE) showed public employment growing by 1.0% in the first quarter compared to the fourth quarter of 2017. Compared with the first quarter of 2017, public employment was 4.4% higher.

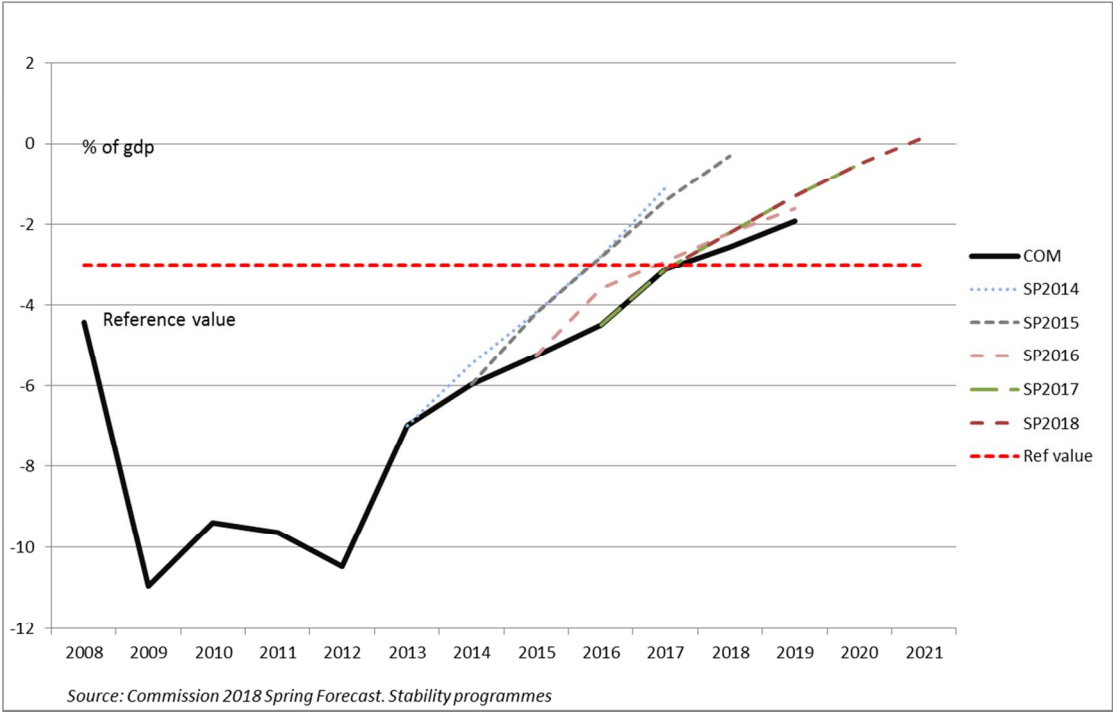
After 2018, the fiscal strategy relies on a slightly increasing revenue ratio, while the expenditure ratio would steadily decline to 38.6% of GDP in 2021. The expected increase in the revenue ratio by 0.4 percentage point over the programme period is all due to the rise in tax revenues, in particular direct taxes (+0.5 percentage point), while the ratio of other revenues is expected to decrease slightly (0.2 percentage point). For the entire programme period, these plans seem to rely on strong revenue elasticities. The programme foresees the expenditure ratio to fall for most spending categories over the programme period, due to the denominator effect of robust nominal GDP growth – although expenditure in most categories is still expected to outpace potential growth. The programme also assumes strict enforcement of the expenditure rule at all government levels.

Table 2: Composition of the budgetary adjustment

(% of GDP)	2017	2018		2019		2020	2021	Change: 2017-2021
	COM	COM	SP	COM	SP	SP	SP	SP
Revenue	37.9	38.1	38.3	38.1	38.5	38.6	38.7	0.8
<i>of which:</i>								
- Taxes on production and imports	11.6	11.7	11.6	11.7	11.8	11.7	11.7	0.1
- Current taxes on income, wealth, etc.	10.2	10.4	10.4	10.5	10.5	10.7	10.9	0.7
- Social contributions	12.3	12.2	12.4	12.1	12.4	12.5	12.5	0.3
- Other (residual)	3.8	3.9	3.9	3.9	3.8	3.7	3.5	-0.3
Expenditure	41.0	40.7	40.5	40.0	39.8	39.1	38.6	-2.5
<i>of which:</i>								
- Primary expenditure	38.5	38.3	38.2	37.6	37.5	36.9	36.4	-2.1
<i>of which:</i>								
Compensation of employees	10.6	10.4	10.3	10.4	10.1	10.0	9.9	-0.6
Intermediate consumption	5.0	4.9	4.9	4.8	4.8	4.7	4.6	-0.4
Social payments	17.8	17.6	17.7	17.3	17.7	17.4	17.1	-0.8
Subsidies	1.0	1.0	1.0	1.0	0.9	0.9	0.9	-0.2
Gross fixed capital formation	2.0	2.2	2.2	2.1	2.1	2.1	2.1	0.1
Other (residual)	2.0	2.1	2.0	2.1	2.0	1.8	1.8	-0.2
- Interest expenditure	2.6	2.4	2.4	2.4	2.3	2.3	2.2	-0.4
General government balance (GGB)	-3.1	-2.6	-2.2	-1.9	-1.3	-0.5	0.1	3.3
Primary balance	-0.5	-0.2	0.1	0.4	1.0	1.7	2.3	2.9
One-off and other temporary	0.0	0.0	-0.2	0.0	0.0	0.0	-0.1	0.0
GGB excl. one-offs	-3.1	-2.5	-2.0	-1.9	-1.3	-0.5	0.2	3.2
Output gap ¹	-0.2	1.4	1.1	2.3	1.6	2.2	2.5	2.7
Cyclically-adjusted balance ¹	-3.0	-3.3	-2.8	-3.2	-2.2	-1.7	-1.2	1.8
Structural balance²	-3.0	-3.3	-2.5	-3.2	-2.1	-1.7	-1.1	1.8
Structural primary balance ²	-0.4	-0.9	-0.2	-0.8	0.2	0.6	1.1	1.5
Notes:								
¹ Output gap (in % of potential GDP) and cyclically-adjusted balance according to the programme as recalculated by Commission on the basis of the programme scenario using the commonly agreed methodology.								
² Structural (primary) balance = cyclically-adjusted (primary) balance excluding one-off and other temporary measures.								
Source:								
Stability Programme (SP); Commission 2018 spring forecasts (COM); Commission calculations.								

As evident in Figure 1, the headline targets in successive Stability Programmes have tended to reflect the EDP targets valid at the time of their submission. Hence, the last two editions reflect the Council Notice of August 2016.

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



3.3. Measures underpinning the programme

The Stability Programme builds on the measures already reported in the no-policy-change DBP for 2018, while including the new measures, described below (estimated incremental budget impact in brackets).

- A reduction in the personal income tax for low income households, combined with larger tax breaks regarding expenses on childcare facilities, large families and dependent spouses (-0.1% of GDP in 2018 and 2019, respectively).
- Increases in pension expenditure (0.2% of GDP in both 2018 and 2019), namely: i) the increase of pensions by 1.6% in 2018 and 1.5% in 2019, above the statutory minimum revaluation of 0.25%, ii) the increase in minimum and non-contributory pensions by 3% and iii) the increase of the survivor pensions’ regulatory base by 4 percentage points.

The Stability Programme announces that the government will study the creation of a new tax on revenue from digital activities to fund part of the increases in pensions set out in the DBP (0.05% and 0.1% of GDP in 2018 and 2019, respectively). Moreover, as part of the 2018 budget negotiations, the government has agreed to delay by four years (i.e., from 2019 to 2023) the entry into force of the pension sustainability factor, which links the initial level of pension to changes in life expectancy. Based on the projections in the forthcoming 2018 Ageing Report, this postponement is expected to have a visible budgetary impact only after the programme period (2018-2021). It is not referred to explicitly in the Stability Programme.

- Increases in public servants' wages by 1.75% in 2018 and between 2.5% to 2.75% in 2019⁵ (0.2% of GDP in 2018 and 0.3% of GDP in 2019).
- Additional expenditure in 2018 for young workers benefitting from the youth guarantee, and the reduction in social contributions for the self-employed in 2018 following law 6/2017 (EUR 500 million and EUR 530 million, respectively).
- A reduction in the VAT tax rate for tickets to movie theatres, with a marginal budgetary impact.
- The Stability Programme also includes investments in road infrastructure taken over from a number of bankrupt motorway companies, as well as some related capital transfers, which are treated as one-off measures, totalling EUR 1.8 billion (0.15% of GDP). This is EUR 200 million lower than previously estimated in the no-policy-change DBP for 2018. In 2019, the Stability Programme expects one-off revenues of EUR 1 billion (0.1% of GDP) from the resale of the abovementioned motorways. This is offset by higher one-off expenditure from the expected reversion of the Aigües Ter Llobregat water concession in Catalonia. Lastly, for 2019, the Stability Programme factors in additional 0.04% of GDP expenditure in compensation for the elimination for the tax on the retail sales of selected hydrocarbons, commonly referred to as *céntimo sanitario*. This follows a court ruling in 2017 and is also treated as a one-off.

The Stability Programme does not include new policy measures for 2019 or for the outer years. The yields reported over 2019-2021 derive from measures taken in 2018 or in earlier years.

The net overall impact from all fiscal policy measures reported in the Stability Programme (i.e., planned and already adopted) is deficit-increasing in 2018 (-0.6% of GDP) and, to a lesser extent, also in 2019 (-0.2 of GDP). The Commission 2018 spring forecast includes a net impact from fiscal policy measures amounting to -0.4% of GDP in 2018 and a positive effect of 0.1% in 2019. The main differences between the Stability Programme and the Commission spring forecast are the following:

- The Stability Programme attributes the salary increase in the public sector to a policy measure; the Commission forecast includes it in its baseline projections. Moreover, starting from 2016, the Commission has included the savings from the 2013 pension reform (reported at EUR 950 million in 2018 and in 2019) in the baseline of social transfers other than in kind, rather than treating them as a new policy measure.
- The Commission forecast does not include the additional increases of 1.6% and 1.5% in public pensions in 2018 and 2019, respectively, as they were announced after its cut-off date, nor does it factor in any potential compensatory measures such as the planned tax on revenue from digital activities, which are not yet fully specified.

⁵ The final figure will depend on whether the domestic fiscal targets are met or not and on the growth rate of the Spanish economy.

- Unlike the Stability Programme, the Commission forecast for 2018 includes an additional EUR 400 million in gross fixed capital formation as a result of the new incentives to sustainable investment projects at subnational government level.⁶
- Moreover, on the revenue side, the Commission forecast considers that the impact of the lower social security contributions for the self-employed is mostly felt in 2019, rather than in 2018 in the government forecast. Lastly, the spring forecast includes the estimate provided by the government in its April 2018 quarterly budgetary execution report for the fee for the conversion of DTAs into tax credits (0.04% of GDP in 2018).

Table 3. Main budgetary measures

Revenue	Expenditure
2017	
<ul style="list-style-type: none"> • 2014 Personal Income Tax reform (0.1% of GDP) • 2014 Corporate Income Tax reform, (0.1% of GDP) • 2016 increase in Corporate Income Tax advance payments (-0.3% of GDP) • Fight against tax fraud (0.1% of GDP) • 2016 increases in Corporate Income Tax (0.1% of GDP) • Measures to reduce deferred taxes (0.1% of GDP) • Tax measures at subnational government level (0.1%) • Others (0.1% of GDP) 	<ul style="list-style-type: none"> • 1% increase in public sector wages (0.1% of GDP) • 2013 pension reform (-0.1% of GDP) • Others (-0.1% of GDP)
2018	
<ul style="list-style-type: none"> • 2018 Personal Income Tax cuts for low income households (-0.1% of GDP) • Tax on revenue from digital activities (0.05% of GDP) • Others (0.0% of GDP) 	<ul style="list-style-type: none"> • 1.75% increase in public sector wages (0.2% of GDP) • Pension revaluation and increases in minimum, non-contributory and survivor's pensions (0.2% of GDP) • 2013 pension reform (-0.1% of GDP) • Investments in road infrastructure taken over from a number of bankrupt motorway companies, as

⁶ Royal Decree Law 1/2018, in force since 25 March 2018, allows local governments, under certain conditions, to spend their surpluses on an longer list of sustainable investment projects. A similar provision, albeit with overall less strict requirements, is provided for in the draft budget law for regional governments having complied with the public deficit, public debt and expenditure rule targets in 2017.

Revenue	Expenditure
	well as related capital transfers (0.15% of GDP) <ul style="list-style-type: none"> • Others (0.1% of GDP)
2019	
<ul style="list-style-type: none"> • 2018 Personal Income Tax cuts for low income households (-0.1% of GDP) • Tax on revenue from digital activities (0.1% of GDP) • Others (0.0% of GDP) 	<ul style="list-style-type: none"> • 2.5% to 2.75% increase in public sector wages and replacement rate (0.3% of GDP) • Pension revaluation (0.2% of GDP) • 2013 pension reform (-0.1% of GDP) • Expected resale of the abovementioned bankrupt motorways (-0.1% of GDP) • Expected reversion of the the Aigües Ter Llobregat water concession in Catalonia (0.1% of GDP) • Compensation for the elimination for the tax on the retail sales of selected hydrocarbons (0.04% of GDP) • Others (-0.1% of GDP)
<p><u>Note:</u> The budgetary impact in the table is the impact reported in the programme, i.e. by the national authorities. A positive sign implies that revenue / expenditure increases as a consequence of this measure.</p>	

3.4. Debt developments

According to the programme, the gross general government debt-to-GDP ratio of general government is expected to decrease by about 9.2 percentage points over the programme period to reach 89.1% of GDP in 2021. The pace of debt reduction is expected to accelerate throughout the period, as the primary balance gradually improves and nominal GDP growth continues to have a reducing effect on the ratio. These factors have a larger impact than the stock-flow adjustments, which are planned to have a debt-increasing average impact of about 0.6 percentage point per year over the programme horizon. The programme does not specify where these adjustments would stem from.

As shown in Figure 2, the debt projections in recent programme updates have been relatively accurate, as the expected economic recovery has materialised. The debt ratio in 2017 was only about 0.5% of GDP lower than projected in the 2017 Stability Programme.

Table 4: Debt developments

(% of GDP)	Average 2012-2016	2017	2018		2019		2020	2021
			COM	SP	COM	SP	SP	SP
Gross debt ratio¹	96.0	98.3	97.6	97.0	95.9	95.2	92.4	89.1
Change in the ratio	5.9	-0.7	-0.7	-1.3	-1.7	-1.9	-2.7	-3.3
<i>Contributions²:</i>								
1. Primary balance	3.5	0.5	0.2	-0.1	-0.4	-1.0	-1.7	-2.3
2. “Snow-ball” effect	2.1	-1.2	-1.6	-1.6	-1.4	-1.6	-1.6	-1.5
<i>Of which:</i>								
Interest expenditure	3.2	2.6	2.4	2.4	2.4	2.3	2.3	2.2
Growth effect	-0.8	-2.9	-2.7	-2.5	-2.2	-2.3	-2.1	-2.0
Inflation effect	-0.2	-0.9	-1.3	-1.4	-1.5	-1.6	-1.8	-1.7
3. Stock-flow adjustment	0.3	0.1	0.7	0.5	0.1	0.7	0.6	0.7

Notes:

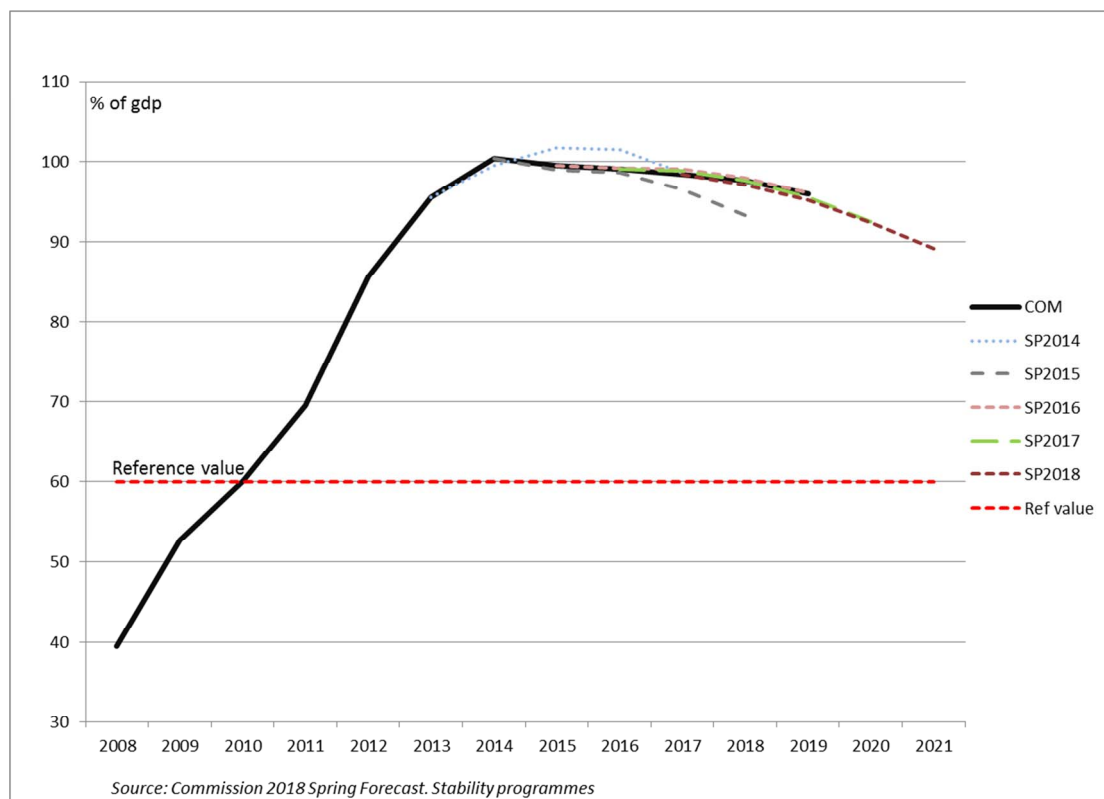
¹ End of period.

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:

Commission 2018 spring forecast (COM); Stability Programme (SP), Commission calculations.

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



3.5. Risk assessment

The main risks to budgetary targets and debt projections in the Stability Programme stem, on the revenue side, from social contributions not reaching the planned levels and, on the expenditure side, from compensation of employees being higher than forecast. This risk assessment is based on the Commission 2018 spring forecast projecting a general government deficit of 2.6% of GDP and 1.9% of GDP in 2018 and 2019 respectively, 0.4 percentage point and 0.6 percentage point higher than the Stability Programme in the two respective years. In particular, the Commission assumes the total wage bill to grow faster than in the Stability Programme, reflecting the agreed wage hikes in 2018 and 2019, but also expectations of strong growth in public sector employment, in particular in 2018. It must be noted that the Commission forecast does not include the additional expenditure on pensions announced after the cut-off date of the Commission forecast (including the increase in pensions by 1.6% in 2018 and a further 1.5% in 2019 rather than the stipulated annual revaluation of 0.25%. Had these been included, the deficit would have been higher in the Commission forecast in both years.

Although the Stability Programme incorporates a budgetary impact of the possible settlement regarding distressed toll motorways of 0.15% of GDP in 2018, other contingent liabilities, such as the compensation for land expropriations, constitute a downside risk. Other contingent liabilities that were not incorporated into the Commission 2018 spring forecast but are included in the forecast underlying the Stability Programme in 2019 (such as the resale of the motorways or the cancellation of the Aigües Ter Llobregat water concession in Catalonia), could have either a positive or a negative impact depending on if and when they materialise and what their eventual fiscal impact will be.

4. COMPLIANCE WITH THE PROVISIONS OF THE STABILITY AND GROWTH PACT

Box 1. Council recommendations addressed to Spain

- *On 8 August 2016, the Council gave notice to Spain under Article 126(9) of the Treaty to correct its excessive deficit by 2018. According to that notice, Spain is to reduce the general government deficit to 4.6% of GDP in 2016, to 3.1% of GDP in 2017 and to 2.2% of GDP in 2018. That improvement in the general government deficit is consistent with a deterioration of the structural balance by 0.4% of GDP in 2016 and a 0.5% of GDP improvement in both 2017 and 2018, based on the updated Commission 2016 spring forecast. Spain is to also use all windfall gains to accelerate deficit and debt reduction. In addition to the savings already included in the updated Commission 2016 spring forecast, Spain is to adopt and fully implement consolidation measures for the amount of 0.5% of GDP in both 2017 and 2018. Spain shall stand ready to adopt further measures should risks to the budgetary plans materialise. Fiscal consolidation measures are to secure a lasting improvement in the general government structural balance in a growth-friendly manner. Moreover, Spain is to adopt measures to strengthen its fiscal framework, in particular with a view to increasing the automaticity of mechanisms to prevent and correct deviations from the deficit, debt and expenditure targets and to strengthening the contribution of the Stability Law's spending rule to public finance sustainability. Furthermore, Spain is to set up a consistent framework to ensure transparency and coordination of public procurement policy across all contracting authorities and entities with a view to guaranteeing economic efficiency and a high level of competition. That framework is to include appropriate ex-ante and ex-post control mechanisms for public procurement to ensure efficiency and legal compliance.*
- *On 11 July 2017, the Council also addressed recommendations to Spain in the context of the European Semester. In particular, in the area of public finances the Council recommended to*

Spain to ensure compliance with the Council Decision of 8 August 2016, including also measures to strengthen the fiscal and public procurement frameworks.

4.1. Compliance with EDP recommendations

After achieving the headline deficit target of 3.1 % of GDP required by the Council decision of August 2016, according to the Commission 2018 spring forecast, the headline deficit target of 2.2% of GDP for 2018 is not expected to be fulfilled. However, at 2.6% of GDP, the headline is forecast to be below the Treaty reference value of 3.0%, in line with the deadline set by the Council. According to the Commission 2018 spring forecast, it is also expected to remain well below 3% of GDP in 2019, making it likely that the excessive deficit will be durably corrected.

The Council decision requires Spain to improve the structural balance by 0.5 percentage point in 2018. However, the Commission 2018 spring forecast projects a widening of the structural deficit in 2018 of 0.3 percentage point. Correcting for the change in the estimated potential growth between the projections underlying the Council decision and the Commission 2018 spring forecast, as well as revenue shortfalls projected for 2018 compared to the Council decision, the estimated change in the structural balance is -0.4 percentage point. On a cumulative basis over 2016-2018, the estimated gap with the requirement amounts to 0.9% of GDP when measured against the unadjusted change in the structural balance, and to 0.6% of GDP when adjusted. The bottom-up estimate of the fiscal effort falls short of the requirement by 1.0% of GDP in 2018 and by 0.8% of GDP over 2016-2018.

Table 5: Compliance with the requirements of the corrective arm

(% of GDP)	2017	2018	
	COM	SP	COM
Headline balance			
Headline budget balance	-3.1	-2.2	-2.6
EDP requirement on the budget balance	-3.1	-2.2	
Fiscal effort - change in the structural balance			
Change in the structural balance ¹	0.3	0.4	-0.3
Cumulative change ²	-0.6	-0.1	-0.9
Required change from the EDP recommendation	0.5	0.5	
Cumulative required change from the EDP recommendation	0.1	0.6	
Fiscal effort - adjusted change in the structural balance			
Adjusted change in the structural balance ³	0.3	-	-0.4
of which:			
<i>correction due to change in potential GDP estimation (α)</i>	-0.1	-	-0.1
<i>correction due to revenue windfalls/shortfalls (β)</i>	0.0	-	0.0
Cumulative adjusted change ²	-0.2	-	-0.6
Required change from the EDP recommendation	0.5	0.5	
Cumulative required change from the EDP recommendation	0.1	0.6	
Fiscal effort - calculated on the basis of measures (bottom-up approach)			
Fiscal effort (bottom-up) ⁴	0.4	-	-0.5
Cumulative fiscal effort (bottom-up) ²	0.7	-	0.2
Requirement from the EDP recommendation	0.5	0.5	
Cumulative requirement from the EDP recommendation	0.5	1.0	
Notes			
¹ Structural balance = cyclically-adjusted government balance excluding one-off measures. Structural balance based on programme is recalculated by Commission on the basis of the programme scenario using the commonly agreed methodology. Change compared to <i>t-1</i> .			
² Cumulated since the latest EDP recommendation.			
³ Change in the structural balance corrected for unanticipated revenue windfalls/shortfalls and changes in potential growth compared to the scenario underpinning the EDP recommendations.			
⁴ The estimated budgetary impact of the additional fiscal effort delivered on the basis of the discretionary revenue measures and the expenditure developments under the control of the government between the baseline scenario underpinning the EDP recommendation and the current forecast.			
<i>Source:</i>			
<i>Stability Programme (SP); Commission 2018 spring forecasts (COM); Commission calculations.</i>			

4.2. Compliance with the debt criterion

Following the correction of its excessive deficit, as from 2019, Spain would be in a transition period as regards compliance with the debt criterion and therefore subject to the Minimum Linear Structural Adjustment (MLSA). According to the Commission 2018 spring forecast Spain is not expected to make sufficient progress towards compliance with the debt criterion in 2019. The change in the structural balance is expected to be 0.1% of GDP, which is 0.8% of GDP below the required adjustment.⁷

Table 6. Compliance with the debt criterion

	2019	
	SP	COM
Gross debt ratio	95.2	95.9
Gap to the debt benchmark ^{1,2}		
Structural adjustment ³	0.4	0.1
<i>To be compared to:</i>		
Required adjustment ⁴	n.a.	0.9
Notes:		
¹ Not relevant for Member States that were subject to an EDP procedure in November 2011 and for a period of three years following the correction of the excessive deficit.		
² Shows the difference between the debt-to-GDP ratio and the debt benchmark. If positive, projected gross debt-to-GDP ratio does not comply with the debt reduction benchmark.		
³ Applicable only during the transition period of three years from the correction of the excessive deficit for EDP that were ongoing in November 2011.		
⁴ Defines the remaining annual structural adjustment over the transition period which ensures that - if followed - Member State will comply with the debt reduction benchmark at the end of the transition period, assuming that COM (S/CP) budgetary projections for the previous years are achieved.		
<i>Source :</i>		
<i>Commission 2018 spring forecast (COM); Stability Programme (SP), Commission calculations.</i>		

4.3. Compliance with the MTO or the required adjustment path towards the MTO

In 2019, Spain would be subject for the first time to the requirements of the SGP preventive arm. It will therefore need to ensure an appropriate adjustment path towards its MTO, defined as a balanced budget in structural terms. In view of the uncertainty surrounding the output gap estimates for Spain (see assessment in Box 2), the Commission has decided that an annual structural adjustment of 0.65% of GDP in 2019, corresponding to a maximum growth rate of net primary government expenditure of 0.6%, appears appropriate.

⁷ The Stability Programme does not include sufficiently long projections to calculate the required MLSA based on the programme information.

Based on the information contained in the Stability Programme, in 2019, nominal expenditure growth is forecast not to comply with the applicable benchmark rate of 0.6%.⁸ The gap is projected to reach -1.4% of GDP (see Table 7), thus pointing to a risk of significant deviation. The (recalculated) structural balance is forecast to improve by 0.4% of GDP, 0.3 percentage point below the required adjustment of 0.65% of GDP.

The Commission forecasts a smaller improvement in the structural balance for 2019 than the Stability Programme. The gap with the required improvement amounts to -0.6 % of GDP, implying a risk of significant deviation. Growth in nominal expenditure net of discretionary revenue measures and one-offs is not forecast to meet the target rate of 0.6% either. The gap with the target stands at -0.9% of GDP, also pointing to a risk of significant deviation. This higher gap (relative to the structural balance indicator) is mostly due to the lower potential growth rate factored in in the expenditure benchmark calculations than in the structural balance; while the former uses as reference a 10-year moving average of annual potential growth estimates, including years with negative potential growth, the latter relies on an estimate of potential growth in 2019. The deviation in the expenditure benchmark based on the Commission forecast is also less negative than the one based on the Stability Programme's figures. This is due to the former not having included the additional pension increases in 2018-2019 announced by the government after its cut-off date. It also reflects a different appreciation of some of the one-off measures included in the programme.

In sum, the Commission 2018 spring forecast shows there is a risk of a significant deviation in 2019 from the requirements of the preventive arm.

Box 2. Assessment of uncertainty surrounding the output gap estimate for 2019

Using the production function method as endorsed by the ECOFIN Council on 12 July 2002 (known as the commonly agreed methodology), Spain is projected to reach a positive output gap of 2.3% of potential GDP in 2019. This would correspond to 'good economic times', according to the matrix of requirements under the Stability and Growth Pact.

An assessment of uncertainty surrounding the output gap estimate based on the production function approach has been performed, taking into account a broader range of economic indicators.

First, at 13.8%, Spain is still expected to record one of the highest unemployment rates in the EU in 2019 (EU average 6.7%), and the number of employed persons is forecast to still be almost one million below its pre-crisis peak in 2008. This should contribute to contain wage pressures, especially in the private sector, as well as inflation, which is projected to remain below 2%. The very high share of involuntary part-time work (61% in 2017), temporary employees (22% in 2017) as well as in-work poverty (at 13.1% in 2016) are further signs that the remaining slack in the labour market could be larger than implied by the output gap estimated with the production function approach.

Second, output gap estimations for 2019 provided by other national and international

⁸ As part of the agreement on the EFC Opinion on "*Improving the predictability and transparency the SGP: a stronger focus on the expenditure benchmark in the preventive arm*", which was adopted by the Economic and Financial Committee on 29 November 2016, the expenditure benchmark, that is the maximum allowable growth rate of expenditure net of discretionary revenue measures, is expressed in nominal terms as from 2018.

institutions vary greatly and are generally lower than the estimate based on the commonly agreed methodology.⁹ In addition, while the output gap estimate in 2017 is not flagged by the plausibility tool¹⁰ as being implausible, the rather wide confidence band highlighted by the tool also suggests high uncertainty.

The above-mentioned factors show that the output gap estimate based on the common methodology is subject to a degree of uncertainty.

⁹ Output gap estimates range between -0.3% of potential GDP by the OECD (Economic Outlook, November 2017) and 1.6% in the current Stability Programme (as recalculated by the Commission). The IMF World Economic Outlook of April 2018 estimated the output gap at 0.7% of potential GDP.

¹⁰ The 'plausibility tool' is a transparent and economically grounded tool to statistically test the plausibility of the output gap estimates for individual Member States estimated on the basis of the common method. It is based on a set of cyclically relevant indicators as well as thresholds/ranges - to signal cases when the outcomes of the commonly agreed methodology could be interpreted as being subject to a large degree of uncertainty and therefore deserving of further investigation on the part of the Commission.

Table 7: Compliance with the requirements under the preventive arm

(% of GDP)	2019	
Initial position¹		
Medium-term objective (MTO)	0.0	
Structural balance ² (COM)	-3.2	
Structural balance based on freezing (COM)	-	
Position vis-a-vis the MTO³	Not at MTO	
(% of GDP)	2019	
	SP	COM
Structural balance pillar		
Required adjustment ⁴	0.65	
Required adjustment corrected ⁵	0.65	
Change in structural balance ⁶	0.4	0.1
<i>One-year deviation from the required adjustment⁷</i>	-0.3	-0.6
Expenditure benchmark pillar		
Applicable reference rate ⁸	0.6	
One-year deviation adjusted for one-offs ⁹	-1.4	-0.9
<i>PER MEMORIAM: One-year deviation¹⁰</i>	-1.2	-0.9
Notes		
<p>¹ The most favourable level of the structural balance, measured as a percentage of GDP reached at the end of year t-1, between spring forecast (t-1) and the latest forecast, determines whether there is a need to adjust towards the MTO or not in year t. A margin of 0.25 percentage points (p.p.) is allowed in order to be evaluated as having reached the MTO.</p> <p>² Structural balance = cyclically-adjusted government balance excluding one-off measures.</p> <p>³ Based on the relevant structural balance at year t-1.</p> <p>⁴ Based on the position vis-à-vis the MTO, the cyclical position and the debt level (See European Commission: Vade mecum on the Stability and Growth Pact, page 38.).</p> <p>⁵ Required adjustment corrected for the clauses, the possible margin to the MTO and the allowed deviation in case of overachievers.</p> <p>⁶ Change in the structural balance compared to year t-1.</p> <p>⁷ The difference of the change in the structural balance and the corrected required adjustment.</p> <p>⁸ Reference medium-term rate of potential GDP growth. The (standard) reference rate applies from year t+1, if the country has reached its MTO in year t. A corrected rate applies as long as the country is adjusting towards its MTO, including in year t.</p> <p>⁹ Deviation of the growth rate of public expenditure net of discretionary revenue measures, revenue increases mandated by law and one-offs from the applicable reference rate in terms of the effect on the structural balance. The expenditure aggregate used for the expenditure benchmark is obtained following the commonly agreed methodology. A negative sign implies that expenditure growth exceeds the applicable reference rate.</p> <p>¹⁰ Deviation of the growth rate of public expenditure net of discretionary revenue measures and revenue increases mandated by law from the applicable reference rate in terms of the effect on the structural balance. The expenditure aggregate used for the expenditure benchmark is obtained following the commonly agreed methodology. A negative sign implies that expenditure growth exceeds the applicable reference rate.</p>		
<i>Source:</i>		
<i>Stability Programme (SP); Commission 2018 spring forecast (COM); Commission calculations.</i>		

5. LONG-TERM SUSTAINABILITY

Spain does not appear to face fiscal sustainability risks in the short run. This is thanks to the improved macro-financial situation, while the short-term challenges from the fiscal side are not sufficiently severe to generate short-term fiscal stress at the aggregate level.¹¹

Based on the Commission 2018 spring forecast and a no-policy-change scenario beyond the forecast, government debt, at 98.3% of GDP in 2017, is expected to rise to a peak of 109.5% in 2028, thus remaining well above the 60% of GDP Treaty threshold. Sensitivity analysis all show an upward trend for the debt ratio.¹² Overall, this highlights high risks for the country from debt sustainability in the medium term. The full implementation of the Stability Programme would instead put the debt ratio on a decreasing path by 2028, although remaining above the 60%-of-GDP Treaty reference value in that year.

The medium-term fiscal sustainability risk indicator S1¹³ also indicates high sustainability risks in the medium term, primarily due to the initial level of government debt and budgetary position. The full implementation of the Stability Programme would almost halve the sustainability risk indicator S1, leading to a lower medium-term risk, although still in the high category. Overall, risks to fiscal sustainability over the medium term are, therefore, high. Fully implementing the fiscal plans in the Stability Programme would decrease those risks, without however modifying the high risk classification.

The long-term fiscal sustainability risk indicator S2¹⁴ points to medium fiscal sustainability risks, mainly related to the initial budgetary position, but also to the projected ageing-related costs. Full implementation of the programme would lower the S2 indicator, leading to low long-term risk.

The 2011 and 2013 pension reforms, the expected impact of which are included in the sustainability calculations above, were designed to contribute to containing pressure on expenditure in the long term.¹⁵ However, as part of the 2018 budget negotiations, important deviations have been agreed from these reforms for 2018 and 2019, in particular regarding the annual revaluation mechanism and the entry into force of the sustainability factor, leading to increased uncertainty as to the political commitment to some of the elements of these reforms. At the same time, Spain has also taken some measures to improve the sustainability of its health care system, for instance through a reduction of public expenditure on outpatient pharmaceuticals from 2010 to 2012. In addition, a central government agreement with the pharmaceutical industry that includes a budget rule on healthcare and pharmaceutical spending for application at regional level was approved in mid-June 2015.

¹¹ This conclusion is based on the short-term fiscal sustainability risk indicator S0. See the note to Table 5 for a definition of the indicator.

¹² Sensitivity analysis includes several deterministic debt projections, as well as stochastic projections (see Debt Sustainability Monitor 2017 for more details).

¹³ See the note to Table 5 for a definition of the indicator.

¹⁴ *Ibidem*.

¹⁵ The reforms, which are expected to improve the long-term sustainability of government finances, revised eligibility criteria and the indexation of pensions and introduced, as from 2019, the so-called sustainability factor, which is an automatic adjustment of future retirees' new pensions to take account of changes in life expectancy. Even after these reforms, the benefit and replacement rates are expected to be around EU average levels also in the long term.

Table 8: Spain. Sustainability indicators

<i>Time horizon</i>	Commission Scenario		Stability / Convergence Programme Scenario	
Short Term	LOW risk			
S0 indicator ^[1]	0.4			
Fiscal subindex	0.6	HIGH risk		
Financial & competitiveness subindex	0.3	LOW risk		
Medium Term	HIGH risk			
DSA ^[2]	HIGH risk			
S1 indicator ^[3]	5.4	HIGH risk	2.8	HIGH risk
<i>of which</i>				
Initial Budgetary Position	2.3		0.1	
Debt Requirement	2.7		2.6	
Cost of Ageing	0.5		0.2	
<i>of which</i>				
Pensions	0.3		0.1	
Health-care	0.2		0.2	
Long-term care	0.1		0.1	
Other	-0.1		-0.2	
Long Term	MEDIUM risk		LOW risk	
S2 indicator ^[4]	2.4		0.1	
<i>of which</i>				
Initial Budgetary Position	1.9		-0.1	
Cost of Ageing	0.5		0.1	
<i>of which</i>				
Pensions	-0.7		-0.9	
Health-care	0.5		0.4	
Long-term care	1.0		0.9	
Other	-0.3		-0.3	
Source: Commission services; 2018 stability/convergence programme.				
Note: the 'Commission' scenario depicts the sustainability gap under the assumption that the structural primary balance position evolves according to the Commissions' spring 2018 forecast covering until 2019 included. The 'stability/convergence programme' scenario depicts the sustainability gap under the assumption that the budgetary plans in the programme are fully implemented over the period covered by the programme. Age-related expenditure as given in the 2018 Ageing Report.				
[1] The S0 indicator of short term fiscal challenges informs the early detection of fiscal stress associated to fiscal risks within a one-year horizon. To estimate these risks S0 uses a set of fiscal, financial and competitiveness indicators selected and weighted according to their signalling power. S0 is therefore a composite indicator whose methodology is fundamentally different from the S1 and S2 indicators, which quantify fiscal adjustment efforts. The critical threshold for the overall S0 indicator is 0.46. For the fiscal and the financial-competitiveness sub-indices, thresholds are respectively at 0.36 and 0.49*.				
[2] Debt Sustainability Analysis (DSA) is performed around the no fiscal policy change scenario in a manner that tests the response of this scenario to different shocks presented as sensitivity tests and stochastic projections*.				
[3] The S1 indicator is a medium-term sustainability gap; it measures the upfront fiscal adjustment effort required to bring the debt-to-GDP ratio to 60 % by 2032. This adjustment effort corresponds to a cumulated improvement in the structural primary balance over the 5 years following the forecast horizon (i.e. from 2020 for Commission scenario and from last available year for the SCP scenario); it must be then sustained, including financing for any additional expenditure until the target date, arising from an ageing population. The critical thresholds for S1 are 0 and 2.5, between which S1 indicates medium risk. If S1 is below 0 or above 2.5, it indicates low or high risk, respectively*.				
[4] The S2 indicator is a long-term sustainability gap; it shows the upfront and permanent fiscal adjustment required to stabilise the debt-to-GDP ratio over the infinite horizon, including the costs of ageing. The critical thresholds for S2 are 2 and 6, between which S2 indicates medium risk. If S2 is below 2 or above 6, it indicates low or high risk, respectively*.				
* For more information see Fiscal Sustainability Report 2015 and Debt Sustainability Monitor 2017.				

6. FISCAL FRAMEWORK

The Council Decision of 8 August 2016 required Spain to strengthen its fiscal framework, in particular by increasing the automaticity of mechanisms to prevent and correct deviations from the deficit, debt and expenditure targets and strengthening the contribution of the Stability Law's spending rule to public finance sustainability.

The updated DBP reports actions taken in 2017 to implement the preventive and corrective tools set out in Spain's Stability Law, such as the adoption in 2017 of economic and financial plans for regions not having complied with some or any of the 2016 domestic fiscal targets. However, it does not report any new measures to enhance the automaticity of the mechanisms to prevent and correct deviations from the fiscal targets. Neither does it include measures to review the Stability Law's expenditure rule, with a view to strengthening its contribution to fiscal consolidation, especially during cyclical upturns, as is now the case.

In particular, the domestic expenditure rule could be improved to avoid that revenue windfalls are spent on permanent expenditure increases. The rule in its current formulation does not call on non-compliant public administrations to make up for spending slippages after their occurrence. This makes it easier to observe the rule in the year after it is not complied with, as it allows for a higher base level of expenditure. It also does not ensure convergence towards the MTO (at the aggregate level) as, unlike the expenditure benchmark of the SGP, the reference rate of growth of eligible expenditure does not depend on whether Spain has reached its MTO or not.

The Council notice of 8 August 2016 also required Spain to strengthen its public procurement policy framework, in particular, to include appropriate ex-ante and ex-post control mechanisms for public procurement to ensure efficiency and legal compliance. Law 9/2017, on public sector contracts, in force since 9 March 2018, sets out among other things, a new structure governing Spain's public procurement. However, the new legislation can only improve the efficiency and transparency of public procurement if it is swiftly and ambitiously implemented, by setting up the new governance structure and enhancing control mechanisms of procurement procedures at all levels of government. The new cooperation committee, a collegiate body with representatives from the central, regional and local public authorities tasked with the drawing up and monitoring of a nation-wide Public Procurement Strategy, convened on 19 February for the first time. Other elements of the governance structure, i.e., the new independent office for public procurement regulation and supervision, had not been set up at the time of writing.

Lastly, on 11 July 2017, the Council, upon recommendation by the Commission, recommended Spain to undertake a comprehensive expenditure review in order to identify possible areas for improving spending efficiency. On 2 June, Spain's Council of Ministers commissioned AIReF to carry out a spending review, focusing on public subsidies. The review is expected to be completed by early 2019.

Compliance with domestic numerical fiscal rules

On 13 April, the Ministry of Finance published a report assessing compliance with the domestic fiscal targets by the central, regional and local governments in 2017.¹⁶ The report notes firstly that in 2017 the central government and the social security missed their headline deficit target, whereas local and regional governments outperformed their respective targets. Secondly, unlike regional governments, the central and local governments complied with the Stability Law's spending rule, which in 2017 capped the variation in the eligible expenditure at 2.1%. Finally, the general government debt-to-GDP ratio stood at 98.3%, slightly below the target for that year. The central and local governments outperformed their debt targets, more than compensating for the slippage at regional level.

On 17 April 2018 and on 22 May, AIREF published two reports on the 2018 draft budget law and on the 2018-2021 Stability Programme, respectively.¹⁷ AIREF deems the fulfilment of the general government deficit targets set in the Stability Programme over 2018-2021 as 'improbable', with the likelihood of compliance going down over the programme period. With respect to the 2018 draft budget law, AIREF flags risks to the compliance of the domestic Stability Law's spending rule by the central government, –as the personal income tax cut will lower the level of eligible expenditure. AIREF also flags some uncertainty on regional governments' compliance while it considers it likely that the rule will be complied with by local governments. Furthermore, AIREF expects the regions and local governments to attain their public deficit objectives in 2018, unlike the central government and the social security administration.

As regards the rule set out in the Stability Law on the pace of reduction of the general government debt-to-GDP ratio (requiring a reduction by at least 2 percentage points once Spain's real GDP or net employment grows by at least 2%), it is not expected to be complied with in 2018 and 2019, according to the Commission forecast (see section 3.4).

To sum up, based on information provided in the stability programme and the assessment by AIREF and the Commission spring 2018 forecast, Spain's past and expected fiscal performance in Spain appears to comply only partially with the requirements of the applicable domestic numerical fiscal rules.

The macroeconomic projections underpinning the Stability Programme were endorsed on 28 of April 2018 by Spain's independent fiscal institution (AIREF). AIREF deems the programme's macroeconomic scenario as "prudent" in the early years of the programme, and "probable" in the outer years, and the composition of growth as realistic. AIREF considers risks to the macroeconomic scenario to be balanced in the short term, and tilted to the downside in the medium term.

Lastly, the 2018 Stability Programme is considered as Spain's national medium-term fiscal plan (see page 5 of the programme). Neither the Stability Programme nor the national reform programme indicate the expected economic returns on non-defence public investment projects that have a significant budgetary impact, as required by Article 4(1) of Regulation 473/2013.

¹⁶ Available at:

[http://www.minhfp.gob.es/Documentacion/Publico/CDI/Estabilidad%20Presupuestaria/Informe%20Completo%20EP%202017%20\(1\).pdf](http://www.minhfp.gob.es/Documentacion/Publico/CDI/Estabilidad%20Presupuestaria/Informe%20Completo%20EP%202017%20(1).pdf)

¹⁷ The reports can be accessed at www.airef.es

7. SUMMARY

In 2017, Spain achieved a headline deficit of 3.1% of GDP, in line with the EDP deficit target. Spain plans to correct its excessive deficit by the 2018 deadline set by the Council, but the programme does not project to reach the MTO set in Spain's Stability Law within the programme horizon.

Based on the Commission 2018 spring forecast, the headline deficit is expected to decrease to 2.6% of GDP in 2018 and further to 1.9% of GDP in 2019. Short-term risks to the achievement of the fiscal targets relate to uncertainty about tax revenues at this stage of cycle, the pace of public employment growth and the possible materialisation of contingent liabilities.

Based on the Commission 2018 spring forecast, the projected change in the unadjusted structural balance falls short of the fiscal effort required by the Council in 2018 and cumulatively over the 2016-18 period. This also holds for the adjusted change in the structural balance and the fiscal effort measured by the bottom-up method. This reflects the expansionary nature of the draft 2018 budget, including the additional expenditure on pensions following from the higher annual revaluation of the pensions than foreseen by the 2011-13 pension reforms.

Should the excessive deficit be corrected in a durable manner by 2018, as expected, Spain will be subject to the preventive arm of the Stability and Growth Pact from 2019 onwards and to the transition period as regards compliance with the debt criterion. According to the Commission 2018 spring forecast, Spain would be at risk of significant deviation from the recommended adjustment path towards its MTO in 2019. Moreover, in 2019, Spain would not progress towards compliance with the debt criterion either.

In addition, in August 2016, the Council required Spain to take measures to improve its fiscal and public procurement policy frameworks. However, the Stability Programme does not report plans to improve its fiscal policy framework. Spain has made progress with the adoption of a new law on public sector contracts in November 2017. Nevertheless, the new legislation can only improve the efficiency and transparency of public procurement if it is swiftly and ambitiously implemented by setting up the new governance structure and enhancing control mechanisms of procurement procedures at all levels of government.

8. ANNEXES

Table I. Macroeconomic indicators

	2000-2004	2005-2009	2010-2014	2015	2016	2017	2018	2019
Core indicators								
GDP growth rate	3.7	1.8	-0.8	3.4	3.3	3.1	2.9	2.4
Output gap ¹	3.0	1.3	-7.0	-4.7	-2.2	-0.2	1.4	2.3
HICP (annual % change)	3.2	2.7	1.8	-0.6	-0.3	2.0	1.4	1.4
Domestic demand (annual % change) ²	4.2	1.6	-2.0	4.0	2.6	2.9	2.7	2.2
Unemployment rate (% of labour force) ³	11.3	11.0	23.3	22.1	19.6	17.2	15.3	13.8
Gross fixed capital formation (% of GDP)	27.0	29.1	20.5	19.8	20.0	20.6	21.2	21.6
Gross national saving (% of GDP)	23.0	21.4	19.7	21.4	22.4	22.9	23.2	23.8
General Government (% of GDP)								
Net lending (+) or net borrowing (-)	-0.5	-2.0	-8.5	-5.3	-4.5	-3.1	-2.6	-1.9
Gross debt	51.3	41.8	82.2	99.4	99.0	98.3	97.6	95.9
Net financial assets	-38.5	-24.7	-59.4	-81.0	-82.7	-81.4	na	na
Total revenue	38.2	38.5	37.5	38.5	37.7	37.9	38.1	38.1
Total expenditure	38.6	40.5	46.0	43.8	42.2	41.0	40.7	40.0
<i>of which: Interest</i>	2.6	1.6	2.9	3.1	2.8	2.6	2.4	2.4
Corporations (% of GDP)								
Net lending (+) or net borrowing (-)	-3.1	-3.1	5.3	4.7	5.1	5.4	5.1	4.7
Net financial assets; non-financial corporations	-101.8	-137.1	-131.8	-126.6	-121.0	-116.5	na	na
Net financial assets; financial corporations	2.9	4.3	8.0	-1.1	0.9	-1.6	na	na
Gross capital formation	15.4	16.2	13.7	14.7	15.3	15.4	15.5	16.0
Gross operating surplus	20.2	22.2	23.8	23.9	24.5	24.9	24.8	24.8
Households and NPISH (% of GDP)								
Net lending (+) or net borrowing (-)	0.2	-2.3	2.7	2.3	1.6	-0.3	-0.8	-0.9
Net financial assets	95.4	83.5	91.9	118.5	118.3	118.0	na	na
Gross wages and salaries	37.9	38.6	38.5	38.4	38.0	37.7	37.6	37.6
Net property income	4.4	3.5	3.9	4.0	3.7	3.5	3.3	3.3
Current transfers received	19.2	19.3	23.2	22.5	22.0	21.6	21.4	21.1
Gross saving	7.1	5.6	6.2	5.5	4.8	3.5	3.3	3.4
Rest of the world (% of GDP)								
Net lending (+) or net borrowing (-)	-3.4	-7.4	-0.5	1.7	2.1	2.0	1.7	1.9
Net financial assets	42.8	74.6	92.2	91.0	85.4	82.4	na	na
Net exports of goods and services	-2.7	-4.6	1.1	2.3	3.0	2.7	2.4	2.5
Net primary income from the rest of the world	-0.9	-2.0	-0.9	-0.2	0.0	0.0	0.0	0.0
Net capital transactions	0.9	0.5	0.5	0.7	0.2	0.2	0.3	0.3
Tradable sector	46.9	43.0	43.4	43.8	43.9	44.2	na	na
Non tradable sector	43.8	47.9	48.1	46.9	46.8	46.5	na	na
<i>of which: Building and construction sector</i>	9.7	10.2	6.3	5.1	5.1	5.2	na	na
Real effective exchange rate (index, 2000=100)	88.2	100.7	95.4	90.3	89.5	89.7	90.8	90.9
Terms of trade goods and services (index, 2000=100)	96.3	99.6	96.2	95.8	96.2	94.5	93.4	93.3
Market performance of exports (index, 2000=100)	109.1	101.6	104.7	105.7	106.3	106.3	106.1	106.3
Notes:								
¹ The output gap constitutes the gap between the actual and potential gross domestic product at 2005 market prices.								
² The indicator on domestic demand includes stocks.								
³ Unemployed persons are all persons who were not employed, had actively sought work and were ready to begin working immediately or within two weeks. The labour force is the total number of people employed and unemployed. The unemployment rate covers the age group 15-74.								
Source:								
AMECO data, Commission 2018 spring forecast								