Spain

Country note, june 2017

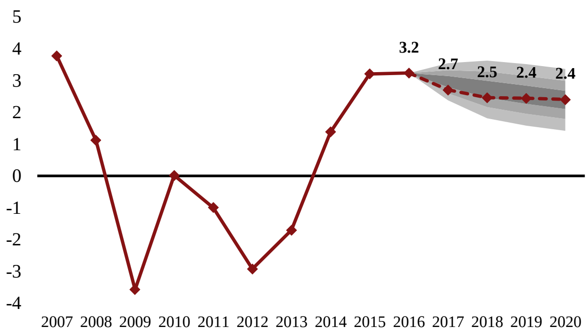
Key messages:

- **The economy keeps growing at high rates**
- **2017 target for the general government is unlikely due to one-off operations and revenue performance uncertainty**
- **2018-2020 headline targets are feasible but less likely in the outer years of the time horizon**
- **Gross debt sustainability requires reductions in the structural deficit**

Macroeconomic outlook

AIReF has endorsed the macroeconomic scenario underlying the Stability Programme Update (SPU) for 2017-2020. It is a likely scenario with upside risks in the short-term (chart 1) since data are confirming the very robust economic growth rates of the beginning of 2017. AIReF considers feasible a sustainable and balanced economic annual growth rate around 2.5%.

Chart 1: economic growth rates 2017-2020 (% change)



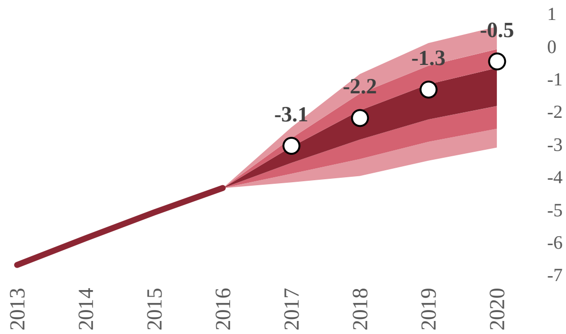
Short-term fiscal outlook

The 2017 target for the general government (3.1 % of GDP) is not likely to be met as a result of the 0.2% of GDP costs to be assumed by the central government to compensate to financially-distressed toll motorways. Excluding this one-off operation the target would become feasible but still very demanding. Revenue performance, in particular direct taxes, is the main source of uncertainty. There is a 64% probability that the level of revenues for the general government would be lower than officially foreseen. AIReF assessment of 2017 targets by subsector (see targets in the table): unlikely for the central government; highly unlikely for the Social Security (already recognized by the government in its March EDP notification); likely for the regions as a whole thanks to additional funding approved in 2017 State Budget although 6 regions exhibit serious risks of non-compliance; the local government subsector will overachieve its balance budget target for 2017 at least consolidating the 2016 surplus.

Medium-term fiscal outlook

The government does not plan reaching the MTO (balance budget in structural terms) by 2020 as stated in the Budgetary Stability Law. Headline deficits for 2018-2020 are feasible but demanding and become less likely in the outer years of the SPU (chart 2). Official expenditure projections are feasible while revenue forecasts are optimistic. The 7 pp reduction of the ratio of gross public debt to GDP foreseen in the SPU exceeds AIReF's central scenario estimates (chart 3); official forecasts for 2020 are optimistic. Gross public debt is sustainable and would converge towards the 60% of GDP target by 2037 provided structural deficit is reduced.

Chart 2: general government balance 2017-2020 (% of GDP)

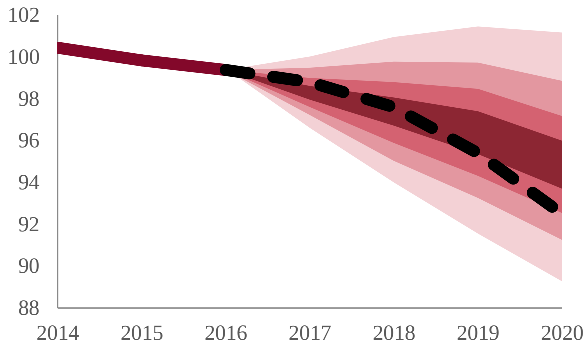


Fiscal framework and national fiscal rules

The lack of reliable fiscal targets is one of the main drawbacks of the current system of fiscal rules hindering its enforcement and credibility. The distribution of the general government targets (vertical and horizontal) needs to take account expenditure needs, adequate funding, and the expenditure rule. The SPU recognizes the public debt target (60% of GDP) will not be met by 2020. Financial stability of the Social Security requires adopting measures within the Toledo Pact. Tax and expenditures measures of the central government need a monthly follow-up and similar prevention and corrective procedures to the ones in place for subnational governments. 3 regions have been recommended to agree a multiyear adjustment plan with MoF while 2 have been recommended to adjust their budgets to take into account risks identified.

Key MoF's indicators-SPU 2017-2020	2016	2017	2018	2019	2020	AIReF's assessment of 2017 targets
Real GDP growth rate (% change)	3,2	2,7	2,5	2,4	2,4	upside risk
Output Gap (% GDP)	-3,3	-1,5	-0,1	1,1	2,1	
GG balance – targets (% GDP)	-4,5	**-3,1**	**-2,2**	**-1,3**	**-0,5**	unlikely
Central Government	-2,7	-1,1	-0,7	-0,3	0,0	unlikely
Regional governments	-0,8	-0,6	-0,3	0,0	0,0	likely
Local governments	0,6	0,0	0,0	0,0	0,0	highly likely
Social Security	-1,6	-1,4	-1,2	-1,0	-0,5	highly unlikely
GG structural balance (% GDP)	-2,5	-2,0	-2,0	-1,9	-1,6	upside risk
GG debt (% GDP)	99,4	**98,8**	**97,6**	**95,4**	**92,5**	optimistic

Chart 3: general government public debt to GDP 2017-2020



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