

Key messages:

- 2017 aggregate fiscal target feasible but with different composition of budgetary items from official forecasts
- After a very dynamic growth in 2017 political uncertainty weighs on 2018 economic and fiscal prospects
- 2018 fiscal target feasible provided short-lived institutional crisis and under the assumption of extension of the State Budget
- General Government gross debt sustainability requires reductions in the structural deficit

Macroeconomic outlook

Upside risks in 2017 government growth forecasts as previously identified by AIReF have materialized. The official scenario underlying the Draft Budgetary Plan for 2018 presents an upward revision of 4 tenths of GDP for 2017 economic growth (3.1%). However, uncertainty linked to the political situation in Catalonia has led to an official downward revision of 2018 economic growth by 2 tenths with respect to the SPU (2.3%). AIReF has endorsed this scenario.

Short-term fiscal outlook

The deficit target for the general government in 2017 (3.1 % of GDP) is considered feasible once the 0.2% of GDP costs to compensate financially-distressed toll motorways are not going to materialize this year. 2018 fiscal outlook is subject to high uncertainty stemming from the political situation in Catalonia and the lack of a State Budget for next year. The deficit target of the General Government (2.2% of GDP) seems feasible (Chart 2) but with a different distribution across subsectors from government targets (see Table). AIReF foresees Local Governments will exhibit a surplus (overachieving the balance target) that will compensate deviations by the Central Government and the Social Security. Provided financial resources to regions are those agreed in July, the target for the regional subsector is feasible with only 3 regions at risk.

Medium-term fiscal outlook

The Government does not plan on reaching the MTO (balance budget) by 2020 as required in the Budgetary Stability Law. Headline deficits for 2018-2020 are feasible but demanding and less likely in the outer years of the SPU. The 7 pp reduction of the ratio of gross public debt to GDP foreseen in the SPU is in line with AIReF's central scenario estimates (chart 3). According to AIReF's central projections, gross public debt is sustainable and would converge towards the 60% of GDP target by 2035, 15 years later than stated in the Budgetary Stability Law. The downward trend in debt dynamics is highly dependent on a continued reduction of the structural deficit.

Fiscal framework and national fiscal rules

The lack of a sound medium-term fiscal plan with reliable fiscal targets for each public administration is one of the main drawbacks of the current domestic fiscal framework. Financial stability of the Social Security requires measures within the Toledo Pact.

Chart 1: economic growth rates 2017-2018 (% change)

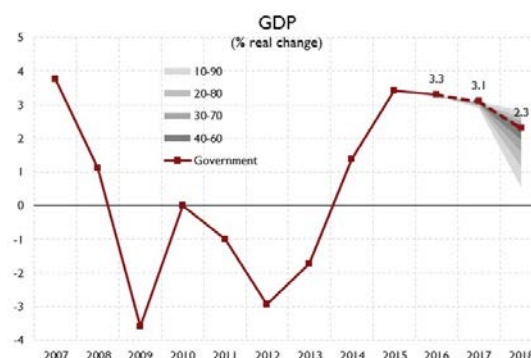


Chart 2: general government balance target 2018 (% of GDP)

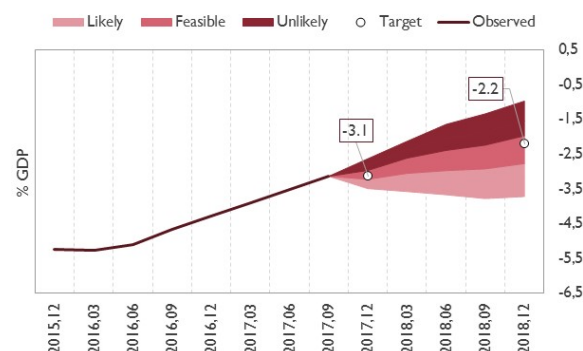
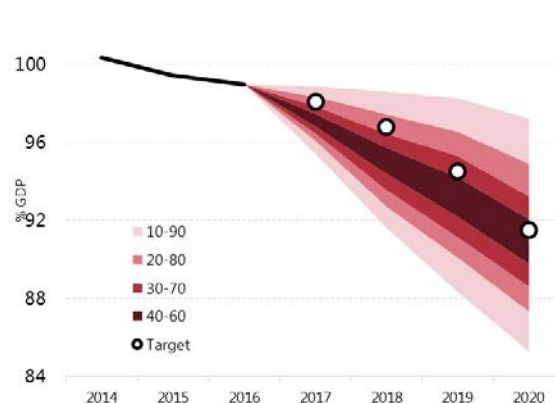


Chart 3: general government public debt to GDP 2017-2020



Key MoF's indicators-DBP 2018	2016	2017	2018	2019	2020	AIReF's assessment of 2018 targets
Real GDP growth (%)	3.3	3.1	2.3	-	-	downside risk
GDP deflator (%)	0.3	1.2	1.6	-	-	likely
Output Gap (% GDP)	-3.1	-0.9	0.5	1.6	2.5	downside risk
GG balance – targets (% GDP)	-4.5	-3.1	-2.2	-1.3	-0.5	feasible
Central Government	-2.7	-1.1	-0.7	-0.3	0.0	unlikely
Regional Governments	-0.8	-0.6	-0.4	-0.1	0.0	feasible
Local Governments	0.6	0.0	0.0	0.0	0.0	very likely
Social Security	-1.6	-1.4	-1.1	-0.9	-0.5	very unlikely
GG structural balance (% GDP)	-2.5	-2.4	-2.3	-2.2	-1.9	downside risk
GG debt (% GDP)	99.0	98.1	96.8	94.5	91.5	likely

Spain

Country note, January 2018

