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COMMISSION OPINION

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on the updated Draft Budgetary Plan of Spain

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GENERAL CONSIDERATIONS

1. Regulation (EU) No 473/2013 sets out provisions for enhanced monitoring of budgetary policies in the euro area to ensure that national budgets are consistent with the economic policy guidance issued in the context of the Stability and Growth Pact (SGP) and the European Semester for economic policy coordination.

2. Article 6 of Regulation (EU) No 473/2013 requires Member States to submit annually to the Commission and to the Eurogroup a Draft Budgetary Plan presenting by 15 October the main aspects of the budgetary situation of the general government and its subsectors for the forthcoming year.

CONSIDERATIONS CONCERNING SPAIN

3. On the basis of the updated Draft Budgetary Plan for 2018 submitted on 30 April 2018 by Spain, the Commission has adopted the following opinion in accordance with Article 7 of Regulation (EU) No 473/2013. The updated Draft Budgetary Plan followed the submission of a 'no-policy change' 2018 Draft Budgetary Plan in October 2017. The updated Draft Budgetary Plan for 2018 and the 2018 Stability Programme were submitted together, with identical macroeconomic and budgetary projections for 2018.

4. The updated Draft Budgetary Plan contains economic and budgetary projections incorporating the measures presented to the Spanish parliament in the draft budget law on 3 April 2018 as well as additional expenditure on pensions (including raising pensions by 1.6% rather than the stipulated minimum revaluation of 0.25% in 2018), only partly funded by extra revenue measures.

5. Spain is currently subject to the corrective arm of the Stability and Growth Pact. The Council opened the Excessive Deficit Procedure (EDP) for Spain on 27 April 2009. 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 has to reduce the general government deficit to 4.6% of GDP in 2016, 3.1% of GDP in 2017 and 2.2% of GDP in 2018. The required adjustment in the general government deficit was considered 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.

6. The updated Draft Budgetary Plan rests on a forecast for real GDP growth of 2.7% in 2018, 0.2 pps lower than the Commission 2018 spring forecast. Lower real growth in the updated Draft Budgetary Plan is accompanied by a higher GDP deflator growth and, therefore, nominal GDP growth is projected to be broadly similar in the two forecasts. Both the updated Draft Budgetary Plan and the Commission forecast project a positive impact on domestic demand from the new planned fiscal measures. The impact is smaller in the Commission forecast as it includes a smaller set of measures. Divergences in the composition of real growth mainly relate to a lower projection for private consumption in the updated Draft Budgetary Plan, despite

higher employment (in persons) and wage growth. By contrast, the updated Draft Budgetary Plan forecasts a slightly higher contribution to growth from investment and net exports (on account of lower import growth) than the Commission forecast. The positive output gap[1] is lower in the updated Draft Budgetary Plan (1.1% of potential output) than in the Commission 2018 spring forecast (1.4%). Overall, the macroeconomic projections underlying the updated Draft Budgetary Plan seem plausible for 2018.

7. Spain complies with the requirement of Regulation EU No 473/2013 that the draft budget has to be based on independently endorsed or produced macroeconomic forecasts. The macroeconomic forecasts underpinning the updated Draft Budgetary Plan have been endorsed by the *Autoridad Independiente de Responsabilidad Fiscal* (AIReF). AIReF estimates the risks related to the external environment as broadly balanced in the short term, but notes that protracted uncertainty related to developments in Catalonia could eventually weigh on Spain's growth outlook.

8. The updated Draft Budgetary Plan targets the general government deficit to narrow to 2.2% of GDP in 2018. This is 0.1 pps lower than in the no-policy change Draft Budgetary Plan, as the upward revision to GDP growth more than compensates for the net deficit-increasing impact of the measures included in the draft 2018 budget bill. The Commission 2018 spring forecast projects a general government deficit of 2.6% of GDP in 2018. This is 0.4 pps higher than the updated Draft Budgetary Plan, reflecting a more cautious view on revenue developments, in particular regarding social contributions, and more dynamic expenditure, especially regarding compensation of employees and other expenditure. However, the Commission forecast does not factor in the additional expenditure on pensions mentioned above, as it was announced after the cut-off date. Its inclusion would have raised the Commission deficit forecast for 2018 by 0.1% of GDP. While the recalculated structural deficit[2] based on the projections in the updated Draft Budgetary Plan narrows by 0.1 % of GDP in 2018, the Commission forecast projects it to widen by 0.3 %, due to the difference in the headline deficit forecast and the different appreciation of one-off measures, in particular in relation to the impact of compensation to distressed motorways. The updated Draft Budgetary Plan projects interest expenditure to continue to decline to 2.4 % of GDP in 2018, in line with the Commission forecast. At the same time, the Draft Budgetary Plan forecasts the primary balance to turn into a small surplus in 2018, for the first time in 11 years, while the Commission forecast still projects a primary deficit.

9. The projection for the gross debt ratio has been revised up by 0.2 % of GDP in 2018 in the updated Draft Budgetary Plan compared with the no-policy change Draft Budgetary Plan. This reflects the combination of a higher starting position, a higher debt-increasing stock-flow adjustment and a lower primary balance more than offsetting lower interest expenditure and faster nominal GDP growth. The ratio is projected to reach 97.0% of GDP in 2018, somewhat lower than in the Commission 2018 spring forecast, mainly due to a higher primary balance in the updated Draft Budgetary Plan.

[1] In percent of potential GDP, with potential GDP growth recalculated by Commission services on the basis of the updated Draft Budgetary Plan for 2018 / 2018 Stability Programme macroeconomic scenario using the commonly agreed methodology.

[2] Cyclically adjusted balance net of one-off and temporary measures, recalculated by the Commission using the commonly agreed methodology.

10. The main risks to budgetary targets and debt projections in the updated Draft Budgetary Plan 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. Although the Draft Budgetary Plan 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 and the cancellation of the Aigües Ter Llobregat water concession in Catalonia, constitute a risk.

11. The updated Draft Budgetary Plan reports the following main deficit-increasing measures: i) personal income tax cuts for low income households, ii) the reduction in the VAT tax rate on movie theatre tickets, iii) the increase of pensions above the statutory minimum revaluation of 0.25% and for selected pension categories, as well as iv) hikes in public servants' wages. The projections in the Draft Budgetary Plan also include 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. The reported net overall impact from all fiscal policy measures (i.e. planned and adopted) is deficit-increasing in 2018 and, to a lesser extent, also in 2019. The Commission forecast incorporates a less negative net budgetary impact from fiscal policy measures in 2018, mainly due to the fact that it does not include the above-mentioned additional increases in public pensions.

12. After achieving the headline deficit target of 3.1 % of GDP required by the Council decision of August 2016, the target of 2.2 % of GDP for 2018 is not expected to be met, according to the Commission 2018 spring forecast. Still, at 2.6 % of GDP, the headline deficit is forecast to be below the Treaty reference value of 3.0%. The Council decision requires Spain to improve the structural balance by 0.5 pps in 2018. Instead, the Commission 2018 spring forecast projects a widening of the structural deficit in 2018 by 0.3 pps. 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 pps. On a cumulative basis over 2016-2018, the estimated shortfall amounts to 1.5% of GDP when measured against the unadjusted change in the structural balance, and to 1.2% of GDP when adjusted. The bottom-up estimate of the fiscal effort falls short of the requirement by 0.8% of GDP over 2016-2018.

13. In August 2016, the Council also requested Spain to take measures to improve its fiscal framework, by increasing the automaticity of mechanisms to prevent and correct deviations from the fiscal targets and strengthening the contribution of the Stability Law's spending rule to fiscal consolidation. The 2018 Draft Budgetary Plan does not report plans in these areas. The Council also requested Spain to take measures to improve its public procurement policy framework. Spain has made progress with the adoption of a new law on public sector contracts in November 2017. 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. In particular, the forthcoming National Public Procurement Strategy should specify the ex-ante and ex-post controls to be carried out by the new structure. Lastly, in June 2017, the government commissioned AIReF to carry out a spending review on selected public sector subsidies. The review is expected to be completed by early 2019.

14. Overall, the Commission is of the opinion that the updated Draft Budgetary Plan of Spain, which is currently under the corrective arm of the SGP, is broadly compliant with the provisions of the SGP, as the Commission 2018 spring forecast projects that the excessive deficit will be corrected in a timely manner. However, the Commission forecast projects that in 2018 neither the headline deficit target nor the required fiscal effort set by the Council notice will be met. On the contrary, the updated Draft Budgetary Plan is expansionary, while the Spanish economy is growing above its potential growth rate. The Commission invites the authorities to stand ready to take further measures within the national budgetary process to ensure that the 2018 budget is compliant with the SGP.

The Commission is also of the opinion that Spain has made some progress with regard to the structural part of the Council notice of 8 August 2016 and the fiscal recommendations issued by the Council in the context of the 2017 European Semester, calling for a strengthening of Spain's fiscal and public procurement policy frameworks. The Commission invites the authorities to make further progress.

Done at Brussels, 23.5.2018

For the Commission
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