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Assessment of the 2019-22 Stability Programme for

Spain

(Note prepared by DG ECFIN staff)

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CONTENTS

EXECUTIVE SUMMARY

Spain has been subject to the corrective arm of the SGP since 27 April 2009. Following the timely and durable correction of the excessive deficit, and pending the Council Decision abrogating Decision 2009/417/EC on the existence of an excessive deficit in Spain, as recommended by the Commission, in 2019 Spain will have become subject to the preventive arm of the Stability and Growth Pact. Since Spain's public debt is above the 60% of GDP reference value of the Treaty, Spain will also have become subject to the transitional arrangements as regards compliance with the debt reduction benchmark.

The expansion of the Spanish economy is maturing. Real GDP growth is slowing down somewhat, but is still expected to continue recording an above-potential rate of 2.1% in 2019 and 1.9% in 2020. GDP growth is supported by domestic demand, which, however, is on a decelerating path due to private consumption and investment activity slowing down. When compared with the Commission 2019 spring forecast, the programme projects only marginally faster GDP growth in 2019. In 2020, it projects somewhat faster wage growth than the Commission forecast, leading to a faster expansion of tax bases. Overall, the macroeconomic projections underpinning the Stability Programme appear plausible for the period 2019-2022.

The general government deficit declined to 2.5% of GDP in 2018, thereby falling below the 3% of GDP reference value. The Stability Programme plans the deficit to reach 2.0% of GDP in 2019 before falling to 1.1% in 2020. This corresponds to an almost unchanged (recalculated) structural balance in 2019 compared to 2018 and a 0.7% of GDP improvement in 2020. This is the result of a fiscal strategy based on increasing the revenue ratio, with a package of tax measures planned for 2020. The main risks to budgetary targets in the Stability Programme stem from the revenue side, where, in 2019, direct taxes and social contributions may not reach the planned levels and, in 2020, the planned package of revenue-increasing measures, if adopted and implemented, may not yield the projected amount.

Based on the Commission forecast, Spain is at risk of significant deviation from the adjustment path towards the MTO both in 2019 and in 2020. In addition, in none of the two years would sufficient progress towards compliance with the debt reduction benchmark be ensured.

1. INTRODUCTION

On 30 April 2019, Spain submitted its 2019 Stability Programme, covering the period 2019-2022.

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. Following the timely and durable correction of the excessive deficit, and pending the Council Decision abrogating Decision 2009/417/EC on the existence of an excessive deficit in Spain, as recommended by the Commission, in 2019 Spain will have become subject to the preventive arm of the Stability and Growth Pact. Spain should therefore ensure sufficient progress towards its medium-term budgetary objective (MTO). As the debt ratio in 2018, at 97.1% of GDP, exceeded the Treaty 60%-of-GDP reference value, and as Spain was already in EDP when the Six Pack amendments to the SGP were adopted (8 November 2011), Spain will also have become subject to the transitional arrangements as regards compliance with the debt reduction benchmark. During the three years following the correction of the excessive deficit, Spain should thus make sufficient progress towards compliance with the debt reduction benchmark.

This document complements the Country Report published on 27 February 2019 and updates it with the information included in the Stability Programme.

Section 2 presents the macroeconomic outlook underlying the Stability Programme and provides an assessment based on the Commission 2019 spring forecast. The following section presents the recent and planned budgetary developments, according to the Stability Programme. In particular, it includes an overview on the medium term budgetary plans, an assessment of the measures underpinning the Stability Programme and a risk analysis of the budgetary plans based on Commission forecast. Section 4 assesses compliance with the rules of the SGP, including on the basis of the Commission forecast. Since Spain is flagged by the plausibility tool, this section includes a box on the application of constrained judgement. Section 5 provides an overview on long-term sustainability risks and Section 6 on recent developments and plans regarding the fiscal framework. Section 7 provides a summary.

2. MACROECONOMIC DEVELOPMENTS

In 2018, real GDP growth was 2.6%, 0.4 percentage points lower than in the previous year. The Stability Programme projects a gradual slowdown of economic activity as the economic cycle reaches a more mature stage. Real GDP growth is set to decelerate to 2.2% in 2019 and 1.9% in 2020, before levelling off at 1.8%, the potential growth estimate according to the programme, in 2021-2022. GDP growth is supported by domestic demand, which is on a decelerating path due to private consumption slowing down, as households increase their savings rate, and a decrease of investment growth. Net exports are projected to provide a less negative contribution to growth in 2019 relative to 2018, and a neutral one in the following years of the projection horizon.

Compared to the 2019 Draft Budgetary Plan (DBP) submitted in October 2018, the growth forecast for 2019 is lower in the Stability Programme, by 0.1 percentage point. A weaker-than-expected export performance in 2018 is carried over to 2019 with export markets growing less than assumed in the DBP. The forecast of private consumption growth remains unchanged and so does domestic demand, though gross capital formation growth has been revised downward 0.4 percentage points in the programme.

The Commission 2019 spring forecast projects lower real GDP growth in 2019 than the Stability Programme (by 0.1 percentage point, at 2.1%) and the same rate of growth in 2020. However, the flash estimate of GDP growth for the 1st quarter 2019, released on 30 April (that is, after the final storage of the forecast), posted a better than expected growth rate (0.7% quarter-on-quarter, 0.1 percentage point above Commission forecast). Leaving the remaining quarters of the year unchanged, this would bring the real GDP growth forecast to 2.2% for 2019 as a whole, as in the Stability Programme. Nominal GDP growth is also projected to be broadly similar in 2019-20 since both forecasts of GDP deflator growth are equal. In terms of composition, the Stability Programme projects higher growth of gross fixed capital formation than the Commission forecast. The main difference between both forecasts refers to wage growth in 2020, which is 0.4 percentage points higher in the programme than in Commission projection.[1] This leads to a somewhat higher tax base for personal income tax and social contributions for 2020 in the Stability Programme.

Both macroeconomic scenarios imply a positive output gap starting from 2018. The output gap as recalculated by Commission based on the information in the programme, following the common agreed methodology, is projected to increase more slowly than the one in the Commission forecast, owing to a higher potential growth in the former. However, the programme also argues, in a dedicated box, that the uncertainty surrounding estimates of the output gap is particularly large for Spain, something that the plausibility tool developed by the Commission in consultation with Member States seems to support. The analysis based on the constrained judgement approach can be found in box 2 in section 4.

Overall, the macroeconomic projections underpinning the Stability Programme are broadly in line with the Commission 2019 spring forecast in 2019-2020 and appear overall plausible for the period 2019-2022. They were endorsed on 25 of April by Spain's independent fiscal institution (AIReF) (see section 6). AIReF deems the programme’s macroeconomic scenario as "prudent".

[1] Though the projections for employment in headcount terms, shown in Table 1, are also rather different in 2020, those in full-time equivalent terms are broadly similar.

Table 1: Comparison of macroeconomic developments and forecasts

	2018		2019		2020		2021	2022
	COM	SP	COM	SP	COM	SP	SP	SP
Real GDP (% change)	2.6	2.6	2.1	2.2	1.9	1.9	1.8	1.8
Private consumption (% change)	2.3	2.3	1.9	1.9	1.6	1.6	1.5	1.4
Gross fixed capital formation (% change)	5.3	5.3	3.6	4.0	2.9	3.5	3.3	3.1
Exports of goods and services (% change)	2.3	2.3	2.3	2.7	2.9	2.8	2.7	2.6
Imports of goods and services (% change)	3.5	3.5	2.7	3.1	3.0	2.9	2.8	2.7
Contributions to real GDP growth:								
- Final domestic demand	2.8	2.8	2.2	2.3	1.8	1.9	1.8	1.8
- 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	-0.1	-0.1	0.0	0.0	0.0	0.0
Output gap[1]	0.9	0.8	1.6	1.4	2.0	1.6	1.9	2.2
Employment (% change)	2.1	2.1	2.0	2.0	1.5	1.9	1.8	1.7
Unemployment rate (%)	15.3	15.3	13.5	13.8	12.2	12.3	11.0	9.9
Labour productivity (% change)	0.1	0.1	0.1	0.1	0.2	0.1	0.1	0.1
HICP inflation (%)	1.7		1.1		1.4			
GDP deflator (% change)	1.0	1.0	1.6	1.6	1.7	1.7	1.8	1.7
Comp. of employees / f.t.e. employment (% change)	0.8	0.8	2.0	2.1	1.8	2.2	2.3	2.3
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	1.5	1.5	1.5	1.2	1.6	1.1	1.1	1.0

Note:

[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.

Source :

Commission 2019 spring forecast (COM); Stability Programme (SP).

3. RECENT AND PLANNED BUDGETARY DEVELOPMENTS

3.1. Deficit developments in 2018 and 2019

Driven by the continued cyclical improvement of the economy and lower interest expenditure, the general government deficit shrank from 3.1% of GDP in 2017 to 2.5% of GDP in 2018. This is 0.3 percentage points above the deficit target required by the Council notice of August 2016, but below the 3% of GDP reference value. Compared with the projections in the 2019 DBP submitted in October 2018, the 2018 deficit turned out 0.2 percentage points lower. In particular, the revenue ratio turned out 0.3 percentage point higher, at 38.9% of GDP, which was only partly offset by a 0.1 percentage point higher expenditure ratio, at 41.3% of GDP. On the revenue side, both corporate income tax revenues and other revenues surprised on the upside, whereas on the expenditure side compensation of employees turned out a bit higher. Capital transfers were also affected by the payback of taxes on maternity benefits (see Section 3.3), which was not included in the 2019 DBP.

For 2019, the Stability Programme projects the general government deficit to narrow to 2.0% of GDP, mainly reflecting the continued cyclical upswing. The projection includes the incremental impact of measures adopted in 2018, such as the tax cut for low-income earners, pay hikes for public sector employees and a number of measures regarding pensions and social contributions that were adopted through Royal Decree Law in December 2018 (see

Section 3.3). The deficit reduction in 2019 is driven by a 0.2 percentage point increase in the revenue ratio, which reaches 39.1% of GDP, and a decrease of a similar magnitude in the expenditure ratio, to 41.1% of GDP. While the former is entirely driven by an increase in social contributions, reflecting strong employment growth, the impact of the minimum wage increase and other base broadening measures, the expenditure ratio is decreasing mainly as a result of positive cyclical conditions and declines in interest expenditure, capital transfers and gross fixed capital formation (partly because of the non-recurrence of temporary factors from 2018, such as the take-over by the state of distressed motorways).

The 2019 DBP targeted the deficit to narrow by 0.9 percentage points, from 2.7% of GDP in 2018 to 1.8% of GDP in 2019, based on a package of measures with net deficit-reducing impact that were then included in the 2019 draft budget bill, which was presented to parliament in January 2019 but subsequently rejected. It was based on the revenue ratio rising by 0.6% of GDP, while the expenditure ratio was expected to decline by 0.3% of GDP. Despite the budget bill being rejected, the targeted deficit for 2019 of the Stability Programme is only 0.2 percentage points above that of the 2019 DBP, thanks to a better starting position and the impact of the social contribution measures included in the Royal Decree Law of December 2018 (but not in the 2019 DBP). The structural balance is estimated to have been stable in 2018, while the recalculated structural balance based on the programme would deteriorate slightly in 2019.

3.2. Medium-term strategy and targets

The medium-term strategy presented in the programme aims at balancing the general government budgetary position by the end of the programme period, with intermediate targets of 1.1% of GDP for 2020 and 0.4% of GDP for 2021. The new targets are to be achieved by increasing revenue from 38.9% of GDP in 2018 to 40.7% of GDP by the end of the programme period, while expenditure would decrease somewhat, from 41.3% of GDP to 40.7% over the same period. To reach the revenue targets, the programme relies on tax measures in 2020 and a tax-rich composition of growth, while the reduction in the expenditure-to-GDP ratio is supported by economic growth above potential growth.

For 2020, the programme includes the tax measures that were put forward in the rejected draft 2019 budget bill. The authorities expect they will yield EUR 5.6 billion (around 0.5% of GDP). The programme targets also rely on the implementation of recommendations from the spending reviews commissioned to AIReF in 2018 and 2019 (see section 3.3 and 6). The only expenditure category expected to grow at a faster pace than nominal GDP is social transfers other than in kind, mostly reflecting the expected evolution of pension expenditure.

The fiscal strategy presented in the programme translates into a narrowing structural deficit. Recalculated by the Commission on the basis of the information in the programme according to the commonly agreed methodology, the structural balance improves by 0.7, 0.5 and 0.3 percentage points, respectively, in 2020-2022, resulting in a cumulative improvement of 1.4 percentage points over the programme period. The programme confirms the medium-term budgetary objective (MTO) of Spain to be a balanced budget in structural terms. This is more stringent than required by the Pact, but it is not planned to be met over the years covered by the programme.

Table 2: Composition of the budgetary adjustment

(% of GDP)	2018	2019		2020		2021	2022	Change: 2018-2022
	COM	COM	SP	COM	SP	SP	SP	SP
Revenue	**38.9**	**38.9**	**39.1**	**38.9**	**39.8**	**40.3**	**40.7**	**1.8**
of which:								
- Taxes on production and imports	11.7	11.8	11.6	11.7	11.8	11.8	11.8	0.1
- Current taxes on income, wealth, etc.	10.7	10.6	10.7	10.7	11.2	11.6	11.9	1.2
- Social contributions	12.4	12.5	12.7	12.5	12.8	12.9	13.0	0.6
- Other (residual)	4.0	4.0	4.0	4.0	4.0	3.9	3.9	-0.1
Expenditure	**41.3**	**41.2**	**41.1**	**41.0**	**41.0**	**40.7**	**40.7**	**-0.7**
of which:								
- Primary expenditure	38.9	38.9	38.7	38.8	38.7	38.5	38.5	-0.4
of which:								
Compensation of employees	10.5	10.5	10.5	10.5	10.5	10.4	10.4	-0.1
Intermediate consumption	5.0	5.0	5.0	4.9	5.0	4.9	4.9	-0.1
Social payments	17.9	18.1	18.0	18.2	18.1	18.1	18.1	0.3
Subsidies	1.0	1.0	1.0	1.0	0.9	0.9	0.9	-0.1
Gross fixed capital formation	2.1	2.1	2.0	2.1	2.0	2.0	2.1	0.0
Other (residual)	2.4	2.3	2.3	2.1	2.2	2.1	2.1	-0.3
- Interest expenditure	2.5	2.3	2.4	2.1	2.3	2.2	2.2	-0.3
General government balance (GGB)	**-2.5**	**-2.3**	**-2.0**	**-2.0**	**-1.1**	**-0.4**	**0.0**	**2.5**
Primary balance	**0.0**	**0.0**	**0.3**	**0.1**	**1.2**	**1.8**	**2.1**	**2.2**
One-off and other temporary	-0.3	-0.3	-0.2	0.0	0.0	0.0	-0.1	0.2
GGB excl. one-offs	**-2.2**	**-2.0**	**-1.9**	**-2.0**	**-1.1**	**-0.4**	**0.0**	**2.2**
Output gap[1]	0.9	1.6	1.4	2.0	1.6	1.9	2.2	1.4
Cyclically-adjusted balance[1]	-3.0	-3.3	-2.9	-3.2	-2.1	-1.6	-1.3	1.6
Structural balance[2]	**-2.7**	**-2.9**	**-2.7**	**-3.2**	**-2.1**	**-1.6**	**-1.3**	**1.4**
Structural primary balance[2]	-0.2	-0.7	-0.4	-1.1	0.2	0.6	0.9	1.1

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.

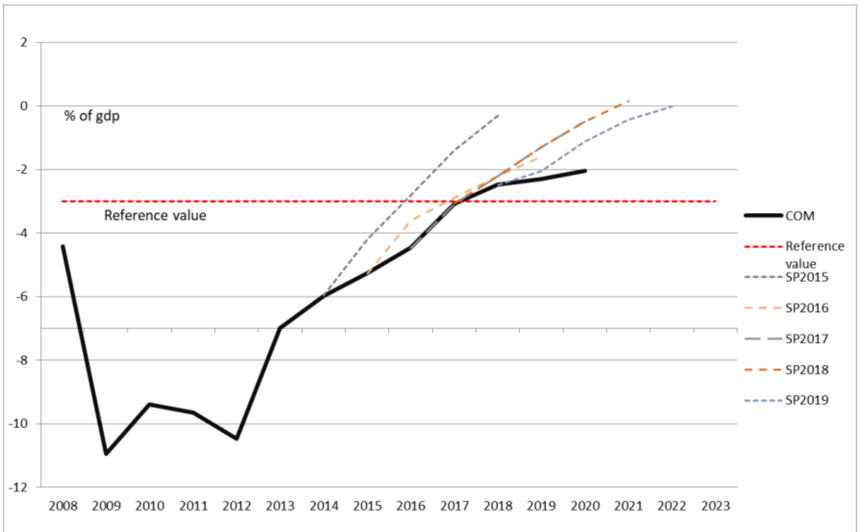
Source :

Stability Programme (SP); Commission 2019 spring forecasts (COM); Commission calculations.

The budgetary targets presented in the programme have not yet been formally endorsed by the parliament. They are supported by measures up until 2020, although the chances of some measures to be adopted by parliament in that year and their budgetary impact are as yet uncertain (see Section 3.5). The budgetary targets for 2021-2022 are not yet underpinned by specified measures.

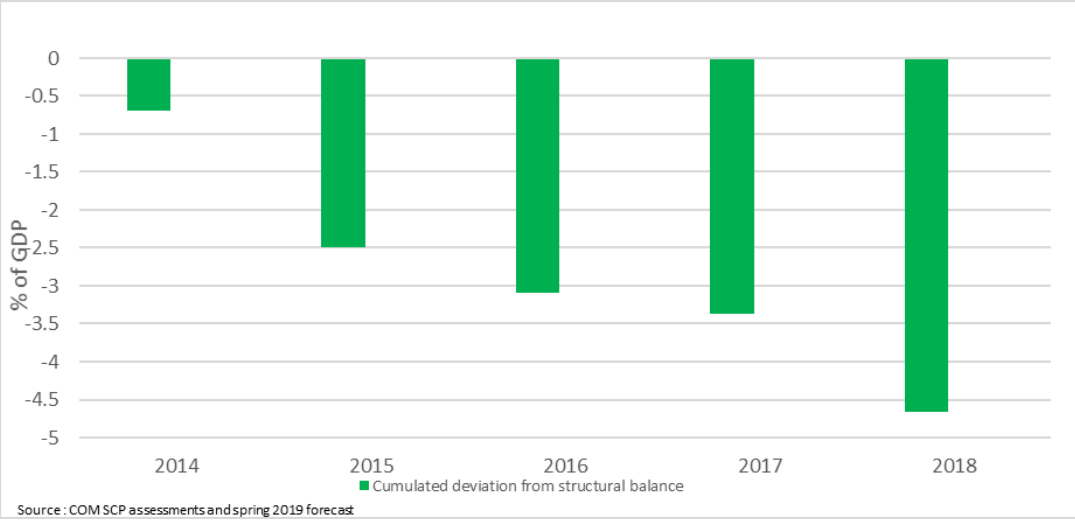
The 2018 Stability Programme set deficit targets for the three years 2019-2021 that were significantly lower than the ones presented in the current Stability Programme. However, starting from a higher deficit projection in 2019, the targets for 2020 and 2021 imply a deficit reduction of broadly the same magnitude as the corresponding targets of the 2018 Stability Programme (See Figure 1 below).

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



Source: Commission 2019 Spring Forecast. Stability and convergence programmes

Figure 2: Cumulative deviations of the preceding five years from structural effort requirements (in % of GDP)



In 2014-2015, Spain's structural adjustment fell short of the targets laid down in the 2013 EDP recommendation valid at that point in time. As Spain also missed the headline deficit target for 2015, this led to Spain being found, in 2016, not to have delivered effective action in response to the Council recommendation of 21 June 2013 and a new adjustment path for the years 2016-18 was addressed to Spain through the August 2016 notice. In 2016 and 2017, Spain did not deliver the requested improvement of the structural balance, but met the interim headline deficit targets. In 2018, Spain met neither the headline deficit nor the structural effort target, but brought the government deficit below 3% of GDP, necessary to exit the corrective arm of the SGP. Figure 2 shows the cumulated gap between the structural effort delivered and the one recommended/required.[2]

3.3. Measures underpinning the programme

The Stability Programme builds on the measures already reported in last year's Stability Programme, the 2019 DBP and the draft budget law. However, with the rejection by Parliament of the latter, only a sub-set of the planned social expenditure and revenue measures are being implemented in 2019, following adoption through separate urgent legislative procedure (in end December 2018 and during the first quarter of 2019). The Stability Programme assumes that most of the tax measures put forward in the draft 2019 budget law will be implemented in 2020.

For 2018, the Stability Programme reports and describes several measures adopted since mid-2018, but does not always recall their budgetary impact.

[2] As the time period covered by the graph includes, in the case of Spain, two different EDP adjustment paths (one for the 2013-16 period, another for the 2016-18 period), a cumulation of the yearly implementation gaps may to some extent overstate the slippage. On the other hand, the fact that there have been revenue windfalls in recent years (artificially improving the structural balance), works in the opposite direction.

For 2019, the Stability Programme mainly reports on new revenue and expenditure measures affecting the social security fund. The main measures are described below:

- Increases in pension expenditure (0.2% of GDP), namely: (i) increase of pensions by 1.6% in 2019, above the statutory minimum revaluation of 0.25%, (ii) increase in minimum and non-contributory pensions by 3% (iii) increase of the survivor pensions' regulatory base by 4 percentage points and (iv) compensation for the 2018 consumer price inflation being above its forecast (gap of 0.1%).

- Increases in social expenditure (0.1% of GDP): child care support for low income families, increased coverage and protection of the long term unemployed aged 52 or more, and gradual alignment of the conditions for paternity leave to those applying for maternity leave (5 to 8 weeks in 2019, up to 12 weeks in 2020 and to 16 weeks in 2021).

- Increase in social security revenues (0.3% of GDP) originating mainly from: (i) the 2019 increase in the minimum wage, (ii) a 7% hike of the maximum contribution base for social security contributions and (iii) a gradual increase of the minimum contribution base for sickness and accident at work for all employees and the self-employed. For the self-employed, the contribution is made compulsory for all types of contingencies (cessation of activity, accident and sickness at work etc.).

At regional level, the main budgetary measures in the Stability Programme in 2019 include the sale of assets and the increase of the regional tax rate on hydrocarbon to the maximum tax rate in more regions (both amounting to 0.1% of GDP of additional revenues). At local level, about EUR 1410 million of expenditures (such as increase in compensation of employees, intermediate consumption and others) and EUR 1417 million of revenues (indirect and direct taxes) are reported in the Stability Programme, balancing each other.

For 2020, new measures reported and quantified in the Stability Programme consist of the following:

- Changes in the corporate income tax by: (i) taxing (in part) subsidiaries' dividends and capital gains generated abroad and setting a minimum tax rate on large companies' taxable base (0.1% of GDP) while (ii) reducing the corporate income tax rate for SMEs (0.02% of GDP).

- Creation of a tax on financial transactions (0.1% of GDP), which levies 0.2% on the value of acquisitions of shares of large Spanish companies.

- Creation of a tax on revenues from digital activities (0.1% of GDP), which is levied on the revenues from online advertisement services, online intermediation services and the sale of user data.

- New legislative measures to fight tax fraud (0.1% of GDP), which mainly consist of publishing the identity of tax payers in arrears vis-a-vis the tax authorities, further restricting the use of cash payments between companies and consumers, and strengthening the capacity of the tax authority to oversee the tax declarations of high net worth individuals.

- Annual savings from the spending review on hiring incentives, estimated at 0.04% of GDP, though the review has only been just launched.

- Others (0.1% of GDP), such as: (i) increases in taxation on diesel oil for non-professional consumers, (ii) increases in the personal income tax rate on the incomes and savings of high wage earners, (iii) increases in the wealth tax rate for tax payers with net assets exceeding EUR 10 million, and (iv) reductions in VAT for veterinary services, for female hygiene products and for e-books.

The Stability Programme reports one-offs expenditures amounting to 0.3% of GDP in 2018 and 0.2% of GDP in 2019. In 2018, the programme includes the compensation to bankrupt motorways, the exemption in personal income tax for maternity or paternity benefits following the court ruling in 2018, diverse court rulings affecting regional governments, further repayments of the 2012-2014 Christmas bonus to public employees and financial sector support. For 2019, the information provided in the Stability Programme is less detailed. It reports additional claims for the exemption of personal income tax for maternity or paternity benefits and interest payments. Additional interest payments treated as a one-off is also mentioned for 2022 without quantification.

Overall, the Stability Programme does not provide a detailed overview and quantification of all the measures having an effect on the general government balance, which is inconsistent with the guidelines laid down in the Code of Conduct. The programme does not either make a distinction between direct impact of the measures and second round effects. All this prevent making a direct comparison between the net impact of all fiscal policy measures reported in the Stability Programme and those included in the Commission 2019 spring forecast (amounting to -0.2% of GDP in 2019 and +0.3% in 2020).

The main differences between the Stability Programme and the Commission spring forecast are the following:

- The Commission forecast includes a slightly higher amount of one-off expenditures in 2019 (0.3% of GDP) than reported in the Stability Programme. On top of the exemption for maternity or paternity benefits mentioned in the Stability Programme, the Commission forecast includes compensation claims due to the elimination of the tax on the retail sales of selected hydrocarbons, commonly referred to as *céntimo sanitario*, the reversion of the asset following the annulment of the water company (Aigües Ter Llobregat) concession, the guarantee call under the asset protection scheme, and an estimate of eligible differed tax assets in the banking sector (linked to the resolution of Banco Popular).

- The Commission forecast only treats as a measure the additional social security contributions originating from the automatic increase in the minimum contributory base (assumed to be EUR 750 million) while the additional social contributions paid by minimum wage earners are treated as a second round effect.

- The Commission forecast does not include the tax measures that the programme includes in 2020 (with an expected yield at around 0.5% of GDP), as they were announced by the caretaker government after the cut-off date of the forecast.

Main budgetary measures included in the Programme

Revenue	Expenditure
2018	
	• Differed tax assets (0.1% of GDP) • Exemption in personal income taxes (0.1% of GDP) • Investments / capital transfers related to bankrupt motorway companies (0.15% of GDP)
2019	
• Increase in social security contributions (0.3% of GDP) • Local level: increase of direct and indirect taxes (0.1% of GDP) • Regional level: sale of assets and hydrocarbon tax (0.1% of GDP)	• Pension expenditure increases (0.2% of GDP) • Social policies (0.1% of GDP) • Local level expenditures (0.1% of GDP)
2020	
• Corporate income tax (0.1% of GDP) • Tax on financial transactions (0.1% of GDP) • Tax on revenue from digital activities (0.1% of GDP) • Fight against tax fraud (0.1% of GDP) • Social security contribution (0.04% of GDP) • Others (0.1% of GDP)	

Note: The table refers to the main measures included in the 2019 Stability Programme that have an incremental budgetary impact over the programme period. 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.

3.4. Debt developments

According to the programme, the gross general government debt-to-GDP ratio is expected to decrease by about 8.4 percentage points over the programme period, to reach 88.7% of GDP in 2022. The pace of debt reduction is expected to accelerate throughout the period, as the debt-reducing impact of continued robust nominal GDP growth combines with that of a gradually increasing primary surplus to more than offsett the interest burden. The stock-flow adjustment is planned to have a debt-increasing impact of about 0.4 percentage points on average per year over the programme horizon. The programme does not specify where these adjustments would stem from.

As shown in Figure 3, the debt projections in recent programme updates have been relatively accurate. The debt ratio in 2018 was only about 0.1% of GDP higher than projected in the 2018 Stability Programme, as nominal growth continued surprising on the upside and stock-flow adjustments on the downside, almost compensating for slippages on the targeted headline deficit.

Table 3: Debt developments

(% of GDP)	Average 2013-2017	2018	2019		2020		2021	2022
			COM	SP	COM	SP	SP	SP
Gross debt ratio[1]	**98.4**	**97.1**	**96.3**	**95.8**	**95.7**	**94.0**	**91.4**	**88.7**
Change in the ratio	2.5	-1.0	-0.8	-1.2	-0.6	-1.9	-2.5	-2.7
Contributions[2]:								
1. Primary balance	**2.1**	**0.0**	**0.0**	**-0.3**	**-0.1**	**-1.2**	**-1.8**	**-2.1**
2. "Snow-ball" effect	**0.8**	**-0.9**	**-1.1**	**-1.2**	**-1.2**	**-1.1**	**-1.1**	**-0.9**
Of which:								
Interest expenditure	3.1	2.5	2.3	2.4	2.1	2.3	2.2	2.2
Growth effect	-1.8	-2.4	-2.0	-2.1	-1.7	-1.8	-1.7	-1.6
Inflation effect	-0.4	-0.9	-1.5	-1.5	-1.6	-1.5	-1.6	-1.5
3. Stock-flow adjustment	**-0.4**	**-0.1**	**0.3**	**0.3**	**0.7**	**0.4**	**0.4**	**0.4**

Notes:

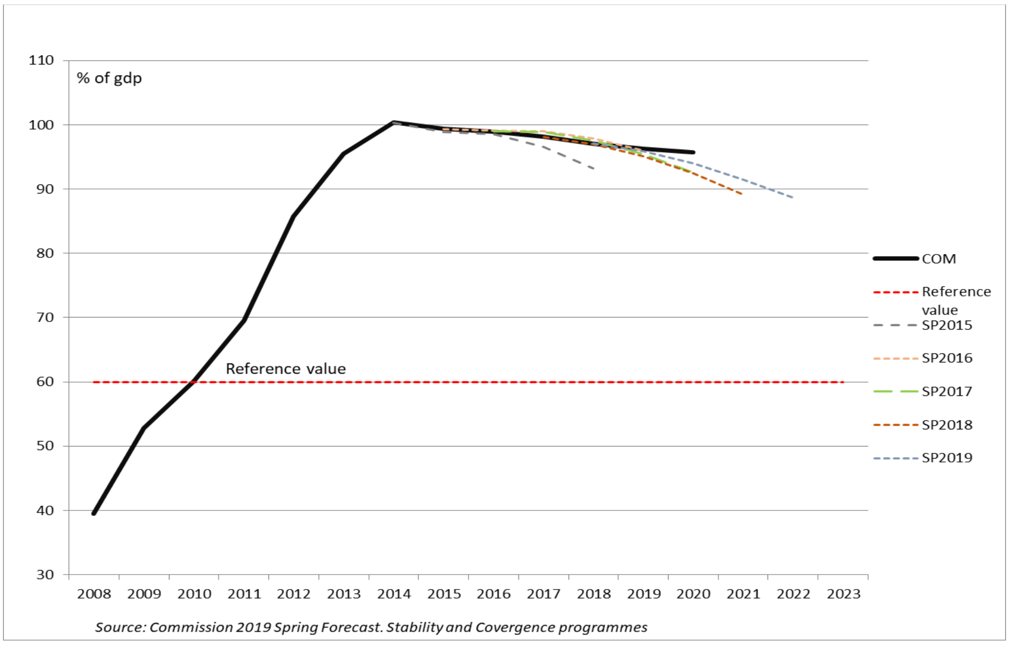
[1] End of period.

[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 2019 spring forecast (COM); Stability Programme (SP), Comission calculations.

Figure 3: 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 from the revenue side, where, in 2019, direct taxes and social contributions may not reach the planned levels and, in 2020, the planned package of revenue-increasing measures remains to be adopted and, once implemented, may not yield the planned amount. As the general elections on 28 April 2019 did not result in a clear-cut majority for the governing party, the likelihood of those tax measures being adopted is uncertain. On the expenditure side, social payments, subsidies and gross fixed capital formation may turn out slightly higher, partly due to uncertainty around the timing of the savings that can be achieved from implementing the recommendations of the spending reviews of AIReF. At the same time, the projections regarding interest expenditure presented in the Stability Programme look conservative, in particular in view of recent outturn data for the first three months of 2019. This risk assessment is based on the Commission 2019 spring forecast projecting a general government deficit of 2.3% of GDP and 2.0% of GDP in 2019 and 2020 respectively, 0.3 and 0.9 percentage points higher than the Stability Programme in the two respective years.

The Commission forecast for 2019 is affected by a number of deficit-increasing temporary measures of a one-off character. All in all, they amount to 0.3% of GDP, which is slightly higher than the 0.2% of GDP reported in the Stability Programme. The programme does not give much detailed information on these one-offs, but it may be that the programme does not include all the measures that are included in the Commission 2019 spring forecast. In addition, there is the risk of further temporary transactions being recorded in 2019 following pending court decisions. This is, in particular, the case of the compensation for foregone revenue claimed by Abertis, a motorway company, due to the drop in traffic volumes during the crisis for an amount of EUR 2 billion (almost 0.2% of GDP).

In the latter years of the programme period (2021-2022), the planned reduction of the headline government deficit rests on improvements in the structural balance of about 0.5% of GDP per year. As the programme does not specify measures to achieve this structural improvement, the headline targets presented are subject to a large degree of risk.

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. To this end, Spain was 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 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. Spain was 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 was to adopt and fully implement consolidation measures for the amount of 0.5% of GDP in both 2017 and 2018. Spain should stand ready to adopt further measures should risks to the budgetary plans materialise. Fiscal consolidation measures were to secure a lasting improvement in the general government structural balance in a growth-friendly manner.

On 13 July 2018, 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. Thereafter, Spain should ensure that the nominal growth rate of net primary government expenditure does not exceed 0.6 % in 2019, corresponding to an annual structural adjustment of 0.65 % of GDP. It should also use windfall gains to accelerate the reduction of the general government debt ratio."

4.1. Compliance with EDP recommendations

Spain achieved a headline government deficit of 2.5% of GDP in 2018, 0.3 percentage points above the 2.2% of GDP target required by the Council decision of August 2016. However, the headline deficit 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 2019 spring forecast, it is also expected to remain well below 3% of GDP in 2019 and 2020, indicating that the excessive deficit has been durably corrected.

The Council decision required Spain to improve the structural balance by 0.5 percentage point in 2018. However, the Commission 2018 spring forecast calculates an unchanged structural balance in 2018. 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 −0.9 percentage point. On a cumulative basis over 2016-2018, the estimated gap with the requirement amounts to 1.2% of GDP when measured against the unadjusted change in the structural balance, and to 1.8% of GDP when adjusted. The bottom-up estimate of the fiscal effort falls short of the requirement by 1.2% of GDP in 2018 and by 0.9% of GDP over 2016-2018.

Table 4: Compliance with the requirements of the corrective arm

(% of GDP)	2018	2019		2020	
	COM	SP	COM	SP	COM
Headline balance					
Headline budget balance	-2.5	-2.0	-2.3	-1.1	-2.0
EDP requirement on the budget balance	-2.2				
Fiscal effort - change in the structural balance					
Change in the structural balance[1]	0.0	-0.1	-0.2	0.7	-0.3
Cumulative change[2]	-0.6				
Required change from the EDP recommendation	0.5				
Cumulative required change from the EDP recommendation	0.6				
Fiscal effort - adjusted change in the structural balance					
Adjusted change in the structural balance[3]	-0.9	-		-	
of which: *correction due to change in potential GDP estimation (α)*	-0.1	-		-	
correction due to revenue windfalls/shortfalls (β)	0.8	-		-	
Cumulative adjusted change [2]	-1.2	-		-	
Required change from the EDP recommendation	0.5				
Cumulative required change from the EDP recommendation	0.6				
Fiscal effort - calculated on the basis of measures (bottom-up approach)					
Fiscal effort (bottom-up)[4]	-0.7	-		-	
Cumulative fiscal effort (bottom-up)[2]	0.1	-		-	
Requirement from the EDP recommendation	0.5				
Cumulative requirement from the EDP recommendation	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 *t-1* .

[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.

Source :

Stability Programme (SP); Commission 2019 spring forecasts (COM); Commission calculations.

4.2. Compliance with the debt criterion

Following the correction of its excessive deficit, as from 2019, Spain is 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 2019 spring forecast, Spain is not expected to make sufficient progress towards compliance with the debt criterion neither in 2019 nor in 2020, as the change in the structural balance is expected to be -0.2% and -0.3% of GDP, respectively. These expected negative changes in the structural balance compare with a MLSA of 0.5 and 1.1 percentage points in 2019 and 2020, respectively. The programme does not contain sufficient information to allow a calculation of the required adjustment based on the information in the programme.

Table 5. Compliance with the debt criterion

	2018	2019		2020	
		SP	COM	SP	COM
Gross debt ratio	**97.1**	**95.8**	**96.3**	**94.0**	**95.7**
Structural adjustment [1]	0.0	-0.1	-0.2	0.7	-0.3
To be compared to:					
Required adjustment [2]		n.a.	0.5	n.a.	1.1

Notes:

[1] Applicable only during the transition period of three years from the correction of the excessive deficit for EDP that were ongoing in November 2011.

[2] 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

Source :
Commission 2019 spring forecast (COM); Stability Programme (SP), Commission calculations.

4.3. Compliance with 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, the Commission decided that a maximum growth rate of net primary government expenditure of 0.6%, corresponding to an annual structural adjustment of 0.65% of GDP in 2019, appeared appropriate.

Based on the information contained in the Stability Programme and information provided subsequently by the authorities, in 2019, nominal expenditure growth is forecast not to comply with the applicable benchmark rate of 0.6%.[3] The gap is projected to reach –1.0% of

[3] 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

GDP (see Table 7), thus pointing to a risk of significant deviation. Based on the Commission 2019 spring forecast, growth in nominal expenditure net of discretionary revenue measures and one-offs is not forecast to stay below the benchmark rate of 0.6%. The gap with the target stands at -1.1% of GDP, pointing to a risk of significant deviation.

The (recalculated) structural balance of the Stability Programme is forecast to deteriorate by 0.1% of GDP, 0.8 percentage point below the required adjustment of 0.65% of GDP. The Commission forecasts only a slightly larger deterioration in the structural balance for 2019 than the Stability Programme. The gap with the required improvement amounts to 0.9 % of GDP, implying a risk of a significant deviation also judging by this metric. The higher gap of the expenditure benchmark 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.

Regarding 2020, a maximum growth rate of net primary government expenditure of 0.9%, corresponding to an annual structural adjustment similar to the one for 2019 (0.65% of GDP), appears appropriate. Based on the information contained in the Stability Programme and information provided subsequently by the authorities, nominal expenditure growth is not forecast to comply with the applicable benchmark rate of 0.9%. The gap is projected to reach 0.7% of GDP (see Table 7), thus pointing to a risk of significant deviation. Measured as a 2-year average for the period 2019-2020, the deviation is 0.9% of GDP. Based on the Commission 2019 spring forecast, growth in nominal expenditure net of discretionary revenue measures and one-offs is not forecast to stay below the benchmark rate of 0.9%. The gap with the target stands at 1.3% of GDP, pointing to a risk of significant deviation. The 2-year average is at 1.2% of GDP, confirming this conclusion.

According to the programme, the (recalculated) structural balance is forecast to improve by 0.7% of GDP, slightly above the required adjustment of 0.65% of GDP. On a 2-year average basis, the deviation is 0.4% of GDP. The Commission forecasts a larger deterioration in the structural balance for 2020 than the Stability Programme. The gap with the required improvement amounts to 0.95% of GDP, implying a risk of a significant deviation. As in 2019, the higher gap of the expenditure benchmark 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. The relatively large difference between the Commission and the Stability Programme regarding the structural balance development in 2020 is mostly due to the latter including a number of planned measures that are not included in the Commission 2019 spring forecast.

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.

Table 6: Compliance with the requirements under the preventive arm

(% of GDP)	2019		2020	
Background budgetary indicators[1]				
Medium-term budgetary objective (MTO)	0.0		0.0	
Structural balance[2] (COM)	-2.9		-3.2	
Setting the required adjustment to the MTO				
Structural balance based on freezing (COM)	-2.9		-	
Position vis-à-vis the MTO[3]	Not at MTO		Not at MTO	
Required adjustment[4]	0.7		0.7	
Required adjustment corrected[5]	0.7		0.7	
Corresponding expenditure benchmark[6]	0.6		0.9	
Compliance with the required adjustment to the MTO				
	SP	**COM**	**SP**	**COM**
Structural balance pillar				
Change in structural balance[7]	-0.1	-0.2	0.7	-0.3
One-year deviation from the required adjustment[8]	-0.8	-0.9	0.0	-1.0
Two-year average deviation from the required adjustment[8]	n.a.	n.a.	-0.4	-0.9
Expenditure benchmark pillar				
Net public expenditure annual growth corrected for one-offs[9]	3.4	3.7	2.8	4.4
One-year deviation adjusted for one-offs[10]	-1.0	-1.1	-0.7	-1.3
Two-year deviation adjusted for one-offs[10]	n.a.	n.a.	-0.9	-1.2
Finding of the overall assessment	Significant deviation	Significant deviation	Significant deviation	Significant deviation

Legend

'Compliance' - the recommended structural adjustment or a higher adjustment is being observed.

'Some deviation' - a deviation from the recommended structural adjustment is being observed, but it is below the threshold for a significant deviation.

'Significant deviation' - a deviation which has reached or breached the threshold for a significant deviation (i.e. 0.5% of GDP over one year, 0.25% of GDP over two years on average).

Irrelevant for the Significant Deviation Procedure' - a SDP would not be opened only based on the two-year deviation if the MTO has reached (at the time of the freezing or on the base of the last storage) in one of the two

Notes

[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 point is allowed in order to be evaluated as having reached the MTO.

[2] Structural balance = cyclically-adjusted government balance excluding one-off measures.

[3] Based on the relevant structural balance at year t-1.

[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, 2018 edition, p.38.). In case of a SDP, the requirement corresponds to the Council recommendation when available; otherwise it refers to the Commission recommendation to the Council.

[5] Required adjustment corrected for the clauses, the possible margin to the MTO and the allowed deviation in case of overachievers.

[6] 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.

[7] Change in the structural balance compared to year t-1. Expost assessment (for 20XX-1) is carried out on the basis of Commission 20XX spring forecast.

[8] The difference of the change in the structural balance and the corrected required adjustment.

[9] Net public expenditure annual growth (in %) corrected for discretionary revenue measures, revenue measures mandated by law and one-offs (nominal)

[10] 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.

Source :
Stability Programme (SP); Commission 2019 spring forecast (COM); Commission calculations.

Box 2. Implementation of the "constrained judgement" approach and its impact in the context of fiscal surveillance

The objective of the plausibility tool is to have 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 commonly agreed methodology. To this end, the Commission developed, in consultation with the Member States, an objective screening tool based on a set of cyclically relevant indicators as well as thresholds/ranges - to signal cases when the outcomes of the common method could be interpreted as being subject to a large degree of uncertainty and therefore deserving further investigation on the part of the Commission. In such cases, the Commission carries out an "in depth" analysis, which could lead to the application of a "constrained" degree of judgement in conducting Member States' budgetary assessments.

Using the commonly agreed methodology, Spain is projected to reach a positive output gap of 2.0% of potential GDP in 2020. This would correspond to ‘good economic times’, according to the matrix of requirements under the Stability and Growth Pact.

An assessment of uncertainty surrounding this output gap estimate has been performed, taking into account a broader range of economic indicators.

The output gap estimate for 2018 based on the common methodology is flagged by the plausibility tool as subject to particularly high uncertainty. In particular, the central estimate of the tool indicates an output gap of -0.5% of potential GDP, rather than +0.9% as resulting from the common methodology. If the same -1.4 percentage point difference between the central estimate of the plausibility tool and the common methodology output gap in 2018 were applied to the output gap estimate for 2020 (+2.0%), Spain would be considered in ‘normal economic times’ in that year.

Moreover, the very high share of involuntary part-time work (56% in 2018) and temporary employees (27% in 2018) are signs that the slack in the labour market could be larger than implied by the output gap estimated with the production function approach.

It should also be noted that output gap estimations for 2019-20 provided by other national and international institutions vary greatly, especially at a moment when there is a change in the sign of output gap, and are generally lower than the estimate based on the commonly agreed methodology[4].

The above-mentioned considerations show that the output gap estimate based on the common methodology is subject to a high degree of uncertainty. On this basis, a lower requirement of a maximum growth rate of net primary government expenditure of 0.9%, corresponding to an annual structural adjustment of 0.65% of GDP in 2020, appears appropriate.

[4] Output gap for 2019 is estimated at 0.0% of potential GDP by the OECD (Economic Outlook, November 2018) and at 0.7% by IMF World Economic Outlook of April 2019. For 2020 these estimates are: 0.9% (OECD) and 0.8% (IMF).

5. DEBT SUSTAINABILITY ANALYSIS AND FISCAL RISKS

Spain does not appear to face fiscal sustainability risks in the short run. Nonetheless, there are some indications that the fiscal side of the economy poses potential challenges, especially if financial markets' perceptions were to rapidly change.[5] Among the variables indicating higher risk are the gross financing needs, the cyclically-adjusted deficit and net government debt.

Based on the Commission 2019 spring forecast and a no-policy-change scenario beyond the forecast horizon, government debt, projected at 96.3% of GDP in 2019, is expected to rise to a peak of 111.1% in 2029, thus remaining well above the 60% of GDP Treaty threshold. Sensitivity analysis shows similar developments.[6] 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 2029, although remaining above the 60%-of-GDP Treaty reference value in that year.

The medium-term fiscal sustainability risk indicator S1[7] also indicates high sustainability risks in the medium term due to the high level of government debt and the initial budgetary position. The full implementation of the Stability Programme would almost halve the sustainability risk indicator S1. Based on the debt sustainability analysis and the S1 indicator, overall medium-term fiscal sustainability risks 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 S2 points to indicating medium fiscal sustainability risks, primarily 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.[8] However, the debt sustainability analysis discussed above points to high risks, so that, overall, long-term fiscal sustainability risks are assessed as high for Spain.

The 2011 and 2013 pension reforms, the expected impact of which are included in the sustainability calculations reported above, were designed to contribute to containing pressure on expenditure in the long term. The reforms would still leave the generosity of Spanish pensions at an above EU average level in 2070. However, recently, important deviations from these reforms have been agreed 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. As reported in the 2019 Country Report, relinking pensions to inflation could imply additional expenditure for pensions of 4% of GDP by 2050, unless compensating measures are taken.

[5] This conclusion is based on the short-term fiscal sustainability risk indicator S0. See the note to Table 7 for a definition of the indicator.

[6] Sensitivity analysis includes several deterministic debt projections, as well as stochastic projections (see Fiscal Sustainability Report 2018 for more details).

[7] See the note to Table 7 for a definition of the indicator.

[8] The projected costs of ageing that are used to compute the debt projections and the fiscal sustainability indicators S1 and S2 are based on the projections of the 2018 Ageing Report.

Table 7: Debt sustainability analysis and sustainability indicators

Time horizon			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]			5.6	HIGH risk	2.9	HIGH risk
of which	Initial Budgetary Position		2.6		0.2	
	Debt Requirement		2.6		2.5	
	Cost of Ageing		0.4		0.2	
	of which	Pensions	0.2		0.1	
		Health care	0.2		0.2	
		Long-term care	0.1		0.1	
		Other	-0.2		-0.2	
Long-term			**HIGH risk**			
DSA [2]			HIGH risk			
S2 indicator [4]			2.4	MEDIUM risk	0.1	LOW risk
of which	Initial Budgetary Position		2.1		0.1	
	Cost of Ageing		0.3		0.1	
	of which	Pensions	-0.8		-0.9	
		Health care	0.5		0.4	
		Long-term care	1.0		0.9	
		Other	-0.3		-0.3	

Source: Commission services; 2019 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 2019 forecast until 2020. 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-indexes, 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 2033. This adjustment effort corresponds to a cumulated improvement in the structural primary balance over the 5 years following the forecast horizon (i.e. from 2021 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 2018.

6. FISCAL FRAMEWORK

The Council Decision of 8 august 2016 required Spain to strenghthen its fiscal framework. In this regard, the 2019 Stability Programme reports on actions taken to implement the preventive and corrective tools set out in Spain's Stability Law. However, the programme does not set out plans to make the enforcement of these tools automatic and to review the Stability Law's expenditure rule, with a view to strengthening its contribution to fiscal consolidation, especially during economic upturns. The Council Decision also required Spain to strengthen its public procurement policy framework and a more detailed assessment can be found in the 2019 country report for Spain[9].

In May 2019[10], the Ministry of Finance published a report assessing compliance with the domestic fiscal targets by the central, regional and local governments in 2018. The report notes firstly that the central government and the social security missed their domestic deficit targets as set in July 2017, whereas local and regional governments outperformed their respective ones[11]. Secondly, unlike the central government, the regional and local governments complied with the Stability Law's spending rule, which in 2018 capped the variation in the eligible expenditure at 2.4%[12]. Finally, the general government debt-to-GDP ratio stood at 97.1% in 2018, about 0.5 percentage point below the target for that year. The social security together with central and local governments complied with their debt reduction targets, compensating for the slight deviation at regional level[13].

On 5 April 2019 and on 9 May, AIReF published two reports on the 2019 draft budget law and on the 2019-2022 Stability Programme, respectively.[14] AIReF deems the fulfilment of the general government deficit targets set in the Stability Programme over 2019-2021 as 'feasible', though the likelihood of compliance declines over time and becomes 'improbable' in 2022. For 2019, AIReF flags medium risks to the compliance of the domestic spending rule by the regions, though based on partial information on the 2018 outcomes. AIReF considers that the rule will likely be complied with by central and local governments. For the central government, the extension of the 2018 budget in 2019 has capped expenditures with no new measures (apart from those affecting the social security fund). Furthermore, AIReF expects

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[9] SWD(2019) 1008 final.

[10] With delays compared with the deadline set in the Organic Law on Budgetary Stability and Fiscal Sustainability. See: www.hacienda.gob.es/es-ES/CDI/Paginas/EstabilidadPresupuestaria/InformesCompletosLEP.aspx

[11] In particular, the central government and the social security missed their target by 0.6 and 0.3 percentage points of GDP, respectively. The local government and the regions outperformed their target by 0.5 and 0.2 percentage points of GDP, respectively.

[12] The central government eligible expenditures increased by 10.2% of GDP, significantly exceeding the 2.4% rule. The regional and local governments eligible expenditure increased by 2.0% and 1.5% of GDP, respectively. This is an assessment done at the aggregate level for the regions. Some regions have compensated for the slippages from Valencia, Andalusia, Murcia and Balearic Islands.

[13] The social security together with central government met the target, being 0.1 percentage point of GDP above. The local governments outperformed their target by 0.6 percentage points of GDP. The regional governments missed it by 0.2 percentage points of GDP.

[14] The reports can be accessed at www.airef.es

the regions and local governments to attain their public deficit objectives in 2019, unlike the central government and the social security administration.

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

To sum up, based on the information provided in the Stability Programme, the past, planned, and forecast fiscal performance in Spain appears to comply only partially with the requirements of the applicable national numerical fiscal rules. In particular, while the regional and local governments met all the three domestic targets in 2018, substantial slippages from central government were observed. At aggregate level, the 2018 domestic deficit target of 2.2% of GDP was therefore not met.

The macroeconomic projections underpinning the Stability Programme were endorsed on 25 of April 2019 by Spain's independent fiscal institution (AIReF). AIReF considers the government revenue estimates as optimistic and not fully consistent with the prudent macroeconomic forecasts. AIRef also noted that the Stability Programme does not include sufficient information on the fiscal risks.

In 2018, AIRef undertook a comprehensive expenditure review on behalf of the Ministry of Finance in order to identify areas for improving spending efficiency. The recommendations resulting from the review are briefly summarised in the Stability Programme. The Stability Programme claims the incorporation in the projections for social transfers over 2019-2022 of significant savings from the spending review on prescription drugs, but without quantifying them. Also, the Stability Programme assumes moderating growth (at about 1% per year) of subsidies as from 2020, based on their recommendations from the relevant spending review. On 14 December 2018, Spain's Council of Ministers commissioned AIRef to carry out four additional spending reviews, focusing on pharmaceutical expenditure in hospitals, investments in public infrastructure, tax expenditure and hiring incentives. They are expected to yield first results early 2020. The Stability Programme includes EUR 500 million of annual savings as from 2020 in social contributions stemming from the review of hiring incentives.

Lastly, the Stability Programme is considered as Spain's national medium-term fiscal plan (see footnote 1 on page 6 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.

7. SUMMARY

In 2018, Spain achieved a headline deficit of 2.5% of GDP, above the EDP target of 2.2% of GDP. Moreover, the fiscal effort has not been delivered neither on the basis of the top-down nor the bottom-up method. However, as the headline deficit was below the reference value of 3% of GDP and is expected to remain so over the forecast horizon, Spain is considered to have durably corrected its excessive deficit in a timely manner.

Spain plans a growth rate of government expenditure, net of discretionary revenue measures, that is not in line with the applicable expenditure benchmark rate in neither 2019 nor 2020 and plans a small deterioration in the recalculated structural balance of 0.1 percentage points in 2019 and an improvement of 0.7 percentage points in 2020. This path implies a deviation of 0.9% of GDP from the required adjustment path towards the MTO in 2019. In 2020, on the other hand, the planned progress towards the MTO appears appropriate. However, according to the Commission 2019 spring forecast, there is a risk of significant deviation both in 2019 and 2020 following an overall assessment.

Based on the Stability Programme, compliance with the transitional debt rule is not ensured in neither 2019 nor 2020. This is confirmed by the Commission 2019 spring forecast.

8. ANNEXES

Table I. Macroeconomic indicators

	2001-2005	2006-2010	2011-2015	2016	2017	2018	2019	2020
Core indicators								
GDP growth rate	3.4	1.1	-0.1	3.2	3.0	2.6	2.1	1.9
Output gap [1]	2.7	-0.1	-7.0	-2.3	-0.5	0.9	1.6	2.0
HICP (annual % change)	3.2	2.5	1.2	-0.3	2.0	1.7	1.1	1.4
Domestic demand (annual % change) [2]	4.2	0.5	-1.1	2.4	3.0	3.0	2.2	1.9
Unemployment rate (% of labour force) [3]	10.8	13.2	23.8	19.6	17.2	15.3	13.5	12.2
Gross fixed capital formation (% of GDP)	27.8	27.7	19.8	19.9	20.5	21.2	21.6	21.9
Gross national saving (% of GDP)	23.0	20.9	20.1	22.6	23.0	22.9	23.2	23.5
General Government (% of GDP)								
Net lending (+) or net borrowing (-)	0.0	-4.1	-7.7	-4.5	-3.1	-2.5	-2.3	-2.0
Gross debt	48.1	45.4	90.1	99.0	98.1	97.1	96.3	95.7
Net financial assets	-35.2	-26.8	-67.7	-82.8	-81.2	-80.1	n.a	n.a
Total revenue	38.4	37.8	37.9	37.7	37.9	38.9	38.9	38.9
Total expenditure	38.5	42.0	45.6	42.2	41.0	41.3	41.2	41.0
of which: Interest	2.3	1.7	3.1	2.8	2.6	2.5	2.3	2.1
Corporations (% of GDP)								
Net lending (+) or net borrowing (-)	-3.5	-1.1	5.3	5.1	5.6	5.3	4.9	4.7
Net financial assets; non-financial corporations	-107.0	-139.7	-131.7	-122.7	-119.7	-108.8	n.a	n.a
Net financial assets; financial corporations	2.9	6.9	3.7	-0.4	-3.2	-1.2	n.a	n.a
Gross capital formation	15.6	15.5	14.1	15.4	15.5	15.7	16.0	16.1
Gross operating surplus	20.2	22.9	23.9	24.7	25.3	25.1	24.9	24.9
Households and NPISH (% of GDP)								
Net lending (+) or net borrowing (-)	-0.5	-1.5	2.9	1.7	-0.4	-1.2	-0.9	-1.0
Net financial assets	92.6	80.1	103.7	120.7	121.1	113.4	n.a	n.a
Gross wages and salaries	37.7	39.0	38.2	37.8	37.3	37.4	37.5	37.5
Net property income	4.1	3.3	4.1	3.7	3.4	3.5	3.3	3.1
Current transfers received	19.0	20.0	23.3	22.2	21.7	21.6	21.8	21.9
Gross saving	6.8	5.7	6.0	4.9	3.4	2.9	3.4	3.5
Rest of the world (% of GDP)								
Net lending (+) or net borrowing (-)	-4.1	-6.7	0.5	2.4	2.2	1.5	1.5	1.6
Net financial assets	47.3	80.0	92.9	86.1	83.8	77.5	n.a	n.a
Net exports of goods and services	-3.1	-3.9	1.8	3.2	2.9	2.0	1.9	1.9
Net primary income from the rest of the world	-1.1	-2.0	-0.7	0.1	-0.1	0.0	0.0	0.0
Net capital transactions	0.9	0.5	0.5	0.2	0.2	0.5	0.6	0.6
Tradable sector	46.1	42.7	43.6	44.2	44.6	44.0	n.a	n.a
Non tradable sector	44.4	48.5	47.7	46.6	46.1	46.4	n.a	n.a
of which: Building and construction sector	9.9	9.7	5.7	5.3	5.6	5.9	n.a	n.a
Real effective exchange rate (index, 2000=100)	90.3	101.5	93.3	88.8	89.2	89.6	88.8	88.4
Terms of trade goods and services (index, 2000=100)	97.5	99.8	95.3	96.0	95.2	93.4	93.6	93.7
Market performance of exports (index, 2000=100)	108.4	101.0	105.9	106.8	106.9	106.6	106.1	105.5

Notes:

[1] The output gap constitutes the gap between the actual and potential gross domestic product at 2015 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 2019 spring forecast

Mandatory variables not included in the Stability Programme

Not included mandatory variables to some extent impede the Commission's ability to properly assess the Stability Programme on the basis of the programme's assumptions. In particular, the programme does not include comprehensive data on the incremental impact of discretionary revenue measures, which prevented the Commission from calculating the expenditure benchmark based on the information contained in the Stability Programme. The missing information was subsequently provided by the authorities through contacts at technical level.