ISSN 2443-8014 (online)

Post-Programme Surveillance Report

Spain, Autumn 2022

INSTITUTIONAL PAPER 188 | NOVEMBER 2022

EUROPEAN ECONOMY

Economic and Financial Affairs

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Luxembourg: Publications Office of the European Union, 2022

PDF ISBN 978-92-76-43955-4 ISSN 2443-8014 doi:10.2765/75574 KC-BC-22-025-EN-N

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European Commission
Directorate-General for Economic and Financial Affairs

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Spain, Autumn 2022

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Institutional Paper 188

ACKNOWLEDGEMENTS

The report was prepared under the direction of Declan Costello, Deputy Director General, and Luc Tholoniat, Director, Directorate General for Economic and Financial Affairs. The preparation of the report was overseen by Gabriele Giudice, Deputy to the Director and Head of Unit - Croatia and Spain, Directorate General for Economic and Financial Affairs and Rainer Wichern, Head of Unit - National financial systems, Directorate General for Financial Stability, Financial Services, and Capital Markets ([1]).

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The Post-Programme Surveillance assessment was prepared in liaison with staff from the European Central Bank (ECB) ([2]). The European Stability Mechanism (ESM) was consulted.

This report reflects information available and policy developments that have taken place until 31 October 2022. Therefore, the macroeconomic and budgetary projections, including those underlying the debt sustainability analysis, are in line with the Commission 2022 autumn forecast released on 11 November 2022 (with cut-off date 31 October 2022).

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([1]) The executive summary of this report was adopted as Commission Communication C(2022)8549 on 22 November 2022. The rest of the report is the Staff Working Document SWD(2022)370 accompanying this Communication.

([2]) ECB Staff participated in this mission, and in the drafting of this report, in accordance with the ECB's competences and thus provided expertise on financial sector policies and macro-critical issues, such as headline fiscal targets and sustainability and financing needs.

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ABBREVIATIONS

APP	Asset Purchase Programme
BdE	Banco de España, Bank of Spain
CET1	Common Equity Tier 1
CID	Council Implementing Decision
COVID-19	Coronavirus (nCoV) disease 2019
DSA	Debt Sustainability Analysis
EBA	European Banking Authority
ECB	European Central Bank
EFSF	European Financial Stability Facility
EFSM	European Financial Stabilisation Mechanism
ESM	European Stability Mechanism
ESRB	European Systemic Risk Board
FROB	Fondo de Reestructuración Ordenada Bancaria
GDP	Gross Domestic Product
HICP	Harmonised Index of Consumer Prices
ICO	Instituto de Crédito Oficial
IFRS	International Financial Reporting Standards
LSIs	Less Significant credit Institutions
LTD	Loan-To-Deposit ratio
MREL	Minimum Requirement for own funds and Eligible Liabilities
NFCs	Non-Financial Corporations
NIIP	Net International Investment Position
NPL	Non-Performing Loan
PEPP	Emergency Purchase Programme
PPS	Post-programme surveillance
RED	Real Estate Developments loans
REOs	Real Estate Owned assets
RRF	Recovery and Resilience Facility
RRP	Recovery and Resilience Plan
RWA	Risk-Weighted Assets
Sareb	Sociedad de Gestión de Activos Procedentes de la Reestructuración Bancaria S.A.
SIs	Significant credit Institutions
SRB	Single Resolution Board
VAT	Value Added Tax

EXECUTIVE SUMMARY

This eighteenth post-programme surveillance mission to Spain took place virtually from 27 to 28 September 2022. The virtual mission involved staff from the European Commission, in liaison with European Central Bank staff ([3]). The European Stability Mechanism (ESM) participated on aspects related to the ESM's Early Warning System. The report focuses on macroeconomic and financial sector developments over the past months, complementing the surveillance by the European Commission under the European Semester of economic policy coordination.

The Spanish economy continued to expand in 2022 despite the growing disruptions prompted by Russia's war of aggression against Ukraine, but a rapid slowdown is expected heading into 2023, amid high uncertainties with risks tilted to the downside. Real GDP expanded by 5.5% in 2021. After a weak first quarter of 2022, GDP rebounded in the second quarter, but a marked slowdown was registered in the third quarter and a contraction is expected in the last quarter of the year. The contribution from external demand was the key driver steering growth in the second quarter, on the back of revamped international and domestic tourism during the summer season and to a lesser extent thanks to the input from private consumption. Together with the impetus stemming from the implementation of the Recovery and Resilience Plan (RRP), these factors are expected to underpin a GDP expansion of 4.5% in 2022, according to the Commission's 2022 autumn forecast. For 2023, GDP is set to post subdued growth in the first half, before picking up in the following quarters to a more robust pace. GDP is therefore projected to grow by 1.0% in 2023. However, downside risks to the outlook are predominant as a result of the uncertain geopolitical context. The materialisation of additional disruptions in the energy market could lead to further deterioration of the economic environment. Moreover, the gradual tightening of financial conditions could influence the behaviour of economic agents, affecting the development of activity over the forecast horizon.

Headline inflation has been accelerating considerably from mid-2021 until reaching double digits in June 2022, pushed by energy and food prices. HICP inflation is expected to ease from the last quarter of 2022 and in 2023 (4.8% on average), down from 8.5% in 2022 thanks to the gradual abatement of energy prices, cooling down of demand and the impact of government measures to limit the price of gas used in electricity generation. The pass-through from energy and food prices to other goods and services has become increasingly visible in 2022 and will prompt core inflation to remain elevated over the forecast horizon.

The general government balance has improved, helped by strong revenues, but the underlying deficit remains high and the elevated level of debt is a source of vulnerability. The general government deficit is expected to decrease from 4.6% of GDP in 2022 to 4.3% in 2023 and narrow further in 2024 (3.6%). Revenues kept gaining momentum until summer 2022 due to positive labour market developments and growing tax revenues from sustained private consumption, robust corporate profits and also high inflation. The revenue-to-GDP ratio continues to grow above historical levels, although it remains to be seen what part of this evolution will be permanent. The main areas of taxation keep recording double-digit growth. The phasing-out of most measures taken in response to the COVID-19 crisis has also helped reduce the public deficit, but some of these measures are likely to result in structural spending. The government approved several sets of measures to ease the economic and social consequences of Russia's war with an overall estimated cost amounting to 1.6% of GDP, including the reduction of VAT on electricity and gas, a fuel rebate of 20 cents per litre, direct payments to low-income households and for gas-intensive and electro-intensive companies, among others. Some of these measures are expected to be extended to 2023. The relinking of pensions to inflation will weigh considerably in the 2023 budget (estimated cost of 1.4% of GDP) and may result in higher expenditure than envisaged in 2024 if inflationary pressure remains. The structural deficit is likely to stay above 3% of GDP within the

([3]) European Central Bank (ECB) Staff participated in this mission, and in the drafting of this report, in accordance with the ECB's competences and thus provided expertise on financial sector policies and macro-critical issues, such as headline fiscal targets and sustainability and financing needs.

forecast horizon. Given Spain's high levels of debt, a credible strategy of fiscal consolidation in the medium term would be desirable to anchor expectations and ensure debt sustainability.

The banking sector has remained resilient, as potential cliff-edge effects after the expiry of support measures have not materialised, but the second-round effects stemming from higher energy prices and interest rates warrant close oversight. The slowdown in lending activity observed in 2021 has continued in 2022 with lending to non-financial corporations outpacing lending to households in recent months. The public support measures have helped to safeguard the asset quality of Spanish banks, which continued to improve in the first half of 2022. The non-performing loans (NPL) ratio continued to decrease and reached 3.88% at the end of June 2022, the lowest level since March 2009. However, the increase in interest rates coupled with the increase in energy prices is likely to adversely impact the debt repayment capacity of borrowers, in particular of those that are more vulnerable and from the more energy intensive sectors. Banking sector profitability continued to be robust in the first quarter of 2022, despite the absence of the one-off effect that influenced the strong 2021 results. The temporary bank levy, currently under discussion in Parliament, is likely to adversely impact the profitability of banks in the coming years and reduce their capacity to organically generate capital. The capital ratios of Spanish banks continue to be lower than EU peers and warrants close monitoring, as credit quality may deteriorate in the coming months. SAREB, which has continued to operate under its new legal framework, has disposed of roughly 45% of its assets and redeemed one third of the issued senior debt. SAREB has approved a new organisational structure, but the full implementation of the "sustainability principle", which implies that SAREB may transfer assets to develop social housing policies, is still subject to the approval of the updated Business Plan.

Spain retains the capacity to service its debt. The Commission's debt sustainability assessment shows that Spain's government debt would stabilise in the medium term at around 114% of GDP. Spain faces gross financing needs of about 20% of GDP in 2023. Structural features of outstanding Spanish government debt in terms of maturity and investor base appear to be favourable and stable. Following a period of accommodative monetary policy – including the set of actions undertaken by the ECB in response to the COVID-19 crisis – since December 2021, the ECB has started a path of monetary policy normalisation. It should be recalled, however, that the ECB has announced its intention to reinvest the principal payments from maturing securities under the Pandemic Emergency Purchase Programme (PEPP) and Asset Purchase Programme (APP). These factors reduce the vulnerabilities arising from the elevated debt levels and rising market interest rates. The ongoing implementation of the package of reforms and investment funded by the Recovery and Resilience Facility is expected to support growth in the short to medium term and to upgrade the growth potential and the resilience of the economy, further strengthening Spain's capacity to repay its debt.

1. INTRODUCTION

1. This report presents the main findings from the 18th PPS mission (4). Staff from the European Commission, in liaison with staff from the ECB, held post programme surveillance (PPS) mission to Spain. Staff from the European Stability Mechanism (ESM) participated in these in-person meetings on aspects related to the ESM's Early Warning System. Under the PPS, the Commission carries out regular review missions to EU Member States that have had an EU-supported financial assistance programme. The objective of the PPS mission is to assess the economic, fiscal and financial situation to ensure the Member State maintains its capacity to service its debt to the European Financial Stabilisation Mechanism (EFSM), the European Financial Stability Facility (EFSF).

2. Spain received financial assistance for the recapitalisation of financial institutions in July 2012 and successfully exited the related programme in January 2014. The financial assistance programme was agreed by the Eurogroup on 9 July 2012 for a period of 18 months (5) and provided financing by the euro area Member States of up to EUR 100 billion, to be lent by the European Stability Mechanism (ESM). Eventually, Spain used EUR 41.0 billion for bank recapitalisation, under restructuring and resolution plans approved by the European Commission consistently with State aid rules, and around EUR 2.2 billion for capitalising SAREB, the Spanish asset management company.

3. The outstanding amount of the ESM loan stands at EUR 23.7 billion, which represents 57% of the total amount disbursed to Spain under the programme. The repayment of the loan principal by the Spanish Government started in July 2014. Between July 2014 and October 2018, Spain made nine voluntary early repayments.

4. The post-programme surveillance (PPS) (6) aims at a broad monitoring, on a biannual basis, of the repayment capacity of a country having received financial assistance. There is no policy conditionality under the PPS, although the Council can issue recommendations for corrective actions if deemed necessary and appropriate.

5. Since the 17th mission held in spring 2022, Spain continued its steady recovery from the economic downturn induced by the COVID-19 pandemic. The growth in economic activity in the course of 2022 led to further improvements in the levels of internal and external debt ratios. Nonetheless, the stocks of debt, both private and public, remain high, in a context of low productivity and high of unemployment. Given these macroeconomic imbalances, coupled with the economic and energy fallout stemming from Russia's military aggression against Ukraine, monitoring of the developments of the Spanish economy continues to be warranted (7).

6. This report reflects information available and policy developments that have taken place until 31 October 2022. The macroeconomic and budgetary projections, including those underlying the debt sustainability analysis, are based on the Commission 2022 autumn forecast released on 11 November 2022 (with cut-off date 31 October 2022).

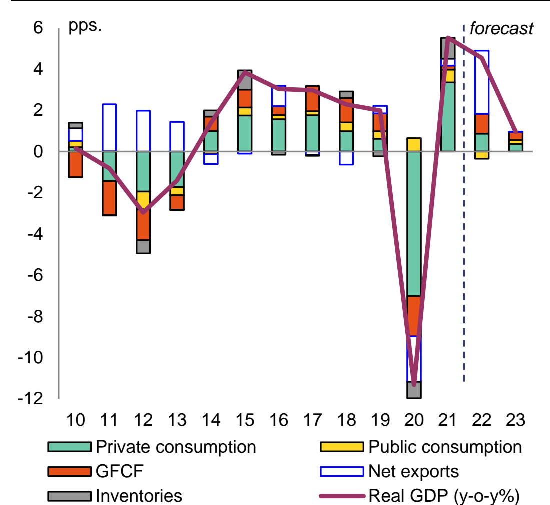
(4) The cut-off date for the data included in this report is 31 October 2022.
(5) However, the completion of the restructuring of the banks receiving public support under the State aid rules was due to take place after the exit from the programme.
(6) Under Regulation (EU) No 472/2013, the PPS will continue until at least 75% of the financial assistance received under the programme has been repaid. The previous PPS report was published as Institutional Paper 174 in May 2022.
(7) Commission SWD(2022)370 final.

2. MACROECONOMIC DEVELOPMENTS

7. The Spanish economy gained momentum in the second quarter of 2022. After posting an annual expansion by 5.5% in 2021, Spain's real GDP contracted marginally in the first quarter of 2022 by 0.2%. This fall is mainly attributable to the decline in private consumption and investment amid the negative impact of the Omicron wave in winter, as well as supply-side disruptions and rapidly rising inflation. Economic growth rebounded strongly in the second quarter of the year thanks to the contribution of external demand, steered by the sharp recovery of international (and domestic) tourism. As a result, real GDP grew by 1.5% in Q2 2022. This robust outturn was also the consequence of the easing of the last restrictions in place connected to the COVID-19 pandemic and the absorption of the pent-up demand built in the previous quarters. Activity slowed down steeply in the third quarter to 0.2% q-o-q, but growth was maintained in positive territory underpinned by the contribution of private consumption and, to a lesser extent, to the impetus provided by inbounds tourist inflows over the summer season. A contractionary turn is expected in the fourth quarter of 2022, on the back declined domestic demand and fading contribution of tourism to net exports. Overall, taking these elements into account and thanks to the stronger than anticipated expansion in the second quarter and the positive carry over from 2021, real GDP is projected to expand by 4.5% in 2022, according to the European Commission autumn forecast.

8. The rebound of tourism and a positive carry-over effect have helped Spain to weather the uncertainty in 2022 caused by the economic fallout of the war. The Russian military aggression against Ukraine that began at the end of February has triggered important supply disruptions in international markets that have been particularly acute from spring 2022 and are expected to linger, albeit to a gradually lower magnitude, throughout the forecast period. Despite the limited direct exposure of the Spanish economy to the Russian and Ukrainian markets, the surge of global energy prices is exacerbating Spanish producers' costs. In particular, the current shock poses an additional challenge to the energy-intensive industry, such as transport and construction, which were already affected by the impact of the COVID-19 pandemic. In turn, confidence of economic agents has been plummeting in 2022 and rising inflation is denting consumers' purchasing power. On the other hand, supportive policy measures (see below), together with the elevated level of households' savings accumulated during the pandemic and a resilient labour market are proving effective in partially cushioning the effects of the shock on households and firms.

Graph 2.1: **Composition of GDP growth**



GFCF: gross fixed capital formation
Source: INE, European Commission Economic Forecast, autumn 2022.

9. Growth is expected to remain weak in the first quarters of 2023, before picking up steadily in the second half of the year amid reduced uncertainties and supported by the implementation of the Recovery and Resilience Plan (RRP). Quarterly growth is set to stagnate in the first quarter before resuming in the second quarter of 2023 and gain vigour in the second half of next year. Moreover, an acceleration in RRP funds ([8]) reaching final beneficiaries, along with

([8]) As part of the RRF, which aims at supporting investments and reforms in the Member States, Spain is expected to receive EUR 69.5 billion in grants to support measures in its RRP taken since February 2020 and until August 2026, as decided by the Council in its Implementing Decision (CID) of 13 July 2021. The largest share of funds are envisaged for disbursement by 2023. Spain received the 13% pre-financing payment in August (EUR 9 billion),the first disbursement in December 2021 (EUR 12 billion) and the second disbursement in July 2022 (EUR 12 billion), following the satisfactory fulfilment of milestones and targets as envisaged in the Annex accompanying the CID. The current maximum financial allocation (current prices) is indicative, of which 70% is based on the Commission's Autumn 2020 Economic Forecast for real GDP growth in

bolstered consumers' confidence and further normalisation of international tourism are expected to contribute to sustain economic expansion. Against this background, and also taking into account the very low carry over from the second half of 2022, real GDP is expected to grow by 1.0% in 2023. Under this scenario, the gap with the pre-pandemic output level (Q4-2019) is now set to be closed in early-2024.

10. HICP inflation gained pace in the first half of 2022 to reach very elevated levels, but is set to moderate in 2023 whilst remaining well-above the ECB's target. Headline inflation reached a peak of 10.7% year-on-year in July, before declining to 7.3.% in October. Although the steep increase in HICP recorded since the beginning of the year is mostly imputable to energy and food prices, the pass-through to other goods and services in the CPI basket has become increasingly evident in 2022. Core inflation reached 6.2% at the end of the third quarter of 2022 and is projected to remain high over the forecast horizon. HICP inflation is expected to ease slightly from the last quarter of this year, whilst remaining at elevated levels. This will the result of a combination of factors including positive base effect, especially regarding electricity and gas, cooling down of demand and the impact of government measures, notably the VAT cut on gas and the mechanism to limit the price of gas used in electricity generation. Thus, according to the European Commission's Autumn forecast, annual HICP inflation is expected to reach 8.5% in 2022, up from 3.0% in 2021. In 2023, the progressive moderation of energy prices and the gradual easing of remaining supply-side bottlenecks is projected to reduce annual HICP inflation to 4.8% before falling further to 2.3% in 2024.

11. Second-round effects stemming from the pick-up in inflation on wages were very limited, with the growth of nominal wages remaining well-below inflation throughout 2022. Wages are expected to pick-up moderately next year, yet still slower than price change, also partly due to the relatively low –but increasing- share of collective agreements with indexation clauses, the multi-year nature of collective bargaining and the existing flexibility mechanisms for firms. This is expected to mitigate second round effects also in 2023 but could result in further losses in workers' purchasing power should inflation surprise on the upside in the coming quarters.

12. Downside risks to activity cloud the outlook over the forecast horizon, against a very uncertain geopolitical and energy context. Pressure stemming from the persistently high energy price and supply bottlenecks are expected to partially ease by mid-2023. Meanwhile, after narrowing the gap during the summer 2022, it is assumed that international tourism will fully recover to its pre-pandemic level in 2023, allowing GDP to gain more traction from the second half of next year. Nonetheless, the outlook depicted is subject to considerable uncertainty, chiefly due to the materialisation of further disruptions in the energy market. Such adverse conditions relate primarily to the supply of gas, despite the relatively favourable position of Spain compared to other EU countries in terms of gas supply exposure to Russia. More broadly, consumption and investment decisions might be postponed because of persisting high levels of commodity prices and general uncertainty. This could result in further precautionary savings by most households, while low-income households and individuals could be exposed to increasing pressure. Additionally, the process of monetary policy normalisation and the consequent tightening of financial conditions could influence the behaviour of economic agents by weighing negatively on the dynamism of aggregate consumption and investment. The unfolding geopolitical developments may also impact the implementation of the RRP, as shortages of inputs in sectors receiving a large share of these funds (e.g., construction ([9])) could affect the delivery of some investments envisaged in the Plan. As a result, the balance of risk to activity is tilted to the downside.

13. The policy response by the authorities to protect households' income and affect retail prices has been vigorous and is expected to continue in the upcoming months. The major intervention mechanism in the electricity market (the so-called Iberian exception) was deployed in

2020 and 2021. The 30% allocation was revised in June 2022 based on actual outturn data from Eurostat.

([9]) In addition, (Bank of Spain, 2022) highlights the risk of employment shortages in sectors with a high allocation of funds.

June 2022, introducing until May 2023 a cap on the price of gas used for electricity generation in the Iberian market. Furthermore, since the end of March 2022, the Government approved a number of measures to protect firms and households' disposable income. These include aid to the electricity-intensive and gas-intensive industries via subsidies as well as a sharp reduction (80%) in the fees the companies in such sectors would pay for having access to transport and electricity networks. Besides, a set of new policies was recently approved, including revisions in the contribution to regional taxes, such as corporate tax rate for SMEs, that will decrease from 25% to 23%. Moreover, non-taxable income threshold is increased from EUR 14 000 to EUR 15 000. In order to cushion the effect of the ongoing crisis on retail prices and public finances, the authorities reduced the VAT rate on electricity from 21% to 5% from July to December 2022 for supplies up to 10kW, coupled with the reduction of special tax on electricity from 5% to 0.5%. Some of the above-mentioned measures represent an extension of previous packages adopted in 2021. Also, from October, the VAT rate on gas was reduced from 21% to 5%. A deduction of EUR 0.20 for both companies and households on fuel price financed by the government has been in force since spring. On the labour market side, the RED mechanism ([10]) to support firms and workers in transition, which became operational in April 2022 is set to represent the key line of defence counteracting cyclical macroeconomic shocks and sectoral transformation requiring reskilling and job reallocation.

14. The growth of activity and prices in the housing market has moderated over the course of 2022, after a strong rebound in 2021. Housing demand is expected to weaken under a more negative economic outlook, the loss of households' purchasing power and the tightening of monetary and financial conditions (see next paragraph for details). A disorderly slowdown is however not envisaged, given limited housing valuation and credit gaps, as well as existing income buffers. The latter take includes accumulated savings during the COVID-19 period, reinforced short-time work schemes lowering pro-cyclicality of unemployment and government support measures particularly addressed to vulnerable households. House sales increased by 35% in 2021, with the share of new units in line with the average of previous years (20%) and hence limiting risks associated with ongoing construction and real estate activities which are intensive in leverage. In the first half of 2022, house sales growth moderated to 23% y-o-y. The slowdown seems to have further intensified in the summer, particularly in the segment of new houses (-2.5% y-o-y in July compared to 10.4% y-o-y for second-hand units). These developments were generalized across Autonomous Communities, although with strong heterogeneity ([11]). House prices increased by 3.7% in 2021, slightly above CPI-inflation of 3.1%. The quarterly profile showed a strong acceleration in the second half of 2021, which extended up to the first quarter of 2022 (8.5% y-o-y) in both new and second-hand segments. Data for the second quarter of 2022 already show a moderation, which has been more intense for new house sales (8.8% y-o-y from 10.1% y-o-y in the first quarter). The overall housing price increase (8% y-o-y) was also lower than CPI-inflation (9.1% y-o-y) for the first time since the debt crisis in 2012-2013. These price developments were generalized across Autonomous Communities, and contrary to volumes, show also a high degree of synchronisation and intensity, suggesting the prevalent role of common factors and limited accumulated overheating risks.

15. The private sector debt-to-GDP ratio continued decreasing in the second quarter of 2022 due to high inflation and a further moderation in loan growth, yet deleveraging needs persist. The debt ratio of the non-financial private sector decreased to 139% of GDP in the last quarter of 2021, down by 9 pps compared to the same period of the previous year ([12]). The stock of debt accumulated by non-financial corporations (NFCs) accounted to 81% in terms of GDP, while total household liabilities amounted to 58%. Data

([10]) The RED mechanism is a new employment flexibility and stabilisation mechanism created with the objective to establish a permanent scheme to adjust to cyclical and structural shocks, by covering the suspension or reduction of working time through an employment regulation plan that includes the requirement to improve or retrain workers in the skills identified as being in demand. The scheme has two modalities: one for cyclical macroeconomic shocks, and the other for sectoral transformation.

([11]) Total house sales in the Balearic and Canary Islands posted in July growth rates of 20 to 24% y-o-y, while La Rioja, Madrid and Navarra recorded declines of 9 to 13% y-o-y.

([12]) Data are expressed in consolidated terms.

for the second quarter of 2022 show a further decline of the debt ratio for both segments mainly driven by a signification acceleration of nominal GDP growth (11.8% y-o-y) due to higher inflation rates, and the moderation of loan growth, particularly for NFCs (-0.9% y-o-y from 0.8% y-o-y in the previous quarter). Recent developments further contributed to keep debt ratios significantly below those recorded prior to the global financial crisis and expectations of lower credit demand anticipate an extension of this trend. However, debt ratios remain above prudential levels and fundamental-based benchmarks, while a worsening of the economic outlook could hamper further deleveraging once the debt absorbing effect of high inflation fades.

16. Spain's external net debtor position in terms of GDP improved over the course of 2022. Spain's negative net international investment position (NIIP) recovered from 85.7% of GDP at the end of 2020 to 64.9% of GDP in the second quarter of 2022, remaining however above prudential and fundamental-based benchmarks. Still, it is markedly below the level reached during the financial crisis. The excellent performance of tourism receipts over the 2022 summer contributed to partially offset the negative impact of higher energy prices on imports of goods, resulting in a current account balance of 0.9% in 2022. Persistent high level of energy prices in the coming quarters could exert pressure on the trade balance, against the cooling down on the impetus of international tourism. According to the Commission's Autumn Forecast, the current account balance is expected to decrease slightly to 0.8% in 2023 before improving to 1.2% in 2024.

3. PUBLIC FINANCE DEVELOPMENTS

3.1. FISCAL PERFORMANCE

17. The public finances of Spain keep improving. In 2021, the general government deficit decreased by more than 3pp to 6.9% of GDP helped by the solid performance of revenues, that rose by 12.9%. In particular, tax revenue collection was higher than the pre-pandemic level despite the remaining GDP gap. The dynamism came from direct and indirect taxation, both recording a double-digit growth. Positive labour market developments and higher corporate profits drove the former, whereas stronger private consumption from the second quarter of the year mainly explained the latter. As for the expenditure side, the gradual phasing out of COVID-19 measures played an important role in the containment of spending. In 2022, the public deficit is expected to keep narrowing. According to the 2023 Draft Budgetary Plan submitted by Spain on 15 October, the general government is set drop to 5% of GDP. The European Commission in its 2022 Autumn Forecast expects a deficit of 4.6% in 2022.

18. Revenues continue to beat expectations in 2022. From January to September, central government revenues have grown by 21.9%, clearly outperforming the 2022 Draft Budgetary Plan estimation (10.8%) for the entire year. All the main areas of taxation keep showing a strong performance. The corporate income tax has grown by 31% (y-o-y), reflecting the positive momentum of the corporate sector. The expansion of employment as well as higher salaries and pensions explain the good performance of the personal income tax, with a growth of 27.2% until September. As for VAT, the robust housing market, the rising consumer prices and resilient private consumption are behind its sustained growth (19.8%, y-o-y).

19. This continued positive evolution from the revenue side is helping to close the tax revenue-to-GDP gap vis a vis the EU average. The ratio of tax revenues (including compulsory Social Security Contribution) over GDP progressively increased in Spain since the Great Financial Crisis and more intensely than many other Member States. However, the negative gap remained sizeable in 2019 (5 percentage points relative to the weighed EU average. The increase of the tax revenue-to-GDP ratio accelerated in 2020 (37.5%) and 2021 (39%), strongly deviating from historical elasticities and reaching consecutive maximum levels since Spain joined the Monetary Union. This trend seems to have continued in 2022. Several factors may explain these developments: a) income support policies by the public sector (reinforced short-time work schemes reducing the pro-cyclicality of unemployment during the crisis); b) possible decrease in the capacity to engage in tax avoidance and tax fraud practices during the pandemic as a result of reinforced antifraud policies and the higher use of credit cards; c) changes in consumption patterns towards online shopping, entailing more transparency and invoicing and electronic payments; d) the methodological differences in the measurement of activity over time by the National Accounts, as opposed to measuring activity inferred from tax bases (decoupling). It is still unclear the relative impact of the different factors and the nature of these developments, whose effect on revenue growth could be temporary to a significant degree, and they will need to be closely monitored given their importance for the fiscal sustainability analysis of public finances.

20. Expenditures are broadly contained despite the energy measures approved. Overall expenditures are in line with expectations for 2022. However interest expenditure is on the rise and may continue to grow throughout the rest of the year. The phasing out of COVID-19 measures has been pivotal in the performance of expenditures. From weighting around 3% of GDP in 2022, COVID-19 measures are expected to weight around 0.4% in 2022. This is mainly due to the reduction of short-term working schemes subsidies and social contribution waivers but also to the lower impact of contingent liabilities on the deficit. It remains to be seen, however, how much of the measures impacting the deficit in 2022 will be permanent, with some indication emerging that this may be the case concerning social transfers to regions for health expenditure.

21. Spain has passed several packages of measures this year in the framework of the national plan for response to the economic and social consequences of Russia's war. These sets of measures, seeking to help the most vulnerable

sectors as well as mitigate the effects of war and inflation on businesses and citizens, have an estimated cost amounting to 1.6% of GDP. The packages include the reduction of VAT on electricity and gas, the reduction of the special tax on electricity and the suspension of the tax on the value of electricity production (with a combined estimated cost of more than EUR 5 billion from April to December 2022). In addition, the energy packages included a sizeable fuel rebate of 20 cents per litre (estimated cost of EUR 5 billion), subsidies for public transports that are likely to be renewed in 2023 and different types of support for companies (notably, direct payments to the transport, primary, gas-intensive and electro-intensive sectors) and households, including a social heat voucher, complementary payments in scholarships and direct payments to low-income households.

3.2. FISCAL OUTLOOK

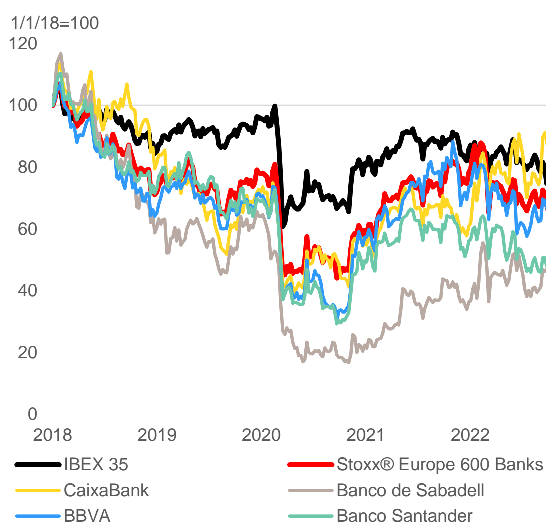
22. The decreasing path of the general government deficit is projected to continue in 2023 and 2024, but the high levels of deficit and debt remain sources of vulnerability. According to the 2023 Draft Budgetary Plan, the general government deficit is set to drop to 3.9% of GDP in 2023. The Commission's 2022 Autumn Forecast also expects the public deficit to narrow to 4.3% in 2023 and drop further in 2024 to 3.6%. Spain is making swift progress in the implementation of its national recovery and resilience plan. To date, the Commission has made two regular disbursements to Spain for the implementation of reforms and investments under the plan. While the budget execution at general government level has been moderate so far, the large number of projects in the pipeline are expected to materialise soon and provide a significant impact on the economy throughout the forecast horizon. Likewise, implementation of reforms continues with momentum, and their effects should be increasingly visible, as is the case of the reform of the labour marked passed at the end of 2021. Some revenue measures to be included in the 2023 Draft Budgetary Plan will keep improving the public deficit. The announced temporary taxes to energy companies and financial institutions are projected to add EUR 7 billion to the budget in the next two years. A newly created "solidarity" wealth tax for contributors having assets in excess of EUR 3 million will also apply in 2023 and 2024. The government also hopes to raise an extra EUR 2.4 billion in two years through a temporary measure limiting the amount of money that large companies can offset to 50% of losses. On the expenditure side, some energy measures are likely to stay -at least for some months- in 2023 such as the social heat voucher and the subsidies for public transport. The relinking of pensions to inflation will weigh considerably in the 2023 budget (estimated cost of 1.4% of GDP) and may also result in higher expenditure than envisaged in 2024 if inflationary pressure remains. Some of the remaining COVD-19 expenditure measures still in force by end 2022 are set to become permanent, impacting the public deficit. Finally, in 2023 and 2024 the Autonomous Communities will exceptionally receive higher funds from the regional funding system, coming from the liquidation of the previous two years of strong revenue growth, which present a risk of increasing expenditures with permanent effects. Overall, the structural deficit is likely to stay above 3% of GDP throughout the forecasting horizon, remaining a source of vulnerability for the Spanish economy. Given the high levels of debt, setting out a credible strategy to substantially reduce the structural deficit in the medium-term would be desirable.

4. FINANCIAL SECTOR DEVELOPMENTS

4.1. RECENT TRENDS

23. The banking sector has remained resilient, but the second round effects stemming from higher energy prices and interest rates warrant close oversight. After the upward trend in 2021 on the back of the rebound in economic growth and the two important banking sector mergers, the share prices of Spanish banks have faced increased volatility after the onset of the Russian aggression against Ukraine. The increase in uncertainty coupled with second round effects (in particular, due to higher energy prices and higher inflation as well as supply side bottlenecks) are weighing on the share prices of Spanish banks. Overall, the share prices of most of the largest Spanish banks have continued to remain below their pre-pandemic levels (Graph 4.1) and have underperformed compared to the IBEX 35 and Stoxx® Europe 600 banking subindex.

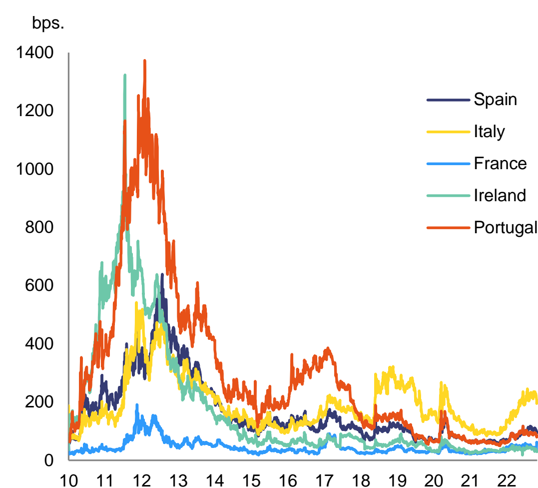
Graph 4.1: **IBEX35, STOXX 600 Banks and selected Spanish banks stocks**



Source: Madrid Stock Exchange, own calculations.

24. After the steady decline in 2021, sovereign spreads have been more volatile in 2022. The implicit nominal interest rate on central government debt declined continuously from around 4% in late 2012 to 1.5% in early 2022. The latest monthly figures suggest that the decline in average interest rate expenditure has bottomed out as expenditure on servicing debt has climbed above 1.6%. The spread between the Spanish benchmark 10-year government bond and the 10-year German bund fluctuated largely around the levels before the onset of the pandemic in the first seven months of 2022 (Graph 4.2). Nevertheless, the prospects of the slowdown in economic growth, the increase in inflation and the transition towards a less accommodative monetary policy stance led to an increase in spreads since August 2022. Overall, sovereign spreads have continued to remain above those of France, Ireland and Portugal, though below Italy's. On 18 March 2022, Standard & Poor's changed Spain's sovereign credit rating outlook from negative to stable and affirmed the credit rating grade at A. On 15 July, Moody's affirmed Spain's Baa1 rating and maintained a stable outlook. According to Moody's, the stable outlook balances Spain's efforts to enhance the shock absorption capacity of the economy and improve the functioning of its labour market. Nevertheless, in Moody's view, negative near-term risks prevail as inflationary pressures increase and the real economy slows in a highly uncertain global environment ([13]).

Graph 4.2: **Sovereign spreads to the 10-year German bund**



Source: IHS Markit, own calculations.

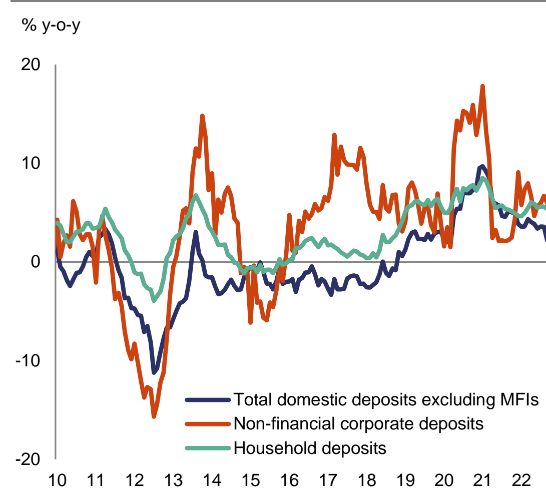
25. The liquidity position of Spanish banks has remained reassuring, while the conditions for retail and wholesale market access have slightly deteriorated. The Spanish banks' borrowing from

([13]) Spain's credit rating by the main rating agencies is A (stable outlook by Standard& Poor's, stable outlook by DBRS), A- with stable outlook by Fitch and Baa1 with stable outlook by Moody's.

the ECB more than doubled since March 2020. The reliance on the ECB remained broadly flat since April 2021 ([14]). The total borrowing from the ECB stood at roughly EUR 290 billion at the end of August 2022, the same level as during the same period last year. Deposit funding has continued to expand in 2022, albeit at lower pace than in 2021. Total domestic bank deposits from households and non-financial corporations increased by 3.6% year-on-year (y-o-y) in August 2022. In 2022, non-financial corporations have mainly driven the increase in total deposits, which went up by 6.7% y-o-y in August 2022. Meanwhile, the deposits of households also continued to increase, albeit at a slower pace by 5.6% y-o-y (Graph 4.3). The loan-to-deposit ratio (LTD) increased slightly in the second quarter of 2022 and reached 101.19% compared to 100.01% in December 2021 ([15]). Nevertheless, the LTD ratio declined compared June 2021, when it stood at 102.13%. The decline in the LTD ratio was mainly triggered by the increase in deposits of both households and non-financial corporations. Despite the increasingly challenging macroeconomic outlook, the Spanish credit institutions have continued to issue MREL compliant debt securities in 2022. ([16]) Banks have mainly issued senior preferred and senior non-preferred bonds. According to Bank of Spain, the significant credit institutions issued MREL compliant debt instruments of roughly EUR 30 billion in the first nine months of 2022, with a peak of EUR 7 billion being placed in September. Meanwhile, the cost of debt issuances in the post-summer period has increased. Nevertheless, based on the latest available data, Spanish banks do not have difficulties to comply with MREL targets.

([14]) https://www.bde.es/webbde/es/estadis/infoest/a0199.pdf
([15]) Bank of Spain, *Nota de prensa estadistica*, 20 October 2022. El Banco de España publica las estadísticas supervisoras de las entidades de crédito correspondientes al segundo trimestre de 2022 (bde.es)
([16]) Minimum Requirement for own funds and Eligible Liabilities (MREL)

Graph 4.3: **Bank deposits**

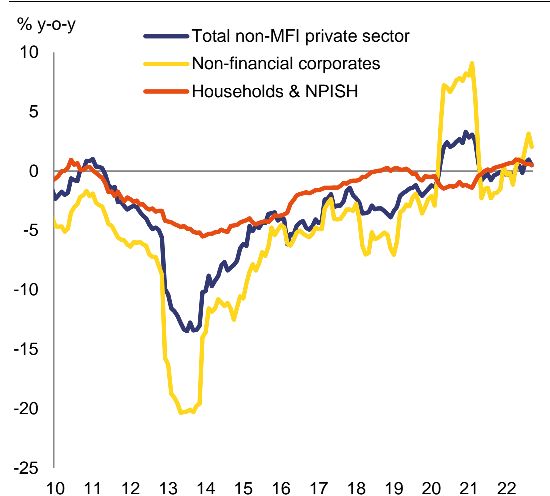


Source: BdE.

26. The slowdown in lending activity observed in 2021 has continued in 2022. Following a sluggish evolution in the second half of 2021 and first half of 2022, total lending to the private sector (excluding interbank lending) increased marginally by just below 1% y-o-y in August 2022. Lending to non-financial corporations registered a positive evolution since April 2022 and increased by 3.2% y-o-y in August. Lending to non-financial corporations and lending to the sectors which were the most impacted by the Covid-19 pandemic has benefitted from the support of government guarantees via the state-owned development bank, *Instituto de Crédito Oficial* (ICO). Following the enactment of the Royal Decree Law 34/2020, many companies have extended the maturity of their ICO guaranteed loans. Lending to households, supported by both mortgage and consumer lending, had been more resilient in 2021 and the first months of 2022. Nevertheless, in recent months, lending to non-financial corporations outpaced the lending to households, which increased by 0.6% y-o-y in August. Lending to the government entered negative territory in March 2022 and fell by 0.6% y-o-y in August. The cost of lending has increased in recent months, with the bank lending rate reaching 1.28% in August 2022, up from 1.12% in July. The one-year Euribor®, which is used as the main reference to set the interest rate on the mortgage loans granted by banks, rose to 2.233% in September 2022, up from 1.249% August. Taking the last twelve months as reference, the one-year Euribor® increased by 2.725 percentage points. The total

volume of loans granted by the Spanish banks (on an individual basis) increased by 4.8% in August 2022 (provisional data) compared to August 2021, reaching roughly EUR 2.136 trillion ([17]).

Graph 4.4: **Bank loans to the private sector**



The decrease in the stock of loans in late 2012 and early 2013 was due to the transfer of assets to SAREB.
Source: BdE, own calculations.

27. The Bank Lending Survey for the third quarter of 2022 indicated that credit standards in Spain and the euro area tightened for all categories of loans. After the tightening in the second quarter of 2022, credit standards for loans to non-financial corporations in Spain tightened further on the back of the increase in the perceived risk due to the deterioration in the economic outlook,the lower risk tolerance by banks and, to a lesser extent, higher costs of funds and balance sheet constraints ([18]). Credit standards for loans for house purchases and consumer credit tightened as well due to lower risk tolerance, higher cost of funds and balance sheet constraints and the increase in the risk perception by banks on the back of the worsening economic outlook and the decline in borrower creditworthiness. Overall, terms and conditions on new loans tightened for all categories of loans, however, there was a net narrowing of banks' margins in a context of strong competition. Loan demand by non-financial corporations fell slightly in the third quarter of 2022, as the decline in loan applications due to higher interest rates, financing of fixed investment and greater use of internal financing surpassed the demand of financing for inventory and working capital. Regarding lending to households, loan demand for house purchases and for consumer credit decreased in the third quarter of 2022 due to declining consumer confidence and the general level of interest rates. Spanish banks perceived that the access conditions on retail and wholesale markets have worsened. Banks indicated that a general worsening of conditions was more pronounced for securitisations and longer terms instruments. For the fourth quarter of 2022, Spanish banks expect credit standards to tighten for all categories of loans, while loan demand for all categories of loans is forecast to decrease.

28. The asset quality of Spanish banks continued to improve in the first half of 2022. Benefitting from the decrease in the stock of impaired assets due to sales and write-offs ([19]), the NPL ratio continued to decrease and reached 3.9% at the end of June 2022, the lowest level since March 2009 and down from 4.3% at the end of 2021. (Graph 4.5). The disposal of NPLs by banks has continued, as NPL sales in the first half of 2022 went up significantly. The construction sector continued to have the highest share of NPLs. Nevertheless, the NPL ratio for the construction sector declined to 8.4% at the end of June 2022, down from 8.5% at the end of December 2021. The NPL ratios for real estate declined in 2021, but rose slightly to 4.4% at the end of March 2022 (up from 4.1% at the end of 2021), before declining to 4.0% at the end of June 2022. Meanwhile, the NPL ratio for productive activities fell to 4.6% at the end of June 2022 (down from 4.8% at the end of 2021), the lowest level since March 2009. Loans to households continue to have the lowest level of impairment, with the NPL ratio going down to 3.32% at end of June 2022, by roughly 0.5 percentage points lower than at the end of 2021. The NPL ratio on mortgage loans also declined and stood at 3.0% at the end of June 2022. After the increase in 2021, due to the precautionary approach adopted by several banks following an analysis at sectoral level, Stage 2 loans (according to IFRS 9 ([20])) at consolidated level have declined in the first half of

([17]) Source: Banco de España (BdE), https://www.bde.es/webbde/es/estadis/infoest/a0802e.pdf
([18]) For further details see BdE, July 2022 Bank Lending Survey in Spain. Banco de España - Publications - Bulletins and journals - Analytical Articles (bde.es)
([19]) Non-performing loan (NPL)
([20]) International Financial Reporting Standards (IFRS)

2022. According to the latest data published by the European Banking Authority (EBA), the share of Stage 2 loans as percentage of total loans and advances stood at 6.7% at the end of June 2022, below the EU average of 9.5%, and by 0.6 percentage points lower than in June 2021. While NPLs have been on a declining trend so far, the increase in interest rates coupled with the increase in energy prices is likely to adversely impact the debt repayment capacity of borrowers, in particular, of those more vulnerable and from the more energy intensive sectors. While the bulk of new mortgage loans are granted with fixed interest rates, roughly 73% of the total stock mortgage loans has variable rates.

Graph 4.5: **Ratio of non-performing loans**

(1) The scope of non-performing loans covered in these figures overlap with BdE's definition of doubtful loans.
(2) Home loans comprise also loans that are not mortgages
Source: BdE, own calculations. (to be updated)

29. The public support measures have helped to safeguard the asset quality of Spanish banks. According to the Bank of Spain, roughly 99% of granted loan moratoria have already expired. ([21]) In the first quarter of 2022, the total volume of loans and advances of significant institutions subject to support measures granted after the onset of the Covid-19 pandemic stood at EUR 113.8 billion, down from EUR 116.2 billion at the end of 2021. This decline was caused to a large extent by the drop in the new loans and advances subject to public guarantee programs, which went down to EUR 102.1 billion (corresponding to 4.48% of the total loans and advances of significant institutions). For less significant institutions, the volume of new loans and advances subject to public guarantee programs stood at EUR 5.6 billion (i.e. 4.52% of their total loans and advances). Meanwhile, refinanced loans, in particular those backed by ICO guarantees warrant close oversight ([22]). According to the latest EBA data (consolidated data), the loans subject to public guaranteed loans classified as Stage 2 loans increased by a negligible 0.3 percentage points in the second quarter of 2022 compared to the first quarter and stood at 21.8%, below the EU average of 23.7%. The NPL ratio for the loans subject to public guarantee schemes increased to 5.1% in the second quarter of 2022, up from 4.6% in the first quarter and stood above the EU average of 3.7%. Meanwhile, the NPL ratio for already expired EBA-compliant moratoria remained flat in the second quarter of 2022 and stood at 8.6%. Nevertheless, the deterioration in the performance of loans with expired moratoria has continued to be higher than the EU average (i.e. 6.2%).

30. Banking sector profitability has continued to be robust in the first half of 2022, albeit less buoyant than in 2021. Banking sector profitability benefitted from the increase in net interest income and commissions coupled with lower loan-loss provisions. (Graph 4.6) Meanwhile, the banking groups with international footprint benefitted from the good results obtained by their subsidiaries outside the EU. According to Bank of Spain data ([23]), the operating profit reached roughly EUR 27 billion in the second quarter of 2022, while the return on equity (consolidated basis) stood at 9.83% compared to 10.85% in the second quarter of 2021. Nevertheless, when comparing the return on equity

([21]) The volume of loans and advanced covered by non-expired EBA compliant moratoria granted by significant credit institutions (SIs) declined to roughly EUR 110 million at the end of June 2022 compared to EUR 114 million at the end of March 2022. For further information, see Bank of Spain, *Nota de prensa estadistica*, 20 October 2022. El Banco de España publica las estadísticas supervisoras de las entidades de crédito correspondientes al segundo trimestre de 2022 (bde.es)

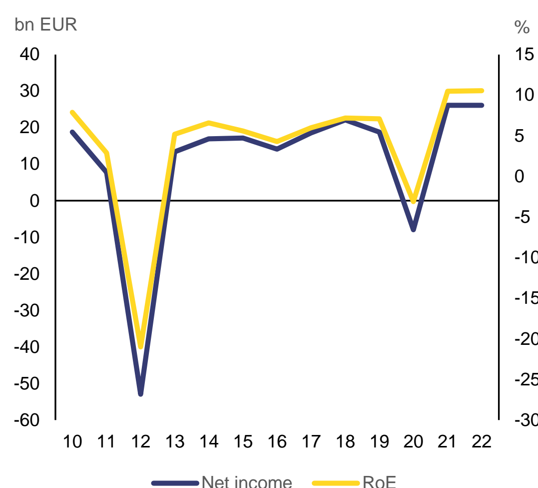
([22]) The increase in refinanced loans is basically due to a group of ICO operations that according to RDL 34/2020, need not to be considered as proper refinanced loans. For prudential reasons though, they have been classified as refinanced operations.

([23]) Bank of Spain, Nota de prensa estadistica, 20 October 2022.
El Banco de España publica las estadísticas supervisoras de las entidades de crédito correspondientes al segundo trimestre de 2022 (bde.es)

in 2022 and 2021, it has to be taken into account that the profitability in the first quarter of 2021 was influenced by a one-off item stemming from the Bankia - CaixaBank merger. Meanwhile, the cost of risk registered a slight decrease in the second quarter of 2022 compared to the previous quarter and stood at 0.97% (equal to the level the end of 2021), but by 0.2 percentage points lower than in the second quarter of 2021. Spanish banks continue to be highly reliant on interest income, notwithstanding the efforts made to diversify the sources of income. Compared to EU peers, fee income and commissions have a lower contribution to the total income of Spanish banks. The net interest income as percentage of total income stood at 67.4% (the third highest in the EU after Greece and Cyprus) at end of March 2022 compared to the EU average of 55.2% (ECB data). Banks have resumed the distribution of dividends to their shareholders after the phasing out at the end of September 2021 of the Recommendation ECB/2020/62 on dividends distribution. Several major banks have also included share buy-back programmes in their dividend distribution policies. Nevertheless, banks are expected to remain prudent regarding their decisions on the remuneration policy to be able to cope with potential headwinds. Overall, Spanish banks have been more efficient than most of their EU peers. Efficiency has slightly decreased after the onset of the Covid-19 pandemic, but the cost rationalisation entailed by the recent banking mergers is gradually kicking in. According to the ECB data, the cost-to-income ratio of Spanish banks stood at 48.3% in the first quarter of 2022, down from 52.1% at the end of 2021 and below the EU average of 60.3%. In the near future, headwinds on the profitability of the largest banks are likely to come from bank levy currently under discussion in Parliament ([24]).

([24]) For further details on the bank tax, see Chapter 4 on Financial sector reforms and policy.

Graph 4.6: **Bank sector profitability (consolidated basis)**



Since 2019, return on equity (RoE) is calculated dividing Net income by the average of total own funds, while before that year RoE was calculated according to the market standards, this means dividing the Income attributable to the controlling entity by the average of shareholders´ equity.
Source: BdE, Financial Stability Report.

31. After strengthening in 2020 and 2021, banking sector capitalisation declined slightly in 2022. According to the latest Bank of Spain data, the solvency ratio at banking system level stood at 16.6% at the end of June 2022, 0.8 percentage points lower than at the end of 2021 and by 0.6 percentage points lower than in June 2021. Less significant credit institutions (LSIs) continued to have higher capital ratios than significant credit institutions (SI). The total capital of LSIs stood at 21.96% at the end of June 2022, while the total capital of SIs reached 16.31% ([25]). Meanwhile, the Common Equity Tier 1 (CET1) ratio at system level declined to 13.1% at the end of June 2022 (from 13.51% at the end of 2021). Since the second half of 2020, Spanish banks have increased their capital buffers partly due to the CRR "quick fix" measures introduced in response to the COVID-19 pandemic ([26]), but also due to the capitalisation of retained earnings, but this trend

([25]) Bank of Spain, *Nota de prensa estadistica*, 20 October 2022.
El Banco de España publica las estadísticas supervisoras de las entidades de crédito correspondientes al segundo trimestre de 2022 (bde.es)

([26]) Regulation (EU) 2020/873 has helped mitigate the impact of the COVID-19 outbreak on financial intermediaries and incentivise the flow of credit to the real economy. The regulation allows to defer the application of the leverage ratio and introduces flexibility and favourable treatment of certain types of risks (e.g. exposures to SMEs, public debt).

reversed in 2022. In 2022, banking sector capitalisation declined due to increase in the risk-weighted assets (RWA) and, to a lesser extent, due to the decrease in the CET1 capital. Overall, the capitalisation of Spanish banks continues to be lower than for the EU peers, with the CET1 ratio being the second lowest in the EU after the CET1 ratio of Greek banks. The capitalisation of Spanish banks warrants close monitoring as the increase in inflation and interest rates is likely to put strain on the debt repayment capacity of some borrowers. Moreover, since the bank levy is expected to impact the profit of banks, the potential for the organic generation of capital in the near future could also be more limited.

4.2. REFORMS AND POLICY

32. The Bank of Spain decided to keep the countercyclical capital buffer at 0% in the fourth quarter of 2022. Even though the credit-to-GDP gap, the most relevant indicator, has remained above the warning threshold since the start of the pandemic, its behaviour can be explained by the sharp fall in GDP deriving from the health crisis, and by the authorities' measures to support credit, which are now being corrected after the recovery in economic activity from mid-2021. Moreover, going forward, the high uncertainty generated by the unjustified invasion of Ukraine poses risks to economic recovery ([27]).

33. Resolution planning continues for all credit institutions. Ten significant institutions, under the remit of the Single Resolution Board (SRB), and all less significant institutions, under the Bank of Spain's, have a resolution plan. SRB and Bank of Spain have finished the notification of MREL decisions related to the end of 2020, while those referring to the end of 2021 will be communicated by the end of Q2 2023.

34. The authorities have proposed a new levy on banks. According to the current draft law, currently under discussion in Parliament, the levy would amount to 4.8% of banks' net interest and fee income, and would apply only to banks with over EUR 800 million of net interest income and fee income in 2019. The levy would be paid in 2023 and 2024 based on 2022 and 2023 data. It would not be deductible from corporate tax, and banks would be forbidden to pass on the cost to clients. It is key that the final design of the levy is proportionate and avoids unwarranted consequences on financial stability and on the financial sector.

35. With a view to improving the protection of financial services clients, the government is preparing the creation of a new authority. The authority will centralise the current complaints services of the three sectoral supervisory authorities. It will resolve disputes between financial customers and the entities providing them, issuing binding decisions for claims amounting to less than EUR 20 000. Its decisions would be issued within a maximum of 90 days. In addition, access to this system would be free of charge for customers.

36. The FROB ([28]) has maintained its 16.2% participation in Caixabank. According to FROB's divestment strategy and with a view to maximise the recovery of public funds, the conditions needed to execute a sale of its stake have not been met, while further improvements in Caixabank's price may be expected. Caixabank announced a share buy-back programme in May 2022. If the FROB does not participate, its stake in the bank could increase to 17.3%.

37. SAREB ([29]) has continued to operate under its new legal framework. After SAREB's reclassification into the general government sector, the authorities updated its legal framework. The reform allowed FROB to reach 50.14% of the capital of SAREB. In June 2022 SAREB approved a new organizational structure, by appointing a new CEO and changing the nature of the chairman to non-executive. In addition, it reduced the

([27]) Indeed, the European Systemic Risk Board (ESRB) has issued a warning on vulnerabilities in the EU financial system. The ESRB acknowledges that macroprudential policy decisions should be made considering each Member State's specific macro-financial outlook and banking sector conditions.

([28]) *Fondo de Reestructuración Ordenada Bancaria* (FROB) was created in 2009 to provide public support for the consolidation of the Spanish banking sector by, inter alia, strengthening the capital buffers of credit institutions.

([29]) *SAREB (Sociedad de gestión de Activos procedentes de la Reestructuración Bancaria)* is an asset management company that was created to divest the assets transferred from the old savings banks and help the economy recover.

number directors in its board from 14 to 9. However, the full implementation of the "sustainability principle" is still subject to the approval of the updated Business Plan. The principle, which was included in the recent reform, implies that SAREB may transfer assets to develop social housing policies, incorporating this factor to its objective of maximising value.

38. By the end of June 2022, SAREB had sold 45% of its assets. Since its creation, the balance composition has tilted towards real-estate owned assets (REOs). Currently, 42% of their assets are Real Estate Developments loans (RED, mostly non-performing) and 58% REOs, as the result of SAREB's efforts to convert loans into the underlying collateral, which can then be marketed and sold in the retail property market. SAREB is focussing on divesting all types of assets in order to maximise cash flow generation during its remaining life until 2027.

39. Senior debt has been reduced by 34%. SAREB's senior debt, which is State-guaranteed and held by the banks that had received State aid during the financial crisis, amounts to EUR 33.6 billion at end-June. SAREB has been able to continue operating with negative equity, due to the legal changes that waived SAREB from the general obligations in corporate law related to compulsory winding-up and capital reduction.

40. During the first half of the year, SAREB has broadly met its business plan. Revenues from the sales of financial assets have performed better than those coming from real estate, and the sales mix is more aligned with its portfolio composition, by increasing the relative sales of lower-quality assets. SAREB has continued to deploy the efficiency plan set up in 2020 and has managed to achieve lower than expected operating expenses. However, financial costs are expected to increase during the year due to higher interest rates. The good behaviour of cash flows so far will allow SAREB to reinforce its ability to repay its senior debt.

5. SOVEREIGN FINANCING AND CAPACITY TO REPAY

42. Spain retains the capacity to service its debt. In the short run, public debt continues to decline gradually, but this trend is projected to reverse in the medium term and the debt-to-GDP ratio is projected at 113.8 of GDP in 2033 in a baseline scenario of the debt sustainability analysis (DSA) ([30]). Based on data validated by Eurostat, general government debt stood at 118.3% of GDP in 2021. The general government debt-to-GDP ratio is expected to decrease to 114.0% in 2022 according to the Commission 2022 autumn forecast. Government debt is projected to decline further to 112.1% in 2024. Based on the Commission's analysis, in a baseline scenario, the positive short-term trend is projected to reverse in the medium term and the debt ratio is expected to rise gradually to 113.8% of GDP in 2033. In a scenario where the structural primary balance (SPB) converges to a deficit of 1.1% of GDP (its historical average), the debt ratio in 2033 is projected to be similar as in the baseline scenario. In an adverse interest—growth rate differential scenario, government debt in relation to GDP is projected at 123.2% of GDP in 2033. (See Annex B for the debt sustainability analysis.)

43. Structural features of outstanding Spanish government debt appear to be stable. Most of outstanding Spanish debt is issued by the central government, whose share at the end of 2021 was about 70% of the total. The debt issued by regional governments (autonomous communities) accounted for about 22% while the remaining, 8% was issued by local governments and social security funds. As regards regional government debt, the average interest rate of the outstanding debt and the average maturity were estimated at 0.89% and 5.5 years, respectively. As regards the structure of central government outstanding debt, the largest category of debt is long-term government bonds *(bonos)* which accounts for about 70% of outstanding debt, according to the Treasury. The maturities of these bonds range from 10 to 50 years and roughly 55% of the outstanding bonds are 10-year bonds. In July 2022, the largest group of holders of the central government debt were non-resident investors (40%) while the second largest holder was the Bank of Spain (37%). Also, resident credit institutions (13%) and insurance companies (6%) held part of central government debt. Compared to 12 months earlier, the changes in the holder structure have been small: the central bank has increased its share while the share of both the resident credit institutions and non-resident investors declined by about 1pp and 2pps, respectively. Following a period of accommodative monetary policy – including the set of monetary policy actions undertaken by the ECB in response to the COVID-19 crisis – since December 2021, the ECB started a path of monetary policy normalisation. It should be recalled, however, that the European Central Bank has announced its intention to continue reinvesting the principal payments from maturing securities under the Asset Purchase Programme (APP) and the Pandemic Emergency Purchase Programme (PEPP) ([31]).

44. The decline in nominal implicit interest rate has ended and the spread vis-a-vis German bonds has widened in 2022. Central government interest rate expenditure in relation to the stock of public debt (the implicit nominal interest rate) declined continuously from around 4% in late 2012 to 1.5% in early 2022. The latest monthly figures suggest that the decline in average interest rate expenditure has bottomed out as expenditure on servicing debt has climbed above 1.6%. Spain's 10-year government bond spread with respect to German bonds remained stable at around 65 basis points in 2021. The spread started to increase in 2022, moved above 100 basis points in June 2022 (see section 4 for more discussion and Graph 4.2).

45. While financing conditions for the government have remained broadly favourable in 2022 and investors continue to purchase Spanish bonds with longer maturities, funding

([30]) For a more detailed debt sustainability analysis, see Annex B.

([31]) The announcement that net purchases under the pandemic emergency programme (PEPP) would conclude in March 2022 was followed by the curtailment and the eventual cessation of net purchases under the asset purchase programme (APP) by the start of the third quarter of 2022, as well as the ECB's communication on the likely timing of interest rate lift-off, in line with its forward guidance. In July 2022 the ECB then raised the three key rates for the euro area (interest rates on the main refinancing operations, on the marginal lending facility and on the deposit facility) by 50 basis points and approved the Transmission Protection Instrument (TPI). Subsequently, the ECB increased the three key rates by 75 basis points in September 2022, and by a further 75 basis points in October 2022.

costs are increasing. According to the Treasury's funding strategy for 2022, the net-financing planned for the current year is EUR 75 billion. In 2022, the redemptions of maturing debt are estimated at EUR 162 billion. Up to September this year, the Treasury had already issued EUR 74.6 billion new debt in net-terms. In line with the strategy, the Treasury increased the amount of outstanding long-term government bonds while it slightly reduced outstanding T-bills. During 2022, the stock of 10-year bonds and the stock of 20-50 years bonds have been increasing more than the average increase in the debt stock. The average life at issuance of *bonos* and *obligaciones* increased steadily in recent years and reached 11.4 years in the first half of 2022. The average maturity of the debt stock overall increased to above eight years in 2021. As recently the stock of longer maturity bonds has grown faster than the overall debt stock, this should support the average maturity to remain at recent levels in going forward. In the recent issuances, however, investors have demanded higher returns on investment than in 2021 when the average yield at issuance by the Treasury (short-term T-bills and long-term bonds) was slightly negative at -0.052%. In 2021, Spain was able to issue T-bills and government bonds up to 7 years maturity paying effectively negative interest. In 2022 (January-September), the average yield at issuance was 1.035%. For instance, the yield on 10-year bond that was issued in September 2022 was 2.7% while just 12 months earlier the yield on the same bond was 0.32%. In September 2022, yields at issuance on all maturities were positive.

46. The market conditions have changed rapidly over the past 12 months, and such developments require monitoring in view of the high debt levels. In the course of 2022, market interest rates have started to increase, and this is reflected in the pricing of debt issued in the course of the year. In tandem, the spread compared to German bonds has increased. Given the high overall debt stock, the evolution of interest rates merits constant monitoring. As regards central government debt, in 2022 and 2023 debt redemptions are estimated at 12.7% and 11.6% of total outstanding debt, respectively, while the central government deficit is projected to remain large, above 4% of GDP. Given these factors, according to the Commission 2022 autumn forecast, financing needs are estimated to reach around 20% of GDP in 2022 and 2023 taking into account debt redemptions, primary deficits, interest rate expenditure and other net-debt creating flows (see Annex B). These estimated short-term financing needs and increased market rates will start resulting in an increase in actual interest expenditure. On a positive side, there are currently no signs of investors seeking less risky, shorter maturity bonds so the Treasury has some buffer in case the investors' demand for high yield or lower risk would intensify. As regards other government sector debt, the current situation is considered stable. Overall, risks concerning Spain's public debt are currently sufficiently contained to ensure the capacity to service its debt.

ANNEX A
Main macroeconomic and financial indicators

Table A.1: **Main macroeconomic and financial indicators**

	2000 -2007	2008 -2013	2014	2015	2016	2017	2018	2019	2020	2021	2022 (f)	2023 (f)
Core indicators												
GDP growth rate	3.7	- 1.3	1.4	3.8	3.0	3.0	2.3	2.0	- 11.3	5.5	4.5	1.0
of which domestic demand incl. stocks	4.5	- 3.1	1.9	3.9	2.0	3.1	2.9	1.6	- 9.1	5.2	1.5	1.0
Private consumption (annual % change)	3.7	- 2.1	1.7	2.9	2.7	3.0	1.7	1.1	- 12.2	6.0	1.5	0.6
Public consumption (annual % change)	5.0	0.9	- 0.6	2.0	1.0	1.0	2.3	1.9	3.5	2.9	- 1.6	1.0
HICP (annual % change)	3.2	2.2	- 0.2	- 0.6	- 0.3	2.0	1.7	0.8	- 0.3	3.0	8.5	4.8
Unemployment rate (% of labour force)	10.6	20.2	24.5	22.1	19.6	17.2	15.3	14.1	15.5	14.8	12.7	12.7
Gross fixed capital formation (% of GDP)	27.7	21.4	17.8	18.0	18.0	18.7	19.4	20.0	20.4	19.8	20.0	20.4
Gross national saving (% of GDP)	22.3	18.8	19.6	21.0	21.9	22.2	22.3	22.9	21.0	21.8	21.9	22.2
General Government (% of GDP)												
Balance (g)	0.4	- 9.0	- 6.1	- 5.3	- 4.3	- 3.1	- 2.6	- 3.1	- 10.1	- 6.9	- 4.6	- 4.3
Gross debt	46.7	69.0	105.1	103.3	102.7	101.8	100.4	98.2	120.4	118.3	114.0	112.5
Interest expenditure	2.2	2.4	3.5	3.0	2.8	2.5	2.4	2.3	2.2	2.2	2.2	2.3
Households												
Households saving rate	8.9	8.9	6.3	7.2	7.1	5.8	5.6	8.2	17.7	13.8	8.5	8.3
Rest of the world (% of GDP)												
Trade balance	- 3.7	- 0.1	3.1	3.0	4.0	3.6	2.7	2.9	1.5	1.5	1.2	1.0
Trade balance, goods	- 6.8	- 4.1	- 2.1	- 1.9	- 1.3	- 1.9	- 2.4	- 2.1	- 0.8	- 1.6	- 5.9	- 5.9
Trade balance, services	3.1	4.0	5.2	5.0	5.3	5.5	5.1	5.1	2.2	3.1	7.1	6.9
Current account balance	- 5.9	- 2.9	1.7	2.0	3.2	2.8	1.9	2.1	0.6	1.0	0.9	0.8
Net financial assets	- 55.3	- 91.6	- 95.4	- 88.3	- 84.7	- 85.3	- 77.3	- 72.5	- 85.4	- 70.2	- 63.3	n.a.
Net international investment position (h)	- 56.5	- 91.6	- 95.9	- 88.9	- 85.4	- 85.5	- 79.1	- 73.7	- 85.7	- 71.5	- 60.2	- 51.6
Competitiveness (index, 2015=100)												
Real effective exchange rate relative to the rest of the euro area	104.6	107.9	100.4	100.0	98.3	98.1	97.7	99.7	102.4	102.3	100.8	100.9
Real effective exchange rate relative to the rest of the European Union	104.8	107.7	100.3	100.0	98.1	97.6	97.2	99.1	101.8	101.8	100.1	100.1
Real effective exchange rate relative to the rest of 37 industrialised countries	104.4	111.7	104.2	100.0	99.0	99.9	101.1	101.6	105.0	n.a.		
Banking sector												
Assets (% of GDP)	214.9	325.0	287.9	262.4	244.8	234.3	219.7	214.9	258.8	248.8		
Private domestic credit (y-o-y %)	17.8	- 3.0	- 6.5	- 4.2	- 4.1	- 2.0	- 3.9	- 1.5	3.3	- 0.2		
Non-performing loans (NPLs), total (%) (i)	1.0	7.7	12.5	10.1	9.1	7.8	5.8	4.8	4.5	4.3		
NPLs, productive activities (%)	1.0	10.8	18.5	14.6	13.1	10.3	6.9	5.4	5.0	4.8		
" of which, construction, and (%)	0.9	17.3	32.6	30.0	29.1	24.1	14.0	11.7	9.2	8.5		
" real estate activities (%)	0.5	19.8	36.2	27.5	25.5	18.1	9.0	5.2	5.0	4.1		
NPLs, residential mortgages (%)	0.4	3.7	6.3	5.1	5.2	5.6	4.9	4.1	3.8	3.5		
ECB ratios (%) (j)												
NPL (domestic and controlled foreign branches and banks)	n.a.	n.a.	8.1	6.3	5.7	4.4	3.7	3.1	2.8	2.9		
" of which non-financial corporations	n.a.	n.a.	16.4	12.8	10.9	7.9	5.9	4.7	4.6	4.8		
" of which households	n.a.	n.a.	5.3	4.5	4.5	4.4	4.0	3.6	3.4	3.8		
Coverage	n.a.	61.7	46.4	46.8	45.0	42.7	43.7	43.7	45.6	41.7		
Return on equity (k)	n.a.	1.8	6.7	6.6	5.0	7.0	8.2	6.7	- 3.5	10.2		
Return on assets (k)	n.a.	0.1	0.5	0.5	0.4	0.5	0.6	0.5	- 0.2	0.7		
Total capital	n.a.	12.1	13.6	14.5	14.7	15.4	15.4	15.7	16.8	17.3		
CET 1	n.a.	n.a.	11.8	12.7	12.8	12.6	12.2	12.5	13.2	13.3		
Tier 1	n.a.	9.8	11.8	12.7	13.0	13.2	13.5	13.8	14.7	15.0		
Loan-to-deposit	n.a.	n.a.	90.3	91.7	92.5	89.3	90.6	92.6	85.5	82.8		
Interest rates												
10 year spread vis-à-vis the Bund (%)	0.1	2.1	1.5	1.2	1.3	1.2	1.0	0.9	0.9	0.6		
CDS 5 year (basis points)	n.a.	221.5	90.3	84.1	82.0	67.4	62.6	52.0	68.0	33.6		

Updated on 31 October 2022.
(f) forecast
(g) General government balances include capital transfers related to support of banks
(h) ESA2010 and BPM6, latest quarter divided by a 4 quarters rolling GDP
(i) NPLs: ratios, in % of total loans, end-of-period, source: BdE
(j) ECB ratios, end-of-period
(k) annualised
Source: Ameco, BdE, Boursorama, ECB, Eurostat, IHS Datainsight.

ANNEX B
Debt sustainability analysis

This Annex assesses fiscal sustainability risks for Spain over the short-, medium- and long-term. It follows the same multi-dimensional approach as the 2021 Fiscal Sustainability Report, updated based on the Commission 2022 autumn forecast. ([32])

Short-term risks

Spain is assessed to face low fiscal sustainability risks in the short-term. The Commission's early-detection indicator (S0) does not signal major short-term fiscal risks. Government gross financing needs are expected to remain large at around 20.5% of GDP in the short-term (i.e. over 2023-2024), although declining compared with the recent peak in 2020 (Table 1). Financial markets' perceptions of sovereign risk are investment grade, as confirmed by the main rating agencies.

Medium-term risks

Medium-term fiscal sustainability risks for Spain appear high overall. According to the Commission DSA for Spain, under the baseline, the government debt-to-GDP ratio is expected to remain at a high level over the medium-term (at 113.8% of the GDP in 2033), despite a decline until 2027 (Graph 1). ([33]) These baseline projections rest on a 'no-fiscal policy change' assumption where no additional fiscal measures are incorporated beyond the forecast horizon (2024). The assumed structural primary balance (a deficit of 1.1% of GDP) appears limited compared with past fiscal performance, meaning that the country has room for corrective action. ([34]) At the same time, the baseline projections up to 2033 benefit from a favourable nominal interest-growth rate differential, notably thanks to the favourable impact of Next Generation EU, with real GDP growth at around 0.6% of GDP over 2025-2033. Government gross financing needs are expected to remain relatively large over the projection period, reaching around 21% of GDP in 2033, slightly above the level forecast for 2024.

These baseline projections are stress-tested against alternative assumptions. Four alternative scenarios around the baseline illustrate the impact of changes in key assumptions (Graph 1). ([35])

Reverting to historical fiscal trajectories under the 'historical structural primary balance' scenario would support the reduction of the government debt ratio. If the structural primary balance (SPB) gradually converged to a deficit of 1.1% of GDP (its historical average), as in the baseline, the projected debt-to-GDP ratio would be similar to the baseline in 2033.

Stress tests scenarios would lead to worse results, with particularly adverse developments under the 'adverse r-g' scenario. A permanent worsening of the macro-financial conditions, as reflected under the 'adverse interest- growth rate differential' scenario would result in a persistently higher government debt-to-GDP ratio, by around 9 pps. of GDP by 2033, as compared with the baseline. A temporary worsening of financial conditions, as reflected in the 'financial stress 'scenario, would lead to a slightly higher public

([32]) The assumptions underlying the Commission's 'no-fiscal policy change' baseline notably comprise: (i) a structural primary deficit, before ageing costs, of 1.1% of GDP as of 2024; (ii) inflation converging linearly towards the 10-year forward inflation-linked swap rate 10 years ahead (which refers to the 10-year inflation expectations 10 years from now); (iii) the nominal short- and long-term interest rates on new and rolled over debt converging linearly from current values to market-based forward nominal rates by T+10 (as for all Member States); (iv) real GDP growth rates from the Commission 2022 autumn forecast until 2024, followed by EPC/OGWG 'T+10 methodology projections between T+3 and T+10, i.e. for 2025-2033 (on average 0.6%); (v) ageing costs in line with the 2021 Ageing Report (European Commission, Institutional Paper 148, May 2021). For information on the methodology, see the Fiscal Sustainability Report 2021 (European Commission, Institutional Paper 171, April 2022).

([33]) The baseline debt projection shows the projected government debt and its breakdown into the primary balance, the snowball effect (the combined impact of interest payments and nominal GDP growth on the debt dynamics) and the stock-flow adjustment.

([34]) Based on past historical performance, this value falls within the *lower* range of the distribution.

([35]) The 'historical SPB' scenario assumes that the structural primary balance (SPB) gradually returns to its past (15 years, i.e. 2007-2021) average level. In the 'lower SPB' scenario, the SPB level is permanently reduced by half of the cumulative forecast change (i.e. over 2022-2024) in the Commission 2022 autumn forecast. The 'adverse interest-growth rate' scenario assumes a less favourable snowball effect than in the baseline (i.e. the differential between market interest rates and nominal GDP growth is permanently 1 pp. higher). In the 'financial stress' scenario, the country temporarily (one year) faces higher market interest rates in 2023 (i.e. market interest rates are assumed to increase temporarily by 2.4 pps. in 2023). Moreover, a risk premium is added for those countries with a debt-to-GDP ratio exceeding 90% of GDP in 2022. This risk premium is equal to 0.06 times the excess of the 2022 debt level over 90% of GDP.

debt-to-GDP ratio by 2033 (+2.0 pps. of GDP) compared with the baseline. The 'lower structural primary balance' scenario would also lead to a slightly higher government debt-to-GDP ratio by 2033 (+1.8 pps of GDP) compared with the baseline.

Stochastic projections show a high sensitivity of these projections against plausible unforeseen events. ([36]) These stochastic simulations point to 46% probability of the debt ratio in 2027 being greater than in 2022, entailing high risk given the high level of debt expected for 2022 at (114% of GDP). In addition, such shocks point to significant uncertainty surrounding the government debt baseline projections (Graph 2). ([37])

Moreover, the large fiscal effort required to bring the debt ratio below 60% of GDP within 15 years confirms the high risk classification. The S1 indicator shows that, compared to the baseline, the SPB would need to improve by 4.8 pps. of GDP, in cumulated terms over 5 years, to bring the debt-to-GDP ratio to the Treaty reference value of 60% by 2039. ([38]) This result is mainly driven by the high level of the Spanish government debt ratio (contribution of 3.7 pps. of GDP), and, to a lower extent, to the unfavourable initial budgetary position (contribution by 1.3 pps. of GDP) (Table 2 and 3).

Long-term risks

Long-term fiscal sustainability risks for Spain appear medium overall. The S2 indicator points to **low** fiscal sustainability risks. ([39]) The indicator shows that, relative to the baseline, the SPB would need to improve slightly to ensure debt stabilisation over the long term. This result is underpinned by the unfavourable initial budgetary position (contribution of 1.7 pps. of GDP), partly offset by the projected decrease in ageing-related costs (contribution of -0.7 pp. of GDP). Ageing costs' developments are primarily driven by the projected decrease of public pension expenditure (contribution of -2.0 pps. of GDP) ([40]), while health and long-term care spending is instead projected to increase over the projection period (joint contribution of 1.7 pps. of GDP) (Table 2 and 3). Yet, combined with debt vulnerabilities, as highlighted by the DSA, long-term risks are assessed as medium.

Finally, some additional risk factors need to be considered in the assessment. On one hand, risk-increasing factors are related to external sustainability. The net international investment position remains very negative, despite it has improved substantially, to -70% of GDP in Q3 2022, mainly due to strong positive valuation effects and high nominal GDP growth. It is set to continue its decline, albeit to a slower pace as economic expansion slows down. Labour market weaknesses also remain a concern, albeit marked improvements have been recorded in the recent past. The unemployment rate declined substantially over the last decade, but remains among the highest in the EU, at 14.8% in 2021, particularly among the youth and long-term segments. According to the Commission's Autumn forecast, it is set to fall to 12.7% in 2022 and stagnate in 2023 before marginally declining to 12.6 in 2024, also on the back of the reforms undertaken as part of the Recovery and Resilience Plan.

([36]) The stochastic projections show the joint impact on debt of 2000 different shocks affecting the government's budgetary position, economic growth, interest rates and exchange rates. The cone covers 80% of all the simulated debt paths, therefore excluding tail events.

([37]) The level of uncertainty is measured by the difference between the 10th and 90th debt distribution percentiles.

([38]) S1 measures the consolidation effort, in terms of the 5-year cumulative change in the structural primary balance compared to the baseline, needed to bring debt to 60% of GDP in 15 years. The risk classification based on S1 depends on the amount of consolidation required. If the S1 value (in pps of GDP) is negative, the country is deemed at 'low risk'; if S1 value is between 0 and 2.5, the country is assigned 'medium risk'; and if S1 value is above 2.5, the country is assigned 'high risk'.

([39]) S2 measures the consolidation effort required to stabilise debt over an infinite horizon. If the S2 value (in pps of GDP) is lower than 2, the country is assigned 'low risk'; if S2 is between 2 and 6, the country is assigned 'medium risk'; and if S2 is above 6, the country is assigned 'high risk'.

([40]) These figures do not reflect the latest expenditure-increasing reforms adopted since the 2021 Ageing Report.

Table 1. Baseline debt projections	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033
Gross debt ratio (% of GDP)	**120.4**	**118.3**	**114.0**	**112.5**	**112.1**	**111.9**	**111.7**	**111.4**	**111.4**	**111.5**	**111.8**	**112.4**	**113.2**	**113.8**
Change in debt	22.2	-2.1	-4.3	-1.4	-0.5	-0.2	-0.2	-0.3	0.0	0.1	0.3	0.6	0.9	0.6
of which														
Primary deficit	*7.9*	*4.7*	*2.4*	*2.0*	*1.4*	*1.2*	*1.0*	*0.8*	*0.8*	*0.8*	*0.8*	*0.8*	*0.8*	*0.9*
Snowball effect	*13.5*	*-6.7*	*-6.7*	*-3.4*	*-2.6*	*-1.4*	*-1.3*	*-1.1*	*-0.8*	*-0.7*	*-0.5*	*-0.2*	*0.0*	*-0.3*
Stock-flow adjustment	*0.8*	*-0.1*	*0.0*	*-0.1*	*0.7*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*
Gross financing needs (% of GDP)	27.8	24.8	21.0	20.5	20.6	19.9	19.8	19.7	19.8	20.0	20.2	20.5	20.9	21.1

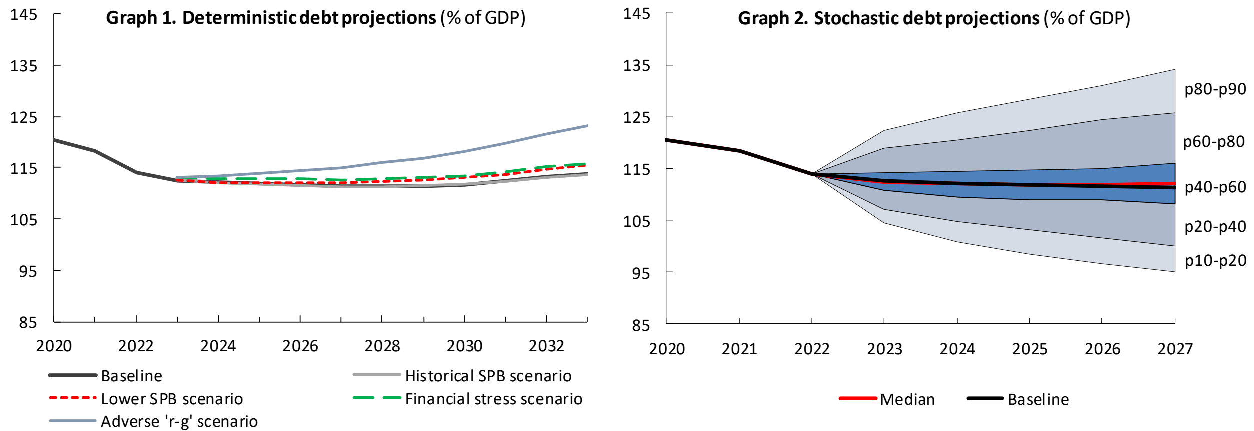


Table 2. Breakdown of the S1 and S2 sustainability gap indicators

		S1	S2
Overall index (pps. of GDP)		**4.8**	**1.0**
of which			
Initial budgetary position		1.3	1.7
Debt requirement		3.7	
Ageing costs		-0.1	-0.7
of which	*Pensions*	*-0.3*	*-2.0*
	Health care	*0.4*	*1.1*
	Long-term care	*0.1*	*0.6*
	Others	*-0.4*	*-0.4*

Table 3. heat map of fiscal sustainability risks for Spain (1)

Short term: Overall (S0)	Medium term: Overall (S1+DSA)	S1	DSA: Overall		Deterministic scenarios: Baseline	Historical SPB	Lower SPB	Adverse 'r-g'	Financial stress	Stochastic projections	Long term: S2	Overall (S2+DSA)
LOW	HIGH	HIGH	HIGH	Overall	MEDIUM	MEDIUM	HIGH	HIGH	HIGH	HIGH	LOW	MEDIUM
				Debt level (2033), % GDP	114	114	116	123	116			
				Debt peak year	2022	2022	2033	2033	2033			
				Fiscal consolidation space	74%	74%	80%	74%	74%			
				Probability of debt ratio exceeding in 2027 its 2022 level						46%		
				Difference between 90th and 10th percentiles (pps. GDP)						39		

(1) *Debt level* in 2033. Green: below 60% of GDP. Yellow: between 60% and 90%. Red: above 90%. (2) The *debt peak year* indicates wether debt is projected to increase overall over the next decade. Green: debt peaks early. Yellow: peak towards the middle of the projection period. Red: late peak. (3) *Fiscal consolidtation space* measures the share of past fiscal positions in the country that were more stringent than the one assumed in the baseline. Green: high value, i.e. the assumed fiscal position is plausible by historical standards and leaves room for corrective measures if needed. Yellow: intermediate. Red: low. (4) *Probability of debt ratio exceeding in 2027 its 2022 level*. Green: low probability. Yellow: intermediate. Red: high (also reflecting the initial debt level). (5) the *difference between the 90th and 10th percentiles* measures uncertainty, based on the debt distribution under 2000 different shocks. Green, yellow and red cells indicate increasing uncertainty.
Source: European Commission (for further details on the Commission's multidimensional approach, see the 2021 Fiscal Sustainability Report)

(1) The heat map presents the overall fiscal sustainability risk classification. The short-term risk category is based on the S0 indicator, an early-detection indicator of fiscal stress in the upcoming year. The medium-term risk category is derived from the debt sustainability analysis (DSA) and the S1 indicator. The DSA assesses risks to sustainability based on several criteria: the projected debt level in 10 years' time, the debt trajectory ('peak year'), the plausibility of fiscal assumptions and room for tighter positions if needed ('fiscal consolidation space'), the probability of debt not stabilising in the next 5 years and the size of uncertainty. The long-term risk category is based on the S2 indicator and the DSA.

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