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Assessment of the 2016 Stability Programme for Spain

(Note prepared by DG ECFIN staff)

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1. INTRODUCTION

This document assesses Spain's April 2016 Stability Programme (hereafter called Stability Programme), which was submitted to the Commission on 30 April and covers the period 2016-2019. It was approved by the government on 29 April.

Spain is currently subject to the corrective arm of the Stability and Growth Pact (SGP). The Council opened the Excessive Deficit Procedure (EDP) for Spain on 27 April 2009 and issued a recommendation to correct it by 2012. Since then, the Council issued three new recommendations to Spain on the basis of Article 126(7) of the Treaty on the functioning of the European Union (TFEU), on 2 December 2009, 10 July 2012 and 21 June 2013, extending the deadline for correcting the excessive deficit to 2013, 2014 and 2016 respectively, as the Council considered that Spain had taken effective action, but unexpected adverse economic events with major unfavourable consequences for government finances had occurred.[1] The latest Council recommendation to Spain on the basis of Article 126(7) of the Treaty was issued on 21 June 2013, which recommended Spain to correct the excessive deficit situation by 2016.

On 9 March 2016, based on the Commission 2016 winter forecast, the Commission concluded that there was a risk of non-compliance with the deadline to correct the excessive deficit, given the significant excess over the 4.2% of GDP intermediate headline balance target for 2015 and the 2.8% of GDP target for 2016 and the fact that the fiscal effort achieved until then fell short of the recommended one. On that basis, the Commission issued a recommendation to Spain to: (i) take measures to ensure a timely and durable correction of the excessive deficit, including by making full use as appropriate of the preventive and corrective tools set out in Spain's Stability Law to control for slippages at the sub-central government level from the respective deficit, debt and expenditure rule targets, and (ii) to report to the Commission on measures in response to the Commission Recommendation in its updated 2016 Draft Budgetary Plan or, at the latest, in a dedicated section of its forthcoming 2016 Stability Programme.

On 18 May 2016, the Commission adopted country-specific recommendations (CSRs) in the context of the European Semester.[2] In the area of public finances, the Commission recommended that Spain ensure a durable correction of its excessive deficit by 2017. The year following the correction of the excessive deficit, Spain will be subject to the preventive arm of the SGP and should ensure sufficient progress towards its medium-term budgetary objective (MTO). As the debt-to-GDP ratio in 2017 is projected at 99.6%, i.e., above the 60% of GDP reference value in the Treaty, in the three years following the correction of the excessive deficit, Spain will also be subject to the transitional arrangements as regards compliance with the debt criterion, during which time it should ensure sufficient progress towards compliance.

This document complements the Country Report published on 26 February 2016 with the information included in the Stability Programme.

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[1] All documents related to the EDP of Spain can be found at: http://ec.europa.eu/economy_finance/economic_governance/sgp/deficit/countries/spain_en.htm .

[2] See: http://ec.europa.eu/europe2020/pdf/csr2016/csr2016_spain_en.pdf

Section 2 presents the macroeconomic outlook underlying the Stability Programme and provides an assessment based on the Commission 2016 spring forecast. The subsequent 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. Based on the Commission forecast, Section 4 assesses compliance with the rules of the SGP and consistency with the 18 May 2016 Commission fiscal CSR. Section 5 provides an overview of sustainability risks and Section 6 discusses recent developments and plans regarding the fiscal framework. Section 7 provides a summary.

2. MACROECONOMIC OUTLOOK

The Stability Programme forecasts the economic recovery to continue over the programme period, albeit at a decelerating pace. After reaching 3.2% in 2015, annual real GDP growth in Spain is projected to decrease to 2.7% in 2016 and 2.4% in 2017, before levelling off at 2.5% in 2018-2019.[3] Regarding 2016, this is somewhat lower than the real GDP growth forecast in the 2016 Draft Budgetary Plan submitted in September 2015, which projected growth to reach 3.0% in 2016. The main component explaining this revision is a more negative contribution of net exports to growth, which more than offsets the continued help from lower oil prices, easier financing conditions and faster employment growth. A somewhat more pronounced deceleration in exports as a result of slower external demand combined with more dynamic imports stemming from robust domestic demand explains the revision.

The macroeconomic scenario in the programme implies a closing and subsequent reversal of the negative output gap over the programme period. The output gap as recalculated by the Commission, following the commonly agreed methodology, is set to narrow from -3.7% of GDP in 2015 to -0.3% of GDP in 2017, before turning positive, at 0.3% of GDP, in 2018, and increasing further to 2.1% of GDP in 2019.[4] According to the Commission 2016 spring forecast the output gap would narrow and turn positive already in 2017, at 0.3% of GDP.

The macroeconomic projections in the first two years covered by the programme appear plausible when compared with the Commission 2016 spring forecast. For 2016, the programme forecast of real GDP growth of 2.7% is only slightly stronger than the 2.6% projected in the Commission 2016 spring forecast. However, it is worth noticing that slightly higher growth in 2016 in the programme comes with more public expenditure restraint, which unveils a stronger underlying macroeconomic scenario. In 2017, the programme seems slightly more conservative, with GDP growth at 2.4% compared with 2.5% forecast by the Commission, which appears consistent with the more sizeable fiscal consolidation measures incorporated in the programme. In terms of growth composition, the scenario depicted in the programme is also very similar to that in the Commission spring 2016 forecast, with growth being driven by domestic demand. In 2016, stronger private consumption and gross fixed capital formation in the programme are partly offset by a slightly more negative contribution by net exports. Public consumption, however, is expected to grow at similar rates in the two sets of projections. In 2017, faster private consumption in the programme is partly offset by somewhat weaker gross fixed capital formation and only marginally lower growth in public

[3] In accordance with the Code of Conduct, Spain has used the common external assumptions on the main extra-EU variables provided by the Commission.

[4] The output gaps as presented in the programme differ somewhat from the recalculated output gaps. The former are falling at a marginally more pronounced pace, narrowing from -5.6% of GDP in 2015 to -0.7% in 2018 before turning positive in 2019, with an expected output gap of 0.6% of GDP.

consumption. Moreover, a stronger pick-up in imports compared to the Commission forecast yields a slightly more negative contribution to growth by net exports. Projections for nominal GDP growth also appear plausible on average. Higher nominal GDP growth by 0.2 pp. in the programme in 2016 is broadly offset by lower nominal growth by the same magnitude in 2017. Employment growth and the projected unemployment rate in the programme are also broadly in line with the Commission forecast, with only minor divergences in 2017. However, the programme projects faster increases in unit labour costs than the Commission forecast.

Finally, for the later years of the programme period, growth at 2.5% per year appears somewhat favourable in light of the positive output gap.

The macroeconomic forecasts underpinning the Stability Programme were endorsed on 25 April 2016 by Spain's independent fiscal institution (AIReF) and published on its website.[5]

Table 1: Comparison of macroeconomic developments and forecasts

	2015		2016		2017		2018	2019
	COM	**SP**	**COM**	**SP**	**COM**	**SP**	**SP**	**SP**
Real GDP (% change)	3.2	3.2	2.6	2.7	2.5	2.4	2.5	2.5
Private consumption (% change)	3.1	3.1	3.0	3.2	2.3	2.6	2.4	2.4
Gross fixed capital formation (% change)	6.4	6.4	4.7	5.6	5.0	4.6	4.7	4.8
Exports of goods and services (% change)	5.4	5.4	4.5	5.3	5.2	5.7	5.6	5.7
Imports of goods and services (% change)	7.5	7.5	5.8	7.0	5.8	6.7	6.3	6.1
Contributions to real GDP growth:								
- Final domestic demand	3.6	3.6	2.9	3.1	2.6	2.6	2.5	2.5
- Change in inventories	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0
- Net exports	-0.5	-0.5	-0.3	-0.4	-0.1	-0.2	0.0	0.0
Output gap[1]	-3.7	-3.7	-1.5	-1.7	0.3	-0.3	0.9	2.1
Employment (% change)	2.9	2.9	2.5	2.7	2.2	2.4	2.5	2.5
Unemployment rate (%)	22.1	22.1	20.0	19.9	18.1	17.9	15.8	14.0
Labour productivity (% change)	0.2	0.3	0.1	0.0	0.5	0.0	0.0	0.1
HICP inflation (%)	-0.6	n.a.	-0.1	n.a.	1.4	n.a.	n.a.	n.a.
GDP deflator (% change)	0.6	0.6	0.9	0.9	1.4	1.2	1.5	1.8
Comp. of employees (per head, % change)	0.5	0.5	0.8	0.8	1.0	1.3	1.6	1.9
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	2.1	2.1	2.3	2.4	2.1	2.2	2.2	2.3

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 2016 spring forecast (COM); Stability Programme (SP).

[5] See: http://www.airef.es/system/assets/archives/000/001/449/original/2016_04_26_Informe_Evaluaci%C3%B3n_del_Proyecto_de_Actualizaci%C3%B3n_del_Programa_de_Estabilidad_del_Reino_de_Espa%C3%B1a_APE_%C3%BAltimo.pdf?1461660189

3. RECENT AND PLANNED BUDGETARY DEVELOPMENTS

3.1. Deficit developments in 2015

The general government deficit reached 5.1% of GDP in 2015. This is 0.9% of GDP above the EDP headline deficit target for that year as well as the target set in the 2015 Stability Programme and confirmed in last autumn's 2016 Draft Budgetary Plan. The reason behind the slippage is twofold. First, the cuts in the personal income tax, and, to a lesser extent, in the corporate income tax implied a revenue loss of around 0.4 % of GDP, more than offsetting the impact of other revenue-increasing measures. Second, expenditure slippages at both central and regional government level more than offset the impact of deficit-reducing expenditure trends, i.e. another year of virtually stable social transfers and a fall in interest expenditure of more than 0.3% of GDP.

The 2015 budgetary outcome was affected by several one-off factors. On the one hand, deficit-increasing one-offs included: (i) a decision by Eurostat to reclassify some public-private partnership (PPP) projects within the general government sector with a negative impact on the deficit in 2015 of about 0.2% of GDP, (ii) support to the financial sector of 0.1% of GDP, and (iii) the pay-back of part of the foregone Christmas bonus in 2012 following a court decision, whose budgetary impact amounted to 0.1% of GDP. On the other hand, deficit-reducing one-offs included the budgetary outcome from a sale of UMTS licences, which decreased capital expenditure by 0.2% of GDP in 2015. Overall, one-off factors increased the 2015 general government deficit by 0.2% of GDP.

Compared to the 2016 Draft Budgetary Plan, higher-than-expected expenditure explains most of the overall deviation from the deficit target. Due to nominal GDP data revisions in the context of the October 2015 EDP notification to Eurostat, comparisons between the projections included in the 2016 Draft Budgetary Plan and outturn data is not straightforward when considering levels of nominal expenditure. However, between 2014 and 2015, gross fixed capital formation as a share of GDP rose faster than expected in the 2016 Draft Budgetary Plan, by almost 0.4% of GDP, instead of decreasing by 0.1% of GDP as planned. Most other expenditure categories also showed slightly less restraint than forecast, with the exception of interest expenditure, which decreased by 0.1% of GDP more than expected.

3.2 Medium term strategy and targets

The strategy presented in the Stability Programme is to mainly rely on economic growth to reduce the general government deficit throughout the programme horizon. However, in view of the considerably higher-than-planned deficit outcome of 2015, the programme no longer plans a correction of the excessive deficit by 2016, as planned in the 2015 Stability Programme, but postpones it to 2017 (Figure 1). On the back of the envisaged closure and subsequent opening up of the output gap, the structural balance recalculated by the Commission, following the commonly agreed methodology, is forecast to narrow marginally from -2.9% of GDP in 2015 to -2½% in 2017, before rising to 2¾% of GDP in 2018-2019.[6] As the programme does not contain any new fiscal policy measures as from 2017, it does not

[6] The Stability Programme is not entirely consistent in its reporting of one-offs. Notably, line 11 of Table 4.3.1. gives "temporary measures" rather than "one-offs". The numbers given in this line is clearly different from those that go into the calculation of the structural balance, which seem to be based on line 4 of Table 4.6.1, showing "non-recurrent temporary measures". For the recalculation of the structural balance, the latter set of figures has been used.

plan to reach the MTO of a structural balance – which is in line with the requirements of the SGP – within the programme period.[7]

The budgetary target for 2016 as presented in the programme is to bring the headline general government deficit down to 3.6% of GDP. This is 0.8% of GDP higher than the targets in both the 2015 Stability Programme and the 2016 Draft Budgetary Plan and broadly reflects the negative base effect related to a worse-than-previously-envisaged starting position in 2015. Whereas the 2016 Draft Budgetary Plan projected that the revenue side would contribute by 0.2% of GDP to the overall deficit reduction, the programme envisages the decrease of the headline deficit to be fully expenditure-driven. Indeed, current taxes on income are now expected to decrease by 0.3% of GDP compared to 2015, while a small increase was expected in the 2016 Draft Budgetary Plan. On the expenditure side, the biggest differences compared to the plan stem from a much more modest expected decrease in the ratio of compensation of employees-to-GDP (-0.1% of GDP in the programme, compared to -0.3% of GDP in the Draft Budgetary Plan) and a steep decline in gross fixed capital formation, which was expected to stay flat in the plan.[8] The programme does not include any sizeable one-off measures for 2016. The programme forecasts a narrowing of the structural deficit, as recalculated by the Commission, following the commonly agreed methodology, from -2.9% of GDP in 2015 to -2.7% in 2016. The structural balance in the programme taken at face value is expected to remain unchanged in 2016.

The Commission 2016 spring forecast projects that the 2016 headline deficit will narrow to a somewhat lesser extent, to reach 3.9% of GDP. Almost the whole difference compared to the programme is explained by higher expenditure. Whereas the Commission forecast projects a slightly more pronounced decline in the ratio of compensation of employees-to-GDP, it projects broadly stable developments for gross fixed capital formation and other expenditures, for which the programme plans significant decreases. Specifically, once adjusted for the impact of one-offs affecting 2015, the latter two expenditure categories are expected to maintain their ratios in 2016, while the programme projects an overall decline by 0.6% of GDP. The Commission forecast projects the structural deficit to widen slightly from 2.9% of GDP in 2015 to 3.1% in 2016. The difference compared to the programme is related to different prospects regarding the total expected impact of fiscal policy measures for 2016 (see next section).

The budgetary target for 2017 as presented in the programme is to bring the headline general government deficit down to 2.9% of GDP. This is higher by 1.5% of GDP than the targets in both the 2015 Stability Programme and the 2016 Draft Budgetary Plan, reflecting the worse starting position, a less benign macroeconomic scenario and a relaxation of the fiscal effort. The expected improvement in the 2017 deficit of 0.7% of GDP is about half as large as in the 2015 Stability Programme, mainly due to a smaller reduction in the expenditure ratio. The biggest differences compared to the 2015 Stability Programme stem from a much more modest expected decrease in the ratio for compensation of employees (-0.1% of GDP, compared to -0.3% of GDP in last year's programme) and social payments (-0.3% of GDP, compared to -0.5% of GDP in last year's programme). The programme claims one-off measures of 0.2% of GDP in 2017, but gives no further information on them. The programme forecasts a continued marginal narrowing of the structural deficit, as recalculated by the Commission, following the commonly agreed methodology, from -2.7% of GDP in 2016 to

[7] The 2015 Stability Programme expected that the MTO would be reached in 2019, whereas Spain's Stability Law provides for its achievement in 2020

[8] About 0.2% of GDP of the 0.5% of GDP decline is due to the deficit-increasing one-off in 2015 reclassifying private investment in relation to some PPP projects as public investment following a decision by Eurostat.

-2.5% in 2017. The structural balance in the programme taken at face value is expected to narrow by 0.1% of GDP in 2017.

The Commission 2016 spring forecast projects that the 2017 headline deficit will narrow to 3.1% of GDP. The expected change in the deficit from 2016 is therefore similar to that in the programme. The main differences relate to the composition of expenditure, where the Commission forecast envisages a more pronounced decline in the ratio of compensation of employees-to-GDP, which is offset by less restraint in intermediate consumption. The Commission forecast projects that the structural deficit will widen slightly further from 3.1% of GDP in 2016 to 3.2% in 2017, compared to an improvement of 0.2% of GDP in the recalculated structural balance of the programme. The difference is to a large extent due to the programme including a one-off of 0.2% of GDP, which the Commission forecast does not.

The budgetary targets for 2018 and 2019 as presented in the programme are headline general government deficits down at 2.2% and 1.6% of GDP, respectively. For 2018, this is higher by 1.9% of GDP than the target in the 2015 Stability Programme. The expected improvement in the 2018 deficit by 0.7% of GDP is lower than in the 2015 Stability Programme by 0.4% of GDP, mainly due to a less pronounced reduction in the expenditure ratio, in particular for compensation of employees and intermediate consumption.

The programme projects that most of the planned deficit reduction in 2016 will stem from the regional government level, where the deficit is expected to narrow by 1.0% of GDP to 0.7% of GDP. Reductions are also expected at central government level, where the deficit is set to narrow from 2.6% to 1.8% of GDP, and in the social security sector, with a planned reduction by 0.2% of GDP to 1.1% of GDP. By contrast, the programme forecasts that the local government level will move from a surplus of 0.4% of GDP in 2015 to a balanced budget in 2016.

The deficit reduction projected in 2017-2019 is again expected mostly at the central and regional government level (by 0.9% and 0.7% of GDP, respectively), but also to some extent from social security (by 0.4% of GDP). The local government level is expected to maintain a balanced budget position in all three years.

Overall, the deficit reduction path envisaged in the programme seems to rely heavily on high economic growth, in particular in the outer years.

Table 2: Composition of the budgetary adjustment

(% of GDP)	2015	2016		2017		2018	2019	Change: 2015-2019
	COM	**COM**	**SP**	**COM**	**SP**	**SP**	**SP**	**SP**
Revenue	**38.2**	**38.2**	**38.2**	**38.3**	**38.3**	**38.4**	**38.5**	**0.3**
of which:								
- Taxes on production and imports	11.7	11.9	12.0	12.0	11.9	11.9	11.9	0.2
- Current taxes on income, wealth, etc.	10.1	9.9	9.8	10.1	10.1	10.4	10.8	0.6
- Social contributions	12.2	12.2	12.2	12.1	12.1	12.1	12.0	-0.2
- Other (residual)	4.2	4.1	4.2	4.1	4.1	4.0	3.9	-0.3
Expenditure	**43.3**	**42.1**	**41.8**	**41.3**	**41.2**	**40.6**	**40.1**	**-3.3**
of which:								
- Primary expenditure	40.3	39.2	39.0	38.7	38.5	38.0	37.6	-2.6
of which:								
Compensation of employees	11.0	10.7	10.9	10.3	10.8	10.7	10.6	-0.4
Intermediate consumption	5.2	4.9	4.9	5.1	4.8	4.7	4.6	-0.6
Social payments	18.4	18.0	18.0	17.6	17.7	17.4	17.1	-1.3
Subsidies	1.2	1.1	1.1	1.1	1.1	1.0	1.0	-0.2
Gross fixed capital formation	2.5	2.3	2.0	2.3	2.1	2.1	2.3	-0.2
Other (residual)	2.1	2.3	2.0	2.2	2.0	2.1	2.0	-0.1
- Interest expenditure	3.1	2.9	2.9	2.7	2.7	2.6	2.5	-0.6
General government balance (GGB)	**-5.1**	**-3.9**	**-3.6**	**-3.1**	**-2.9**	**-2.2**	**-1.6**	**3.5**
Primary balance	**-2.0**	**-1.1**	**-0.8**	**-0.4**	**-0.2**	**0.4**	**0.9**	**2.9**
One-off and other temporary	-0.2	0.0	0.0	0.0	-0.2	0.0	0.0	0.2
GGB excl. one-offs	**-4.9**	**-3.9**	**-3.6**	**-3.1**	**-2.7**	**-2.2**	**-1.6**	**3.3**
Output gap[1]	-3.7	-1.5	-1.7	0.3	-0.3	0.9	2.1	5.8
Cyclically-adjusted balance[1]	-3.1	-3.1	-2.7	-3.2	-2.7	-2.7	-2.7	0.4
Structural balance[2]	**-2.9**	**-3.1**	**-2.7**	**-3.2**	**-2.5**	**-2.7**	**-2.7**	**0.1**
Structural primary balance[2]	0.2	-0.2	0.2	-0.5	0.2	-0.1	-0.3	-0.5

Notes:

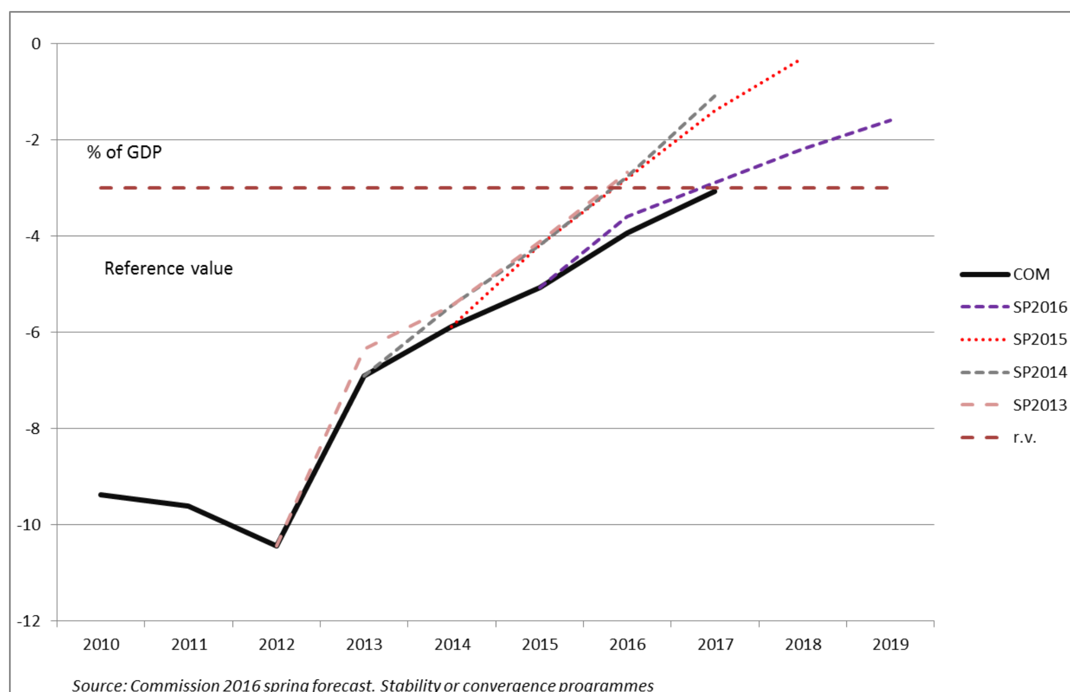
[1]Output gap (in % of potential GDP) and cyclically-adjusted balance according to the programme as recalculated by Commission on the basis of the programme scenario using the commonly agreed methodology.

[2]Structural (primary) balance = cyclically-adjusted (primary) balance excluding one-off and other temporary measures.

Source:

Stability Programme (SP); Commission 2016 spring forecasts (COM); Commission calculations.

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



3.3 Measures underpinning the programme

The programme presents measures with an expected net deficit-reducing impact of about 0.6% of GDP in 2016, including 0.4% of GDP from the savings at central and regional government level announced in response to the March 2016 Commission recommendation. By contrast, the Commission 2016 spring forecast incorporates a net deficit-reducing impact of measures of about 0.2% of GDP, including 0.3% of GDP from the above-mentioned savings. In particular, the Commission has a more prudent estimate of the budgetary impact of savings at regional level, as well as of the 2013 local administration reform, the fight against tax fraud and the expected impact on employment growth of rebates in employers' social security contributions.

Given the political situation in which it was prepared, with only a caretaker government and with pending elections, the programme does not contain any fiscal consolidation measures affecting 2017 or later years other than those already adopted or credibly announced.The programme considers the savings from the new measures announced in March/April 2016 to be of a permament nature, whereas the spring forecast assumes that the majority of those have a temporary effect, which will therefore not be carried over to 2017.

Main budgetary measures

<table>
<tr><th>Revenues</th><th>Expenditure</th></tr>
<tr><td colspan="2">2015</td></tr>
<tr><td>

- Reduction in personal income tax (including on non-residents) (−0.3% of GDP)
- Reduction in corporate income tax (−0.3% of GDP)
- Value Added Tax (0.1% of GDP)
- Local government tax measures (0.1% of GDP)
- Fight against tax fraud (0.1% of GDP)

</td><td>

- Partial repayment of 2012 Christmas bonus (0.1% of GDP)
- Public employment restraint measures (−0.1% of GDP)
- Other public employment measures at regional level (0.1% of GDP)
- Public administration reform (CORA) (−0.1% of GDP)
- Local public administration reform (−0.1% of GDP)
- Pension reform (−0.1% of GDP)
- Compensation claims related to the fuel tax judged illegal by the ECJ ("*céntimo sanitario*") (−0.2% of GDP)

</td></tr>
<tr><td colspan="2">2016</td></tr>
<tr><td>

- Reduction in corporate income tax (−0.1% of GDP)
- Reduction in personal income tax (−0.3% of GDP)
- Fight against tax fraud (0.1% of GDP)

</td><td>

- Public employment restraint measures (−0.1% of GDP)
- Spending cuts (*acuerdos de no disponibilidad*) at central government level (−0.2% of GDP)
- Spending cuts (*acuerdos de no disponibilidad*) and other saving measures at regional government level (−0.2% of GDP)
- Public administration reform (CORA) (−0.1% of GDP)
- Local public administration reform (−0.1% of GDP)
- Pension reform (−0.1% of GDP)

</td></tr>
<tr><td colspan="2">2017</td></tr>
<tr><td>

- Reduction in personal income tax (including on non-residents) (−0.1% of GDP)
- Fight against tax fraud (0.1% of GDP)

</td><td>

- Partial repayment of 2012 Christmas bonus (−0.1% of GDP)
- Pension reform (−0.1% of GDP)

</td></tr>
<tr><td colspan="2">Note: The budgetary impact in the table is the impact reported by the national authorities. A positive sign implies that revenue / expenditure increases as a consequence of this measure.
Source: 2016 Stability Programme, 2016 and 2015 Draft Budgetary Plan.</td></tr>
</table>

3.4. Debt developments

After having risen steeply during the recent recession, the general government debt-to-GDP ratio stabilised in 2015 (even decreasing marginally to 99.2% of GDP) as a result of the impact of a debt-decreasing stock-flow adjustment of 1.5% of GDP (which reflected the net sale of financial assets) just more than offsetting the still negative impact from the deficit-growth dynamics. The programme plans the debt-to-GDP ratio to fall at a gradually increasing pace to reach 96.0% in 2019. This evolution is mainly driven by an improving primary balance (which is expected to turn into surplus in 2018), and the debt-decreasing effect of a favourable "snow-ball effect", as the interest burden keeps decreasing and inflation gradually picks up. According to the programme, debt-increasing stock-flow adjustments add about 0.5% of GDP per year to the debt ratio as from 2017. The programme does not provide any information about the nature of these adjustments. Based on the debt projections of the programme, reducing the debt-to-GDP ratio to 60% by 2020, as required by Spain's Stability Law, is clearly out of reach.

Although the evolution of the debt ratio was significantly underestimated in the 2011 and 2012 Stability Programmes, projections in the more recent programmes have been more accurate, as the expected economic recovery has materialised. The debt ratio in 2015 was only about 0.3% of GDP higher than projected in the 2015 Stability Programme (Figure 2).

The programme expects a marginally lower debt profile in 2016-2017 compared with the Commission 2016 spring forecast, which projects the debt-to-GDP ratio to peak at 100.3% in 2016 before decreasing to 99.6% of GDP in 2017. The difference is mainly due to the Commission 2016 spring forecast projecting for 2016 a larger primary deficit and a debt-increasing stock-flow adjustment. For the latter, the Commission forecast incorporates the projection in the 2016 Draft Budgetary Plan.

Table 3: Debt developments

(% of GDP)	Average 2010-2014	2015	2016		2017		2018	2019
			COM	SP	COM	SP	SP	SP
Gross debt ratio[1]	**81.6**	**99.2**	**100.3**	**99.1**	**99.6**	**99.0**	**97.9**	**96.0**
Change in the ratio	9.3	-0.1	1.1	0.0	-0.7	-0.1	-1.1	-1.9
Contributions[2] *:*								
1. Primary balance	**5.6**	**2.0**	**1.1**	**0.8**	**0.4**	**0.2**	**-0.4**	**-0.9**
2. "Snow-ball" effect	**3.3**	**-0.6**	**-0.5**	**-0.7**	**-1.1**	**-0.8**	**-1.2**	**-1.6**
Of which:								
Interest expenditure	2.8	3.1	2.9	2.9	2.7	2.7	2.6	2.5
Growth effect	0.5	-3.1	-2.5	-2.6	-2.4	-2.3	-2.3	-2.4
Inflation effect	-0.1	-0.6	-0.9	-0.9	-1.3	-1.2	-1.4	-1.7
3. Stock-flow adjustment	**0.4**	**-1.5**	**0.6**	**-0.1**	**0.0**	**0.5**	**0.5**	**0.6**
Of which:								
Cash/accruals diff.								
Acc. financial assets								
Privatisation								
Val. effect & residual								

Notes:

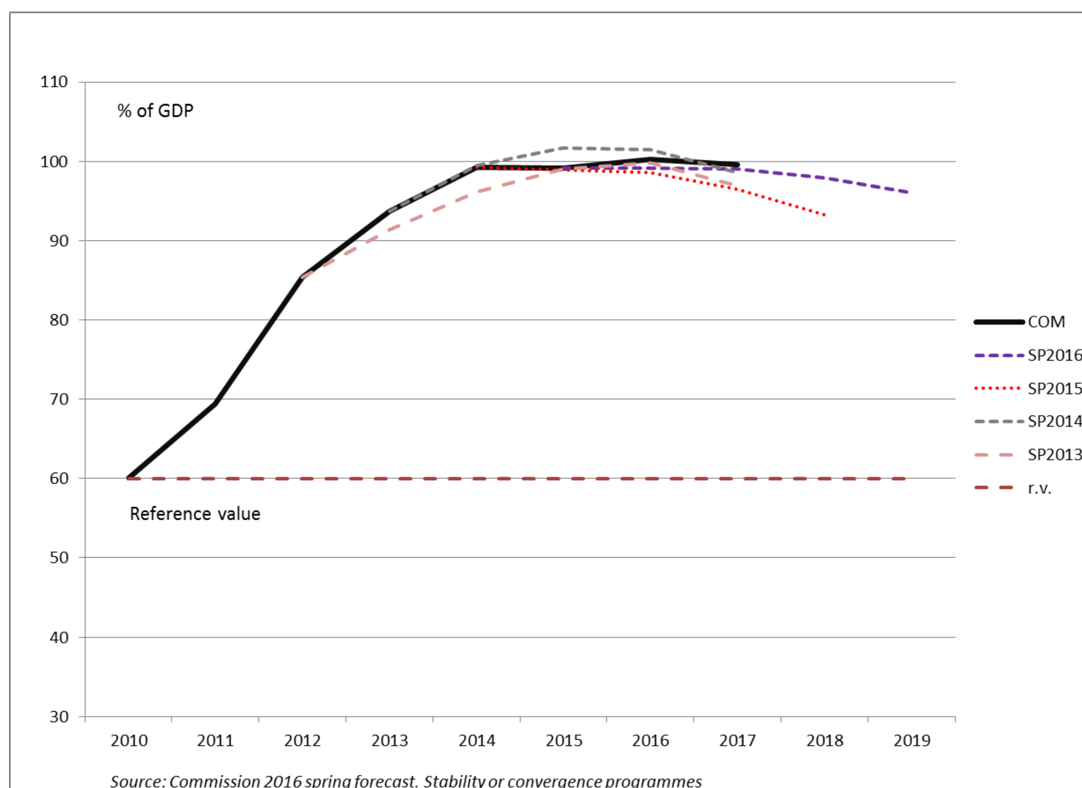
[1] End of period.

[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 2016 spring forecast (COM); Stability Programme (SP), Comission calculations.

Figure 2: Government debt projections in successive programmes (% of GDP)



3.5. Risk assessment

Based on the Commission 2016 spring forecast, there are risks to the achievement of the budgetary targets. Whereas the programme sees the headline deficit narrowing to 3.6% of GDP and 2.9% in 2016 and 2017, respectively, the Commission 2016 spring forecast projects that the headline deficit will reach 3.9% and 3.1% of GDP in the two respective years.

Risks mainly stem from uncertainty regarding the implementation of the spending cuts at central and regional level announced in March/April, as they remain largely unspecified, especially at regional level, require active involvement by different tiers of government and strict enforcement. There are also risks related to their continued implementation in 2017.

These risks are especially relevant given the track record of Spain in achieving its headline targets. In all years covered by the EDP recommendation, Spain missed its headline targets and in 2015 the slippage was particularly large, despite economic good times.

Risks to the debt ratio projection stem from risks to the budgetary target discussed above.

4. COMPLIANCE WITH THE PROVISIONS OF THE STABILITY AND GROWTH PACT

Box 1. Council recommendations addressed to Spain and May 2016 Commission proposal for a CSR

On 21 June 2013, the Council recommended Spain under Art. 126(7) of the Treaty to correct its excessive deficit by 2013. To this end, Spain should reach a headline deficit target of 6.5% of GDP in 2013, 5.8% of GDP in 2014, 4.2% of GDP in 2015, and 2.8% of GDP in 2016, which is consistent with an improvement of the structural balance of 1.1%, 0.8%, 0.8%, and 1.2% of GDP in the years 2013-2016 respectively, based on the Commission 2013 spring forecast extended to 2016. Spain was also recommended to: (a) implement the measures adopted in the 2013 budget plans at all levels of government and stand ready to take corrective action in case of deviations from budgetary plans; (b) reinforce the medium-term budgetary strategy with well-specified structural measures for the years 2014-2016 that are necessary to achieve the correction of the excessive deficit by 2016; (c) strengthen the effectiveness of the institutional framework by raising further the transparency in implementation of the Stability Law as well as by establishing an independent fiscal council to provide analysis, advice and monitor compliance of fiscal policy with national and EU fiscal rules; (d) undertake concrete steps to rein in the increasing structural deficit in the social security system; and, (e) give a greater emphasis to the growth friendliness of the consolidation, including by conducting systematic reviews of expenditure and the tax system. In addition, to ensure the success of the fiscal consolidation strategy, the Council highlighted the importance of backing the fiscal consolidation by comprehensive structural reforms, in line with the Council recommendations addressed to Spain in the context of the European Semester and the Macroeconomic Imbalances Procedure.

On 18 May 2016, in the context of the European Semester, the Commission issued a recommendation for a Council recommendation to Spain in the form of a CSR[9]. In the area of public finances, the Commission recommends calling Spain to ensure a durable correction of the excessive deficit by 2017, reducing the general government deficit to 3.7% of GDP in 2016 and to 2.5% of GDP in 2017, by taking the necessary structural measures and by using all windfall gains for deficit and debt reduction. This is consistent with an improvement in the structural balance of 0.25% of GDP in 2016 and of 0.5% of GDP in 2017. The Commission

[9] COM (2016) 329 final

also recommended to implement at all government levels the tools set out in the fiscal framework law and to enhance control mechanisms for public procurement and coordination of procurement policies across government levels. In line with its duty to monitor the implementation of the excessive deficit procedure under Article 126 of the Treaty, the Commission will come back to the assessment of the situation of Spain in early July

Compliance with the June 2013 EDP recommendation

As stated in Section 3.1, Spain did not fulfil the 4.2% EDP headline deficit target in 2015. In addition, while the June 2013 EDP recommendation required Spain to achieve an improvement in the structural balance of 0.8% of GDP in 2015, the Commission estimates based on the 2016 spring forecast point to a structural balance deterioration of 1% of GDP. In cumulative terms over 2013-2015, the unadjusted change in the structural balance stands at 0.6% of GDP, which is significantly below the cumulative recommended structural improvement of 2.7% of GDP. This warrants a careful analysis.

The adjusted change in the structural balance amounts to -0.7% of GDP in 2015, leading to a gap of 1.5% of GDP vis-à-vis the recommended structural improvement of 0.8% of GDP. In cumulative terms over 2013-2015, the adjusted change in the structural balance equals -0.2% of GDP, which is again well below the recommended cumulative structural improvement of 2.7% of GDP.

The fiscal effort based on the bottom-up method yields -0.5% of GDP in 2015, well below what is deemed necessary to comply with the EDP recommendation (1% of GDP), and to no effort over the 2013-2015 period, against a recommended cumulative fiscal effort of 3% of GDP.

For 2016 – i.e. the deadline for the correction of the excessive deficit set out in the June 2013 recommendation – the headline deficit is forecast to reach 3.9%, well above the deficit reference value of the Treaty and the recommended deficit target of 2.8% of GDP. The unadjusted and adjusted changes in the structural balance are both projected to be -0.2% of GDP, further widening the gap vis-a-vis the recommended effort. Also based on the bottom-up method, no fiscal effort is projected to be delivered by Spain in 2016, which implies falling significantly short of the 1.5% of GDP effort deemed necessary to achieve the target.

Table 4: Compliance with the requirements of the corrective arm

(% of GDP)	2015	2016		2017	
	COM	SP	COM	SP	COM
Headline balance					
Headline budget balance	-5.1	-3.6	-3.9	-2.9	-3.1
EDP requirement on the budget balance	-4.2	-2.8		-	
Fiscal effort - change in the structural balance					
Change in the structural balance[1]	-1.0	0.2	-0.2	0.2	-0.1
Cumulative change[2]	0.6	-0.7	-1.1	-	-
Required change from the EDP recommendation	0.8	1.2		-	
Cumulative required change from the EDP recommendation	2.7	3.9		-	
Fiscal effort - adjusted change in the structural balance					
Adjusted change in the structural balance[3]	-0.7	-	-0.2	-	-
of which: *correction due to change in potential GDP estimation (α)*	-1.0	-	-0.1	-	-
correction due to revenue windfalls/shortfalls (β)	-0.3	-	0.1	-	-
Cumulative adjusted change [2]	-0.2	-	-1.3	-	-
Required change from the EDP recommendation	0.8	1.2		-	
Cumulative required change from the EDP recommendation	2.7	3.9		-	
Fiscal effort - calculated on the basis of measures (bottom-up approach)					
Fiscal effort (bottom-up)[4]	-0.5	-	0.0	-	-
Cumulative fiscal effort (bottom-up)[2]	0.0	-	0.0	-	-
Requirement from the EDP recommendation	1.0	1.5		-	
Cumulative requirement from the EDP recommendation	3.0	4.5		-	

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 2016 spring forecasts (COM); Commission calculations.

Consistency with the May 2016 fiscal country-specific recommendation

On 18 May 2016, in the context of the European Semester, the Commission recommended to the Council to call on Spain to correct its excessive deficit by 2017.

For 2016, the deficit ceiling of 3.7% of GDP set out in the Commission fiscal CSR is slightly above the 3.6% of GDP deficit envisaged in the programme. The recommended structural effort of 0.25% of GDP is broadly in line with the narrowing of the structural deficit (as recalculated by the Commission following the commonly agreed methodology) by 0.2% of GDP that is planned in the programme. Therefore, based on the programme, the intermediary

targets for 2016 that are set out in the May 2016 Commission fiscal CSR appear within reach. By contrast, the deficit projection of 3.9% of GDP in 2016 in the Commission 2016 spring forecast and the resulting deterioration of the structural balance by 0.2% of GDP imply that further measures will need to be taken in 2016 to achieve the targets in the Commission fiscal CSR.

Table 5: Consistency with the May 2016 fiscal country-specific recommendation

(% of GDP)	2015	2016		2017	
	COM	SP	COM	SP	COM
Headline balance					
Headline budget balance	-5.1	-3.6	-3.9	-2.9	-3.1
May 2016 fiscal CSR on the budget balance	-	-3.7		-2.5	
Fiscal effort - change in the structural balance					
Change in the structural balance[1]	-1.0	0.2	-0.2	0.2	-0.1
Cumulative change[2]	-	0.2	-0.2	0.4	-0.3
Required change from the May 2016 fiscal CSR	-	0.25		0.5	
Cumulative required change from the EDP recommendation	-	0.25		0.75	

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.

Source :

Stability Programme (SP); Commission 2016 spring forecasts (COM); Commission calculations.

For 2017, both the programme and the Commission forecast point to a headline deficit above the target set in the Commission fiscal CSR. Similarly, the change in the structural balance is projected to fall short of the effort of 0.5% of GDP set out in the Commission fiscal CSR. The gap vis-à-vis the targets in the Commission fiscal CSR for 2017 is larger according to the Commission 2016 spring forecast.

5. FISCAL SUSTAINABILITY[10]

Spain does not appear to face fiscal sustainability risks in the short run[11].

Based on the Commission 2016 spring forecast and a no-policy-change scenario beyond the forecast horizon, government debt, at 99.2% of GDP in 2015, is expected to decrease to 98.5% in 2026, thus remaining above the 60% of GDP Treaty reference value. Over this horizon, government debt is projected to peak in 2020 at more than 101% of GDP. This points to high risks for the country from debt sustainability analysis in the medium term. The full implementation of the Stability Programme would nonetheless put debt on a faster decreasing path by 2026, although remaining above the 60% of GDP reference value in 2026.

The medium-term fiscal sustainability risk indicator S1 is at 3.4 pps. of GDP, primarily related to the high level of government debt and the initial budgetary position contributing with 3.0 and 1.4 pps. of GDP, respectively, thus indicating high risks in the medium term. The full implementation of the Stability Programme would put the sustainability risk indicator S1 at 3.5 pps. of GDP, leading to similar medium-term risk. Overall, risks to fiscal sustainability over the medium term are, therefore, high. Fully implementing the fiscal plans in the Stability Programme would leave those risks fairly unchanged.

The long-term fiscal sustainability risk indicator S2 (which shows the adjustment effort needed to ensure that the debt-to-GDP ratio is not on an ever-increasing path) is at 0.8 pps. of GDP. In the long-term, Spain therefore appears to face low fiscal sustainability risks, primarily related to pensions and other expenditure projections (contributing with -0.7 pp. of GDP and -1.8 pps. of GDP, respectively) partly offsetting the negative impact of the initial budgetary position and projections for health care and long-term care (contributing with 1.5 pps., 0.8 pp. and 1.1 pps. of GDP, respectively). Full implementation of the programme would leave the S2 indicator at 0.8 pp. of GDP, confirming the low long-term risk.

The 2013 pension reform will help to contain pressure on expenditure in the long term. The reform revised the indexation of pensions and introduced, as from 2019, the so-called sustainability factor, which is an automatic adjustment of future retirees' new pensions to take account of changes in life expectancy. In December 2015, based on the pension reform, the government adopted the minimum nominal increase of pensions of 0.25 % for 2016.

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[10] The analysis in this section includes the new long-term budgetary projections of age-related expenditure (pension, health care, long-term care, education and unemployment benefits) from the 2015 Ageing Report published on 12 May. It therefore updates the assessment made in the Country Reports published on 26 February. See http://ec.europa.eu/economy_finance/publications/european_economy/2015/ee3_en.htm and http://ec.europa.eu/europe2020/making-it-happen/country-specific-recommendations/index_en.htm.

[11] This conclusion is based on the short-term fiscal sustainability risk indicator S0, which incorporates 14 fiscal and 14 financial-competitiveness variables. The fiscal and financial-competitiveness sub-indexes (reported in table 5) are based on the two sub-groups of variables respectively. For sustainability risks arising from the individual variables, by country, see the Commission's Fiscal Sustainability Report 2015 (page 67).

Table 6: Sustainability indicators

Time horizon			No-policy Change Scenario		Stability / Convergence Programme Scenario	
Short Term			**LOW risk**			
S0 indicator [1]			0.2			
Fiscal subindex (2015)			0.3	LOW risk		
Financial & competitiveness subindex (2015)			0.2	LOW risk		
Medium Term			**HIGH risk**			
DSA [2]			HIGH risk			
S1 indicator [3]			3.4	HIGH risk	3.5	HIGH risk
of which						
	IBP		1.4		1.2	
	Debt Requirement		3.0		3.2	
	CoA		-1.0		-0.9	
Long Term			**LOW risk**		**LOW risk**	
S2 indicator [4]			0.8		0.8	
of which						
	IBP		1.5		1.2	
	CoA		-0.7		-0.4	
	of which					
		Pensions	-0.7		-0.6	
		HC	0.8		0.8	
		LTC	1.1		1.1	
		Other	-1.8		-1.6	

Source: Commission services; 2016 stability/convergence programme.

Note: the 'no-policy-change' scenario depicts the sustainability gap under the assumption that the structural primary balance position evolves according to the Commissions' spring 2016 forecast until 2017. 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 2015 Ageing Report.

[1] The S0 indicator reflects up to date evidence on the role played by fiscal and financial-competitiveness variables in creating potential fiscal risks. It should be stressed that the methodology for the S0 indicator is fundamentally different from the S1 and S2 indicators. S0 is not a quantification of the required fiscal adjustment effort like the S1 and S2 indicators, but a composite indicator which estimates the extent to which there might be a risk for fiscal stress in the short-term. The critical threshold for the overall S0 indicator is 0.43. For the fiscal and the financial-competitiveness sub-indexes, thresholds are respectively at 0.35 and 0.45.

[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. See Fiscal Sustainability Report 2015.

[3] The medium-term sustainability gap (S1) indicator shows the upfront adjustment effort required, in terms of a steady adjustment in the structural primary balance to be introduced over the five years after the forecast horizon, and then sustained, to bring debt ratios to 60% of GDP in 2030, including financing for any additional expenditure until the target date, arising from an ageing population. The following thresholds were used to assess the scale of the sustainability challenge: (i) if the S1 value is less than zero, the country is assigned low risk; (ii) if a structural adjustment in the primary balance of up to 0.5 p.p. of GDP per year for five years after the last year covered by the spring 2015 forecast (year 2017) is required (indicating an cumulated adjustment of 2.5 pp.), it is assigned medium risk; and, (iii) if it is greater than 2.5 (meaning a structural adjustment of more than 0.5 p.p. of GDP per year is necessary), it is assigned high risk.

[4] The long-term sustainability gap (S2) indicator shows the immediate and permanent adjustment required to satisfy an inter-temporal budgetary constraint, including the costs of ageing. The S2 indicator has two components: i) the initial budgetary position (IBP) which gives the gap to the debt stabilising primary balance; and ii) the additional adjustment required due to the costs of ageing. The main assumption used in the derivation of S2 is that in an infinite horizon, the growth in the debt ratio is bounded by the interest rate differential (i.e. the difference between the nominal interest and the real growth rates); thereby not necessarily implying that the debt ratio will fall below the EU Treaty 60% debt threshold. The following thresholds for the S2 indicator were used: (i) if the value of S2 is lower than 2, the country is assigned low risk; (ii) if it is between 2 and 6, it is assigned medium risk; and, (iii) if it is greater than 6, it is assigned high risk.

6. FISCAL FRAMEWORK

Since 2011,[12] Spain's fiscal framework has been strengthened with, among other things, a structural balanced budget target, a limit to the public debt-to-GDP ratio equal to the reference value laid down in the European regulations, as well as an adjustment path towards both objectives. Other changes include the definition of annual headline deficit and public debt targets and a spending rule for each general government subsector, together with preventive and corrective provisions to ensure their compliance. This section reviews the Stability Programme's compliance with domestic fiscal rules, drawing upon assessments made by AIReF,[13] Spain's independent fiscal institution, and the Ministry of Finance.[14]

Compliance with the domestic deficit targets

The large deviation of the general government deficit in 2015 from the EDP target reflects deviations from the deficit targets set for each level of government. Slippages were concentrated at the regional level, where on average, the deficit turned out 0.9% of GDP higher than the targeted 0.7% of GDP, and the social security system, which recorded a deficit of 1.3% of GDP, 0.7% of GDP above its target. Despite this, in 2015, no preventive (nor corrective) measures set out in Spain's Stability law have been applied by the Ministry of Finance to regions at risk of non-compliance with the 2015 fiscal targets. By contrast, the central and local governments over-performed their respective targets by a total of 0.6% of GDP (Table 7).

Table 7: General government deficit, debt and spending rule targets for 2015 and 2016

	2015			2016
	Target	Outcome	Deviation	Target
Public deficit outcome (% of GDP)				
General Government	-4.2	-5.1	-0.9	-3.6
1. Central Administration	-2.9	-2.6	0.3	-1.8
2. Autonomous Communities	-0.7	-1.7	-1.0	-0.7
3. Local Authorities	0	0.4	0.4	0
4. Social Security	-0.6	-1.3	-0.7	-1.1
Public debt targets (% of GDP)				
General government	101.7	99.2	2.5	99
1. Central Administration and social security	76.3	71.7	4.6	71.7
2. Autonomous Communities	21.5	24.2	-2.7	24.2
3. Local Authorities	3.9	3.3	0.6	3.1
Expenditure rule outcome (i.e., % change in eligible spending)				
1. Central Administration	1.3	5.5	-4.2	1.8
2. Autonomous Communities	1.3	4.4	-3.1	1.8
3. Local Authorities	1.3	1.7	-0.4	1.8

Source: IGAE (Ministry of Finance)

Compared with last year's Stability Programme, the 2016 domestic deficit targets for the general government subsectors have been revised, with the exception of local governments. The central government faces a more demanding target (-1.8% of GDP, vs. -2.2%), which, however, falls within the range of possible deficit outcomes estimated by AIReF. Conversely,

[12] The strengthening of Spain's fiscal framework follows the amendments made to Article 135 of the Spanish Constitution and the enactment of Spain's Stability Law, which implements it.

[13] See AIReF's report on the 2016 Stability Programme.

[14] See Spain's Ministry of Finance April 2016 report on compliance with the 2015 deficit, debt and spending rule domestic targets.

the targets for regional governments and social security have become less demanding, at -0.7% and -1.1% of GDP, respectively (compared with -0.3% each in the 2015 Stability Programme). Based on AIReF's assessment, regional governments could reach the revised target, conditional upon the full implementation of consolidation measures announced in response to the March 2016 recommendation. However, AIReF also advised against the practice of setting the same deficit target for all regional governments, as it could be too demanding for some and too unambitious for others. Finally, the social security's new deficit target is outside the range of likely deficit outcomes estimated by AIReF.

Spain's Stability law also prescribes a path for the structural adjustment, whereby the general government structural deficit must drop by at least 0.8% of GDP per year until it reaches a balanced position, by 2020 at the latest, unless Spain is placed under the EDP. In that case, the required structural adjustment is adjusted to the terms thereof. Section 4 has already provided an assessment of the structural adjustment in light of the June 2013 EDP recommendation. It concludes that the past and expected reduction of the general government structural deficit falls short of the effort required from Spain in the context of its EDP.

Compliance with the domestic debt targets

The Stability Law provides that once the Spanish economy achieves a real growth rate of at least 2% or generates net employment with growth of at least 2% per annum, public debt should be reduced annually by at least 2% of GDP. In 2015, the general government is reported[15] to have complied with the 2015 domestic target of 101.7% of GDP, which was adopted by the Council of Ministers in June 2014. This largely owed to the central and local governments over achieving their targets, despite a slippage recorded at regional level. However, the 2015 Stability Programme already forecast a lower debt-to-GDP-ratio, at 98.9% of GDP, in light of a more favourable macroeconomic scenario than expected on year earlier. Based on the outturn data for 2014, with a debt to GDP ratio of 99.3% of GDP and considering that both real GDP and employment increased by more than 2% in 2015, the debt to GDP ratio should have fallen to 97.3% of GDP, as per the above-mentioned rule.

For 2016-2019, the public debt targets in the Stability Programme also fall short of the requirements of Spain's Stability Law. Specifically, although Spain is expected to grow above 2% in each year of the programme period, the cumulated reduction of the debt-to-GDP ratio over 2016-2019 amounts to 3.2% of GDP, which is below the 8% of GDP required by that law.

Compliance with the domestic spending rule

On 15 April, the Ministry of Finance reported that the central, regional and local governments failed to comply with the Stability Law's spending rule, whereby the variation in the eligible expenditure[16] of the central, regional and local governments should not exceed the reference rate of medium-term growth of Spain's GDP. The reference rate for the change of eligible spending was set by the Ministry of Economy at 1.3% in 2015 and 1.8% in 2016, which in light of the Commission's estimate of potential growth based on the commonly agreed

[15] See Spain's Ministry of Finance April 2016 report on compliance with the 2015 deficit, debt and spending rule domestic targets.

[16] According to Spain's Stability Law, eligible expenditure consists of non-financial expenditure not including debt servicing, non-discretionary expenditure on unemployment benefits, the part of expenditure financed with assigned funds from the European Union or from other Public Administrations and transfers to Autonomous Communities and Local Corporations tied to financing systems.

methodology appears high. Moreover, as also noted by AIReF, the Stability Programme does not include sufficient information to allow an assessment of compliance with the domestic expenditure rule over 2016-2019.

To sum up, based on the assessment provided by national institutions and information provided in the Stability Programme, the past and expected fiscal performance in Spain appears to comply only partially with the requirements of the applicable national numerical fiscal rules.

The Stability Programme as national medium-term fiscal plan

The 2016 Stability Programme is considered as Spain's national medium-term fiscal plan in the sense of Two-Pack, although it does not explicitly include such an indication (unlike in the 2014 Stability 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 (EU) No 473/2013.

7. CONCLUSIONS

In 2015, Spain achieved a headline deficit of 5.1% of GDP, exceeding the target under the EDP by 0.9% of GDP. Moreover, the required fiscal effort has not been delivered either on the basis of all metrics. The government debt-to-GDP ratio stabilised at just above 99%.

The 2016 Stability Programme envisages Spain to correct its excessive deficit by 2017, i.e. one year later than the deadline set by the Council in the lastest EDP recommendation. Based on a macroeconomic scenario that appears plausible in 2016 and 2017 and somewhat favourable thereafter, the planned reduction of the deficit over the programme period relies to a large extent on the continued recovery. In addition, the programme assumes full implementation of the planned but yet-to-be specified measures to rein in public spending at central and regional level, which are expected to be of a permanent nature. Given the political situation in which it was prepared, with only a caretaker government and pending elections, the programme does not contain any further new fiscal consolidation measures affecting 2017 or later years.

The planned improvement in the structural balance in 2016 falls short of the effort required by the Council in the latest EDP recommendation, on the basis of both the unadjusted and the ajdusted changes in the structural balance. Based on bottom-up method, the effort is also below the requirement in 2016. The same conclusion could be drawn on the basis of the Commission 2016 spring forecast.

At 3.9% of GDP in 2016 and 3.1% of GDP in 2017, the headline deficit in the Commission 2016 spring forecast is slightly higher than the targets set in the programme. After peaking at slightly above 100% of GDP in 2016, the debt ratio is projected to decline to 99.6% of GDP in 2017. The structural deficit is projected to slightly increase in both years. Risks to the deficit targets in the programme largely stem from uncertainties surrounding the implementation of the savings from the March/April 2016 measures.

Finally, while in line with its duty to monitor the implementation of the excessive deficit procedure under Article 126 of the Treaty, the Commission will come back to the situation of of Spain in early July, based on the programme, the intermediate targets for 2016 that are set out in the 18 May 2016 Commission fiscal CSR appear within reach. By contrast, the deficit projection in the Commission 2016 spring forecast and the resulting deterioration of the

structural balance imply that further measures will need to be taken in 2016 to achieve the targets in the Commission fiscal CSR. For 2017, both the programme and the Commission forecast point to the need for additional measures, with the gap vis-à-vis the targets in the Commission fiscal CSR being larger according to the Commission forecast.

8. ANNEX

Table I. Macroeconomic indicators

	1997-2001	2002-2006	2007-2011	2012	2013	2014	2015	2016
Core indicators								
GDP growth rate	4.4	3.4	0.1	-2.1	-1.2	1.4	2.8	2.6
Output gap [1]	1.3	2.6	-1.8	-7.4	-7.9	-6.4	-3.8	-1.8
HICP (annual % change)	2.4	3.3	2.4	2.4	1.5	-0.2	-0.6	1.1
Domestic demand (annual % change) [2]	4.9	4.5	-1.1	-4.2	-2.7	2.3	3.3	2.8
Unemployment rate (% of labour force) [3]	14.2	10.3	15.7	24.8	26.1	24.5	22.4	20.5
Gross fixed capital formation (% of GDP)	24.6	28.7	25.8	19.7	18.5	18.9	19.4	20.0
Gross national saving (% of GDP)	22.4	23.0	20.1	19.8	20.4	20.1	21.2	21.5
General Government (% of GDP)								
Net lending (+) or net borrowing (-)	**-2.0**	**0.5**	**-6.4**	**-10.3**	**-6.8**	**-5.8**	**-4.5**	**-3.5**
Gross debt	**60.0**	**45.1**	**51.4**	**84.4**	**92.1**	**97.7**	**100.4**	**101.4**
Net financial assets	**-47.3**	**-31.8**	**-31.6**	**-58.1**	**n.a**	**n.a**	**n.a**	**n.a**
Total revenue	38.1	38.9	36.9	37.0	37.5	37.8	37.9	37.8
Total expenditure	40.0	38.4	43.4	47.3	44.3	43.6	42.4	41.4
of which: Interest	3.6	2.1	1.8	2.9	3.3	3.3	3.1	3.0
Corporations (% of GDP)								
Net lending (+) or net borrowing (-)	**-1.9**	**-4.6**	**0.3**	**8.1**	**5.3**	**3.7**	**2.6**	**1.4**
Net financial assets; non-financial corporations	**-97.5**	**-115.0**	**-137.9**	**-129.3**	**n.a**	**n.a**	**n.a**	**n.a**
Net financial assets; financial corporations	**0.9**	**2.0**	**10.2**	**14.8**	**n.a**	**n.a**	**n.a**	**n.a**
Gross capital formation	14.6	16.0	14.7	13.7	13.6	14.2	14.7	15.2
Gross operating surplus	20.0	19.6	22.6	23.1	23.1	23.0	22.6	22.3
Households and NPISH (% of GDP)								
Net lending (+) or net borrowing (-)	**2.2**	**-1.1**	**0.5**	**2.3**	**3.6**	**3.2**	**3.5**	**3.5**
Net financial assets	**113.9**	**94.9**	**76.9**	**84.7**	**n.a**	**n.a**	**n.a**	**n.a**
Gross wages and salaries	38.2	37.6	39.4	37.6	36.9	37.0	37.2	37.1
Net property income	4.0	3.9	3.3	3.4	3.6	4.3	4.4	4.5
Current transfers received	19.7	18.7	20.9	23.5	23.8	22.9	22.5	22.2
Gross saving	7.7	7.0	7.0	6.1	6.8	6.4	6.7	6.8
Rest of the world (% of GDP)								
Net lending (+) or net borrowing (-)	**-1.7**	**-5.2**	**-5.7**	**0.1**	**2.1**	**1.0**	**1.6**	**1.4**
Net financial assets	**30.9**	**50.6**	**83.3**	**89.2**	**n.a**	**n.a**	**n.a**	**n.a**
Net exports of goods and services	-1.5	-3.8	-2.8	1.6	3.4	2.4	2.4	2.1
Net primary income from the rest of the world	-0.8	-1.2	-2.0	-0.8	-0.7	-0.6	-0.1	-0.1
Net capital transactions	0.9	0.8	0.4	0.5	0.7	0.4	0.4	0.4
Tradable sector	48.8	45.2	42.8	44.0	44.1	43.8	n.a	n.a
Non tradable sector	42.3	45.0	48.9	47.8	47.2	47.4	n.a	n.a
of which: Building and construction sector	8.8	10.1	9.0	5.8	5.2	5.1	n.a	n.a
Real effective exchange rate (index, 2000=100)	85.2	92.6	101.7	92.1	92.4	91.6	87.5	86.7
Terms of trade goods and services (index, 2000=100)	94.8	98.5	99.2	94.8	96.2	95.8	97.3	96.9
Market performance of exports (index, 2000=100)	108.6	106.2	101.6	106.1	108.4	109.0	110.6	111.4

Notes:

[1] The output gap constitutes the gap between the actual and potential gross domestic product at 2005 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 :

Commission 2015 spring forecast (COM); SCP: Stability programme (SP).