

9. SPAIN

Strong, balanced economic growth

Economic activity continues to exceed expectations, underpinned by a more balanced growth pattern than before the crisis. Growth is set to ease, driven by the expected slowdown in private consumption, despite the projected rebound in investment and the positive external outlook. Unemployment is set to continue declining, and inflation is expected to pick up as core inflation recovers. Thanks to the positive macroeconomic outlook and the impact of mainly corporate taxation measures, the budget deficit and the public debt ratio are expected to continue declining.

The recovery continues

Now in its fourth year of expansion, Spain continues to grow faster than the euro area average, and the volume of GDP is expected to surpass its pre-crisis peak this year. Hard and soft indicators suggest that growth gathered further pace in the first quarter of this year. A more balanced growth pattern than in the pre-crisis years is supporting the strong recovery, with net exports having a positive contribution to growth despite the strength of final demand. Nevertheless, domestic demand remains the main engine of growth, supported by strong job creation.

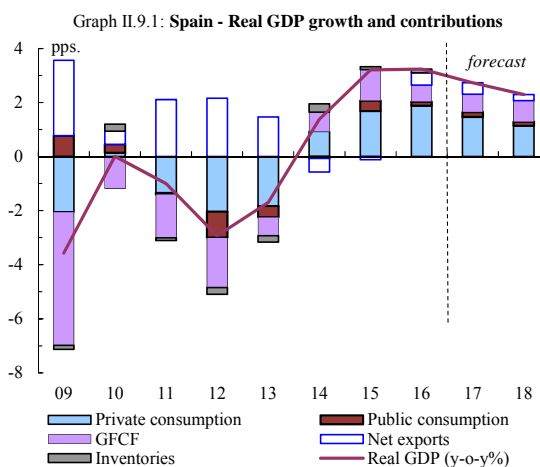
Improved outlook for 2017 and 2018, but deceleration still expected

Strong activity in the first quarter has led to an upward revision of the growth forecast for 2017 and 2018 compared to the Commission's winter 2017 forecast. However, growth is still expected to ease over this year and the next, to an annual average of 2.8% in 2017 and 2.4% in 2018. Private consumption is expected to remain the main driver of growth, but to slow down as job creation eases and other factors that supported household disposable income gains in recent years, such as the decline in oil prices, gradually abate. After weak growth in the second half of 2016, investment is expected to rebound in 2017 and 2018, driven by the gradual recovery of construction investment. Equipment investment, by contrast, is forecast to moderate in line with final demand.

Net exports are set to contribute to growth

The contribution of the external sector to growth turned positive in 2016, as exports recorded sizeable gains in market shares and import growth remained contained despite the strength of final demand. Exports are expected to accelerate in 2017, as Spain continues to record strong gains in export market shares and its trading partners

recover. However, export growth is expected to moderate in 2018, despite faster growth in Spain's export markets, as gains in market shares slow down. Imports are also expected to rebound in 2017 and moderate somewhat in 2018, in line with final demand. As imports are expected to continue growing more slowly than exports, net trade should make a positive contribution to growth throughout the forecast horizon. After widening in 2016, Spain's current-account surplus is forecast to decline in 2017 and 2018, as a consequence of worsening terms of trade. However, this decline is mostly offset by an improving capital account, and Spain's net external lending position is expected to remain broadly stable.



Inflation projected to pick up

Oil price developments are set to continue dominating consumer price inflation in the short term. Headline inflation is forecast to turn positive, rising from -0.3% in 2016 to 2.0% in 2017 before decreasing to 1.4% in 2018, as the base effects of energy price increases fade away in the second half of 2017. Core inflation is projected to gradually recover over the forecast horizon, as wages pick up, the output gap closes, and second round effects from energy price increases are passed-through into consumer prices.

Unemployment is expected to decline further

Administrative data suggest that the pace of job creation in the first quarter of the year picked up after a slowdown in the second half of 2016. Although employment growth is set to ease over the forecast period, it is projected to remain strong, allowing for further reductions in the unemployment rate, which is expected to fall below 16% by 2018, the lowest level since 2009. Wage growth is projected to pick up moderately this year, and, combined with low productivity gains, should lead to increases in nominal unit labour costs over the forecast horizon. Cost-competitiveness gains vis-à-vis the euro area are expected to continue, though slowing down.

Strong growth continues to reduce the deficit

Spain's general government deficit narrowed to 4.5% of GDP in 2016, a reduction of 0.6 pps. of GDP compared to 2015. Thanks to measures adopted in the autumn to strengthen corporate tax revenues, the final quarter of the year yielded more than half of the total deficit reduction achieved during 2016.

In 2017, the forecast incorporates a number of additional measures adopted by parliament in

December 2016. These consist primarily of base-broadening measures in the field of corporate taxation, but also of increases in excise duties on alcohol and tobacco as well as a broadening of the base for social contributions. Previous improvements in financing conditions imply that interest expenditure is set to continue decreasing. In combination with the positive macroeconomic outlook, which should support tax revenues and reduce expenditure on unemployment benefits, the deficit is expected to narrow to 3.2% of GDP in 2017. In 2018, at unchanged policies, it is expected to narrow further to 2.6% of GDP on the back of the cyclical recovery. Risks to the fiscal outlook mainly relate to contingent liabilities and uncertainty regarding the impact of recent tax measures.

After deteriorating significantly in 2015, Spain's structural deficit is expected to have widened further by some 1% of GDP in 2016. It is set to improve marginally in 2017 before stabilising in 2018. Over the forecast horizon, the general government debt ratio is expected to decrease slightly to 98.5% of GDP, as a result of relatively strong nominal GDP growth more than offsetting the budget deficit.

Table II.9.1:

Main features of country forecast - SPAIN

	2015			Annual percentage change						
	bn EUR	Curr. prices	% GDP	97-12	2013	2014	2015	2016	2017	2018
GDP	1075.6	100.0	100.0	2.2	-1.7	1.4	3.2	3.2	2.8	2.4
Private Consumption	625.0	58.1	58.1	1.9	-3.1	1.6	2.9	3.2	2.5	2.0
Public Consumption	208.5	19.4	19.4	3.5	-2.1	-0.3	2.0	0.8	0.9	0.8
Gross fixed capital formation	212.1	19.7	19.7	1.8	-3.4	3.8	6.0	3.1	3.4	3.9
of which: equipment	72.7	6.8	6.8	2.9	5.0	8.3	8.9	5.0	3.9	3.7
Exports (goods and services)	356.9	33.2	33.2	4.5	4.3	4.2	4.9	4.4	5.7	4.8
Imports (goods and services)	330.5	30.7	30.7	4.2	-0.5	6.5	5.6	3.3	4.8	4.4
GNI (GDP deflator)	1074.9	99.9	99.9	2.2	-1.5	1.6	3.5	3.4	2.8	2.3
Contribution to GDP growth:										
Domestic demand				2.3	-2.9	1.6	3.2	2.6	2.3	2.1
Inventories				0.0	-0.2	0.3	0.1	0.1	0.0	0.0
Net exports				0.0	1.5	-0.5	-0.1	0.5	0.4	0.3
Employment				1.3	-3.4	1.1	3.0	2.9	2.3	2.1
Unemployment rate (a)				14.1	26.1	24.5	22.1	19.6	17.6	15.9
Compensation of employees / f.t.e.				3.0	1.4	0.0	0.4	0.0	1.0	1.3
Unit labour costs whole economy				2.1	-0.4	-0.3	0.2	-0.4	0.5	1.0
Real unit labour cost				-0.4	-0.7	0.0	-0.3	-0.7	-0.5	-0.4
Saving rate of households (b)				10.2	9.6	9.0	8.2	7.7	7.2	7.4
GDP deflator				2.6	0.4	-0.3	0.5	0.3	1.1	1.4
Harmonised index of consumer prices				2.7	1.5	-0.2	-0.6	-0.3	2.0	1.4
Terms of trade goods				-0.2	0.6	-0.5	2.0	0.3	-2.0	-0.4
Trade balance (goods) (c)				-5.5	-1.4	-2.2	-2.0	-1.6	-1.9	-1.9
Current-account balance (c)				-4.6	1.5	1.0	1.3	1.9	1.6	1.6
Net lending (+) or borrowing (-) vis-a-vis ROW (c)				-3.9	2.1	1.5	2.0	2.0	1.9	1.9
General government balance (c)				-3.1	-7.0	-6.0	-5.1	-4.5	-3.2	-2.6
Cyclically-adjusted budget balance (d)				-3.2	-2.3	-2.1	-2.7	-3.6	-3.3	-3.4
Structural budget balance (d)				-	-1.9	-1.7	-2.5	-3.5	-3.4	-3.4
General government gross debt (c)				54.3	95.5	100.4	99.8	99.4	99.2	98.5

(a) as % of total labour force. (b) gross saving divided by adjusted gross disposable income. (c) as a % of GDP. (d) as a % of potential GDP.