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COMMISSION OPINION

of 20.11.2019

on the Draft Budgetary Plan of Spain

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GENERAL CONSIDERATIONS

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

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

CONSIDERATIONS CONCERNING SPAIN

3. On 15 October 2019, Spain submitted the Draft Budgetary Plan for 2020. On that basis, the Commission has adopted the following opinion in accordance with Article 7 of Regulation (EU) No 473/2013.

4. The Draft Budgetary Plan was submitted by the outgoing government on the basis of unchanged policies. By letter of 22 October 2019, the Commission invited the Spanish authorities to present, as soon as possible and in parallel with the submission of a draft Budget Law to the Spanish parliament, an updated Draft Budgetary Plan to the European Commission and the Eurogroup that ensures compliance with the Council recommendation for Spain. [1]

5. Spain is subject to the preventive arm of the Stability and Growth Pactand should make sufficient progress towards its medium-term budgetary objective of a balanced budgetary position in structural terms. On 9 July 2019, the Council recommended Spain to ensure that the nominal growth rate of net primary government expenditure does not exceed 0.9% in 2020, corresponding to an annual structural adjustment of 0.65% of GDP, and use any windfall gains to accelerate the reduction of the general government debt ratio. As the latter amounted to 97.6% of GDP in 2018, the year in which it corrected its excessive deficit, and exceeded the 60% of GDP reference value of the Treaty, Spain also needs to make sufficient progress towards compliance with the debt reduction benchmark.

6. According to the Commission 2019 autumn forecast, the Spanish economy is expected to grow by 1.9% in 2019 and 1.5% in 2020. The Draft Budgetary Plan forecasts real GDP growth to reach 2.1% in 2019, 0.2 percentage points higher than the Commission 2019 autumn forecast. For 2020, the Draft Budgetary Plan forecasts real GDP growth to slow to 1.8%, 0.3 percentage point higher than the Commission 2019 autumn forecast, with small differences in the composition of growth. Another difference between the two macroeconomic forecasts in 2019 and 2020 relates to the

[1] Council Recommendation of 9 July 2019 on the 2019 National Reform Programme of Spain and delivering a Council opinion on the 2019 Stability Programme of Spain, OJ C 301, 5.9.2019, p. 48.

GDP deflator, which is expected to be higher in the Draft Budgetary Plan than in the Commission forecast in both years. Higher real GDP growth and a larger GDP deflator result in higher nominal GDP growth in the Draft Budgetary Plan than in the Commission forecast (at 3.7% and 2.9%, respectively, in 2020). The Draft Budgetary Plan is also more optimistic on employment growth in 2020, as it expects it at 2%, vs 1% in the Commission 2019 autumn forecast. National accounts data for the third quarter of 2019, released after the cut-off date of the Commission forecast, show slightly higher real and nominal GDP growth, but lower employment than expected in the Commission forecast. Overall, the macroeconomic projections underpinning the Draft Budgetary Plan appear slightly favourable. The macroeconomic projections in the Draft Budgetary Plan have been endorsed by Spain's independent fiscal authority (AIReF). In order to ensure compliance with the requirement of Regulation (EU) No 473/2013, the draft Budget Act to be transmitted to the national parliament would need to be based on an independently-endorsed macroeconomic forecast.

7. The Draft Budgetary Plan projects a headline deficit of 2.0% of GDP in 2019. In 2020, the Draft Budgetary Plan projects a reduction of the deficit by 0.3 percentage points, which translates into a deficit target of 1.7% of GDP and an improvement of the structural balance[2] of 0.1% of GDP. The Commission 2019 autumn forecast expects the headline government deficit to only narrow from a projected 2.3% of GDP in 2019 to 2.2% of GDP in 2020 and the structural balance to worsen by 0.1% of GDP. The difference is mainly due to lower nominal GDP growth in the Commission 2019 autumn forecast. Moreover, the Draft Budgetary Plan includes one-off expenditure of about 0.1% of GDP in its deficit forecast for 2020, relating to the repayment of the 2012-2014 Christmas bonus affecting regional governments and to compensatory payments to households and companies for damage caused by the adverse weather conditions in 2019. The Commission forecast treats these as measures with a temporary effect that do not qualify as one-offs.

8. Spain’s Draft Budgetary Plan presents a neutral fiscal stance in 2020, as measured by the change in the (recalculated) structural balance. This is broadly confirmed by the Commission 2019 autumn forecast. As the Draft Budgetary Plan is of a no-policy change nature, it does not contain any new measures. However, it incorporates some deficit-increasing measures not yet adopted, but already credibly announced for 2020 and included in the 2019 Stability Programme, amounting to 0.4% – 0.5% of GDP. These are a salary increase in the public sector and full pension indexation based on the projected consumer price index. Both measures have also been included in the Commission 2019 autumn forecast.

With respect to the Recommendation of 9 July 2019 addressed by the Council to Spain to preserve the sustainability of the pension system, and take measures to improve its fiscal and public procurement policy framework, there has been limited progress. The Draft Budgetary Plan is silent about the review of the Stability Law's spending rule. It does not report either on measures to make the use of the Stability Law's mechanisms to prevent and correct deviations from the fiscal targets more automatic. While the new law on public sector contracts was adopted in November 2017, the new envisaged governance bodies have still not been fully set up or are not yet operational, and the adoption of the planned Procurement Strategy is delayed. Moreover, a continuation of the relinking of pension increases to inflation (as

[2] Cyclically adjusted balance net of one-off and temporary measures, recalculated by the Commission on the basis of the information in the Draft Budgetary Plan using the commonly agreed methodology.

decided in 2018, 2019 and planned in the Draft Budgetary Plan for 2020) and the postponement of the sustainability factor would require compensatory measures to ensure the sustainability of the pension system in the medium to long term.

9. In 2019, for Spain to comply with the requirements of the preventive arm, the nominal growth rate of government expenditure, net of discretionary revenue measures and one-offs, should not exceed 0.6%, corresponding to an annual structural adjustment of 0.65% of GDP.

According to the information provided in the Draft Budgetary Plan, the growth rate of government expenditure, net of discretionary revenue measures, will in 2019 exceed the applicable expenditure benchmark rate, leading to a deviation of 0.8% of GDP. The Draft Budgetary Plan points to an improvement in the (recalculated) structural balance of 0.1% of GDP, implying a deviation from the recommended improvement of 0.6% of GDP. Thus, both indicators point to a risk of significant deviation in 2019. This conclusion is confirmed based on the Commission 2019 autumn forecast, which points to even wider gaps of 1.2% of GDP regarding the expenditure benchmark and 0.9% of GDP regarding the improvement in the structural balance.

In 2020, for Spain to comply with the requirements of the preventive arm, the nominal growth rate of government expenditure, net of discretionary revenue measures and one-offs, should not exceed 0.9%, corresponding to an annual structural adjustment of 0.65% of GDP.

The Draft Budgetary Plan indicates a deviation of 1.0% of GDP in 2020, and of 0.9% of GDP on average over 2019 and 2020 taken together, from the expenditure benchmark. The Draft Budgetary Plan points to an improvement in the (recalculated) structural balance of 0.1% of GDP, implying a deviation from the recommended improvement of 0.6% of GDP in 2020 and on average over 2019 and 2020 taken together. Thus, both indicators point to a risk of significant deviation in 2020 based on the no-policy-change Draft Budgetary Plan. This conclusion is confirmed based on the Commission 2019 autumn forecast, which points to even wider gaps of 1.2% of GDP regarding the expenditure benchmark and 0.8% of GDP regarding the improvement in the structural balance (with two-year average deviations of 1.2% and 0.8%, respectively).

10. The output gap estimate based on the common methodology is subject to a high degree of uncertainty, as confirmed by the fact that Spain has been flagged by the plausibility tool. That uncertainty has been reflected in the Council Recommendation of 9 July 2019, which stipulates an adjustment requirement of 0.65% of GDP for 2020 instead of the 1% of GDP stemming from the commonly agreed adjustment matrix of requirements under the Stability and Growth Pact.

11. The Draft Budgetary Plan indicates that the government debt-to-GDP ratio will decline from 97.6% in 2018 to 95.9% in 2019 and to 94.6% in 2020, below the Commission's projection of 96.6% for 2020. The Draft Budgetary Plan does not include sufficient information to assess compliance with the transitional debt rule. According to the Commission 2019 autumn forecast, Spain is not expected to make sufficient progress towards compliance with the debt reduction benchmark in 2019 and 2020, which would require an improvement of the structural balance of 0.5% and 1.0% of GDP in 2019 and 2020, respectively.

12. Overall, while acknowledging the no-policy-change nature of its projections, the Commission is of the opinion that the Draft Budgetary Plan of Spain is at risk of non-compliance with the provisions of the Stability and Growth Pact. In particular, the Commission projects a risk of significant deviation from the required adjustment path to the medium-term budgetary objective. Moreover, Spain is not expected to make sufficient progress towards compliance with the debt reduction benchmark in 2019 and 2020.

The Commission is also of the opinion that Spain has made limited progress with regard to the structural part of the fiscal recommendations contained in the Council Recommendation of 9 July 2019 in the context of the European Semester. It thus invites the authorities to accelerate progress. A comprehensive description of progress made with the implementation of those recommendations will be provided in the 2020 Country Report and assessed in the context of the country-specific recommendations to be proposed by the Commission in spring 2020.

As soon as a new government submits a draft Budget Law to the Spanish parliament and as a rule at least one month before the draft Budget Law is planned to be adopted by the national parliament, the authorities are invited to submit an updated Draft Budgetary Plan to the Commission and the Eurogroup. The Commission invites the authorities to take the necessary measures within the national budgetary process to ensure that the 2020 budget will be compliant with the Stability and Growth Pact and to use any windfall gains to accelerate the reduction of the government debt-to-GDP ratio.

Done at Brussels, 20.11.2019

For the Commission
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Member of the Commission