# 9. SPAIN

## The recovery becomes firmer while the rebalancing of the economy continues

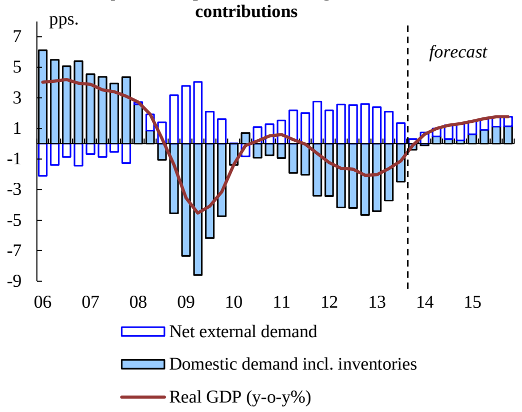
*The incipient economic recovery is forecast to get firmer in the coming quarters, backed by improved confidence and some easing of financing conditions. While the rebalancing of the economy is expected to continue, the growth contribution from external demand is expected to narrow. Employment is forecast to start growing, and the unemployment rate to retreat gradually, amidst continued moderation in unit labour costs. The budget deficit is set to narrow in 2014 but government debt will still rise.*

Spain returned to positive growth territory since the third quarter of 2013 amidst improved confidence and some relaxation of financial conditions. Spain successfully exited the Financial Assistance Programme for the Recapitalisation of Financial Institutions and the stabilisation of Spanish financial markets continues, with sovereign-bond yields at new lows. In general, financing conditions have improved, although they remain onerous for some borrowers, especially for SMEs. Despite these improvements, the still large debt levels and high unemployment weigh on growth prospects and a source of vulnerability to adverse shocks.

### Domestic demand to offset narrowing net exports

GDP growth accelerated to 0.3% q-o-q in the last quarter of 2013 and the recovery is foreseen to consolidate gradually over 2014. While GDP contracted by 1.2% in 2013, it is expected to grow by 1% in 2014 and to gain some further momentum in 2015.

*Graph II.9.1:* **Spain - Real GDP growth and contributions**




The narrowing contribution from the external sector in the second half of 2013 has been more than offset by a less negative contribution from domestic demand. This more balanced growth composition is expected to continue over the coming quarters, with domestic demand gaining some momentum while net external demand provides a positive but declining contribution.

Deleveraging in the private sector will continue to constrain private consumption and investment. Nevertheless, private consumption is forecast to rise, backed by increases in disposable income, improved employment prospects and higher confidence. The projected increase in real gross disposable income, also helped by low inflation (0.3% in 2014), should also allow for a rising – albeit still low – household saving rate over the forecast horizon.

Private investment in equipment is foreseen to benefit from the improved economic outlook and the relative strength of exports, which is one of its most important drivers. By contrast, the adjustment of residential investment, while well advanced, has not reached its inflection point yet, with building permits at historical lows and still falling. Housing transactions seem to have stabilised at very low levels.

Despite a recent deceleration, export growth is set to remain robust, backed by ongoing improvements in price and cost-competitiveness and healthy foreign markets growth. At the same time, imports are forecast to accelerate in line with final demand. As a result of the rising current-account surplus, Spain's net lending is projected to expand over the forecast horizon to around 2.3% of GDP in 2015.

### Employment growth back to positive territory

Having peaked at 27.2% in the first quarter of 2013, the unemployment rate retreated to 26% at the end of last year, mainly due to the decline in the labour force, whereas employment kept falling. However, the process of job destruction is bottoming out and employment is expected to start registering positive growth rates in 2014, contributing to a moderate fall in unemployment. Although productivity growth is expected to decelerate, wage moderation should allow for further improvements in nominal unit labour costs and competitiveness gains.

Downside risks to the growth forecast include a possible stronger-than-expected slowdown of emerging economies and in particular South America, where the exposure of the banking sector is significant. On the upside, a faster-than-expected easing of financing conditions could boost domestic demand.

### Budget deficit reduction set to continue, helped by recovery

Outturn data for 2013 suggest that fiscal consolidation continued last year, but at a more moderate pace than in 2012. The general government deficit is expected to reach 6.7% of GDP for the full year (net of bank recapitalisation costs of about 0.5% of GDP), as the latest data indicate that current revenues may underperform expectations and some expenditure posts might not have fallen as much as planned, inter alia government investment.

The slightly improved macroeconomic outlook contributes to the expected reduction in the general government deficit to 5.8% of GDP in 2014. In addition to the measures presented in the 2014 Budget, further measures of about ¼% of GDP have been announced at the end of last year, including a widening of the base for social security contributions to previously exempt benefits in kind such as transportation aid, lunch vouchers and company cars, as well as the introduction of direct billing. On the expenditure side, cuts were announced regarding some severance payments. While interest and pension expenditure are expected to rise further, falling unemployment and the change in the pension indexation formula should contribute to a deceleration of social transfers in 2014.

Under the no-policy-change assumption, the headline deficit is expected to widen to 6.5% of GDP in 2015. This projection assumes that some temporary tax measures will expire in 2014. The structural deficit is estimated to be close to 4¼% of GDP in both 2013 and 2014 before rising to 5¾% in 2015. Large public deficits and low nominal GDP growth are projected to push the general government gross debt to 99% of GDP in 2014 and 103% of GDP in 2015.

*Table II.9.1:*
**Main features of country forecast - SPAIN**

| | 2012 | | Annual percentage change | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | bn EUR Curr. prices | % GDP | 94-09 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 |
| GDP | 1029.0 | 100.0 | 2.9 | -0.2 | 0.1 | -1.6 | **-1.2** | **1.0** | **1.7** |
| Private Consumption | 610.4 | 59.3 | 2.7 | 0.2 | -1.2 | -2.8 | **-2.4** | **0.6** | **1.1** |
| Public Consumption | 207.7 | 20.2 | 4.0 | 1.5 | -0.5 | -4.8 | **-1.1** | **-0.9** | **-0.2** |
| Gross fixed capital formation | 197.5 | 19.2 | 3.6 | -5.5 | -5.4 | -7.0 | **-5.6** | **0.1** | **2.0** |
| of which: equipment | 60.7 | 5.9 | 4.3 | 5.0 | 5.5 | -3.9 | **1.2** | **5.8** | **6.7** |
| Exports (goods and services) | 336.0 | 32.7 | 5.8 | 11.7 | 7.6 | 2.1 | **4.9** | **5.4** | **6.4** |
| Imports (goods and services) | 328.3 | 31.9 | 6.7 | 9.3 | -0.1 | -5.7 | **0.2** | **3.3** | **4.9** |
| GNI (GDP deflator) | 1017.0 | 98.8 | 2.8 | 0.4 | -0.7 | -0.8 | **-0.8** | **0.5** | **1.3** |
| Contribution to GDP growth: Domestic demand | | | 3.2 | -0.9 | -2.0 | -4.1 | **-2.7** | **0.2** | **0.9** |
| Inventories | | | 0.0 | 0.3 | -0.1 | 0.0 | **0.0** | **0.0** | **0.0** |
| Net exports | | | -0.3 | 0.4 | 2.1 | 2.5 | **1.6** | **0.8** | **0.7** |
| Employment | | | 2.0 | -2.3 | -2.2 | -4.8 | **-3.3** | **0.1** | **1.1** |
| Unemployment rate (a) | | | 13.7 | 20.1 | 21.7 | 25.0 | **26.4** | **25.7** | **24.6** |
| Compensation of employees / f.t.e. | | | 3.5 | 0.4 | 1.3 | 0.2 | **0.5** | **0.6** | **0.6** |
| Unit labour costs whole economy | | | 2.8 | -1.7 | -1.0 | -3.0 | **-1.6** | **-0.4** | **0.0** |
| Real unit labour cost | | | -0.5 | -1.8 | -1.0 | -2.9 | **-1.9** | **-0.9** | **-0.7** |
| Saving rate of households (b) | | | - | 13.9 | 12.7 | 10.4 | **10.4** | **10.6** | **10.9** |
| GDP deflator | | | 3.4 | 0.1 | 0.0 | 0.0 | **0.3** | **0.5** | **0.7** |
| Harmonised index of consumer prices | | | 3.0 | 2.0 | 3.1 | 2.4 | **1.5** | **0.3** | **0.9** |
| Terms of trade goods | | | 0.4 | -2.3 | -3.5 | -2.3 | **0.6** | **1.3** | **-0.1** |
| Trade balance (c) | | | -5.3 | -4.6 | -4.2 | -2.5 | **-1.2** | **-0.4** | **-0.2** |
| Current-account balance (c) | | | -4.3 | -4.4 | -4.0 | -1.2 | **1.1** | **1.6** | **1.8** |
| Net lending (+) or borrowing (-) vis-a-vis ROW (c) | | | -3.4 | -3.8 | -3.5 | -0.6 | **1.9** | **2.2** | **2.3** |
| General government balance (c) | | | - | -9.6 | -9.6 | -10.6 | **-7.2** | **-5.8** | **-6.5** |
| Cyclically-adjusted budget balance (c) | | | - | -7.4 | -7.5 | -8.2 | **-4.7** | **-4.3** | **-6.3** |
| Structural budget balance (c) | | | - | -7.4 | -7.2 | -5.1 | **-4.3** | **-4.2** | **-5.8** |
| General government gross debt (c) | | | 53.7 | 61.7 | 70.5 | 86.0 | **94.3** | **98.9** | **103.3** |

(a) Eurostat definition. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.