9. SPAIN

Growth easing slightly but remains robust

Economic growth is set to ease but remain robust, underpinned by sustained job creation, better financing conditions, high confidence and low oil prices. Inflation is expected to return to positive though low values, while unemployment continues declining. The general government deficit is expected to narrow further thanks to the economic recovery.

Smooth deceleration to continue

Economic growth in Spain eased slightly in the third quarter of 2015, to 0.8% quarter-on-quarter, and is projected to have maintained the same pace in the last quarter. Although growth is forecast to moderate thereafter, it is projected to remain robust over the forecast horizon, backed by positive labour market developments, improved access to credit for firms and households, high confidence and low oil prices. The drag on domestic demand from private sector deleveraging is expected to fade out. Accordingly, Spain's economy is expected to have expanded by 3.2% in 2015 and is forecast to grow by 2.8% and 2.5% in 2016 and 2017, respectively, driven by domestic demand.

According to hard and soft data on economic activity, private consumption growth remained robust in the last quarter of 2015. Despite moderating in 2016, it is expected to remain the main driver of growth throughout the forecast horizon, supported by low inflation and steadily improving labour market conditions. However, the increase in gross disposable income is also foreseen to allow households to increase their savings slightly in 2017.

Equipment investment is also forecast to decelerate over the forecast horizon, albeit still growing at healthy rates, underpinned by positive demand prospects, supportive financing conditions and the projected rebound in exports. After picking-up in 2015, construction investment is forecast to moderate slightly in 2016 but to regain momentum thereafter, mainly driven by non-residential construction dynamics, especially public investment. Residential investment also looks set to gather strength.

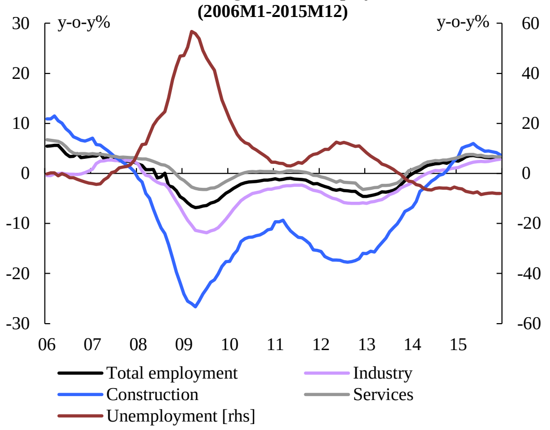
Exports are expected to remain resilient, with exports of goods progressively gathering steam, fuelled by continued improvements in competitiveness and recovering growth in Spain's main export markets. However, while imports are forecast to decelerate in line with final demand, they are expected to continue to outpace exports. As a result, net exports are set to prove negative for growth in 2015 and 2016 and broadly neutral in 2017. The current account surplus is set to widen to 1.5% of GDP in 2015 but to narrow thereafter, due to the decline in terms of trade. Net external lending is expected to narrow from 2.0% of GDP in 2015 to 1.7% in 2017.

In 2015, inflation averaged -0.6%, driven by the fall in oil prices. It is expected to turn slightly positive again in the short term, but to remain low over the forecast horizon, due to low external price pressures and remaining slack in the economy.

Employment growth to moderate

Despite decelerating slightly, job creation remained very robust in the second half of 2015, while the labour force registered a small expansion, limiting the decline in the unemployment rate to 21.2% in the third quarter of 2015, with a further expected decrease in the fourth. Ongoing wage moderation keeps a lid on nominal unit labour cost growth, supporting robust though decelerating job creation. In turn, unemployment is expected to continue falling over the forecast horizon, falling below 19% by 2017.

Graph II.9.1: **Spain - Affiliates to the social security by sector and registered unemployment (2006M1-2015M12)**



Downside risks to the growth forecast stem mainly from the uncertainty surrounding the formation of the new government.

Deficit reduction driven by the recovery

Driven by strong economic growth and the positive effect of improved financing conditions, Spain's public finances continued to improve in 2015. After reaching 5.9% of GDP in 2014, the general government deficit ratio narrowed by a further 0.5 pps. in the first three quarters of 2015 compared to the same period the year before. The pace of deficit reduction is, however, waning, despite rapid GDP growth. In the third quarter, the deficit fell by just 0.1% of GDP, and monthly data for October for all government levels (except local government) indicate no further reduction. Despite cuts in personal income taxes, total tax revenues have held up well, helped by a strong recovery in domestic demand and corporate tax revenues. Government expenditure is however expected to have grown faster in the second half of the year than in the first half, with notable increases in intermediate consumption and public investment.

The reduction of the general government deficit is expected to continue to rely to a large extent on the positive macroeconomic outlook, which will continue supporting tax revenues and keeping social transfers in check. In particular, while pension expenditure is expected to continue rising, falling unemployment limits the growth of social transfers in the near future. Previous improvements in financing conditions and the decelerating public debt ratio imply that interest expenditure will continue to fall. Overall, Spain's general government deficit is expected to have fallen to 4.8% of GDP in 2015 and to narrow to 3.6% in 2016 and, under a no-policy-change assumption, by a further percentage point in 2017. Risks to this deficit forecast stem from uncertainty about the degree of expenditure restraint, primarily at regional government level.

Spain's structural balance is expected to have deteriorated significantly in 2015 and is set to remain broadly stable at 2½% of GDP over the forecast period. Thanks to a narrowing deficit and stronger nominal GDP growth, the public debt ratio is expected to peak in 2016 at 101.2% of GDP before falling back to 100.1% in 2017.

Table II.9.1:

Main features of country forecast - SPAIN

		2014		Annual percentage change						
	bn EUR	Curr. prices	% GDP	96-11	2012	2013	2014	2015	2016	2017
GDP		1041.2	100.0	2.6	-2.6	-1.7	1.4	**3.2**	**2.8**	**2.5**
Private Consumption		606.8	58.3	2.3	-3.5	-3.1	1.2	**3.1**	**3.4**	**2.3**
Public Consumption		202.4	19.4	3.9	-4.5	-2.8	0.0	**2.2**	**0.6**	**0.6**
Gross fixed capital formation		204.1	19.6	2.5	-7.1	-2.5	3.5	**6.1**	**4.6**	**4.8**
of which: equipment		66.6	6.4	3.9	-8.5	4.0	10.6	**9.7**	**8.0**	**5.9**
Exports (goods and services)		338.8	32.5	5.1	1.1	4.3	5.1	**6.0**	**6.1**	**5.8**
Imports (goods and services)		312.9	30.1	5.1	-6.2	-0.3	6.4	**7.9**	**7.4**	**6.2**
GNI (GDP deflator)		1036.9	99.6	2.5	-1.6	-1.4	1.4	**3.4**	**2.6**	**2.5**
Contribution to GDP growth:	Domestic demand			2.7	-4.5	-2.8	1.3	**3.5**	**3.0**	**2.4**
	Inventories			0.0	-0.3	-0.2	0.2	**0.1**	**0.0**	**0.0**
	Net exports			-0.1	2.1	1.4	-0.2	**-0.4**	**-0.2**	**0.1**
Employment				1.7	-4.9	-3.5	1.1	**3.0**	**2.6**	**2.0**
Unemployment rate (a)				13.8	24.8	26.1	24.5	**22.3**	**20.4**	**18.9**
Compensation of employees / f.t.e.				3.3	-0.6	1.7	-0.6	**0.6**	**0.5**	**1.0**
Unit labour costs whole economy				2.5	-2.9	-0.2	-0.8	**0.4**	**0.4**	**0.6**
Real unit labour cost				-0.3	-3.0	-0.8	-0.4	**-0.3**	**-0.6**	**-0.7**
Saving rate of households (b)				10.6	8.8	10.0	9.6	**9.5**	**9.6**	**9.7**
GDP deflator				2.8	0.0	0.6	-0.4	**0.8**	**1.0**	**1.3**
Harmonised index of consumer prices				2.8	2.4	1.5	-0.2	**-0.6**	**0.1**	**1.5**
Terms of trade goods				-0.1	-1.1	0.9	-1.0	**3.7**	**1.7**	**-0.4**
Trade balance (goods) (c)				-5.5	-2.8	-1.4	-2.2	**-1.9**	**-2.0**	**-2.5**
Current-account balance (c)				-4.6	-0.4	1.5	1.0	**1.5**	**1.4**	**1.3**
Net lending (+) or borrowing (-) vis-a-vis ROW (c)				-3.9	0.1	2.2	1.6	**2.0**	**1.8**	**1.7**
General government balance (c)				-2.8	-10.4	-6.9	-5.9	**-4.8**	**-3.6**	**-2.6**
Cyclically-adjusted budget balance (d)				-3.1	-6.3	-2.3	-2.1	**-2.6**	**-2.6**	**-2.5**
Structural budget balance (d)				-	-3.4	-1.9	-1.7	**-2.5**	**-2.6**	**-2.5**
General government gross debt (c)				53.0	85.4	93.7	99.3	**100.7**	**101.2**	**100.1**

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