

## SPAIN

The Spanish economy has grown strongly in 2016, led by domestic demand spurred by easy monetary policy in the euro area and a fiscal stimulus. The expansionary phase is expected to continue in 2017 and 2018, with domestic demand leading the recovery, albeit at a slower pace as some factors that have contributed to boost consumption, such as low oil prices and lower taxes, will recede. Inflation will gradually pick up as the effects of low oil prices diminish, but pressures will remain moderate due to still high unemployment.

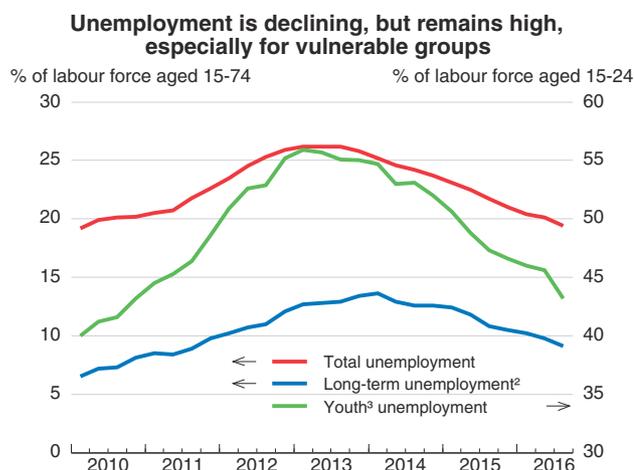
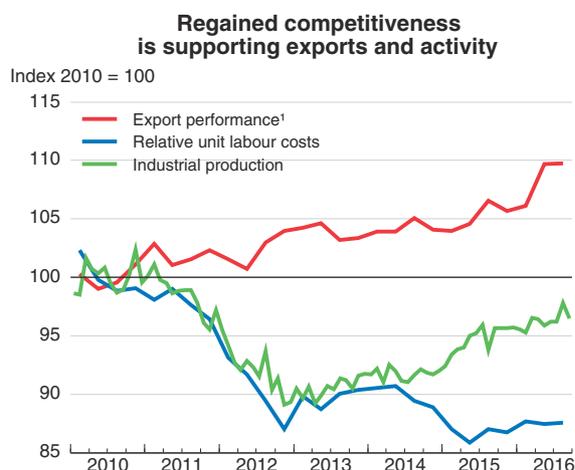
The unemployment rate is declining, but remains high, at about 19%. While falling, high long-term and youth unemployment pose particularly acute challenges. More effective active labour market policies and re-skilling are needed, along with a recovery in demand. Boosting living standards in the medium term hinges on increasing productivity via higher investment in innovation, strengthening skills and more intense competition.

After the significant easing of fiscal policy in 2015 and 2016, the fiscal stance will provide modest support over the projection period. With public debt around 100% of GDP and the deficit still at slightly below 5% of GDP, the scope for fiscal expansion is limited. It is nevertheless important to stimulate growth by shifting spending towards growth-enhancing outlays, such as education, active labour market policies and R&D, which are all below those in peer countries after having fallen substantially since the crisis. The structure of taxation remains tilted towards labour income which penalises growth and employment, and the tax burden should be shifted towards consumption and environmental taxes.

### Growth is keeping its momentum

Economic growth remains robust: activity has grown steadily at an annualised 3.2% rate over the past two years. Domestic demand has been the main engine of growth, with

### Spain



1. Ratio between the growth in export volumes and the growth of the country's export market.

2. Long-term unemployment refers to those who have been unemployed for 12 months or more.

3. 15-24 year-olds.

Source: OECD Economic Outlook 100 database; OECD Main Economic Indicators database; and Eurostat.

StatLink <http://dx.doi.org/10.1787/888933437933>

Spain: **Demand, output and prices**

	2013	2014	2015	2016	2017	2018
	Current prices EUR billion	Percentage changes, volume (2010 prices)				
<b>GDP at market prices</b>	1 025.6	1.4	3.2	3.2	2.3	2.2
Private consumption	598.5	1.6	2.9	3.4	2.1	1.6
Government consumption	201.8	-0.3	2.0	0.9	1.2	1.2
Gross fixed capital formation	192.4	3.8	6.0	4.3	4.7	4.7
Final domestic demand	992.7	1.6	3.3	3.1	2.4	2.2
Stockbuilding <sup>1</sup>	- 0.5	0.3	0.1	0.1	0.0	0.0
Total domestic demand	992.2	1.9	3.4	3.2	2.4	2.2
Exports of goods and services	330.5	4.2	4.9	5.8	4.5	4.6
Imports of goods and services	297.1	6.5	5.6	5.9	5.0	4.7
Net exports <sup>1</sup>	33.4	-0.5	-0.1	0.1	0.0	0.1
<i>Memorandum items</i>						
GDP deflator	—	-0.3	0.5	0.6	1.2	1.1
Harmonised index of consumer prices	—	-0.2	-0.6	-0.3	1.5	1.3
Private consumption deflator	—	0.2	-0.2	-0.1	1.1	0.9
Unemployment rate	—	24.4	22.1	19.6	17.7	16.4
Household saving ratio, net <sup>2</sup>	—	3.2	2.3	1.9	2.4	2.5
General government financial balance <sup>3</sup>	—	-6.0	-5.1	-4.6	-3.6	-2.9
General government gross debt <sup>3</sup>	—	118.9	116.8	118.4	119.1	119.3
General government debt, Maastricht definition <sup>3</sup>	—	100.4	99.8	101.3	102.1	102.2
Current account balance <sup>3</sup>	—	1.1	1.4	2.1	1.7	1.7

1. Contributions to changes in real GDP, actual amount in the first column.

2. As a percentage of disposable income.

3. As a percentage of GDP.

Source: OECD Economic Outlook 100 database.

StatLink  <http://dx.doi.org/10.1787/888933439206>

euro-area monetary policy, fiscal stimulus and a strong labour market supporting household purchasing power and consumption. Business investment growth has continued its dynamic pace supported by favourable financial conditions, solid profit margins and reduced indebtedness. Residential investment has become more positive as households and non-financial corporations have taken advantage of easier financing conditions. Exports are benefitting from gains in competitiveness and from a significant expansion of export markets in recent years. Moderate wage growth has helped preserve competitiveness. Inflation has recently turned positive, but remains moderate owing to low energy prices and still significant slack.

### **Sustaining growth and putting public finances on a stronger footing will require reforms**

After several years of substantial fiscal consolidation, a significant relaxation of the fiscal stance in 2015-2016 supported demand. The budget deficit is expected to decline to 4.6% of GDP in 2016 from 5.1% in 2015, driven by dynamic growth and some consolidation measures, including expenditure cuts and recent amendments to the corporate income tax to make up for a loss in revenue following the 2015 reform. The fiscal stance will provide modest support in 2017 and 2018. While more demand is needed to raise growth further and reduce unemployment significantly, high debt and deficits limit the scope for fiscal

expansion. Any available fiscal space should be used to finance initiatives leading to faster and more inclusive growth. Priorities for higher spending include strengthening vocational education and training and active labour market programmes to effectively fight youth and long-term unemployment. Fighting poverty, especially among families with children, by strengthening minimum income support programmes should also be a priority, as both poverty and inequality have worsened after the crisis.

The government should elaborate a medium-term fiscal plan with an explicit and steady path to medium-term fiscal sustainability. This should be combined with reforms of the tax and spending structure that promote growth. Further tax reform could reduce social security contributions on low-wage workers, broaden the income, corporate and value-added tax bases and make greater use of environmentally-related taxes, which are under-exploited. Exemptions and reduced rates significantly reduce VAT revenues and the new government should reassess the merits of reduced rates and start by progressively eliminating those that mainly benefit higher-income households. Spain has considerable scope to rely more on environmentally-related taxes, which would enhance investment incentives and help reduce the negative impact of growth on the environment. There is scope to raise taxes on fuel for road transport and to increase the taxation of diesel.

### ***Growth will continue at a dynamic pace***

GDP growth is projected to remain dynamic over the forecast period, but to slow somewhat as the pace of growth of domestic demand eases. The contribution of external demand will be subdued, given weakness in trading partners and anaemic world trade. Continued accommodative monetary policy in the euro area should keep boosting investment, but at a slower pace. Inflation will slowly increase, but remain moderate due to continuing slack. The unemployment rate is projected to edge down to 16% by late 2018, but remain almost double that of the euro area.

The balance of risks is tilted to the downside. Domestically, a minority government could reduce Spain's ability to continue to make the necessary reforms to boost growth sustainably. Externally, renewed turbulence in international financial markets could damp private sector confidence and raise the cost of public-debt servicing. A stronger-than-projected impact of Brexit would indirectly hurt Spain through its trade linkages with European markets. On the upside, internal demand could prove more resilient than expected on the back of a stronger pass-through of favourable financing conditions to consumers and businesses.