9. SPAIN

Net exports only source of growth over forecast horizon

External financing conditions improve but the real economy still remains subdued

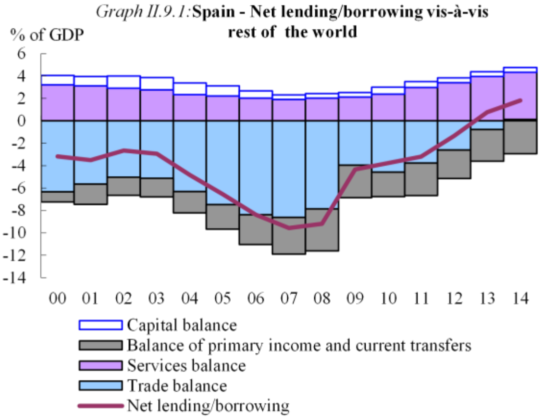
External financing pressures, which had weighed on the Spanish economy for most of the year, started to ease towards the end of 2012. The announcement of the Outright Monetary Transactions programme by the ECB and other decisions at euro-area level, in combination with progress on bank recapitalisation and restructuring under the banking sector programme and progress on key structural reforms, led to a reduction in the Spanish sovereign bond spreads and a higher inflow of private foreign capital. However this improvement in external financing conditions for the sovereign and for financial institutions has not yet fully reached the real economy. Therefore, the short-term outlook for internal credit conditions remains broadly similar to the autumn 2012 forecast.

The rebalancing of the Spanish economy continued in the second half of 2012, with the share of net exports in GDP rising at the expense of domestic demand. The protracted correction of the large external and internal imbalances accumulated in the boom period is holding back private consumption and investment. This continues to have a large negative effect on employment and, hence, unemployment is set to rise further. The necessary consolidation of public finances is also weighing on economic growth in the short term.

Real GDP is expected to contract by around 1½% in 2012 and 2013. After the intensification of the contraction in the fourth quarter of 2012, the fall in GDP is expected to moderate in the course of 2013, with GDP bottoming out towards the end of the year. Economic growth is expected to return to positive territory in 2014 under the usual no-policy-change assumption.

The rebalancing of the economy is expected to proceed over the forecast horizon. Private consumption is forecast to continue to contract on the back of rising unemployment and household deleveraging, although the contraction of households' gross disposable income is set to ease in 2013. However, the saving rate is likely to remain low, as consumers attempt to smooth their consumption level. Private investment is affected by the subdued economic outlook. Thus, despite the relative strength of exports, which are one of the most important drivers of investment in equipment, private investment should continue to contract. Notably, the adjustment of residential investment is maintained, with housing starts at historically low levels and continuing to fall.

Graph II.9.1: **Spain - Net lending/borrowing vis-à-vis rest of the world**



Sources: INE and Commission services.

On the positive side, exports are set to remain strong and to contribute positively to GDP growth. Despite a weakening outlook for the euro area, the main destination of Spanish exports, export sales have shown significant resilience. Improvements in price competitiveness and strong increases of exports towards emerging market economies support this positive outlook. Alongside the relatively good performance of exports, imports are contracting sharply due to weak domestic demand. As a result, Spain has reduced its overall external deficit and is set to record a current-account surplus from 2013 onwards.

Employment destruction accelerated in the last quarter of 2012, pushing the unemployment rate to a record high of 26%. In 2013, the effects of the latest labour market reform should start to have a more noticeable effect, allowing a more balanced adjustment between wages and employment, which could reduce the pace of job destruction. There are already signs that wages are becoming more sensitive to the economic situation, with a clear moderation of wage growth in 2012. This wage moderation is taking place alongside significant increases in apparent labour productivity. As a result, Spanish cost competitiveness is improving, which is a necessary factor for the continuing expansion of exports.

Fiscal consolidation hampered by weak revenue growth

Following the entry into force of additional consolidation measures (increase in VAT, elimination of the Christmas bonus in the public sector, corporate tax measures), budgetary consolidation advanced in the final months of 2012. Also at regional level, expenditure cuts in education are expected to have had their main impact in the last quarter. For the year as a whole, the deficit is therefore expected to narrow to about 7% of GDP, down from 8.9% in 2011, excluding in both years the effects of bank recapitalisations. The latter are currently estimated at around 3.2% of GDP in 2012, but final figures will only be available after the EDP notification in April.

The budgetary performance in 2012 was blighted by considerable shortfalls of both indirect and direct tax revenues. These shortfalls are linked with negative composition effects (due, *inter alia*, to shifts in private consumption patterns and the slump in housing transactions), an even sharper-than-expected fall in employment and labour income, and negative asset price developments. Additional revenue-raising measures introduced throughout the year helped to offset these shortfalls, so that final tax revenues are likely to have turned out broadly in line with initial plans.

In 2013, the general government deficit (excluding bank recapitalisations) is expected to narrow somewhat further, thanks to discretionary measures likely to more than offset the impact of the continued recession. The general government deficit is forecast to reach around 6¾% of GDP in 2013. Stronger VAT revenues due to the full effect of the rate hike and some increased cost control should outweigh an increase in expenditure on social transfers and interest. Despite the return to positive, albeit weak, growth in 2014, the general government deficit is expected to deteriorate to around 7¼% of GDP on a no-policy-change assumption, due to the possible expiry of some of the measures introduced in 2012.

Large public deficits, negative or low nominal GDP growth and the costs of bank recapitalisation are likely to result in a rise of the general government gross debt from around 88% of GDP in 2012 to above 100% of GDP in 2014.

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

	2011			Annual percentage change					
	bn EUR Curr. prices	% GDP	92-08	2009	2010	2011	2012	2013	2014
GDP	1063.4	100.0	3.0	-3.7	-0.3	0.4	**-1.4**	**-1.4**	**0.8**
Private consumption	620.0	58.3	2.8	-3.8	0.7	-1.0	**-1.9**	**-2.7**	**-0.2**
Public consumption	222.7	20.9	3.9	3.7	1.5	-0.5	**-4.1**	**-5.4**	**-1.1**
Gross fixed capital formation	224.0	21.1	3.7	-18.0	-6.2	-5.3	**-8.9**	**-6.6**	**-1.0**
of which : equipment	63.0	5.9	4.2	-24.5	3.0	2.4	**-6.0**	**-3.0**	**0.1**
Exports (goods and services)	321.8	30.3	7.1	-10.0	11.3	7.6	**3.1**	**4.2**	**5.7**
Imports (goods and services)	330.3	31.1	7.5	-17.2	9.2	-0.9	**-5.0**	**-3.8**	**2.0**
GNI (GDP deflator)	1041.9	98.0	2.8	-3.0	0.3	-0.3	**-1.2**	**-1.4**	**0.9**
Contribution to GDP growth : Domestic demand			3.3	-6.6	-0.8	-1.8	**-3.8**	**-4.0**	**-0.5**
Inventories			0.0	0.0	0.1	-0.1	**0.0**	**0.0**	**0.0**
Net exports			-0.3	2.9	0.3	2.3	**2.5**	**2.6**	**1.3**
Employment			2.1	-6.5	-2.3	-1.7	**-4.4**	**-3.1**	**0.0**
Unemployment rate (a)			13.9	18.0	20.1	21.7	**25.0**	**26.9**	**26.6**
Compensation of employees/f.t.e.			4.2	4.4	0.0	0.7	**-0.1**	**1.4**	**0.1**
Unit labour costs whole economy			3.4	1.5	-2.0	-1.4	**-3.2**	**-0.3**	**-0.7**
Real unit labour costs			-0.5	1.4	-2.4	-2.4	**-3.1**	**-2.0**	**-1.9**
Saving rate of households (b)			-	17.8	13.1	11.0	**8.3**	**8.4**	**9.4**
GDP deflator			3.8	0.1	0.4	1.0	**0.0**	**1.7**	**1.3**
Harmonised index of consumer prices			-	-0.2	2.0	3.1	**2.4**	**1.7**	**1.0**
Terms of trade of goods			0.2	4.5	-2.2	-3.3	**-2.9**	**0.8**	**0.7**
Merchandise trade balance (c)			-5.2	-4.0	-4.6	-3.8	**-2.6**	**-0.4**	**0.7**
Current-account balance (c)			-4.0	-4.8	-4.4	-3.7	**-1.9**	**1.0**	**2.5**
Net lending(+) or borrowing(-) vis-à-vis ROW (c)			-3.2	-4.3	-3.8	-3.2	**-1.5**	**1.4**	**2.9**
General government balance (c)			-2.3	-11.2	-9.7	-9.4	**-10.2**	**-6.7**	**-7.2**
Cyclically-adjusted budget balance (c)			-2.3	-9.2	-7.4	-7.5	**-8.0**	**-4.6**	**-6.1**
Structural budget balance (c)			-	-8.6	-7.4	-7.3	**-5.9**	**-4.7**	**-5.5**
General government gross debt (c)			53.4	53.9	61.5	69.3	**88.4**	**95.8**	**101.0**

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