9. SPAIN

Growth to decelerate as private consumption eases

Growth is expected to remain robust but decelerate as households restrain consumption to increase their savings. Unemployment is forecast to continue its decline despite decelerating job expansion, and wage growth is expected to pick up. Steady decline in the government deficit is set to keep the debt ratio on a moderate downward path.

Growth has been robust but lower than expected in the first half of the year

Now in its fifth year of expansion, Spain's economy started to show signs of a mild deceleration in the first half of the year. According to the revised national accounts, real GDP growth stood at 0.6% q-o-q in both Q1 and Q2, slightly lower than anticipated. Together with a downward revision of growth estimates for 2017, this implies a lower growth momentum for 2018 as a whole. The composition of growth has also been somewhat different than anticipated, with a lower contribution of net exports. The pace of economic activity is projected to remain broadly stable in the second half of 2018, as the entry into force of the measures contained in the 2018 budget is set to support an otherwise moderating private consumption. Overall, GDP growth for 2018 is now projected at 2.6%, 0.2 pps. lower than in the summer interim forecast.

Private consumption set to slow, but investment expected to remain dynamic

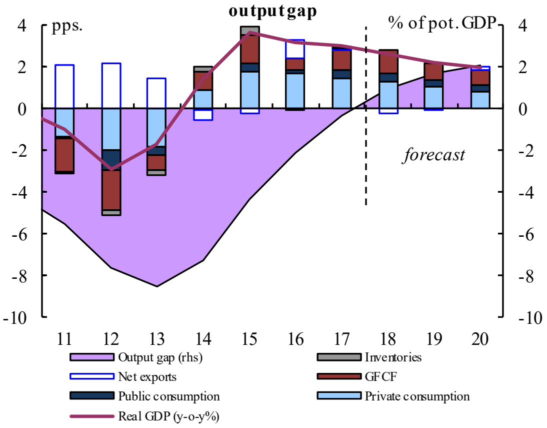
Growth is expected to decelerate further, to 2.2 % in 2019 (also 0.2 pps. lower than in the summer interim forecast) and 2.0% in 2020. The deceleration is mainly driven by a slowdown in private consumption, as oil prices increase further and pent-up demand is absorbed. However, still robust job expansion and accelerating wage growth – also due to the planned increase in the minimum wage - should continue to support disposable income growth over the forecast horizon. As a result, the saving rate, which is expected to reach a historic low in 2018, is projected to rebound in 2019 and increase slightly further in 2020.

Investment is expected to accelerate this year, before moderating over the forecast horizon. Equipment investment, which has surprised by its strength in recent quarters, is expected to slow down but continue growing above final demand, backed by favourable financing conditions. After accelerating this year, construction investment is expected to gradually slow down but remain dynamic over the forecast horizon.

Net exports should support growth again

After a weak start to the year, exports are expected to accelerate in H2-2018 and 2019 and then stabilise, as export markets recover, cost-competitiveness gains continue, and the impact of the appreciation of the euro fades away. After growing more strongly than expected in 2017, imports are set to slow over the forecast horizon as final demand moderates. As a consequence, the contribution of net exports to growth is expected to be negative in 2018, before turning positive again next year. The terms of trade are forecast to deteriorate further this year and then become broadly neutral. These factors should result in a decline of the current account surplus in 2018 and 2019, before improving slightly in 2020.

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



Unemployment set to continue falling

Employment growth is expected to slow down as a consequence of the deceleration of final demand, as well as the dampening impact of the planned increase in the minimum wage. Still, unemployment is set to continue falling, to 13.4% in 2020, its lowest level since 2008. Wage growth is expected to peak in 2019, also under the impact of the increase of the minimum wage, and moderate but still grow at a rate above inflation in 2020. As labour productivity is forecast to grow moderately over the forecast horizon, this will lead to increases in nominal unit labour costs. After reaching 2% in 2017, HICP is expected to gradually moderate over the forecast horizon to 1.5% in 2020, driven by base effects in oil prices. This is despite the gradual increase in core inflation, which is expected to reach 1.7% in 2020, as the output gap widens and wages increase.

Budget deficit set to continue narrowing

After decreasing by 1.4 pps. to 3.1% of GDP in 2017, the general government deficit is expected to decline and reach 2.7% of GDP in 2018, thanks to still robust economic growth. The somewhat slower pace of deficit reduction is due to measures included in the 2018 budget law, namely the higher revaluation of pensions, the pay hike for public employees and, to a lesser extent, the tax cut for low-income earners. The headline deficit is set to decline further in 2019, to 2.1% of GDP, on the back of continued firm economic growth and the net impact of measures in the 2019 draft budgetary plan. The latter include higher revenues from environmental taxes and corporate and household income taxes, as well as new taxes on digital services and financial transactions. Higher expenditure on items such as pensions, long-term care and paternity leave are also included and partly offset the impact of revenue-raising measures. In 2020, at unchanged policies, the deficit is expected to narrow to 1.9% of GDP.

This forecast is based on a cautious assessment of the measures included in the 2019 budget plan. In particular, there is uncertainty regarding the yield of some of the new tax measures, as well as the fiscal impact of the planned increase of the minimum wage. In addition, some of the planned expenditure measures may not be fully executed. Regarding downside risks, compensation payments due following the Supreme Court decision of February 2018 to declare void the ATLL water concession in Catalonia may add to the deficit forecast.

Spain's structural deficit is expected to deteriorate by about ¼% of GDP in 2018 to reach about 3% of GDP, before stabilising around that level over the 2019-2020 period. The general government debt-to-GDP ratio is expected to decrease slightly to 95.4% by 2020, as a result of strong nominal GDP growth and the narrowing budget deficit.

Table II.9.1:

Main features of country forecast - SPAIN

		2017		Annual percentage change						
		bn EUR Curr. prices	% GDP	99-14	2015	2016	2017	2018	2019	2020
GDP		1166.3	100.0	1.7	3.6	3.2	3.0	**2.6**	**2.2**	**2.0**
Private Consumption		670.5	57.5	1.3	3.0	2.9	2.5	**2.3**	**1.8**	**1.4**
Public Consumption		215.7	18.5	3.0	2.0	1.0	1.9	**1.9**	**1.7**	**1.5**
Gross fixed capital formation		239.0	20.5	0.9	6.7	2.9	4.8	**5.4**	**3.9**	**3.3**
of which: equipment		82.4	7.1	2.0	11.9	5.2	6.0	**6.0**	**4.1**	**3.7**
Exports (goods and services)		400.2	34.3	3.7	4.2	5.2	5.2	**2.6**	**3.3**	**3.4**
Imports (goods and services)		366.2	31.4	2.9	5.4	2.9	5.6	**3.5**	**3.5**	**3.2**
GNI (GDP deflator)		1165.0	99.9	1.7	3.7	3.5	2.8	**2.6**	**2.2**	**2.0**
Contribution to GDP growth:	Domestic demand			1.6	3.5	2.4	2.8	**2.8**	**2.2**	**1.8**
	Inventories			0.0	0.5	-0.1	0.1	**0.0**	**0.0**	**0.0**
	Net exports			0.1	-0.3	0.8	0.1	**-0.2**	**0.0**	**0.1**
Employment				0.7	3.3	3.0	2.9	**2.4**	**1.7**	**1.5**
Unemployment rate (a)				15.1	22.1	19.6	17.2	**15.6**	**14.4**	**13.3**
Compensation of employees / f.t.e.				2.8	0.8	-0.5	0.3	**1.0**	**2.4**	**1.7**
Unit labour costs whole economy				1.8	0.5	-0.6	0.2	**0.9**	**1.9**	**1.2**
Real unit labour cost				-0.4	0.0	-0.9	-1.0	**-0.5**	**0.3**	**-0.5**
Saving rate of households (b)				9.8	8.7	7.8	5.5	**4.5**	**5.1**	**5.2**
GDP deflator				2.2	0.5	0.3	1.2	**1.4**	**1.6**	**1.7**
Harmonised index of consumer prices				2.5	-0.6	-0.3	2.0	**1.8**	**1.7**	**1.5**
Terms of trade goods				-0.4	2.1	0.1	-0.8	**-1.6**	**-0.6**	**-0.1**
Trade balance (goods) (c)				-5.4	-2.0	-1.4	-1.9	**-2.3**	**-2.4**	**-2.3**
Current-account balance (c)				-4.3	1.1	2.2	1.9	**1.2**	**1.0**	**1.1**
Net lending (+) or borrowing (-) vis-a-vis ROW (c)				-3.7	1.7	2.4	2.2	**1.5**	**1.3**	**1.4**
General government balance (c)				-3.5	-5.3	-4.5	-3.1	**-2.7**	**-2.1**	**-1.9**
Cyclically-adjusted budget balance (d)				-3.0	-2.8	-3.3	-2.9	**-3.2**	**-3.1**	**-3.1**
Structural budget balance (d)				-	-2.5	-3.3	-2.9	**-3.1**	**-3.1**	**-3.1**
General government gross debt (c)				58.6	99.3	99.0	98.1	**96.9**	**96.2**	**95.4**

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