9. SPAIN

Growth set on a moderating though still robust path

Growth is expected to ease slightly throughout 2019 and then stabilise as the projected slowdown in private consumption is partly offset by a gradual rise in the contribution of net exports to growth. Unemployment is forecast to continue falling despite slower job creation. Thanks to strong economic growth, the government deficit is projected to continue declining, but at a slower pace.

Growth projected to ease but remain robust

Despite some slow down over the course of the year, real GDP in Spain grew by 2.6% in 2018, above the euro area average for the fourth year in a row. Real GDP is expected to have expanded by 0.6% q-o-q in Q1-2019, the same as in the previous quarter and more than previously anticipated. Activity is projected to moderate mildly in the second quarter of this year and stabilise thereafter at a rate of around 0.5% q-o-q over the forecast horizon, as the projected improvement in external performance compensates for the expected slowdown in domestic demand. Overall, GDP growth is forecast at 2.1% in 2019 and 1.9% in 2020.

Private consumption and investment expected to slow down

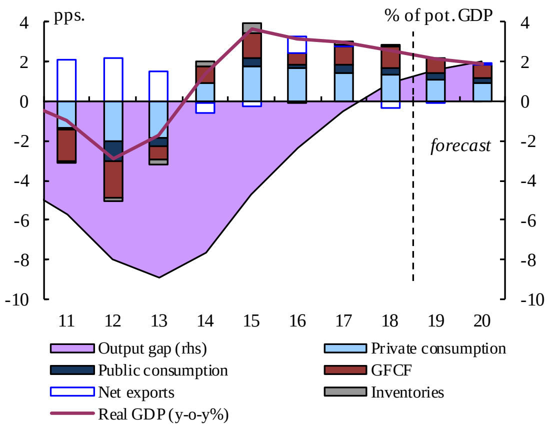
The expected moderation in domestic demand is mainly driven by a slowdown in private consumption, as the absorption of pent-up demand wears off and households start rebuilding their balance sheets in a context of strong disposable income growth over the forecast horizon. The latter is driven by slowing but still robust job creation, together with stronger wage growth, partly due to the increase in the minimum wage. The saving rate, which reached a historic low in 2018, is projected to rebound in 2019 and increase further in 2020.

Investment is also expected to decelerate over the forecast horizon. Equipment investment, which weakened at the end of last year, should recover as exports of goods rebound in the second half of 2019. However, it will still grow less this year than in 2018 and is expected to increase only slightly in 2020, also driven by export growth. Construction investment peaked in 2018 due to the rebound in non-residential construction and continued strong housing investment, although the latter has been on a weakening trend since 2017. As the cycle matures over the forecast horizon, both residential and non-residential construction are expected to slow down.

The contribution of net exports to growth should gradually improve

After a weak end of the year in 2018, especially for goods, exports are expected to strengthen in 2019 and in 2020 as Spain's export markets recover and the transitory factors that impacted export performance last year, in particular in the automotive industry, gradually unwind. Still, due to a weak carryover from last year, export growth is expected to remain stable this year in annual terms before accelerating in 2020. Imports, which were also weaker than expected in 2018, should ease further in 2019, in line with slowing final demand, before picking up again in 2020, driven by the recovery in exports. Overall, the contribution of net exports to growth, which was -0.3 pps. in 2018, is expected to improve but remain negative in 2019 before turning neutral in 2020. The current account balance, which deteriorated in 2018 due to a worsening in the terms of trade and weak export performance, is expected to remain stable at 0.9% over the forecast horizon.

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



Unemployment to continue falling

Employment growth has continued to exceed expectations. Job creation is expected to remain robust but to slow down as final demand moderates and as a result of the increase in the minimum wage. In turn, the unemployment rate is set to continue falling to 12.2% in 2020, the lowest since 2008. Wage growth is expected to peak in 2019, under the impact of the increase in the minimum wage, and then moderate but still grow above inflation in 2020. As labour productivity is forecast to grow very moderately over the forecast horizon, this should lead to a rise in nominal unit labour costs, especially in 2019. After reaching 1.7% in 2018, HICP inflation is forecast to decline to 1.1% in 2019 and 1.4% in 2020, due to oil price developments and a gradual increase in core inflation.

Pace of budget deficit reduction set to slow

The general government deficit decreased by 0.6 pps., to 2.5% of GDP, in 2018. Continued relatively strong and tax-rich GDP growth resulted in a 6.2% rise in revenues, while expenditure expanded by a robust 4.5%, its strongest pace since 2009. In 2019, the deficit is projected to decline further to 2.3% of GDP. Favourable cyclical developments and decreasing debt servicing costs would be partly offset by deficit-increasing measures, some of which of a temporary nature. As the 2019 draft budget act was rejected by the parliament in February, the 2019 forecast is based on the extended 2018 budget and a number of new expenditure and revenue measures adopted by royal decree law. The latter include, on the expenditure side, some additional pension increases and a number of social policy measures. On the revenue side, they include measures broadening the base for social contributions. Moreover, some measures adopted in the 2018 budget law, such as a pay hike for public sector workers, the higher revaluation of pensions and the tax cut for low-income earners, are also expected to have a budgetary impact in 2019. Compensation payments to a motorway concession expected for 2019, currently treated as a contingent liability, may further add to the deficit. Assuming no change in policy, the headline deficit is set to decline to 2.0% of GDP in 2020.

Spain's structural deficit stabilised at 2.7% of GDP in 2018 before deteriorating slightly over the forecast period. The general government debt-to-GDP ratio is expected to gradually decrease to 95.7% by 2020, mainly driven by strong nominal GDP growth.

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**	**2.1**	**1.9**
Private Consumption	670.5	57.5	1.3	3.0	2.9	2.5	**2.3**	**1.9**	**1.6**
Public Consumption	215.7	18.5	3.0	2.0	1.0	1.9	**2.1**	**1.7**	**1.5**
Gross fixed capital formation	239.0	20.5	0.9	6.7	2.9	4.8	**5.3**	**3.6**	**2.9**
of which: equipment	82.4	7.1	2.0	11.9	5.2	6.0	**5.4**	**3.0**	**3.1**
Exports (goods and services)	400.2	34.3	3.7	4.2	5.2	5.2	**2.3**	**2.3**	**2.9**
Imports (goods and services)	366.2	31.4	2.9	5.4	2.9	5.6	**3.5**	**2.7**	**3.0**
GNI (GDP deflator)	1165.0	99.9	1.7	3.7	3.5	2.8	**2.7**	**2.1**	**1.9**
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	**0.1**	**0.0**	**0.0**
Net exports			0.1	-0.3	0.8	0.1	**-0.3**	**-0.1**	**0.0**
Employment			0.7	3.3	3.0	2.9	**2.5**	**2.0**	**1.7**
Unemployment rate (a)			15.1	22.1	19.6	17.2	**15.3**	**13.5**	**12.2**
Compensation of employees / f.t.e.			2.8	0.8	-0.5	0.3	**0.8**	**2.0**	**1.8**
Unit labour costs whole economy			1.8	0.5	-0.6	0.2	**0.8**	**1.9**	**1.6**
Real unit labour cost			-0.4	0.0	-0.9	-1.0	**-0.2**	**0.4**	**-0.1**
Saving rate of households (b)			9.8	8.7	7.8	5.5	**4.9**	**5.5**	**5.8**
GDP deflator			2.2	0.5	0.3	1.2	**1.0**	**1.6**	**1.7**
Harmonised index of consumer prices			2.5	-0.6	-0.3	2.0	**1.7**	**1.1**	**1.4**
Terms of trade goods			-0.4	2.1	0.1	-0.8	**-2.1**	**0.3**	**-0.1**
Trade balance (goods) (c)			-5.4	-2.0	-1.4	-1.9	**-2.6**	**-2.5**	**-2.5**
Current-account balance (c)			-4.3	1.1	2.2	1.9	**0.9**	**0.9**	**0.9**
Net lending (+) or borrowing (-) vis-a-vis ROW (c)			-3.7	1.7	2.4	2.2	**1.5**	**1.5**	**1.6**
General government balance (c)			-3.5	-5.3	-4.5	-3.1	**-2.5**	**-2.3**	**-2.0**
Cyclically-adjusted budget balance (d)			-3.0	-2.5	-3.1	-2.8	**-3.0**	**-3.3**	**-3.2**
Structural budget balance (d)			-	-2.2	-3.1	-2.7	**-2.7**	**-2.9**	**-3.2**
General government gross debt (c)			58.6	99.3	99.0	98.1	**97.1**	**96.3**	**95.7**

(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.