



**STABILITY PROGRAMME  
UPDATE 2019-2022**

**KINGDOM OF SPAIN**

**2019 - 2022**



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## 1. EXECUTIVE SUMMARY

The 2019-2022 Stability Programme (SP) Update of the Kingdom of Spain presents a prudent and realistic macroeconomic and fiscal scenario based on conservative assumptions<sup>1</sup>. **The Independent Authority for Fiscal Responsibility (AIReF) has endorsed the Government's macroeconomic scenario and considers it prudent overall**, taking into account the exogenous assumptions and policies defined therein. It has also underlined the progress made in transparency vis-à-vis previous years in response to recommendations on good practices.

Over the past twenty years, Spain has experienced a complete business cycle with periods of growth and recession of higher intensity than those in its neighbour countries. Following five years of recession between 2008 and 2013, the GDP turned positive in 2014, entering a phase of expansion that continues to date. Despite the global slowdown, **the economy has grown robustly for five years**, with a GDP growth rate of 2.6% in 2018, higher than the EU average, and a full-time equivalent employment (FTE) creation rate of 2.5%<sup>2</sup>.

Developments in the Spanish economy in recent years reflect not only its high resilience and robust post-crisis recovery, but also significant structural changes that have reinforced its medium-term growth potential due to a **more balanced and sustainable growth pattern**.

Unlike in previous periods, growth is not underpinned by unsustainable factors (excessive credit growth, over-dimensioned real estate sector, an excessive current account deficit and net external borrowing). It has now a more solid foundation, leading to a fast and sustained growth that is compatible with a balanced macroeconomic framework. Thus, economic growth since 2014 has facilitated progress in **adjusting several major inherited imbalances**: a reduction of the unemployment rate by more than twelve points from a high of 26.9% in the first quarter of 2013; a positive current account balance since then, despite high growth rates in domestic demand; a reduction of the Spanish economy's net debtor position towards the rest of the world; and resizing of the residential construction sector.

The macroeconomic scenario put forward in this Stability Programme and in the National Reform Programme reflects this situation amid a gradual maturing expansionary cycle, which started in 2014, and a slowdown in global growth, particularly within the Eurozone. In this context, **Spain is expected to continue achieving higher economic growth and job creation rates than the expected for the rest of the Eurozone as a whole**, albeit at a more moderate pace than in previous years, with an estimated GDP growth of 2.2% in 2019, 1.9% in 2020 and 1.8% in 2021 and 2022. Employment growth will remain slightly below GDP

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<sup>1</sup> This Stability Programme is the medium-term national fiscal plan referred to in Article 4 of Regulation (EU) No. 473/2013.

<sup>2</sup> According to the Labour Force Survey, the year-on-year growth rate of employed people was 2.7% in 2018, equivalent to a 2.5% growth in full-time equivalent employment.

growth, with a full-time equivalent employment rate of 2.1% in 2019, which will continue to moderate to 1.6% in 2022. The unemployment rate will continue its downward trend, falling to below 14% in 2019 and below 10% in 2022.

From the structural analysis side, most estimates appear to suggest that the closing of the output gap in 2018 was the turning point of the long-term cycle<sup>3</sup>. However, Spain's high unemployment rate, intense pace of job creation and absence of inflationary and wage tensions, among other factors, suggest that the Spanish economy still has excess capacity. Therefore, in the absence of external shocks or a less than favourable development in the global economy than expected, it appears that Spain will remain on an economic growth path in the coming years towards a potential growth rate of 1.8%.

On the supply side, **the positive development in the labour market is expected to continue** for the forecast period 2019-2022, creating 950,000 jobs between 2018 and 2019.

**Spain must take full advantage of this favourable phase of the business cycle to progress in the adjustment of the imbalances that still persist in the Spanish economy** -large public and external debt, high unemployment rate, increase in inequality in recent years in all areas (wages, income, consumption and wealth, intergenerational, territorial and gender distribution)- through more ambitious and active economic and fiscal policies. The adjustment of these imbalances will reduce the vulnerability of the Spanish economy to potential exogenous shocks. Furthermore, the implementation of a structural reform and investment agenda will provide a strong foundation for sustainable and inclusive economic growth.

**The Government's commitment to fiscal discipline is unquestionable.** In July 2018, soon after the change of Government, the AIReF -in line with the European Commission- estimated that the level of implementation at that date of the 2018 Budget and the commitments included in it would yield a deficit of 2.7% of GDP. However, the deficit has been reduced to 2.48%, six tenths less than the previous year, thanks to the commitment to fiscal discipline, an extremely prudent budgetary management and the use of savings and extra revenue. This **will allow Spain to withdraw from the Excessive Deficit Procedure** in which it has been immersed since 2009. Continued commitment to fiscal consolidation, economic growth and job creation is needed in the current and following years.

Despite the failure to adopt a new Budget for 2019 that would have allowed broader rebalancing of public accounts, additional revenue measures have been implemented to increase collection to an estimated €3.8 billion in 2019. This, together with public spending moderation, will allow reducing the deficit to 2% of GDP. In addition to these fiscal measures, **the Government will allocate one-off revenue or savings (for instance, from reduced interest rates) to enable further reductions in public deficit or debt.**

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<sup>3</sup> Refer to the output gap and NAWRU analyses in section 4.6.



Fiscal consolidation efforts shall continue until 2022 through a variety of fiscal measures, which are already in an advanced stage of their administrative and approval process, with a projected deficit reduction from 2.5% in 2018 to 2% in 2019, 1.1% in 2020 and 0.4% in 2021, reaching a balance in 2022.

**Primary surpluses will be achieved starting in 2019. This will quicken the pace of reduction of the public debt-to-GDP ratio to below 90%** at the end of the forecast horizon.

This fiscal effort is also reflected in developments in public spending and revenue levels. In 2019, public revenue will increase whilst public spending will decrease slightly to 39% and 41% of GDP, respectively. This fiscal consolidation effort will continue until the end of the Stability Programme; therefore, public revenue and public spending will approach 41% in 2022 in terms of GDP. **It is in this context of fiscal consolidation that priority shall be given to Welfare State spending** (education and health), with a share of 9.9% of GDP in 2017 (the latest year with available data on expenditure by function) **and to productive investments** to reach 2% of GDP in RDI in 2022.

**The planned consolidation efforts shall be added to the significant fiscal adjustment carried out in Spain in recent years.** In 2011-2018, the public deficit-to-GDP ratio was reduced by more than 7 percentage points. Virtually half of the fiscal adjustments made in this period have been structural, making Spain one of the European countries with the highest fiscal consolidation carried out. The actual evolution of the main variables suggests that the models used hitherto have led to an overestimation of the NAWRU and, therefore, an underestimation of potential GDP and structural balance.

Considering the cyclical position of the Spanish economy, the high elasticity of job creation vis-à-vis economic growth and the need to move forward to adjust inherited imbalances, **an ambitious and realistic budgetary consolidation path should be put forward, anchored in a structural effort consistent with developments in the Spanish business cycle, stance of monetary policy and economic situation within the Eurozone.**

This Stability Programme seeks to reduce the public deficit from 2.47% of GDP in 2018, excluding financial assistance, to a balanced budget in 2022, and achieve a structural deficit reduction of 1.5 percentage points (p.p.) of GDP, from 2.6% in 2018 to 1.1% in 2022.

Finally, it should be noted that the reform efforts geared towards the recovery of the main macroeconomic indicators after the crisis must now focus also on two primary goals: facing the significant challenges for the future, crucial to its long-term prosperity; and, strengthening social cohesion and inclusion, key to a socially stable macroeconomic success that is politically enduring.

**In addition to maintain a financially stable economic growth, it is essential to leverage the current favourable economic conditions to lay the foundation for**

**an environmentally and socially inclusive and sustainable growth in the medium term.**

To that end, the **National Reform Programme**, submitted together with this Stability Programme, includes a **coherent** roadmap for **structural reforms and investments to boost the potential growth of the economy** in the coming decades, based on strengthening production factors and productivity that prioritise response to climate change and to ongoing economic and technological transformations. Sociodemographic developments, climate change, the digital revolution, technological changes and market globalization are the major challenges that have to be faced at the national, regional and global levels, and that crosscut the entire economy and society. These challenges are also opportunities to increase the potential of our economies **within the framework of the 2020 Goals, the UN Agenda 2030 for Sustainable Development and the European Pillar of Social Rights.**

**These lines of action are consistent with the EU's Country Specific Recommendations** and the observations of various international institutions in recent years, which insist on the need for a qualitative change in Spain's economic policy to address social problems and medium- and long-term economic challenges.

Both the macroeconomic scenario on which this Stability Program is based, as well as the fiscal projections contained therein, have been previously submitted to the AReF to enable the assessment required by relevant regulations. A mutual exchange of information has taken place during this process, and the issues proposed by the authority mentioned above were taken into consideration, where possible.

## 2. INTRODUCTION

This Stability Programme Update is divided into nine chapters, including the Executive Summary and this Introduction. These chapters cover the material part of the changes in the main variables of Spain's economy derived from the economic policy that will be applied in the years ahead. This responsible and active economic policy will combine fiscal discipline and measures to reduce inequality and raise our economy's growth potential. The Programme develops the three key areas of the Government's economic policy:

- secure economic and financial stability;
- fight against inequality and strengthen social cohesion; and
- address structural reforms required to lay the foundations for sustainable and fair growth in the medium and long term, and correcting the imbalances in the Spanish economy, including high structural unemployment, low productivity and high public debt.

Chapter 3 focuses on the macroeconomic outlook for 2019-2022. The Spanish economy will continue along the path of robust economic growth moving forward, with an expected 2.2% increase in real GDP in 2019, followed by a more moderate 1.9% in 2020 and 1.8% in 2021 and 2022. Indeed, all national and international institutions argue that the Spanish economy will grow over the next four years at a higher rate than the leading countries in its neighbourhood. This higher relative growth vis-à-vis our competitors will take place in an environment with job growth and progressive reduction of the unemployment rate. This combined with moderate inflation and current account surplus enables continued decline of our external debt. This macroeconomic scenario underlies the medium-term budgetary projections.

Chapter 4 focuses on developments in Spain's public deficit and debt, as well as measures to achieve the targets. The main conclusion to be drawn here is the unwavering commitment to fiscal consolidation, evidenced by developments in public deficit and debt throughout the period. Following the significant reduction in both areas in 2018 -the highest for public debt in the last 3 years- public deficit in Spain stands now at 2.48% of GDP, whilst the debt-to-GDP ratio is 97.1%. Consequently, Spain will withdraw this year from the Excessive Deficit Procedure in which it has been involved since 2009. Spain's economy is expected to keep moving towards fiscal consolidation to achieve a balanced budget by 2022 and a debt-to-GDP ratio of 88.7%. The unwavering commitment to fiscal consolidation, together with measures to improve social cohesion and structural reforms, will make it possible to tackle the challenges ahead.

Chapter 5 shows a comparison with the previous Stability Programme and various sensitivity analysis. The main difference vis-à-vis previous years is the change in the international scenario due to trade tensions, the slowdown in most of the world's leading economies or uncertainties stemming from possible effects of Brexit. In keeping with the Stability Programme's methodology, a theoretical exercise was conducted to estimate the possible effects of changes

in the prudent and conservative assumptions underlying the baseline scenario. The analysis focused, in particular, on changes in interest rates, economic growth of our trading partners and oil prices.

Given that sustainability is viewed as the common denominator that spans all economic policy actions, Chapter 6 addresses the sustainability of public finances, with particular emphasis on the 2016-2070 projections of ageing-related expenditure. The analysis concentrates on pensions, health, long-term care, education and unemployment.

Chapter 7 on the quality of public finances describes a fiscal policy that is based on a combination of revenue and expenditure to lay the foundation for more inclusive and sustainable growth. On the revenue side, this fiscal policy would require a new taxation approach, better adapted to the current economic situation. Indeed, the new income policy focuses on increasing environmental protection; strengthening tax equity for citizens and businesses; reinforcing the fight against tax fraud and introducing new taxes for new digital or undertaxed sectors. On the expenditure side, fiscal policy not only focuses on prioritising public spending to ensure the sustainability of the welfare system and boost potential growth but also conducts a comprehensive public spending review. This review, conducted together with the AIReF, affects the General Government as a whole.

Chapter 8 provides a summary of the implementation of the fiscal policy's institutional framework, which includes preventative, control, corrective and publicity mechanisms for the budgetary performance of the Public Administrations at all territorial levels. It also refers to the extension of the surplus rule to fund financially sustainable investments in Autonomous Regions (known in Spain as CCAA) and Local Corporations and outlines the conditions for the gradual access of Regional Governments to financial markets.

Finally, the last chapter compares and analyses economic forecasts and actual performance. This chapter appears in the Stability Programme of the Kingdom of Spain for the first time following the implementation of the Directive on budgetary framework requirements applicable to the Member States. The variables compared are those expressly mentioned in the different updates of the Stability Programme. The analysis covers the period between 2014 and 2018. Building on the prudence principle, the forecasts do not seem to have important biases, and the deviations are quite similar to the ones obtained on average by main national and international institutions, both public and private.

### **3. MACROECONOMIC OUTLOOK**

#### **3.1. Recent developments in the Spanish economy**

##### **3.1.1. International environment**

The world economy lost momentum in 2018, growing at a rate of 3.6%, two tenths lower than in 2017, when it reached the maximum level since 2011. Trade tensions between the United States and China and the weakening of activity in some European and emerging economies contributed to moderating global growth, against a backdrop of a slowdown in world trade and high political uncertainty. At the same time, various factors, including macroeconomic policies to support growth, improved conditions in financial markets and low commodity prices, have dampened the global GDP slowdown.

In this context, the IMF and the OECD have revised downwards the growth forecasts they made for world GDP a few months ago. The IMF foresees a 3.3% growth in 2019 and 3.6% in 2020, whilst the OECD forecasts 3.3% for this year and a slight uptick in 2020 to 3.4%.

In this scenario, downside risks prevail for the world economy, including possible heightened trade tensions, increased volatility in financial markets, geopolitical tensions in the Middle East, a larger-than-expected downturn in the Chinese economy and uncertainty over "no deal" exit of the UK from the EU. The downward revision of the global growth forecast for this year by both institutions is explained by the factoring in of some of these risk factors into the IMF and OECD projections, together with the negative carryover effect derived from the lower dynamism of activity in the second half of 2018.

Slower global demand, greater uncertainty and existing risks have negatively affected both developed and emerging economies, with growths of 2.2% and 4.5%, respectively, at the end of the year, lower than in 2017.

The Eurozone's real GDP grew in 2018 at an annual rate of 1.8%, seven tenths lower than in 2017, and the lowest since 2014. The weakening of activity was especially noticeable in the second half of the year, particularly in Germany and Italy, with quarter-on-quarter growth of the Eurozone GDP at 0.1% in the third quarter, and 0.2%, in the fourth. External factors contributed to this slowdown, including mounting uncertainty fuelled by trade tensions, as well as internal factors such as the fall in automobile production, primarily in Germany, and social tensions in France.

This deceleration is expected to continue in 2019, with the IMF estimating a GDP growth of 1.3% in the Eurozone, and a slight recovery of two tenths, up to 1.5% in 2020. Meanwhile, the OECD and the European Central Bank (ECB) foresee lower growth rates for this year, approximately 1%, and a slight recovery for the next, up to 1.2% according to OECD and 1.6% the ECB.

The breakdown by Eurozone countries shows that the German economy lost dynamism in 2018, especially in the second half of the year, down to an average annual rate of 1.5%, i.e. one point lower than in 2017. This slowdown stems primarily from a weak export momentum, adversely affected by weakening global trade growth and sluggish private consumption, partly influenced by the entry into force in early September of the new European automobile emissions regulation. Given that this sector weighs heavily in the industry, this regulation has had a very significant impact on Germany. According to the IMF, Germany's GDP will grow by 0.8% in 2019, five tenths lower than the rate projected in January, and 1.4% in 2020. Meanwhile, the OECD foresees a downturn in German GDP growth to 0.7% in 2019 and 1.1% in 2020.

In France, the economy also slowed down in 2018, with a real GDP of 1.6%, seven tenths less than the previous year. Social protests have hurt economic activity, although specific fiscal measures aimed at increasing disposable income have averted further deterioration. Against this background, the IMF foresees a broad stabilisation of growth in the French economy in 2019 and 2020, approximately 1.3%, consistent with the OECD forecast.

The Italian economy entered a technical recession in the second half of last year, ending 2018 with an average annual growth of 0.8%, nine tenths less than in 2017. The two main international institutions, IMF and OECD, foresee a further economic slowdown in 2019, down to 0.1% and -0.2%, respectively, followed by a slight recovery in 2020 to 0.9% and 0.5%.

Outside the Eurozone, the United Kingdom's GDP decelerated by four-tenths in 2018 to 1.4% and is likely to remain on the slowdown path that started in 2014 when it grew by 2.9%. The IMF has revised its growth forecasts downwards for the United Kingdom by three-tenths in 2019 to 1.2%, and two-tenths in 2020 to 1.4%. However, these projections are highly uncertain due to Brexit. Meanwhile, the OECD is more pessimistic with a projected growth of 0.8% and 0.9%, respectively.

In the United States, the economy ended 2018 with an average annual growth of 2.9%, seven-tenths higher than the previous year and the highest since 2015, when the same GDP growth rate was recorded. The IMF forecasts a slower growth of the US economy to 2.3% in 2019 and 1.9% in 2020, in response to the easing of fiscal stimuli measures and the gradual normalisation of monetary policy. Nonetheless, GDP will remain above potential GDP during these two years. Meanwhile, the OECD anticipates higher rates for this year, of 2.6% and 2.2% for the coming one.

As for emerging economies, the Chinese economy grew by 6.6% in 2018, which is the lowest rate in almost three decades. This deceleration is expected to continue despite the fiscal stimuli measures in place to mitigate the adverse effects of higher tariffs by the United States and trade tensions. The IMF and the OECD are forecasting GDP rates of 6.3% and 6.2%, respectively, in 2019, and of 6.1%, and 6% in 2020. China's government has lowered its economic growth

target for this year to 6-6.5% and has announced several measures to boost growth.

India's economy will benefit from lower oil prices and a less contractionary economic policy enabling continued growth, reaching 7.5% in 2020. In Latin America, the Mexican economy's forecasts have been revised downwards, and Venezuela will see a higher-than-expected contraction. Likewise, the projections for Brazil have been revised downward, though still higher than 2% for this year and next, thus consolidating its economic recovery following the recession in 2015 and 2016.

### **3.1.2. Recent developments and correction of macroeconomic imbalances in Spain in 2018**

The Spanish economy recorded a GDP growth rate of 2.6% in 2018, linking five consecutive years of expansion, the last four with growth rates well above that for the EU as a whole and the Eurozone. Since the beginning of the economic recovery in 2014, the Spanish economy has continued to expand at a solid pace with an average annual growth of around 3%, driven by robust job creation, favourable financial conditions and advances in the correction of several macroeconomic imbalances. Nonetheless, in the context of a gradual slowdown in global activity, this expansion is moderating in line with the maturity of the cycle, and the real GDP growth rate is progressively converging with the potential GDP, estimated at 1.8%.

According to the Quarterly National Accounts figures (QNA), GDP in volume and with calendar and seasonally adjusted data, recorded a quarter-on-quarter growth of 0.6% in the fourth quarter of 2018, a figure higher than in the preceding quarter and one-tenth above the one for the Eurozone (0.2%). GDP grew 2.3% year-on-year, two-tenths less than in the third quarter, ending last year with an average annual growth of 2.6%, one-tenth higher than the flash estimate (2.5%) published in January by the National Institute of Statistics (known in Spanish as INE) and eight-tenths higher than the Eurozone (1.8%). In the second half of last year, Spain's positive growth differential vis-à-vis the Eurozone was double that of the first half, resulting in a broadening of the differential for 2018 by three-tenths with respect to 2017.

According to the QNA figures published by the INE, the dynamism of economic activity intensified in the first quarter of 2019, with a quarter-on-quarter real GDP of 0.72%, almost two-tenths (0.17 points) higher than the fourth quarter of 2018. GDP grew by 2.4% year-on-year, one-tenth more than in the previous quarter. This acceleration is explained by higher net external demand (0.2 points vs -0.2 points in the fourth quarter of 2018), whilst domestic demand contributed 2.2 points, three tenths less than in the previous quarter.

Spain's economic growth in recent years has been driven primarily by **domestic demand**, although the external sector has also contributed positively to GDP growth, especially in 2016 (0.8 points) and, to a lesser extent, in 2017 (0.1 points). Both in 2018 and 2017, domestic demand contributed 2.9 points, whilst net

external demand turned negative again (-0.3 points), mainly due to the negative impact on exports of the lower dynamism of our export markets, in particular, the Eurozone.

Among the domestic demand components, **private final consumption expenditure** in volume grew last year at an average annual rate of 2.3%, similar to that of 2017 (2.5%), driven by robust job creation, a slight upturn in compensation per employee, favourable financial conditions and solid household balance sheets. The overall strength of private consumption in 2018 was also boosted by increased housing wealth and the positive impact on household income of the measures contained in the 2018 General State Budget, albeit partially offset by the negative effects of higher oil prices. Thus, real private consumption virtually reached the maximum levels attained in 2007, both in terms of non-durable and durable consumer goods. This could indicate the end of pent-up demand for durable goods that existed during the crisis, a factor that drove this variable above fundamentals during most of the recovery years.

The most recent short-term information on private consumption is overall positive for the first quarter of this year, owing to sustained advances in dynamic job creation (according to the Labour Force Survey, the number of employed people grew by 3.2% year-on-year in the first quarter, and the number of Social Security-covered workers grew by nearly 3%) and favourable financing conditions (new consumer loans and credits for households grew in January-February at a year-on-year rate close to 9%).

Meanwhile, final consumption expenditure of the General Government, in volume, ended 2018 with an average annual growth of 2.1%, the highest since 2010, but much lower than the pre-crisis average, contributing four-tenths to real GDP growth.

Fixed capital investment has also contributed to the expansion of domestic demand in recent years, growing by 5.3% in 2018, at a rate higher than in the previous two years. This was driven by the increase in domestic and external demand and favourable financial conditions, as well as by a reduction in non-financial corporations' debt, promising business expectations and the need to recover investments made before the crisis. The recovery of gross fixed capital formation, following the sharp fall during the crisis, has made it possible to reach 2009 volume levels, being the recovery of the equipment component especially pronounced. This variable increased by 5.2% in 2018, a rate similar to that of the previous two years. It has risen for six consecutive years, exceeding the maximum pre-crisis levels since the end of 2017. However, this strong expansionary profile in equipment investment has not translated into a substantial increase in apparent labour productivity, probably due to low investment in human and intangible capital. Meanwhile, investment in construction experienced an annual increase of 6.2% in 2018, more than 1.5 points higher than the previous year. However, it still falls well short of the levels before the crisis, because the adjustment of this investment component was more intense and extended than that of investment in equipment.



Short-term equipment investment indicators appear to indicate continued dynamism in the first months of 2019. This is based on the number of freight vehicles registered, which increased year-on-year by 3.3% in the first quarter compared to 0.7% in the fourth quarter of 2018, or the degree of productive capacity utilisation of investment goods, which stands at 87% in the first quarter of 2019, 2.1 points higher than the previous quarter.

Concerning the external sector, net external demand reduced annual GDP growth by three-tenths in 2018, following the negligible positive contribution (0.1 points) in the previous year. This development stems from a slowdown in the growth of exports of goods and services that is greater than that for imports.

Exports of goods and services increased by 2.3% in 2018, having grown at rates considerably higher in the previous five years, between 4% and 5% (5.2% in 2017). The loss of dynamism in exports in 2018 has been a widespread phenomenon among the major comparable economies, including Germany, France and Italy, that experienced a similar downturn. Weaker export growth in 2018 has affected both goods and services, with annual export rates of 1.8% and 3.3%, respectively, lower by 2.9 and 3.0 points than in 2017.

The main factors affecting the performance of Spanish exports are lower global demand, high trade-related uncertainty and recovery of some competing tourism destinations.

By product, and according to Customs data, exports of automobiles was the most significant negative contribution to the annual sales rate of goods in nominal terms in 2018. This drop in automobile exports, which is replicated in the leading Eurozone economies, is due to a combination of several factors, including the aforementioned slowdown in global activity and global trade.

By destination, and according to Customs data, exports of goods in volume to the EU slowed down by 5.5 points in 2018 to 0.9%, and those to the rest of the world dropped to 2%, after the slight advance (11.7%) recorded in the previous year.

The slowdown in exports of services is mainly due to a downturn in tourism-related services, whilst non-tourism services continue to grow at an annual rate of 4.5%, identical to that of 2017. Indeed, the export of tourism services increased by 1.7%, a rate lower than the record high of 8.9% in the previous year which, nonetheless, reflects very positive figures in terms of number of visitors -82 million- and increase in average spending -3.2%-. The year-on-year decline in the growth rate masks the remarkable outcome of the tourism sector in 2018.

Meanwhile, real imports of goods and services accelerated by 2.1 points in 2018, recording a year-on-year rate of 3.5%, in line with final domestic demand.

The strong growth in recent years has allowed for the correction of macroeconomic imbalances that were exacerbated by the crisis - unemployment rate, public deficit, private external debt and net external borrowing- although there are still significant imbalances, especially in the fields of labour and equality.

Concerning the labour market, strong job creation continues, with employment increasing in the last four years at an annual rate close to 3%, standing at the end of 2018 above 19.5 million, according to the Labour Force Survey. Job creation is mainly attributable to people working full-time and, in particular, employees with open-ended contracts, which has reduced the temporary employment rate in 2018 to a much lower level than in the pre-crisis period. Likewise, the share of involuntary part-time employment (part-time workers because they could not find a full-time job) continues to fall. This favourable development in the labour market has continued in the first quarter of 2019, notably in terms of job creation, with the number of employed people increasing by 3.2% year-on-year.

Meanwhile, the number of unemployed has continued to fall in recent years, at around 500.000 people per year, with most of the decline -two thirds- concentrated in the long-term unemployed, which fell by more than 300,000 people in 2018. The unemployment rate has dropped below 15% of the labour force, a more than 10-point reduction from the peak of 26.9% in the first quarter of 2013, although it is still the second highest in the EU. Furthermore, long-term unemployed still account for about 40% of the total, and the youth unemployment rate exceeds 30%. Developments in the number of employed and unemployed people during the recovery have taken place against the backdrop of wage containment and, more recently, gradual normalisation. According to the Quarterly National Accounts data, compensation per employee increased by 0.8% in 2018, half a point more than in 2017.

Meanwhile, economic growth was accompanied by moderate inflation rates. In effect, the GDP deflator increased by 1% in 2018, owing to a 1.6% increase in the domestic demand deflator, partially offset by a negative terms-of-trade (-1.8%, primarily due to the rebound in Brent oil prices). In particular, consumer prices increased by 1.6% on annual average according to the private consumption deflator, and by 1.7% according to the Consumer Price Index (CPI). Last year's overall CPI profile was strongly affected by developments in energy prices, which significantly accelerated up to the third quarter, and moderated in the fourth. Core inflation remained stable throughout the year with rates close to 1%. In the first months of 2019, inflation remained contained at 1.3% in March, two-tenths higher than that of February.

The public debt-to-GDP ratio is another significant imbalance in the Spanish economy. It has fallen more than three points since its peak in 2014, standing at 97.1% at the end of 2018. However, it should be noted that the increase in public debt up to 2014 occurred in parallel to an intense deleveraging process of the private sector, which has seen its consolidated debt reduced by 69 points of GDP since its peak in mid-2010. The debt stood at 133.3% of GDP in the

fourth quarter of 2018. Approximately two-thirds of the reduction has been achieved through deleveraging of non-financial corporations, whilst the other third corresponds to households.

This deleveraging is compatible with the dynamism of new credit operations to households and SMEs (using as a proxy for credits to SMEs those under one million euros) registering annual increases of 12.8% and 5.4%, respectively. The ECB's expansionary monetary policy supports this positive development. Likewise, interest rates applied by credit institutions to new loans and credit operations to households and non-financial corporations have significantly decreased in all segments, reaching record lows. Interest rates (APRs) on loans to households for house purchase have decreased by nearly 390 basis points (b.p.) since the record high registered at the end of 2008, standing slightly above 2.3% at the beginning of 2019, and those for consumption and other purposes have decreased more than 300 b.p., down to 8.6% and 4.5%, respectively. Meanwhile, the rates on loans to non-financial corporations for less than one million euros have fallen by almost 450 b.p., down to 2.5% at the beginning of this year. In addition, the rates on loans exceeding one million euros have decreased by a similar amount, reaching 1.5%.

On the other hand, the growth of the Spanish economy in recent years is consistent with the progress in the correction of external imbalances, given the growing internationalisation of Spanish business due to their high competitiveness. According to the available Balance of Payments data, the Spanish economy generated net lending to the rest of the world for seven consecutive years and six years of surplus in the current account balance, the last five coinciding with strong growth in domestic demand.

However, these external balances were more moderate in 2018 than in previous years. The Spanish economy's net lending decreased by six-tenths (as a percentage of GDP), from 2.1% in 2017 to 1.5% in 2018, owing to the reduction of the current account surplus, by nine-tenths to 0.9%, whilst the capital account increased three-tenths, up to 0.5% of GDP. Meanwhile, the lower current account balance is entirely explained by the narrowing of the goods and services surplus, by one point, to 1.9%. This is primarily due to the widening of the goods deficit from higher oil prices and the slowdown in world trade, which has weighed down exports, despite the gains in price competitiveness throughout most of the year.

Indeed, the price-competitiveness of the Spanish economy, according to Bank of Spain's indices, based on unit labour costs of manufactured products, increased by 1.7% in 2018 compared to the Eurozone. Spain has achieved a 1.1% gain in competitiveness vis-à-vis the developed countries, due to a decrease in the relative price index of 1.8%, whilst the nominal effective exchange rate appreciated by 0.7%. Likewise, Spain's export market share, in nominal terms, based on IMF's global imports estimate, stood at 1.76% until October 2018, virtually identical to the same period of the previous year (1.79%). Finally, in addition to the goods and services, the current account also

includes primary and secondary income, with a deficit stabilised at 1% for the third consecutive year.

These results have contributed to reducing the debtor balance of the net international investment position to 77.1% of GDP in the fourth quarter of 2018, which is 6.4 points lower than in the same period of the previous year, whilst Spain's external debt stood at 166.7% of GDP, similar to one year earlier.

Despite the correction in some imbalances, Spain has seen an increase in the different dimensions of inequality in recent years: wages, income, consumption and wealth, intergenerational, territorial distribution and gender. The Gini Index<sup>4</sup> peaked in 2014 (34.7, compared to an average of 31 in the EU), a record high in the last two decades. The improvement in the economic situation in recent years has had minimal impact on this indicator, underlining that all segments of the population do not equally enjoy the benefits of recovery. Moreover, although the reduction of unemployment has mitigated, to some extent, the number of people at risk of poverty or social exclusion in our country since the peak reached in 2014, there are still 12 million people in this situation according to the AROPE Index<sup>5</sup>. Meanwhile, a significant number of workers are in low-paid, precarious jobs. Some estimates suggest that one in six middle-class households fell into poverty during the crisis and have not recovered the pre-crisis situation during the expansion.

Furthermore, insufficient public investment in social policies has reduced the redistributive impact of the public sector, barely mitigating the increase in the number of people at risk of poverty, even amongst children. Since 1990, Spain's growth has become increasingly unequal, and GDP per-capita growth has not translated into higher disposable household income. This has been accompanied by a notable increase in inequality.

Reducing inequalities and achieving balanced and inclusive growth is essential, not just for political and social reasons, but also from the economic perspective, given that it contributes to making the economic model sustainable, reducing the intensity of the cycles and increasing economic capitalisation and public revenue.

### **3.2. Assumptions of the Macroeconomic Scenario**

Table 3.2.1 includes the basic assumptions on which the macroeconomic scenario included in this Stability Programme Update is based. These have been prepared using the information included in the EC forecasts, available for 2019 and 2020, the latest forecasts published by the ECB and own estimates of the Ministry of Economy and Business.

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<sup>4</sup> The Gini Index of 0 represents perfect equality, whilst an index of 100 implies perfect inequality. Therefore, any increase in the index value indicates an increase in inequality.

<sup>5</sup> Three components are used to calculate the At-Risk-Of Poverty and Exclusion (AROPE) Index: (1) severely materially deprived (survey year); (2) risk of poverty; and (3) work intensity of the household. Therefore, each data covers two years (mainly the income year).

**Table 3.2.1. Basic assumptions of the Macroeconomic Scenario 2019-2022**  
year-on-year % change, unless otherwise specified

	2018 (A)	2019 (F)	2020 (F)	2021 (F)	2022 (F)
Short-term interest rates (3-month Euribor)	-0.3	-0.3	-0.3	0.1	0.2
Long-term interest rates (10-year debt, Spain)	1.4	1.3	1.4	1.5	1.6
USD/euro exchange rate	1.18	1.13	1.13	1.13	1.13
Nominal effective exchange rate of the Eurozone	4.8	-1.6	-0.1	0.0	0.0
World excluding EU, GDP growth	3.9	3.6	3.8	3.8	3.8
Euro-zone GDP growth	1.8	1.2	1.6	1.5	1.4
World import volume, excluding EU	4.7	3.0	3.6	3.6	3.6
Spanish export markets	3.0	2.6	3.2	3.0	2.9
Oil price (Brent, Dollars/barrel)	71.5	68.9	67.6	65.0	65.0
(A) Advance; (F) Forecast.					
Sources: European Central Bank, European Commission and Ministry of Economy and Business.					

Concerning the international context, forecasts for this year's global economic growth, excluding the EU, are more moderate than expected a few months ago, down to 3.6%. This is due to the partial materialisation of the risks contemplated in previous forecasts, including heightened trade tensions, a greater-than-expected slowdown of the global economy, uncertainty associated with the UK leaving the EU and increased global uncertainty. Throughout the rest of the projection period, rates are expected to stabilise at around 3.8%. Against this background, the growth of the Eurozone economy throughout the forecast horizon will be more moderate than expected a few months ago, owing to weaker global activity and greater global uncertainty.

Regarding the evolution of the exchange rate, the euro is expected to trade at an annual average of 1.13 dollars per euro during the whole projection period.

Projections on export markets point to a slight slowdown in 2019, following a significant downward revision in 2018, and a slight recovery in 2020, in line with the trends in demand predicted for our main trading partners, with the rates stabilised at around 3% throughout the forecast period.

In line with the gradual normalisation of the Eurozone's monetary policy, positive and rising short-term interest rates are expected as of 2021. Long-term interest rates are also expected to increase, with the Spanish 10-year government bond yielding 1.6% at the end of the forecast period.

As for commodity prices, the Brent oil price continues its downward trend, from over 80 dollars per barrel in October 2018 to below 60 dollars at the end of the year, influenced in part by the slowdown in global activity. Thus far, in 2019, the oil price has increased marginally, trading at slightly over 70 dollars in April. Against this background, oil prices are expected to reach almost 68 dollars per barrel this year and the next, and remain at a level slightly below this price for the rest of the projection period, in line with the evolution of Brent futures prices.

### **3.3. 2019-2022 Macroeconomic Scenario**

The AIReF has endorsed the macroeconomic forecasts of this Stability Programme Update, based on exogenous assumptions and other information provided. The AIReF considers that the Government's macroeconomic scenario, provided with this 2019-2022 Stability Programme Update, is prudent as a whole. The Government acknowledges the recommendations concerning the purpose of the report.

The macroeconomic scenario that accompanies this Stability Programme Update extends the recent trends in the Spanish economy, and projects a moderation of growth as the cycle matures and reaches its potential, in line with the projections of the main national and international institutions. The estimated growth for the Spanish economy in 2019 remains robust, at 2.2%, higher than the Eurozone average, and more sustainable and balanced than in previous periods. For the rest of the projection period, a robust expansion is expected, based on job creation, favourable financial conditions and progress in the correction of macroeconomic imbalances, with growth rates of 1.9% in 2020 and 1.8% in 2021 and 2022.

The moderation of growth is due primarily to the progressive maturation of the business cycle. Furthermore, it reflects the gradual deceleration of global activity in an international context characterised by high uncertainties.

Domestic demand continues to drive growth, although its contribution is expected to decline progressively from 2.3 percentage points in 2019 to 1.8 points in 2022. Meanwhile, net external demand will recover in the projection period, with a slightly negative contribution expected this year (-0.1 points) and neutral for the rest of the period.

**Table 3.3.1. Macroeconomic outlook**  
Chain-linked volume indices  
2010=100, unless otherwise specified

	ESA Code	2018 (A)	2018 (A)	2019 (F)	2020 (F)	2021 (F)	2022 (F)
		Level	year-on-year % change				
1. Real GDP	B1*g	108.2	2.6	2.2	1.9	1.8	1.8
2. Nominal GDP. Thousands of millions of Euros	B1*g	1208.2	3.6	3.9	3.6	3.6	3.5
<b>Components of real GDP</b>							
3. Private consumption expenditure (*)	P.3	103.0	2.3	1.9	1.6	1.5	1.4
4. Government consumption expenditure	P.3	99.4	2.1	1.9	1.5	1.4	1.3
5. Gross fixed capital formation	P.51	104.1	5.3	4.0	3.5	3.3	3.1
6. Change in inventories and net acquisition of valuables (% of GDP)	P.52 + P.53	0.1	0.1	0.0	0.0	0.0	0.0
7. Exports of goods and services	P.6	139.2	2.3	2.7	2.8	2.7	2.6
8. Imports of goods and services	P.7	116.7	3.5	3.1	2.9	2.8	2.7
<b>Contributions to real GDP growth</b>							
9. Final domestic demand		-	2.8	2.3	1.9	1.8	1.8
10. Change in inventories and net acquisition of valuables	P.52 + P.53	-	0.1	0.0	0.0	0.0	0.0
11. External balance of goods and services	B.11	-	-0.3	-0.1	0.0	0.0	0.0
(*) It also includes households and non-profit institutions serving households (NPISH).							
(A) Advance; (F) Forecast.							
Sources: National Institute of Statistics and Ministry of Economy and Business.							

Among the domestic demand components, private consumption is expected to continue to grow strongly, albeit at a more moderate pace than in previous years, because of lower job creation and smaller pent-up demand for durable consumer goods, among other factors, despite a rise in real wages. In a context of gradual normalisation of the monetary policy in the Eurozone, a gradual restructuring of the household savings rate can be expected, having reached record lows in recent years. As a result, a four-tenths slowdown of private consumption is foreseen in 2019, down to 1.9%, and of three additional tenths in 2020, to 1.6%, with rates of 1.5% and 1.4% in the last two years of the forecast horizon.

Fixed capital investment will continue to grow at high rates, albeit at a more subdued pace than in previous years, up to 4% in 2019, compared with 5.3% in 2018, and between 3% and 3.5% in the rest of the period analysed. Investment in equipment and cultivated assets, the most dynamic component of GDP in 2017 and 2018, is projected to increase 3.7% this year, one point and a half less than in 2018, and continue along the mild slowdown path until 2022. The positive performance of investment in equipment is underpinned by growing final demand, restructuring of corporate balance sheets and favourable financial conditions. Construction investment is also expected to reach high growth rates in the forecast period, progressively decreasing from 4.5% in 2019 to 3%-4% in subsequent years. The dynamism of construction investment in the forecast horizon is based on the continuation of the job creation process and low-interest rates.

In line with the subdued growth of activity, full-time equivalent employment is expected to grow at a more moderate rate, down to 2.1% in 2019 and slightly less in subsequent years. Meanwhile, the unemployment rate will continue to

decline, reaching a rate below 10% of the labour force in 2022, a figure not reached since 2008.

Given the expected evolution for GDP and employment, the apparent labour productivity will remain almost stable in the projection period.

**Table 3.3.2. Labour market<sup>(\*)</sup>**

	ESA Code	2018 (A)	2018 (A)	2019 (F)	2020 (F)	2021 (F)	2022 (F)
		Level	year-on-year % change				
1. Total employment (Thousands of persons)		19.9	2.1	2.0	1.9	1.8	1.7
2. Full-time equivalent employment (Thousands of persons)		18.4	2.5	2.1	1.8	1.7	1.6
3. Employed (Thousands of hours worked)		33,900.5	2.8	2.7	2.3	2.0	1.8
4. Labour productivity per employee (Thousands Euros)		58.7	0.4	0.2	0.0	0.0	0.1
5. Labour productivity, full-time equivalent (Thousands Euros)		63.5	0.1	0.1	0.1	0.1	0.1
6. Productivity per hour worked (Euros)		0.0	-0.2	-0.4	-0.4	-0.2	0.0
7. Compensation per employee <sup>(**)</sup> (Thousands of Euros)		35.5	0.8	2.1	2.2	2.3	2.3
8. Unit Labour Cost		-	0.8	1.9	2.0	2.1	2.1
9. Compensation of employees (Million Euros)	D.1	569.7	4.1	4.3	4.1	4.1	4.1
10. Unemployment rate (% of labour force)		-	15.3	13.8	12.3	11.0	9.9

<sup>(\*)</sup> National Account data, except for unemployment rate.  
<sup>(\*\*)</sup> Compensation per employee, full-time equivalent.  
(A) Advance; (F) Forecast.  
Sources: National Institute of Statistics and Ministry of Economy and Business.

With regard to the external sector, real exports of goods and services will grow at rates close to 3% throughout the period, higher than in 2018 (2.3%) but lower than the average of the previous five years, close to 5%, favoured by Spain's growing export markets, the broadening of the Spanish export base built-up over recent years and an increase in unit labour costs lower than that of our main trading partners.

Meanwhile, imports will grow at similar rates as exports, around 3%, in line with developments in final demand. In this context, the current account balance will continue to run surpluses, standing at 0.5% of GDP at the end of the forecast period, accumulating ten consecutive years of external surpluses, nine of them with positive growth rates, which shows that the Spanish economy's growth pattern is sustainable. This will allow Spain to reduce its external debt further.



**Table 3.3.3. Price developments**

	ESA Code	2018 (A)	2018 (A)	2019 (F)	2020 (F)	2021 (F)	2022 (F)
		Level	year-on-year % change				
1. GDP deflator		103.3	1.0	1.6	1.7	1.8	1.7
2. Private consumption deflator (*)		109.4	1.6	1.2	1.4	1.5	1.5
3. Public consumption deflator		101.0	1.1	2.0	1.4	1.5	1.5
4. Gross fixed capital formation deflator		98.9	1.9	2.5	2.4	2.5	2.3
5. Exports prices deflator (goods and services)		107.8	1.2	1.5	1.7	1.6	1.6
6. Imports prices deflator (goods and services)		115.4	3.1	1.6	1.5	1.4	1.4

(\*) It includes households and non-profit institutions serving households.  
(A) Advance; (F) Forecast.  
Sources: National Institute of Statistics and Ministry of Economy and Business.

Inflation is expected to remain subdued throughout the forecast horizon, at 1.2% in 2019 for the private consumption deflator, gradually increasing to 1.5% in 2022. The public consumption deflator profile is determined mainly by the rise in public wages, which were agreed with the trade unions for the period 2018-2020, with a gradual increase to 1.5% in 2022. The investment deflator will register rates close to 2.5% during the whole period, whilst exports in goods and services will stand at slightly less than 2%. On the other hand, the imports deflator will slow down by one and a half points this year, down to 1.6%, and will stabilise at approximately 1.5% as of 2020, in line with developments in oil prices. Against this background, the GDP deflator will follow a path of moderate acceleration, converging towards 1.7% at the end of the forecast period.

**Table 3.3.4. Sector balances**

% of GDP						
	ESA Code	2018 (A)	2019 (F)	2020 (F)	2021 (F)	2022 (F)
1. Net lending (+) / Net borrowing (-) vis-à-vis the rest of the world	B,9	1.5	1.2	1.1	1.1	1.0
- Balance on goods and services		2.0	1.8	1.8	1.9	1.9
- Balance of primary incomes and transfers		-1.0	-1.1	-1.2	-1.2	-1.4
- Capital account		0.5	0.5	0.5	0.5	0.5
2. Net lending (+) / Net borrowing (-) of the private sector	B,9	3.9	3.2	2.3	1.5	1.0
3. Net lending (+) / Net borrowing (-) of General Government (*)	B,9	-2.5	-2.0	-1.1	-0.4	0.0

(\*) The figures include financial assistance.  
(A) Advance; (F) Forecast.  
Sources: National Institute of Statistics and Ministry of Economy and Business.

From a sector-wide perspective, developments in net lending in the Spanish economy are attributable to a weaker private sector balance, which will moderate its net lending throughout the forecast period. Meanwhile, the General Government balance is expected to improve from a deficit of 2.5% of GDP in 2018 to a balanced budget in 2022.

### **Methodological aspects of the 2019-2022 Macroeconomic Scenario**

This box is included in the Stability Programme Update to clarify the methodology used to develop the macroeconomic scenario, in line with the recommendations made by the AIReF in this regard. The methodology used, as well as the basic assumptions and external hypotheses on which the macroeconomic scenario is based, are detailed below.

#### **Methodology**

Equation models for short and long-term predictions, including co-integration relationships in error correction models, were used to forecast developments in different variables of the scenario presented herein. It, therefore, allows for a long-term equilibrium relationship between economic variables and the existence of imbalances in the short term, which are gradually corrected through partial adjustments in the error term.

These individual equations are integrated into a simultaneous equations model to ensure consistency of forecasts for main macroeconomic aggregates.

Explanatory variables include indicators for the different assumptions used in the scenario presented herein, as well as credit development indicators and a comprehensive set of auxiliary variables such as confidence indices and labour market and prices indicators, amongst others. The extrapolation of the behaviour of these variables in the medium term requires the use of single-equation prediction models for each component. The models are regularly updated with data from the National Accounts and auxiliary variables.

For the short-term forecasts, multi-factor models were used to estimate GDP growth in the Spanish economy, as well as transfer functions based on the Composite Activity Indicator (known in Spanish as ISA), developed and published by the Ministry of Economy and Business. These models use the information available from a wide range of monthly activity indicators that summarise overall economic developments in Spain. These short-term growth estimates are incorporated into medium and long-term prediction models, feeding the initial dynamics and the starting point of the evolution of the independent variables included in the assumptions.

Meanwhile, two significant changes were recently made to the methodology used to forecast General Government Final Consumption Expenditure. On the one hand, the Composite Public Consumption Indicator used to build the forecast model has been redesigned to include new partial indicators, and the deflators have been revised. On the other hand, both the transfer function used to estimate the next quarter and the ARIMA model used for long-term estimates have been updated.

The REMS model is the main tool used to estimate the effects of the different

measures affecting public expenditure and revenue and structural reforms and to perform the sensitivity exercises included in the Stability Programme. The REMS model is a general equilibrium model for the Spanish economy, built on a system of microeconomics-based equations, which includes several nominal and real rigidities and enables the analysis of its dynamic evolution in the presence or absence of a structural change. It describes a small and open economy, where households, businesses (some of which operate in a context of imperfect competition), economic authorities and external sector interact. In the factor market, physical capital and energy are exchanged in a perfectly competitive context.

### **Basic assumptions and external hypotheses**

- Dollar/euro exchange rate

For the years 2019 and 2020, the assumption used was the evolution of the dollar/euro exchange rate forecast by the EC, and for 2021 and 2022, the exchange rate remains constant at the level of 2020.

- Brent oil price

The assumptions for the Brent oil price for 2019 and 2020 coincide with those contemplated by the EC. In 2021 and 2022, the crude price remains constant at levels slightly below those of 2020.

- Short- and long-term interest rates

The EC provided the forecasts for the three-month Euribor rates and the 10-year Spanish government bond until 2020.

- World GDP excluding the EU

The EC provided the 2019 and 2020 global GDP growth forecasts, excluding the EU, and a growth stabilisation for the next two years is projected.

- Eurozone GDP

The EC provided the assumptions for GDP growth in the Eurozone for 2019 and 2020. A slight slowdown is expected in the remaining years.

- World import volume, excluding EU

The European Commission's assumptions on the evolution of this aggregate are incorporated for 2019 and 2020. For the rest of the projection period, a path consistent with the forecasts for world imports is expected.

- Spain's Export Markets

Export markets are calculated as a weighted average of the imports of goods and services in volume of the different countries to which Spain export, considering the weights of Spanish exports to those countries. In 2019 and 2020, Spanish export markets are expected to evolve according to the EC forecasts, and for 2021 and 2022, markets are expected to slow down, in line with the IMF's projections for imports of goods and services in advanced countries and emerging economies.

### **3.4. Comparison with the scenarios of other institutions**

The main national and international institutions have maintained or slightly revised downwards the growth forecasts for the Spanish economy for 2019 and 2020, foreseeing rates very similar to those included in the macroeconomic scenario that accompanies the Stability Programme. The latest forecasts of the Bank of Spain, in particular, point to a 2.2% growth of the Spanish economy in 2019 and 1.9% in 2020, similar to that of the Government.

As in the Government's scenario, the main institutions view domestic demand as the main driver of growth and foresee positive contributions both this year and the next. In the Government's scenario, the contribution of domestic demand to growth stands at 2.3 points in 2019, similar to the projection of the Bank of Spain (BoS) and the OECD, and slightly higher than that estimated by the EC and the IMF (2.2 points). For 2020, the domestic demand's contribution to growth falls by four-tenths in the EC, OECD and Government scenarios, whilst in the BoS and IMF's scenarios it falls by three-tenths and five-tenths, respectively.

Meanwhile, according to the main institutions, net external demand will make a negative contribution to growth throughout the forecast period. According to the scenario included in this Stability Programme, the external sector will contribute -0.1 points in 2019 and null in 2020, with the main bodies forecasting similar contributions in this period. For 2019, the BoS expects the external sector to contribute by -0.1 points to growth, the same figure as that of the Government, whilst according to the EC, OECD and IMF the contribution will be null. In 2020, the OECD forecasts a contribution to the external sector identical to that of the Government scenario, whilst the EC and the IMF estimate contributions of 0.1 points and 0.2 points, respectively, and the BoS foresees a negative contribution of one-tenth.

Private consumption in the macroeconomic scenario increases by 1.9% in 2019 and 1.6% in 2020. The OECD and the EC predict rates similar to those of the Government for this period, whilst the IMF and the BoS expect a growth rate three-tenths higher this year (2%), and somewhat lower next year (1.7%).

The projected growth in the General Government's final consumption expenditure, 1.9% and 1.5%, respectively for the 2019-2020 biennium envisaged in the Stability Programme's scenario is slightly higher than the one estimated by the main national and international institutions. For 2019, the growth rate in

public consumption will be 1.8% according to the BoS, 1.7% the EC and IMF, and 1.6% the OECD. For 2020, although all point to a moderation in the public consumption growth rate, in line with the Government's scenario, the forecasts range between 0.8% of the IMF and 1.5% of the EC.

The Government expects fixed capital investment to grow this year by 4%, a rate very similar to that estimated by the main institutions (around 3.9%), except the IMF, which foresees a lower rate (2.9%). This SP foresees an investment growth of 3.5% in 2020, lower than that estimated by the OECD and the BoS, and higher than the one projected by the EC and the IMF.

According to the Government, the performance of foreign trade flows in the projected horizon will be similar to that of the main national and international institutions. In 2019, the SP predicts a rate of 2.7% in exports of goods and services, two-tenths higher than that estimated by the IMF (2.5%) and lower than that of the rest of the institutions mentioned above, ranging between 2.8% of the OECD and 3.3% of the BoS and the EC. For 2020, all point to a higher export growth rate, with the Government and the EC forecasting a one-tenth acceleration; the BoS of seven-tenths; and the OECD and the IMF, of 1.2 and 1.0 points, respectively.

Meanwhile, according to the Government's scenario, imports of goods and services will grow by 3.1% in 2019 and 2.9% in 2020. For 2019, the Government's estimate is lower than that of the BoS and the EC, by five-tenths and four-tenths, respectively, whilst it is two-tenths and four-tenths higher than the growth projected by the OECD and the IMF. The forecasts of the aforementioned institutions for 2020 range between the moderate growth rate of the EC (slightly higher than that predicted by the Government, three-tenths, compared to two-tenths in the SP) and the acceleration foreseen by the IMF, the BoS and the OECD (0.5, 1.0 and 1.2 points, respectively).

The Government foresees an unemployment rate of 13.8% in 2019, identical to that of the OECD and lower than the estimate of the BoS, the EC and the IMF (14.2%, 14.4%, and 14.2%, respectively). For 2020, the Government expects the unemployment rate to fall to 12.3%, similar to the estimate of the OECD (12.5%), and below that of the BoS and the EC (by 0.9 and 1.0 points, respectively, 13.2% and 13.3%), and the IMF (14.1%).

With regards to the net borrowing of the General Government in 2019, all institutions expect it to be between one-tenth and five tenths higher than the Government's forecast (2.0% of GDP), except for the OECD, which foresees a lower deficit (1.8%).

Finally, the SP's scenario for national net lending (1.2% of GDP) is similar to the estimate of the EC (1.3%), the BoS and the IMF (1.1%, both). The Government's estimate for 2020 (1.1% of GDP) is below that of the EC (1.4%), coincides with the IMF and is higher than the BoS (0.8%).

**Table 3.4.1. Comparison of macroeconomic scenarios 2019-2020**  
year-on-year % change, unless otherwise specified

	EC		OECD		IMF		Bank of Spain		
	Forecast november 2018		Forecast november 2018		Forecast april 2019		Forecast march 2019		
	2018	2019	2018	2019	2018	2019	2018	2019	
1. GROSS DOMESTIC PRODUCT	2.1 (1)	1.9 (1)	2.2	1.9	2.1	1.9	2.2	1.9	
2. Private consumption expenditure (a)	1.8	1.4	1.8	1.5	2.0	1.7	2.0	1.7	
3. Government consumption expenditure	1.7	1.5	1.6	1.3	1.7	0.8	1.8	1.3	
4. Gross fixed capital formation	3.9	3.3	3.8	3.8	2.9	2.7	3.9	3.8	
5. Change in inventories + net acquisition of valuables (b)	0.0	0.0	0.0	0.0	0.1	0.0	-	-	
6. Exports of goods and services	3.3	3.4	2.8	4.0	2.5	3.5	3.3	4.0	
7. Imports of goods and services	3.5	3.2	2.9	4.1	2.7	3.2	3.6	4.6	
8. Domestic demand (b) (c)	2.2	1.8	2.3	1.9	2.2	1.7	2.3	2.0	
9. External demand (b)	0.0	0.1	0.0	0.0	0.0	0.2	-0.1	-0.1	
Memo items:									
10. Net lending(+)/net borrowing(-) (% GDP)	1.3	1.4	1.0 (3)	1.0 (3)	1.1	1.1	1.1	0.8	
11. GDP Deflator	1.6	1.7	1.9	1.8	1.4	1.7	1.4	1.6	
12. Private Consumption Deflator	1.2 (1)(2)	1.5 (1)(2)	1.9	1.9	1.2 (2)	1.6 (2)	1.2 (2)	1.5 (2)	
13. Total employment (d)	1.7	1.5	2.0 (4)	1.8 (4)	1.6 (4)	0.6 (4)	1.6	1.6	
14. Unemployment rate (% of labour force)	14.4	13.3	13.8	12.5	14.2	14.1	14.2	13.2	
15. Unit labour costs	1.9	1.2	1.5 (5)	1.5 (5)	1.1	0.0	-	-	
16. Net lending(+)/net borrowing(-) of General Government (% GDP)	-2.1	-1.9	-1.8	-1.2	-2.3	-2.3	-2.5	-2.0	
(1) Winter 2019 projections.									
(2) Harmonised Index of Consumer Prices.									
(3) Current-account balance.									
(4) Labour Force Survey. Millions jobs.									
(5) OECD definition: Compensation of employees per unit of product.									
(a) Households and Non-profit institutions serving households.									
(b) Contribution to GDP growth.									
(c) OECD and IMF: annual growth of domestic demand.									
(d) Full-time equivalent jobs.									
Sources: European Commission, International Monetary Fund, OECD and Bank of Spain.									

## 4. PUBLIC DEFICIT AND DEBT

### 4.1. The General Government in 2018

Spain ended 2018 with a deficit of 2.47% of GDP, compared to 3.03% in 2017. This means that the 2018 deficit has been reduced by 15.5%, from €35.4 billion in 2017 to €29.9 billion one year later. Ten years on, this deficit reduction will allow Spain to exit the Excessive Deficit Procedure, a process in which the country has been immersed since 2009. If financial assistance, which amounts to €78 million, were included, the deficit would be 2.48% of GDP in 2018 (compared to 3.08% in 2017).

**Table 4.1.1. General Government balance in 2018**  
% of GDP

	2017	2018
Central Government	-1.89	-1.36
Regional Governments	-0.36	-0.23
Local Governments	0.61	0.52
Social Security	-1.44	-1.41
<b>General Government</b>	<b>-3.08</b>	<b>-2.48</b>
<i>Financial assistance</i>	<i>-0.04</i>	<i>-0.01</i>
<b>General Government<sup>(1)</sup></b>	<b>-3.03</b>	<b>-2.47</b>
<sup>(1)</sup> Excluding financial assistance Source: General State Comptroller (IGAE).		

This reduction in the public deficit is due to the 6.2% growth in revenues, higher than the 4.5% registered by expenditure. The rise in non-financial revenues stems from higher tax revenues and social security contributions, which have increased by 6.5% and 4.9%, respectively. Among the expenditure items, compensation of employees, intermediate consumption and social benefits other than social transfers in kind saw the highest levels of spending.

**Table 4.1.2. General Government in 2018**

	2017	2018	year-on-year % change	2017	2018
	Million euros			% of GDP	
<b>Revenues</b>	<b>442,223</b>	<b>469,538</b>	<b>6.2</b>	<b>37.92</b>	<b>38.86</b>
Tax revenues	259,601	276,383	6.5	22.26	22.87
Direct taxes	124,359	134,499	8.2	10.66	11.13
Indirect taxes	135,242	141,884	4.9	11.60	11.74
Social contributions	143,056	150,114	4.9	12.27	12.42
Other revenues	39,566	43,041	8.8	3.39	3.56
<b>Expenditures</b>	<b>478,126</b>	<b>499,520</b>	<b>4.5</b>	<b>40.99</b>	<b>41.34</b>
Compensation of employees	123,045	127,017	3.2	10.55	10.51
Intermediate consumption	58,817	60,634	3.1	5.04	5.02
Social transfers	177,711	185,093	4.2	15.24	15.32
Interests	29,817	29,752	-0.2	2.56	2.46
Subsidies	12,088	12,108	0.2	1.04	1.00
Social transfers in kind (market production)	30,014	30,863	2.8	2.57	2.55
EU own resources: VAT and GNR	8,082	10,314	27.6	0.69	0.85
Fixed gross capital formation	23,019	25,442	10.5	1.97	2.11
Aids to investment and other capital transfers	6,863	10,154	48.0	0.59	0.84
Other expenses	8,670	8,143	-6.1	0.74	0.67
<b>Net lending (+) / Net borrowing (-)</b>	<b>-35,903</b>	<b>-29,982</b>	<b>-16.5</b>	<b>-3.08</b>	<b>-2.48</b>
Financial assistance	-508	-78	-84.6	-0.04	-0.01
<b>Net lending (+) / Net borrowing (-)<sup>(1)</sup></b>	<b>-35,395</b>	<b>-29,904</b>	<b>-15.5</b>	<b>-3.03</b>	<b>-2.47</b>

<sup>(1)</sup> Excluding financial assistance  
Source: General State Comptroller (IGAE).

The Central Government (Table 4.1.3.), which includes the State and its Organisms, has reduced its deficit from 1.85% of GDP in 2017 to 1.35% in 2018, excluding financial assistance. This subsector reduced its deficit the most in this period.



**Table 4.1.3. Central Government in 2018**

	2017	2018	year-on-year % change	2017	2018
	Million euros			% of GDP	
<b>Revenues</b>	<b>196,151</b>	<b>212,948</b>	<b>8.6</b>	<b>16.82</b>	<b>17.62</b>
Tax revenues	161,035	173,832	7.9	13.81	14.39
Direct taxes	66,983	75,001	12.0	5.74	6.21
Indirect taxes	94,052	98,831	5.1	8.06	8.18
Social contributions	10,085	10,022	-0.6	0.86	0.83
Current transfers within General Government	10,352	12,425	20.0	0.89	1.03
Other revenues	14,679	16,669	13.6	1.26	1.38
<b>Expenditures</b>	<b>218,187</b>	<b>229,324</b>	<b>5.1</b>	<b>18.71</b>	<b>18.98</b>
Compensation of employees	23,200	23,937	3.2	1.99	1.98
Intermediate consumption	8,609	8,832	2.6	0.74	0.73
Social transfers	18,217	19,053	4.6	1.56	1.58
Interests	26,461	26,422	-0.1	2.27	2.19
Current transfers within General Government	110,551	113,400	2.6	9.48	9.39
EU own resources: VAT and GNR	8,082	10,314	27.6	0.69	0.85
Fixed gross capital formation	7,085	7,899	11.5	0.61	0.65
Investment grants and other capital transfers	3,703	6,768	82.8	0.32	0.56
Other expenditures	12,279	12,699	3.4	1.05	1.05
<b>Net lending (+) / Net borrowing (-)</b>	<b>-22,036</b>	<b>-16,376</b>	<b>-25.7</b>	<b>-1.89</b>	<b>-1.36</b>
Financial assistance	-508	-78	-84.6	-0.04	-0.01
<b>Net lending (+) / Net borrowing (-)<sup>(1)</sup></b>	<b>-21,528</b>	<b>-16,298</b>	<b>-24.3</b>	<b>-1.85</b>	<b>-1.35</b>

<sup>(1)</sup> Excluding financial assistance  
Source: General State Comptroller (IGAE).

Revenues have increased by 8.6%, as a result of the rise in tax revenue (7.9%), due to the increase in indirect taxes (5.1%) and direct taxes (12%).

On the other hand, non-financial expenses increased by 5.1%. Particularly noteworthy is the larger contribution of VAT and GNR, the increase of other capital transfers and of gross fixed capital formation for reasons stated below when referring to the State's deficit. Social transfers (4.6%), compensation of employees (3.2%) and intermediate consumption (2.6%) also increased.

The State deficit stood at 1.47% of GDP, a fall of 0.46 points of GDP. In addition, for the second consecutive year, the State has run a primary surplus equal to 0.72% of GDP in 2018.

This is attributable to the 8.3% rise in non-financial revenue, whilst non-financial expenditure grew by 5.2%.

Tax revenues, which account for 85% of total revenues, increased by 7.9% (€12.5 billion more than in 2017). Whilst revenues from all tax types increased, particularly noteworthy, in terms of national accounts, were 11.2% in Personal Income Tax, 13.2% in Corporate Income Tax and 5.9% in VAT.

Regarding expenses, special mention deserves the increase in transfers to other Public Administrations, which grew by 3.4%. Other expenditure items that increased were EU own resources: VAT and GNR, up 27.6% from last year; social benefits other than social transfers other than in kind, up 4.9%; and compensation of employees, which grew 2.7% and includes the effect of the 1.75% increase in remunerations vis-à-vis 1% in 2017, and the standardisation of wages for National Police and Civil Guard with regional police forces, for approximately €283 million.

Gross fixed capital formation grew by 18.6%, which includes the Administration's Asset Liability (Spanish acronym "RPA") in the case of the reversion of certain toll motorways to the State, with an estimated market value of €686 million.

Finally, investment aid and other capital transfers increased by 124%, owing to the €1.1 billion from the RPA that were not registered as an investment, to the €622 million from the maternity tax exemption scheme, and to the registered of €1 billion in tax credits payable to the Tax Administration.

The expenditure items that decreased were intermediate consumption by 1.3%, current international cooperation (3.5%), product subsidies (0.7%) and interest payments (0.1%).

The Central Government Organisms run a surplus of €1.4 billion, excluding financial assistance, compared to €889 million at the end of 2017, which is an improvement of 58.4%.

Regional Governments (Table 4.1.4) have reduced their deficit by more than 33% (0.23 % of GDP), a 0.13 p.p. decline vis-à-vis the previous year.

**Table 4.1.4. Regional Governments in 2018**

	2017	2018	year-on-year % change	2017	2018
	Million euros			% of GDP	
<b>Revenues</b>	<b>169,153</b>	<b>177,958</b>	<b>5.2</b>	<b>14.50</b>	<b>14.73</b>
Tax revenues	60,175	63,108	4.9	5.16	5.22
Direct taxes	45,385	47,068	3.7	3.89	3.90
Indirect taxes	14,790	16,040	8.5	1.27	1.33
Current transfers within General Government	91,241	95,019	4.1	7.82	7.86
Other revenues	17,737	19,831	11.8	1.52	1.64
<b>Expenditures</b>	<b>173,384</b>	<b>180,768</b>	<b>4.3</b>	<b>14.87</b>	<b>14.96</b>
Compensation of employees	74,848	77,395	3.4	6.42	6.41
Intermediate consumption	28,212	29,352	4.0	2.42	2.43
Interests	4,354	4,405	1.2	0.37	0.36
Social transfers in kind (market production)	27,374	28,070	2.5	2.35	2.32
Current transfers within General Government	14,842	17,181	15.8	1.27	1.42
Fixed gross capital formation	10,196	10,747	5.4	0.87	0.89
Investment grants and other capital transfers	2,431	2,697	10.9	0.21	0.22
Other expenditures	11,127	10,921	-1.9	0.95	0.90
<b>Net lending (+) / Net borrowing (-)</b>	<b>-4,231</b>	<b>-2,810</b>	<b>-33.6</b>	<b>-0.36</b>	<b>-0.23</b>

Source: General State Comptroller (IGAE).

Virtually all Regional Governments improved their balance compared to 2017. Indeed, 15 governments met the deficit target, five with a surplus in 2018.

This is due to a 5.2% increase in non-financial revenue, and a 4.3% increase in expenditures.

This result is influenced by an increase in Regional Governments revenue. Indeed, the revenue from Transfer Tax and Stamp Duty increased by €842 million and net transfers from the financing system increased by €3,8 billion.

On the expenditure side, the compensation of employees is noteworthy because it grew by 3.4%, mainly due to the 1.75% wage increase in 2018, as was also the case for the rest of agents and sub-sectors, compared to 1% in 2017 and, to a lesser extent, to the increase in the number of public employees. Meanwhile, spending on intermediate consumption has increased by 4% compared to the previous year, and social transfers in kind grew by 2.5%.

Local Governments (Table 4.1.5.) have run a surplus for the seventh consecutive year. This positive balance amounts to €6.3 billion in 2018. The surplus peaked at 0.52% of GDP, compared to 0.61% in the previous year.

**Table 4.1.5. Local Corporations in 2018**

	2017	2018	year-on-year % change	2017	2018
	Million euros			% of GDP	
<b>Revenues</b>	<b>75,039</b>	<b>75,711</b>	<b>0.9</b>	<b>6.43</b>	<b>6.27</b>
Tax revenues	38,391	39,443	2.7	3.29	3.26
Direct taxes	11,991	12,430	3.7	1.03	1.03
Indirect taxes	26,400	27,013	2.3	2.26	2.24
Current transfers within General Government	25,132	24,566	-2.3	2.15	2.03
Other revenues	11,516	11,702	1.6	0.99	0.97
<b>Expenditures</b>	<b>67,900</b>	<b>69,419</b>	<b>2.2</b>	<b>5.82</b>	<b>5.75</b>
Compensation of employees	22,486	23,151	3.0	1.93	1.92
Intermediate consumption	20,958	21,382	2.0	1.80	1.77
Interests	628	574	-8.6	0.05	0.05
Subsidies	1,355	1,311	-3.2	0.12	0.11
Current transfers within General Government	12,409	12,068	-2.7	1.06	1.00
Fixed gross capital formation	5,590	6,634	18.7	0.48	0.55
Other expenditures	4,474	4,299	-3.9	0.38	0.36
<b>Net lending (+) / Net borrowing (-)</b>	<b>7,139</b>	<b>6,292</b>	<b>-11.9</b>	<b>0.61</b>	<b>0.52</b>

Source: General State Comptroller (IGAE).

This development is due to a 2.2% growth in non-financial expenditure, mainly for the increase in financially sustainable investments, compared to revenues that only grew by 0.9%.

The Social Security Funds (Table 4.1.6.) ended the year with a €17.1 billion deficit, equal to 1.41% of GDP, slightly lower than the 1.44% recorded in 2017.

**Table 4.1.6. Social Security in 2018**

	2017	2018	year-on-year % change	2017	2018
	Million euros			% of GDP	
<b>Revenues</b>	<b>148,418</b>	<b>155,103</b>	<b>4.5</b>	<b>12.73</b>	<b>12.84</b>
Social contributions	132,410	139,526	5.4	11.35	11.55
Current transfers within General Government	14,892	14,664	-1.5	1.28	1.21
Other revenues	1,116	913	-18.2	0.10	0.08
<b>Expenditures</b>	<b>165,193</b>	<b>172,191</b>	<b>4.2</b>	<b>14.16</b>	<b>14.25</b>
Compensation of employees	2,511	2,534	0.9	0.22	0.21
Intermediate consumption	1,038	1,068	2.9	0.09	0.09
Social transfers	154,931	161,454	4.2	13.28	13.36
Subsidies	2,179	2,323	6.6	0.19	0.19
Current transfers within General Government	3,815	4,025	5.5	0.33	0.33
Other expenditures	719	787	9.5	0.06	0.07
<b>Net lending (+) / Net borrowing (-)</b>	<b>-16,775</b>	<b>-17,088</b>	<b>1.9</b>	<b>-1.44</b>	<b>-1.41</b>

Source: General State Comptroller (IGAE).

This result is attributable to a 4.5% increase in non-financial revenue vis-à-vis expenditure, which grew by 4.2%. Of particular note is the positive development of social security contributions, which increased by 5.4% in the sub-sector as a whole (€7.1 billion). On the expenditure side, social contributions in this sub-sector increased by 4.2%.

The results obtained by the Social Security benefited from the outcome of the Master Plan for Decent Work 2018, 2019 and 2020, approved by the Council of Ministers on July 27, 2018.

By agents, the Social Security System improves its deficit from 1.65% of GDP to 1.55%. This results from the increase in revenues (5.8%) which was higher than expenditures (4.6%). Revenue from social security contributions rose by 5.3%. On the expenditure side, social benefits increased by 4.7%, mainly as a result of more spending on contributory pensions (4.8%), as both the number of pensioners and the average monthly pension increased.

The State Public Employment Service (Spanish acronym "SEPE") run a positive balance of €1.5 billion, equivalent to 0.12% of GDP. The growth of social security contributions stands out at 5.8%, partially offset by the decline in transfers from the State, which fell from €1.6 billion in 2017 to €55 million in 2018, due to positive developments in the labour market.

The Wage Guarantee Fund (Spanish acronym "FOGASA") recorded a surplus of €166 million in 2018, compared to €396 million in the previous year. This was also mainly due to a decline in transfers from the State, which fell by €283 million.

### **Ex post evaluation of the 2018 forecasts**

Article 8 of the Royal Decree 337/2018, of May 25, on the requirements applicable to macroeconomic and budgetary forecasts, which partially transposes the Council Directive 2011/85/EU of 8 November 2011 on requirements for budgetary frameworks of the Member States, sets an obligation of mandatory ex post evaluation of the main macroeconomic and budgetary forecasts at least once a year.

In this context, deviations between the forecast for fiscal year 2018 included in the 2019 Draft Budgetary Plan, drafted in October 2018, and the actual year-end data are analysed below. This forecast, rather than the one included in the previous Stability Programme, is taken as reference, given that the October forecast is the first one to which the current Government is committed<sup>6</sup>.

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<sup>6</sup>The baseline in Chapter 9 is April 2018. Given the change of government, this section will exceptionally use the October 2018 Draft Budgetary Plan; however, the aim is always to use April as the reference date.

**Table 4.1.7. Deviations between the 2018 year-end forecast included in the 2019 Budget Plan and actual year-end data**  
% of GDP

	ESA Code	2018 Forecast included in Draft Budgetary Plan 2019	2018 Year-end data	Difference
<b>1. Total revenue target</b>	<b>TR</b>	<b>38.53</b>	<b>38.86</b>	<b>0.33</b>
1.1. Taxes on production and imports	D.2	11.71	11.74	0.04
1.2. Current taxes on income, wealth, ect.	D.5	10.45	10.68	0.22
1.3. Capital taxes	D.91	0.48	0.46	-0.03
1.4. Social contributions	D.61	12.41	12.42	0.02
1.5. Property income	D.4	0.62	0.63	0.01
1.6. Other		2.86	2.93	0.07
<b>2. Total expenditure target</b>	<b>TE</b>	<b>41.25</b>	<b>41.34</b>	<b>0.10</b>
2.1. Compensation of employees	D.1	10.44	10.51	0.07
2.2. Intermediate consumption	P.2	5.00	5.02	0.02
2.3. Social transfers	D.62, D.63	17.86	17.87	0.02
Of which unemployment benefits		1.42	1.45	0.03
2.4. Interests	D.41	2.44	2.46	0.02
2.5. Subsidies	D.3	0.99	1.00	0.01
2.6. Gross fixed capital formation	P.5	2.23	2.10	-0.13
2.7. Capital transfers	D.9	0.70	0.84	0.14
2.8. Other		1.58	1.53	-0.05

Source: Ministry of Finance.

The improvement in the end-of-the-year deficit of 0.23 percentage points (p.p.) of GDP, from 2.7% of the projected GDP in October to 2.48%, including financial assistance, results from an increase in revenue as a share of GDP, from 38.53% to 38.86%, equivalent to 0.33-point increase on GDP. This offsets the higher expenditure-to-GDP ratio that grew from 41.25% to 41.34%, i.e., 0.10 p.p. on GDP.

On the revenue side, the increase stems from positive developments in the Spanish economy. Worthy of note is the strong performance of income taxes (especially Corporate Income Tax), assets and other revenue sources (mostly due to higher inflows from EU Funds, in particular, ERDF).

On the expenditure side, there have been small upward deviations from the October forecast in some headings, for instance, compensation of employees. Meanwhile, gross capital formation has declined, mainly because a certain amount of the RPA collected under this heading must now be recorded under capital transfers according to the Eurostat. The recently approved tax refund on maternity benefit also affects this last heading.

In light of the above, it can be concluded that the improvement of the 2018 deficit vis-à-vis the October forecast is mainly attributable to the good performance of the Spanish economy, with higher-than-expected revenue and expenditure restraint.

## **4.2. Budgetary scenario for 2019**

The failure to submit the 2019 General State Budget Bill for approval before the first day of the fiscal year resulted in the automatic extension of the 2018 Budget in 2019. Afterwards, the public accounts were rejected by Parliament and sent back to the Government, so that the automatic extension of the 2018 General State Budgets through 2019 will continue until a new Budget Bill is approved.

The General State Budget includes the budgets of the Central Government, i.e., the State and its Organisms, as well as that of the Social Security. Therefore, the budget extension affects not only the State's budget but also all institutional frameworks, including state-owned corporations, public funds and state foundations, as well as the Social Security Budget.

### **4.2.1. The State Budget for 2019**

#### **State expenditure budget**

The extension of the budget means that the initial budgets of the previous fiscal year are carried over, excluding the expenditure appropriations related to programmes or activities that ended in the year whose budget is extended.

Thus, the State's non-financial expenditure for 2019 amounted to €158 billion, 0.1% lower than in 2018. This means that the extended Budget covers virtually the same levels of expenditure as the 2018 Budget.

Against this backdrop, the organic structure of the extended Budget has been adjusted to the current administrative organisation without changing the total amount for 2019.

Moreover, to ensure compliance with the budget stability commitment, on 28<sup>th</sup> December 2018, the Council of Ministers approved the Agreement on the criteria for extending the 2018 General State Budget through 2019. It also formally defines the distribution of funds by ministerial departments, adopts measures for strengthening control over public expenditure, and ensures the continuation of the public deficit reduction process throughout this extension scenario. This seeks to ensure the fulfilment of the objectives of budgetary stability and current expenditure rules.

It also establishes that the ministerial departments are required to send to the Ministry of Finance a semi-annual schedule outlining all the activities planned for 2019 that involve certain types of expenses, including subsidies; agreements; expenses financed through credits managed by Regional Governments; fees or contributions to international organisms; transfers to businesses, public corporations, foundations and other public entities with state-funded forward budgets; acquisitions of shares and stocks; asset contributions; subscription of shares and contributions in International Financial Institutions; and granting of loans. The Ministry of Finance must approve this schedule and expenditure

procedures cannot be initiated if they refer to expenses not included in those schedules.

It also includes concrete monitoring measures for the implementation of the Budget, and sets specific limits for the opening of new expense files. Nonetheless, in exceptional circumstances and for duly substantiated reasons, the Ministry of Finance may authorise certain expenditures once the established limits have been exceeded.

During this budgetary extension period, the budget is (and may be) modified as required to adjust the budget items, carry out actions identified as a priority, and implement measures included in the 2019 General State Budget and that were adopted even prior to its rejection. This is the case of the measures contained in Royal Decree-Law 24/2018, of 21 December, approving urgent measures on public sector remuneration, which regulates the rise in the wages of public employees in 2019, in compliance with the Second Agreement for the Improvement of Public Employment and Working Conditions, reached between the Government and trade unions on March 8, 2018.

The increase in wages in 2019 establishes a 2.25% fixed increase for all public employees (state, regional and local), plus a variable percentage of up to 0.25% linked to a GDP development above 2.5%. Public employees will also benefit from another 0.25% in additional funds, which distribution will depend, in this case, on negotiations between each administration and the trade unions.

Particularly remarkable is the CPI-based revaluation of civil servant pensions and the four-point rise in the contribution base for civil servant widow's pensions, regulated by Royal Decree-Law 28/2018, of December 28, on the revaluation of public pensions and other urgent measures related to social, labour and employment issues, which also contains other far-reaching social measures that will be addressed in another section.

### **State revenue budget**

Developments in revenue will be affected this year by the absence of new tax measures owing to the rejection of the 2019 General State Budget Bill.

Economic forecasts predict nominal GDP growth of 3.9% in 2019, above that of 2018 (3.6 %), which would appear to support stronger growth in tax collection, in line with developments in recent years. Factors contributing to this positive tax collection include the projected evolution in compensation of employees estimated at 4.6%, above that of 2018 (4.1%). This will further improve the performance of Personal Income Tax (PIT) and final consumption expenditure, estimated at 3.2% which, although lower than in 2018 (3.8%), still has strong growth and will boost the collection of indirect taxes.

Against this backdrop of absence of new tax measures, the projected tax revenue for 2019 is €218 billion, a 4.6% increase over 2018. Indirect taxes will grow at a rate of 5.9%, raising €100 billion more than direct taxes (3.4%), or €116



billion. By tax types, worthy of note is the strong increase in Excise Taxes, up 9.3%), yielding a revenue of about €22 billion. This increase was driven mainly by strong growth in the Hydrocarbon Tax, explained by the integration of the regional tranche in the state tranche, leading to an increase of the tax payable in the regions that had not established the maximum payable regional rate. This measure was already included in the 2018 Budget but did not enter into force until 2019.

Meanwhile, the PIT grows by 3.9% despite the dynamic evolution of wages, mainly owing to the ruling of the Supreme Court exempting maternity benefits from tax and the measures implemented under the 2018 Budget, such as tax exemption for lowest income households through changes in the deduction on earned income or increase of the amount deductible for families.

The Corporate Income Tax is showing a stronger growth, of 4.9% or about €26 billion. The VAT also grows at a higher rate (5%), yielding a revenue of about €73 billion.

**Table 4.2.1.1. Total tax revenue 2018-2019**

Million €

Taxes	Incomes 2018	Forecast 2019	Year-on-year % change
Personal Income Tax	82,858	86,126	3.9
<i>Withholdings on earned-incomes and business activity</i>	73,339	77,504	5.7
<i>Withholdings on rentings</i>	1,870	1,931	3.3
<i>Withholdings on investmen funds</i>	504	583	15.6
<i>Withholdings on capital</i>	3,126	3,244	3.8
<i>Lottery tax</i>	405	450	11.2
<i>Split payments</i>	2,923	3,100	6.1
<i>Result of tax declarations and Administration liquidations</i>	12,212	11,872	-2.8
<i>Tax returns</i>	11,265	12,290	9.1
<i>Pay to the Catholic church</i>	256	268	4.6
Corporate Income Tax	24,838	26,063	4.9
Non-residents Income Tax	2,665	2,874	7.8
Environmental taxes	1,872	1,000	-46.6
Others	201	220	9.5
<b>I. Direct Taxes</b>	<b>112,433</b>	<b>116,283</b>	<b>3.4</b>
VAT	70,177	73,712	5.0
Excise duties	20,528	22,440	9.3
<i>Tax on alcohol and alcoholic beverages</i>	821	874	6.4
<i>Tax on beer</i>	320	340	6.4
<i>Tax on intermediate products</i>	21	23	8.3
<i>Hydrocarbons tax</i>	11,210	12,963	15.6
<i>Tax on tobacco products</i>	6,533	6,594	0.9
<i>Electricity tax</i>	1,352	1,353	0.1
<i>Tax on coal</i>	271	293	8.0
Others	3,573	3,695	3.4
<b>II. Indirect taxes</b>	<b>94,278</b>	<b>99,847</b>	<b>5.9</b>
<b>III. Others tax revenues</b>	<b>1,973</b>	<b>2,119</b>	<b>7.4</b>
<b>TOTAL TAX REVENUES</b>	<b>208,684</b>	<b>218,249</b>	<b>4.6</b>

Source: Ministry of Finance.

## Tax framework 2019

The fiscal scenario is influenced by several measures adopted in the second half of 2018 and first months of 2019, despite the no instrumentalisation of the measures proposed by the Government in the 2019 General State Budget and constraints to creating new taxes. The following is a compilation of the most relevant measures:

**a) Act 6/2018, of 3 July, 2018 State Budget**

In terms of Personal Income Tax, special mention deserves the increased deduction on earned income aimed at reducing the tax burden of lower-income workers. This improves the disposable income of this group and increases the tax threshold, that is, the amount of annual gross salary above which tax is applied, that is now set at €14,000. Improvements have also been made to the taxation of families through increased deductions for maternity, large families or people caring for a disabled dependent.

Moreover, investment deductions for start-up or recently established enterprises have also increased from 20% to 30%, and the maximum tax-deductible base has been raised from €50,000 to €60,000.

Lastly, also worth mentioning is the increase in the amount exempted from the excise tax on winnings from certain lotteries and betting transactions. The winnings from games of chance held between July 5, 2018 and December 31, 2018 were capped at €10,000, whereas the winnings from games in 2019 and 2020 are capped at €20,000 and €40,000, respectively.

In terms of the Corporate Income Tax, the instalment payment system applicable to venture capital companies has been modified to bring it in line with the one for other companies with low taxation.

It also validates the capacity of the Tax Administration to verify any circumstances (in particular, accounting losses) related to the conversion of deferred tax assets (DTAs) into fully earned receivables.

The VAT applicable to cinema tickets is reduced from 21% to 10% to promote access and dissemination of culture. In order to apply the 4% tax rate to the providers of services for dependent persons (telecare, home help, day and night care centres and residential care), the share of the price of care homes that provides such services covered by the benefit will be slashed from 75% to 10% when they receive financial support under the Act 39/2006, of 14 December, to promote personal autonomy and care for dependent persons.

The VAT Act has been amended to include the changes related to services supplied electronically approved by the EU.

Several Excise Tax-related measures have also been adopted. To ensure market unity in the area of fuels and gas, the regional tranche of the Hydrocarbons Tax has been integrated into the Special State Tax, without this being to the detriment of the revenue of the Regional Governments, and in compliance with the EU's regulatory framework.

The regulation on Carbon Excise Tax has been modified to provide tighter oversight of certain tax benefits and introduces an exemption for biogas used for electricity production for environmental purposes.

Meanwhile, the tax rates on Fluorinated Greenhouse Gases have been reduced in line with the latest forecasts for the market price of CO<sup>2</sup> emissions from 2020 to 2030.

The collection of the Wealth Tax is extended during 2018. The tax on transfer and rehabilitation of titles of nobility, a tax type included under the Property Transfer Tax and Stamp Duty, has been raised by 1%.

**b) Royal Decree-Law 15/2018, of 5 October, on urgent measures for energy transition and consumer protection (Official State Gazette “BOE” of 6 October)**

The law includes several measures aimed primarily at containing price developments in the wholesale electricity market. To that end, the electricity produced and supplied to the national grid during the six peak demand months when prices in the wholesale electricity markets are higher will be exempted from the electricity generation tax. The ultimate goal of this provision is to protect consumers. This exemption is no longer available at the time of the preparation and submission of this Stability Programme.

Energy products intended for the production of electricity at power plants or the production of electricity or the cogeneration of electricity and heat in combined power plants are also exempted from the Hydrocarbons Tax.

**c) Royal Decree-Law 17/2018, of 8 November, amending the consolidated text of the Transfer Tax and Stamp Duty, approved by Royal Legislative Decree 1/1993, of 24 September**

Given the differing rulings by the Supreme Court on this issue, the legislation relating to the Transfer Tax and Stamp Duty has been amended to safeguard the principle of legal certainty. Thus, as an exception to the rule, it provides that, in the case of mortgage-secured loan deeds, the taxpayer will be the lender. This amendment is applicable to public deeds formalised after the law came into force.

**d) Royal Decree-Law 26/2018, of 28 December, approving urgent measures on artistic creation and film production**

The legislation regulating the Personal Income Tax and Corporate Income Tax is amended to reduce withholds and payments on account on capital gains from intellectual property from 19% to 15% when the taxpayer is not the author. On the VAT side, the reduced rate is applied to services provided by natural persons working as performers, artists, directors and technicians for producers

and organisers of cultural works and events. These services were taxed at 21% since 2012.

**e) Royal Decree-Law 27/2018, of 28 December, approving specific measures relating to taxes and cadastre**

The Supreme Court, in its ruling 1462/2018, of 3 October, established in legal doctrine that government-funded maternity benefits paid by the Social Security are exempt from PIT. For this reason, the legislation regulating Personal Income Tax was modified, with effect from 30 December 2018, and applicable to prior tax periods within the statutory limitation, with the express aim of extending the exemption to these benefits, and to public paternity benefits also paid by the Social Security, as they both have the same nature, cause and regulatory regime. The exemption also applies to benefits paid for the above reasons to workers not covered by the Special Social Security Scheme for self-employed workers or self-employed workers covered by social security mutual funds that act as an alternative to this regime. It also bears upon legally recognised benefits for different types of leaves -childbirth, adoption or guardianship and paternity- paid to public employees under a Social Security scheme that confers no right to maternity or paternity benefit. In the latter two cases, the amount exempted will be limited to the maximum benefit recognised by Social Security for such concepts.

This Royal Decree-Law also extends the Wealth Tax through 2019.

**f) Royal Decree-Law 7/2019, of 1 March, on urgent measures relating to housing and rental**

This legislation introduces three new measures on Property Tax.

Firstly, when the property is a rent-controlled residential property, the lessor is exempted from the obligation to pass on the tax to the lessee if the lessor is a public entity.

Secondly, the regulation on the surcharge applicable to permanently vacant residential properties has been amended through referral to the relevant regional or national housing-specific sectoral regulation with the status of law, whether regional or national so it can be applied by city councils through a tax ordinance.

Finally, an optional rebate of up to 95% for rent-controlled properties has been created for eligible subsidised rental housing or social housing for rent in which a regulatory framework controls the rent.

Meanwhile, to enhance urban rental markets as a core element of the housing policy, it would be desirable to lower taxes on rental housing to provide citizens with better access to housing. To that end, the Transfer Tax and Stamp Duty now includes an exemption for certain rental housing.

#### **4.2.2. Measures on Social Security**

The 2019 General State Budget rejected by Parliament contained a raft of social measures to address the more pressing issues for citizens, including access to employment and a living wage, energy poverty, family and child protection, gender inequality, access to decent housing and transition to a new energy model.

The 2019 General State Budget seeks to buttress the Welfare State, increasing budget allocations in education, health, dependence and pensions whilst ensuring the medium- and long-term sustainability of the system.

The 2019 General State Budget clearly had a social orientation to bring the benefits of economic growth to all citizens, especially the groups most affected by the recent economic crisis.

The Government's commitment to social policy is so profound that most of these measures have been implemented through relevant regulations.

The first relevant legislation is Royal Decree 1462/2018, of 21 December, setting the minimum inter-professional wage (Spanish acronym "SMI") for 2019 at €900 per month, an increase of 22.3%. This measure, which benefits almost 2.5 million workers, seeks to prevent poverty at work, raise the living standard of the lowest-paid workers, such as women and youth, and encourage more dynamic wage growth. This will translate into a progressive reduction of poverty and wage inequalities, helping to promote sustained, sustainable and inclusive growth.

Moreover, a higher SMI also contributes to the sustainability of the Social Security System, given that a high minimum contribution to Social Security translates into a substantial increase in social contributions estimated at around €1.3 billion.

Also in 2018, Royal Decree-Law 28/2018, of 28 December, on the revaluation of public pensions and other urgent measures related to social, labour and employment issues, contained far-reaching measures to improve social benefits, in particular, pensions and protect self-employed workers, as well as ensure the sustainability of Social Security.

An initial revaluation of 1.6% will be applied universally in 2019 to all contributory pensions and 3% to minimum and non-contributory pensions. If there is an upward year-end deviation of the CPI, higher than the universal increase, the Social Security System will pay the difference in 2020 with an additional payment.

It also provides for the payment of the difference between the 1.6% revaluation applied in 2018 and the 1.7% calculated as the twelve-month average of the monthly consumer price indexes of the last 12 months. This deviation is lower than initially estimated.

The contribution base for calculating the widow's pension is raised by four points from 56% to 60%.

These pension-related measures are also applicable to pensions paid to public employees.

This Royal Decree-Law also provides for the extension of social protection and contribution to more than 2.5 million self-employed workers. The main development here is the mandatory inclusion of all contingencies: common (common illness and non-work accident) and professional (occupational accident and disease), cessation of activity and training and prevention, except for the Special Scheme for Self-Employed Farm Workers (Spanish acronym "SETA").

Finally, this regulation includes measures to improve Social Security's revenues and ensure its medium- and long-term sustainability:

- The minimum contribution to the SETA and the Special Regime for Self-Employed Workers (Spanish acronym "RETA") has increased by 1.25%.
- For the General Social Security System, the cap on the contribution base was increased by 7%.
- Concerning the Premium Tariff on contributions for professional contingencies, the minimum rate has increased from 0.9% to 1.5%. Moreover, the contribution for professional contingencies of self-employed workers who, based on their activity, are eligible for a reduction coefficient of the retirement age will be based on the highest rate.
- The contribution base of the Special Scheme for Domestic Workers is divided into 10 remuneration brackets.
- The 20% reduction in contributions for domestic workers and the 45% discount for large families are maintained.
- The General Social Security System should also include people who participate in training programs, non-work placements or external academic placements.
- The surcharge on employer's contribution has increased from 36% to 40% in contracts that last no more than 5 days.

Additionally to these measures, and prior to the rejection of the 2019 General State Budget, the Government considered the approval of another set of social measures extremely urgent and a priority.

On the one hand, Royal Decree-Law 6/2019, of 1 March, on urgent measures to ensure equal treatment and opportunities for women and men in employment and the workplace was adopted. This law seeks to eliminate the gender pay gap and ensure male and female workers rights to work-life balance and shared responsibility.

The parental leave for the natural parent other than the biological mother, following the birth of a child, is gradually extended to equate both parents (8 weeks in 2019; 12 weeks in 2020 and 16 weeks in 2021). Moreover, a new benefit was established for shared responsibility for the care of an infant.

This regulation also reinstates the special agreement on informal carers of dependent persons.

Meanwhile, Royal Decree-Law 8/2019, of 8 March, on urgent measures for social protection and against job insecurity, seeks to provide the necessary coverage to people who are in a particularly vulnerable situation such as long-term unemployed, pensioners, youth, migrants and certain groups of workers.

New features include reinstating unemployment benefits for people over 52 and increasing the amount of family benefit and minimum pension for Total Permanent Disability for people under 60.

In terms of employment incentives, it establishes bonuses for the hiring of long-term unemployed people; reduces the contribution base of wage earners in the Special Farm Workers Scheme and introduces a conversion plan to encourage farm workers to work under open-ended contracts or permanent seasonal contracts. It also includes measures to extend the active professional life of seasonal workers in highly seasonal, tourism-related sectors.

**Table 4.2.2.1. Social contributions measures**  
Million €

Measure description	Regulation	Impact
The social contribution to Social Security of the policemen benefiting from the reduction coefficient of the retirement age is increased in an additional percentage	Law 6/2018, of 3 July, of General State Budgets for 2018	254
Increase of social contributions and minimum contribution bases due to the increase of the minimum inter-professional wage up to 900 €	Royal Decree 1462/2018, of 21 December, setting the minimum inter-professional wage	1,339
Increase of the maximum contribution bases by 7%	Royal Decree-Law 28/2018, of 28 December, on the revaluation of public pensions and other urgent measures related to social, labour and employment issues	850
The minimum contribution tariff for professional contingencies is increased up to 1.5%		425
The contribution tariff of professional contingencies for self-employed workers is increased up to the maximum if there is a reduction coefficient of the retirement age		31
Total coverage of professional contingencies in the Special Regime for Self-Employed Workers (RETA)		205
Increase of the farm workers contribution		14
New covenant for training and non-work placements		74
New contribution tranche in the Special Scheme for Domestic Workers		16
Additional contribution in contracts lasting no more than 5 days		50
Increase of social contributions due to the reinstatement of the unemployment benefit for people over 52 years		193
Reduction of the contribution of farm workers		-42
The contributions corresponding to all contingencies of self-employed workers with activity cessation in 2018 and who have been in a temporary disability situation for more than 60 days when the RDL 28/2018 entered into force, will be paid by the managing entity of the contributions linked to the activity cessation	Royal Decree-Law 8/2019, of 8 March, on urgent measures for social protection and against job insecurity	81
Reinstatement of the contributions of non-professional carers of dependent people	Royal Decree-Law 6/2019, of 1 March, on urgent measures to ensure equal treatment and opportunities for women and men in employment and the workplace	296
<b>Total</b>		<b>3,786</b>

Source: Ministry of Finance.





**Table 4.2.2.2. Social expenditure measures**  
Million €

Measure description	Regulation	Impact
The age to access retirement pension is reduced using a reduction coefficient for those local policemen who fulfilled certain requirements	Royal Decree 1449/2018, of 14 December, establishing the coefficient reducing the retirement age of local police of Local Administration	142
Increase of the contribution base used for calculating the widow's pension from 56% to 60%	Royal Decree-Law 28/2018, of 28 December, on the revaluation of public pensions and other urgent measures related to social, labour and employment issues	357
3% increase of non contributory pensions in 2019		77
3% increase of minimum pensions in 2019		618
1.6% increase of contributory pensions		1,619
Revaluation of pensions with 2018 CPI. Amount of the one pay to compensate for the 0.1% deviation in 2018		123
Revaluation by 3.1% in 2019 of the allowance paid to families with children > 18 years and a disability		33
<b>TOTAL MEASURES INCLUDED IN RDL 28/2018</b>		<b>2,827</b>
Orphanage allowance: an economic allowance is established for the children of women killed by gender-based violence if they are in a situation of absolute orphanage	Law 3/2019, of 1 March, to improve the orphanage situation of the children of women killed by gender-based violence	5
In 2019 the extension of the parental leave for the natural parent other than the biological mother is extended from five to eight weeks	Royal Decree-Law 6/2019, of 1 March, on urgent measures to ensure equal treatment and opportunities for women and men in employment and the workplace	252
Joint responsibility in the lactating child care: the working day is reduced half an hour for both parents.		17
Reinstatement of the unemployment benefit for people over 52 years	Royal Decree-Law 8/2019, of 8 March, on urgent measures for social protection and against job insecurity	349
The family allowance for having children is increased for the most vulnerable families. The annual allowance is raised from 291 € to 341 € for families in poverty situation and to 588 € for families in extreme poverty situation		158
The minimum amount of the pension linked to permanent disability due to common disease is fixed for people under 60 years		25
<b>TOTAL MEASURES APPROVED IN 2019</b>		<b>806</b>
<b>TOTAL MEASURES</b>		<b>3,775</b>
<b>New measures financed by the extended budget</b>		
Measures to support the extension of the activity period of seasonal workers in highly seasonal, tourism-related sectors: 50% reduction of the social contribution of the employer for common contingencies, unemployment, FOGASA and FP	Royal Decree-Law 8/2019, of 8 March, on urgent measures for social protection and against job insecurity	15
Conversion plan to encourage farm workers to work under open-ended contracts or permanent seasonal contracts		13
Bonuses for the hiring of long-term unemployed people		26
<b>Total</b>		<b>54</b>

Source: Ministry of Finance.

### 4.3. Fiscal Strategy for 2019-2022

Spain reduced its public deficit in 2018 to 2.47% of GDP, down from 3.03% in 2017, excluding financial assistance, putting an end to the Excessive Deficit Procedure.

This development is explained by a 6.2% increase in revenues, higher than that of expenditure at 4.5%. This trend, which is expected to continue in the coming years, underlies the fiscal strategy presented by the Government of Spain in this Stability Programme, driven by the booming Spanish economy.

Notwithstanding the budgetary decisions made by the new Government for this year, this fiscal strategy is built on the present scenario where the State and Social Security budgets have been extended into 2019. This extension scenario is accompanied by the measures already adopted by the Government,

including special spending and discretionary measures to increase social contributions and ensure the sustainability of the Social Security system, which has already been analysed in detail herein.

In subsequent financial years, and given the current political situation, the 2020 scenario does not include new measures except for three that have already been proposed by the Government: (1) the tax package included in the 2019 General State Budgets; (2) the measures against fraud; and (3) the creation of two new tax developed in relevant legislative projects.

This scenario also includes the CPI-based revaluation of pensions and the increase of public employee wages. Both elements are core to the current policy and are expected to be implemented in a no-policy-change scenario.

This is also the case for the implementation of some recommendations made by the AIReF within the framework of the spending review underway. This process reflects the Kingdom of Spain's commitment to its EU partners. The recommendations will be implemented in future scenarios.

In the face of the rejection of the 2019 Budget and the suspension of the rules to create new tax types, the forecast now is to reach a 2% deficit in 2019.

In fiscal years 2020 and 2021, developments in revenue and spending, as well as other measures detailed above, would allow the deficit targets set by the current Government in its proposed new consolidation path, rejected by Parliament, to be achieved. Thus, the deficit target for 2020 is 1.1% and 0.4% in 2021. Finally, the budget balance is likely to be achieved in 2022.

**Table 4.3.1. Budgetary projections**  
Excessive Deficit Procedure

Stability Programme Update 2019-2022

	ESA Code	2018 (A)	2018 (A)	2019 (F)	2020 (F)	2021 (F)	2022 (F)
		Level (Million €)	% of GDP				
<b>Net lending (+) / Net Borrowing (-) (EDP.B9)</b>							
<b>1. Total General Government(*)</b>	<b>S. 13</b>	<b>-29,982</b>	<b>-2.5</b>	<b>-2.0</b>	<b>-1.1</b>	<b>-0.4</b>	<b>0.0</b>
<b>1a. Excluding the net costs to support the banking sector</b>		<b>-29,904</b>	<b>-2.5</b>	<b>-2.0</b>	<b>-1.1</b>	<b>-0.4</b>	<b>0.0</b>
2. Central Government (*)	S. 1311	-16,376	-1.4	-0.5	-0.1	0.0	0.0
3. Regional Government	S. 1312	-2,810	-0.2	-0.3	-0.1	0.0	0.0
4. Local Government (**)	S. 1313	6,292	0.5	0.0	0.0	0.0	0.0
5. Social Security funds	S. 1314	-17,088	-1.4	-1.2	-0.9	-0.4	0.0
<b>General Government (S.13)</b>							
6. Total revenue	TR	469,538	38.9	39.1	39.8	40.3	40.7
7. Total expenditure	TE	499,520	41.3	41.1	41.0	40.7	40.7
7a. Net balance linked to banking restructuring		-78	0.0	0.0	0.0	0.0	0.0
8. Net lending / Net borrowing	EDP. B9	-29,982	-2.5	-2.0	-1.1	-0.4	0.0
8a. Net borrowing without banking restructuring expenditures		-29,904	-2.5	-2.0	-1.1	-0.4	0.0
9. Interest expenditure	EDP. D41	29,752	2.5	2.4	2.3	2.2	2.2
10. Primary balance		-230	0.0	0.3	1.2	1.8	2.1
11. Temporary measures		-3,653	-0.3	-0.2	0.0	0.0	-0.1
<b>Revenues</b>							
12. Total Taxes		276,383	22.9	22.8	23.5	23.8	24.1
12a. Indirect taxes	D.2	141,884	11.7	11.6	11.8	11.8	11.8
12b. Direct taxes	D.5	128,996	10.7	10.7	11.2	11.6	11.9
12c. Taxes on capital	D.91	5,503	0.5	0.4	0.4	0.4	0.4
13. Social contributions	D.61	150,114	12.4	12.7	12.8	12.9	13.0
14. Property income	D.4	7,591	0.6	0.7	0.7	0.7	0.7
15. Other revenue		35,450	2.9	2.9	2.9	2.9	2.9
<b>16. Total revenue</b>	<b>TR</b>	<b>469,538</b>	<b>38.9</b>	<b>39.1</b>	<b>39.8</b>	<b>40.3</b>	<b>40.7</b>
p.m.: Tax burden		424,659	35.1	35.7	36.5	36.9	37.3
<b>Expenditures</b>							
17. Compensation of employees and intermediate consumption (17a+17b)	D.1+P.2	187,651	15.5	15.5	15.5	15.4	15.3
17a. Compensation of employees	D.1	127,017	10.5	10.5	10.5	10.4	10.4
17b. Intermediate consumption	P.2	60,634	5.0	5.0	5.0	4.9	4.9
18. Social payments (18= 18a+18b)		215,956	17.9	18.0	18.1	18.1	18.1
18a. Social transfers in kind supplied via market producers	D.63 (1)	30,863	2.6	2.5	2.5	2.4	2.3
18b. Social transfers other than in kind	D.62	185,093	15.3	15.5	15.6	15.7	15.8
19. Interest expenditure	EDP D.41	29,752	2.5	2.4	2.3	2.2	2.2
20. Subsidies	D.3	12,108	1.0	1.0	0.9	0.9	0.9
21. Gross capital formation	P.5	25,414	2.1	2.0	2.0	2.0	2.1
22. Capital transfers		10,154	0.8	0.7	0.7	0.6	0.6
23. Other		18,485	1.5	1.6	1.6	1.5	1.5
<b>24. Total expenditure</b>	<b>TE</b>	<b>499,520</b>	<b>41.3</b>	<b>41.1</b>	<b>41.0</b>	<b>40.7</b>	<b>40.7</b>
p.m.: Government consumption	P.3	222,643	18.4	18.3	18.2	18.0	17.9
(*) Including the net cost to support the banking sector.							
(**) In accordance with current regulation, a target of budgetary equilibrium is set.							
(1) D.63 = D.6311+D.63121+D.63131.							
(A) Advance; (F) Forecast.							
Sources: Ministry of Economy and Business and Ministry of Finance.							

The revenue-to-GDP ratio will increase from 38.9% in 2018 to 40.7% in 2022. This steady increase in the GDP weight of public revenues reflects both the favourable development of the economy, driving the growth of tax bases and collection, as well as the Government's strategy for strengthening the cumulative collection of revenue to bring Spain's levels of taxation closer to the average of the neighbouring countries. The progressive fiscal model seeks to ensure that the wealthier contribute their fair share in taxes. Citizens would pay according to their ability to do so, and receive in accordance with their needs,

thus safeguarding the middle- and working class, who have borne the brunt of the crisis.

In this regard, the Government of Spain favours coordinated tax measures for financial transactions, digital economy and green taxation within the EU context.

Thus, the forecasts for 2020 include the tax measures introduced in the 2019 General State Budget, anti-fraud measures and new taxes (Tax on Financial Transactions and Tax on Certain Digital Services), which will yield the expected outcome as shown in the table below.

**Table 4.3.2. Impact of new revenue measures**

Million €

<b>Measures</b>	<b>Impact</b>
Corporate Income tax: exemption limitation and minimum taxation	1,776
Corporate Income tax: Reduction tax rate for SMEs	-260
Increase Personal Income Tax	328
Environmental taxes	670
VAT: reduction tax rate for veterinary services	-35
Measures of gender tax and equity	-18
VAT: reduction tax rate for e-book	-24
Increase Wealth Tax	339
New Financial Transaction Tax	850
New Digital Services Tax	1,200
Fight against tax fraud: cash payment limitation	218
Fight against tax fraud: reinforcement tax defaulters list	110
Fight against tax fraud: adopt the best international practices	500
<b>Total impact</b>	<b>5,654</b>
Source: Ministry of Finance.	

Social contributions might have a dynamic evolution in 2019 (6.5%), owing to favourable developments in the labour market and wage growth, as well as the measures adopted in recent months. On the one hand, the increase of the SMI, which has led to a rise in the minimum contribution bases, with an estimated positive impact of €1.3 billion. On the other hand, Royal Decree-Law 28/2018, of 28 December, for the revaluation of public pensions and other urgent measures related to social, labour and employment issues, which is expected to bring in an additional €1.7 billion in contributions. Finally, the reinstatement of the unemployment benefit for unemployed people over 52 will also lead to higher revenue from social contributions to the tune of €193 million. The reintroduction of the agreement on social security contributions for informal carers of dependent persons will bring in an additional €296 million.

Account should also be taken of the higher social security contributions that are being paid by city police, who benefit from the retirement age reduction

coefficient since the additional contribution rate approved by Act 6/2018, of 3 July, on the 2018 State Budget came into force. Moreover, the Master Plan for Decent Work is already bearing fruit in terms of conversion of fixed-term contracts into open-ended contracts and identification of the so-called false self-employed, which will have a positive effect on social contributions.

Finally, the reorganisation of existing hiring incentives will bring in an additional €500 million starting in 2020. This conservative estimate of potential savings is the expected outcome of several projects that the AIReF will carry out in the second phase of the spending review in 2019.

This element along with a dynamic labour market suggests a 4.4% growth in social contributions for the remainder of the period (2020-2022).

The Government also foresees an increase in revenues from the European Social Fund, due mainly to the amendment of the regulation on the National Youth Guarantee System provided for in Royal Decree-Law 8/2019, of 8 March, allowing certification of higher spending. Furthermore, the end of the current Multiannual Financial Framework and the existence of the "N+3" rule for the certification of expenditure in the European Structural and Investment Funds, also allow predicting substantial revenue from these concepts.

Meanwhile, the expenditure-to-GDP ratio declines very gradually from 41.3% of GDP in 2018 to 40.7% in 2022.

Virtually all expenditure items have seen a negligible drop in weight, which is explained by an increase in expenditure at more moderate rates than nominal GDP, rather than by a fall in spending. Social transfers are the exception, given its increased GDP weight.

Compensation of employees increases throughout the projection period. On the one hand, the Second Agreement for the Improvement of Public Employment and Working Conditions, signed between the Government and the trade unions, will take effect in 2020. Furthermore, from that year onwards, the policy on increased compensation of public employees will be maintained to ensure their purchasing power. On the other hand, this heading also incorporates upward developments in public sector staffing.

Intermediate consumption shows a relatively dynamic development, particularly in 2019 and 2022. More specifically in the latter year due to upcoming elections in the following year.

Social transfers in kind increase throughout the period, but at rates below that of 2018, owing to greater efficiency in health and education arrangements, including hospital spending. This is achieved, inter alia, through the implementation of several recommendations made by the AIReF in its spending analysis on prescription drugs, which is part of the first phase of the spending review implemented in 2018. The implementation of these measures would yield

substantial savings in the 2019-2022 period, tempering developments in this expenditure.

Given that social transfers spending will see record growth rates above the economy's nominal growth, its GDP weight will increase. This evolution is determined by the behaviour of pension spending, the main expenditure item under this heading. Thus, rising pensions are a consequence of the growing number of pensioners, the replacement effect as new pensions are higher than existing ones and the CPI-based revaluation of pensions.

Other elements that explain increasing expenditure in social transfers, albeit to a lesser extent, are social measures recently adopted by the Government that will be consolidated within the projection horizon, including reintroduction of the unemployment subsidy for people over 52, the gradual increase in paternity leave up to 16 weeks and increased benefits for dependent children.

The projected spending on interest is based on a slow but steady increase in interest rates. However, this is affected by two court rulings on one-off elements which translate into higher interest expenditure in 2019 and 2022 via-à-vis effective interest rates.

Also worthy of note is the spending on subsidies, which in 2019 is very similar to that of 2018 due to the extended budget scenario. A very moderate growth of 1% per annum is expected for the rest of the fiscal years, owing to the implementation of the measures recommended by AIREF in its project "Evaluation of Grant Strategy and Procedure", which will include developments in expenditure.

The forecast on gross capital formation foresees steady increases ahead, owing to financially sustainable investments and more significant investments by the State. In any case, 2019 will see a drop since several one-off elements recorded in 2018 will not be replicated in 2019. This means, in absolute values, that investment has fallen. This is the case, amongst others, of the toll road RPA (partially offset under this heading), the impact of the reversion of the AP1 toll road and several court rulings that affect Regional Governments. Meanwhile, the most significant increase under this heading is expected in 2022, due to the upcoming elections in the following year.

Finally, also worth mentioning are other capital expenditures, which in 2019 and 2020 fell significantly. This is attributable to several items that appear under this heading in 2018 but which no longer will appear in 2019, for instance, the toll roads RPA. Following a Supreme Court ruling and relevant amendments of applicable regulations, this heading also includes, both in 2018 and 2019, the PIT refund on maternity and paternity benefits for tax periods within the statutory limitation. These impacts are not replicated in future tax years, which explains the fall in 2020.

### **No-policy-change scenario**

As already mentioned above, the only measures included in these budgetary projections are the tax measures that the Government had already presented.

Given the broad consensus amongst signatories of the Toledo Agreement on the need for a CPI-based revaluation of pensions, this will occur in a future scenario.

Meanwhile, the Second Agreement for the Improvement of Public Employment and Working Conditions signed between the Government and the trade unions covers the increase in compensation of public employees in 2020. There is reason to believe that compensation will continue to gradually increase to maintain purchasing power, as was the case before the economic crisis.

Therefore, the only difference between the measures-driven scenario and the no-policy-change scenario is higher revenue collection, as expenses are expected to remain unchanged.

**Table 4.3.3. Forecasts in a no-policy-change scenario**

	2018 (A)	2018 (A)	2019 (P)	2020 (P)	2021 (P)	2022 (P)
	Level (Million €)	% of GDP				
Total Revenues	469,538	38.9	39.1	39.4	39.8	40.2
Total Expenditures	499,520	41.3	41.1	41.0	40.7	40.7

(A) Advance; (F) Forecast.  
Source: Ministry of Finance.

### Comparison with the Commission's forecasts

In order to implement Article 4.1 of Council Directive 2011/85/EU, of 8 November 2011, on requirements for budgetary frameworks of the Member States, and Article 6 of Royal Decree 337/2018, of 25 May, on requirements for macroeconomic and budgetary forecasts, budgetary projections in a measure-based scenario are compared below with the latest available forecasts of the European Commission (EC), the autumn forecasts, which cover 2019 and 2020.

**Table 4.3.4. Comparison with the Commission's forecasts**  
% of GDP

	2019		2020	
	Spain	European Commission	Spain	European Commission
Total Revenue	39.1%	38.8%	39.8%	38.8%
Total Expenditure	41.1%	40.9%	41.0%	40.8%
Net lending (+) / Net borrowing (-)	2.0%	2.1%	1.1%	1.9%

Source: Ministry of Finance.

For 2019, the public deficit forecast stands at 2% of GDP, in line with that of the European Commission at 2.1%. However, there are differences in the total volume of expected revenue and expenditure.

The EC estimates a revenue-to-GDP ratio of 38.8% vs 39.1% of the Government. It should be noted in this regard that the EC's forecast dates back to November, whilst the Government has updated the figures to prepare this document. Therefore, the Government's projection takes into account the year-end data for 2018 which includes the favourable evolution of certain revenues in the last months of the year, as is the case of the Corporate Income Tax. Furthermore, the Government's forecast also takes stock of the impact of different measures that seek to increase social contributions and ensure the sustainability of the Social Security system. Despite the above, the difference is not significant because the EC's forecast also included some tax measures from the Government's draft 2019 General State Budget that were not implemented due to its rejection.

On the expenditure side, the EC foresees 40.9% of GDP, whilst the Government's estimate is 41.1%. Again, the forecast in this document uses the latest data available, which provides more accurate information on developments in the main expenditure items. In this case, there is a slight increase in certain expenditures. Hence, it was considered advisable to revise this forecast upwards.

The most significant differences arise in the 2020 scenario. The Government predicts a public deficit of 1.1% of GDP vs the EC's 1.9%. The difference stems from the inclusion of various revenue-related measures that the Government of Spain plans to reinstate next year. These measures will raise the revenue-to-GDP ratio to 39.8% vs 38.8% estimated by the EC.

By contrast, spending estimates are almost identical, i.e. EC 40.8% and the Government 40.9%.

### **Tax measures from 2020 onwards**

As discussed above, the fiscal projection proposed by the Government of Spain in this Stability Programme contains tax measures from the 2019 General State Budget that will be implemented from 2020 onwards, as well as measures to combat fraud and the creation of two new taxes.



To that end, the content of these measures and the two new taxes require further clarification.

#### A. Corporate Income Tax measures

These measures seek to bring effective and nominal rates closer so that large companies and consolidated groups contribute more.

On the one hand, tax exemptions will be limited to avoid double taxation of dividends and capital gains from shares in subsidiary companies abroad. The rate will drop from 100% to 95%, within the taxation framework provided by the EU regulations for these operations.

On the other hand, a minimum 15% tax rate (minimum payable tax) will be applied to the positive tax base of Corporate Income Tax. In the case of entities taxable at the increased rate of 30%, this minimum tax will be 18%. This measure will only affect the groups eligible under the tax consolidation regime and companies not members of a group whose net turnover is equal to or greater than €20 million. Therefore, it will not affect SMEs.

Finally, a reduction of the nominal Corporate Income Tax rate, from 25% to 23%, is also envisaged for companies with a turnover of less than €1 million. This will help SMEs that are at the heart of our production model.

#### B. Increases in Personal Income Tax rates for high-income households

The rate applicable to the general tax base for incomes higher than €130,000 is increased by two p.p. and by four p.p. for those exceeding €300,000. The State tax rate for savings income higher than €140,000 will also increase by four p.p., from 23% to 27%.

This measure focuses on social justice, and citizens' ability to pay taxes, i.e. those with a higher income should pay more.

#### C. Green taxation

Taxation on diesel fuel increases to €38 per one thousand litres. However, taxes on commercial and agricultural diesel fuel will remain unchanged to give users more time to switch to less-polluting products in their economic activity. The purpose of this measure is to ensure their competitiveness during this adjustment period.

This measure seeks to equate taxation on diesel fuel and gasoline gradually, in line with international recommendations, without affecting carriers and farmers. Therefore, tax collection is not its primary aim, but rather the protection of the environment through internalisation of negative externalities.

#### D. VAT reduction for veterinary services

The VAT tax rate on veterinary services will be reduced to 10%, as the taxation on these services need to be adapted to that of drugs for veterinary use, which are also taxed at 10%.

#### E. Gender and inequality taxation measures

The following measures will be introduced to mainstream gender into the tax system.

- The VAT rate for feminine hygiene products will be reduced to 4%.
- A deduction on Corporate Income Tax will be introduced to promote gender equality. Companies that increase the number of women on their Board of Directors in order to meet the gender parity goal established in Organic Law 3/2007, of 22 March, on effective gender equality between women and men, may deduct 10% of the compensation paid to these female directors during that tax period.

#### F. Reduced VAT on e-books

The VAT on books, newspapers and magazines in electronic format will be subject to a super-low 4% rate. In so doing, Spain applies the recently approved EU rule that will bring VAT on such publications in line with the rates charged on printed publications.

#### G. Higher Wealth Tax

The tax rate applicable to assets exceeding €10 million increases by 1%, requiring wealthier citizens to pay more.

#### H. Creation of the Tax on Financial Transactions

The Tax on Financial Transactions will be relaunched, that consists of applying a 0.2% tax to all share purchase transactions carried out in Spain by financial operators, regardless of the place of residence of the persons or entities involved in the transaction, or where they are traded, provided they meet the following conditions:

- Shares admitted to trading on a regulated market; and
- Company's market capitalisation value is higher than €1 billion;

Overall, these transactions are not subject to any indirect tax; therefore, the introduction of this tax is a major development in terms of tax equity. This new tax is based on the proposal, that is currently under discussion in the strengthening co-operation procedure on this tax to which Spain is a party.

#### I. Creation of the Tax on Specific Digital Services

The creation of the Tax on Specific Digital Services will also be stepped up to ensure that revenues generated in Spain by large international companies that

engage in certain digital activities not covered by the current fiscal framework are taxed.

A 3% tax would be levied on revenue generated from online advertising services, online brokerage services and sale of data obtained from information shared by users.

This tax will be applied only to legal persons and other entities with a net turnover greater than €750 million in the previous calendar year, and whose revenue comes from the provision of services subject to this tax in Spain that exceed €3 million in the last calendar year. This helps ensure that this tax is not applied to SMEs.

This tax is based on the one proposed by the European Commission for digital activities that generate added value from the participation of users situated within the EU territory, but which are not taxed by the Member States under the current fiscal framework.

#### J. Anti-fraud measures

These measures seek to strengthen the fight against tax fraud with a two-fold purpose. On the one hand, it incorporates the European Union's internal law into tax evasion measures stemming from aggressive international tax planning and tax dispute resolution mechanisms. On the other hand, it introduces regulatory changes to establish tax justice parameters and facilitates actions aimed at preventing and fighting fraud by strengthening tax control.

#### *List of Tax Havens*

Tax regulations geared towards putting an end to tax havens used by fraudsters to avoid contributing to society are being strengthened through stricter limitations. Thus, any country without minimum tax standards shall be added to Spain's list of tax havens. Additionally, the national list of tax havens is aligned with international standards and lists.

Meanwhile, to react more effectively to certain types of fraud, there is a need to identify preferential tax regimes that exist in certain countries or territories that facilitate tax fraud, provided the lists are compiled under applicable laws.

#### *Limits on cash payments*

The quantitative limits on cash payments have been reduced from €2,500 to €1,000 across the board, and from €15,000 to €10,000 on payments made by private individuals with tax residence outside Spain.

However, the €2,500 limit shall continue to apply to small domestic economies for payments made by natural persons who are not entrepreneurs or professionals.

### *Strengthening the list of debtors to the Tax Authorities*

Owing to the vital role played by co-debtors in the existence of debts, the list of debtors is being expanded expressly to include not only the main debtors but also the co-debtors who are jointly liable for the debt. Moreover, the ceiling for being included in the list is reduced from €1,000,000 to €600,000.

### *Adoption of best international practices for preventing and combating fraud*

New regulatory, organisational and operative measures are being adopted in line with the best international practices to adjust the State Tax Administration (known in Spanish as AEAT) to the changing economic environment. These measures include (1) a right-from-the-start strategy for start-ups to encourage voluntary compliance with tax obligations; (2) regulatory measures against the manufacture, distribution and use of so-called sales suppression software; (3) creation of a control unit for high net worth individuals (HNWI); and (4) optimisation of the information obtained through the Immediate Disclosure of Information and Common Reporting Standard for the automatic exchange of information (Big Data and Data Analytics).

## **4.4. Role of Regional Governments and Local Entities in the fiscal strategy**

### **4.4.1. Regional Governments (CCAA)**

#### **4.4.1.1. 2019 Budget**

The analysis of budgetary developments provided below is based on the General Budget Report of the Regional Governments for the financial year 2019, published on 1 April 2019 by the Ministry of Finance.

**Table 4.4.1.1. Budgetary developments of Regional Governments**  
% rate of change

Total Regional Governments	Budget 2019 / 2018 % change	Budget 2019 / Recognized Rights or Obligations 2018	Budget 2019 / Recognized Rights or Obligations 2018 adjusted
Chap. 1,2,4. Taxes & Current Transfers	4.00%	4.19%	4.19%
System resources subject to payment and settlement	3.24%	3.89%	3.89%
Inheritance and Gift Tax	4.17%	2.81%	2.81%
Property transfer & Stamp Duty Tax	11.61%	6.52%	6.52%
Other tax	-1.20%	0.15%	0.15%
Other current transfers	7.71%	7.24%	7.24%
3. Fees, public prices and other Revenues	10.27%	-12.47%	-12.47%
5. Property income	-3.61%	142.30%	142.30%
6. Real investment sales	34.69%	113.61%	113.61%
7. Capital Transfers	0.25%	53.70%	53.70%
<b>Non-Financial Revenues</b>	<b>4.06%</b>	<b>5.14%</b>	<b>5.14%</b>
1. Personnel Spending	2.65%	2.25%	2.06%
2. Current spending in goods and services	1.27%	-4.07%	-6.22%
3. Financial Spending	-2.81%	5.81%	5.67%
4. Current Transfers	3.29%	2.23%	2.27%
5. Contingency fund	5.59%	-	990.72%
6. Real Investments	3.05%	53.64%	52.96%
7. Capital Transfers	4.98%	46.51%	47.45%
<b>Non-Financial Expenditure</b>	<b>2.56%</b>	<b>5.04%</b>	<b>4.49%</b>

Source: Ministry of Finance.

\*Data relating to the 17 Regional Governments, 7 of which have extended their budgets. These are Andalusia, Aragon, Castilla-La Mancha, Castilla and Leon, Catalonia, Basque Region and La Rioja. The rates of change shown in this table are conditional on this circumstance.

\*For the Regional Governments with extended budgets, the financing system revenues envisaged are those reported by the General State Administration in January 2019 when the General State Budget was extended. These amounts are based on the data available at the time of the extension of these Regional Government's budgets.

Concerning the revenue from the regional financing system, the Regional Governments that have adopted general budgets for 2019 have taken into consideration a multi-deliverable on account revenue arrangement and settlement consistent with the figures reported by the General State Administration in July 2018. They have also integrated their forecasts about the impact of the Integrated VAT System, except the Canary Islands and Madrid, which only included the amounts reported in July 2018, without additional quantities.

After the General State Budget Bill was put on hold, the Regional Governments considered different financing scenarios in the medium-term budgetary plans submitted. The Canary Islands is working on the most conservative scenario, as their revenue comes from the extended General State Budgets only. Meanwhile, Madrid, Galicia, La Rioja and Comunitat Valenciana have submitted a scenario consistent with the data reported in July 2018 as a forecast of the financing system's resources for the 2019 financial year. The

remaining Regional Governments have foreseen a scenario that is virtually identical to the one included in the draft General State Budget.

Concerning compliance with the different objectives, the Regional Governments that adopted their 2019 General Budgets expect to achieve the budgetary stability target of -0.1% for 2019. All Regional Governments have confirmed this forecast in their mid-term budgetary plans.

As for the expenditure rule, compliance is expected throughout, with the exception of Comunitat Valenciana, which foresees a 7.6% change rate; Galicia which will officially be compliant, although it exceeds the target, albeit slightly, if the expenditure rule's change rate is correctly applied; and Comunidad Foral de Navarra, which considers that this deviation can be redirected using the variability margin derived from the execution data. Nonetheless, based on the data subsequently provided in the medium-term budgetary plans, all Regional Governments have forecasted compliance with the 2019 expenditure rule.

By functions, the sum of Health, Education and Social Security and Social Protection-related items represent 61% of the total credits of the 2019 expenditure budget. Likewise, each function analysed individually has increased: Health by 1.83% vis-à-vis the previous year, accounting for 32.76% of the budget for this fiscal year; Education by 4.13%, and Social Security and Social Protection by 5.23% compared to 2018. Finally, the expenditures allocated to "Public Debt" increased by 6.14% in 2019, which means that it represents 16.8% of this year's budget.

### **Measures for 2019**

On the revenue side, the measures amount to €754 million, mainly for non-tax measures (€430 million), which primarily stem from the Regional Governments' disposal of investments and assets. This effect results from the standardisation of the maximum regional rates of the Hydrocarbons Tax, which starting in 2019 are part of the State Excise Tax, amounting to €342 million. Personal Income Tax (PIT) related measures will also have a positive impact on collection, namely €111 million. Meanwhile, the amount of tax collected from Inheritance and Gift Tax measures are expected to decline by €115 million vis-à-vis the previous year.

On the expenditure side, a more detailed analysis of staffing measures should be conducted, breaking down the repayment of bonus pays and all the other measures. In 2019, three Regional Governments (Andalusia, Aragon and Catalonia) carried out partial restitution of the 2018 extra pay for €323 million. The restitution of the 2013 extra pay would amount to an additional -€240 million in Catalonia and Murcia. Finally, all other measures not related to the restitution of extra pays amounted to -€312 million, including refund of wage supplements, and compensation, seniority and career options in basic public services. The overall effect of the 2019 staffing measures would amount to -€229 million.

Concerning all other measures in 2019, pharmaceutical expenses and health

products stand out for their positive effect, both the centralised procurement and agreements with the pharmaceutical industry. Worthy also of note is the net effect of the measures on non-availability and blocking of budgetary credits, which amount to €160 million.

On the negative side, the measures associated with current and capital transfers stand out, in particular, those derived from the compensation paid to Local Entities in the Canary Islands due to the impact on tax collection, and the social inclusion income in Comunitat Valenciana for dependent people and construction of education centres.

### **2020-2022 Scenario**

Concerning the economic and financial scenario foreseen for 2020-2022, the medium-term budgetary plans submitted by the Regional Governments focus on achieving the 0% stability target in 2020 and 2021, even extending this target to 2022, although it has yet to be benchmarked. As for the expenditure rule, the Regional Governments aim to comply with the current benchmark rates of 2.9% and 3.1% for 2020 and 2021, respectively. Comunitat Valenciana alone expects to exceed this target in 2020 with a 7.2% change rate.

On the revenue side, the measures envisaged for 2020-2022 lead to a decline in revenue of €75 million, €212 million and €23 million, respectively. In 2020, this decrease will be due mainly to the reversal of measures related to the disposal of investments in 2019. Negative impacts are also expected over this period due to measures taken or foreseen for Personal Income Tax. The Wealth Tax measures to be included in the Government's package in 2020 will have a positive impact, generating additional revenue of €339 million.

As for expenditure measures in 2020-2022, these include a detailed analysis of those affecting staff costs. Firstly, the restitution of the 2013 extra pay, which ends in 2021, would amount to a loss of €72 million in 2020. The total amount refunded would be €322 million. Secondly, the restitution of the 2014 extra pay, which also affects Catalonia and Murcia, is expected to reach -€15 million in 2020, -€293 million in 2021 and -€68 million in 2022, owing to the partial impact of the restitution of the amounts paid in the previous year. Lastly, all other staffing measures would have a differential impact of -€272 million, -€120 million and -€32 million in each of the years from 2020 to 2022, mostly due to measures related to teaching staff and career options for statutory staff.

Concerning the remainder of the measures in 2020-2022, pharmaceutical expenses and medical devices will continue to feel the impact of these measures in 2020, and non-availability agreements will be reversed or budgetary credits will be blocked. The measures on current expenditures and agreements will have less impact than in the past.

#### **4.4.2. Local Entities (Spanish acronym "EELL")**

Local Entities as a whole have achieved fiscal surplus since 2012. From the baseline deficit of 0.4% in 2011<sup>7</sup>, Local Entities have run surpluses of 0.32% of GDP in 2012, 0.55% in 2013, 0.53% in 2014, 0.42% in 2015, 0.62% in 2016, 0.61% in 2017 and 0.52% in 2018 (€6.3 billion). The application of the expenditure rule helped achieve this result. Increased revenues and expenditure control have allowed achieving the fiscal target and even exceed it.

Regarding the effects of Law 27/2013, of 27 December, on Rationalisation and Sustainability of the Local Administration (known in Spanish as LRSAL) included in the Stability Programme of April 2018, revenue from negative settlements has been watered down<sup>8</sup>. Indeed, reductions in capital expenditures from non-performance of investments or reduction of capital transfers to finance investment projects in other sectors, including those implemented by entities accountable to the Local Entities are now more relevant.

#### A) Expenditure

According to the budgets and budget plans of the Local Entities for 2020-2022, investments and capital transfers are expected to fall in 2019 by €653 million. This will be the primary source for savings of Local Entities in this fiscal year. However, current transfer expenses slightly increased to €917 million. The combined effect of these actions on local investments and financing for other sectors (including entities dependent on the local sector) will translate into lower savings in 2019 (-€264 million).

Moreover, 2019 will see an increase in wages and procurement spending on goods and services delivered to the Local Entities, up to €403 and €743 million, respectively.

The expenditure side will yield lower savings of €1.4 billion.

Considering the data in the budget plans, spending will increase each year in the 2020-2022 period, especially in 2021 and 2022 due to expected increased expenditure in investments by the Local Entities.

#### B) Local public sector resizing

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<sup>7</sup> Excluding the effect of negative settlements of local financing systems related to its participation in state taxes.

<sup>8</sup> Act 27/2013, of 27 December, on Rationalisation and Sustainability of the Local Administration requires services to be eliminated and integrated except when there is a surplus. Therefore, these concepts appear to have a lower-than-expected impact on the programme over the years. The savings stemming from the devolution of powers to the Regional Governments in health, education and social services was also reconsidered in 2016, following a ruling of the Constitutional Court, of 3 March 2016, declaring unconstitutional the provisions on which those devolutions were based, allowing the Regional Governments to regulate these matters as they deem suitable. In this case, one might take the view that Local Entities will not achieve any savings.



- a) For the sake of prudence, the effects will not be taken into account from 2019 onwards. It is conceded that the number of dependent entities needs to be reduced.
- b) The pace of adjustment of the local public sector will moderate, whilst the number of entities will continue to decline at an annual rate of less than 2%.

C) Elimination of small Local Entities: the Regional Governments have the last word in this matter and have yet to take any decision

Resizing rules will continue to be applied to the local public sector in 2019 with special monitoring of Local Entities subject to adjustment plans.

Between 2013 and 2018, 961 dependent entities were eliminated, which will reduce expenditure by €735 million (including savings in operating expenses, non-financial expenses and negative results).

D) Revenue

On the revenue side, it is estimated that direct and indirect taxes will increase to €1.3 billion in 2019, whereas public fees and prices will grow to €30 million. Total revenue savings will amount to €1.4 billion compared to 2018. The larger projected revenue will virtually balance the largest expenditure item in 2019.

For the rest of the projection period, an upward trend in tax revenues is expected that will offset higher expenditure.

E) Organic Law on Budgetary Stability and Financial Sustainability (known in Spanish as LOEPSF)

Also in 2019, monitoring of compliance with the tax rules provided for in the LOEPSF will continue. This will require the adoption of economic-financial plans for breaches of the expenditure rule or the budgetary stability target, as well as strengthening of the fiscal discipline of Local Entities by monitoring the implementation of the standards contained in the LOEPSF and in the consolidated text of the Law Regulating the Local Revenue Authorities.

F) Financially Sustainable Investments

Local Entities may allocate the 2018 surplus to purposes other than the amortisation of public debt, as this measure has been extended to 2019 through Royal Decree-Law 10/2019, of 29 March. In essence, as further explained in another section, if Local Entities pay their suppliers within an average payment period of 30 days, they may allocate the remainder to financially sustainable investments (IFS).

G) Transparency

In the period between 2019 and 2022, efforts will continue for increased transparency in local public management. The information on "Payables for operations against budget" in the account balance, first published in the first quarter of 2016, will continue to be published to disseminate knowledge on the liabilities recognised by Local Entities in their accounting but not in their budgets<sup>9</sup>. Likewise, Local Entities in breach of their duty to provide information shall receive a request to remedy the situation.

#### **4.4.3. Reform of the Financing System**

Concerning the reform of the Regional Financing System, the Permanent Technical Evaluation Committee (known in Spanish as CTPE, provided for in the seventh additional provision of Law 22/2009), in its first phase, completed its assessment of the recommendations made by the Committee of Experts on the reform of regional financing, and discussed various proposals based on these recommendations.

A commitment has been made to continue to push this reform process, which entails both technical analyses on the progress made and in-depth debates and negotiations, and even a political stance to bring diverse opinions closer together and secure consensus on the changes to be made.

Although steps have been taken to facilitate discussions at the political level, in recent months, the conditions have been unfavourable to reach the necessary consensus to move the reform of the Regional Financing System forward, since this work must be carried within a framework conducive to medium-term political stability, which is expected to be achieved after the formation of a new Government.

Concerning the reform of the local financing system, the Ministry of Finance and the Spanish Federation of Municipalities and Provinces (FEMP) have met to discuss the main concerns for the Local Entities and establish guidelines to reform the local financing system.

#### **4.5. Public debt forecasts**

In 2018, Spain reduced its public debt-to-GDP ratio for the fourth consecutive year down to 97.1% (Table 4.5.2), one p.p. below that recorded in 2017, and 3.3 p.p. below that of 2014, when the maximum was reached.

The reduction in the debt ratio in 2018 is mainly due to nominal GDP growth, which contributed to reducing the ratio by 3.4 points of GDP and, to a lesser extent, by the stock-flow adjustment, which had a slight downward effect, equivalent to 0.1% of GDP. Favourable developments of interest rates in debt markets and sound management of the State Treasury have allowed reducing the net issuance of debt vis-à-vis the forecast, as well as the financial

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<sup>9</sup> This account has declined from €1.838 million in the first quarter of 2016 to €1.143 million in the fourth quarter of 2017, and down to €1.020 million in the third quarter of 2018.

expenditure. In keeping with the Government's commitment to fiscal consolidation, savings and windfall gains have been used to reduce the debt-to-GDP ratio as quickly as possible.

On the other hand, the General Government's net borrowing stood at 2.48% of GDP in 2018, 0.6 points lower than the previous year. Excluding interest expenditure (2.46% of GDP), the primary budgetary balance stood closer to budgetary balance, at -0.02% of GDP.

**Table 4.5.1. Stock-flow adjustment of debt in 2018**  
% of GDP

	<b>2018</b>
<b>Stock-flow adjustment</b>	<b>-0.1</b>
Net acquisition of financial assets(*)	0.8
Other accounts payable(*)	-0.7
Other adjustments	-0.2
(*) Operations within General Government consolidated. Sources: Bank of Spain and Ministry of Economy and Business.	

The downward effect of the stock-flow adjustment on the General Government's borrowing need in 2018 is due to the negative contributions of other accounts payable (-0.7%) and other adjustments (-0.2%), which more than offset the positive value of net acquisitions of financial assets, amounting for 0.8% of GDP. Thus, the stock-flow adjustment in 2018 stood at -0.1% of GDP (Table 4.5.1.) compared to 0.1% of GDP in 2017.

At the end of 2019, public debt is expected to be reduced by 1.2 points vis-à-vis the previous year and will represent 95.8% of GDP. This reduction is due mainly to the increase in nominal GDP, with an impact on the debt-to-GDP ratio of -3.6 points, and to an improvement of the primary budgetary balance, which will run a surplus in 2019 for the first time after eleven years of deficit. It is estimated that the stock-flow adjustment will be positive this year, standing at around 0.3% of GDP.

The public debt-to-GDP ratio will maintain its downward trend in the upcoming years, favoured by nominal GDP growth and the primary balance, which will continue to run a surplus. Therefore, both items will offset the positive contribution of stock-flow adjustment.

In 2022, public debt is expected to reach 88.7% of GDP, a reduction of more than eight points in four years, thus, contributing to correcting a major macroeconomic imbalance of the Spanish economy.

**Table 4.5.2. Public debt dynamics**  
% of GDP

	2018	2019	2020	2021	2022	Cumulated 2018-2022
1. Gross debt / GDP ratio	97.1	95.8	94.0	91.4	88.7	
2. Change in gross debt / GDP ratio	-1.0	-1.2	-1.9	-2.5	-2.7	-8.4
<b>Contributions to change in gross debt / GDP ratio</b>						
3. Primary balance	0.0	-0.3	-1.2	-1.8	-2.1	-5.4
4. Interest expenditure	2.5	2.4	2.3	2.2	2.2	9.0
5. Effect of nominal GDP growth	-3.4	-3.6	-3.4	-3.3	-3.1	-13.4
6. Other factors (stock-flow adjustment)	-0.1	0.3	0.4	0.4	0.4	1.4
p.m.: Implicit interest rate	2.6	2.5	2.5	2.4	2.4	

Source: Ministry of Economy and Business.

#### 4.6. Fiscal Stance

In order to analyse the fiscal stance, this Stability Programme Update includes both the real GDP growth rates and the potential GDP, as well as the output gap estimates for 2019-2022. It uses the production function methodology agreed within the Output Gap Working Group (OGWG) that is applied by the European Commission.

As in previous Stability Programme Updates, some statistical changes have been introduced to obtain estimates that are more accurate and consistent with the business cycle of the Spanish economy. In particular, the latest population projections published by the INE have been used. Likewise, the new semi-elasticities estimated by the European Commission in 2019, which correct the budget balance of the fluctuations in the business cycle updated every six years, have been applied. In Spain's case, this semi-elasticity has increased from 0.54 in 2013 to 0.60 in 2019, which implies that the budget is more sensitive to the cycle.

**Table 4.6.1. Cyclical developments<sup>(1)</sup>**  
 % of GDP, unless otherwise specified

	2018	2019	2020	2021	2022
1. Real GDP growth (% change)	2.6	2.2	1.9	1.8	1.8
2. Net lending (+) / Net borrowing of General Government	-2.5	-2.0	-1.1	-0.4	0.0
3. Interest expenditure	2.5	2.4	2.3	2.2	2.2
4. One-offs and other temporary measures	-0.3	-0.2	0.0	0.0	-0.1
5. Potential GDP growth (% change)	1.3	1.4	1.6	1.7	1.8
Contributions:					
- total factor productivity	0.3	0.3	0.3	0.3	0.4
- labour	0.5	0.6	0.7	0.8	0.8
- capital	0.4	0.5	0.5	0.6	0.6
6. Output gap	0.6	1.5	1.8	1.9	1.9
7. Cyclical balance	0.4	0.9	1.1	1.2	1.2
8. Cyclically-adjusted balance (2-7)	-2.9	-2.9	-2.2	-1.6	-1.2
9. Cyclically-adjusted primary balance (8+3)	-0.4	-0.5	0.1	0.6	1.0
10. Structural balance (8-4)	-2.6	-2.7	-2.2	-1.6	-1.1
11. Primary structural balance (10+3)	-0.1	-0.4	0.1	0.6	1.1

<sup>(1)</sup> Using Potential GDP (output function). NAWRU calculated with a forward-looking Phillips Curve.  
 Source: Ministry of Economy and Business.

According to the estimates based on the European Commission's methodology, after the minimum level reached in 2013, potential GDP initiated an expansionary path in 2014 with positive and gradually rising growth rates. Such positive growth rates are expected to gradually increase to 1.8% at the end of the forecast horizon. The acceleration of potential GDP in the 2019-2022 period is due to a higher contribution of labour and capital factors, whilst total factor productivity (TFP) will maintain a relatively stable contribution, at around 0.3 or 0.4 p.p.

The recovery of the labour factor is primarily due to the drop in the structural unemployment rate (NAWRU), which at the end of the forecast horizon stands at levels lower than in 2007. Meanwhile, the positive and increasing contributions (from 0.4 p.p. in 2018 to 0.6 p.p. in 2022) of the capital factor during the analysed period is attributable to the expected dynamism of investment.

Having reached the maximum difference between potential and real GDP in 2013 (-9%), the output gap has progressively narrowed until the end of 2018, due to developments in real and in potential GDP. The output gap has already yielded slightly positive values in 2018, signalling the start of a new economic cycle. The output gap would expand in 2019, as the real GDP would grow at a higher rate than that of potential GDP, and will reach 1.9% at the end of the forecast horizon.

As detailed above, the General Government deficit closed 2018 at 2.48% of GDP according to figures that have been validated by Eurostat, which will

allow Spain to exit the Excessive Deficit Procedure. The deficit is expected to reach 2% of GDP in 2019, half a point lower than last year, as a result of a neutral and prudent fiscal policy stance, compatible with the free play of automatic stabilisers.

The Country Specific Recommendations (CSR) for Spain, approved by the European Council in July 2018, note that, the nominal growth rate of net primary government expenditure should not exceed 0.6% in 2019, which is consistent with a structural adjustment of 0.65 p.p. of GDP. According to the estimates of the *Expenditure Benchmark* based on the European Commission's methodology, this Stability Programme Update would yield a slightly negative structural effort of one-tenth, and a nominal increase of net primary government expenditure of 3.9%.

The adoption of the 2019 General State Budgets would have allowed the implementation of the revenue measures envisaged by the Government and the achievement of a structural effort of around five-tenths of GDP, thus complying with the European Council's recommendation. This structural effort, along with the measures approved in the first months of 2019, would have yielded a public deficit of 1.3% of GDP, as foreseen in the General State Budget.

In any case, in order to assess the implementation of the European Commission's fiscal recommendation, it is important to bear in mind that the recommended structural effort is based on output gap estimates that, in the case of the Spanish economy, have shown significant limitations/deviations over the past few years, due to the uncertainty and variability to which they are exposed (see box below in this chapter for examples of these discrepancies).

There are significant differences in the output gap estimates for the current year and the following, which show that the results are sensitive to the approach and the inputs used. The output gap estimates for 2019 and 2020, provided by various institutions, vary widely in terms of values, from slightly negative figures in the lower range of the AIReF's estimates to around 2% or above in those using the European Commission methodology. These differences have significant implications in formulating the fiscal policy recommendations for Spain, resulting in variations of half a percentage point of GDP (between 0.5 and 1 p.p.) in the structural effort required by the Commission for the current year or the next.

To that end, caution should be exercised when formulating fiscal policy recommendations that take account of the output gap, which is highly volatile and uncertain. The same applies to the analysis of the fiscal policy's adequacy, which varies substantially according to the estimates used. In 2019, according to the AIReF or IMF estimates, the structural effort would be zero versus the slightly negative effort obtained when applying the Commission's methodology. In any case, it should be noted that the budgetary scenario included in this Stability Programme Update shows, for each year of the forecast horizon, an increase in the General Government's total expenditure that is lower than

nominal GDP growth. Accordingly, the expenditure-to-GDP ratio is expected to fall from 41.3% in 2018 to 40.7% in 2022.

**Table 4.6.2. Calculation of the Expenditure Benchmark**

Billion €, unless otherwise indicated

	2018	2019
Nominal GDP (1)	1,208.2	1,255.2
Total General Government expenditure (2)	499.5	516.0
Interest expenditure (3)	29.8	29.8
Government expenditure on EU programmes fully matched by EU funds revenues (4)	6.58	5.61
<i>Gross fixed capital formation fully matched by EU funds revenue</i>	3.94	3.01
<i>Total Gross fixed capital formation</i>	25.4	24.8
Gross fixed capital formation net of EU funds revenues (5)	21.5	21.8
Annual average gross fixed capital formation t-3 to t, net of EU funds revenues (6)	21.17	21.00
Cyclical unemployment expenditure (7)	0.2	-0.9
<b>Corrected expenditure aggregate (nominal) (8 = 2-3-4-5+6-7)</b>	<b>462.7</b>	<b>480.8</b>
Discretionary revenue measures (9) (*)	0.6	3.4
One-offs on the revenue side (10)	0.0	-0.7
One-offs on the expenditure side (11)	-3.6	-1.2
Total one-offs (12)	-3.6	-1.9
Discretionary revenue measures net of one-offs on the revenue side (13) (*)	1.35	4.07
<b>Corrected expenditure aggregate net of one-offs on the expenditure side (nominal) (14) = (8) + (11)</b>	<b>459.1</b>	<b>479.5</b>
<b>Corrected expenditure aggregate net of one-offs (nominal) (15) = (14) - (13)</b>	<b>457.8</b>	<b>475.4</b>
<b>Change in corrected expenditure aggregate net of one-offs in % (nominal)</b>		<b>3.9</b>
(*) On an incremental basis over the previous year.		
Sources: Ministry of Economy and Business and Ministry of Finance.		

As detailed in Chapter 4, starting in 2020, the fiscal projections in this Stability Programme call for the implementation by the Government of the revenue measures contained in the 2019 General State Budget, as well as the measures to combat fraud and create two new tax types that had already been promoted through regulatory projects. These measures will entail a structural effort of 0.5 p.p. of GDP in 2020, which, together with the contribution of the economic cycle and the impact of the one-off measures, will reduce public deficit by nine-tenths to 1.1% of GDP. Furthermore, starting this year, the primary structural balance is expected to run a surplus, expanding further in the last two years of the forecast period. This will contribute to reducing the public debt-to-GDP ratio, correcting a major vulnerability in the Spanish economy.

This adjustment path, therefore, makes it possible to progress decisively in adjusting the inherited fiscal imbalances and to use savings and windfall gains to reduce public debt and deficit in a manner compatible with the preservation of economic growth and of job creation.

Finally, the intense fiscal consolidation process undertaken in Spain in recent years should be noted. Throughout 2011-2018, public deficit fell by more than seven points of GDP, standing below 3% in 2018, allowing Spain to exit the Excessive Deficit Procedure this year. Virtually half of the fiscal adjustments made in this period have been structural, making Spain one of the European countries with the highest fiscal consolidation in the last decade.

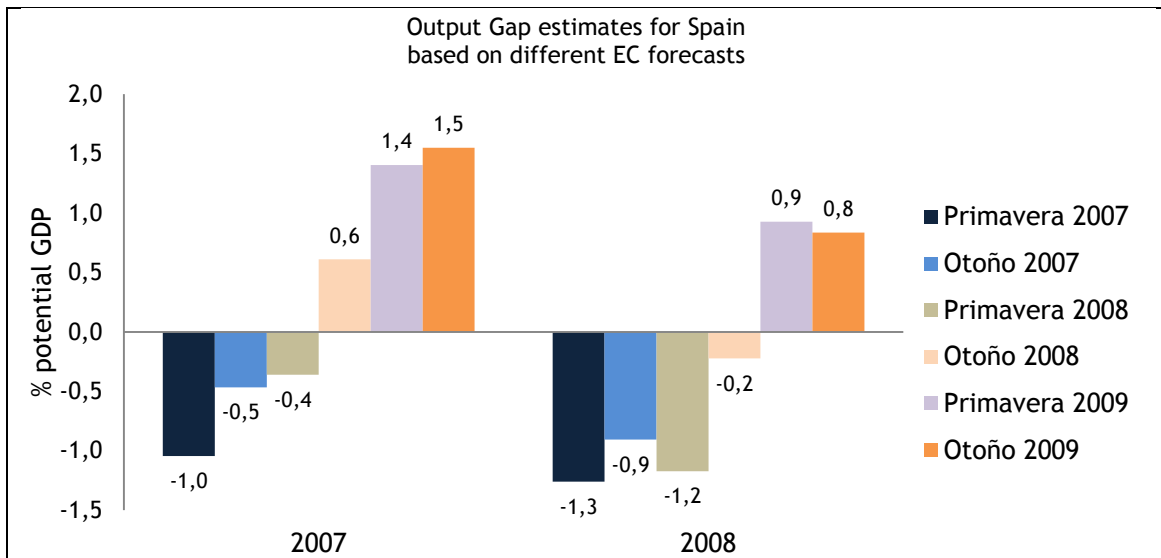


### **The output gap: the need for an adequate diagnosis**

Despite the strong growth of the Spanish economy in recent years, there are no signs of overheating. Unemployment levels -which are still high-, the remarkable job creation pace of the last five years, the absence of wage pressures and the moderate inflation rates, particularly the core inflation, appear to suggest that our country has overcapacity.

The above -based on empirical evidence- is in stark contrast with the conclusions of several models, based on unobservable variables, that point to an expansionary cyclical position. The sizeable differences in estimating our economy's output gap and the ensuing uncertainty about our cyclical position are very relevant as the output gap is used as a core variable to assess the fiscal stance. Indeed, its estimate influences the calculation of the structural effort and the convergence margin to the medium-term objective (MTO) applied to the reference rate used for calculating the EU's expenditure benchmark.

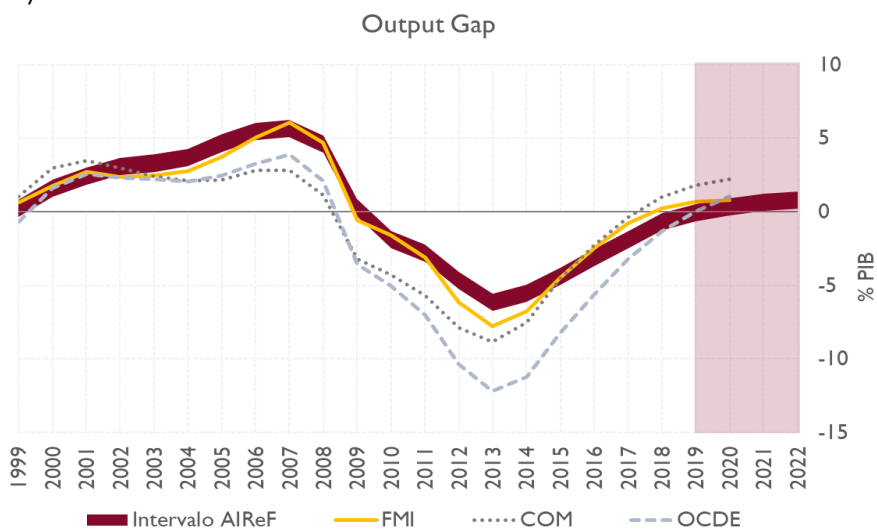
For instance, in its latest autumn forecasts, the Commission's output gap estimate for the Spanish economy was 2.2% in 2020, whilst that of the IMF and OECD's for that same year was 1% and 0.9%, respectively. This type of deviations is frequent, especially where the estimates are in real time, i.e. for the current year or the immediate year thereafter. For 2019, whereas the European Commission estimates an output gap of 1.8% in its Autumn Outlook 2018, the IMF and the OECD place it at 0.7% and 0%, respectively. It should be added that the uncertainty in these estimates is particularly acute in a situation like the current one, where the output gap turns from negative to positive: after nine years of negative values current estimates indicate that the output gap would turn positive. The previous swing of our output gap in the available time series occurred a decade ago, albeit in the opposite direction, from an expansionary to a contractionary cyclical position. The comparison between Spain's output gap estimates in 2007 and 2008, carried out between 2007 and 2009, clearly illustrates this volatility as shown in the following graph.



Source: Ministry of Economy and Business

The uncertainty that surrounds the output gap estimates is particularly acute in the Spanish economy, as shown by the discrepancy between the estimates produced by the Commission's common methodology and the alternative estimate (the so-called "*plausibility tool*", adopted in 2016), which amounted to 1.6 p.p. of GDP in 2018. Spain was one of the countries with the largest gap in the European Union.

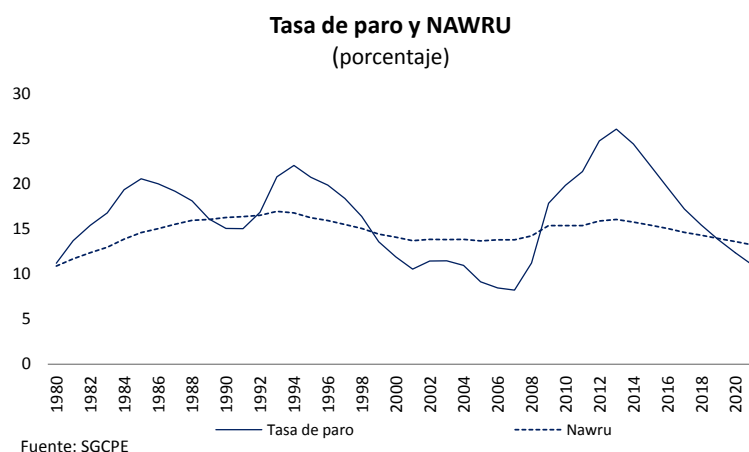
The current estimates for Spain's output gap in 2019 and 2020 fall within a broad range of values, as shown in the graph below. The lower range of the AIReF estimates still places the output gap at negative levels in 2019 and 2020 compared to the European Commission's estimates of 1.8% and 2.2%, respectively. The IMF and OECD estimates fall in between these values.



Source: AIReF

Moreover, in the Spanish case, the behaviour of the labour market and the disparity between current estimates of the structural unemployment level

(NAWRU) adds a layer of difficulty. Although the NAWRU shows some procyclicality, it remains at unusually high levels. Indeed, according to the estimates of the common methodology, the unemployment rate has already dropped below the NAWRU in 2018. If this were the case, wages would already have been subjected to upward pressure. However, in 2018, the compensation of employees continued to grow below average inflation (1.1% versus 1.7%). In short, the high uncertainty around estimated NAWRU values raises questions about its ability to predict future developments in the unemployment rate.



Source: Ministry of Economy and Enterprise

Several factors affect the structural adjustment requirements within the preventive arm, including the output gap which plays a key role. Moreover, the calculation of the structural effort is also strongly influenced by the estimates of potential GDP growth (in the *top-down* approach and, to a lesser extent, in the *bottom-up* approach). Therefore, caution must be exercised, not only in the calculation of the output gap but especially in the economic policy recommendations derived from this unobservable variable and in the assessment of the fiscal policy. This is essential to avert erratic or misguided policies.

In conclusion, in a volatile, uncertain, complex and ambiguous environment, it is more important than ever to properly analyse the current reality, taking into account the speed at which events develop and the need to incorporate and monitor new emerging variables associated with the important structural changes that are taking place. Otherwise, inappropriate formulas could be applied to the current challenges. To that end, it would be advisable to develop methodological improvements that promote broader consensus in measuring unobservable variables of the economy, including NAWRU and the output gap, to achieve a better understanding of the Spanish economy and adapt the *policy mix* to the changing economic reality and the challenges moving ahead.

#### 4.7. Adjustment path towards the Medium-Term Objective (MTO)

The current updated version of the Code of Conduct of the Stability and Growth Pact approved in May 2017, establishes the obligation to extend the forecasts of the main macroeconomic variables until it meets the medium-term objective (MTO) (the maximum structural deficit allowed for the countries signatories to the Fiscal Compact is 0.5% of GDP), or the one resulting from the sustainability conditions in place, if it was more stringent. It must also outline the main variables for achieving this objective.

In the case of Spain, the medium-term objective (MTO) established by the Organic Law on Budget Stability is more ambitious for reaching structural balance. The projected annual structural effort of 0.5 p.p. of GDP in the 2020-2022 period will result in a substantial reduction of the structural deficit, down to 1.1% of GDP in 2022.

## 5. COMPARISON WITH THE PREVIOUS STABILITY PROGRAMME. SENSITIVITY ANALYSIS

Table 5.1.1. compares the forecasts of this Stability Programme Update for 2019-2022 with the previous update forecasts. In both cases, the macroeconomic scenario predicts reductions in growth rates during the reference period. The previous update forecast a slowdown in economic growth from 2.7% in 2018 to 2.3% in 2021. This update also projects moderated growth in the coming years. The real GDP growth rate in 2021 is half a point lower than in the previous update. Owing to the lower growth rate and the non-approval of the 2019 General State Budget proposed by the Government that included additional deficit reductions, the adjustment has been delayed by one year. However, it should be made clear that the goal is to reduce the deficit and debt further, as indicated in Chapter 4, using the 2018 Budget in force. The table below provides the details.

**Table 5.1.1. Differences with the previous Stability Programme Update**

	2018	2019	2020	2021	2022
<b>GDP (% volume growth)</b>					
Previous update	2.7	2.4	2.3	2.3	
Current update	2.6	2.2	1.9	1.8	1.8
Difference	-0.1	-0.2	-0.4	-0.5	
<b>Budget Balance (% GDP)</b>					
Previous update	-2.2	-1.3	-0.5	0.1	
Current update	-2.5	-2.0	-1.1	-0.4	0.0
Difference	-0.3	-0.7	-0.6	-0.5	
<b>EDP Debt (% PIB)</b>					
Previous update	97.0	95.2	92.4	89.1	
Current update	97.1	95.8	94.0	91.4	88.7
Difference	0.1	0.6	1.6	2.3	
<b>GDP deflator (% growth)</b>					
Previous update	1.5	1.8	1.9	1.9	
Current update	1.0	1.6	1.7	1.8	1.7
Difference	-0.5	-0.2	-0.2	-0.1	

Source: Ministry of Economy and Business.

The National Accounts data show that the budgetary balance has improved by two-tenths vis-à-vis the June 2018 target, which stood at -2.7% of GDP, with a 2.5% deficit at year-end.

Meanwhile, the path of budgetary adjustment outlined for 2019-2022 shows higher net borrowing than in the previous update. This is due to the different baseline used and the non-approval of the 2019 General State Budget Project, which led to a call for general elections on 28 April that precluded the approval of new fiscal measures contained in the draft 2019 General State Budget. The deficit path included in this Stability Programme Update assumes the entry into force of these measures in 2020.

Finally, both the expected deficit path and the lower nominal economic growth translate into slightly higher public debt-to-GDP ratios than anticipated in the previous update. Starting from the baseline debt (97.1% of GDP) reached in 2018, the new path implies additional reductions in order to reach 88.7% the end of the forecast horizon.

### **5.1. Risk scenarios and sensitivity analysis**

In macroeconomic and fiscal projections, a sensitivity analysis must be made on possible changes in the assumptions underpinning the baseline scenario. The European Commission's Code of Conduct on the format and content of Stability Programmes urges Member States to examine how sensitive macroeconomic and fiscal projections are to different shocks. In particular, the Code of Conduct emphasises the interest rate and exchange rate. Moreover, the increase in oil prices since 2017 vis-à-vis those in 2016 make it advisable to include sensitivity to this third shock.

Meanwhile, Royal Decree 337/2018, of 25 May, on requirements for macroeconomic and budgetary forecasts establishes that the sensitivity analysis will include, at least, a comparison of the forecast of the main budgetary variables of the baseline scenario and the forecast of the same variables in scenarios with different growth assumptions and interest rates. Differences in revenue and expenditure, as well as government balance or debt level are expressed as a percentage of GDP to facilitate the valuation of implied changes on fiscal variables in the sensitivity analysis.

Given the current situation, the main risks facing the Spanish economy are lower external demand owing to protectionist tensions, higher-than-expected oil prices or rise in interest rates, should the European Central Bank abandon the current monetary policy stance and replace it with others that imply higher interest rates.

The interest rate plays a key role in the macroeconomic and fiscal scenario. On the one hand, it has a direct impact on public finances, as it alters the financial burden of the debt. On the other hand, it has an indirect effect since it is a key factor in GDP growth due to its influence on consumption and investment decisions of private agents. For these reasons, the first sensitivity analysis focuses on a potential increase in interest rates. Although this is an unlikely scenario in the short term, given the progressive reduction of risk premiums and announcements made by the European Central Bank regarding the maintenance of the monetary policy expansionary stance based on the Eurozone's economic outlook, at least in the short run.

In the second analysis, a rise in the exchange rate would negatively affect growth, mainly through net exports that, in turn, would affect public finances. A negative demand shock was simulated based on lower demand from Spain's trading partners. This scenario is more likely now than in the previous analysis, even though the assumptions underlying the macroeconomic scenario of this

update have already factored in the past slower growth in the Eurozone and the one expected in 2019.

This simulation could account for the possible effects of greater protectionism in other countries, mainly non EU, since the membership in the European Union implies free movement of goods, as well as an appreciation of the nominal effective exchange rate versus the rest of the world or the effects of a "no deal" exit of the United Kingdom from the European Union.

Meanwhile, oil prices affect macroeconomic aggregates through energy cost changes. Spain, as a net importing country, would be affected in two ways by a shock on oil prices: production costs and current account balance. A sensitivity analysis should be carried out on how the main macroeconomic aggregates would be affected by an increase in oil prices similar to the upward trend from mid-2017 until nearly the end of 2018.

Simulations were carried out using the REMS<sup>10</sup> model, a dynamic general equilibrium model with a rigorous microeconomic foundation applied to the Spanish economy. However, the results should be interpreted with caution as they are expressed as a percentage of deviation from the baseline scenario that REMS uses as a starting point for the shock.

### **5.1.1. Change in interest rates**

An analysis has been carried out to assess the effect on the main macroeconomic aggregates of raising the interest rate by 120 b.p. in eight quarters (15 b.p. each quarter) and sustaining this increase until the end of the forecast horizon, and then returning to its initial value. However, this is an unlikely hypothesis in the short term as the ECB announced that it would maintain the monetary policy stance for a long period of time.

According to the results shown in Table 5.1.1.1, GDP could be approximately 1% lower than in the baseline scenario at the end of the projection horizon, hampered by weaker domestic demand.

This lower growth, in turn, would influence fiscal variables. Government balance would be affected by lower tax collection and increased spending on social benefits in an environment where domestic demand and job creation would be weakened. In addition, the increase in rates means higher interest payments, although the REMS model may overestimate this effect by assuming that all debt is short-term debt, obliging the borrower to refinance it in each period. In practice, an increase of 120 b.p. in interest rates would have a lower-than-expected impact on interest payments, since a large percentage of Spain's debt is medium or long-term debt. At the end of the forecast period, the

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<sup>10</sup> Boscá, J. E., Díaz, A., Doménech, R., Ferrí, J., Pérez, E. y Puch, L. (2011) "A rational expectations model for simulation and policy evaluation of the Spanish economy", en Boscá, J.E., Doménech, R., Ferrí y Varela, J. (Eds.) *The Spanish Economy: a General Equilibrium Perspective*, Palgrave Macmillan.

public deficit and debt are higher than in the baseline scenario by 0.8 and nearly 2 percentage points of GDP, respectively.

**Table 5.1.1.1. Impact of a 120 b.p. increase in interest rate** Cumulated deviations from the baseline scenario (REMS 2)

	2019	2020	2021	2022
Real GDP	-0.6	-0.5	-0.9	-1.0
General Government revenue (net of lump-sum transfers)	-0.1	0.0	0.1	0.1
General Government expenditure	0.1	0.4	0.7	0.8
General Government balance	-0.2	-0.3	-0.6	-0.7
Public debt	0.2	0.6	1.2	2.0
Full time equivalent employment	-0.6	-0.3	-0.4	-0.3
Employment rate	-0.3	-0.4	-0.7	-0.8

Source: Ministry of Economy and Business.

### 5.1.2. Changes in the economic growth of trade partners

An analysis has been conducted on the effect on the main macroeconomic aggregates of an export market growth 4 p.p. lower than that foreseen in the baseline scenario for 2019 contained in this Stability Programme Update. This shock, which is of a significant magnitude, seeks to simulate the combined effects of greater protectionism and appreciation of the exchange rate. Unlike the analyses carried out in previous years, the lower external demand in 2019 could stem from a weaker expansion of the Eurozone economies or the combined effects of protectionist measures and a possible appreciation of the exchange rate. Indeed, the simulated shock may be more likely to occur now than in previous years.

According to the results detailed in Table 5.1.2.1, GDP could fall by approximately 0.4% at the end of the projection horizon compared to its baseline scenario. In this case, external demand would be the leading cause.

This scenario would also affect fiscal variables, albeit less than in the previous shock scenario. At the end of the forecast period, public deficit and debt are higher than in the baseline scenario by 0.1 and 0.2 percentage points of GDP, respectively.

**Table 5.1.2.1. Impact of 4 p.p. fall in export demand** Cumulated deviations from the baseline scenario



	2019	2020	2021	2022
Real GDP	-0.5	-0.3	-0.4	-0.4
General Government revenue (net of lump-sum transfers)	-0.1	0.0	0.0	0.0
General Government expenditure	0.0	0.0	0.1	0.1
General Government balance	-0.1	0.0	0.0	-0.1
Public debt	0.1	0.1	0.2	0.2
Full time equivalent employment	-0.7	-0.3	-0.3	-0.3
Employment rate	-0.2	-0.2	-0.3	-0.2
Exports	-3.0	-3.0	-3.1	-3.4

Source: Ministry of Economy and Business.

### 5.1.3. Change in oil prices

An analysis was conducted of the effects on the main macroeconomic aggregates of changes in oil prices that stray from the baseline scenario, with average prices of \$68.9/barrel in 2019, \$67.6 in 2020 and \$65.0 in the last two years of the forecast horizon. These prices would be higher, on average, by ten dollars (\$78.90 in 2019, \$77.60 in 2020 and \$75/barrel in 2020), as detailed in Table 5.1.3.1.

**Table 5.1.3.1. Assumptions on oil price**

	2018	2019	2020	2021	2022
Baseline scenario (Dollars / barrel)	71.5	68.9	67.6	65.0	65.0
Baseline scenario (Euros / barrel)	60.6	61.0	59.8	57.5	57.5
Alternative scenario (Dollars / barrel)	71.5	78.9	77.6	75.0	75.0
Alternative scenario (Euros / barrel)	60.6	69.8	68.7	66.4	66.4

Source: Ministry of Economy and Business.

This shock was applied by gradually increasing the price of an oil barrel in four quarters, keeping it at the new levels for four years, and then returning to the 2018 value.

According to the results detailed in Table 5.1.3.2, GDP could fall by about 0.5% from its level in the baseline scenario at the end of the forecast period. This adverse scenario would also affect fiscal variables, albeit to a lesser extent than in the interest rate shock scenario, and slightly higher than in that of weaker external demand. At the end of the forecast period, public deficit and debt are higher than in the baseline scenario by 0.2 and 0.7 percentage points of GDP, respectively.

**Table 5.1.3.2. Impact of an increase in oil prices of €8.9/barrel**  
Cumulated deviations from the baseline scenario

	<b>2019</b>	<b>2020</b>	<b>2021</b>	<b>2022</b>
Real GDP	-0.1	-0.3	-0.4	-0.4
General Government revenue (net of lump-sum transfers)	-0.1	-0.2	-0.2	-0.1
General Government expenditure	0.0	0.0	0.0	0.0
General Government balance	-0.1	-0.2	-0.2	-0.2
Public debt	0.1	0.2	0.5	0.7
Full time equivalent employment	-0.1	-0.2	-0.2	-0.1
Employment rate	0.0	-0.1	-0.1	-0.2

Source: Ministry of Economy and Business.

## 6. THE SUSTAINABILITY OF PUBLIC FINANCES

### 6.1. Long-term budget projections

Projections on age-related public expenditure, by the Ageing Working Group (AWG) of the Economic Policy Committee (EPC) and the European Commission, are generally updated every three years by mandate of the ECOFIN Council. The latest projections were published on May 25, 2018 in the Aging Report 2018 (AR2018).

This analysis is based on the population projections published by Eurostat for 2015-2080, along with the macroeconomic scenario created according to the common methodology shared by all Member States. An essential feature of this methodology is that the macroeconomic scenario is based on the Commission's Spring 2017 forecasts that do not include economic policy changes other than the measures approved at the end of the projection year, in this case, 2017. Five public expenditure categories are analysed in this exercise: pensions, health care, long-term care, education and unemployment.

Table 6.1.1. shows the projections for Spain from this exercise.

**Table 6.1.1. 2016-70 Projections of ageing-related expenditure**  
% of GDP

	Increase 2016-2070	2016	2020	2030	2040	2050	2060	2070
<b>TOTAL EXPENDITURE (1+2+3+4+5)</b>	<b>-0.2</b>	<b>24.0</b>	<b>24.1</b>	<b>24.6</b>	<b>26.5</b>	<b>27.1</b>	<b>24.9</b>	<b>23.8</b>
1. Pension expenditure	-1.5	12.2	12.3	12.6	13.9	13.9	11.4	10.7
Old age and early retirement pensions <sup>(a)</sup>	-0.7	8.7	9.0	9.4	10.8	10.9	8.6	8.0
Disability pensions	-0.2	1.2	1.1	1.1	1.1	0.8	0.8	1.0
Survivor pensions	-0.5	2.3	2.2	2.0	2.1	2.1	1.9	1.8
2. Healthcare expenditure	0.5	5.9	6.0	6.4	6.7	6.8	6.7	6.4
3. Long-Term care expenditure	1.3	0.9	1.0	1.2	1.5	1.9	2.2	2.2
4. Education expenditure	0.3	3.7	3.7	3.5	3.7	4.1	4.1	3.9
5. Unemployment expenditure	-0.9	1.3	1.1	0.9	0.7	0.5	0.5	0.5
<b>Memo items: Main Assumptions</b>								
Potential GDP real growth <sup>(b)</sup>	1.5	0.4	0.8	1.3	1.0	1.8	2.2	1.9
Labour productivity growth <sup>(b)</sup>	0.8	0.7	1.0	1.1	1.5	1.6	1.6	1.5
Male participation rate (15-64)	-1.4	79.3	79.1	78.8	78.4	77.9	77.6	77.9
Female participation rate (15-64)	7.1	69.2	71.7	75.6	77.0	76.4	76.0	76.2
Total participation rate (15-64)	2.8	74.3	75.4	77.3	77.7	77.1	76.8	77.1
Unemployment rate (15-64)	-13.1	21.5	17.7	15.0	11.6	8.4	8.4	8.4
Population over 64/population 15 to 64	18.0	28.6	31.0	40.8	54.7	61.9	53.2	46.6
<sup>(a)</sup> Including minimum and non-contributory pensions.								
<sup>(b)</sup> The column "Increase 2016-2070" is the 2016-2070 average growth rate.								
Sources: Ageing Report 2018, Ministry of Economy and Business, OECD, UOE and ESSPROS.								

As can be seen in Table 6.1.1, at the end of the projection period, in 2070, age-related public expenditure would stand at levels similar to that of 2016, close to 24% of GDP, with an increase of more than three percentage points between 2016 and 2050 and a similar fall amount between 2050 and 2070.

The analysis of the evolution of the different categories of ageing-related expenditure shows that the main item is pensions. However, its relevance changes throughout the projection period. During the 2016-2050 phase,

pension expenditure will account for slightly more than half of the ageing-related expenditure. However, during the second half of the projection horizon, its weight within ageing-related expenditure falls slightly below 50%.

Health expenditure is the second most important item in ageing-related expenditure, representing approximately 25%. Although its weight during the first half of the projection horizon remains unchanged and expenditure is lower for the period 2050-2070, its role gains importance during the latter phase, accounting for nearly 27% of total ageing-related expenditure.

Long-term care expenditure continues its upward trend (1.3 p.p.) throughout the period 2016-2060, remaining unchanged during the last years of the projection horizon, primarily due to the demographic assumptions underlying the Eurostat model. These developments showed that spending in long-term care increased from 3.75% in 2016 to 9.24% of the ageing-related expenditure in 2070.

Education expenditure remained unchanged during the 2016-2040 period. Accordingly, and given the growth in ageing-related expenditure during this phase, the importance of education expenditure within the ageing cost falls from 15.41% in 2016 to 13.96% in 2040. During the second phase of the 2040-2070 projection horizon, education expenditure increases as it is closely tied to the demographic assumptions underlying the Eurostat model. Therefore, given the reduction of ageing-related expenditure during this last phase of the projection, spending on education increases its weight to 16.38%.

Finally, developments in unemployment expenditure are not so strictly linked to the ageing of the population, but rather to the macroeconomic assumptions, more specifically, the unemployment rate.

Pensions are therefore the main ageing-related expenditure item, whose GDP ratio is largely determined by the evolution of the dependency rate.

In analysing the sustainability of the pension system, the outcome of the analysis is significantly affected by the baseline assumptions and the scenarios related to the demographic projections, the macroeconomic forecasts and the pension revaluation.

This large set of baseline assumptions and scenarios explains the existence of different models and methodologies, being the most prominent, the Ageing Report, and those used by the Ministry of Labour, Migration and Social Security and by the Independent Responsibility Authority (AIReF).

The analysis performed to date show that developments in pension expenditure can be divided into two phases: (1) a steady increase between 2016 and 2045 (+2.2 p.p.); and (2) a decline until 2070 (-3.7 p.p.). The increase in the first phase is explained by the ageing of the population associated with the upcoming retirement of the so-called *baby-boom* generation after 2023, which is reflected in an increase in the dependency rate (the ratio between the population over

64 and the population aged 15-64), which according to these forecasts would grow from 28.6% in 2016 to 61.9% in 2050. The higher expenditure derived from the demographic evolution is partially offset by the fall in the unemployment rate, which converges from the baseline level of 21.5% in 2016 to 8.4% in 2070, the increase in the activity rate, which grows from 74.3% in 2016 to 77.1% in 2070, and the lower replacement rate, which falls from 57.7% in 2016 to 34.3% in 2060, and back up to 37.6% in 2070. The upward trend of pension expenditure-to-GDP ratio is drastically reversed in the second half of the projection horizon, as a result of the lower dependency rate from 2050 onwards, which would reach 46.6% in 2070.

It is worth noting that the demographic projections published by the Eurostat at the beginning of 2017 foresee an increase in total Spanish population from 46 million in 2015 up to 50 million in 2070. These figures represent an upward revision vis-à-vis the previous Eurostat projection, which foresaw a stabilisation of the Spanish population in the long term, at approximately 46 million between 2013 and 2060. The upward revision of the population is mainly due to the higher expected net migration and to the higher fertility rates.

The evolution of some macroeconomic variables partially moderates the upward trend of public pension expenditure -to-GDP ratio. As noted above, a convergence of the unemployment rate is expected, from the baseline level of 21.5% in 2016 to 8.4% in 2070. Moreover, the participation rate increases from 74.3% in 2016 up to 77.1% in 2070 and the potential GDP growth rate jumps from 0.4% in 2016 up to approximately 2% in 2070.

As already mentioned above, the outcome of the analysis is significantly affected by the baseline assumptions, the demographic projections, the macroeconomic forecasts and the pension revaluation scenarios.

Thus, the differences between the results of the Ageing Report 2015 and the Ageing Report 2018 are due exclusively to the different demographic and macroeconomic scenarios and the different initial budgetary position. For the period between 2016 and 2060 (common projection horizon of the AR2015 and AR2018), the current scenario foresees a reduction of pension expenditure -to-GDP ratio of 0.8 p.p., slightly lower than that recorded in the previous report (-1.1 p.p.).

The simulation of the Ageing Report has been outlined in theoretical terms, based on a revaluation of pensions that is not foreseen in the Spanish regulation currently in force or in future actions. More specifically, the projections in the Ageing Report do not fully implement the effects of the Pension Revaluation Index (known in Spanish as IRP), nor the cap on the maximum pension currently in force. The estimated pension expenditure is higher than that of the projections conducted by the Ministry of Labour and Social Security and by AIReF.

Indeed, the analyses carried out in the past year by the Ministry of Labour and

Social Security show that estimates of pension expenditure in 2050 can differ by almost 4 p.p. from the AR2018 scenario, with the corresponding impact on the sustainability of the system.

**Table 6.1.2. Comparison of ageing-related expenditure projections**  
% of GDP

Simulation <sup>(1)</sup>	2016	2030	2040	2050
Ageing Report 2015	12.0%	11.2%	11.9%	12.3%
Ageing Report 2018 <sup>(1)</sup>	12.2%	12.6%	13.9%	13.9%
Ministry of Labour, Migrations and Social Security <sup>(2)</sup>	10.7%	10.1%	10.0%	9.4%

(1) In the Ageing Report 2015 and in the Ageing Report 2018, the maximum entry pension was revalued with the GDP deflator with no maximum limit.  
(2) It does not include retired civil servants pensions and non-contributory pensions. In addition, it considers that the maximum entry pension is revalued with the PRI and that the sustainability factor enters into force in 2019.  
Sources: Ministry of Economy and Business, Ministry of Finance, European Commission and Ministry of Labour, Migrations and Social Security.

Meanwhile, AIReF has elaborated projections of Social Security contributory pensions expenditure based on the 2018 legislation, with a CPI-based revaluation of 1.8%. The results are shown in the following table:

**Table 6.1.3. Evolution of pension expenditure. AIReF baseline scenario**  
% of GDP

Simulation	2023	2028	2038	2048
Pension expenditure projections	10.9%	11.1%	12.7%	13.4%

Source: AIReF (Opinion 1/19 on the sustainability of the Social Security System).

In short, the analysis in such a long perspective, along with the wide array of options concerning the baseline assumptions and the underlying scenarios, is giving rise to a relevant methodological and technical debate on the sustainability of the pension system. This debate explains the proliferation of a number of well-founded scenarios on pension expenditure developed by several agencies and institutions. Hence, in the months to come, it will be crucial to conduct an in-depth analysis about the different macroeconomic assumptions, demographic projections and pension revaluation scenarios to reach a methodological consensus, in order to minimise the existing technical discrepancies and to enable proper decision-making.

## 6.2. Strategy

### **The pension system**

The reform of the public pension system introduced by Act 27/2011, of 1 August, on updating, adapting and modernising the Social Security system, contains the following core measures: (1) gradual increase of the statutory retirement age by two years, to 67, phased-in gradually between 2013 and 2027; (2) recognition of long contribution careers (38 and a half years), eligible to retire

at 65 with full retirement benefits; (3) better incentives for voluntary extension of working life beyond the statutory retirement age; and (4) the consideration of the contributions made during the 25 years prior to retirement when calculating the regulatory base, as opposed to the 15 years used before the reform.

Two pension-related laws were adopted in 2013: (1) the Royal Decree-Law 5/2013, of 15 March, on measures to encourage older workers to opt to extend their working life and promote active ageing; and (2) Act 23/2013, of 23 December, regulating the sustainability factor and the Pension Revaluation Index (IRP). Among other measures, the Royal Decree-Law 5/2013 delays the age for early retirement. For involuntary retirement (derived from termination of employment due to reasons beyond the worker's free will), between 2013 and 2027, the age increases from 61 to 63 years and 33 contribution years are required (as before the reform). For voluntary retirement, a gradual age increase is expected between 2013 and 2027, from 63 to 65, and a contributory period of 35 years is required (previously it was 33 years). Partial early retirement is also restricted by raising the minimum age from 61 to 63 for long careers (36.5 years or more) and from 61 to 65 for medium ones (between 33 and 36.5 years).

The IRP is the revaluation rate that enables a link between the revenue and the expenditure of the pension system, taking into account revenue growth, on the one hand, and on the other, the increase in the number of pensions and the average pension in the absence of revaluation. According to all organisations' estimates, an unchanging IRP throughout the projection horizon would translate into a significant loss of purchasing power for pensioners, on average 15%, and almost 30% after 20 years in retirement.

To extend the benefits of growth to pensioners, the Royal Decree-Law 28/2018, of 28 December, for the revaluation of public pensions and other urgent measures related to social, labour and employment issues, approved the revaluation of general pensions in 2019 by 1.6% and by 3% for minimum and non-contributory pensions. It also increased the regulatory base for widow's pensions from 56% to 60%. This Royal Decree-Law also provides for the payment of the difference between the 1.6% revaluation applied in 2018 and the 1.7% calculated as the twelve-month average of the monthly consumer price index for 2018. On the revenue side, the maximum contribution base is increased in 2019 by 7% up to €4,070.10 per month.

Furthermore, the Royal Decree-Law provided that within six months, the Government would agree to propose, within the framework of the social dialogue, a pensions revaluation mechanism to ensure maintenance of the purchasing power, whilst safeguarding social and financial sustainability of the Social Security system, following the recommendations of the Evaluation and Monitoring Commission for the Toledo Pact.

The Parliamentary Commission of the Toledo Pact made progress in this direction through various proposals, to implement an in-depth reform of the pension system within a multi-partisan consensus. However, the end of the legislative term failed to lead to an agreement within the time limit provided,

which would serve as a benchmark for the proposal. Hence, it will have to be raised in the new legislature. To that end, efforts will be made to reach a consensus on this issue as soon as Parliament and the new Government have been formed. Such consensus will be the starting point of a pension system reform that reconciles the need to protect the Welfare State and the sustainability of the pension system.

### **Streamlining of the long-term care system**

A significant reduction in spending has been achieved in 2012, 2013 and 2014 thanks to the reform measures approved in 2012.

Investments fell by €2.3 billion in this period, significantly affecting the quality of the long-term care system and preventing the reduction of the long waiting list and undermined the intensity of services provided.

In February 2017, the Council of Ministers approved the creation of a Commission to analyse the situation of the Autonomy and Dependency Care System (known in Spanish as SAAD) to assess the system's sustainability and efficiency and its current financing mechanisms. The Commission should produce a report on the analyses and conclusions on the issues raised. This report would be submitted for discussion to the Territorial Council of the SAAD, with a view to adopting measures that would ensure the system's efficiency and sustainability and adequate and sufficient benefits. The Commission was established on February 23, 2017, bringing together representatives of the Central Government and the Regional Governments, who jointly carried out a rigorous analysis, followed by a report on October 6, 2017.

This report was submitted to the Territorial Council on October 19, 2017. It was found that there is a need to recover "the agreed amounts, and both the Central Administration and the Regional Governments must recommit to recovering the 15% loss of minimum revenue in 2012."

All Regional Governments agreed with the report's conclusions on the weakness of the financial system and the need to improve its financing. The first measure approved in 2019 sought to recover the Social Security contribution of family carers (€315 million), which will benefit approximately 180,000 people and their dependent relatives.

In the next budget period, the General State Administration's contribution to the SAAD is expected to increase by around €415 million, or 31.7%. According to these estimates, the waiting list of the more severe cases, grade II and grade III dependents, about 75,000 people, could be reduced by around 75%. It would also be possible to finance a new advanced telecare system that would improve its efficiency and invest in innovative technologies. Every million euros invested in dependency generates 34 jobs, both in companies and in the social sector.



From a strategic perspective, social protection, traditionally linked to the labour market, must be revised to cover vulnerable groups that have been left unprotected in recent decades, such as single-parent families, migrants or unemployed youth.

### **Healthcare and pharmaceutical expenditure control**

In 2012, Royal Decree-Law 16/2012, of 20 April, on urgent measures to guarantee the sustainability of the National Health System (known in Spanish as SNS) and improve the quality and safety of its benefits, introduced different measures to reduce the co-financing of medicines and restrict the right to universal public health care on the grounds of austerity and the need to streamline public spending in times of economic crisis.

New income-based pharmaceutical contribution rates were established for the general population. The Government intends to phase-out co-payments, starting with those that affect vulnerable people and, more specifically, pensioners who are not required to file Personal Income Tax returns. This measure will benefit 7.8 million people.

Concerning universal public health, restrictions were placed on access to health care for people who were neither authorised nor registered as resident in Spain. Publicly funded health care was linked to an insured person and his or her beneficiaries. This measure has been repealed by Royal Decree-Law 7/2018, of 27 July, on universal access to the National Health System.

In parallel with these measures to increase the rights of citizens, other measures have been implemented for controlling the growth of pharmaceutical expenditure. In 2018, several measures carried over from the previous legislative term have been implemented, and new measures have been developed for the 2019-2021 period.

The carried over measures are: (i) the roll-out of a reference drug price system; (ii) the application of cost-effectiveness criteria in decisions related to publicly financed drugs; (iii) the management of sustainability agreements other than financing through expenditure ceilings and maximum cost per patient; (iv) the application of the efficiency principle in the prescription of drugs in the SNS and improvement of pharmaceutical IT systems; and (v) the renewal of the instrument to promote sustainability and streamlining of the SNS pharmaceutical and health expenditure and the Agreement on Collaboration between the General State Administration (Ministries of Finance and Public Function, Health, Social Services and Equality) and Farmaindustria (the pharmaceutical industry association).

The new measures developed since June 2018 to be implemented until 2021 are: (i) revision of the user contribution system in out-patient pharmaceutical provision; (ii) development of measures to promote competition in the pharmaceutical sector as a key element for efficiency; (iii) promotion of medicinal products that regulate the market such as generic drugs and

biosimilars; (iv) measurement of the health outcome of the clinical benefit of drugs in clinical practice in the SNS (Valtermed); (v) development of a pay-for-health-outcome financing model for medicinal products; (vi) introduction of a pharmacoeconomic evaluation method for medicinal products and its inclusion in Therapeutic Positioning Reports; (vii) prescription by active ingredient; (viii) modification of the reference price system; (ix) performance of ex officio reviews of the prices of prescription drugs in pharmacies for treating chronic diseases with a high impact on the SNS; and (x) improving transparency on information related to pharmaceutical expenditure.

In addition to the Centralised Procurement Platform that will enhance joint procurement strategies, the introduction of measures aimed at health promotion and disease prevention should also be highlighted. This includes, for instance, integration of services to the common portfolio to ensure long-term cost-effectiveness, such as screening of cervical cancer or the creation of a common ortho-prosthetic services catalogue. In the former case, direct health costs would be offset by savings in health costs, and in the latter case, social costs, vocational reintegration and social inclusion costs, and health costs associated to the treatment of sequelae. Portfolio updates, along the same lines, are scheduled for the 2019-2021 period.

Actions have also been taken in Human Resources to increase efficiency and effectiveness in training healthcare professionals, managing human resources needs and ensuring the stability of employment in the sector. Concerning human resources management, a global public employment offer in the health sector is being developed to reduce the temporality rate.

To solve the difficulties in filling post and positions in medical specialities and healthcare services, the CISNS has set up a task force to identify staffing needs and adopt measures to improve the geographical distribution of physicians by specialities.

Finally, worthy of note is the Royal Decree 1302/2018, of 22 October, amending Royal Decree 954/2015, of 23 October, which regulates the indication, use and authorisation for nurses to dispense medicinal and health products for human use. The engagement of nursing staff at this level increases the system's efficiency, saving healthcare costs that previously rested solely on the medical staff.

The following section mentions the spending review carried out by AIReF on this matter.

### **6.3. Contingent liabilities**

Directive 2011/85/EU on the requirements for budgetary frameworks of the Member States requires the publication of certain General Government information on off-balance-sheet government guarantees and various liabilities in October or December each year. Table 6.3.1 shows the breakdown of the guarantees by different levels of the General Government.

The sharp reduction that started in 2012 is a key feature in the development of contingent liabilities. Since then, contingent liabilities have declined more than €150 billion, standing slightly above 30% of the level recorded at the end of 2012. This downward path continued in 2018, with a €10 billion reduction in the guarantees provided, almost 13.5% of the volume of guarantees in force at the end of 2017.

As shown in Table 6.3.1., the Central Administration accounts for more than 97% of the guarantees. Consequently, given this reduction of more than €8 billion, it is responsible for most of the decline in guarantees provided by the General Government.

Following a one-off increase of almost €930 million in guarantees provided in 2017, the Local Corporations returned to the downward path in 2018, with a €1.3 billion reduction. Last year, the Regional Governments also significantly reduced the volume of guarantees provided by more than €870 million.

In summary, the guarantees provided by the General Government continued to fall in 2018. This decline is attributable to the main subsectors.

**Table 6.3.1. Guarantees provided by the General Government. Outstanding balance**  
Million €

Stability Programme Update 2019-2022

<b>Guarantees granted by the General Government<sup>(*)</sup></b>	<b>2012</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>
<b>General Government</b>							
<b>One-off guarantees</b>							
Total stock, excluding debt assumed by Government	<b>218.179</b>	<b>193.152</b>	<b>133.627</b>	<b>102.955</b>	<b>86.527</b>	<b>77.650</b>	<b>67.213</b>
of which: public corporations	103.175	91.108	74.048	53.538	40.848	34.838	29.488
financial corporations	212.742	188.277	129.585	99.723	83.158	73.827	65.563
Guarantees granted in the context of financial turmoil	105.093	95.604	55.090	46.385	42.656	39.369	36.435
<b>Standardised guarantees</b>							
Total stock	0	0	0	0	0	0	0
<b>Central Government</b>							
<b>One-off guarantees</b>							
Total stock, excluding debt assumed by Government	<b>213.124</b>	<b>188.593</b>	<b>129.842</b>	<b>99.795</b>	<b>83.248</b>	<b>73.920</b>	<b>65.666</b>
of which: public corporations	102.675	90.609	73.557	53.065	40.393	34.416	29.099
financial corporations	212.742	188.277	129.585	99.723	83.158	73.827	65.563
Guarantees granted in the context of financial turmoil	105.093	95.604	55.090	46.385	42.656	39.369	36.435
<b>Standardised guarantees</b>							
Total stock							
<b>Regional Government</b>							
<b>One-off guarantees</b>							
Total stock, excluding debt assumed by Government	<b>3.994</b>	<b>3.604</b>	<b>3.024</b>	<b>2.500</b>	<b>2.411</b>	<b>1.933</b>	<b>1.060</b>
of which: public corporations							
financial corporations							
Guarantees granted in the context of financial turmoil							
<b>Standardised guarantees</b>							
Total stock							
<b>Local Government</b>							
<b>One-off guarantees</b>							
Total stock, excluding debt assumed by Government	<b>1.061</b>	<b>955</b>	<b>761</b>	<b>660</b>	<b>868</b>	<b>1.797</b>	<b>487</b>
of which: public corporations	500	499	491	473	455	422	389
financial corporations							
Guarantees granted in the context of financial turmoil							
<b>Standardised guarantees</b>							
Total stock							
<p>(*) Notes:</p> <p>1. These are only "one-off guarantees".</p> <p>2. Following the conclusions of the "Task Force on the implications of Council Directive 2011/85 on the collection and dissemination of fiscal data", the section "Total stock of guarantees, excluding debt assumed by government", does not include guaranteed debt of units in the General Government sector (§.13) (FROB, FIDSE...) nor guaranteed debt of the ESF.</p> <p>3. Only the guaranteed principal is included.</p> <p>Sources: Ministry of Economy and Business and Ministry of Finance.</p>							

## **7. THE QUALITY OF PUBLIC FINANCES**

Fiscal policy should endeavour to apply the best public revenue-expenditure combination possible to promote the sustainability of the public finances while also protecting economic growth and job creation and enhancing social policies.

On the expenditure side, this means increasing the resources allocated to the welfare state, in particular, health, education, long-term care and pensions, and strengthening expenditure items to boost our economy's productivity and raise growth potential, including investment in RDI, infrastructure or human capital. However, the efficiency and quality of public spending should also be promoted to free up resources for priority actions.

On the revenue side, this fiscal stance would require a new taxation approach in the 21st century. This requires a new progressive tax system in which those who are wealthier contribute their fair share, whilst preserving the middle and working class; contribute to environmental protection through green taxation; help face down the challenges of a globalised world through the taxation of new activities; and, of course, generate sufficient income to sustain a robust welfare state over time.

### **7.1. Spending efficiency, effectiveness and composition**

Efficient management of public resources translates into allocation to those areas of expenditure with the highest priority or with the greatest potential for impact on society and the economy.

Consequently, Spain has committed to its EU partners to undertake a spending review across the General Government to identify possible inefficiencies and overlaps between administrations. The Independent Authority for Fiscal Responsibility (AIReF) was commissioned to carry out this review in various phases and by specific areas of expenditure.

#### **7.1.1. Outcome of the 2018 spending review**

The first phase of this spending review took place throughout 2018, and focused on spending on subsidies and aid. Seven projects related to Regional Governments and the Central Government were identified. These projects were subjected to evaluations involving strategy, procedure, effectiveness and efficiency. The analysis focuses on policies developed until January 2018.

The AIReF has already submitted project-specific reports to the Ministry of Finance, including a detailed description of the work carried out, the outcome and a series of recommendations for different expenditure policies under consideration.

- Project 1 - Strategy and Procedure Evaluation

This project is a cross-cutting analysis of the subsidy framework. Against this backdrop, the AIReF proposes an integrated and consistent public policy planning system covering all public sector activity. This strategic planning would include the definition of policies, budget planning, sectoral planning and the adequacy of the instruments used. The procedure would be based on an integrated information system and indicators, which would strengthen the transparency and accountability of public sector activities, and would allow the implementation of a robust evaluation culture in public policies.

Furthermore, AIReF proposes other measures that could ease the evolution of subsidy expenditure. These measures seek to: (1) improve efficiency in the granting, financial control, reimbursement and sanction procedures for public subsidies; (2) strengthen the rationale behind public and general interest in setting-up and granting public subsidies and aid; (3) enhance complementarity and co-funding of subsidised activities; and (4) restrict the provision of direct subsidies.

- Project 2 - Medicines dispensed by medical prescription (non-hospital pharmacy)

According to the AIReF, there is a need for better public initiatives on demand and supply of medicinal products to streamline spending on drugs provided in pharmacies. An option for maximising savings would be the revision of the structure of the Inter-Ministerial Commission for Medicine Prices and a nation-wide pharmaceutical tender that would allow the public sector to benefit from the discounts currently available to pharmacies. On the demand side, it recommends the inclusion of the best prescription practices found in stewardship and control protocols to maximise savings across the Regional Governments.

- Project 3 - Active employment policies

The comparative study shows that those countries that evaluate their policies, such as Germany, France or Australia, have performed better in the last 25 years. To that end, the AIReF opts for ensuring that the information collected on active policies, coordinated by the State Public Employment Service, is more standardised in terms of training and careers. Useful information would help identify the policies that are working properly.

Likewise, the AIReF notes that the effectiveness of these policies varies between Regional Governments and correlates with their quality. Recommendations aimed at improving the quality of expenditure include an initial diagnosis with predefined itineraries, the distribution of funds partially contingent on the effectiveness of the policies, and a stronger link between demand and supply.

- Project 4 - University grants

As noted by the AIReF, the effectiveness of university grants to ensure equal opportunities would improve if the date of the call was brought forward, as this would bring certainty regarding the amount to be perceived and the payment would coincide with the beginning of the academic year.

- Project 5 - Promotion, talent and employability in RDI

Spending on RDI in Spain is low compared to the main European countries. An improved selection process for PhD grants and stronger cooperation between researchers and doctors and the private sector are two recommendations made by the AIReF to make this policy more effective.

- Project 6 - Strengthening business competitiveness

A productive investment loan program headed by the Ministry of Industry, Commerce and Tourism has been analysed. The AIReF recommends strengthening the strategic definition to improve the outcome of the program and reduce defaults, redefining medium-term goals based on the production system needs, considering instruments other than loans, and bringing all financial instruments together in a global unit.

- Project 7 - Sociedad Estatal Correos y Telégrafos, S.A.

This project evaluated the compensation given to Correos for its Universal Postal Service. The AIReF recommends improvements to its implementation plan and highlights the need for the operator to improve efficiency.

### **Potential savings from the 2018 spending review**

Concerning Project 1 "Strategy and Procedure Evaluation", the implementation of the measures mentioned above recommended by the AIReF will allow the restraint subsidy spending. This impact has been integrated into the budget projections included in this Stability Programme, which explains why this expenditure heading will register a moderate growth of 1% per annum from 2020 onwards.

Project 2 "Medicines dispensed by medical prescription" has resulted in 19 recommendations. The following ones could be implemented immediately:

- A national mechanism for the selection of drugs.
- A new definition of the reference price system.
- A pharmaco-therapeutic review and monitoring protocols for prescriptions.

- Systems for periodic monitoring of public expenditure in prescribed drugs sold through pharmacies to mitigate diversions of medicines.
- Modification of cross-cutting price cut measures introduced under Royal Decree 8/2010, elimination of the 15% deduction for innovative medicines and increase the 7.5% deduction for off-patent drugs that have been in the Spanish market for more than 10 years.

The implementation of these measures would yield substantial savings in the 2019-2022 period, tempering the evolution of this expenditure heading.

Concerning the other 5 projects in the first phase, there are no clear net savings and the proposals mainly seek to make the policies more effective.

### **7.1.2. 2019 Spending review**

The second phase will take place throughout 2019 following the completion of the spending review's first phase. The decision of the Council of Ministers of 14 December 2018 identifies the areas of work in this phase:

- Tax benefits

Tax benefits are tax policy instruments that pursue certain economic and social objectives through savings or improvements by reducing the income tax rate for natural and legal persons. This translates into lower tax collection.

Therefore, there is a critical need to know how effective the instrument is for designing a tax system.

Thirteen tax benefits, totalling around €57 billion, will be evaluated: six for Personal Income Tax, three for Corporate Income Tax, three for Value Added Tax and one for Excise Taxes.

#### **Table 7.1.2.1. Spending review 2019**



<b>Tax benefit</b>	<b>Tax</b>	<b>Expense (million €)</b>
Reduction for earned-incomes	Personal Income Tax	2,575
Reduction for house rentals incomes (owner) and tax deduction for rent (tenant)	Personal Income Tax	1,080
Reduction for contribution to social welfare systems	Personal Income Tax	1,630
Reduction for joint taxation	Personal Income Tax	2,140
Tax deduction for donations	Personal Income Tax	500
Social tax deductions (maternity, large family, disability)	Personal Income Tax	4,800
Incentive to R+D activities	Corporate Income tax	355
Reduced tax rates	Corporate Income tax	395
Donations	Corporate Income tax	127
Reduced tax rates	VAT	25,600
Social exemptions: health service and education	VAT	9,010
Exemption in financial services	VAT	7,040
Reduced tax rate in Hydrocarbons tax	Excise duties	1,935
<b>Total</b>		<b>57,187</b>

Source: AIReF.

- Hospital spending in the National Health System

Public health expenditure in Spain in 2017 (latest year available of COFOG data) amounted to just over €69 billion, of which 61% was hospital spending, about €42.5 billion, according to the 2017 Public Healthcare Spending Statistics.

Within hospital spending, pharmacy accounted for about €6.2 billion in 2016, almost 15% of the total, and nearly 30% of total pharmaceutical-related expenditure.

Meanwhile, improvements in health service provision largely depend on investments in technology, therapeutic and diagnostic equipment, and robotic technology in surgery, which also puts pressure on public spending. Thus, investment in hospital equipment represents close to 2% of total hospital spending (€879 million).

Based on these figures, and its relevance in health provision, it is essential to analyse hospital spending in pharmacy and investment in capital goods.

- Hiring incentives

Active employment policies are vital for improving the employability of the unemployed. Hiring incentives are an essential pillar of these active policies, based on rebates and reductions in Social Security contributions.

In the 2018 budget, extended in 2019, €2.6 billion have been earmarked for these incentives, resulting in a decrease in revenue from social contributions.

There is, therefore, a need to know how effective it is in the realisation of its goal, which are none other than to promote the employment of certain groups. The AIReF proposes to analyse incentives in its Action Plan for:

- Young people under 30 years
- Individuals older than 45 years
- Women underrepresented in certain professions
- Conversion of fixed-term contracts into open-ended contracts
- Flat rate for self-employed workers
- Reductions for self-employed workers both in general and specific terms
- Hiring of people with disabilities

Concerning this project, it is estimated that the reorganisation of current incentives could have an annual economic impact of €500 million from 2020 onwards. This will have a positive effect on social contributions and the sustainability of the Social Security system. These conservative estimates have been incorporated into the budget projections contained in this Stability Programme.

- **Transport infrastructures**

Infrastructures, and more specifically transport infrastructures, improve territorial cohesion and boost the country's economic development.

Before the recent economic crisis, investment in transportation saw significant growth, after which it fell systematically, and has yet to creep back to pre-crisis levels. Nonetheless, the General State Budget for 2018 has allocated €5.7 billion to infrastructure policy, and another €2.2 billion to transport subsidies.

Against this backdrop, the question arises as to the rationale behind investments in transport infrastructure over the last 25 years and the need to recommend improvements.

### **7.1.3. Other actions to strengthen public spending efficiency**

The new governance framework for public procurement provided for in Act 9/2017, of 8 November, on Public Procurement Contracts is another essential tool for efficient public spending, in particular, the Independent Office for Regulating and Monitoring Public Procurement. The role of the National Evaluation Office is particularly relevant in ensuring efficient allocation of economic resources and operational efficiency. It analyses what it is used for and how sustainable it is in the medium and long term.

Also worth mentioning are the sustainability and efficiency measures implemented by the General Government to improve pharmaceutical and health expenditure. To that end, bilateral meetings were held with the Regional Governments in 2018 to evaluate the efficiency of measures with a sustainable positive impact on these expenditures. These bilateral commissions will continue to meet in 2019.

Another relevant measure focused on sustainable spending on pharmaceutical products. The extension of the agreement for cooperation between the AGE (Ministry of Health, Consumption and Social Welfare and Ministry of Finance) and the Spanish Pharmaceutical Industry Association (Farmaindustria) in 2019 is also notable.

## **7.2. Structure and efficiency of the revenue system**

A country's tax policy is part of the social contract between citizens and the State as it provides a means to define the kind of society we want, our collective priorities and what we are willing to finance.

The Constitution defines our country as a social and democratic State under the rule of law, and as such it must protect and promote social justice and the well-being of all citizens through equitable distribution of wealth, fighting against inequalities, protecting the most vulnerable and providing accessible, quality public services.

The tax system is the foundation of the social state. Without enough public revenue, it would be impossible to maintain a robust social state that guarantees equal opportunities and social cohesion. However, taxation is also a powerful tool to encourage economic players to make positive changes towards a more inclusive, sustainable and fairer economic growth and combat inequality in all areas, contributing to environmental protection. It also helps face the daunting challenges of a globalised world to meet the citizens' expectations.

Taxation must be fair and have sufficient capacity for revenue collection to reach these goals. However, these two principles have been diluted in recent years due to policies that have weakened the overall progressivity of the system and undermined its collection potential.

The major priorities of this Government are to recovering the progressiveness of the system, making the wealthier contribute more, and fight against tax fraud and tax avoidance. It is a matter of social equity and justice. Our tax system needs to be modernised to incorporate emerging economic sectors that currently do not contribute.

Spain has historically had lower public revenue than the European average and of the OECD as a whole, i.e., it is one of the countries that collect fewer taxes vis-à-vis the wealth it generates.

This unusual level of revenue is incompatible with the maintenance of a robust welfare state capable of responding the needs and expectations of its citizens and restoring the damage brought about by the economic crisis. It is, therefore, this Government's intention to gradually bring Spain's levels of taxation closer to the average of the countries in our neighbourhood, working at different levels: fighting against tax fraud, reducing the gap between nominal and real tax rates, as is the case of large companies, and incorporating into the tax system the economic sectors that are currently undertaxed or not directly taxed, as is the case of the financial sector and the digital economy, respectively.

The Spanish tax system has become obsolete in the face of the new challenges of the 21st century, such as economic globalisation, digitisation, climate change and rising inequalities. The common denominator is the need for coordinated international action since national governments cannot tackle them alone. To that end, as described in the fiscal strategy, the Government is committed to coordinated tax measures related to financial transactions, digital economy and green taxation within the European Union. This aims to adapt and modernise the tax system, making it fair and efficient, helping transform the economic growth model and ensuring the Social State. The following measures are proposed to achieve:

- Fair taxation, where those who have more contribute more. This will involve, inter alia, setting a minimum Corporate Income Tax rate of 15%, capping tax breaks on dividends and capital gains, and creating a Financial Transactions Tax for large companies and consolidated groups, as well as financial operators.
- Innovative taxation that can adapt to a globalised and digital economy, where there are no longer borders for companies developing business and generating profits. A new tax on digital services in line with the European Commission's proposal.
- A green tax system that contributes to a more sustainable world, protecting the environment and fighting climate change. The main aim of these measures is not tax collection, but rather to discourage practices harmful to the environment. They will be implemented in the context of the reflection on energy transition in this country to move forward towards a green and resource efficient economy that helps create new sources of employment in this sector.
- A tax system focused on equality between men and women, where the gender perspective is being introduced for the first time in different measures, such as reduced VAT for feminine hygiene products, or reduced Corporate Income Tax to promoted gender equality.
- A tax system that fights against tax fraud, making it easier for citizens to exercise their rights and comply with their tax obligations, and expressly prohibits tax amnesties.

## **Fight against fraud**

The approach towards tax fraud is a key indicator for assessing the quality of the tax system. Two actions stand out in this area: on the one hand, the transposition of the Anti-Tax Avoidance Directive (known as ATAD), and, on the other hand, the adoption of the Guidelines of the Annual Tax and Customs Control Plan 2019.

The transposition of the ATAD was mainly due to the significant economic crisis in revenue from Corporate Income Tax. It is aligned, in particular, with several actions carried out under the OECD's BEPS (Base Erosion and Profit Shifting) project to tackle the erosion of tax bases and offshoring of profits, especially large multinational corporations.

Thus, this Directive seeks to ensure that tax is paid where profits and value are generated, strengthen the level of protection against aggressive tax planning and lay down rules against the erosion of tax bases in the internal market and the shifting of profits out of the internal market. It covers different areas, including the establishment of a general anti-abuse rule, a new international fiscal transparency system, the treatment of so-called hybrid mismatches, limitations to the deductibility of interest and the regulation of the so-called exit tax.

Meanwhile, the Guidelines of the Annual Tax and Customs Control Plan 2019, adopted by Resolution of January 11, 2019, of the Directorate-General of the State Tax Agency, set out the priorities for achieving its primary strategic goal, which is none other than improving voluntary compliance with tax obligations.

To that end, actions for preventing and combating tax fraud are carried out, continually adapting to the changing economic, social and regulatory environment, while capitalising on technological advances and organisational changes in the agency, embodied by three pillars:

### *a) Information and assistance to the taxpayer and preventing non-compliances*

In terms of information and assistance to the taxpayer and preventive actions, the Government strives to enhance the diversity and quality of the information and provides helpdesk services to taxpayers through the following actions, amongst others:

- Improvements in Virtual Assistants of the Immediate Disclosure of Information system (known in Spanish as SII) and VAT. Taxpayers who request a visit-by-appointment to clarify doubts or request assistance with the VAT will be able to access the SII without coming personally to an office.
- Improvements in online assistance in the income tax campaign (Renta WEB), including new features to facilitate the declaration of security

portfolios, consolidation of the app introduced in 2018 and the Renta WEB telephone service "Le llamamos". Likewise, taxpayers will be better informed about the information the Tax Agency has about their sources of income to make it easier for them to file the returns correctly and encourage voluntary compliance.

- In line with international trends, a new helpdesk system within the framework of the "Right from the start" strategy that includes a virtual assistant and a new form to help new taxpayers prepare their tax registration. It will also include enhanced preventive access to the census and improvements in census verification campaigns.
- A survey on whether the operations declared by taxpayers subject to SII should be made available to VAT taxpayers who are not subject to SII when the latter is a client or supplier in an operation, with a view to making it easier to file the tax return and encourage them to join the SII voluntarily.

*b) Procedures for verification and investigation of tax and customs fraud*

Overall, the new planning seeks not only to regularise non-compliances, but also to encourage better behaviour from these taxpayers and their environment and, in general, from economic sectors where inspections are frequently performed. Likewise, particular attention will be paid to the reasons behind these regularisations, as a key source of information for planning new control actions.

The main lines of action in 2019 are:

- Capitalising on new international sources of information and technological advances in risk analysis. This includes information obtained under the Multilateral Agreement between Competent Authorities on automatic exchange of information about financial accounts, known as CRS, which involved 102 jurisdictions in 2018, as well as information received from other countries via "Country-by-Country Reports" submitted by large multinational groups, as recommended by one of the actions of the OECD's "BEPS" (Base Erosion and Profit Shifting) project and the G20. Moreover, in 2019, the so-called DAC 6 Directive will be transposed, as recommended by the BEPS project. All intermediaries, consultants and advisers will be obliged to inform the Member States about any cross-border transactions in which they engage that may pose a tax risk. Meanwhile, new risk analysis tools allow capitalising this information by correctly identifying the owner of the financial assets and providing circumstantial information on specific groups of taxpayers and on external signs of wealth and activity to identify hidden assets or undeclared income.
- Strengthening control over multinational groups and large corporations. The monitoring of this type of taxpayers requires stronger preventive

actions to safeguard Spain's tax bases through Prior Assessment Agreements on transfer prices and sharing of costs or benefits, simultaneous controls with other jurisdictions to avert future disputes between countries, and Mutual Agreement Procedures (MAP) to solve conflicts between Administrations. Concerning verification, the selection of risks will be improved in 2019 based on the aforementioned automatic exchange of information on incomes and the information contained in the Country-by-Country Report. As in previous years, special attention will be paid to the correct implementation of anti-tax evasion measures foreseen in the rules, as well as to transfer prices, permanent establishments, tax havens and preferential regimes.

- Enhanced control of assets through the new Central Coordination Unit for Control of Significant Assets. The new Central Coordination Unit for Control of Significant Assets, created within the National Fraud Investigation Office (known in Spanish as ONIF), will coordinate and promote the collection and classification of information throughout Spain, collaborate in the development of new IT tools, and propose, advance and monitor potential taxpayers with significant assets and a specific tax risk profile. Special attention will be paid to assets and rights abroad, as well as to financial and corporate networks.
- Concealment of business or professional activities and abusive use of corporations. In 2019, the number of raids coordinated with the IT audit team will increase. These raids are increasingly more efficient owing to the use of forensic auditing, constant improvements in computer software and ongoing technical training for Tax Administration staff. Controls will be tightened to make effective impact on the end link of the VAT chain, i.e. economic activities with an intensive presence of final consumers. Provisions should be made in this type of actions to ensure that taxpayers who have regularised their situation have changed their behaviour. This type of actions will be reinforced by the planned ban on the use of the so-called dual-use software. Moreover, as in previous years, the interposition of legal entities whose only economic purpose is to channel revenue from natural persons and unlawfully reduce taxation will be analysed. Notwithstanding additional specific analyses to identify other inconsistencies, including the improper deduction of personal expenses.
- New business models. New developments include a preliminary study of FINTECH technologies to prevent their rollout from altering the Tax Agency's knowledge on economic activity, while analysing its potential contribution towards better service for taxpayers. Actions on new distribution models and new activities will continue to be implemented, including "dropshipping", where a company sells a product and another ships it directly, and "store marketplaces" on websites. Likewise, e-commerce-related logistics services will be scrutinised. The analysis and study of the new means of payment will continue to improve control. Concerning tax risks in cryptocurrency transactions, the actions initiated in 2018 will continue in 2019. More specifically, the information provided by

the intermediaries who were involved in cryptocurrency transactions last year will be analysed and put to good use. Moreover, new requests for additional information will be considered. Finally, third-party information on the ownership and trading in virtual currencies in Spain and abroad by taxpayers resident in Spain will be analysed and processed pursuant to new regulations scheduled to be adopted in 2019.

*c) Control in the collection phase*

Tax collection aims to ensure effective debt collection by the National Tax Administration. The actions implemented to that end include those aimed at preventing the avoidance of debt payments using asset concealment techniques, such as false pretence of insolvency, sometimes through frontmen; interposition of companies; or concealment of assets or rights abroad.

Developments in 2019 include improved assessment of tax collection risk, more investigations to identify third parties with debts and provision of proof of the occurrence of the assumptions provided for in legal standards to demand debt payment, and interim measures when there are reasonable grounds to believe that the debtor or third parties will hinder or prevent the payment.

Furthermore, all options available under existing regulations will continue to be applied to levy charges for civil liability from debts and/or fines charged by the Tax Agency, as well as debt linked to unlawful activities.

The involvement of apparently insolvent debtors in the creation of successive corporate entities that fail to fulfil their tax obligations will also be investigated, on the one hand, to obtain evidence to prove the commission of punishable insolvency cases and, on the other hand, to adopt measures to ensure the debt collection. These actions will be complemented with controls to identify bad debtors whose cases may need to be reviewed and, where appropriate, reinstate debts written off as bad debts to arrange collection.

Similarly, the so-called Neutral Point for cooperation with other General Governments will cross-check the payments made by different General Governments with attachment proceedings that these same governments may levy on taxpayers who are simultaneously creditors and debtors of such payments.

Furthermore, risk analysis techniques will be introduced to study the financial soundness of deferral applicants; outstanding debts will be permanently monitored, in particular, debts in the attachment phase; debts suspended or paralysed by complaint or redress will be monitored; agreements with the Central Economic-Administrative Court will be sought to expedite the decisions handed out by the economic-administrative bodies; and debt collection by public entities will be expedited.

Finally, on September 1, 2018, the auction procedure was integrated into the Auction Portal of the "Official State Gazette" State Agency to give the auction



authority nation-wide powers to award assets and rights consistently, and optimise resources, thus saving costs.

## **8. INSTITUTIONAL FRAMEWORK OF THE FISCAL POLICY**

### **8.1. Implementation of the measures provided for in the Organic Law on Budgetary Stability and Financial Sustainability (LOEPSF).**

General Governments at all territorial levels have continued to deploy preventive, monitoring, corrective and advertising mechanisms for budgetary management within the framework of LOEPSF.

Thanks to the responsible management of the Regional Governments and the actions implemented, including the request for Financial Economic Plans, Adjustment Plans, Non-availability Agreements and measures related to the Average Payment Period, where applicable by law, the Regional Government sub-sector has recorded a year-end deficit of 0.23% in 2018, comfortably meeting the budgetary stability target. Moreover, the sub-sector has also complied with the expenditure rule in 2018, as the Regional Governments' change rate of computable expenditure was 2.2%, lower than the maximum allowed of 2.4%.

Similarly, the Local Entities sub-sector registered an overall surplus of 0.5% of GDP in 2018. The implementation data has been monitored, as has been compliance with tax rules. To that end, several Local Entities have been asked to submit Financial Economic Plans or Non-Availability Agreements, or adopt additional measures to control PMP.

The actions developed by the Regional Governments are analysed below in greater detail.

#### a) Economic-Financial Plans (known in Spanish as PEF)

Pursuant to Articles 21 and 23 of the LOEPSF, and in light of the Report on Compliance with Budgetary Stability and Public Debt Targets and Expenditure Rule provided for in Article 17.4 of the LOEPSF, Andalusia, Aragon, Asturias, Castilla and Leon, Castilla-La Mancha, Catalonia, Extremadura, Madrid, Murcia, Navarre, Basque region, La Rioja and Valencia have submitted PEFs. The Fiscal and Financial Policy Council meeting (known in Spanish as CPFF) of July 31, 2018 declared all PEFs appropriate, except Andalusia, Navarre and the Basque region, pending ratification.

Based on the 2018 year-end data, the sub-sector recorded a deficit of 0.23%, comfortably meeting the budgetary stability target. The analysis by Regional Government shows that all Regional Governments that submitted a PEF have met the budgetary stability target save two.

As for compliance with the expenditure rule, the Regional Governments' change rate of computable expenditure in 2018 amounted to 2.2%, below the maximum allowed of 2.4%. All Regional Governments have submitted PEFs except three non-compliant with the expenditure rule.

Meanwhile, the Regional Governments with PEFs in force throughout the period have published the relevant Economic Financial Plan Monitoring Report.

b) Adjustment Plans.

Additionally to monitoring the Regional Governments that have an Adjustment Plan, the Adjustment Plans of Regional Governments attached to the 2019 Regional Liquidity Fund (known in Spanish as FLA) - Aragon, Castilla-La Mancha, Extremadura, Murcia and Comunitat Valenciana- are being processed since March this year.

c) Adoption of the measures provided for in Art. 25 of the LOEPSF

This Article was applied for the first time, in 2016, to Regional Governments with an Adjustment Plan that failed to meet the 2015 stability goals. This resulted in the addition of a Non-Availability Agreement in those that were at risk of failing to comply again with the stability target. This measure has been rolled-back as the Regional Governments meet the budgetary stability target. At the time of the 2018 year-end data, Murcia and Comunitat Valenciana are the only two in which it is still in force.

d) Implementation of measures for non-compliance of the Average Payment Period to suppliers (known in Spanish as PMP)

The preventive measures provided for in Article 18.4 of the LOEPSF are operative in Cantabria, Murcia and Valencia. The corrective measures provided for in Article 20.5 of the LOEPSF are also applied in the latter two regions.

## **8.2. Financially Sustainable Investments (DA 116 of the General State Budget Law for 2018 and Royal Decree-Law 10/2019)**

Given the overall consolidation of the financial situation, Financially Sustainable Investments (IFS) have been introduced to help recover the levels of public investment. The IFS are investments that will have a direct, positive and verifiable impact on the sustainability of public finances and potential growth of the economy. These investments do not compromise debt reduction and achieve sustainable public investment.

For this reason, the rule whereby the 2018 surplus is allocated to IFS, under Royal Decree-Law 7/2019, of 1 March, has been extended and also covers housing investment expenditure.

In the case of the Regional Governments, following verification of compliance of the legally established requirements, the Canary Islands, Navarra and the Basque Region opted to implement the Additional Provision 116 of the LPGE for 2018, whereby the surplus in the 2017 budget was allocated to financially sustainable investments. The amount executed in that year totalled €99 million.

These investments were geared towards various areas, including high-tech health equipment, railway, vocational training equipment, hydraulic works, industrial infrastructures, equipment for air quality network, waste treatment, supply networks, sewerage and storm water networks, expansion and improvement of broadband networks and health education infrastructure and facilities.

Meanwhile, once the year-end data for 2018 has been made disseminate, and following the extension of the Additional Provision by Royal Decree-Law 10/2019, the Regional Governments (Principality of Asturias, Canary Islands, Galicia, Basque Region, and Comunidad Foral de Navarra) that run surpluses in 2018 could opt to make financially sustainable investments, provided they are compliant with current legal requirements.

Local Entities may allocate the surplus from 2018 to purposes other than the amortisation of public debt, as this measure has been extended into 2019 through Royal Decree-Law 10/2019, of 29 March. It should be noted that Local Entities not only had a surplus on December 31, 2018, but also an outstanding debt of €26 billion, or 2.1% of GDP (versus a target of 2.4% for the year).

According to this special rule, Local Entities may allocate the surplus to cancel their pending obligations provided they do not have excessive public debt and if, in addition, the average payment period to suppliers is less than 30 days, they may allocate the remainder to finance financially sustainable investments (hereinafter, FSI), once the pending obligations have been met.

It should be noted that as of July (based on second quarter information for 2019 on the execution of the budget), Local Entities will not submit data on FSI projects they are planning to implement in 2019. Nonetheless, based on the execution rate noted in 2018, the upper limit for FSI estimates in 2019, based on 2018 rates could be €340 billion, financed with the 2018 surplus. Based on the Local Entities implementation rate in 2018, €129 billion worth of FSIs would be implemented in 2019, of which €648 million would be financed with the 2018 surplus and €647 million with that of 2017 (in this latter case, Local Entities must have authorised the expenditure in 2018).

To date, the FSIs implemented by Local Entities were primarily geared towards wealth management, passenger transport, educational centres, public roads and information society.

### **8.3. Gradual access of Regional Governments to financial markets**

The Government Commission for Economic Affairs (known in Spanish as CDGAE) approved the conditions for the gradual access to financial markets of financially sound Regional Governments that are party to the Autonomous Communities Financing Fund.

The requirements for Regional Governments to access the market are:

- Be a party to the Autonomous Communities Financing Fund through the Financial Facility.
- Meet the targets relating to budgetary stability, public debt and expenditure rule according to the LOEPSF Article 17 report, with an average payment period to suppliers does not exceed in thirty (30) days the maximum period foreseen in the regulations on late payments by two consecutive months from the update of its liquidity plan.
- Have, at least, one investment-grade credit rating.

Meanwhile, on 26 July, the CDGAE approved the possibility of refinancing the Regional Governments short-term structural credit operations through long-term debt.

## **8.4. Transparency measures**

### **8.4.1. National Subsidies Database**

Worthy of note is the adoption of Royal Decree 130/2019 regulating the National Subsidies Database and the transparency of public subsidies and aid, making it possible to fulfil the EU's requirements on state and minimis aid.

### **8.4.2. Public procurement**

In addition to the above, an important breakthrough has been achieved in terms of transparency, attributable to the new contractor profile regulation that clusters contractual information and documents of procurement bodies.

This regulation also provides that all information contained in contractor profiles shall be published in open and reusable formats, facilitating its subsequent use for reporting and statistics on public procurement. This, in turn, can provide information that goes beyond individual inputs on each procurement, thus providing greater overall transparency.

Moreover, progress in ensuring transparency has, if anything, increased since Article 63 of Law 9/2017, of 8 November, on Public Sector Contracts made it mandatory to publish virtually all relevant ad extra documents and information in contractor profiles with a breadth that has been replicated in few countries in our environment.

The new regulation on the Public Sector Contracting Platform (known in Spanish as PLACSP) and its links with other regional procurement platforms has also contributed to greater transparency in procurement. This relationship between procurement platforms provides a single point of access to all Spanish public sector tenders.

The gradual adoption of electronic tendering will also contribute to greater flexibility, security and transparency in public procurement procedures.

### **8.4.3. Public Administration's Economic and Financial Information Centre**

Special mention must be made of ongoing improvements in the organisation, processing, accessibility and dissemination of the information provided by the Public Administration's Economic and Financial Information Centre. Its most recent activities include:

- a) Expansion of the economic and financial information collected, making it easier for users to reuse the information through its data bank.
- b) Preparation of territorial maps that allow the user to select economic and financial indicators and view them later in a specific geographical area in a user-friendly manner.
- c) Creation of a detailed catalogue of subjects, variables and time series available in the economic and financial information centre's database for analytical purposes.
- d) Publication for dissemination of macroeconomic and budgetary forecasts of the General State Budget, the Stability Programme and the Draft Budgetary Plan pursuant to the provisions of Royal Decree 337/2018, of 25 May, on requirements for macroeconomic and budgetary forecasts.
- e) Contents will be broadened with statistical information on employment, population and education that is currently not available in the information centre.

To that end, as well as to improve other technical aspects, the process to amend Royal Decree 636/2014, of 25 July, has recently started. It creates the General Government's Economic and Financial Information Centre and regulates the submission of information from the Bank of Spain and other financial entities to the Ministry of Finance. Moreover, the draft Royal Decree implementing the Operating Regulation of the National, Regional and Local Inventory is going through the legislative process and will be subsequently submitted to the Council of State.

### **8.4.4. Oversight of the State Institutional Sector**

Progress has also been made in the oversight of the State Institutional Sector. The Order HFP/371/2018, of 9 April, which will fully enter into force in July 2019, regulates planning, implementation and evaluation of continuous monitoring of entities that are part of the State Institutional Sector, enabling recommendations to improve public bodies or entities subject to continuous monitoring.

## **9. COMPARISON OF ECONOMIC FORECASTS AND REALISATION**

### **9.1. Methodological aspects**

Royal Decree 337/2018, of 25<sup>th</sup> May, laying down the requirements for macroeconomic and budgetary forecasts, foresees an ex-post evaluation of the forecasts of the main macroeconomic and budgetary variables, at least once a year. This Royal Decree transposes the Council Directive on requirements for budgetary frameworks of the Member States. This is, therefore, the first time that this analysis has been carried out in the Stability Programme.

To conduct systematic ex-post evaluations of annual forecasts, there is a need to determine which forecasts will be evaluated, which results will be compared and which deviations are meaningful.

#### **9.1.1. Baseline forecasts**

To ensure homogenous analysis, the economic forecasts that will be compared must be published every year on the same date. This condition is met by the forecasts included in the Stability Programme Update (known in Spanish as APE), published in April, and the Draft Budget Plan (DBP), published in October, given that the publication dates of the draft State General Budget Project and the Spanish Economy Situation Report have widely varied in recent years.

Considering that the deviation in the current year is being measured, the nearly six-month lapse between both publications means that, unlike the Stability Programme Update, the scenario built on the Budget Plan contains more information about the current year.

Therefore, if the aim is to measure the accuracy of forecasts, it could be argued that the forecasts contained in the Stability Programme Update should be used, given that comparing forecasts which include data late in the year would defeat the purpose of assessing that year's deviations.

Meanwhile, given the uncertainty of forecasts for horizons beyond one year, it would seem reasonable to compare only the forecast of the first year included in the Stability Programme with the realised or observed variable.

#### **9.1.2. Observed variables to compare**

The National Accounts, which are subject to successive revisions, include most economic variables used in forecasts. As these revisions contain information that is not generally available at the time of the forecast, it would seem more reasonable to use the realised or observed figures that appear in the first quarterly publication of the Quarterly National Accounts, the Labour Force Survey and the Non-Financial Accounts of Institutional Sectors for the full year analysed. For instance, for 2018, the forecasts included in the Stability Programme Update 2018-2021 should be compared with the annual totals of the 2018 Quarterly National Accounts or the Labour Force Survey or the fourth

quarter of the 2018 Non-Financial Accounts of Institutional Sectors, which would cover information for the full year.

### **9.1.3. Criteria for the existence of a systematic and significant bias**

Given that the aim of the analysis is to determine whether the macroeconomic forecasts have been affected by a significant, systematic bias during at least four consecutive years, there is a need to define the criteria that will be applied to ascertain whether a bias exists under the aforementioned Royal Decree.

Articles 4 and 5 of Royal Decree 337/2018 allows a choice between two types of forecasts, the most likely or the most prudent, both for macroeconomic (Article 4.1) and budgetary (Article 5.2) purposes. The principle of prudence has been chosen on the assumption that a forecast is prudent when its bias or error (the difference between observed and expected value) leads to an understatement of economic growth, employment or government balance. In these cases, it is assumed that the principle of prudence would justify the forecast error, and corrective measures are not needed.

To determine whether the bias, adjusted by the principle of prudence, is meaningful or not, a benchmark is needed to determine the levels of deviation considered meaningful.

To that end, the average forecast of several institutions is used as the benchmark, as it provides a reasonable estimate on the unbiased use of the information available at the time of the forecast. In the case of Spain, the benchmark used in economic forecasts is provided by the Savings Bank Foundation Panel (in particular, the consensus of the FUNCAS Panel), published every two months. The March publication was used here.

A forecast bias will be deemed meaningful for a given variable if it meets the two criteria defined by the Independent Fiscal Authority to assess forecasts in Spain. A bias is meaningful when it appears as an outlier in the interquartile range of the FUNCAS Panel for that same variable, and the absolute value of the forecast error vis-à-vis the observed magnitude is higher than that of the Panel forecast.

### **9.1.4. Variables to compare and implementation of the prudence criterion**

The variables that will be compared are those that appear in the different Stability Programme Updates. More specifically, these variables are included in the following tables of the previous Stability Programme Update: Table 3.3.1. Macroeconomic outlook, Table 3.3.2. Labour market, Table 3.3.3. Price evolution, which should also include the General Government's need for financing and its comparison to the rest of the world (Table 3.3.4). Sector-wide balances. Overall, there are thirty-two variables, i.e., seventeen more than in the FUNCAS Panel, though not all are independent, as some are a basket of other variables.



For those variables that are not covered it is desirable to detail which errors are covered under the principle of prudence to assess these forecasts. To that end, it is necessary to identify what is the threshold value at which the bias is considered meaningful for variables not included in the FUNCAS Panel when these are repeated for four consecutive years.

The principle of prudence does not cover a growth greater than that observed except in the following two cases: (1) public consumption (both growth in volume and deflator), since a forecast higher than realisation implicitly assumes a forecast of a larger public deficit, and (2) imports deflator, since a higher deflator assumes a higher tax base on these transactions, and indirectly a lower deficit.

A related issue is how some predicted variables, such as GDP or labour productivity, can be forecast directly or indirectly based on their components. In this case, possible differences are ignored if the forecasts of the components have errors that are not meaningful or can be justified by the principle of prudence.

Finally, not all the variables predicted in the Stability Programme are forecasted by institutions that participate in the FUNCAS Panel. The decision was made to set a deviation threshold value for these variables. A forecast is deemed acceptable based on the interquartile range of the Panel's forecasts for a similar variable. This range is compared with the standard growth deviation of the variable in the last four years. The error is considered acceptable when the ratio of the standard deviation is equivalent to the interquartile range for a similar variable in the Panel<sup>11</sup>.

When the deviation threshold value is comparable to that of the Panel, this criterion would be more stringent than that applied to the variables explicitly included in the Panel, as the possibility of considering the forecast biased is ruled out when the forecast error is lower than the average forecast of the Panel.

The variables to which this procedure has been applied are deflators, given that the FUNCAS Panel only includes CPI forecasts; employment figures, except full-time equivalent employment; labour factor productivity; unit labour costs; compensation of employees; current account and capital transaction balances; and net external lending and borrowing.

The threshold values for the variables not included in the FUNCAS Panel are:

**Table 9.1.4.1. Threshold for variables not included in the FUNCAS Panel**  
% of GDP

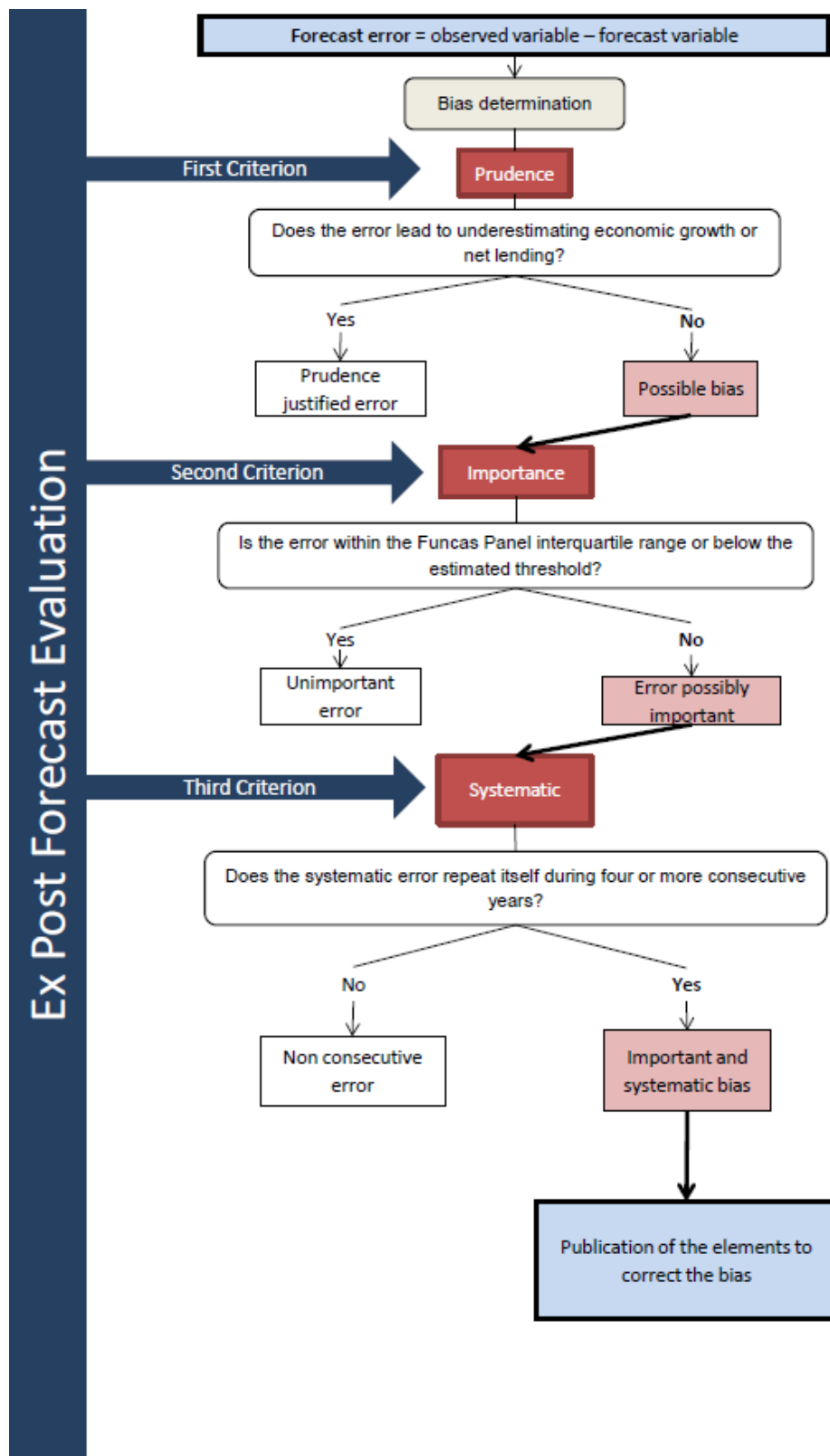
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<sup>11</sup> These methodological aspects will be further developed in a forthcoming document, including variables defined according to this procedure and their threshold values.

	<b>Threshold (%)</b>
Private consumption deflator	0.27
Public consumption deflator	0.17
GFCF deflator	0.21
Exports deflator (goods and services)	0.42
Imports deflator (goods and services)	0.68
Employment (persons)	0.17
Full-time equivalent employment (FTE)	0.20
Employment (hours)	0.33
Labour productivity per employee (persons)	0.39
Labour productivity per employee (FTE)	0.25
Productivity per hour worked	1.20
Current account balance (% GDP)	0.37
Balance of goods and services (% GDP)	0.33
Balance of incomes and transfers (% GDP)	0.08
Capital balance (% GDP)	0.13
Net lending (% GDP)	0.25
Source: Ministry of Economy and Business	

In summary, the following figure shows the decision tree of the procedure used for the ex-post analysis of economic forecasts.

### **Ex-post evaluation of the forecasts**



9.2. Analysis of forecasts 2014-2018

Before the difference between the forecasts and realisations of the magnitudes included in the macroeconomic scenario of the Stability Programme Update are analysed, it is desirable to determine the degree of fulfilment of the assumptions on which these forecasts are based.

The assumptions were from two sources. Firstly, the European Commission provides a number of common assumptions that all Member States use in their Stability Programmes. These are short- and long-term interest rates (the latter adapted to the Spanish situation), Eurozone growth and growth in the rest of the world.

In the case of exchange rates and oil prices, the forecasts are based on the average values of the last ten days prior to the closure of the information used, assuming that the average value of these variables is reasonably close to the value for the rest of the year. Secondly, the growth of the Spanish markets is estimated from the latest IMF forecast on the growth of imports in different world economies, weighted by the importance of each country in terms of Spanish exports.

As detailed in Table 9.2.1, which shows the comparison between assumptions and realisation, the assumptions on interest rates have been reasonably close to the observed values. Only the forecasts on long-term interest rates in 2015 were slightly optimistic. The assumptions about developments in the euro/dollar exchange rate have been slightly optimistic in 2016 and 2017, whereas, by contrast, the euro has seen an appreciation of nominal effective exchange rate marginally higher than expected in four of the five years under consideration.

Although the observed world GDP growth, excluding the EU, shows significant differences with the 2015 assumptions, in two of the other years it was lower than expected. The growth of non-EU markets was lower than expected in all the years analysed, except 2017, a situation that was also echoed in Spanish markets.

Finally, the oil price in euros witnessed an unfavourable deviation in 2016 and 2018.

**Table 9.2.1. Comparison of EU assumptions with final outcome**  
% of GDP

	2014			2015			2016			2017			2018		
	Assump tion	Real	Compa rison	Assump tion	Real	Compa rison	Assump tion	Real	Compa rison	Assump tion	Real	Compa rison	Assump tion	Real	Assump tion
Short-term interest rates (3-month Euribor)	0.4	0.2	0.2	0.0	0.0	0.0	-0.3	-0.3	0.0	-0.3	-0.3	0.0	-0.3	-0.3	0.0
Long-term interest rates (10-year debt, Spain)	3.7	2.7	1.0	<b>1.3</b>	<b>1.7</b>	<b>-0.4</b>	1.7	1.4	0.3	1.7	1.7	0.0	1.6	1.4	0.2
USD/euro exchange rate	1.37	1.30	0.07	1.11	1.11	0.00	<b>1.1</b>	<b>1.1</b>	<b>0.0</b>	<b>1.1</b>	<b>1.1</b>	<b>-0.1</b>	1.23	1.18	0.05
Nominal effective exchange rate of the Eurozone (% change)	<b>1.7</b>	<b>2.1</b>	<b>-0.4</b>	-6.2	-6.8	0.6	<b>1.2</b>	<b>2.7</b>	<b>-1.5</b>	<b>0.5</b>	<b>2.1</b>	<b>-1.6</b>	<b>4.7</b>	<b>4.8</b>	<b>-0.1</b>
World excluding EU, GDP growth	3.6	3.7	0.1	<b>4.0</b>	<b>3.2</b>	<b>-0.8</b>	<b>3.4</b>	<b>3.2</b>	<b>-0.2</b>	3.7	3.9	0.2	<b>4.2</b>	<b>3.9</b>	<b>-0.3</b>
EU GDP growth	1.2	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Euro-zone GDP growth	-	0.9	-	1.5	1.6	0.1	1.4	1.8	0.4	1.7	2.5	0.8	<b>2.4</b>	<b>1.9</b>	<b>-0.5</b>
World import volume, excluding EU	-	-	-	<b>3.9</b>	<b>0.8</b>	<b>-3.1</b>	<b>2.2</b>	<b>0.9</b>	<b>-1.3</b>	3.0	5.1	2.1	<b>5.0</b>	<b>4.8</b>	<b>-0.2</b>
Spanish export markets	<b>4.0</b>	<b>2.4</b>	<b>-1.6</b>	<b>3.8</b>	<b>3.7</b>	<b>-0.1</b>	<b>4.1</b>	<b>2.9</b>	<b>-1.2</b>	3.6	4.4	0.8	<b>4.5</b>	<b>3.0</b>	<b>-1.5</b>
Oil price (Brent, Dollars/barrel)	107.3	99.4	7.4	61.5	52.2	15.2	<b>39.7</b>	<b>44.8</b>	<b>-12.8</b>	<b>53.5</b>	<b>54.2</b>	<b>-1.3</b>	<b>67.7</b>	<b>71.5</b>	<b>-5.7</b>
Oil price (Brent, Euros/barrel)	78.3	76.5	2.4	55.4	47.0	15.2	<b>36.4</b>	<b>40.4</b>	<b>-10.8</b>	50.0	48.0	4.1	<b>55.0</b>	<b>60.6</b>	<b>-10.0</b>

The gray shaded cells correspond to the hypotheses that have turned out to be optimistic with respect to what has been observed, because if they had been fulfilled, a higher growth rate could be expected for the variables that determine real or nominal GDP.  
The positive values in the column named "Comparative" indicate that the variable has presented a more favorable behavior than the assumption, while the negative signs indicate a less favorable behavior.  
In the case of the price of oil, the relevant variable is the price in euros of the Brent barrel and not in dollars, since it allows comparing the change experienced by the agents' costs in the Spanish economy with respect to the corresponding forecasts.  
Source: Ministry of Economy and Business

The cells highlighted in the table indicate the assumptions that were more optimistic than observed. If these assumptions had been fulfilled, the variables that determine real or nominal GDP would have had a higher growth rate.

The positive values in the "Comparison" column indicate that the variable has had a more favourable performance than the assumption, while the negative signs indicate a less favourable performance.

As for oil prices, the relevant variable is the Brent oil price in euros and not in dollars, as it allows for the comparison of the change in the costs of the agents in the Spanish economy vis-à-vis the relevant forecasts.

Table 9.2.2. shows the results of the forecast of the first Stability Programme in Spain compared with the outcome of the first Quarterly National Accounts of that year. The differences arising from subsequent revisions of the National Accounts have been eliminated. The differences that imply a less favourable tax result vis-à-vis the predicted value have been highlighted in the table, regardless of the deviation value.

Table 9.2.2. Forecast bias

	2014		2015		2016		2017		2018	
	Forecast	Real	Forecast	Real	Forecast	Real	Forecast	Real	Forecast	Real
1. Real GDP	1.24	1.39	2.92	3.21	2.74	3.24	2.71	3.05	2.70	2.58
2. Nominal GDP	1.72	0.89	3.56	3.84	3.70	3.55	4.24	4.04	4.26	3.59
<b>Components of real GDP</b>										
3. Private consumption expenditure (*)	1.41	2.42	<b>3.30</b>	3.10	3.15	3.23	<b>2.56</b>	2.38	2.04	2.29
4. Government consumption expenditure	<b>-1.29</b>	0.11	<b>0.10</b>	2.66	1.00	0.78	<b>0.75</b>	1.57	<b>1.10</b>	2.13
5. Gross fixed capital formation	0.53	3.44	6.33	6.38	<b>5.60</b>	3.11	2.82	5.01	4.68	5.26
6. Change in inventories (% of GDP)	0.00	0.15	0.00	0.13	0.00	0.14	0.00	0.12	0.00	0.09
7. Exports of goods and services	<b>5.03</b>	4.16	<b>5.42</b>	5.41	<b>5.26</b>	4.38	<b>5.54</b>	5.03	<b>4.81</b>	2.28
8. Imports of goods and services	<b>3.63</b>	7.63	<b>6.66</b>	7.48	7.03	3.26	<b>4.33</b>	4.66	4.10	3.45
<b>Contributions to real GDP growth</b>										
9. Final domestic demand	0.67	2.07	3.16	3.57	<b>3.15</b>	2.64	2.18	2.67	2.34	2.79
10. Change in inventories	0.00	0.15	0.00	0.13	0.00	0.14	0.00	0.12	0.00	0.09
External balance	<b>0.56</b>	-0.84	<b>-0.24</b>	-0.49	-0.41	0.45	<b>0.53</b>	0.26	<b>0.35</b>	-0.30
<b>Price developments</b>										
1. GDP deflator	0.48	-0.50	0.62	0.61	0.93	0.31	1.49	0.95	1.52	0.99
2. Private consumption deflator (*)	<b>0.34</b>	-0.09	<b>-0.40</b>	-0.54	<b>-0.15</b>	-0.21	1.45	1.77	1.43	1.63
3. Public consumption deflator	0.26	-0.85	<b>0.00</b>	0.41	0.30	0.09	1.04	0.30	<b>1.06</b>	1.07
4. Gross fixed capital formation deflator	<b>0.00</b>	-0.58	0.06	1.43	0.78	1.51	<b>2.84</b>	1.84	<b>2.40</b>	1.92
5. Exports deflator (goods and services)	<b>-0.20</b>	-1.69	-0.91	0.34	<b>0.51</b>	-1.12	<b>2.88</b>	2.50	<b>1.23</b>	1.18
6. Imports deflator (goods and services)	<b>-0.92</b>	-1.26	-3.71	-1.43	-1.96	-1.58	3.55	4.37	1.32	3.08
<b>Labour market</b>										
1. Total employment (Thousands of persons)	0.90	1.27	<b>3.08</b>	2.94	<b>2.74</b>	2.68	<b>2.74</b>	2.59	<b>2.58</b>	2.15
2. Full-time equivalent employment	0.62	1.16	<b>3.03</b>	2.98	2.50	2.85	2.45	2.81	2.50	2.52
3. Employed (Thousands of hours worked)	<b>0.70</b>	0.65	<b>2.82</b>	2.53	<b>3.00</b>	2.33	<b>2.75</b>	1.69	2.00	2.80
4. Labour productivity per employee (Thousands Euros)	<b>0.33</b>	0.12	-0.15	0.27	0.00	0.54	-0.03	0.45	0.12	0.43
5. Labour productivity, full-time equivalent (Thousands Euros)	<b>0.61</b>	0.23	-0.10	0.23	0.23	0.37	<b>0.25</b>	0.23	<b>0.19</b>	0.06
6. Productivity per hour worked (Euros)	0.46	0.74	0.10	0.67	-0.26	0.89	-0.04	1.34	<b>0.68</b>	-0.21
7. Compensation per employee(**) (Thousands of Euros)	<b>0.19</b>	-0.21	0.16	0.51	<b>0.76</b>	0.01	<b>1.25</b>	0.14	<b>1.16</b>	0.85
8. Unit Labour Cost	<b>-0.42</b>	-0.44	0.26	0.28	<b>0.53</b>	-0.36	<b>1.00</b>	-0.09	<b>0.97</b>	0.79
9. Compensation of employees (Million Euros)	0.66	1.35	3.29	3.88	<b>3.38</b>	3.09	<b>3.84</b>	3.27	3.79	4.09
10. Unemployment rate (% of labour force)	24.87	24.44	22.07	22.06	19.86	19.63	17.59	17.22	15.51	15.25
<b>Sectorial balances (% of GDP)</b>										
1. Net lending (+) / Net borrowing (-) vis-à-vis the rest of the world	2.05	1.03	1.73	2.13	2.43	2.04	2.02	1.98	1.92	1.47
Currente balance vis-à-vis the rest of the world	<b>1.31</b>	0.61	1.30	1.40	1.73	1.88	<b>1.89</b>	1.76	<b>1.71</b>	0.94
- Balance on goods and services	-0.73	2.38	<b>2.90</b>	2.49	2.80	2.91	<b>3.19</b>	2.67	<b>2.91</b>	1.95
- Balance on primary income and current transfers	-1.84	-1.77	-1.60	-1.09	-1.06	-1.03	-1.30	-0.91	-1.20	-1.02
- Capital account	<b>0.74</b>	0.42	0.43	0.73	<b>0.69</b>	0.17	0.13	0.23	0.20	0.53
2. Net lending (+) / Net borrowing (-) of the private sector	7.51	6.83	5.92	7.22	6.07	6.58	5.16	5.10	4.15	3.95
3. Net lending (+) / Net borrowing (-) of General Government (*)	<b>-5.46</b>	-5.80	<b>-4.19</b>	-5.08	<b>-3.65</b>	-4.54	-3.14	-3.11	<b>-2.24</b>	-2.48

(\*) It includes households and non-profit institutions serving households.

(\*\*) Full-time equivalent

Sources: Ministry of Economy and Business.

This first estimate, which is the only one to which the principle of prudence has been applied, shows that none of the forecasts of the last five years had a bias in four consecutive years, except exports of goods and services, employed persons, hours worked and General Government net borrowing. As shown in Table 9.2.1, in the case of exports, the deviation is due in part to variations in the baseline assumptions of key variables including world and Eurozone GDP growth, Spanish market GDP growth and oil prices, and ad hoc deviations in exchange rates.

The following table, which highlights the most biased forecasts, shows the outcome of the implementation of the criteria to consider a bias the difference

between forecast and realisation, and its comparison with the FUNCAS Panel forecasts.

**Table 9.2.3. Forecasts with significant biases**

	2014		2015		2016		2017		2018	
	Previsión	Real	Previsión	Real	Previsión	Real	Previsión	Real	Previsión	Real
1. Real GDP	1.24	1.39	2.92	3.21	2.74	3.24	2.71	3.05	2.70	2.58
2. Nominal GDP	1.72	0.89	3.56	3.84	3.70	3.55	4.24	4.04	4.26	3.59
<b>Components of real GDP</b>										
3. Private consumption expenditure (*)	1.41	2.42	3.30	3.10	3.15	3.23	2.56	2.38	2.04	2.29
4. Government consumption expenditure	-1.29	0.11	<b>0.10</b>	2.66	1.00	0.78	0.75	1.57	<b>1.10</b>	2.13
5. Gross fixed capital formation	0.53	3.44	6.33	6.38	<b>5.60</b>	3.11	2.82	5.01	4.68	5.26
6. Change in inventories (% of GDP)	0.00	0.15	0.00	0.13	0.00	0.14	0.00	0.12	0.00	0.09
7. Exports of goods and services	5.03	4.16	5.42	5.41	5.26	4.38	5.54	5.03	4.81	2.28
8. Imports of goods and services	3.63	7.63	6.66	7.48	7.03	3.26	4.33	4.66	4.10	3.45
<b>Contributions to real GDP growth</b>										
9. Final domestic demand	0.67	2.07	3.16	3.57	<b>3.15</b>	2.64	2.18	2.67	2.34	2.79
10. Change in inventories	0.00	0.15	0.00	0.13	0.00	0.14	0.00	0.12	0.00	0.09
External balance	0.56	-0.84	-0.24	-0.49	-0.41	0.45	0.53	0.26	0.35	-0.30
<b>Price developments</b>										
1. GDP deflator	0.48	-0.50	0.62	0.61	0.93	0.31	1.49	0.95	1.52	0.99
2. Private consumption deflator (*)	<b>0.34</b>	-0.09	-0.40	-0.54	-0.15	-0.21	1.45	1.77	1.43	1.63
3. Public consumption deflator	0.26	-0.85	<b>0.00</b>	0.41	0.30	0.09	1.04	0.30	1.06	1.07
4. Gross fixed capital formation deflator	<b>0.00</b>	-0.58	0.06	1.43	0.78	1.51	<b>2.84</b>	1.84	<b>2.40</b>	1.92
5. Exports deflator (goods and services)	<b>-0.20</b>	-1.69	-0.91	0.34	<b>0.51</b>	-1.12	2.88	2.50	1.23	1.18
6. Imports deflator (goods and services)	-0.92	-1.26	-3.71	-1.43	-1.96	-1.58	3.55	4.37	1.32	3.08
<b>Labour market</b>										
1. Total employment (Thousands of persons)	0.90	1.27	3.08	2.94	2.74	2.68	2.74	2.59	<b>2.58</b>	2.15
2. Full-time equivalent employment	0.62	1.16	3.03	2.98	2.50	2.85	2.45	2.81	2.50	2.52
3. Employed (Thousands of hours worked)	0.70	0.65	2.82	2.53	<b>3.00</b>	2.33	<b>2.75</b>	1.69	2.00	2.80
4. Labour productivity per employee (Thousands Euros)	0.33	0.12	-0.15	0.27	0.00	0.54	-0.03	0.45	<b>0.12</b>	0.43
5. Labour productivity, full-time equivalent	0.61	0.23	-0.10	0.23	0.23	0.37	0.25	0.23	0.19	0.06
6. Productivity per hour worked (Euros)	0.46	0.74	0.10	0.67	<b>-0.26</b>	0.89	<b>-0.04</b>	1.34	0.68	-0.21
7. Compensation per employee(**)	0.19	-0.21	0.16	0.51	0.76	0.01	1.25	0.14	1.16	0.85
8. Unit Labour Cost	-0.42	-0.44	0.26	0.28	0.53	-0.36	1.00	-0.09	0.97	0.79
9. Compensation of employees (Million Euros)	0.66	1.35	3.29	3.88	3.38	3.09	<b>3.84</b>	3.27	3.79	4.09
10. Unemployment rate (% of labour force)	24.87	24.44	22.07	22.06	19.86	19.63	17.59	17.22	15.51	15.25
<b>Sectorial balances (% of GDP)</b>										
1. Net lending (+) / Net borrowing (-) vis-à-vis the rest of the world	2.05	1.03	1.73	2.13	2.43	2.04	2.02	1.98	1.92	1.47
Currente balance vis-à-vis the rest of the world	1.31	0.61	1.30	1.40	1.73	1.88	1.89	1.76	1.71	0.94
- Balance on goods and services	-0.73	2.38	<b>2.90</b>	2.49	2.80	2.91	<b>3.19</b>	2.67	<b>2.91</b>	1.95
- Balance on primary income and current transfers	-1.84	-1.77	-1.60	-1.09	-1.06	-1.03	-1.30	-0.91	-1.20	-1.02
- Capital account	<b>0.74</b>	0.42	0.43	0.73	<b>0.69</b>	0.17	0.13	0.23	0.20	0.53
2. Net lending (+) / Net borrowing (-) of the private sector	7.51	6.83	5.92	7.22	6.07	6.58	5.16	5.10	4.15	3.95
3. Net lending (+) / Net borrowing (-) of General Government (*)	<b>-5.46</b>	-5.80	<b>-4.19</b>	-5.08	-3.65	-4.54	-3.14	-3.11	<b>-2.24</b>	-2.48
(*) It includes households and non-profit institutions serving households.										
(**) Full-time equivalent										
Sources: Ministry of Economy and Business.										

The number of forecasts that would be affected by a meaningful bias is significantly reduced when the prudence and relevance criteria are applied. It should be noted that, overall, real GDP growth forecasts and its components on the demand side do not have meaningful biases, except public consumption growth in 2015 and 2018 and gross fixed capital formation growth in 2016. The latter had an impact on the final national demand in that year.

The deflator forecasts followed a broadly prudent direction, with the exception of the forecasts on public consumption deflator growth in 2015 and 2018, investments in 2014 and 2017 and exports in 2014 and 2016.

The combination of these errors has resulted in GDP deflator growth rates consistently lower than the forecast, with significant differences except in 2015, when the difference was negligible (0.01%), and in 2018, when the expected growth was lower than that realised.

On the labour market side, the forecast of full-time equivalent employment has been quite accurate. By contrast, compensation of employee was inaccurate, although the errors are comparable to that of the FUNCAS Panel. Other employment forecasts have been generally affected by errors in predicted hours worked. A similar assessment can be made for productivity estimates.

As for sector-wide balance forecasts, it should be borne in mind that these are independent of each other. Since the sum of the public and private sectors' net lending and borrowing is necessarily equal to the net lending and borrowing of the Spanish economy compared to the rest of the world, only two of the three forecasts have to be assessed.

The private sector's net lending has been taken into account based on that of the public sector, and that of the total economy compared to the rest of the world. Only the latter two have been assessed. Overall, the forecast for net lending compared to the rest of the world, estimated by current account balance, does not show important biases, while the public sector net lending shows important biases in three of the last five years.

The main biases in 2018 are concentrated in the foreign sector. Export and import forecasts for this year are far from the observed figures, although the bias is lower than that of the FUNCAS Panel. The error is mainly due to developments in foreign trade volume, as deflator forecasts have been reasonably close to their realisation. The primary reasons for this deviation in foreign trade flows in real terms are a 1.5% lower-than-expected growth of our target markets, largely due to trade tensions worldwide and their effect on international trade, as well as problems specific to the European automotive market, which have contributed to the deceleration of imports and exports in this sector. Both factors have been instrumental in the evolution of exports and imports.

The 2018 public deficit was three-tenths higher than that foreseen in the Stability Programme submitted on April 30, 2018 (2.5% of GDP vs 2.2%). However, the new Government, after taking office in June 2018, commissioned an independent evaluation to the AReF. Following its conclusions, the Government informed the European Commission about its concerns regarding the feasibility of achieving this rate, proposing a realistic deficit target of 2.7%, consistent with the European Commission's forecast. Finally, favourable developments in revenues and expenditure restraint have made it possible to end 2018 with a lower-than-expected deficit of 2.5% of GDP. The three-tenths difference between the public deficit observed and that initially forecast by the Stability Programme submitted in April 2018 is mainly due to the real and



nominal growth of public consumption derived from the 2018 General State Budget approved by Parliament in May of that year.

## ANNEX

**Methodology, economic models and assumptions underlying the macroeconomic and budgetary forecasts contained in the Stability Programme.**

Estimation technique	Phase of the process in which it is used	Relevant features of technique/model used
Short-term forecast equation models	Preparation of macroeconomic scenario under no-policy change assumption	Multi-factor model and transfer functions
Long-term forecast equation models	Preparation of macroeconomic scenario under no-policy change assumption	Co-integration error correction models
REMS model	Analysis of fiscal and macroeconomic impact of new measures	General dynamic equilibrium macroeconomic model
Tax revenue forecasts	Basis for the fiscal Budgetary Plan and the General Budgetary Plan and quantification of the General State Draft Budget and calculation of the fiscal effect of measures	Microsimulation models based on macroeconomic provisions and analysis of temporal statistical series
Expenditure forecasts	Basis of Budgetary Plan and General State Draft Budget	The expenditure forecasts are based on compliance with fiscal rules, on the sectoral budgetary proposals, the analysis of the time statistical series and on the measures adopted by the Government in relation to, among other, public sector personnel and pension policies
Fiscal effort forecasts	Estimation of structural effort and break-down by ESA subsectors	European Commission methodology developed in the Output Gap Working Group

## ANNEX: TABLES

Table A.1. Amounts to be excluded from the expenditure benchmark

	2018	2018	2019	2020	2021	2022
	Level (millions €)	% of GDP				
Expenditure on EU Programs fully funded with EU funds	6,584	0.54	0.45	0.44	0.43	0.42
<i>Of which, fully financed investments with EU funds</i>	3,937	0.33	0.24	0.23	0.23	0.23
Cyclical expenditure on unemployment benefits	-540	-0.04	-0.13	-0.20	-0.26	-0.29
Interest expenditure	29,752	2.46	2.37	2.27	2.20	2.16

Source: Ministry of Finance.

Table A.2. Expenditure by functions

Functions	COFOG Code	2016	2017	2018	2019	2020	2021
		% of GDP					
1. General public services	1	5.6	5.6	5.5	5.4	5.2	5.1
2. Defense	2	0.9	0.9	0.9	0.9	0.9	0.9
3. Public order and safety	3	1.8	1.8	1.8	1.8	1.8	1.8
4. Economic affairs	4	3.8	4.0	3.7	3.6	3.6	3.6
5. Environmental protection	5	0.9	0.9	0.9	0.9	0.8	0.9
6. Housing and community amenities	6	0.4	0.5	0.4	0.4	0.4	0.4
7. Health *	7	6.0	6.0	6.0	6.0	6.0	6.0
8. Recreation, culture and religion	8	1.1	1.1	1.1	1.1	1.0	1.0
9. Education *	9	4.0	4.0	4.0	4.0	4.0	4.0
10. Social protection	10	16.6	16.7	16.8	16.9	17.0	17.1
<b>11. Total expenditure</b>	<b>TE</b>	<b>41.0</b>	<b>41.3</b>	<b>41.1</b>	<b>41.0</b>	<b>40.7</b>	<b>40.7</b>
<p>* These figures collect the evolution of trend expenditure, which is expected to increase as a result of the reform of the territorial financing system.  Source: Ministry of Finance.</p>							