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CORRIGENDUM

This document corrects document SWD(2022) 631 final of 23.05.2022.
Correction of figures in table 2.1.

The text shall read as follows:

COMMISSION STAFF WORKING DOCUMENT

In-depth review for Spain

in accordance with Article 5 of Regulation (EU) No. 2011/1176 on the prevention and correction of macroeconomic imbalances

Accompanying the document

COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT, THE COUNCIL, THE EUROPEAN CENTRAL BANK, THE EUROPEAN ECONOMIC AND SOCIAL COMMITTEE, THE COMMITTEE OF THE REGIONS AND THE EUROPEAN INVESTMENT BANK

2022 European Semester – Spring Package

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EN EN

On the basis of this in-depth review for Spain undertaken under Regulation (EU) No 1176/2011 on the prevention and correction of macroeconomic imbalances, the Commission has considered in its Communication "European Semester – 2022 Spring Package" (COM(2022)600 final) that:

Spain is experiencing imbalances. Vulnerabilities relate to high external, government and private debt, in a context of high unemployment, and have cross-border relevance. In 2021, debt-to-GDP ratios resumed their declining trends observed before the pandemic and are forecast to fall further this year and next. The current account records a small surplus and the net international investment position has reached its best reading since the mid-2000s. Yet private debt remains higher than before the COVID-19 crisis, still exceeding prudential levels, while the high government debt-to-GDP ratio remains well above its pre-pandemic level. Non-performing loans continued to decrease, but some risks remain especially in energy-intensive sectors and those that were previously hit hard by the COVID-19 crisis. Unemployment started to decrease again in 2021, but labour market segmentation and youth unemployment remain high, although past and recent labour market reforms and the continued implementation of the RRP will help address Spain's remaining vulnerabilities.

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1. INTRODUCTION

In 2021, over the previous annual cycle of surveillance under the Macroeconomic Imbalances Procedure (MIP), the Commission identified "macroeconomic imbalances" in Spain. ([1]) These imbalances were related to high external and internal debt, both public and private, in a context of still high unemployment and had cross-border relevance. The 2022 Alert Mechanism Report concluded that a new in-depth review (IDR) should be undertaken for Spain with a view to assess the persistence or unwinding of imbalances. ([2])

The economic recovery from the COVID-19 crisis has gained momentum, but new risks appear on the horizon. ([3]) The outbreak of pandemic halted six years of strong economic growth and dynamic job creation, as between 2013 and 2019. This cycle came to an abrupt end in 2020, when Spain experienced the largest GDP contraction (10.8%) in the EU. However, with the economic recovery, real GDP increased by 5.1% in 2021. GDP growth is forecast at 4.0% in 2022 and 3.4% in 2023. The external sector will be the main driver of GDP growth in 2022 while the domestic demand in 2023. Russia's invasion of Ukraine has placed a further drag on the economy, due to the continuous disruption in supply chains and the surge in energy prices. As a result, the recovery of the pre-pandemic level of output is expected to be delayed until mid-2023. Inflation has picked up to 3.0% in 2021 and is forecast at 6.3% in 2022 driven by supply bottlenecks, higher energy prices and disruptions associated with the war in Ukraine (see also box 2.1).

This in-depth review presents the main findings of the assessment of imbalances. The assessment is backed by a thematic section on corporate debt developments. Spillovers and systemic cross-border implications of imbalances are also taken into account. In addition, assessments of structural issues made in previous IDRs and in the context of fiscal assessments are also considered if relevant. The MIP assessment matrix is published in the 2022 Country Report for Spain. ([4])

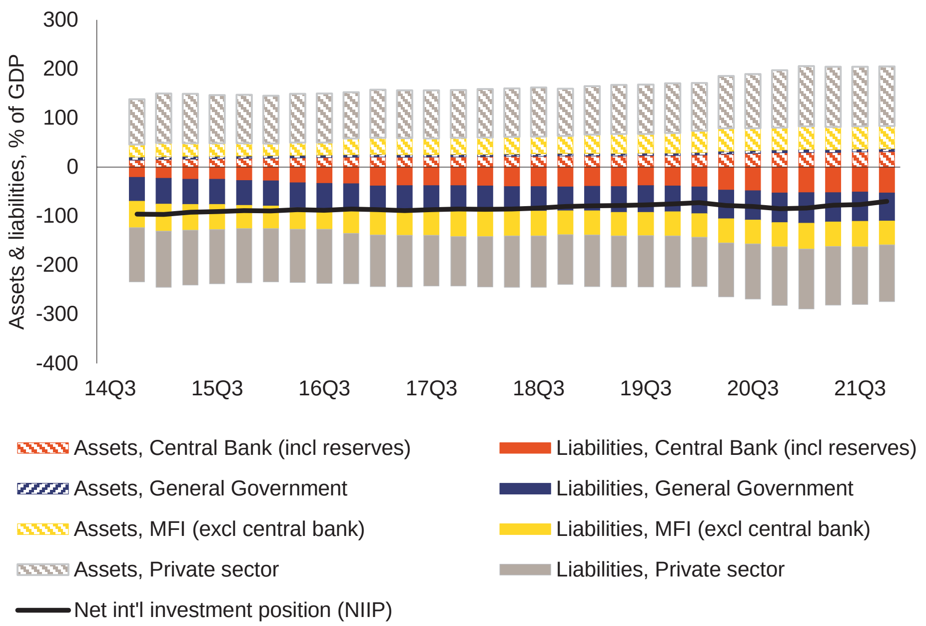
([1]) European Commission (2021), European Semester Spring Package 2021, COM(2021) 500 final.
([2]) European Commission (2021), Alert Mechanism Report 2022, COM (2021) 741 final.
([3]) Forecast data are from European Commission (2022), European Economic Forecast: Spring 2022, Institutional Paper 172.
([4]) European Commission (2022), Country Report Spain 2022, SWD(2022)610 final.

2. ASSESSMENT OF MACROECONOMIC IMBALANCES

Assessment of gravity, evolution and prospects of macroeconomic imbalances

Spain's net international investment position (NIIP) continued to improve after a temporary reversal during the COVID-19 crisis, yet it remains at fairly negative levels. The net international investment position improved since its trough of -98% of GDP in 2009, to -75% at the end of 2019. Due to the COVID-19 pandemic, it temporarily dropped, to -84.9% in 2020. The NIIP improved strongly in 2021 to -70%, to reach its highest value since 2005 although it remains beyond prudential and fundamental benchmarks. Against this backdrop, the composition of Spain's external liabilities helps mitigating some of the vulnerabilities. A large part of external debt is composed of government debt and central bank debt (largely Target2 liabilities) stemming from monetary operations of the Eurosystem, which entails a considerably lower refinancing risk than that of the debt held by the private sector. Moreover, the NIIP excluding non-defaultable instruments (NENDI), accounting for the riskiest categories of external liabilities, stood at -40% of GDP in 2021. The improvement of the NENDI (37 pps) between 2011 and 2019, during which it surpassed the NIIP prudential threshold, has been faster than that of the NIIP (24 pps). This reflects refinancing towards net foreign direct investment (FDI), which contributes to reducing the overall degree of vulnerability.

Graph 2.1: **Decomposition of Net International Investment Position (NIIP) by sector, Spain**



Source: Eurostat

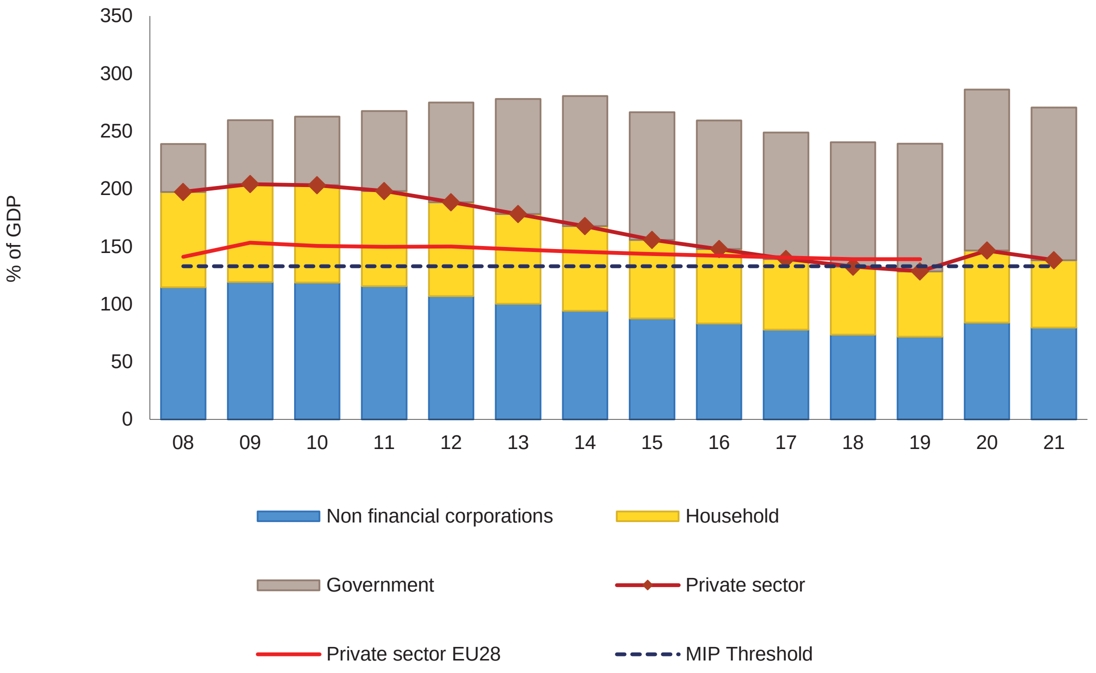
Spain's current account surplus is forecast to return to its pre-pandemic levels and reach 1.8% of GDP in 2022 and 2.1% in 2023. The sharp contraction of GDP and heavy dependence on tourism deteriorated the current account balance throughout the pandemic crisis, albeit remaining in positive territory, dropping from 2.1% in 2019 to 0.8% in 2020 and 0.9% in 2021. The revenue share accruing from tourism is expected to bounce back over the next years on the back of the gradual normalization of international travel, although new disruptions on the horizon (notably, the fallout from the Russian invasion of Ukraine) risk to delay further the return to pre-crisis levels of tourism inflows. The dependence of Spain on imports from Russia is limited though (see box 2.1). Overall, the adjustment perspectives appear favourable. The current account balance required to stabilise the NIIP above the threshold of -35% over the next 20 years is estimated at -0.8% of GDP. The current account norm explained by fundamentals is estimated to be 1.2%, compared to a cyclically adjusted current account balance estimated at -0.9% in 2021.

The Spanish economy is expected to regain cost competitiveness within the forecast horizon. After a decade declining (by -8.0% between 2009 and 2018), real unit labour costs (ULC) picked up by 1.6% in 2019, driven by the strong increase of the statutory minimum wage by 22.3% and losses in real productivity. As in all EU countries, the change in real ULCs in 2020 (+3.8%) is difficult to interpret, as the job retention schemes put in place by national governments during the COVID-19 pandemic manifests in a deterioration in productivity figures. Following a slight reduction in 2021 (-1.4%) — real ULC are expected to return to their 2019 level over the forecast horizon with further decreases in 2022 and 2023, under the assumption of a limited transmission of inflationary pressures to wages.

Private sector deleveraging needs remain for both corporations and households, despite a significant reduction of debt since 2009. On the back of positive GDP growth up until the end of 2019, the stock of private debt was on a declining trend since its peak of 204% of GDP in 2009. Due to the COVID-19 pandemic and the associated drop in tourism and the implementation of diverse support measures aimed at mitigating its impact, the private debt ratio reached 146% of GDP in 2020, up by 18 pps compared to 2019. The corporate debt ratio registered a more pronounced increase than the household debt ratio (12% of GDP vs 6%). Risks persist that the phase-out of state-support measures and potential second-round effects on economic growth from Russia's unprovoked invasion of Ukraine could lead to further vulnerabilities associated to private sector debt.

Private debt deleveraging is expected to resume with a pick-up in economic activity. In the last quarter of 2021, the consolidated debt of non-financial corporations' (NFCs) amounted to 80%, while household debt totalled 58% of GDP. Debt ratios for both corporates and households remain above prudential levels and fundamental benchmarks according to Commission estimates. Moreover, excessive corporate indebtedness emerging from the COVID-19 crisis could have adverse consequences for a steady recovery, especially for those firms operating in sectors considerably hit by the economic fallout of the pandemic, including also tourism (see section 3 on private indebtedness). Whilst the borrower relief measures and the public guarantee schemes implemented during the crisis by the authorities have prevented further financial distress to borrowers and corporates and mitigated the impact of the pandemic on banks' balance sheets by safeguarding asset quality, uncertainty remains about the impact of their phasing out on the economy. Nevertheless, the close monitoring of asset quality developments remains warranted, as the rising pockets of vulnerabilities could be a source of credit deterioration in the future. Household debt is expected to recover to pre-crisis levels by 2022 and is likely to resume its gradual decline that was underway since 2010.

Graph 2.2: **Decomposition of debt by sector (consolidated)**



Source: Eurostat

General government debt resumed its downward path, after a temporary increase in 2020. The general government debt to GDP ratio was on a declining trend until 2019, standing at 98.3% of GDP from 105.1% of GDP in 2014. After peaking at 120% of GDP in 2020, due to the economic contraction and the deployment of government support measures associated to the COVID-19 crisis, it slightly eased to 118.4% of GDP in 2021. The general government debt to GDP ratio is forecast to decline to 115.1% in 2022 and 113.7% in 2023.

According to the Commission's fiscal sustainability assessment, Spain faces high fiscal sustainability challenges over the medium term and medium challenges over the long term. The debt sustainability analysis shows that government debt is projected to remain at a high level in the baseline scenario. This debt path is sensitive to possible shocks to fiscal, macroeconomic and financial variables, as illustrated by alternative scenarios and stochastic simulations, most pointing to high risks. Over the long term, Spain faces medium sustainability risks. To stabilise debt over the long term, it will be necessary to address the unfavourable initial budgetary position and future budgetary pressures stemming from population ageing related to health care and long-term care expenditure. The relinking of pensions to inflation may pose further challenges to the long-term sustainability, which are expected to be only partially offset by measures encouraging longer working lives, contained in the Plan. The introduction of additional offsetting measures to be implemented in 2022 is needed to mitigate the remaining risks.

The main headwinds ahead affecting public debt developments are related to the return of market interest rates to higher levels coupled with additional inflationary pressure. Given long-term average maturities, an increase in average funding costs, currently at historically low levels, would take a number of years to result in significant increases in the interest burden. High inflation, while potentially leading to a depreciation of borrowers' stock of debt and to higher government tax revenues could also result in expenditure pressure. The investor base of Spanish bonds remains broad and diversified. However, Spain would need to establish a credible consolidation path in order to bring down its structural deficit in the medium-term and anchor expectations of future fiscal developments. Based on data from the Treasury, owing to the projected decline in net issuance in 2022, total gross financing needs are expected to decline to EUR 237 billion (around 18.2% of GDP) in 2022, that is 10% and 31% lower than in 2021 and 2020, respectively.

Despite decreasing rapidly in 2021, the unemployment rate remains high, particularly among the young. The outbreak of the pandemic at the beginning of 2020 halted seven years of decline of the unemployment rate (from 26.1% in 2013 to 14.1% in 2019). The unemployment rate jumped up by 3 pps. in the first six months of the crisis, with job losses mostly affecting workers on temporary contracts. Following the initial shock, the extension of the short-time work schemes (ERTEs) deployed at the beginning of the pandemic, coupled with a gradual job-rich recovery of the economy, allowed a fast-paced recovery of the labour market. The unemployment rate fell to 13.6% in the fourth quarter of 2021, the lowest rate in 13 years. However, this is still among the highest in the EU and particularly related to young workers under 25 (31.4%). Moreover, the long-term unemployment rate remains above pre-pandemic levels. The annual unemployment rate is forecast to decline from 14.8% in 2021 to 13.4% in 2022 and 13.0% in 2023.

Strong labour market segmentation is a particular vulnerability of the Spanish economy. In 2021, 25.1% of employees in Spain worked on a temporary contract, among the highest rates in the EU. Widespread use of temporary contracts affects the public sector (30.9%) even more extensively than the private one (23.6%). In addition, the rate of involuntary part-time workers is twice as big as the EU average. The large pool of vulnerable workers in the Spanish labour market makes it sensitive to exogenous shocks and undermines accumulation of human capital, thereby having a negative impact on productivity. The correction of this challenge would increase labour market resilience and would lift the potential output of the economy.

Assessment of MIP relevant policies

Since 2021, Spain deployed a number of policy initiatives in order to cushion its immediate impact on the economy and mitigate its medium-term implications. Those measures included actions undertaken at the national level in response to the COVID-19 crisis, as well as of the broader strategy designed at the EU level under the Recovery and Resilience Facility (RRF), together with Cohesion Policy Funds. Significant policy progress – both within and outside of the framework of the Plan – was initiated across a number of areas, including accelerating the deleveraging process in the private sector and favouring a reduction of the high level of unemployment.

The comprehensive nature of the Spanish Recovery and Resilience Plan (RRP) constitutes a unique opportunity to foster policy progress in the areas affected by macroeconomic imbalances. The wide-ranging reforms and investments contained in the Plan cover all the major vulnerabilities depicted across diverse policy fields, making the RRP a pivotal tool contributing to a faster reduction of the imbalances. Interventions in the areas of public and private finances, business productivity and labour market are particularly relevant.

A number of measures may help to address the high levels of private and external debt, also by increasing the competitiveness of the business sector. SMEs will benefit from improved access to finance in form of guarantees via the '*Compañia Española de Reafianzamiento'* (CERSA). CERSA will allow access to long-term financing and working capital helping to reduce debt overhang on businesses. The guarantees will be granted to SMEs by end-2023. The Plan also includes a set of actions, expected to enter into force in the second quarter of 2022, intended to facilitate preventive debt restructuring and debt relief for natural persons, with the goal of preventing insolvency situations and facilitate resource reallocation. Reforms and investments favouring renewable energy and energy efficiency can reduce dependency on energy imports and contribute to reducing external debt.

A gradual consolidation of public finances and the broadening of the tax base could help address Spain's structural deficits. In this sense, the RRP promotes further rounds of spending reviews to increase the share of public revenues, while, with the aim of establishing a more efficient tax system, a package of measures, including combating tax fraud and a wide-ranging tax reform is underway and expected to be approved by beginning of next year. Furthermore, by year-end, the National Procurement Strategy designed to improve the efficiency and sustainability of public procurement, is scheduled to be adopted. The relinking of pensions to inflation poses additional risks to the long-term fiscal sustainability, unless the offsetting measures foreseen by the Plan and to be introduced in 2022 are forceful enough to mitigate these risks.

The successful implementation of the ongoing labour market reforms envisaged in the RRP is expected to contribute to a more efficient functioning of the labour market. The extension in scope and size of short-time work schemes ('ERTEs') during the pandemic strongly mitigated the effects of the COVID-19 crisis on the labour market and bolstered a faster recovery**.** Building on this favourable experience, to support firms and workers in transition, the Government has created the RED mechanism ([5]), which became operational in April 2022. Although some of its aspects still need to be further specified, the new mechanism is expected to reduce structural unemployment and improve the adjustment process of the economy. Additionally, another reform approved in December 2021 under the RRP aims at reducing the use of temporary contracts in order to generalise the use of open-ended contracts ([6]). This measure is set to favour the correction of labour market duality, which is also key to boost labour productivity in the medium to long term. It should also lead to an increase in social cohesion and to a reduction of at-risk-of-poverty rates.

High regulatory fragmentation and low innovation capacity of firms and regions continue to adversely affect growth and productivity. Boosting productivity is essential for SMEs, which make up a large share of businesses in Spain compared to other large EU Member States. In this regard, despite the fact that RRP foresees some measures expected to positively affect the development of an industry-services ecosystem and to boost entrepreneurship, an additional effort to improve the business environment, reduce regulatory barriers and facilitate the growth of businesses could greatly increase their competitiveness in domestic and foreign markets.

Conclusion

Spain is facing vulnerabilities relating to high external and internal debt, both government and private, in a context of high unemployment, and which have cross-border relevance. After the initial shock caused by the COVID-19 pandemic, in 2021 external and private debt to GDP ratios resumed their gradual decline observed before the pandemic, supported by the rebound in GDP growth. Private debt ratios are still higher than before the COVID-19 crisis, primarily due to the magnitude of the impact of the COVID-19 crisis on Spain. The net international investment position recovered in 2021, and reached its highest level since 2005, although more improvement is needed given its size. The current account has been in surplus in recent years, though it narrowed in 2020 and 2021. The government debt to GDP ratio stood at 118.4% of GDP in 2021, marginally lower than in 2020 but still well above its 2019 level. The Spanish financial system remains resilient and asset quality has been preserved during the pandemic. The NPL ratio for corporates decreased to 4.29% in December 2021, down from 4.51% at the end of December 2020 ([7]), according to data from the Spanish Central Bank. Nonetheless, certain risks related to the rise of contingent liabilities stemming from the sizable value of public guarantees deployed during the COVID-19 crisis call for close monitoring in the coming months. The unemployment rate started to decrease again in 2021, but labour market segmentation and youth unemployment remain high. Going forward, the stocks of internal and external debts are expected to continue moderating. Against this backdrop**,** the war in Ukraine is expected to lead to a slow-down in economic activity and might pose an additional challenge to corporate sector, especially in energy-intensive industry, transport and construction. Moreover, consumption and investment decisions could be also affected due to the persisting high levels of energy prices, high inflation and uncertainty about the geopolitical situation. The dependence on Russian imports is rather limited, but exposure to increases in energy prices is a pressing concern (see box 2.1). Altogether, these developments could affect the ongoing consolidation process and delay the further reduction of debt ratios.

A number of policy initiatives have the potential to accelerate the deleveraging process in the private and public sector, depending on their effectiveness and speed of their implementation. The RRP, thanks to its cross-cutting nature and scope has the potential to provide significant impetus for addressing Spain's macroeconomic vulnerabilities and raise the competitiveness of Spain's business sector. The measures implemented so far, and planned until 2023 include actions improving access to finance for SMEs and measures intended to facilitate preventive debt restructuring and debt relief for

([5]) [2]) The RED mechanism is a new employment flexibility and stabilisation mechanism created with the objective to establish a permanent scheme to adjust to cyclical and structural shocks, by covering the suspension or reduction of working time through an employment regulation plan that includes the requirement to improve or retrain workers in the skills identified as being in demand. The scheme has two modalities: one for cyclical macroeconomic shocks, and the other for sectoral transformation.

([6]) Although it is still early to draw conclusions, initial data point at a declining trend in the use of temporary contracts. Their share in the total number of new contracts has decreased from 90% in December 2021 to 52% in April 2022.

([7])) The level of NPLs for the total economy stood at 2.8% at the end of 2020 and increased to 2.9% at the end of 2021 natural persons. The lower projected fiscal deficit, coupled with measures aimed at improving the efficiency of both the expenditure and revenue side are expected to contribute to accelerating the downward trajectory of public debt. Strong current account surpluses over the next years will be essential to reduce the stock of external liabilities. High regulatory fragmentation and low innovation capacity of firms and regions continue to adversely affect growth and productivity. The ongoing labour market reforms are expected to reduce segmentation and boost labour productivity, notably by upskilling and reskilling of the labour force.

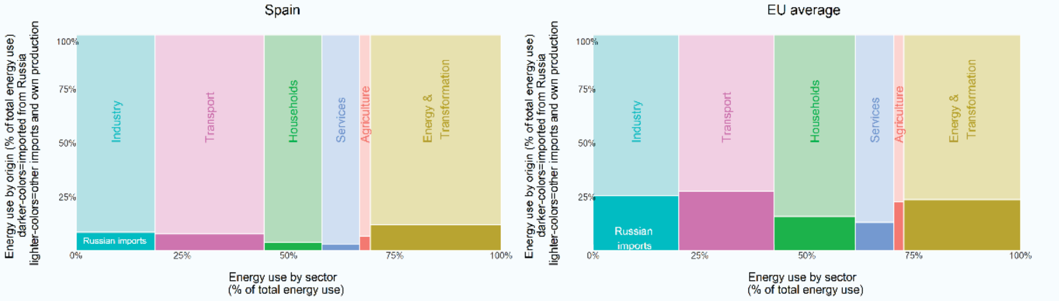
Based on the findings in this in-depth review, the Communication "European Semester – 2022 Spring Package" ([8]) sets out the Commission's assessment as to the existence of imbalances or excessive imbalances in Spain, in line with Regulation 1176/2011.

([8]) European Commission (2022), European Semester Spring Package 2022, COM(2022)600 final.

Box 2.1: Exposures to the commodity price surge, and to Russia

This box reviews and summarizes the risks for the macroeconomic vulnerabilities in Spain related to the increase in commodity prices, and the magnitude of exposures to the Russian economy. The surge in commodity prices since 2021 has been aggravated by the Russian military aggression against Ukraine. Available data suggests that the exposure to sharp increase in energy prices is a pressing concern, however, the dependence on Russian imports is rather limited. Given also the moderate financial links to Russian entities, exposure to Russia is not expected to have a significant impact on the Spanish economy over the medium term.

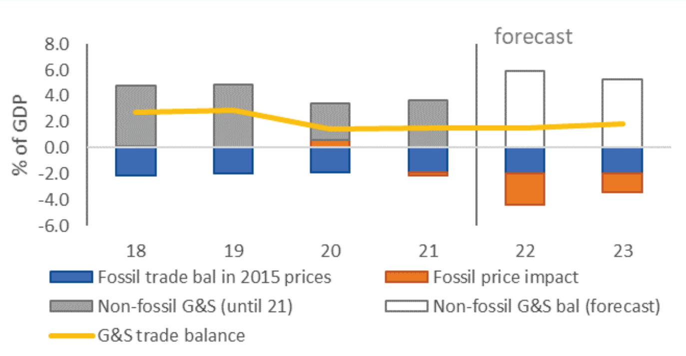
Graph b.1.1: Sectoral distribution of energy use and of energy imported from Russia



Notes: The left panel displays the distribution of primary energy usage in Spain according to Eurostat energy balances. The horizontal axis displays the relative importance of energy-consuming sectors. The vertical axis displays the importance of energy importance from Russia in satisfying that need. Note that this dependence on Russia differs according to sector's use of natural gas vs oil and coal. For comparison, the right hand panels displays the same concept for the EU aggregate. Russian imports include oil and petroleum products,natural gas and solid fossil fuels.
Sources: Eurostat and European Commission services calculations

The distribution of energy use by sector is roughly comparable to the EU average. The exceptions include transport and especially energy production sectors, for which the share of energy consumption in Spain is slightly higher than in the EU (Graph b.1.1). Overall, the reliance across different sectors to energy imports from Russia is limited, including on imports of natural gas (see Table b.1.1). Therefore, the current energy crisis is affecting the economy chiefly through price increases, while to a much lesser extent it is due to potential supply disruptions.

Graph b.1.2: Spain goods and service trade balance – fossil trade contribution



Notes: The graph displays the trade balance as % of GDP, and highlights net trade of petroleum products, natural gas and solid fossil fuels (mainly coal), in 2015 import prices. The 'fossil price impact' component details the impact of price changes on the (also changing) real trade balance. 2022 and 2023 figures reflect central assumptions of the Commission spring forecast, notably combining the forecasted fossil price evolution with broadly forecasted import quantities of fossil energy sources.

The fuel price surge is likely to have a strong impact on the trade balance. The commodity price increase is expected to depress the trade balance by around 4 pp. of GDP in 2022 (see Graph b.1.2). Nonetheless, the current account is likely to remain in surplus.

Spain's financial links to Russian entities are moderate and do not represent a source of concern. Table b.1.1 shows that FDI, portfolio and other investment assets held in and towards Russia are well below the EU average. Exposures to Russian commodities are also limited and the imports of gas and oil from Russia take place on a smaller scale. In terms of energy mix, Spain is planning to phase out the use of coal and limit the scale of nuclear sources in power generation, with renewable energy largely filling the gap. While oil will continue to play a role in the Spanish energy mix for the next decade, a drop of the gas share is envisaged by 2030. On the other hand, the tourism sector can be affected more prominently as the share of Russian tourists was not negligible, even if still below the EU average.

Table b.1.1: Selected exposures

Trade & financial exposures	unit	ES	EU
Domestic value added embodied in exports to Russia	% of GDP	0.3%	0.4%
Non-energy Russian import content in final demand	% of GDP	0.2%	0.4%
Russian tourist nights spent	% of total 2019	2.0%	2.7%
FDI assets held in Russia	% of 2020 GDP	0.1%	2.5%
Portfolio & other inv. assets held in Russia	% of 2020 GDP	0.1%	0.9%
FDI liabilities towards Russia	% of 2020 GDP	0.3%	1.2%
Portfolio & other inv. liabilities towards Russia	% of 2020 GDP	0.2%	1.1%
Consolidated banking exposures towards Russia	% of 2021 GDP	0.1%	0.5%

Energy mix	unit	ES	EU
Solids fossil fuels (incl. peat)	% of gross inland consumption 2020	2.8%	10.8%
Oil and petroleum products	% of gross inland consumption 2020	41.0%	32.7%
Natural gas	% of gross inland consumption 2020	25.0%	24.4%
Renewables and waste	% of gross inland consumption 2020	17.6%	19.0%
Nuclear	% of gross inland consumption 2020	13.6%	13.1%
Commodity exposures	**unit**	**ES**	**EU**
Net petroleum imports from all countries	% of GDP 2021	1.4%	1.2%
Crude oil imports from Russia '20	% of oil imports	1.8%	25.7%
Net gas imports from all countries	% of GDP 2021	0.7%	0.6%
Gas imports from Russia '20	% of gas imports	10.4%	43.6%

Data sources: Eurostat for commodity exposures, European Commission Figaro for value-added exposures, BIS for consolidated banking exposures, European Commission FinFlows for other financial exposures. Energy gross inland consumption excludes net imports of electricity and derived heat.

Table 2.1: **Selected economic and financial indicators (Part 1), Spain**

								forecast	
all variables y-o-y % change, unless otherwise stated	2003-07	2008-12	2013-17	2018	2019	2020	2021	2022	2023
Real GDP	3.5	-1.3	1.9	2.3	2.1	-10.8	5.1	4.0	3.4
Potential growth (1)	3.6	1.2	0.2	0.8	1.0	0.2	0.5	1.2	1.3
Contribution to GDP growth:									
Domestic demand	4.7	-3.0	1.4	2.6	1.8	-8.2	4.1	2.0	3.4
Inventories	0.0	-0.2	0.2	0.3	-0.2	-0.5	0.5	0.0	0.0
Net exports	-1.2	1.8	0.3	-0.6	0.5	-2.2	0.5	2.0	0.0
Contribution to potential GDP growth (1):									
Total Labour (hours)	1.7	0.1	-0.2	0.2	0.5	0.1	0.1	0.6	0.5
Capital accumulation	1.7	0.7	0.2	0.4	0.5	0.3	0.3	0.5	0.6
Total factor productivity	0.2	0.4	0.2	0.1	0.0	-0.1	0.0	0.1	0.2
Output gap (2)	3.4	-4.3	-5.2	1.0	2.1	-9.1	-4.9	-2.2	-0.2
Unemployment rate	9.7	19.1	21.9	15.3	14.1	15.5	14.8	13.4	13.0
Harmonised index of consumer prices (HICP)	3.2	2.3	0.5	1.7	0.8	-0.3	3.0	6.3	1.8
GDP deflator	3.8	0.5	0.5	1.2	1.3	1.1	2.2	3.7	2.4
External position									
Current account balance (% of GDP), balance of payments	-7.0	-3.9	2.3	1.9	2.1	0.8	0.9	1.8	2.1
Trade balance (% of GDP), balance of payments	-4.4	-0.9	3.5	2.7	2.9	1.5	1.5	.	.
Primary income balance (% of GDP)	-1.5	-1.7	-0.2	0.1	0.2	0.6	0.5	.	.
Secondary income balance (% of GDP)	-1.1	-1.3	-1.0	-1.0	-1.0	-1.2	-1.1	.	.
Current account explained by fundamentals (CA norm, % of GDP) (3)	-1.9	-0.7	0.6	1.2	1.3	1.3	1.2	1.4	1.6
Required current account to stabilise NIIP above -35% of GDP over 20Y (% of GDP) (4)	-0.3	1.6	0.0	-0.1	-0.2	-0.3	-0.8	-0.8	-0.6
Capital account balance (% of GDP)	0.6	0.4	0.4	0.5	0.3	0.4	0.9	.	.
Net international investment position (% of GDP)	-66.5	-91.3	-89.7	-80.1	-75.0	-84.9	-70.0	.	.
NENDI - NIIP excluding non-defaultable instruments (% of GDP) (5)	-35.6	-71.8	-64.7	-52.7	-46.8	-52.4	-40.0	.	.
Net FDI flows (% of GDP)	3.3	0.1	1.0	-1.4	0.5	1.7	-0.8	.	.
Competitiveness									
Unit labour costs (ULC, whole economy)	3.4	0.4	-0.3	1.5	3.0	6.1	0.2	2.1	1.2
Nominal compensation per employee	2.9	2.0	0.4	1.6	2.3	-1.4	2.9	3.3	3.5
Labour productivity (real, hours worked)	0.5	1.7	0.8	-0.2	0.2	-0.3	-1.8	0.5	1.7
Real effective exchange rate (ULC)	2.4	-1.7	-0.9	1.2	-0.1	.	.	.	.
Real effective exchange rate (HICP)	1.2	-0.5	-0.2	2.0	-1.6	0.7	0.7	.	.
Export performance vs. advanced countries (% change over 5 years)	8.6	-4.4	-1.4	2.0	0.8	-6.4	.	.	.
Private sector debt									
Private sector debt, consolidated (% of GDP)	158.6	198.3	157.7	132.7	128.6	146.5	138.3	.	.
Household debt, consolidated (% of GDP)	70.1	83.2	69.0	59.0	56.9	62.4	58.4	.	.
Household debt, fundamental benchmark (% of GDP) (6)	35.5	46.5	47.8	43.4	42.8	48.5	46.6	.	.
Household debt, prudential threshold (% of GDP) (6)	49.1	42.0	38.8	41.1	41.8	40.8	40.8	.	.
Non-financial corporate debt, consolidated (% of GDP)	88.5	115.1	88.7	73.7	71.7	84.1	79.8	.	.
Corporate debt, fundamental benchmark (% of GDP) (6)	39.8	49.0	55.3	52.5	51.9	58.6	56.6	.	.
Corporate debt, prudential threshold (% of GDP) (6)	60.3	57.3	55.0	57.0	57.5	57.4	57.4	.	.
Private credit flow, consolidated (% of GDP)	25.3	-0.7	-3.8	0.0	1.1	4.4	2.4	.	.
Corporations, net lending (+) or net borrowing (-) (% of GDP)	-3.4	5.9	6.6	5.0	3.7	6.1	7.2	7.2	7.3
Households, net lending (+) or net borrowing (-) (% of GDP)	-3.9	-0.2	1.2	-0.1	1.7	6.1	1.6	0.5	0.3
Net savings rate of households (% of net disposable income)	3.9	4.6	2.8	1.4	4.2	10.8	.	.	.

(e) estimate based on ECB quarterly data
(1) Potential output is the highest level of production that an economy can reach without generating inflationary pressures. The methodology to compute the potential output is based on K. Havik, K. Mc Morrow, F. Orlandi, C. Planas, R. Raciborski, W. Roeger, A. Rossi, A. Thum-Thysen, V. Vandermeulen, The Production Function Methodology for Calculating Potential Growth Rates & Output Gaps, COM, European Economy, Economic Papers 535, November 2014.
(2) Deviation of actual output from potential output as % of potential GDP.
(3) Current accounts in line with fundamentals ("current account norms") are derived from reduced-form regressions capturing the main determinants of the saving-investment balance, including fundamental determinants, policy factors and global financial conditions. See L. Coutinho et al. (2018), "Methodologies for the assessment of current account benchmarks", European Economy, Discussion Paper 86/2018, for details.
(4) This benchmark is defined as the average current account required to reach and stabilise the NIIP at -35% of GDP over the next 20 years. Calculations make use of Commission's T+10 projections.
(5) NENDI is a subset of the NIIP that abstracts from its pure equity-related components, i.e. foreign direct investment (FDI) equity and equity shares, and from intracompany cross-border FDI debt, and represents the NIIP excluding instruments that cannot be subject to default.
(6) Fundamentals-based benchmarks are derived from regressions capturing the main determinants of credit growth and taking into account a given initial stock of debt. Prudential thresholds represent the debt threshold beyond which the probability of a banking crisis is relatively high, minimising the probability of missed crisis and that of false alerts. Methodology to compute the fundamentals-based and the prudential benchmarks based on Bricongne, J. C., Coutinho, L., Turrini, A., Zeugner, S. (2019), "Is Private Debt Excessive?", Open Economies Review, 1- 42.
Source: Eurostat and ECB as of 2022-05-02, where available; European Commission for forecast figures (Spring forecast 2022)

Table 2.2: **Selected economic and financial indicators (Part 2), Spain**

all variables y-o-y % change unless otherwise stated	2003-07	2008-12	2013-17	2018	2019	2020	2021	forecast 2022	2023
Housing market									
House price index, nominal	14.2	-6.6	1.0	6.7	5.2	2.2	3.7	.	.
House price index, deflated	10.4	-8.2	0.4	5.2	4.1	2.2	1.7	.	.
Overvaluation gap (%) (7)	21.1	14.9	-9.0	2.9	5.5	8.5	11.8	.	.
Price-to-income overvaluation gap (%) (8)	18.6	18.1	-7.1	0.1	1.1	9.3	10.3	.	.
Residential investment (% of GDP)	11.1	6.9	4.3	5.4	5.9	6.0	5.4	.	.
Government debt									
General government balance (% of GDP)	1.0	-9.3	-5.3	-2.6	-3.1	-10.3	-6.9	-4.9	-4.4
General government gross debt (% of GDP)	42.1	62.7	102.7	100.5	98.3	120.0	118.4	115.1	113.7
Banking sector									
Return on equity (%)	.	1.1	6.1	8.3	6.8	-3.6	.	.	.
Common Equity Tier 1 ratio	.	9.4	12.4	13.5	13.8	14.7	.	.	.
Gross non-performing debt (% of total debt instruments and total loans and advances)	.	4.4	5.7	3.2	2.7	2.5	.	.	.
Gross non-performing loans (% of gross loans) (9)	.	.	6.1	3.7	3.1	2.8	2.9	.	.
Cost of borrowing for corporations (%)	4.1	3.6	2.4	1.7	1.5	1.5	1.3	.	.
Cost of borrowing for households for house purchase (%)	4.0	3.4	2.2	2.0	1.7	1.5	1.4	.	.

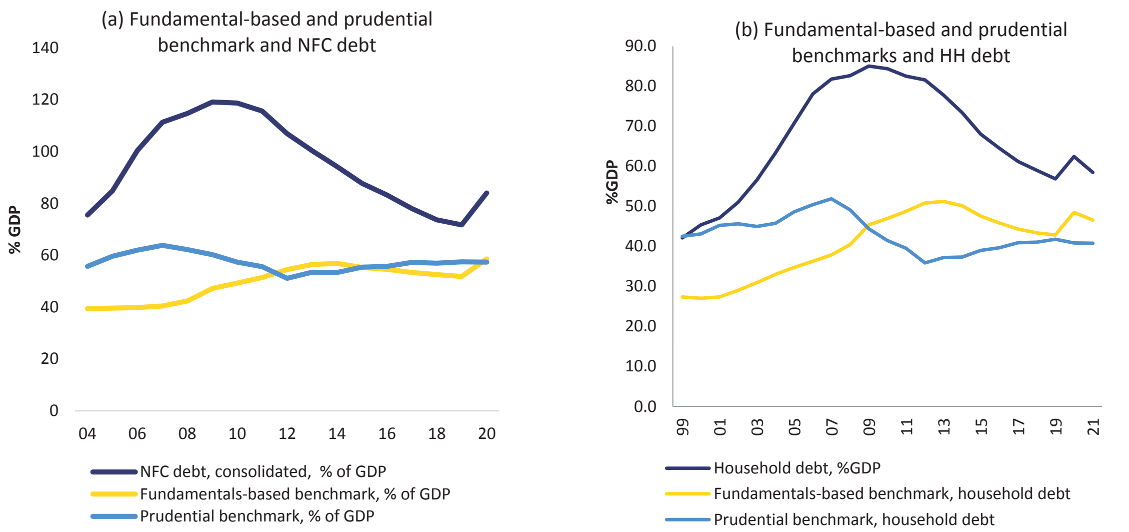
(7) Unweighted average of price-to-income, price-to-rent and model valuation gaps. The model valuation gap is estimated in a cointegration framework using a system of five fundamental variables; total population, real housing stock, real disposable income per capita, real long-term interest rate and price deflator of final consumption expenditure, based on Philiponnet, N., Turrini, A. (2017), "Assessing House Price Developments in the EU," European Economy - Discussion Papers 2015 - 048, Directorate General Economic and Financial Affairs (DG ECFIN), European Commission. Price-to-income and price-to-rent gaps are measured as the deviation to the long term average (from 1995 to the latest available year).
(8) Price-to-income overvaluation gap measured as the deviation to the long term average (from 1995 to the latest available year).
(9) Domestic banking groups and stand-alone banks, EU and non-EU foreign-controlled subsidiaries and EU and non-EU foreign-controlled branches.
Source: Eurostat and ECB as of 2022-05-02, where available; European Commission for forecast figures (Spring forecast 2022)

3. THEMATIC CHAPTER: PRIVATE INDEBTEDNESS

Non-financial corporate debt increased with the COVID-19 crisis, also because of the importance of the tourism for Spain and therefore warrants a more detailed analysis this year. Following the outbreak of the COVID-19 pandemic and the implementation of diverse support measures aimed at mitigating its impact, the private sector debt ratio accelerated in Spain. The private debt to GDP ratio increased during the crisis, to 146.5% in the last quarter of 2020. This increase reverted the declining trend observed from 2010 to 2019 and was steered by the increase of corporate indebtedness and, to a larger extent, by the sizeable fall in GDP experienced by Spain since the beginning of the pandemic. From the second quarter of last year, private indebtedness returned to a gradual downward path, reflecting the pick-up in economic activity since spring 2021.

Corporate indebtedness reached 84% of GDP in 2020, up by more than 12 pps compared to 2019, with sharper increase in tourism-related and communication sectors. The debt to GDP ratio for non-financial corporates level stood 27 pps above the prudential threshold and 26 pps above the fundamental benchmark in 2021, respectively (Graph 3.1). The household debt to GDP ratio stood 22 pps above the prudential threshold and 14 pps above the fundamental benchmark in 2021, respectively.

Graph 3.1: **Thematic Graphs: Private debt**



Source: European Commission services

NFC credit flows increased strongly with the COVID-19 crisis. NFC credit increased from 1.1% of GDP in 2019 to 4.8% in 2020. The ratio remained elevated in 2021, at 2.4%. Net corporate credit flows increased in light of marked revenue losses and perceived liquidity shortages in 2020, which also contributed to a strong increase in corporate deposit holdings. Credit standards for lending to non-financial corporations tightened moderately in the last quarter 2021 and further in the first quarter of 2022, mainly reflecting banks' higher risk perception and lower risk tolerance. Going forward, in the second quarter of 2022, credit standards are set to continue tightening, while demand for new loans is expected to decrease.

Vulnerabilities in the corporate sector remain and may only become visible with some delay after the COVID-19 crisis. According to balance sheet data on loan stocks from the European Banking Authority, at the end of 2020 bankruptcies in the accommodation and food sector were about 2.5 times higher than in 2015, and they started to decline only moderately from early 2021 onwards (Graphs 3.2.d). Bankruptcies in wholesale and industry also increased, but more moderately. In contrast, new business registrations dropped sharply at the beginning of the pandemic but returned quickly thereafter to levels comparable to before the crisis, with little differences across sectors. The share of corporate non-performing loans for the corporate sector as a share of total loans and advances was on a downward path until the beginning of the COVID-19 crisis, a trend that was not significantly affected by the outbreak of the pandemic. According to data from the Spanish Central Bank, NPL ratio for corporates stood at 4.51% in end-December 2020, before declining to 4.29% in December 2021.

The economic fallout from the pandemic and the subsequent recovery significantly differed across sectors. Real gross value added in trade, tourism and transport registered a y-o-y drop of roughly 50% in the second quarter of 2020. Gross value added in the manufacturing industry and construction also dropped markedly (around 25%), yet displaying an uneven recovery profile afterwards. While at the end of 2021 the industrial output was only 3% below its level in Q4-2019, the gap in construction was still 14% (Graph 3.2.a).

Fixed investment in equipment recovered, but investment in construction is lagging behind. Fixed investment in equipment is already above its pre-crisis levels. Some statistical issues seem to have amplified the poor performance of the construction sector in 2020-2021, due to the way in which the execution of a construction project is distributed over time in the national accounts. Uncertainty, reflecting the lingering pandemic, continues to be the biggest constraint to investment reported by SMEs and services in Spain, according to the EIB investment report. ([9])

Excessive corporate indebtedness could hamper investment and business growth in the upcoming future, affecting particularly those corporates particularly stressed by the economic fallout of pandemic. Particularly, as the public support measures are expected to be gradually phased out from the end of the first quarter of 2022, a number of businesses might encounter difficulties repaying the principal component of the government-guaranteed loans taken, leading to those loans being classified as stage 2 loans and thereby potentially facing insolvency situation. Given the sizeable value of public guarantees granted to the corporate sector during the COVID-19 crisis, the risk related to the rise of contingent liabilities in the coming months warrant close monitoring.

Tourism sector

Tourism continues to represent a highly relevant economic activity in Spain. The sector of accommodation and food service activities accounted for 6.4% of total gross value added (GVA) in 2019, compared to 2.9% on average in the EU. Spain’s tourism sector is characterized by a strong international dimension, with cross-border tourists accounting for more than 60% of the nights spent in touristic accommodation establishments in 2019.

Spain’s tourism industry was heavily affected at the onset of the COVID-19 pandemic, before moderately recovering in 2021. After the outbreak of the crisis and the introduction of strict containment measures, tourism collapsed quickly. Throughout 2020, the gross value added generated by the tourism industry dropped to 3.5% of total GVA in 2020, while in nominal terms, firms’ profits dropped by as much as 50% in 2020, according to Eurostat data. Sectoral employment has been more stable, at 90% of 2019 level in the fourth quarter of 2021, only slightly less than for the EU as a whole. The mild decrease reflects to a large extent the effective deployment of short-time work schemes to mitigate the crisis impact on the labour market. In 2021, the tourism sector recovered from some of its losses, showing a turning point in May with the end of the state of emergency, the reinstatement of free movements across the country and softer restrictions affecting the catering industry. Tourism activity recovered more dynamically from mid-2021 onwards, with nights spent reaching 83% of their 2019 level in October 2021 (Graph 3.2.f), with domestic tourism registering a swifter recovery than international tourism.

Vulnerabilities in the tourism sector have increased during the pandemic. Corporate debt seemed to have increased more in the accommodation and food sector than in other areas, according to balance sheet data on loan stocks from the European Banking Authority (Graph 3.2.c). Moreover, bankruptcies in those industries almost tripled in 2020, whereas new business registrations dropped only temporarily in early 2020 (Graph 3.2.d and 3.2.e). The NPL ratio in the tourism sector stayed relative stable due to loan moratoria introduced in response to the COVID-19 crisis, but started to increase lately, from 4.7% in the

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([9]) EIB (2022), EIB Investment Survey 2021 - Spain Overview, European Investment Bank, Luxembourg.

fourth quarter of 2019 to 5.4% in the fourth quarter of 2021, according to the European banking authority. Overall, this points to increasing difficulties of tourism establishments to overcome the cumulative effective of the COVID-19 pandemic.

Developments in the tourism sector in the near future are likely to remain volatile and highly dependent on the full normalisation of international travel. As the containment measures put in place during the pandemic period have gradually been eased, the tourism activity and the revenue share accruing from the tourism and accommodation industry is expected to bounce back. Nonetheless, new disruptions, including the fallout from the war in Ukraine, risk delaying further the return to pre-crisis levels of tourism inflows and can expose the sector to additional vulnerabilities. A new shock could be detrimental for firms that have been sailing into headwind for the last two years. In this context, the newly created RED mechanism is expected to support job preservation and facilitate job reallocation to other sectors from the most affected ones, including tourism.

Policy measures supporting corporates

The Spanish authorities have implemented several measures aimed at minimising the negative impact of the pandemic on corporates, which also helps to limit debt vulnerabilities ([10]). Between the first quarter of 2020 and the July 2021 a sizeable package of cross-cutting legislative acts and financial aid schemes provided stimulus to the economy, supporting borrowers and corporates and particularly targeting small and medium size enterprises (SMEs) and self-employed workers. The key measures included a deferral of tax payments for SMEs and a more flexible use of short-time work schemes (ERTEs), including reduced social security contributions for firms.

To further support the business sector, two guarantee programs were approved at the onset of the pandemic by the government. Thereby the State guaranteed the financing provided by financial institutions to companies and self-employed. EUR 100 billion guarantees were envisaged to facilitate access to credit and liquidity for companies and the self-employed to cope with the impact of the pandemic and EUR 40 billion were approved to cover investment needs. These programs are managed by the public development bank (Instituto de Crédito Oficial, ICO). In addition the authorities approved a solvency support fund worth €10 billion to provide capital support to enterprises. Furthermore, a series of legislative and non-legislative payment moratoria adopted between March and July 2020 played a crucial role in providing borrowers with a temporary breathing space. An additional financial scheme amounting to €11 billion aimed at sustaining the flow of credit to the economy by helping firms whose financial situation had significantly deteriorated throughout the pandemic.

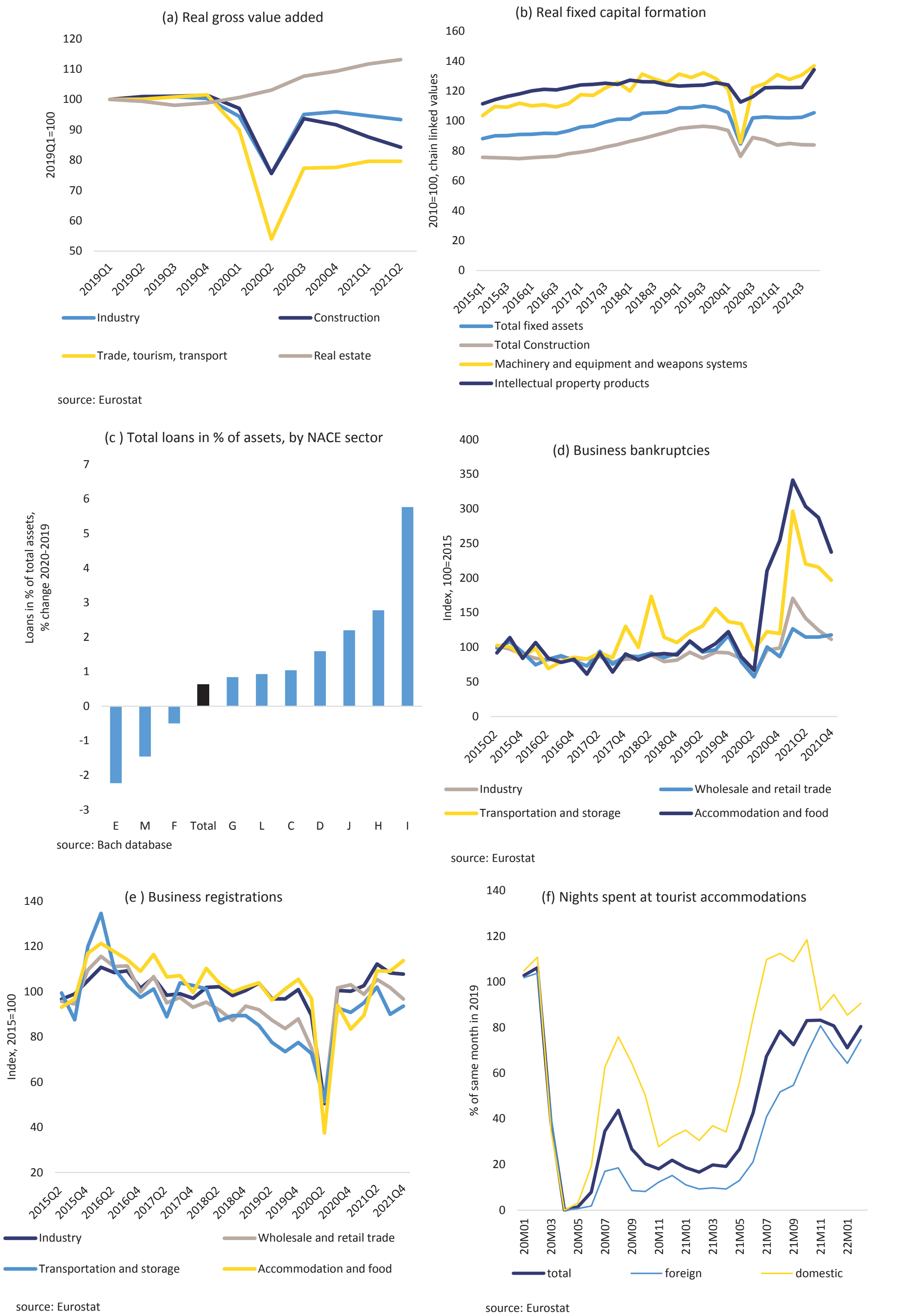
([10]) The emergency actions implemented by the Spanish governments were carried out in light of the amendments to the Temporary Framework approved by the Commission on 3 April 2020.

Table 3.1: **Private debt indicators, Spain**

.											
(Households and Non-financial corporations)	Source	2003-07	2008-12	2013-18	2019	2020	2021f	21Q1	21Q2	21Q3	21Q4
Stocks											
Private debt level (% of GDP)(1)	*(a,d)*	159	198	154	129	147	138	171	168	165	161
Private debt level (% of potential GDP)(1)	*(a,b,d)*	164	190	147	131	133	131	153	156	154	153
Prudential threshold (% of GDP)	*(c)*	108	99	95	99	98	98				
Fundamental benchmark (% of GDP)	*(c)*	74	95	102	95	107	103				
Flows											
Private credit flows (transactions, % of GDP)(4)	*(a)*	25.3	-0.7	-3.1	1.1	4.4	2.4	2.0	16.8	-3.1	0.5
Private credit flows (transactions, % of potential GDP)(4)	*(a,b)*	26.1	-0.5	-2.9	1.2	4.0	2.3	1.8	15.6	-2.9	0.5
Benchmark for flows (% of GDP)	*(c)*										
Households (HH)											
Stocks											
HH debt level (% of GDP)	*(a,d)*	70	83	67	57	62	58	63	61	60	58
HH debt level (% of potential GDP)	*(a,b,d)*	72	80	64	58	57	56	56	57	56	56
Prudential threshold (% of GDP)	*(c)*	48	42	39	42	41	41				
Fundamental benchmark (% of GDP)	*(c)*	35	46	47	43	48	47				
Debt (% of gross disposable income)	*(a,b,d)*	111	130	107	91	94	93	93	95	93	93
Interest paid (% of gross disposable income)	*(a,b)*	3.1	3.4	1.1	0.6	0.4		0.3	0.3	0.3	0.5
Debt (% of gross financial assets)	*(a,d)*	40.7	49.3	33.2	29.2	27.8	26.1	27.2	26.9	26.8	26.1
Share of variable rate loans for house purchase (%)	*(d)*	88.6	85.6	54.2	35.8	34.5	25.9				
Domestic loans in forex (% of dom. loans)	*(d)*	0.3	1.1	0.7	0.5	0.4	0.3				
Flows											
HH credit flows (transactions, % of GDP)(4)	*(a)*	10.7	-0.4	-1.6	0.0	-0.4	0.6	-0.8	5.1	-2.8	0.7
HH credit flows (transactions, % of potential GDP)(4)	*(a,b)*	11.0	-0.3	-1.5	0.0	-0.4	0.5	-0.7	4.8	-2.6	0.7
Benchmark for flows (% of GDP)	*(c)*	4.1	2.2	-0.1	0.9	1.0	0.9				
Savings rate (% gross disposable income)	*(b)*	8.3	9.0	6.6	8.3	15.0	11.4				
Investment rate (% gross disposable income)	*(b)*	15.3	9.9	4.9	5.5	5.6	9.4				
p.m. Bank HH NPLs (% of HH loans) (2)	*(d)*			*4.6*							
Non-financial corporations (NFC)											
Stocks											
NFC debt (% of GDP)(1)	*(a,d)*	89	115	86	72	84	80	109	107	105	103
NFC debt (% of potential GDP)(1)	*(a,b,d)*	92	110	82	73	76	76	97	99	98	98
Prudential threshold (% of GDP)	*(c)*	59	57	55	57	57	57				
Fundamental benchmark (% of GDP)	*(c)*	40	49	55	52	59	57				
Debt (% of value added)	*(a,b,d)*	166	202	156	128	155	146	194	196	192	188
Interest paid (% of gross operating surplus)	*(a,b)*	17.7	15.8	6.3	3.8	3.8		3.2	3.3	2.8	3.2
Debt (% of gross financial assets)	*(a,d)*	119	137	100	83	83	77				
Domestic loans in forex (% dom. Loans)	*(d)*	1.4	1.2	1.7	2.1	1.7	1.9	1.9	1.7	1.8	1.9
Flows											
NFC credit flows (transactions, % of GDP)(4)	*(a)*	14.6	-0.3	-1.5	1.1	4.8	1.8	2.8	11.6	-0.4	-0.2
NFC credit flows (transactions, % of potential GDP)(4)	*(a,b)*	15.1	-0.1	-1.4	1.1	4.3	1.7	2.5	10.8	-0.4	-0.2
Benchmark for flows (% of GDP)	*(c)*										
Investment (% of value added)	*(b)*	28.7	21.3	24.5	27.5	26.4	23.7				
Savings (% of value added)	*(b)*	21.5	29.7	35.2	33.4	34.8	34.4				
p.m. Banks NFC NPLs (% of NFC loans) (3)	*(d)*			*10.8*	*4.7*	*4.6*					

Notes: (f) European Commission forecast, . (1) Quarterly data is non-consolidated. (2) Gross non-performing bank loans and advances to Households and non profit institutions serving households (% of total gross bank loans and advances to Households and non profit institutions serving households). (3) Gross non-performing bank loans and advances to Non-financial corporations (% of total gross bank loans and advances to Non-financial corporations). (4) Quarterly data is annualized.
Sources: Sources: (a) Eurostat, (b) Ameco, (c) European Commission calculations, (d) ECB.

Graph 3.2: **Thematic Graphs: Private Indebtedness**



Source: European Commission services