Regional Analysis Spain

The deficit falls but fails to meet the challenges ahead

Expansión (Spain)

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The public deficit in Spain was reduced by half a percentage point of GDP to 2.5% in 2018, above the drop predicted by BBVA Research, confirming the repeated failure to meet its stability target (-2.2% of GDP). The deficit falls but fails to meet the challenges ahead. These figures confirmed that the positive effect of the economic recovery over the tax revenues was offset by the level of expenditure, which was higher than expected. If we set the share of the deficit that evolves in line with the economic cycle to one side, the estimates suggest that during 2018 the primary structural balance underwent a decline of five percentage points of GDP. This confirms that this decline was exclusively cyclical in nature, and that the fiscal policy had reverted to the expansive tone of previous years.

In this context, the budgetary execution data up to February 2019 indicate a worsening of the deficit mainly due to the moderation of public revenue. For its part, public expenditure continued to increase at the pace of the previous year, affected by the increases in public sector wages and of pensions. This gentle decline belongs almost exclusively to the central administration. The autonomous communities and Social Security have reported the same balance as that observed up to February 2018.

Looking ahead, the current situation of budgetary extension and political uncertainty is affecting the performance of the public accounts. The economic cycle is expected to continue to drive the recovery of the taxable bases and, therefore, tax revenues. In addition, in the context of an unchanging fiscal policy, a slight reduction in public expenditure in terms of GDP is expected, owing more to an increase in nominal GDP than to a control over its growth.

The deficit would therefore drop to 2.2% of GDP and 1.9% in 2020, once again confirming a tax adjustment of an exclusively cyclical nature. Stability targets would again not be met (-1.3% and -0.3%, respectively), with no evidence of a structural improvement in public accounts. According to BBVA Research estimates, the primary structural balance would remain at around 0.3% of GDP during the two-year period. All the foregoing provides the fiscal policy with a practically neutral tone, confirming the unrealistic nature of the current stability targets.

In this regard, the recent review of the SGP for 2019-2022 presented by the Government favours a flexibilisation of the deficit adjustment path (up to 2.1% in 2019 and 1.1% in 2020), and expects the expansive dynamics of the previous year to continue. Specifically, for 2019 the Government considers a budgetary extension scenario like that of BBVA Research, and therefore its target, although slightly more demanding, is assumed to be achievable.

From 2020 onwards, the Government scenario differs from that of BBVA Research, insofar as it includes the measures that were presented in the General State Budget forecast for 2019. In particular, it considers the package of tax measures, a new revaluation of the pensions and public wages and the upward trend of public investment as we progress towards the new electoral cycle.

Taking the joint impact of all these measures into account, the BBVA Research scenario assumes that the deficit in 2020 would, in any event, remain above the 1.1% goal proposed by the Government.

With a deficit below 3% of GDP already in 2018, Spain will move out of the excessive deficit protocol, but continue to be under reinforced surveillance over the next three financial years due to the high level of its public debt (97.2% in 2018). This situation calls for a rate of structural adjustment of 0.65 pp of annual GDP in order to significantly reduce the debt. This adjustment, however, is some distance away from both the one considered in the SGP – more optimistic – and by BBVA Research.

In the medium to long term, in a context where the deficit continues to be high and, above all, with a public debt close to 100% of GDP, the best course would be to take advantage of the years of economic recovery to reduce the debt and to recover the tax margin required to face the challenges ahead.

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