INTERNATIONAL MONETARY FUND

IMF Country Report No. 24/152

SPAIN

June 2024

2024 ARTICLE IV CONSULTATION—PRESS RELEASE; AND STAFF REPORT

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2024 Article IV consultation with Spain, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its June 5, 2024 consideration of the staff report that concluded the Article IV consultation with Spain.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on June 5, 2024 following discussions that ended on April 12, 2024 with the officials of Spain on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on May 15, 2024.
- An **Informational Annex** prepared by the IMF staff.

The documents listed below have been or will be separately released.

Selected Issues
Financial Stability System Assessment

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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PRESS RELEASE

PR 24/207

IMF Executive Board Concludes 2024 Article IV Consultation with Spain

FOR IMMEDIATE RELEASE

Washington, DC – **June 6, 2024:** On June 5, 2024, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Spain.

With a growth rate of 2.5 percent in 2023 and continued solid activity momentum, the Spanish economy has demonstrated remarkable resilience to elevated global uncertainty and tighter financial conditions. Robust services export performance and public consumption have been the main drivers of recent growth. The labor market has sustained its strong performance, including due to significant migration inflows and increasing labor force participation. Nevertheless, despite its most recent pickup, investment is still below end-2019 levels, and this weakness has contributed to low productivity growth. And despite its significant decline, the unemployment rate remains the highest in the euro area.

Headline inflation has fallen significantly from its 2022 peak and core inflation has also been on a downward trend, underpinned by the continued passthrough of energy disinflation to processed food and non-energy industrial goods prices. Despite a tight labor market, wage pressures have remained contained, partly due to the limited prevalence of formal indexation clauses and the guidance provided by the national wage agreement reached in May 2023.

Growth is projected to reach 2.4 percent in 2024 and 2.1 percent in 2025, driven primarily by stronger domestic demand growth. Private consumption is expected to strengthen as the household saving rate normalizes gradually and real wage income continues to increase steadily. Private investment will benefit from easing financial conditions and continued disbursement of Next Generation EU (NGEU) grants. Both headline and core inflation are forecast to decline further throughout 2024-25, nearing the ECB's 2-percent target before mid-2025.

Uncertainty surrounding the outlook has become more balanced, but risks remain tilted to the downside for growth and to the upside for inflation. Risks to growth include domestic political fragmentation, potential under-execution of NGEU funds, a global slowdown, and geo-economic fragmentation. Risks to inflation include a potential rebound in global energy prices and faster-than-expected increases in unit labor costs.

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

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Washington, DC 20431
USA

Executive Board Assessment[2]

Executive Directors commended Spain's strong economic resilience and labor market performance. Directors positively noted the favorable outlook, with growth expected to remain robust and inflation to further decline, and indicated that uncertainties stem from geo-economic and domestic political fragmentation. Against this background, Directors called for continued efforts to sustain macroeconomic stability, and address Spain's structural challenges to foster the country's convergence in living standards towards higher-income peers.

Directors welcomed the continued improvement in public finances and the authorities' commitment to fiscal discipline, despite the difficult political setting. They emphasized that a sustained, growth-friendly fiscal consolidation, embedded in an explicit medium-term fiscal plan focused on reducing tax inefficiencies and broadening the tax base, will be needed in coming years to rebuild fiscal buffers and keep debt on a downward path. Directors stressed the need to ensure that windfall levies on banks and energy companies, if made permanent, are appropriately designed to minimize possible distortions. They also highlighted the importance of adopting a balanced set of measures as needed to ensure the sustainability of the pension system.

Directors highlighted the resilience of the financial sector against tighter financial conditions and supported the recommendations of the Financial Sector Assessment Program to further strengthen financial supervision and crisis management. They stressed the need to increase bank capital buffers to support the banking system's resilience and preserve credit extension in the event of severe adverse shocks. In this regard, Directors welcomed the Bank of Spain's intention to raise the neutral countercyclical capital buffer.

Directors commended the authorities for the unprecedented decline in temporary employment that followed the 2021 labor market reform. Noting that structural unemployment remains the highest in the euro area, Directors encouraged continued efforts to further reduce labor market dualism and better integrate active and passive labor market policies. They also highlighted the need to carefully design future labor market policy initiatives to avoid any unintended effects on employment and growth.

Directors welcomed the authorities' steady progress in implementing Spain's ambitious recovery plan. They stressed the need to optimize the use of NextGeneration EU funds, including by improving coordination at all government levels and focusing on productivity-enhancing reforms and investments. Directors also pointed out that boosting housing supply is key to improving housing affordability.

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[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.IMF.org/external/np/sec/misc/qualifiers.htm.

Spain: Selected Economic Indicators
(Annual percentage change, unless noted otherwise

				Projections 1/		
	2021	2022	2023	2024	2025	2026
Demand and supply in constant prices						
Gross domestic product	6.4	5.8	2.5	2.4	2.1	1.8
Private consumption	7.1	4.7	1.8	1.8	1.9	2.3
Public consumption	3.4	-0.2	3.8	0.9	1.2	0.5
Gross fixed investment	2.8	2.4	0.8	4.5	4.8	2.2
Total domestic demand	6.7	3.0	1.7	2.2	2.4	1.9
Net exports (contribution to growth)	-0.2	2.9	0.8	0.0	-0.2	-0.1
Exports of goods and services	13.5	15.2	2.3	3.4	3.1	3.1
Imports of goods and services	14.9	7.0	0.3	3.0	4.0	3.6
Potential output growth	1.6	1.7	1.9	2.1	2.2	1.8
Output gap (percent of potential)	-4.2	-0.4	0.2	0.4	0.2	0.1
Prices						
GDP deflator	2.6	4.2	5.9	2.8	2.3	1.7
HICP (average)	3.0	8.3	3.4	2.9	2.3	1.9
HICP (end of period)	6.6	5.5	3.3	2.5	2.1	1.8
Core inflation (average)	0.7	5.2	5.8	3.0	2.1	1.8
Core inflation (end of period)	2.2	6.7	4.6	2.5	2.1	1.8
Employment and wages						
Unemployment rate (percent)	14.9	13.0	12.2	11.8	11.5	11.2
Labor costs, private sector	0.0	2.6	5.6	3.3	3.5	2.8
Employment growth	3.3	3.6	3.1	1.3	0.9	0.8
Balance of payments (percent of GDP)						
Current account balance	0.8	0.6	2.6	2.6	2.3	2.0
Net international investment position	-71.0	-60.0	-52.8	-46.5	-41.4	-37.1
Public finance (percent of GDP)						
General government balance	-6.7	-4.7	-3.6	-3.0	-2.9	-3.1
Primary balance	-4.8	-2.6	-1.8	-0.6	-0.3	-0.4
Structural balance	-4.1	-4.5	-3.7	-3.2	-3.0	-3.2
General government debt	116.8	111.6	107.7	105.6	104.4	104.3

Sources: IMF, World Economic Outlook; data provided by the authorities; and IMF staff estimates.

1/ The projections incorporate spending financed by the EU Recovery and Resilience Facility (including the grant and the loan component) amounting to about 0.4, 0.9, 1.0, 1.0, 1.0, 0.9, and 0.2 percent of GDP from 2021 to 2027.

INTERNATIONAL MONETARY FUND

SPAIN

STAFF REPORT FOR THE 2024 ARTICLE IV CONSULTATION

May 15, 2024

KEY ISSUES

- The Spanish economy has been resilient to successive shocks, whose effects were mitigated by unprecedented policy support that is now being phased out. The labor market performance has been exceptionally strong, and some of its perennial deficiencies—most notably the large share of temporary workers and high unemployment—have eased. Growth is projected to reach 2.4 percent in 2024, and headline and core inflation are expected to converge close to the ECB's target before mid-2025. Risks have become more balanced but are still tilted to the downside for growth and the upside for inflation, including predominantly domestic risks (political fragmentation, under-execution of NGEU spending) but also global risks (energy price volatility, geopolitical risks, geo-economic fragmentation).

- The projected pace of discretionary fiscal consolidation for 2024 is broadly appropriate, but it should be sustained over the medium term to rebuild fiscal buffers and keep public debt on a downward path. A detailed medium-term fiscal plan underpinned by specific measures would signal commitment and increase the likelihood of a successful consolidation, which should hinge on reducing the tax system's inefficiencies and broadening the tax base, without further resorting to windfall levies. Additional measures should also offset the growing aging-related spending pressures, particularly on pensions.

- Spain's banking system has shown resilience. Strong economic and labor market performance and deleveraging have helped the private sector cushion the impact from rising interest rates, although pockets of vulnerability remain. The banking sector is capable of weathering severe and persistent global shocks, but enhancements to the already comprehensive macroprudential policy toolkit, including introducing a positive neutral counter-cyclical capital buffer, could help further attenuate risks.

- Implementation of the recovery plan, including NGEU execution, has proceeded steadily, but a renewed reform impetus is needed to amplify recent job gains and revive anemic productivity growth. Prioritizing productivity-enhancing projects, and ensuring effective use of NGEU funds more broadly, is key for the recovery plan to be transformational. The 2021 labor reform has helped reduce duality, but additional policies, including boosting active labor market policies, will be needed to bring down still high structural unemployment. Expanding housing supply is critical to improving housing affordability.

Approved By
Kristina Kostial (EUR)
Dora Iakova (SPR)

Discussions were held in Madrid in April 2-12, 2024 The staff team comprised Romain Duval (Head), Ana Lariau, Carlo Pizzinelli and Yu Shi (all EUR). Jay Surti (MCM, Head of FSAP mission) and Alfred Kammer (EUR Director) joined the concluding meetings. Pablo de Ramón-Laca (Alternate Executive Director), Rosa Moral and Irune Solera Lopez (Advisors to the Executive Director) attended the meetings. Yueshu Zhao, Eunmi Park, Miguel De Asis (EUR), and Natalia Stetsenko (LEG) supported the mission from headquarters. The mission met with Minister of Economy Carlos Cuerpo, Banco de España Governor Pablo Hernández de Cos, and other senior officials. The mission also met with representatives of the financial sector, labor organizations, think tanks, and political parties.

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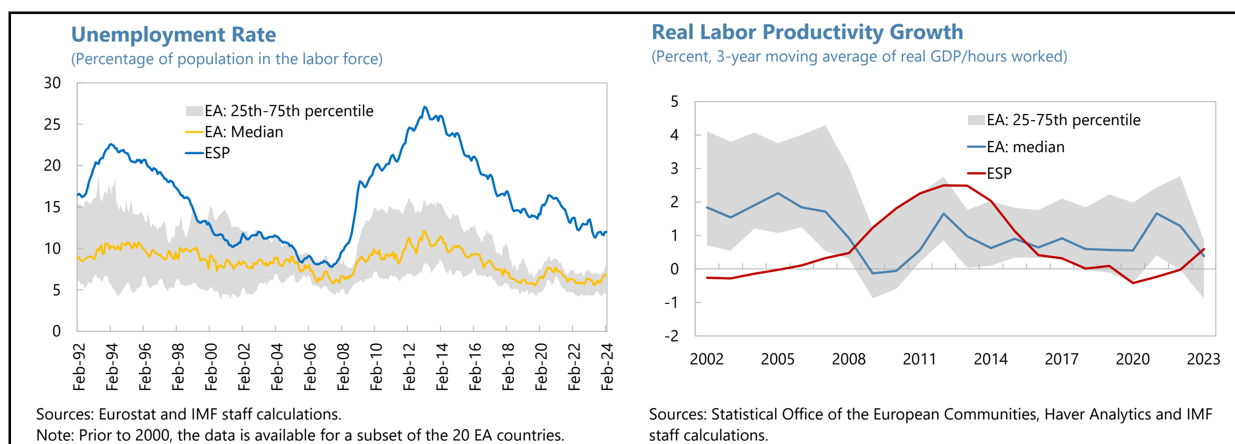
CONTEXT

1. Spain's economic resilience to adverse shocks has improved and long-standing labor market deficiencies have eased. Public support measures played a major role in cushioning the economic fallout from the COVID and energy crises. Of particular importance was the revamped short-time work scheme (ERTE), which prevented significant job destruction during the pandemic in sharp contrast with past crises. More recently, the strong economic recovery, propelled by services, brought the unemployment rate down to levels last seen before the Global Financial Crisis (GFC), while the 2021 labor market reform helped curb dualism between permanent and temporary workers by sharply reducing the prevalence of temporary contracts. In turn, the combination of a strong labor market performance—also fueled by large migration inflows and increased labor force participation—and continued deleveraging efforts by households and firms, helped cushion the impact from tighter financial conditions. Strong tax revenues, together with sustained inflation, contributed to a steady decline in public debt to 107.7 percent of GDP in 2023.

2. Nevertheless, structural unemployment is expected to remain high and productivity would continue to lag peers, calling for a continuation of reform efforts. Spain's structural unemployment rate—estimated at about 11 percent—is projected to remain the highest in the euro area. Employment growth is likely to slow as immigration gradually normalizes and ageing weighs increasingly on labor force participation. Meanwhile, the flip side of large recent employment gains has been a further drop in trend productivity growth from its already low pre-COVID level. The income-per-capita gap between Spain and the highest-income euro area countries was about 32 percent in 2022,[1] about 8 percentage points wider compared to 20 years ago. Together with fiscal consolidation, boosting employment and productivity growth is key for bringing down high public debt over the medium term amid higher interest rates and fading one-off fiscal gains from higher inflation.



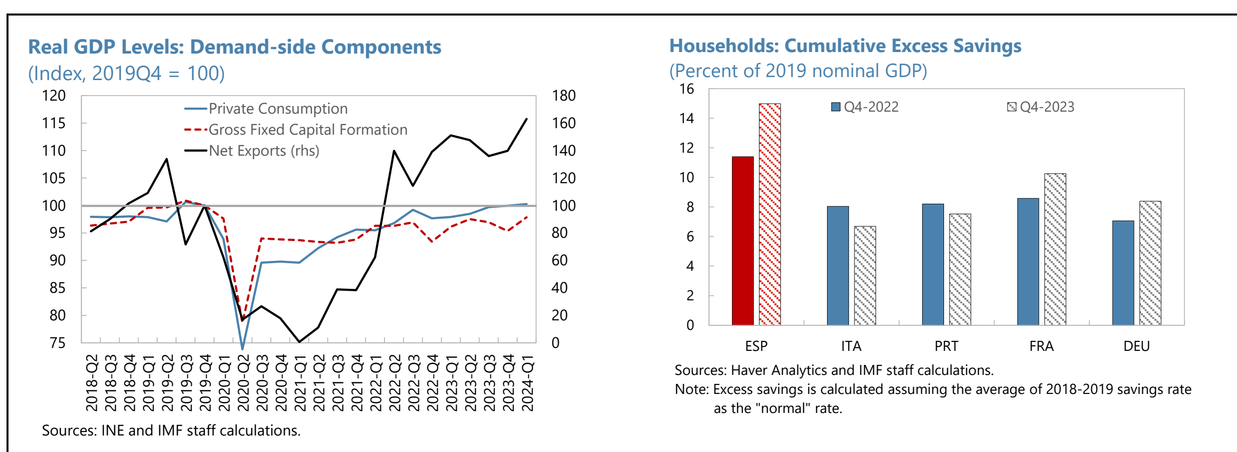
Sources: Eurostat and IMF staff calculations.
Note: Prior to 2000, the data is available for a subset of the 20 EA countries.

Sources: Statistical Office of the European Communities, Haver Analytics and IMF staff calculations.

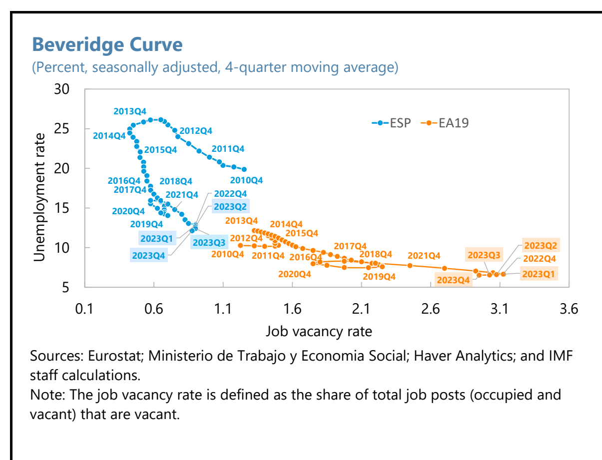
[1] The gap is computed as the difference of PPP-adjusted GDP per capita between Spain and the average of Belgium, Austria, and Netherlands in 2022.

RECENT DEVELOPMENTS

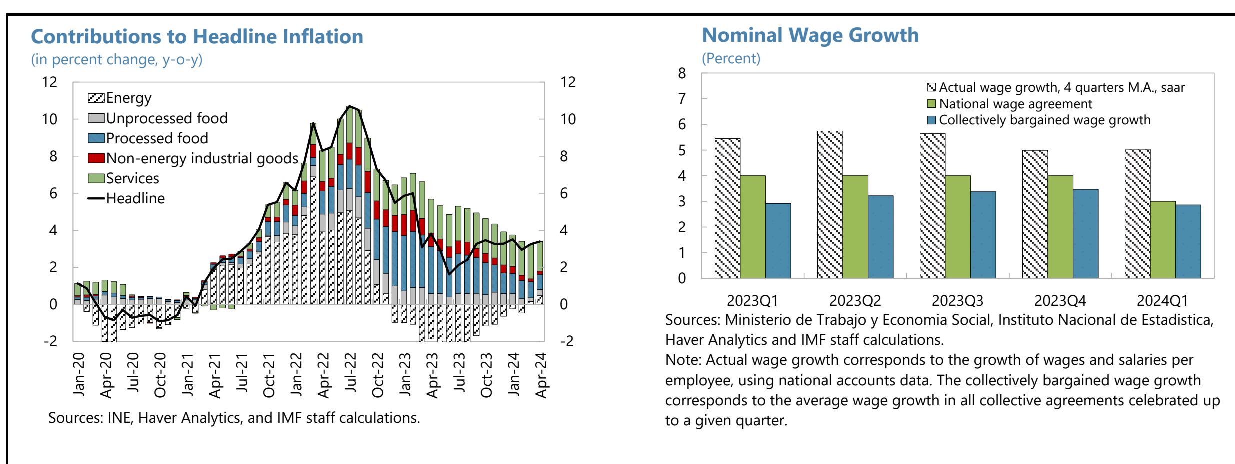
3. The Spanish economy weathered the energy crisis better than most peers, and growth has remained resilient to weaker global trade and the drag from higher interest rates. Real GDP grew by 2.5 percent in 2023, 1.8 percentage points higher than the euro area. Strong labor market performance, which underpinned double-digit household disposable income growth (11 percent in 2023), as well as the normalization of headline inflation, have supported consumption. Even so, consumption has just recovered its pre-pandemic level, and households' excess savings remain high. Despite continued progress in implementing NGEU-funded projects, and a recent pickup, private investment has remained weak overall. Services exports and public consumption have been key drivers of the recovery.



4. Following a sustained period of very strong employment growth, the labor market is rather tight. The resilience of economic activity has been partly underpinned by large net job gains, with social-security-affiliated workers increasing by over ¾ million between December 2022 and April 2024. Employment has absorbed increases in labor force participation, including from older workers as a result of pension reforms. The sharp reduction in the prevalence of temporary contracts that resulted from the 2021 labor market reform (from 25.6 percent in 2021Q4 to 15.7 in 2024Q1) has helped confidence. The unemployment rate has recently broadly stabilized below 12 percent, but the labor market remains tight, with the vacancy-to-unemployment ratio at historical highs. Despite the still large pool of unemployed, factors such as skill and geographical mismatches, as well as the limited housing supply, continue to make it difficult for firms to fill their vacancies.

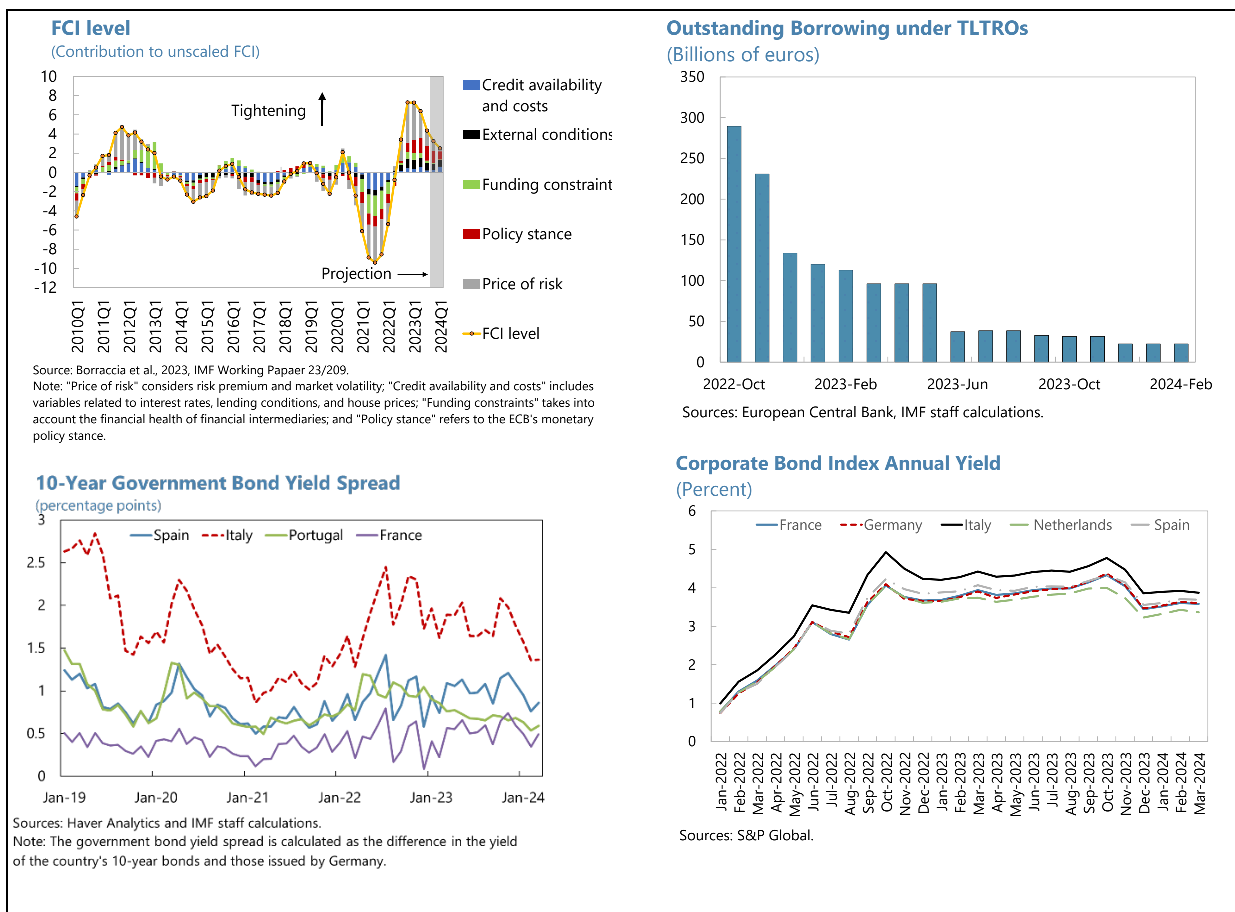


5. Inflation has been falling on lower energy prices and relatively contained wage pressures. After falling below the ECB's 2-percent target in June 2023, headline inflation rebounded to above 3 percent as base effects dissipated. Core inflation has declined steadily, particularly for non-energy industrial goods and processed food, supported by energy disinflation and continued wage moderation. The still-low prevalence of formal indexation clauses (despite the slight increase in 2023), together with the national wage agreement struck in May 2023, helped contain the pick-up in collectively bargained wage growth below 4 percent. Actual wage growth per employee has been higher, but slowed throughout 2023, from 5.7 percent in Q1 to 5.0 percent in Q4.[2] Unit labor costs have displayed a similar pattern.



6. Financial conditions have started easing but remain rather tight, mostly benefiting banks so far. After reaching a peak in the first half of 2023, indicators of financial conditions have started to ease. 10-year sovereign and corporate bond yields and spreads have fallen from their fall 2023 peaks, while the ECB's bank lending survey suggests that Spanish banks had stopped tightening credit standards by late 2023. Further, financial conditions have not been affected materially by the gradual reduction in the ECB's balance of the asset purchase program (APP), and Spanish banks' repayment of TLTRO funding (92 percent of which was already completed by February 2024). House prices have continued to increase on a y-o-y basis, even though transaction volumes registered double-digit y-o-y declines in 2023 (Figure 7). So far, tight financial conditions have strengthened banks' net interest margins (NIMs) while adverse impacts on their asset portfolio have been immaterial, as suggested by broadly stable stage 2 and non-performing loans (NPLs).

[2] The average nominal wage is calculated as wages and salaries divided by the number of employees, based on national accounts data.



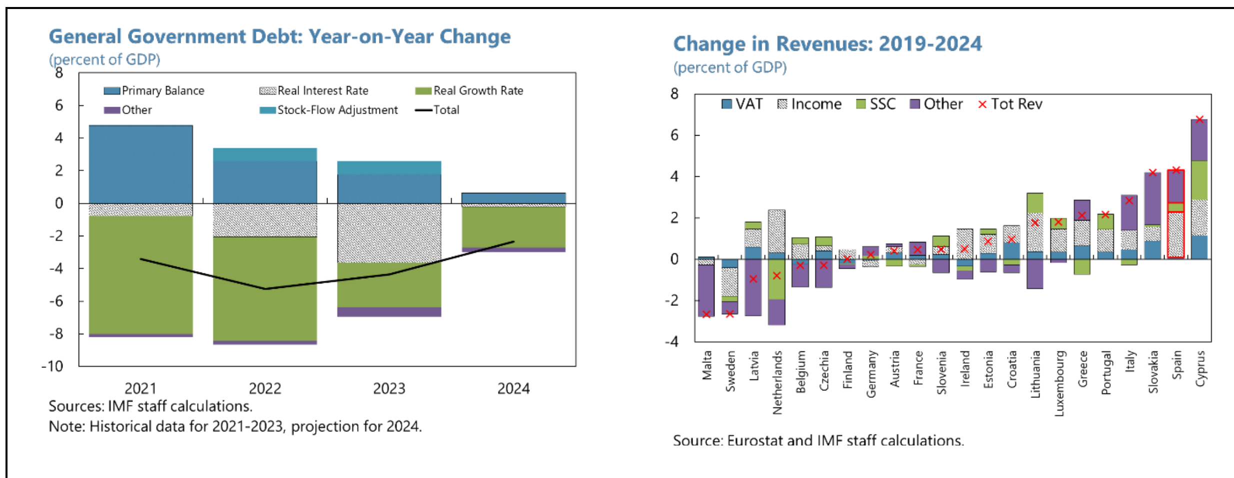
Source: Borraccia et al., 2023, IMF Working Papaer 23/209.
Note: "Price of risk" considers risk premium and market volatility; "Credit availability and costs" includes variables related to interest rates, lending conditions, and house prices; "Funding constraints" takes into account the financial health of financial intermediaries; and "Policy stance" refers to the ECB's monetary policy stance.

Sources: European Central Bank, IMF staff calculations.

Sources: Haver Analytics and IMF staff calculations.
Note: The government bond yield spread is calculated as the difference in the yield of the country's 10-year bonds and those issued by Germany.

Sources: S&P Global.

7. **Public finances have continued to improve, underpinned by a revenue boom, but the public debt ratio remains high.** Buoyant tax revenues reduced the overall fiscal deficit from 4.7 percent of GDP in 2022 to 3.6 percent of GDP in 2023. Personal income taxes and social security contributions continued to rise, supported by growth in employment and nominal salaries, as well as the phasing in of higher pension contribution rates. The temporary levies on the profits of banks and energy companies and the solidarity tax on large fortunes further contributed (0.2 percent of GDP). Strong revenue performance more than offset outlays on energy and food prices support to households and firms, which amounted to approximately 1 percent of GDP in 2023. Some of these measures, notably reduced VAT rates on essential foods and electricity and subsidies to public transportation, were extended for part of 2024, at an estimated cost of 0.2 of GDP. Reflecting the fiscal balance improvement and sustained inflation, the debt-to-GDP ratio declined to 107.7 percent in 2023 from 111.6 percent in 2022. Against the backdrop of a fragile coalition that emerged from the 2023 elections, the failure of the 2024 budget law to pass the parliamentary vote in March 2024 signals a challenging political environment for advancing future fiscal policy and other legislative initiatives.



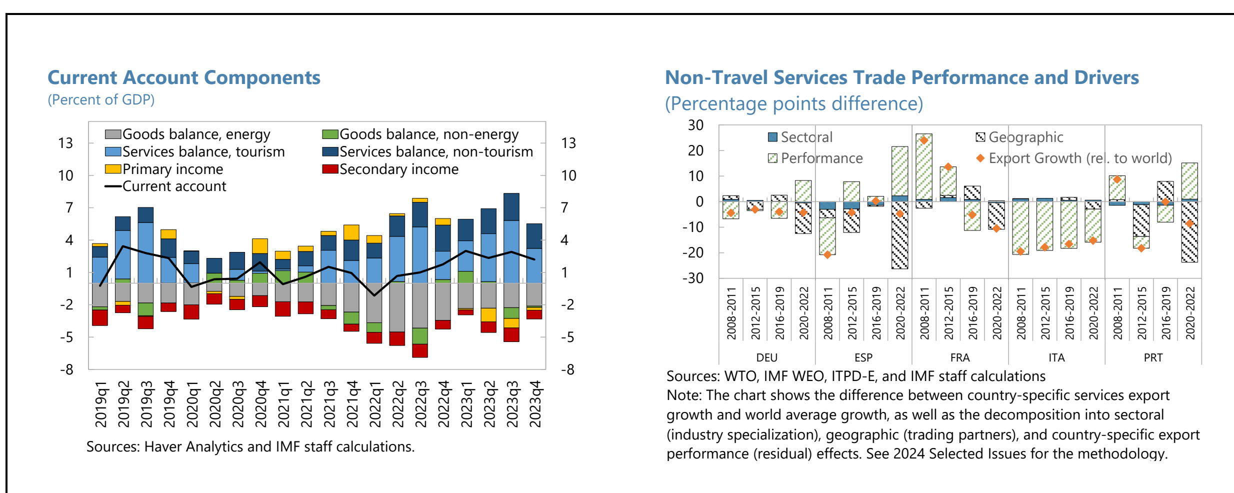
General Government Debt: Year-on-Year Change
(percent of GDP)

Sources: IMF staff calculations.
Note: Historical data for 2021-2023, projection for 2024.

Change in Revenues: 2019-2024
(percent of GDP)

Source: Eurostat and IMF staff calculations.

8. The current account has continued to improve on the back of a sustained expansion of tourism and non-tourism services exports and lower energy prices. The trade balance surplus rose by 3 percentage points of GDP in 2023, largely driven by strong services exports and a lower energy import bill. Foreign tourist arrivals and spending reached new highs, while non-tourism services exports benefitted from Spain's trend gains in price and non-price competitiveness (2024 Selected Issues). Overall, despite the deterioration of the primary income account—explained by a disproportionate impact of higher interest rates on liability payments compared to investment income, especially within the other investment income category—the current account surplus increased to 2.6 percent of GDP in 2023. As a result, and also factoring in the positive impact of NGEU grants on the capital account, the net international investment position continued to improve to -52.8 percent of GDP by end-2023 despite negative valuation effects. The 2023 external position is preliminarily assessed to be moderately stronger than the level implied by medium-term fundamentals and desirable policies, with the gap expected to decline over the medium-term (Annex I).



Current Account Components
(Percent of GDP)

Sources: Haver Analytics and IMF staff calculations.

Non-Travel Services Trade Performance and Drivers
(Percentage points difference)

Sources: WTO, IMF WEO, ITPD-E, and IMF staff calculations
Note: The chart shows the difference between country-specific services export growth and world average growth, as well as the decomposition into sectoral (industry specialization), geographic (trading partners), and country-specific export performance (residual) effects. See 2024 Selected Issues for the methodology.

OUTLOOK AND RISKS

9. Growth is projected to remain robust in the near term before gradually converging to its medium-term potential. Following a strong outturn in 2024Q1, which was supported by a large increase in services exports, in particular, sequential growth is envisaged to settle close to its 2023 pace, averaging 2.4 percent in 2024 and 2.1 percent in 2025. Global assumptions embedded in the forecast include a rebound of trading partners' import growth starting 2024, which will underpin continued strong exports, and a gradual normalization of global energy prices.[3] It is also assumed that the ECB's monetary policy rates will decline by 0.6 and 0.7 percentage points in 2024 and 2025, respectively, while the general government structural primary deficit will fall by 0.7 percentage points in 2024 as energy support measures are withdrawn. Disbursements of NGEU grants, followed by the use of NGEU loans,[4] as well as easing financial conditions will continue to support investment. The gradual normalization of the household savings rate and moderate real wage income growth will also help boost consumption. Potential growth is projected to temporarily surpass its medium-term equilibrium of 1.6 percent, supported by the gradual resolution of supply bottlenecks and NGEU-funded investments. Output is expected to stay close to potential in 2024, and the unemployment rate to fall further towards its medium-term structural level, slightly above 11 percent.

10. Inflation is expected to further decline throughout 2024–25. With the output gap broadly closed, projected further declines in global energy and food prices are expected to support continued declines in headline and core inflation. The full withdrawal of VAT reductions on basic foods and electricity will be leading to one-off price increases in the course of 2024, but inflation should resume its downward trend thereafter. Headline and core inflation are expected to return close to the ECB's target before mid-2025. Under the national wage agreement, such inflation projection would imply 3-percent wage increases for both 2024 and 2025. Actual wages are projected to grow 0.3-0.5 percentage points faster than implied by the national agreement amid a still tight labor market, but wage pressures will remain moderate overall, supporting continued price disinflation.

11. The current account surplus is expected to remain high in 2024 but to gradually decline thereafter. Tourism services exports are likely to continue increasing throughout 2024, though at a slower pace, as the post-COVID catch up in arrivals wanes and higher prices tame demand. Non-tourism services exports should also continue to benefit from the competitiveness gains of the past few years. The energy goods balance will further improve on lower energy prices. In the medium term, the current account balance is projected to gradually decline (from 2.6 percent

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[3] The assumptions are consistent with the April 2024 IMF World Economic Outlook.

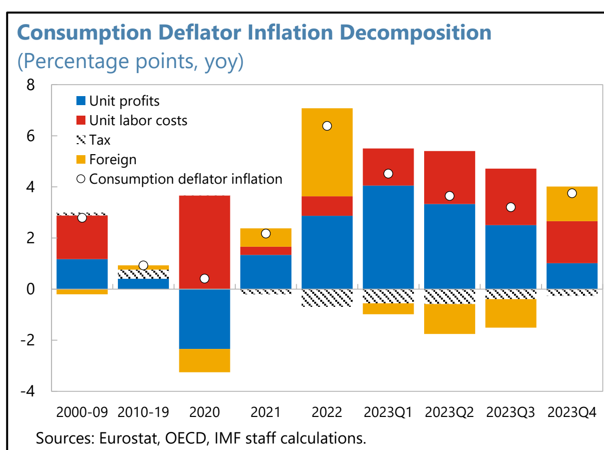
[4] The authorities plan to request the loan component of NGEU in full starting from the second half of 2024. Staff assume that the associated spending will be executed over 2025-27 and that the take-up of credit guarantees will be partial, following patterns observed across previous comparable programs. While the fiscal multipliers from NGEU grant- and loan-financed projects are assumed to be the same, the loans are expected to be less impactful because a large portion will be used for publicly-guaranteed and direct lending programs that hinge on private sector credit demand, which has remained weak.

of GDP in 2024 to 1.8 percent in 2029) as tourism inflows normalize and non-energy imports regain strength—supported by the shift in the economy's growth drivers towards domestic demand, particularly investment which has a high import content.

12. Risks to the outlook have become more balanced but downside risks to growth and upside risks to inflation predominate (Annex II).

- Protracted domestic political fragmentation could undermine the implementation of fiscal commitments[5] and structural reforms, weakening business confidence, investment and growth, particularly if domestic financial conditions were to tighten.

- Greater second-round effects on increases in unit labor costs, alongside limited room for margins to absorb them, could lead to more persistent inflation and deteriorate confidence and external competitiveness if sustained over the medium term—although they would also support consumption in the near term.



- Weaker or less-effective-than-expected use of NGEU funds could weigh on investment and potential growth. So would deepening geo-economic fragmentation or an abrupt euro area or global slowdown.

- Higher energy prices resulting from the intensification of regional conflicts or heightened commodity price volatility would deteriorate terms of trade, lower real incomes and raise inflation.

- On the upside, faster-than-expected monetary policy easing by the ECB and other major central banks would raise growth in the near term, but persistent inflation could lead to weaker confidence and lower domestic demand over the medium term.

Authorities' Views

13. The authorities broadly shared staff's view on the economic outlook and main risks. They emphasized Spain's robust economic performance amid an uncertain global environment. Like staff, the authorities foresee growth hovering around 2 percent in 2024-25, supported mainly by domestic demand. Over the medium term, they see room for stronger growth in investment and productivity to sustain the ongoing economic performance, especially if recently favorable

[5] Fiscal risks could be further increased if changes in the financing of autonomous communities alongside broad-based debt forgiveness were to weaken their incentives to maintain strong fiscal discipline.

demographic trends, including in migration inflows and labor force participation, were to lose momentum. The authorities also concurred with staff's projection that inflation will continue to fall close to the ECB's 2-percent target. They noted that a pickup in real wage growth would help households recover purchasing power and stimulate domestic consumption, while stressing the importance of monitoring risks of second-round effects from higher labor costs. Like staff, the authorities considered that near-term risks had become more balanced, and recognized the need to tackle long-term challenges such as weak productivity growth and housing affordability, highlighting ongoing reform efforts in this direction. They expect the current account balance to stay at around 2 percent of GDP in the medium term, in line with staff's projections.

POLICY AND DISCUSSIONS

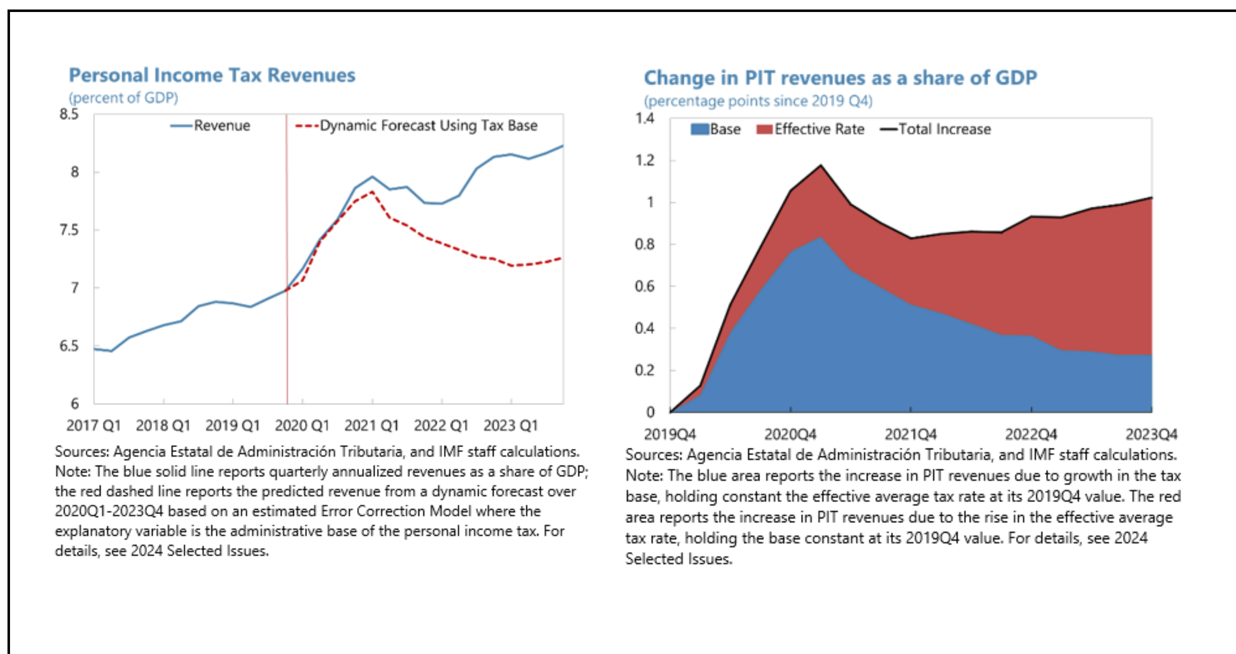
The two overarching policy objectives are to reduce vulnerabilities and raise living standards towards those in the highest-income European countries. Sustained discretionary fiscal consolidation would rebuild fiscal buffers and bring down high public debt. Systemic risks are assessed to be low overall, but enhanced macroprudential policies would ensure the continued resilience of the financial sector. Additional structural reforms are needed to bring down still elevated structural unemployment deep into single digits, support low-income workers and boost the economy's productivity.

A. Fiscal Policy to Rebuild Fiscal Space While Preserving Growth

14. Although a budget law will not be passed by parliament in 2024, the "rollover" of the 2023 budget entails a fiscal deficit target of 3 percent of GDP for 2024, to be reduced further to 2.5 percent in 2025. The better-than-expected 2023 outturn—with a deficit of 3.6 instead of 3.9 percent of GDP—and the authorities' sustained growth projections allow for the 2024 deficit target of 3 percent to be consistent with the partial extension of the energy and food price support policies that was announced in December 2023. These measures, amounting to approximately 1 percent of GDP in 2023, are being gradually phased out throughout 2024. After factoring in the government's decision to expedite the lapsing of the reduced electricity VAT rate by the first quarter of 2024, staff puts the estimated cost of the measures at about 0.2 percent of GDP for the year.

15. Staff project the deficit to remain at or above 3 percent of GDP, and the public debt ratio to stabilize at a high level, in the years ahead. Beyond the phasing out of support measures in 2024 and the extension of the windfall taxes until 2025, no additional consolidation measures are outlined in the government's current plans for 2024-26, and the fragile government majority in parliament could make it challenging to take further significant action in the near term. The overall deficit is therefore expected to fall to 3 percent of GDP in 2024 and to remain at about this level in the medium term. Consequently, the debt-to-GDP ratio would decline to 105.6 percent of GDP by end 2024 and stabilize around 103 percent from 2025 onwards, 5 percentage points above its 2019 level. Part of the tax revenue boom of 2020–23 is expected to gradually wane, leaving only a permanent revenue rise in personal income taxes (PIT) and social security contributions. In particular, the recent rise in the average effective PIT rate is expected to persist over the medium term as national and regional tax schedules are only updated partially and gradually (2024 Selected Issues).

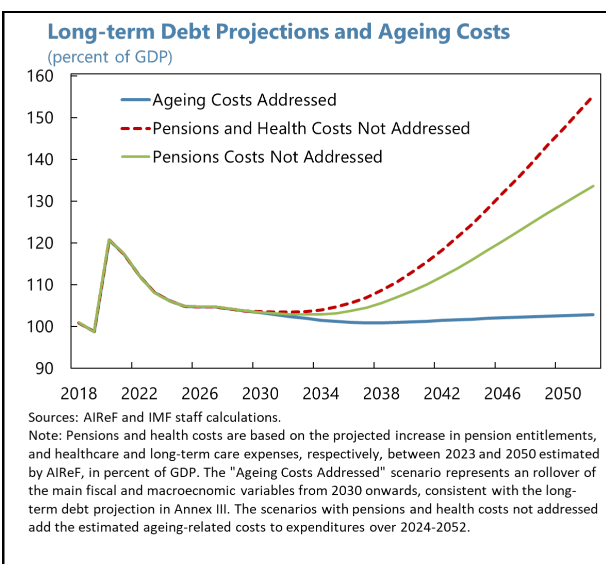
Furthermore, the debt-to-GDP ratio reduction from higher inflation will fade as price growth slows and key expenditure items –notably, pensions– are indexed to past inflation. Meanwhile, the refinancing of maturing debt at higher interest rates will raise the debt-service burden to 2.5-3 percent of GDP over 2024–29. While official figures from the reformed EU fiscal framework are yet to be published, staff's current baseline projection for the fiscal balance would most likely fall short of the expected adjustment path set out by the revamped EU economic governance framework as it does not set debt on a plausibly downward medium-term trajectory. However, the authorities have expressed their strong commitment to abiding by the EU fiscal rules, including by taking further measures as needed.



Sources: Agencia Estatal de Administración Tributaria, and IMF staff calculations.
Note: The blue solid line reports quarterly annualized revenues as a share of GDP; the red dashed line reports the predicted revenue from a dynamic forecast over 2020Q1-2023Q4 based on an estimated Error Correction Model where the explanatory variable is the administrative base of the personal income tax. For details, see 2024 Selected Issues.

Sources: Agencia Estatal de Administración Tributaria, and IMF staff calculations.
Note: The blue area reports the increase in PIT revenues due to growth in the tax base, holding constant the effective average tax rate at its 2019Q4 value. The red area reports the increase in PIT revenues due to the rise in the effective average tax rate, holding the base constant at its 2019Q4 value. For details, see 2024 Selected Issues.

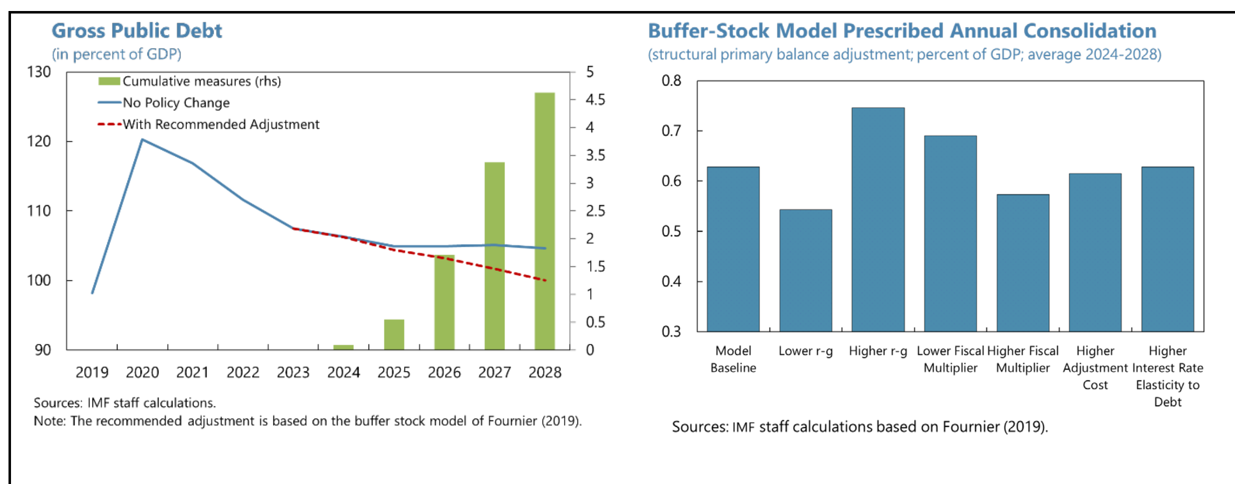
16. Spain's overall risk of sovereign stress is assessed as moderate in the medium term (Annex III). This is because debt and gross financing needs ratios are projected to stabilize at the high levels of 103 percent and 16 percent of GDP, respectively, making debt dynamics and rollover risk very sensitive to lower growth, higher financing costs, and/or a weaker fiscal balance. Furthermore, absent sustained consolidation or additional pension reforms, population ageing will sharply increase health and pensions expenditures starting from the mid-2030s (see Annex III). Thus, staff assess the risk of sovereign debt stress over the long term to be high in a no-further-policy-action scenario. This assessment does not factor in potential, additional fiscal pressures Spain could be



Sources: AIReF and IMF staff calculations.
Note: Pensions and health costs are based on the projected increase in pension entitlements, and healthcare and long-term care expenses, respectively, between 2023 and 2050 estimated by AIReF, in percent of GDP. The "Ageing Costs Addressed" scenario represents an rollover of the main fiscal and macroecnomic variables from 2030 onwards, consistent with the long-term debt projection in Annex III. The scenarios with pensions and health costs not addressed add the estimated ageing-related costs to expenditures over 2024-2052.

facing from defense spending and public investments related to the green transition. Staff also assess fiscal space to be "at risk" under the baseline and in the context of the reinstated EU-wide fiscal rules.

17. With the economy running at close to full capacity and benefitting from NGEU support, there is an opportunity to embark on a steeper, sustained consolidation path to rebuild fiscal space and reduce sovereign stress risk. Factoring in the economy's cyclical position and the objective to lower debt, staff recommend a reduction in the primary structural fiscal deficit of about 0.6 percentage point of GDP each year over 2024-28 to achieve a cumulative fiscal adjustment of about 3 percentage points of GDP. This adjustment would bring debt down to just over 100 percent of GDP and reduce gross financing needs by some 3 percentage points of GDP by 2028 relative to the baseline projection. Such effort would be broadly in line with staff's projection for 2024, but—unlike in the projection—repeated each of the four subsequent years. The recommended cumulative consolidation would build the fiscal space needed to respond to future shocks, including through the—effective but costly—use of short-time work schemes. It is also broadly in line with a buffer-stock model of optimal fiscal policy (Fournier, 2019) used in the 2021 and 2022 Article IV consultations, which trades the gain from reducing debt (in terms of reduced probability of any future debt distress) against its cost (in terms of near-term output loss). Importantly, it also appears sufficient to meet the requirements likely to be set out by the revamped EU economic governance framework under a 7-year adjustment scenario.



Sources: IMF staff calculations.
Note: The recommended adjustment is based on the buffer stock model of Fournier (2019).

Sources: IMF staff calculations based on Fournier (2019).

18. An explicit medium-term fiscal plan would signal commitment and increase the likelihood of a successful consolidation. It would anchor expectations around the objectives of reducing debt and rebuilding fiscal space, making it more likely that the sizeable recommended cumulative adjustment is ultimately achieved. Such plan would also align with the long-term focus of the new DSA-based EU fiscal framework, including the four-year horizon of the National Medium-

Term Fiscal-Structural plan the authorities will need to present to the European Commission.[6] AIReF could play an important role in reviewing the authorities' medium-term projections and evaluating the quantitative impact of fiscal policy proposals. Finally, publication of the plan would foster a healthy public debate about medium-term taxation and spending priorities.

19. A growth-friendly medium-term consolidation should hinge on reducing the tax system's inefficiencies and broadening the tax base, as also advised by the 2022 report of the tax experts' committee. Staff estimate that eliminating VAT exemptions and harmonizing VAT rates could yield an increment in revenues of up to 1.5 percent of GDP. Increasing the taxation of environmental externalities to average EU levels—such as by uprating fuel duties, strengthening vehicle acquisition fees and carbon pricing in residential heating technologies—and improving the coordination across levels of government on the administration of these taxes could mobilize a further 0.7–0.9 percent of GDP of revenues (Staff Report of the 2022 Article IV Consultation for Spain). Together with the withdrawal of the emergency anti-inflationary measures (about 1 percent of GDP), the additional revenue mobilization from VAT harmonization and enhanced environmental taxation could deliver the recommended medium-term consolidation of 3 percentage points of GDP. Throughout the adjustment period, the potential income distribution impact of these tax measures could be addressed through other recommended structural policies to support low-income households, including an in-work tax credit, scaled-up active labor market policies, and enhanced affordable housing supply—all of which are discussed in detail below.

20. Windfall levies do not constitute a growth-friendly consolidation strategy. In 2023, underpinned by high interest rate margins and energy prices in 2022, the temporary levies on the operating margins of financial institutions and energy companies, together with the solidarity tax on large fortunes, provided an important revenue contribution (of 0.2 percent of GDP) to finance the anti-inflation support measures (Annex VII). Should the authorities decide to turn these levies into permanent taxes as signalled, their distortionary effects should be minimized by aligning their bases with a clear definition of exceptional profits. They could also be redesigned to achieve other key policy objectives; for instance, banks' liablity to a revamped levy could be reduced through a tax credit proportional to the magnitude of a positive neutral counter-cyclical capital buffer (CCyB), should the latter be introduced.

21. Over the longer run, revenue measures should be complemented by action to address spending pressures, notably further reforms to ensure the sustainability of the pension system. Improving public spending efficiency, informed by AIReF's 2018-2021 and ongoing reviews, could help curb spending growth while better targeting support to vulnerable households. There is also scope for containing pension outlays, which would otherwise enter a growing trajectory over the next decade. The 2021–23 reforms permanently indexed pensions to inflation and repealed the planned adjustment of entitlements to life expectancy at retirement. In parallel, revenue measures were adopted, which the authorities expect to more than offset the higher pension expenditures

[6] Under the current EU fiscal framework, the government's Stability Program Update (SPU) only establishes reference rates for the fiscal deficit over a three-year period. However, such rates do not constitute a proper medium-term fiscal consolidation plan, as they are based on a no-policy change scenario with no discretionary fiscal consolidation.

over 2024–50. However, the authorities' projections rely on favorable long-term assumptions regarding the economy and the effectiveness of new delayed-retirement incentives compared to those used by the EU Ageing Working Group, Eurostat, the OECD, and AIReF. Estimates by AIReF, rating agencies, and think tanks suggest that a substantial financing gap exists in the pension system and that further measures might be required already at the first mandatory review in 2025.

Long-Term Macroeconomic Assumptions: Alternative Sources

	MISSMI	AIReF	Ageing Report 2024	OECD
Real GDP Growth Rate	2023-2030: 2.5% 2031-2040: 2.1% 2041-2050: 1.5%	2035: 1.4% 2050: 1.4%	2023-2030: 1.2% 2031-2040: 1.1% 2041-2050: 1.4%	2023-2030:1.5 2031-2040: 1.3% 2040-2050: 1.3%
Labor Productivity Growth Rate 1/	2023-2030: 1.2% 2031-2040: 1.5% 2041-2050: 1.6%	2022-2026: 1% 2027-2050: 1.1%	2023-2030: 0.5% 2031-2040: 1.2% 2041-2050: 1.8%	2023-2030: 0.63 2031-2040: 1.4% 2041-2050: 1.65%
Working Age Population Share 2/	2035: 59.4% 2050: 52.8%	2035: 64.3%; 2050: 57.3%	2035: 57.8% 2050: 51.3%	2035: 58.2% 2050: 52.3%
Labor Force Participation Rate 3/	2035: 81% 2050: 84%	2035: 66.8% 2050: 68.4%	2035: 81.4% 2050: 82.2%	
Immigration (Net inflow per year in thousands)	2035: 235 2050: 450	2035: 211.5 2050: 287.6	2035: 234.1 2050: 196.2	
Unemployment Rate	2026: 11.5% 2035: 9% 2050: 5.5%	2026: 11.6% 2035: 10% 2050: 7.1%	2026: 10.7% 2035: 10.4% 2050: 6.6%	

1/ for OECD: "trend labor efficiency"
2/ for MISSMI, AR24, and OECD: age 20-64 for AIREF: age 16-66
3/ Percent of Workign Age Population as defined in 3/.
Sources: Ministry of Inclusion, Social Security, and Migrations, AIReF, European Policy Committee Ageing Working Group, Eurostat, Organisation for Economic Cooperation and Development, and IMF staff calculations.

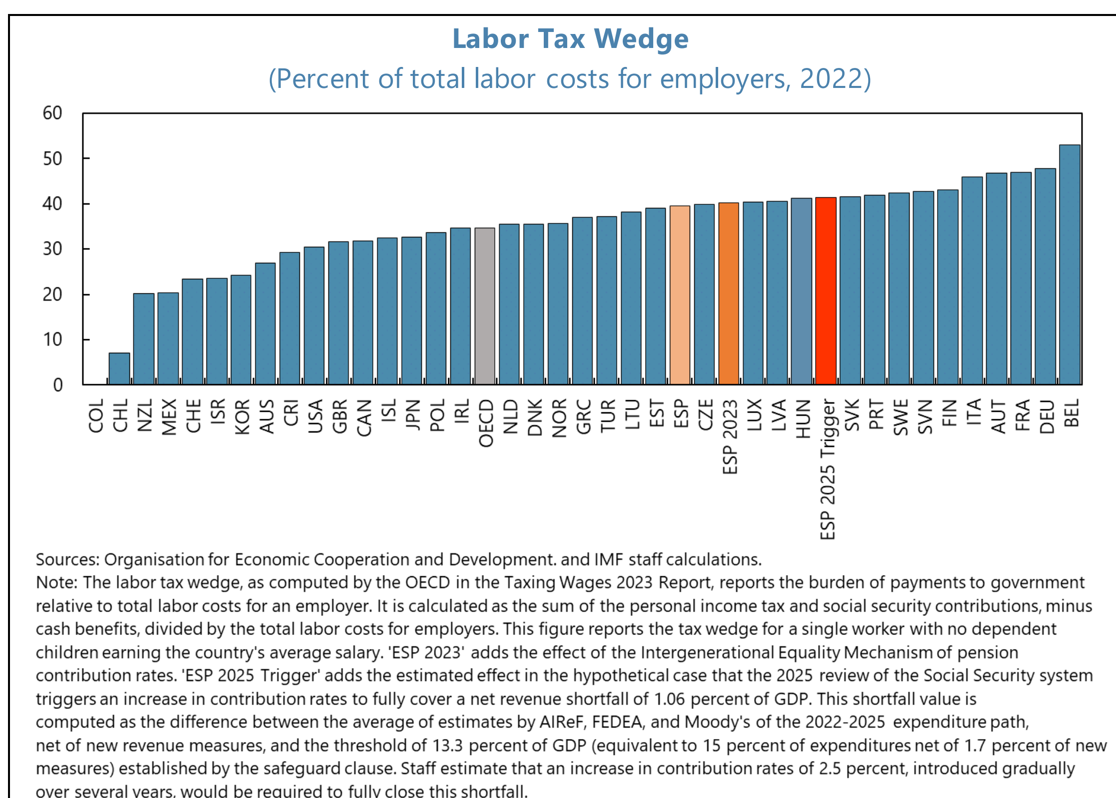
22. **While the combination of revenue and expenditure measures to balance the pension system is ultimately a societal choice, relying predominantly on the former would hurt employment and workers' incomes.** Conducting a review on a regular basis, with the power to mandate corrective measures—as required under the 2023 pension reform—is an important tool to safeguard the sustainability of the system. However, concerns remain over the functioning and macroeconomic implications of this mechanism. If activated, possibly as early as 2025, the mechanism prescribes an automatic increase in contribution rates in case no political agreement on alternative measures can be reached. In a hypothetical scenario under which a future reform relies only on contribution increases, Spain's average labor tax wedge—the gap between a worker's total labor cost and net take-home pay—could rise by up to 1.9 percentage points, 6.8 percentage points above the OECD average. An increase of such magnitude could have large adverse effects on employment, possibly reducing it by about 1 percent, equivalent to around 230,000 jobs.[7] This, in turn, would require even larger increases in contributions to balance the pension system. Additional triggers of the safeguard mechanism in future reviews would keep increasing the labor tax wedge in case the last-resort option of raising social security contribution rates turned out to predominate.

[7] The implied job losses are calculated using an average elasticity from the literature, obtained from both microeconometric studies (Heckman and Pages, 2004) and the macroeconometric literature (Daveri and Tabellini, 2000; Bassanini and Duval, 2009, Egert and Gal, 2016; IMF WEO, 2016), which broadly settle around an average semi-elasticity of the employment rate to the tax wedge of about 0.3.

23. Future pension reforms should therefore consider a balanced set of options. Replacement rates, which stand far above levels in peer countries, could be reduced by extending the benefit computation period towards workers' full careers.[8] Furthermore, the effective labor market withdrawal age, which at 64 years remains 3 years below the standard pensionable age of 67, could be raised by incentivizing older workers' labor force participation.[9] The share of delayed retirements among new pensioners has increased from 4 percent in 2022 to 8 percent in 2023, and to 10 percent in the first two months of 2024. These numbers provide early evidence on the effectiveness of the recent reforms in extending working lives. Additional measures could act along a broader front including health, flexible work arrangements, unemployment assistance (*subsidio por desempleo*) for those aged 52 and above, and active labor market policies (ALMPs). Future reforms could also consider making the system's automatic adjustment mechanism simpler and more forward-looking, and grant AIReF greater autonomy to use its own projections for the assessment of the mechanism's activation.

Labor Tax Wedge

(Percent of total labor costs for employers, 2022)



Sources: Organisation for Economic Cooperation and Development. and IMF staff calculations.
Note: The labor tax wedge, as computed by the OECD in the Taxing Wages 2023 Report, reports the burden of payments to government relative to total labor costs for an employer. It is calculated as the sum of the personal income tax and social security contributions, minus cash benefits, divided by the total labor costs for employers. This figure reports the tax wedge for a single worker with no dependent children earning the country's average salary. 'ESP 2023' adds the effect of the Intergenerational Equality Mechanism of pension contribution rates. 'ESP 2025 Trigger' adds the estimated effect in the hypothetical case that the 2025 review of the Social Security system triggers an increase in contribution rates to fully cover a net revenue shortfall of 1.06 percent of GDP. This shortfall value is computed as the difference between the average of estimates by AIReF, FEDEA, and Moody's of the 2022-2025 expenditure path, net of new revenue measures, and the threshold of 13.3 percent of GDP (equivalent to 15 percent of expenditures net of 1.7 percent of new measures) established by the safeguard clause. Staff estimate that an increase in contribution rates of 2.5 percent, introduced gradually over several years, would be required to fully close this shortfall.

24. It will be important to maintain strong incentives for autonomous communities to contribute to the required fiscal effort. Compliance with the national fiscal rule—which

[8] The OECD's 2023 Pensions at a Glance report (OECD, 2023) estimates that in Spain a 22-year old average earner who starts contributing in 2022 can retire at age 65 with a net replacement rate of 86.5 percent, versus an unweighted average across 15 Euro Area peers of 69.7 percent at a higher prospective average retirement age of 66.5.

[9] The 2024 Ageing Report (European Commission, 2024) estimates that the average effective age of labor market exit in Spain in 2023 was 64.

establishes fiscal targets for all levels of governments in line with the national objectives set by the EU rules—has historically been limited (Martínez López, 2020). The *Fondo de Liquidez Autonómico* (FLA), through which autonomous communities can borrow from the central government instead of issuing debt, also entails only weak conditionality to correct past slippages and establish greater fiscal prudence. Ongoing discussions regarding a partial forgiveness of some autonomous communities' debt to the FLA provide an opportunity to strengthen the design and enforcement of the national fiscal rule in parallel. Any reform of the rule should focus on enhancing incentives for autonomous communities to pursue sound fiscal policies, strengthening the corrective mechanism, and enhancing regions' revenue-raising capacity to align accountability with the degree of expenditure autonomy—in case the latter were to be increased. Finally, in line with the prospective revamped EU fiscal framework, a reformed rule should place greater weight on net primary expenditure targets to support overall fiscal consolidation objectives at the general-government level. Such overhauled institutional framework would constitute a sound basis for all autonomous communities to return to market-based debt issuance as the primary means of financing. Market forces would then provide an additional incentive for fiscal discipline, while the FLA should serve as a last-resort financing instrument with stricter conditionality.

25. The fiscal policy adjustment path should respond flexibly to possible adverse shocks, depending on their nature and magnitude. As a general rule, more decisive and frontloaded consolidation would be needed in the event of adverse inflationary shocks or financing difficulties. In contrast, in the event of adverse disinflationary shocks, such as weaker investment or exports, automatic stabilizers should be allowed to operate. Given the already limited fiscal space, discretionary stimulus should be considered only in case of major and temporary negative shocks and insofar as government funding costs remain low enough to allow for such support.

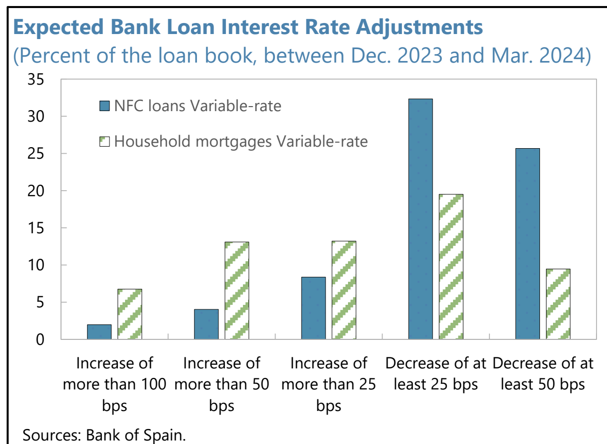
Authorities' Views

26. The authorities reiterated their commitment to sustained fiscal consolidation, starting with a 3 percent of GDP deficit target for 2024. In light of the revamped EU economic governance framework—which the authorities fully support—a medium-term plan is being prepared that will outline the government's proposed measures. The authorities plan to center their consolidation strategy on revenue measures, with a view to aligning taxation levels closer to those of EU peers. Envisioned initiatives would build on recent efforts to increase the overall progressivity of the system and bolster environmental taxation. Moreover, the temporary levies on banks and energy companies and the solidarity tax on wealth could be converted into permanent taxes with revamped designs, including to support other policy goals—such as green investment, for example. In light of sustained employment growth and early evidence on the effectiveness of delayed-retirement incentives, the authorities are confident that recent reforms will not require additional measures to preserve the sustainability of the pensions system while protecting older households' living standards. They are intent on reforming the financing system of autonomous communities to strengthen regional governments' fiscal autonomy while fostering greater accountability and ensuring a fair provision of essential public services across the country.

B. Ensuring Continued Financial Sector Resilience

27. Spain's banking system has weathered well tighter monetary policy and financial conditions (Figure 9), and there are no signs of build-up of significant systemic risks. Spanish significant institutions (SIs) have maintained stable capital and ample liquidity buffers. While above regulatory requirements, CET1 ratios remain below euro area peers. Asset quality indicators have remained sound, with system-wide NPL ratios staying unchanged and the share of stage 2 loans increasing modestly in 2023. With the bulk of variable-rate loans for both households and NFCs having been repriced by end-2023 (text chart), a moderate deterioration in asset quality is expected going forward. Pockets of vulnerability concentrate in specific segments, including loans that were guaranteed by the Official Credit Institute (ICO) under pandemic-relief measures. For the latter, the overall volume of stage 2 loans and NPLs reached €20.5 billion (1.4 percent of GDP) by end-2023.

Expected Bank Loan Interest Rate Adjustments
(Percent of the loan book, between Dec. 2023 and Mar. 2024)

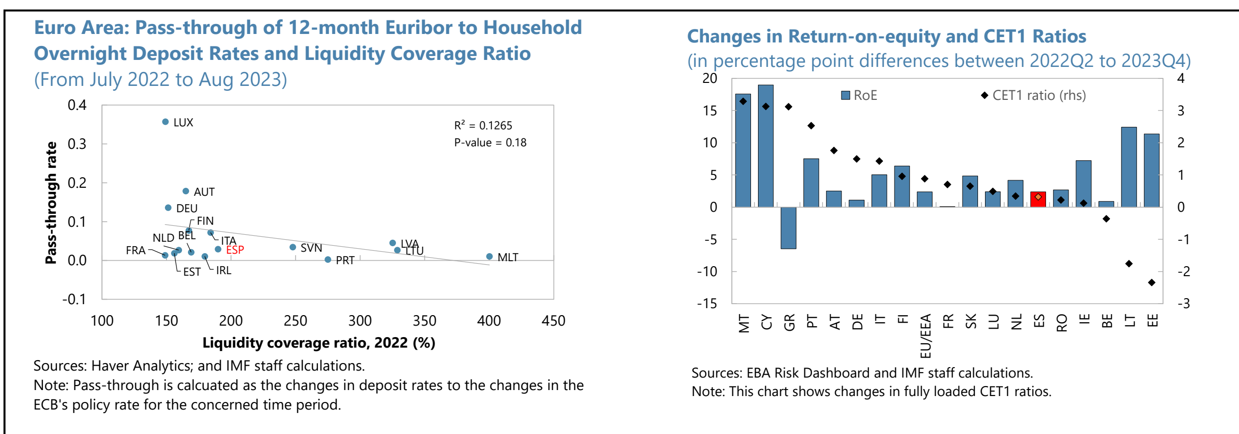


Sources: Bank of Spain.

28. The banking sector has enjoyed solid profitability, primarily driven by higher net interest income in the domestic market. Banks' net income as a percentage of total assets has reached post-GFC highs, and the return-on-equity ratio has been in line with EU peers and on a steady increase since after the pandemic. The pass-through of ECB's monetary rates has been significant for loan rates and new term deposit rates, but it has lagged for overnight deposit rates, possibly reflecting a combination of ample liquidity, high banking sector concentration (Beyer et al., 2023), and consumer inertia. The migration from sight to term deposits has started for both households and NFCs, but overnight deposits still take up most of the deposit base.

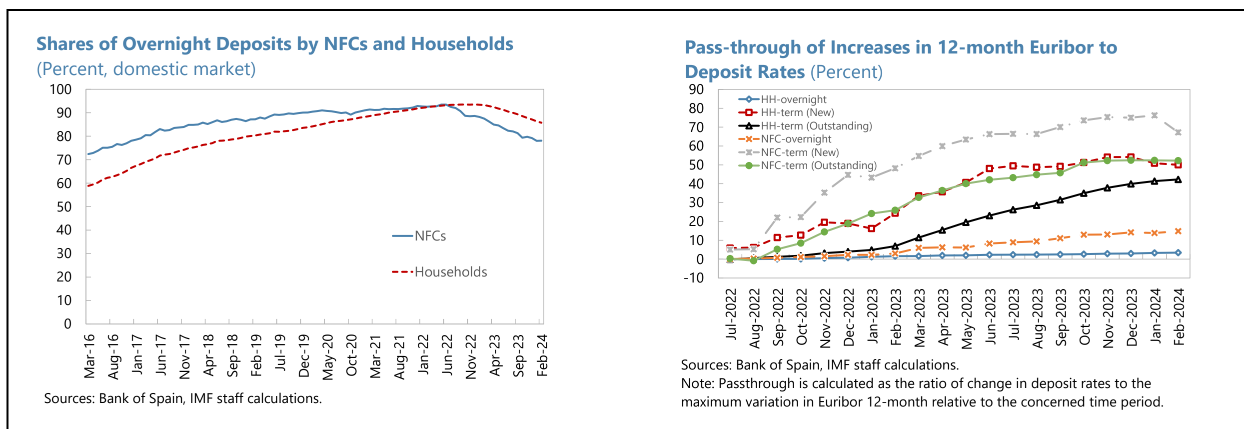
Euro Area: Pass-through of 12-month Euribor to Household Overnight Deposit Rates and Liquidity Coverage Ratio
(From July 2022 to Aug 2023)

Changes in Return-on-equity and CET1 Ratios
(in percentage point differences between 2022Q2 to 2023Q4)



Sources: Haver Analytics; and IMF staff calculations.
Note: Pass-through is calcuated as the changes in deposit rates to the changes in the ECB's policy rate for the concerned time period.

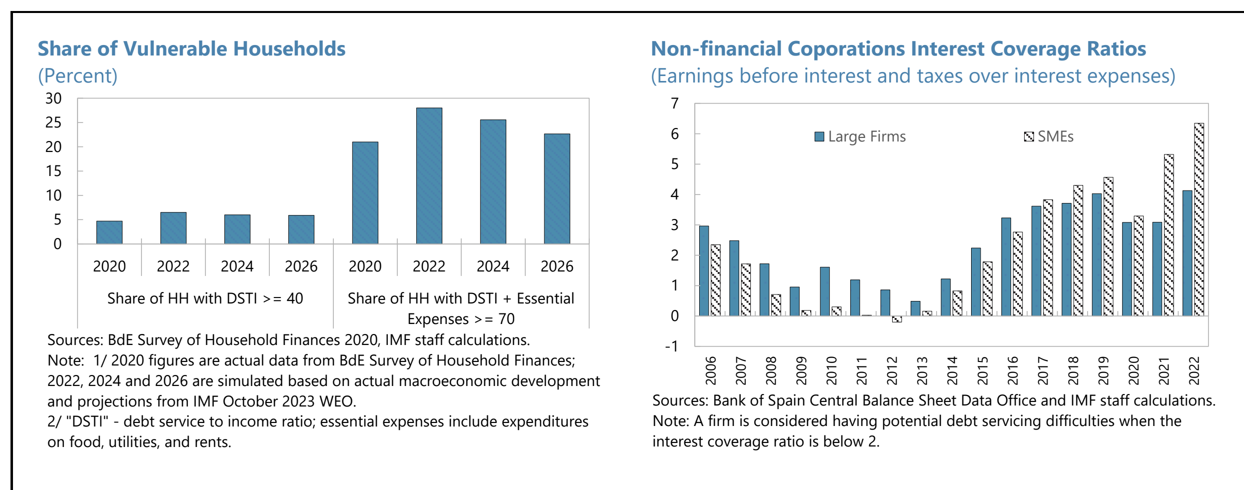
Sources: EBA Risk Dashboard and IMF staff calculations.
Note: This chart shows changes in fully loaded CET1 ratios.



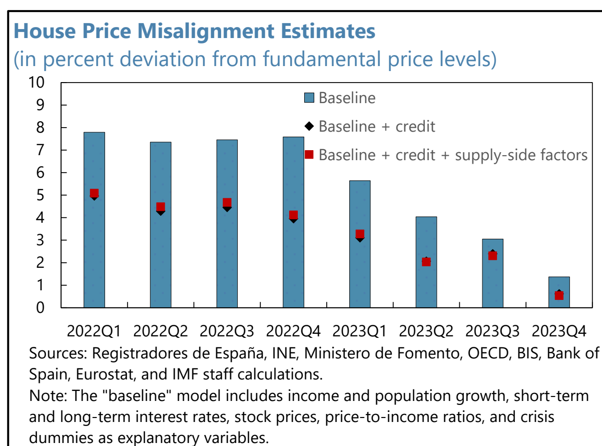
29. The economy's resilience and deleveraging since the GFC have helped cushion the impact of rising interest rates on private sector balance sheets, but pockets of vulnerability remain.

- Households continued deleveraging in 2023 and their indebtedness remains low compared to European peers. Simulations based on the Bank of Spain's 2020 Survey of Household Finances suggest that household vulnerability peaked in 2022 and would further decline under staff's baseline projections going forward, supported by a resilient labor market, robust real income growth, and excess savings accumulated since the pandemic. Vulnerabilities concentrate among low-income households (Figure 5).

- Corporate balance sheet strength has also improved, and the Spanish corporate sector is now among the least indebted in Europe. Corporate liquidity and profitability have continued to increase. Lower debt and improved profitability supported a rebound in firms' debt repayment capacity (as measured by their interest coverage ratio) to pre-pandemic levels by end-2022.



30. There is no evidence of significant residential or commercial real estate overvaluation. Housing transaction volumes fell by over 10 percent in 2023, but prices have continued to register small increases, reflecting mainly increased household formation and supply shortages. Even so, both the price-to-income and the price-to-rent ratios remain below pre-GFC levels, and an empirical model of house prices suggests they were broadly in line with fundamentals in 2023Q4. Nonetheless, close monitoring is warranted, especially in the new dwellings segment, where average price appreciation exceeded 8 percent in 2023. Commercial real estate prices are still below pre-pandemic levels, and banks' exposure to the sector remains low.

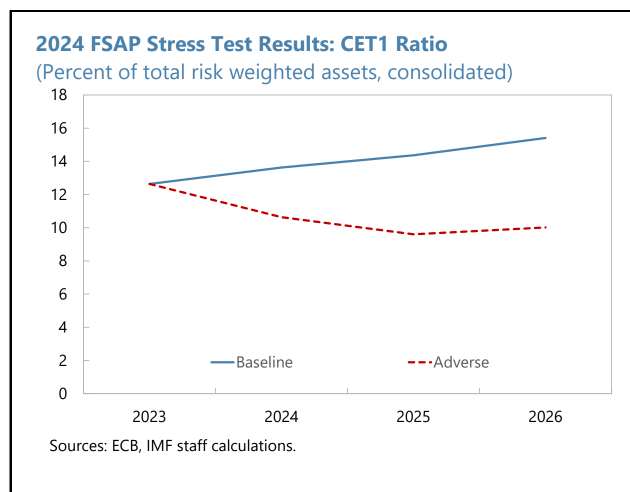


House Price Misalignment Estimates
(in percent deviation from fundamental price levels)

Sources: Registradores de España, INE, Ministero de Fomento, OECD, BIS, Bank of Spain, Eurostat, and IMF staff calculations.
Note: The "baseline" model includes income and population growth, short-term and long-term interest rates, stock prices, price-to-income ratios, and crisis dummies as explanatory variables.

31. The 2024 Financial Sector Assessment Program (FSAP) solvency stress tests indicate that Spanish SIs as a whole would be resilient to severe and persistent global shocks, but with substantial credit deleveraging and heterogeneity across banks, calling for stronger capital buffers *ex ante*.

- Banking sector profitability is expected to remain strong under the baseline. Assuming moderate dividend distributions and the bank levy keeping its current form until 2025, the aggregate CET1 capital ratio of the 10 Spanish SIs would rise by 1.8 percent points, from 12.6 percent in 2023Q3 to 14.4 percent by end-2025. This robust performance reflects a combination of still-high monetary policy rates, persistently low cost of retail funding, and stable loan loss provisioning.



2024 FSAP Stress Test Results: CET1 Ratio
(Percent of total risk weighted assets, consolidated)

Sources: ECB, IMF staff calculations.

- While the system would be resilient under the adverse scenario, this would come at the cost of substantial credit contraction, and there would also be heterogeneity across banks. The aggregate CET1 ratio of the ten SIs would decline sharply, by 3 percentage points, although at 9.6 percent by end-2025 it would remain above regulatory minima. Hence, the solvency stress tests suggest that an increase in profit retention by banks today could deliver a material pay off should downside tail risks materialize, since larger capital buffers would enable them to better satisfy credit demand, thereby dampening the macroeconomic cost of the downturn. Staff recommend that the authorities deploy policies to ensure that banks capitalize on current high profitability to accumulate more buffers.

- Liquidity stress tests show that SIs can cope comfortably with market valuation shocks but could face cash flow challenges under large withdrawals of retail deposits. Systemic risks from interconnectedness among banks and from the nonbank financial intermediation (NBFI) sector appear low; this reflects the small exposures of Spanish banks to other Spanish and foreign banks, as well as the small share of NBFIs in the financial system.

32. To further support banking system resilience and preserve credit extension in the event of adverse shocks, staff recommend introducing as soon as feasible a positive neutral counter-cyclical capital buffer (CCyB). At the current juncture, it is appropriate to keep the CCyB at a neutral rate, reflecting the absence of cyclical imbalances. However, the current neutral rate of 0 would prevent the CCyB from playing its role as the main releasable macroprudential capital buffer to mitigate severe adverse exogenous shocks—particularly those, such as the COVID-19 pandemic, not preceded by a credit boom. Staff welcome that the Bank of Spain may consider introducing a positive neutral CCyB rate and recommend that a decision be made as soon as feasible. Banks could withstand comfortably a moderate positive neutral CCyB given the system's projected voluntary buffers (2.3 percent of risk-weighted assets as of 2023Q3, increasing by a further 1.8 percentage points over 2024-2025 under staff's baseline).

33. The 2024 FSAP also underscores the importance of further strengthening financial system supervision and oversight, maintaining financial integrity, and enhancing the operational capacity of the financial safety net (Annex VI). One key priority is to align supervisory authorities' resources to the complex risks and emerging challenges, such as cyber security risks, they are facing. Supervision of less significant institutions' (LSIs) risk management could be further strengthened, including management of liquidity, interest rate, and concentration risks. Increasing the transparency, impact and accountability of the national macroprudential authority, and granting full autonomy to the National Securities Market Commission over its recruitment process, would further strengthen supervision and oversight. Continued efforts to improve AML/CFT risk-based supervision and oversight, including through comprehensive data collection and risk analysis, are critical to safeguard the integrity of the financial system. The operational capacity of the resolution regime should also be further enhanced, and arrangements for funding in resolution should be clarified.

34. While the new insolvency law is still in the early stages of implementation, evidence so far is generally encouraging. Since the adoption of the law in September 2022, the use of the newly introduced comprehensive restructuring framework for corporates—which includes pre-insolvency out-of-court procedures—has taken off, and the new incentives for individual debtors with more attractive "fresh start" conditions have increased insolvency filings. Meanwhile, the use of the novel special procedure[10] for micro-enterprises has not yet gained speed. Going forward, it is important to continue monitoring the implementation of the new law, including through enhanced data collection as planned. Strong procedural safeguards for all parties of the insolvency processes

[10] The procedure is based on a system of official, electronic, standardized forms, accessible online and free of charge. Its goal is to reduce costs and simplify processes by making debtors in charge of liquidation without the need for assistance from insolvency professionals.

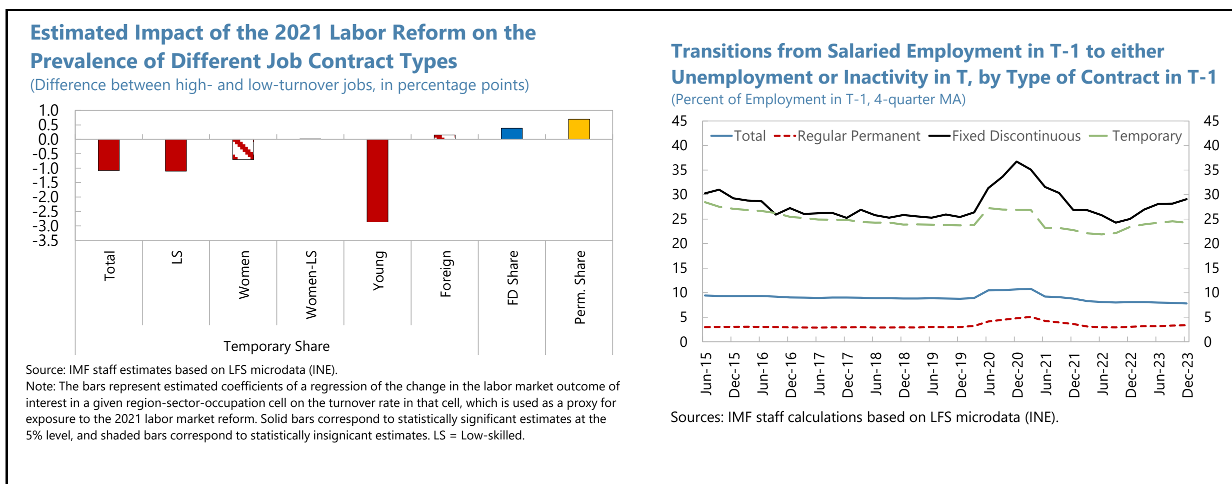
should be ensured. Appropriate institutional capacity, including adequate court resources, is also critical to ensure that Spain's insolvency regime ultimately leads viable firms to be restructured rather than liquidated.

Authorities' Views

35. The authorities concurred with staff's risk assessment and recommendations. They noted the absence of elevated cyclical systemic risks in the financial system and recent signs of easing financial conditions. They also emphasized strong macroeconomic developments, robust private sector balance sheets and the increasing prevalence of fixed-rate mortgages as factors supporting the system's resilience. The Bank of Spain found banks' provisioning levels, credit risk identification, and liquidity and solvency buffers to be adequate, while suggesting that higher solvency buffers could further dampen the macroeconomic cost of severe shocks. They saw no evidence of price misalignment in the residential real estate market and highlighted banks' low exposure to commercial real estate. Recognizing the benefits of a positive neutral CCyB, especially its releasability against the backdrop of volatile financial and real business cycles compared to peers, the Bank of Spain agreed with staff on the need to make a decision soon. The authorities viewed the insolvency law's initial impact positively, attributing the underuse of the special procedure by micro-firms to the need for market participants to familiarize themselves with it.

C. Labor Market Policies to Enhance Employment and Opportunities

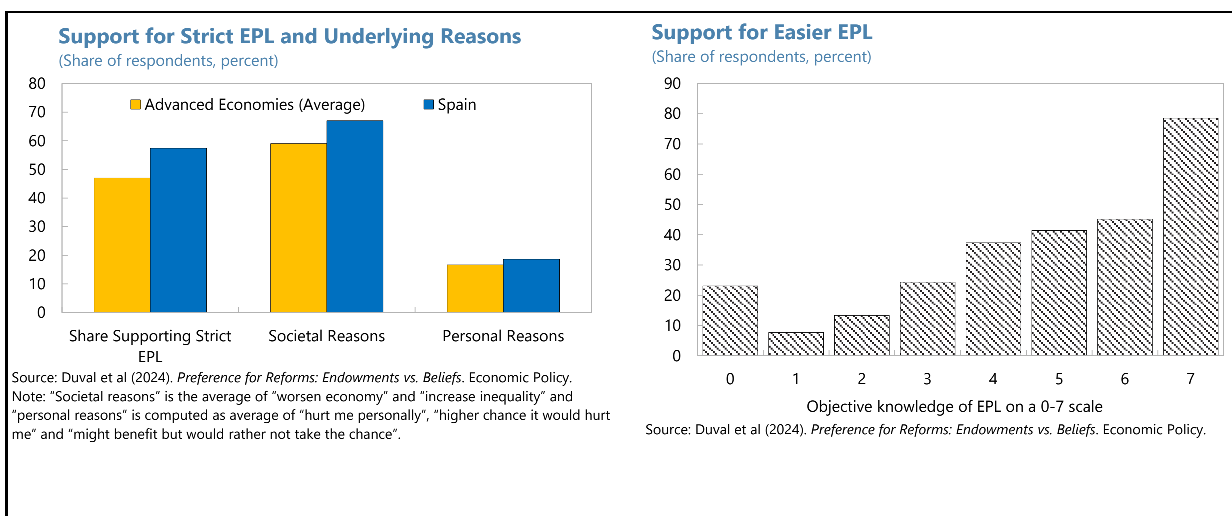
36. The 2021 labor market reform was successful in lowering the share of temporary employment by almost 10 percentage points to average EU levels, although its broader impact on dualism is less clear and structural unemployment remains high. The decline in the temporary employment share was concentrated in the private sector and mirrored by an increase in the share of workers with more stable contracts, namely regular permanent and seasonal open-ended ("fixed-discontinuous", FD hereafter). Key disadvantaged groups in the labor market, including youth and migrants, benefitted disproportionately from improved contractual stability. However, so far the reform does not seem to have materially changed aggregate transitions from employment to unemployment, partly because of some reduction in employment stability among FD and permanent workers (2024 Selected Issues).



Source: IMF staff estimates based on LFS microdata (INE).
Note: The bars represent estimated coefficients of a regression of the change in the labor market outcome of interest in a given region-sector-occupation cell on the turnover rate in that cell, which is used as a proxy for exposure to the 2021 labor market reform. Solid bars correspond to statistically significant estimates at the 5% level, and shaded bars correspond to statistically insignicant estimates. LS = Low-skilled.

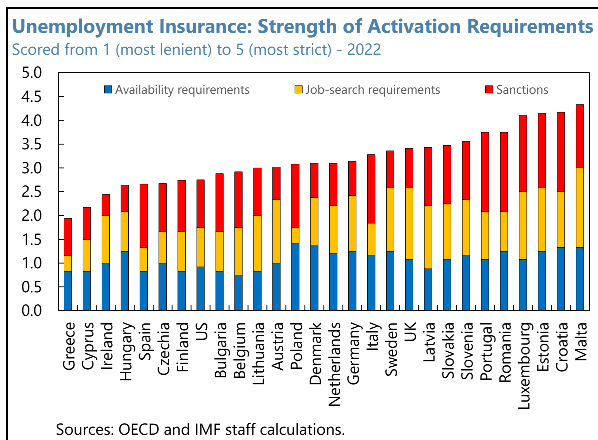
Sources: IMF staff calculations based on LFS microdata (INE).

37. Additional incentives for employers to create regular permanent contracts could further reduce labor market dualism. This could be achieved by reducing the length and cost of dismissal procedures, while increasing the notice period to enable early public employment service support to laid-off workers. The government's plan to tailor severance pay to individual circumstances would instead raise uncertainty around dismissal costs, and thereby could disincentivize employers from offering permanent contracts—particularly for disadvantaged groups—running counter to the spirit and impact of the 2021 reform. Introducing higher unemployment insurance contributions for employers with higher turnover could discourage excessive shifts between activity and inactivity under FD contracts which, in turn, should be monitored more accurately with additional statistical information. Any reform to ease employment protection legislation (EPL) should be carefully communicated and subject to broad public debate, given that political economy obstacles to such reforms in Spain are large and strongly rooted in ideological views, and better-informed voters tend to be more supportive (Duval et al, 2024). Curbing the use of temporary contracts in the public sector for jobs that are permanent in nature, as planned, would also help further bring down the overall temporary employment share.

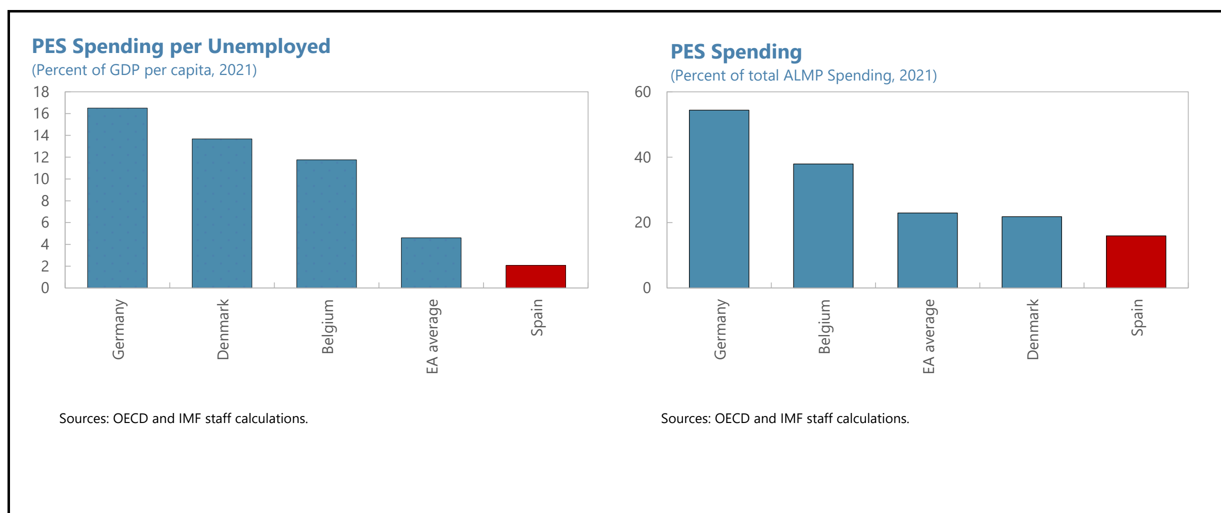


Source: Duval et al (2024). *Preference for Reforms: Endowments vs. Beliefs*. Economic Policy.
Note: "Societal reasons" is the average of "worsen economy" and "increase inequality" and "personal reasons" is computed as average of "hurt me personally", "higher chance it would hurt me" and "might benefit but would rather not take the chance".

Source: Duval et al (2024). *Preference for Reforms: Endowments vs. Beliefs*. Economic Policy.



38. Boosting active labor market policies (ALMPs) is key to cutting structural unemployment. The 2023 Employment Law sets the right approach, but decisive progress on the ground requires strengthening activation requirements, which are comparatively weak in Spain, and better integrating active and passive policies. The latter can be achieved by further converging towards a "one-stop shop" model, where a single caseload worker typically administers benefits, provides activation support, enforces activation requirements, and decides on sanctions in case of non-compliance for a given unemployed worker. Increasing the effectiveness of regional Public Employment Service (PES) agencies could be achieved by tightening the link between central government transfers and their job placement performance, which should be measured through simple indicators such as the achieved reduction in unemployment duration or contractual stability upon finding a job. Finally, there is scope for raising the share of PES resources spent on job placement, the share of PES expenditures in total ALMP spending and—over time as fiscal space is rebuilt—overall ALMP expenditures, all of which remain low in international comparisons. Bringing PES spending per unemployed to the euro area average (as percent of GDP per capita) would entail a direct cost of about 0.15 percent of GDP. Reducing unemployment—including by enhancing ALMPs—would enable the government to recoup such fiscal costs, since a one percentage point decline in the unemployment rate reduces spending on unemployment benefits by about 0.2 percent of GDP.

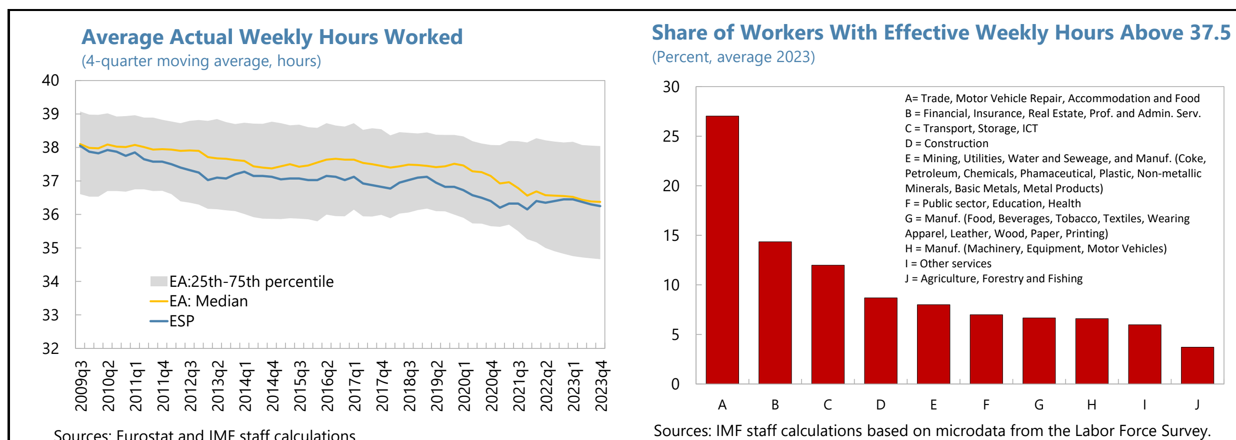


39. Strengthening the rights and obligations of unemployment assistance (UA) recipients could help broaden their income security while speeding up their return to work. The government's proposal to reform the *subsidio por desempleo* is broadly welcome. It would make the scheme more generous by raising benefit levels and broadening coverage, while improving

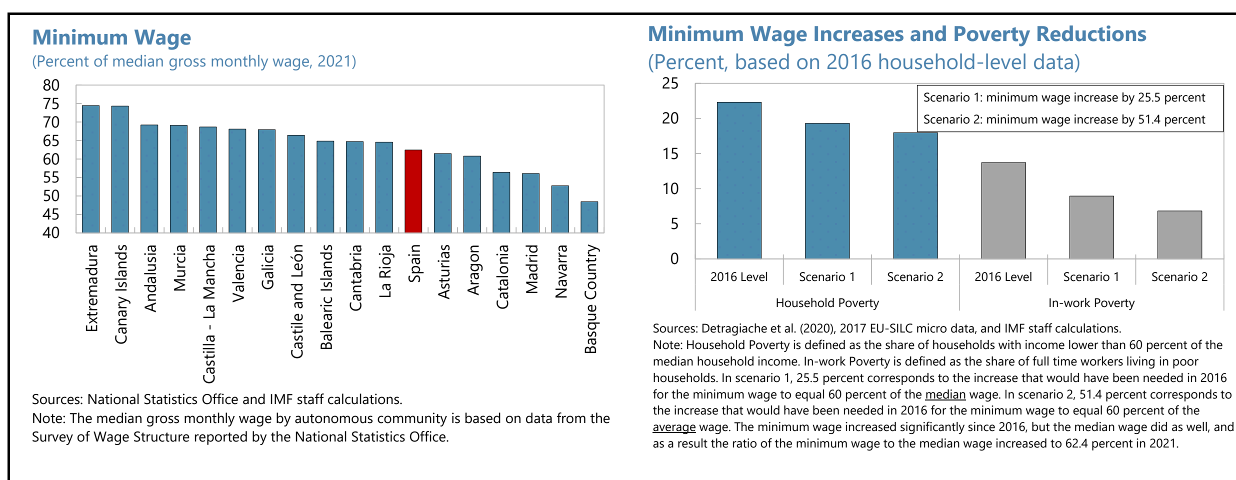
somewhat beneficiaries' work incentives by reducing the benefit amount over time, making benefit receipt temporarily compatible with work, and establishing personalized activation itineraries. Greater job search support and stronger activation requirements for recipients—particularly those aged 52 and over, whose benefit duration is indefinite and who are less likely to find a job—could increase the effectiveness of the proposed reform.

40. Making UA compatible with work, coupled with a well-designed in-work tax credit, would further strengthen employment incentives and support low-income workers. Keeping receiving UA payments for a while after starting a new job—possibly for longer than envisaged in the government's initial reform proposal—would incentivize job take-up, especially for low-wage workers, whose financial gains from activity are typically smaller (Coady et al., 2021). In addition, turning the existing labor earnings tax allowance—which interacts with the PIT withholding schedule in a way that discourages minimum-wage earners from working as many hours as they otherwise would—into a refundable in-work tax credit would support the incomes and employment of the low-skilled, as shown by the successful experiences of other European countries. Together, the in-work tax credit and the compatibility of UA with labor earnings would also promote employment formalization, which would enhance economic security, participation in the social security system, and tax revenue.

41. The government's planned reduction of the working week in the private sector should be carefully designed to mitigate its adverse impact on output and workers' incomes in the long term. The Ministry of Labor has proposed a reduction in legal working hours—without wage reduction—from 40 hours per week to 37.5 hours per week. This measure would affect nearly 9 million salaried workers who currently have effective working weeks longer than 37.5 hours, most of them in the private sector. This reform may entail a decline in income per capita in the medium term, as productivity gains would not be enough to offset the reduction in the labor input. Other countries, such as France, have pursued legal workweek reductions in the past, with mixed results. The French experience indicates that, to minimize output losses and fiscal costs, the reduction in hours worked should be accompanied by wage moderation, accommodate cross-sector heterogeneity through collective bargaining, allow for flexibility—such as through annualization of the hours reduction—to maximize possible productivity gains, and take into account the interplay with the minimum wage. If a working week reduction in the public sector were to be eventually considered, it would have to be commensurate with the already small existing gap between the current effective working time and the new proposed legal norm (Annex VIII).



42. After a rise of nearly 55 percent since 2018, any further increases in the minimum wage need to be carefully calibrated. The government targets a *net* minimum wage level of 60 percent of average *net* monthly earnings of a full-time worker. In 2023, with average net monthly earnings of a full-time worker estimated at €1,681, the monthly minimum wage, which was set at €1,008 in net terms (14 payments), had already reached the target. Based on the ratio of the minimum wage to median *gross* monthly earnings, which is a more widely available metric across countries, Spain now ranks close to the euro area average. Any further increases should be carefully calibrated to avoid unintended effects, particularly on low-skilled employment. In addition, the minimum wage is not a well-targeted anti-poverty and redistributive tool since—unlike an in-work tax credit, for example—it supports low-wage formal workers, not low-income households. Micro simulations suggest that minimum wage increases can be less effective in reducing overall household poverty than in-work poverty. Future increases should also be guided by the recommendations of the Minimum Wage Commission, which should pursue joint employment, poverty and inequality objectives, and be granted more autonomy and greater institutional weight. In addition, the commission should assess the benefits and feasibility of differentiating the minimum wage by age or region.



Authorities' Views

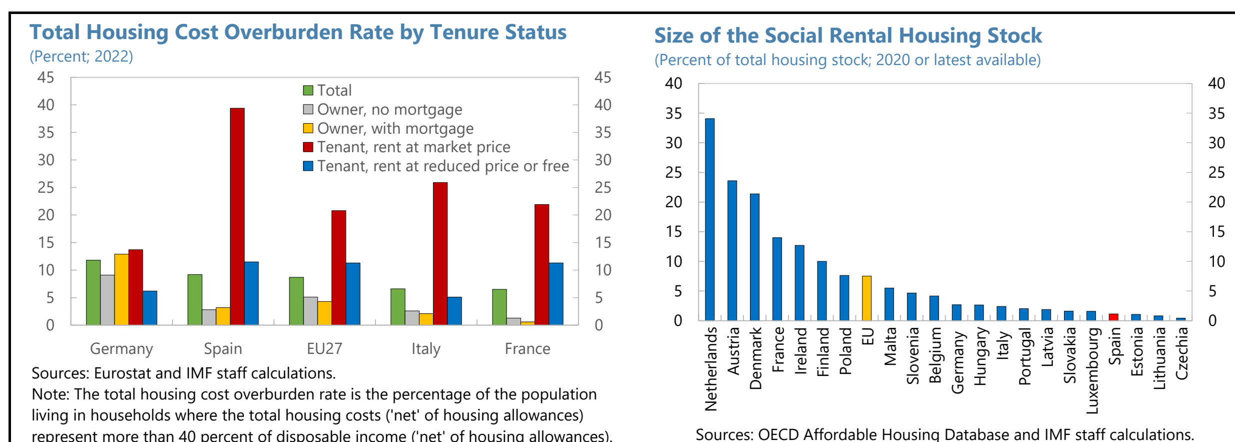
43. The authorities stressed the success of the 2021 labor reform and agreed that efforts should now focus on boosting ALMPs. They concurred with staff on the reform's positive impact on contractual stability and also highlighted favorable outcomes in terms of broader employment stability. The government's objective is to bring the unemployment rate down to 8 percent in the medium term and, to this end, it is prioritizing boosting ALMPs through the development of individualized itineraries for each unemployed, the professionalization of PES staff, linking regional PES transfers to quantifiable performance indicators, and enhancing evaluation. The authorities are confident about passing a revised UA reform proposal. If the increased incentives for job take-up work as intended, they would consider extending this approach to other unemployment benefits. Guided by the European Social Charter, the Ministry of Labor confirmed its intention to tighten EPL by tailoring severance pay for unfair dismissals to individual worker circumstances; the design of this reform, however, is at a very early stage. The government is also committed to reducing the maximum legal working time with unchanged wages, and it is confident that ongoing negotiations between social partners to implement such reduction gradually and flexibly (across sectors and over the year) could help achieve some productivity gains.

D. Structural Reforms to Rekindle Productivity and Income Growth

44. Reform momentum has slowed, and efforts to enhance information on the execution and impacts of NGEU-funded projects should be maintained. Several reforms included in the recovery plan have been carried out and are in the process of being implemented, such as the pension, ALMP, and housing reforms. While the government is now stepping up efforts to meet pending commitments (including the UA reform), last year's election cycle slowed reform momentum, delaying planned initiatives such as the tax reform. Available information suggests that investment execution of the NGEU grants is progressing. While accelerating execution might be needed to spend all available funds by the established deadline, project selection—targeting productivity-enhancing and green projects—should remain the priority. In addition, it is important to ensure an effective use of the funds—including by improving coordination across all government levels and further enhancing the collection and reporting of data (also in national accounting terms) on investment execution, building upon recent efforts.

45. Addressing housing affordability requires boosting supply more than helping demand. Rental affordability continues to be a challenge, especially among low-income tenants, due to high overburden rates. The 2023 Housing Law strengthened tenant protection and introduced rental caps in stressed areas, which so far have been only implemented in Catalonia. Past experiences suggest that rent controls can reduce rental housing supply and limit access to housing among disadvantaged groups, undermining controls' very objectives. Therefore, an evaluation of the early impact of rental caps in Catalonia is warranted, which should inform the future course of policy. To improve housing affordability while also raising aggregate output and income, the authorities should instead prioritize boosting supply, whose weakness explains the recent persistence of price increases. The main constraints for housing development include land scarcity—reflecting the length

and complexity of the procedures involved in unlocking it—and tight lending standards for real estate and construction loans. Social housing supply has also been limited (1 percent of the total housing stock versus 7.5 percent EU average), partly reflecting a historical focus of housing policy on demand-side measures rather than on public housing construction. The government is making progress in boosting housing supply, leveraging NGEU grants to fund the development of affordable housing in public land and the expansion of public housing. Other welcome initiatives are a loan program for the promotion of affordable housing and the proposed streamlining of urban planning, including by reducing red tape in the concession of licenses at the regional and local levels.



46. Reforms to revive weak productivity growth remain critical to raise Spain's living standards towards those in the highest-income euro area economies. While the post-GFC productivity slowdown is largely a global phenomenon, Europe's, and Spain's in particular, has been particularly sharp. A revival of Spain's productivity growth requires a broad-based reform effort to strengthen innovation and business dynamism. Specific measures, some of which were discussed in the Staff Report of the 2022 Article IV Consultation for Spain, include: strengthening government support to business R&D; modernizing higher education and vocational education and training (VET) systems; and introducing regulatory reforms to help the most productive firms grow, including by reducing the large number of size-dependent regulatory thresholds and the differences in regulatory frameworks across regions. Improved access to finance for productive but credit-constrained firms, which would benefit from a deepened EU-wide Capital Market Union, could raise investment and productivity. Spain's ambitious reform agenda under the recovery plan identifies many of the right priority areas, and some of these initiatives have already been pushed forward, such as the adoption of the Business Growth, Startup and Science Laws, the education and VET reforms, and several measures to promote digitalization and public sector efficiency. However, it will take time, continued implementation efforts, and a revival of the broader reform agenda for some productivity gains to materialize. Finally, the upcoming independent National Productivity Council is welcome; if given a prominent role as in some peer countries (such as Australia or The Netherlands, for example), it could help develop new, well-informed, productivity-enhancing policies.

Authorities' Views

47. There is consensus on the need to boost productivity growth and improve housing affordability. The authorities flagged the multiple reforms they already implemented, whose productivity payoff will materialize gradually. They also trust that the upcoming National Productivity Council will help develop new policies and monitor the implementation and impact of those already in place. Stressing that a productivity acceleration will require some pick-up in investment, the authorities are planning a reform to streamline approval of foreign investments, especially those in strategic sectors. Furthermore, they are working on measures to reduce red tape for companies—especially SMEs—by leveraging digital tools. They are also advancing the green agenda, including accelerating the deployment of renewable energy and enhancing the electricity grid, which should be a source of competitiveness in the future. Finally, the authorities reiterated their commitment to use the grant component of NGEU funds in full, as planned. Regarding housing affordability, while the authorities agree on the need to boost housing supply, including by reducing red tape in the concession of licenses and expanding social housing, they are considering a broader set of measures, such as support for young first homeowners. They do not foresee a large negative impact of the rental caps on supply, as these may remain limited to just a handful of regions and only to large homeowners. Finally, the authorities look forward to participating in the IMF's voluntary assessment of transnational aspects of corruption, highlighting the government's ongoing efforts to prevent the supply and facilitation side of corruption.

STAFF APPRAISAL

48. The Spanish economy has withstood recent shocks better than in the past, but major structural challenges remain. Well-designed policy responses to the pandemic and energy crises dampened output and—even more so—job losses, setting the stage for a full economic and labor market recovery. Enhanced export performance, underpinned by price and non-price competitiveness gains in services, further enhanced resilience. The buoyant job market, together with a decade of deleveraging efforts, enabled households and firms to withstand tighter financial conditions after the 2022 inflation spike, which also supported financial system health. However, Spain's unemployment rate remains the highest in the euro area, with current labor market tightness suggesting it is mostly structural. Further, investment has remained subdued and trend productivity growth has been particularly weak—even compared to its low level in euro area peers, impeding convergence in living standards towards those in highest-income euro area economies.

49. Growth is projected to remain solid, inflation is expected to further decline, and risks have become more balanced albeit still tilted to the downside for growth and the upside for inflation. Steady growth above 2 percent is expected throughout 2024-2025, as private consumption benefits from further solid real disposable income gains and a reduction in the household saving rate, while investment picks up as NGEU funds continue to be disbursed and financing conditions gradually improve as the ECB eases monetary policy. Inflation is projected to

return close to the ECB target before mid-2025 as wage pressures remain contained on the back of the 2023 national agreement. Risks have become more balanced in the past year, but domestic (political fragmentation) and international (geopolitical) forces could derail the favorable growth outlook, while greater-than-foreseen wage growth and services inflation persistence could make inflation stickier than expected.

50. An ambitious multi-year fiscal consolidation effort is warranted to bring down high debt and restore fiscal space amid favorable economic conditions. Under staff's baseline projection,the fiscal deficit and public debt ratios would stabilize at uncomfortably high levels in the medium term—around 3 and 103 percent of GDP, respectively. With output close to potential and the economy continuing to benefit from NGEU support, there is a clear case for a sustained consolidation effort to set debt on a firm downward path and restore fiscal space. Staff recommend an improvement in the structural primary balance of about 3 percentage points of GDP overall over 2024-2028, which would be best embedded in a strong medium-term fiscal plan and focused on addressing tax system inefficiencies. If made permanent, the levies on banks and energy companies should be redesigned to minimize their distortionary effects, including by shifting their base to a clearer definition of exceptional profits. Additional pension reforms will also very likely be needed to cope with ageing pressures in the future; they should go beyond the last-resort option of raising social security contribution rates, which could reduce employment.

51. The financial system is resilient and there are no signs of significant systemic risks, but larger bank buffers would mitigate the macroeconomic impact of major adverse shocks. Spain's significant banking institutions have ample liquidity buffers and their capital ratios should continue to improve due to robust profitability. They would also be resilient to severe adverse shocks, as indicated by the 2024 FSAP stress tests. However, strengthening their capital buffers would permit them to better satisfy credit demand and thereby limit the overall economic cost should a downside tail risk materialize. Therefore, the authorities should deploy policies to ensure that banks capitalize on current high profitability to accumulate more buffers, which are lower than their euro area peers. In addition, introducing as soon as feasible a positive neutral CCyB rate would further enhance banking system resilience.

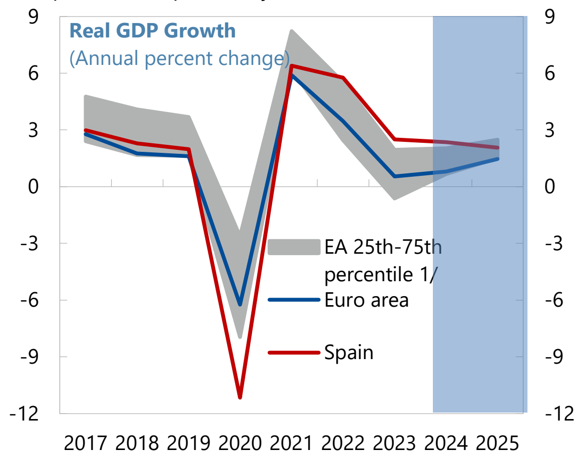
52. While long-standing labor market deficiencies have eased, more reforms will be required to further enhance employment stability and cut still elevated structural unemployment. The 2021 EPL reform reduced long-standing labor market dualism. Going forward, reducing uncertainty around dismissal costs, introducing higher unemployment insurance contributions for employers with higher turnover, and curbing the use of temporary contracts in the public sector could further increase the prevalence of regular permanent contracts. Further progress towards strengthening activation requirements for the non-employed and better integrating active and passive labor market policies could lower the unemployment rate durably into single digits. New labor market policy initiatives, including the planned reduction in the working week, future adjustments to the minimum wage, and possible modifications of legislation regarding severance pay, should be carefully designed to avoid unintended effects on employment and growth.

53. A broad productivity-enhancing policy agenda, including making the most of NGEU funding, is needed to rekindle income convergence. Putting even more emphasis on productivity-enhancing NGEU-funded investments would help, as would a revival of the broader reform agenda including stronger government support to business R&D and regulatory reforms to help the most productive firms grow. To address housing affordability while also supporting investment and economic efficiency, the government should prioritize raising housing supply, including by continuing to streamline urban planning and boosting social housing.

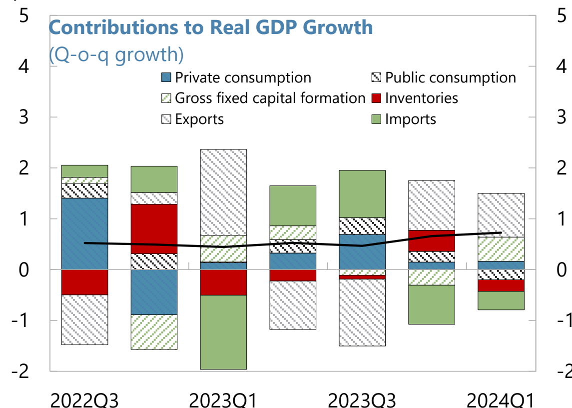
54. It is recommended that the next Article IV consultation take place on the standard 12-month cycle.

Figure 1. Spain: Real Sector and Inflation

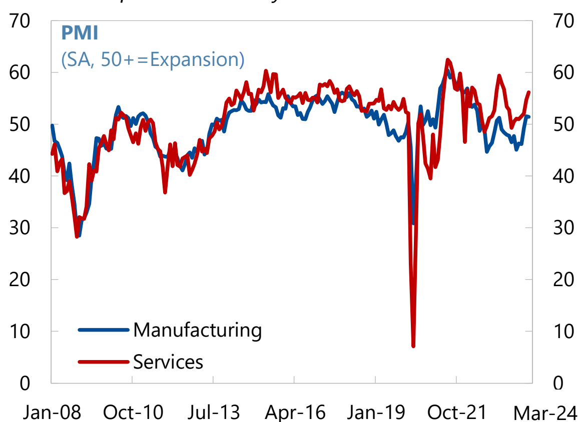
Spain's growth performance has been better than euro area peers in the past two years,



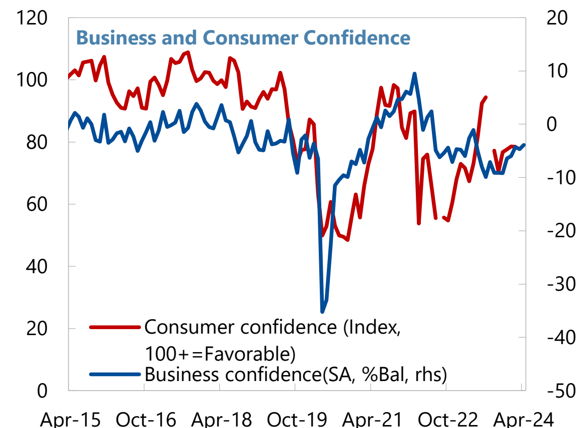
... and growth momentum has been robust in recent quarters.



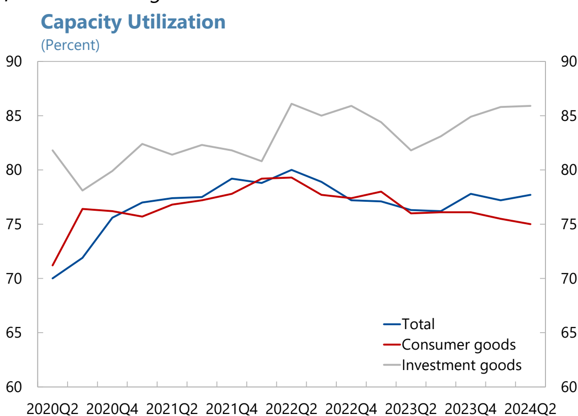
PMIs further rebounded in early 2024, with services momentum continuing to be strong and manufacturing back into expansion territory.



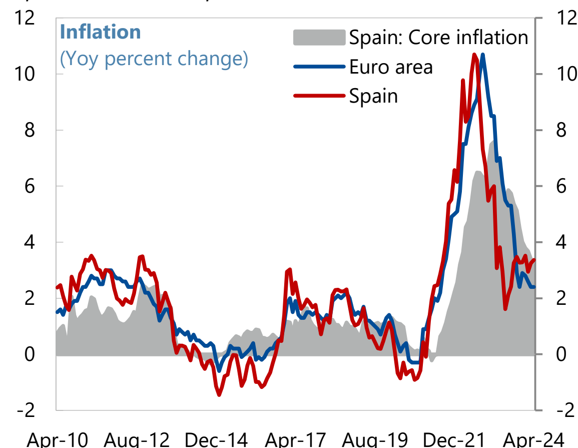
Consumer and business confidence have also started to recover recently.



Capacity utilization has stabilized overall, and improved for investment goods.



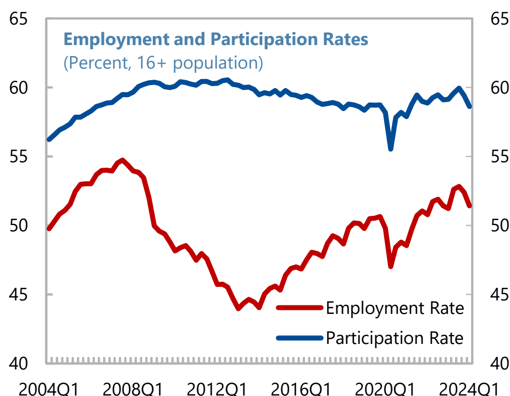
Core inflation continues to normalize, and headline inflation rebounded from low levels last summer.



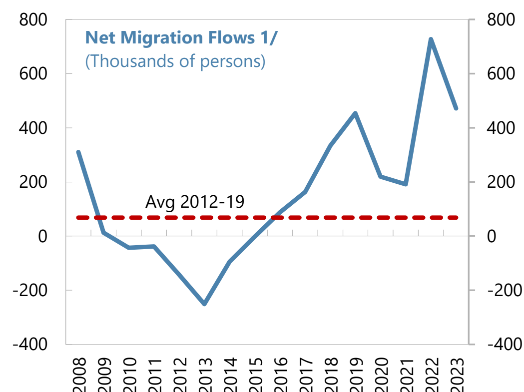
Sources: Bank of Spain, Eurostat, Haver Analytics, and IMF staff calculations.

Figure 2. Spain: Recent Developments in the Labor Market

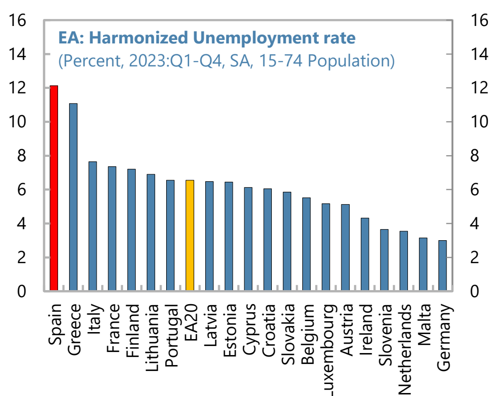
The employment rate has reached its highest level since the mid-2000s, and labor force participation has fully recovered from its COVID-driven drop…



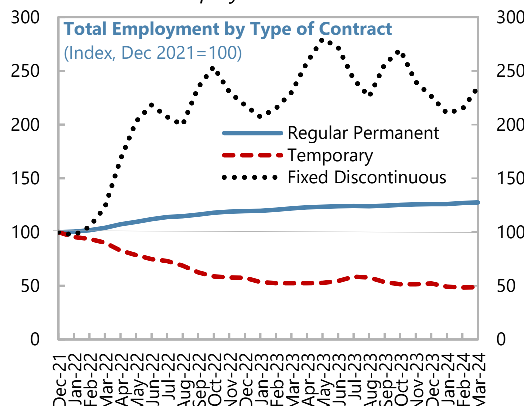
…while large net migration flows are supporting working-age population growth.



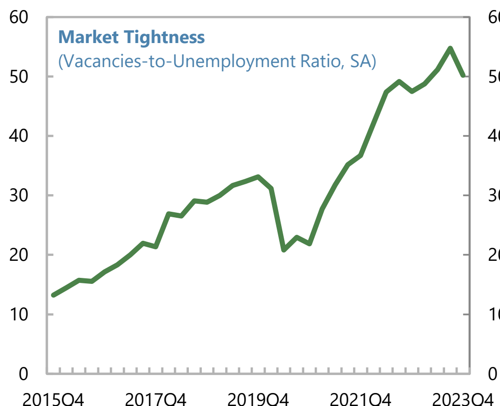
Despite its significant decline, the unemployment rate remains the highest in the euro area.



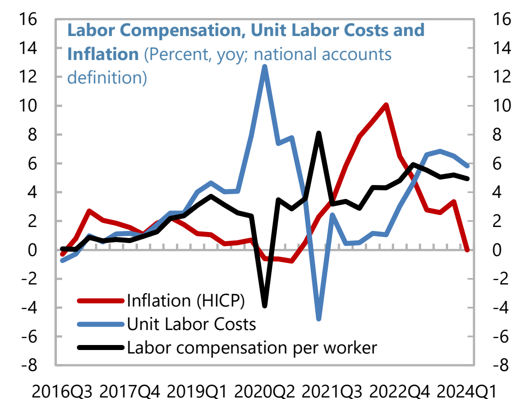
The 2021 labor reform led to a large decline in temporary employment, mirrored by a rise in regular permanent and fixed discontinuous employment.



High vacancy postings and declining unemployment have resulted in a significantly tighter labor market…



…but labor compensation, and to a lesser extent unit labor costs growth, remain moderate.

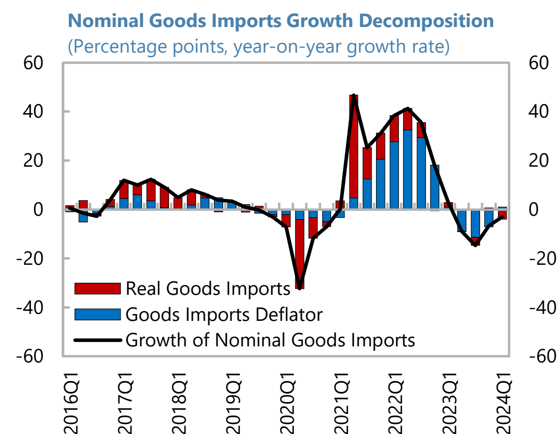


Sources: Ministry of Labor; Ministry of Inclusion, Social Security and Migration; Eurostat; Haver Analytics; and IMF staff calculations.

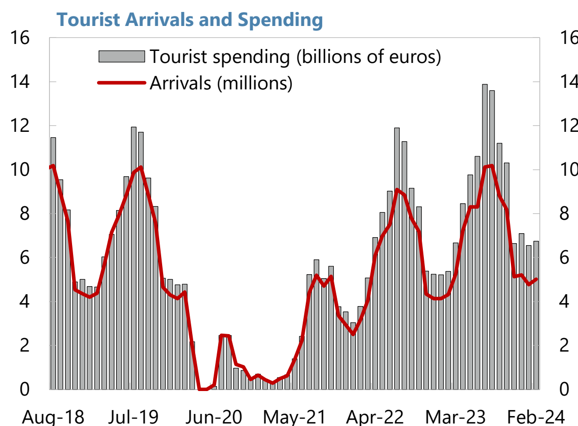
1/ Up to 2020, the data corresponds to the discontinued Migration Statistics. In 2021-22, the data corresponds to the new Statistics on Migration and Changes of Residence, which are published at annual frequency with a one-year lag. In 2023, the data corresponds to a high-frequency proxy from the Population Continuous Statistics.

Figure 3. Spain: Recent Developments in the External Sector

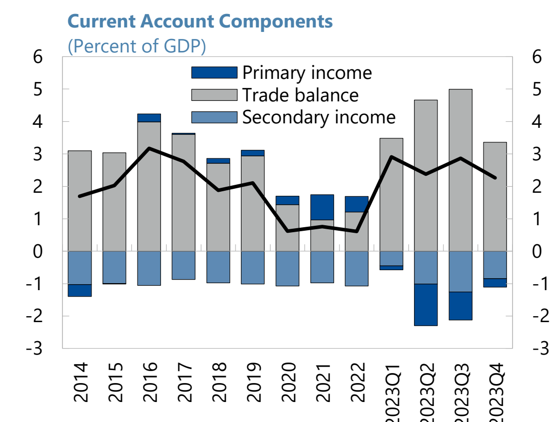
Nominal goods imports growth decelerated as import prices fell on lower energy prices.



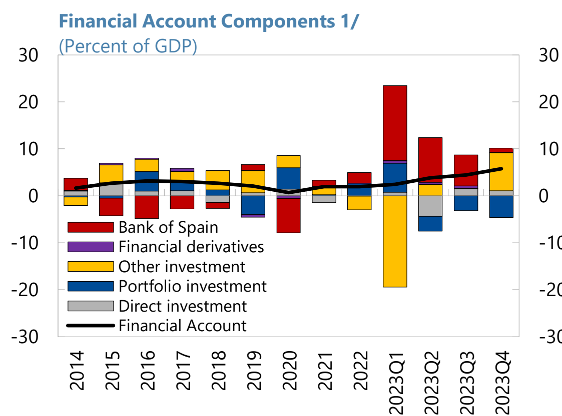
Services exports performed very strongly in 2023, with tourist arrivals and spending reaching record highs.



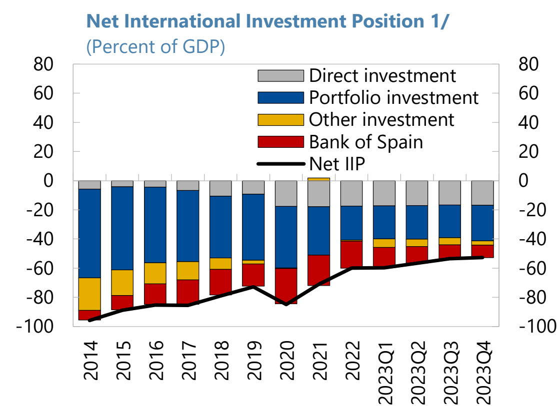
As a result, the current account surplus increased significantly relative to 2022, despite a small decline in primary income.



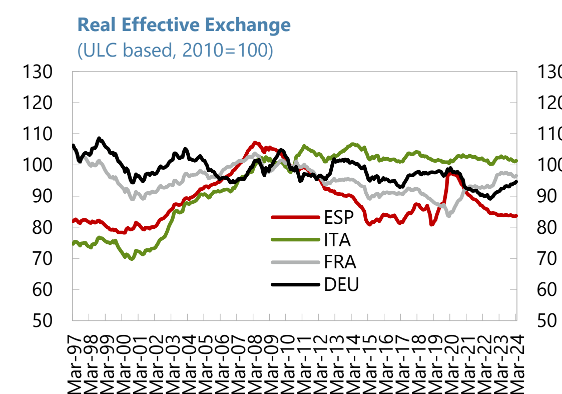
In 2023, the increase in the financial account surplus was largely driven by the Bank of Spain's balance sheet, only partially offset by net outflows in the other components.



The NIIP continues to gradually improve, largely due to the shrinking liability position of the Bank of Spain, while the other components have remained broadly stable.



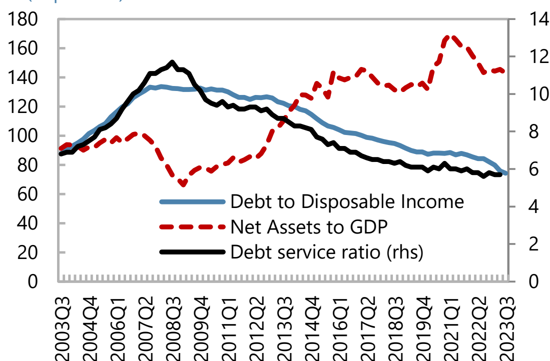
The ULC-based REER remained broadly stable in 2023, and significantly below its pre-GFC peak.



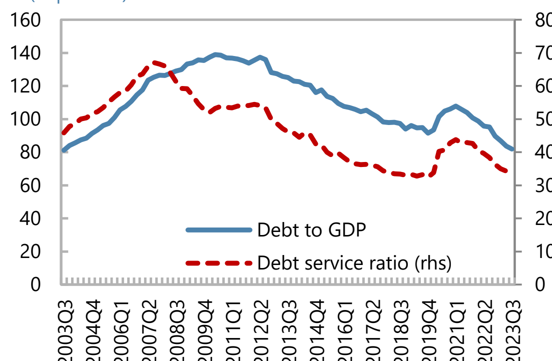
Sources: Bank of Spain, Eurostat, Haver Analytics, INE, WEO, and IMF staff calculations.
1/ Portfolio Investment and Other Investment exclude the Bank of Spain, which is shown separately.

Figure 4. Spain: Credit Developments and Financial Cycle

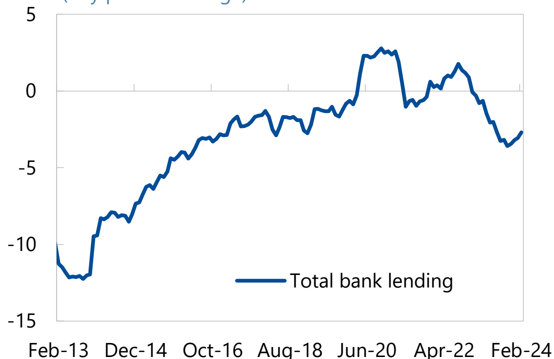
Households have continued to deleverage, ...



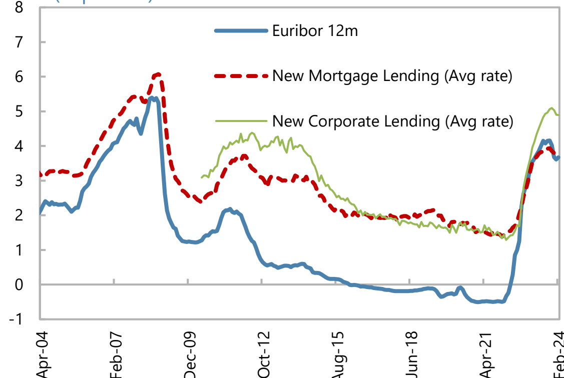
... and so have non-financial corporates.



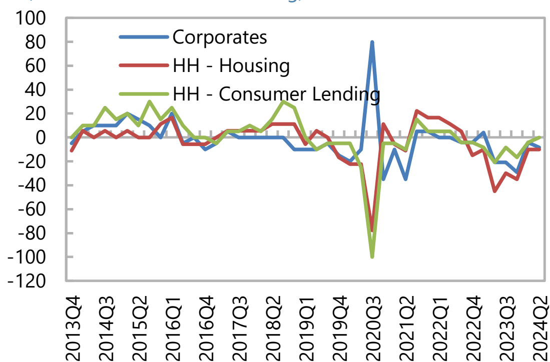
The contraction in bank lending to the private sector is moderating.



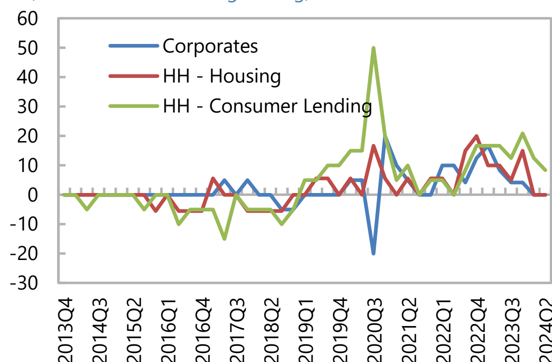
After rising sharply as the ECB hiked its policy rates, the benchmark interest rate has started declining in recent months.



Credit demand has rebounded but remains in negative territory.



Lending standards have stopped tightening lately.

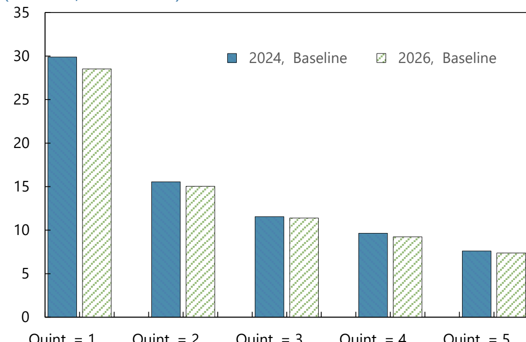


Sources: Bank of Spain, Haver Analytics, and IMF staff calculations.

Figure 5. Spain: Household Sector

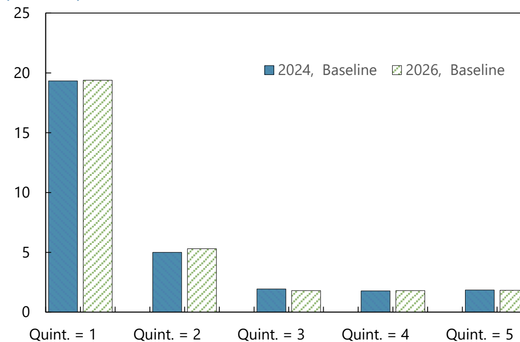
Households' debt servicing burden is expected to ease for all income quintiles, although borrowers in the lowest income quintile will continue to face high pressures.

Households DSTI Ratio by Income Quintile 1/
(Percent, borrowers)



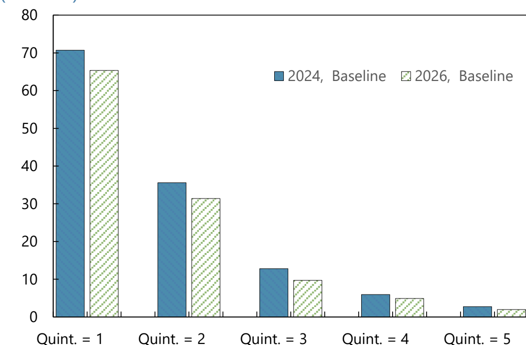
From a debt servicing perspective, households are resilient, and pockets of vulnerability concentrate among the lowest income quintile.

Share of Households at Risk (DSTI >= 40)
(Percent)



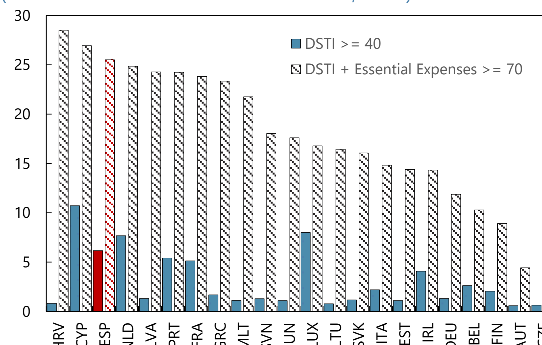
Cost-of-living adjusted measures of household vulnerability are also projected to improve, although low-to-middle income households will remain vulnerable.

Share of Households at Risk (DSTI + Essential Exp.>=70) 2/
(Percent)



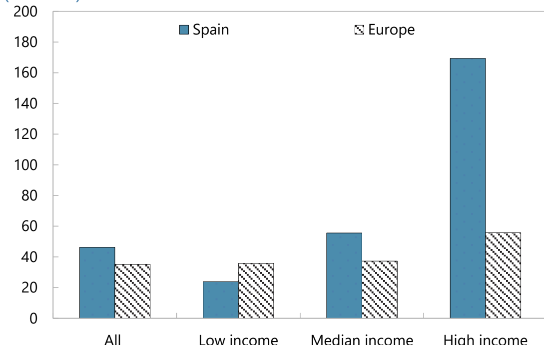
Spanish households are expected to remain more vulnerable than most European peers.

Households at Risk by Different Vulnerability Standards 3/
(Percent of total number of households, 2024)



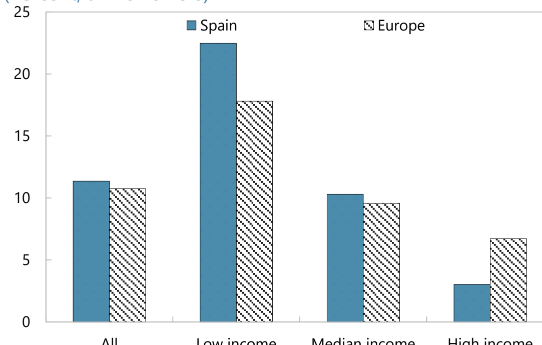
Low-income households have comparatively low financial assets,

Financial Assets to Income Ratio, 2020-2021
(Percent)



... and more of them had loan arrears coming out of the pandemic.

Share of Borrowers with Loan Arrears, 2020 - 2021
(Percent; all Borrowers)

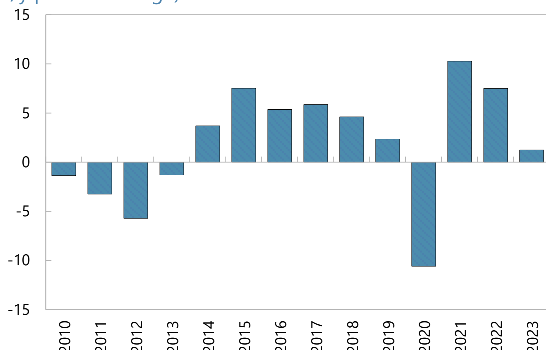


Sources: Bank of Spain Survey of Household Finances, ECB Household Finance and Consumption Survey, IMF staff calculations.
1/ Income quintiles 1-5 range from the lowest-income group to the highest-income group.
2/ "DSTI + Essential Exp." refers to the ratio of debt service and essential expenditures (on food, utilities, and rents) over income.
3/ Macroeconomic assumptions for individual countries are based on IMF 2023 October WEO projections.

Figure 6. Spain: Non-Financial Corporate Sector[1]

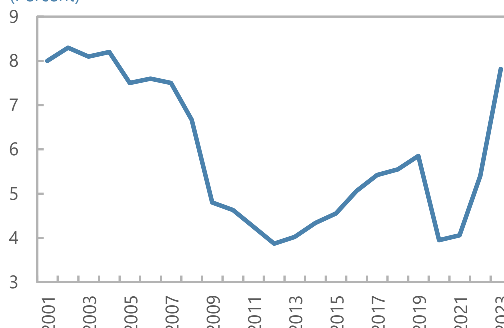
The non-financial corporate sector's turnover continued to grow, albeit at a more moderate pace, in 2023, ...

Corporate Sector Turnover 2/
(Y/y percent change)



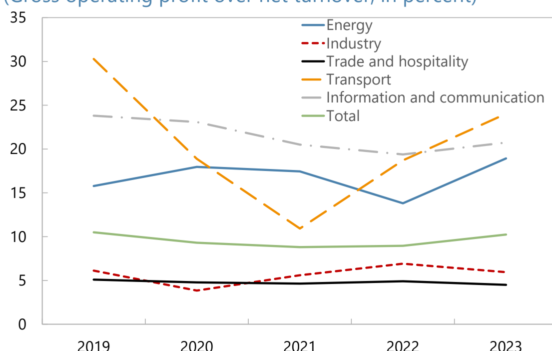
...and their return on assets continued to improve, driven by rising profitability and deleveraging.

Return on Assets
(Percent)



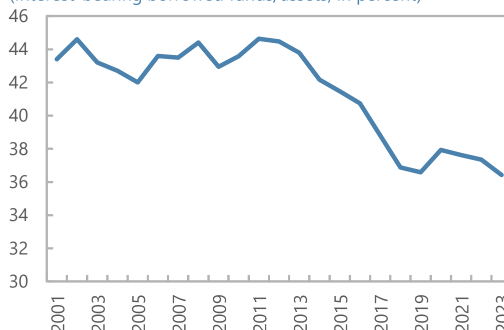
Profit margins are heterogenous across sectors but have remained close to pre-pandemic levels overall.

Corporate Profit Margins
(Gross operating profit over net turnover, in percent)



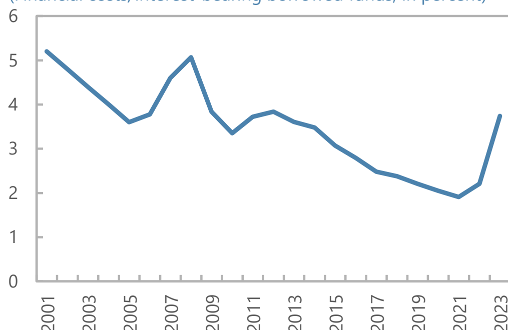
The total debt-to-assets ratio has resumed its downward trend, after a small uptick during the pandemic.

Debt-to-Asset Ratio
(Interest-bearing borrowed funds/assets, in percent)



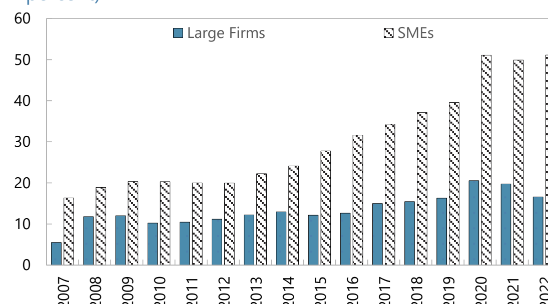
Corporate debt financing costs increased sharply following the ECB's monetary policy tightening.

Debt Financing Cost
(Financial costs/interest-bearing borrowed funds, in percent)



NFCs, in particular SMEs, have generally maintained ample liquidity on their balance sheets.

Liquidity Ratios
(Cash on hand and other equivalent liquid assets/total assets, in percent)

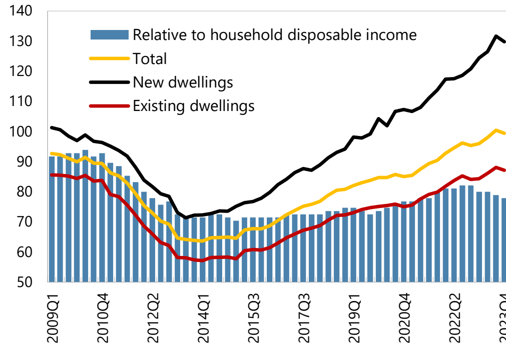


Sources: Bank of Spain Central Balance Sheet Data Office and IMF staff calculations.

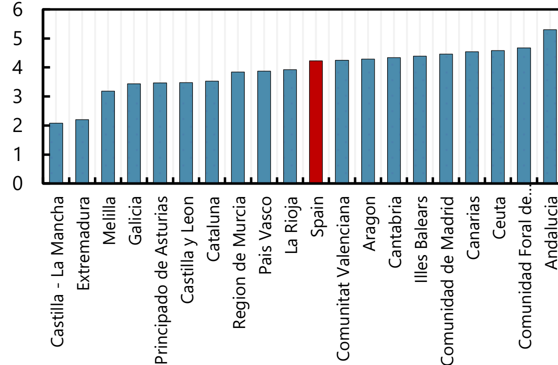
Sources: Bank of Spain Central Balance Sheet Data Office, Agencia Estatal de Administración Tributaria, and IMF staff calculations.
1/ 2023 represents the average of Q1-Q3 in this panel, based on a smaller subset of NFCs.
2/ The energy sector is not included in the aggregate statistics.

Figure 7. Spain: Residential Real Estate Developments

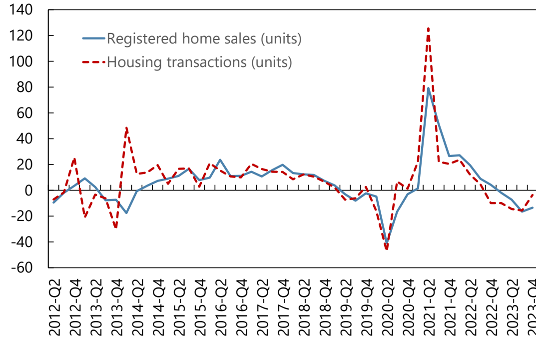
House prices have moderated lately, after growing steadily especially for new dwellings.



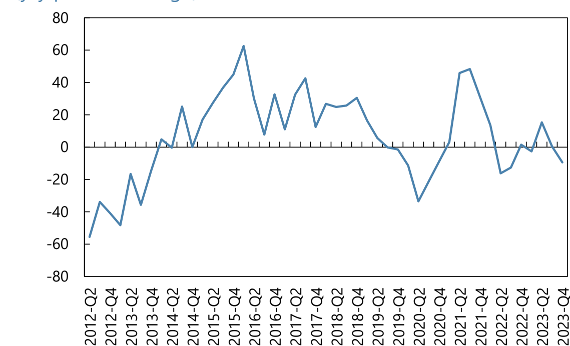
House prices have appreciated across the board, but more so in some autonomous communities.



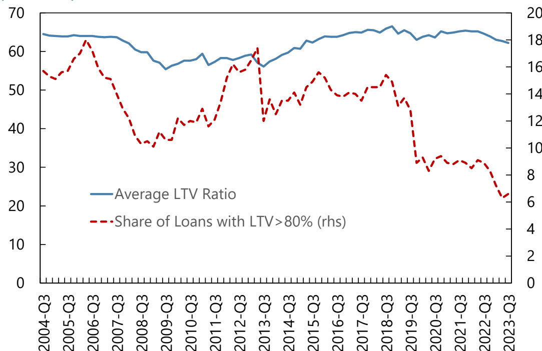
Housing transaction volumes declined sharply in 2023, ...



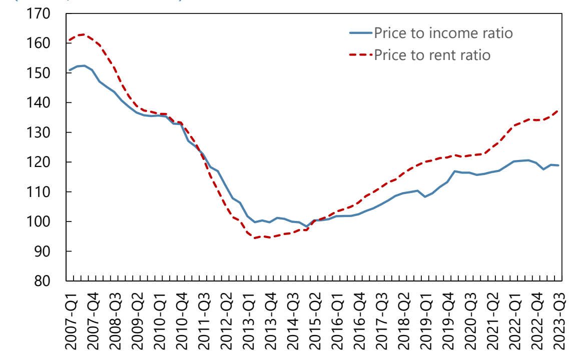
... reflecting a cooling market but also partly weak supply.



Lending standards have remained prudent.



The price-to-income ratio has remained broadly stable and, while rising, the price-to-rent ratio remains far below its pre-GFC peak.

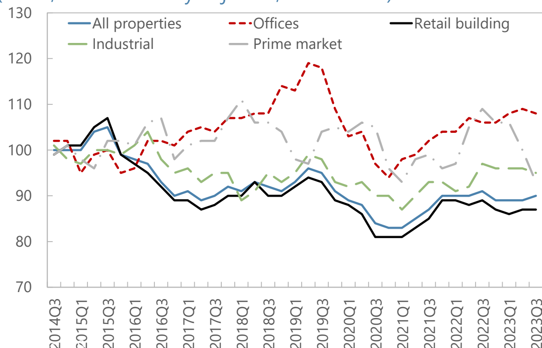


Sources: Registradores de España, INE, Ministero de Fomento, OECD, BIS, BdE, Eurostat, and IMF staff calculations.

Figure 8. Spain: Commercial Real Estate Developments

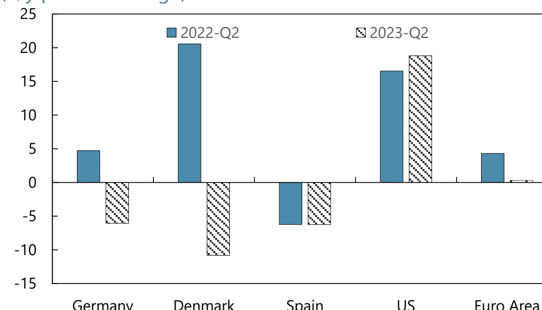
CRE developments have varied across segments, but prices remain generally below pre-pandemic levels.

Spain: Comercial Real Estate Prices
(Index, non-seasonally adjusted, 2014 = 100)



Spain did not experience a recent boom in the CRE market, unlike some other advanced economies.

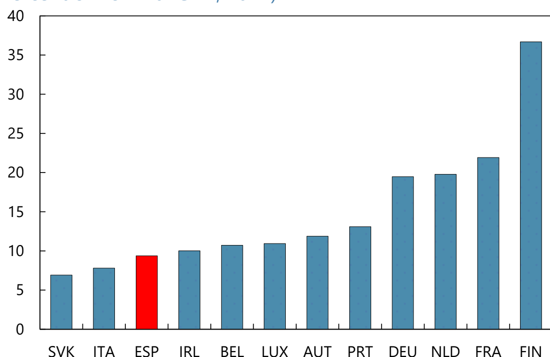
CRE Price Growth in Selected Economies
(Y/y percent change)



Note: Data for the euro area is for 2022-Q4, the latest available, instead of 2023-Q2.

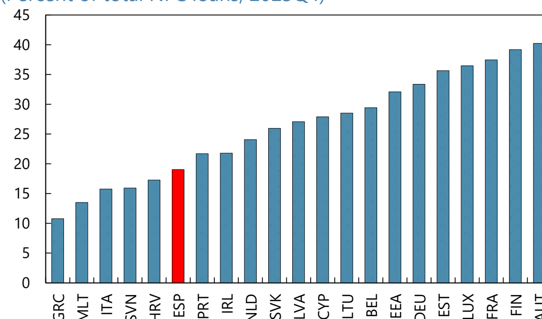
The CRE market is relatively small in Spain, …

CRE Market Size in Selected Euro Area Economies
(Percent of nominal GDP, 2022)



… and banks' exposure to the CRE market is accordingly lower than in most other advanced economies.

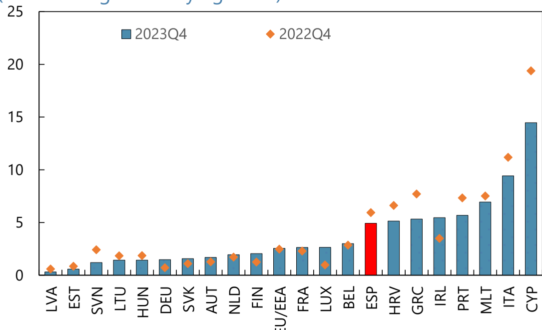
Real Estate and Construction Loans
(Percent of total NFC loans, 2023Q4)



Note: CRE loans include loans to the real estate and the construction sector.

NPL ratios in the CRE portfolio remain relatively high, related to legacies from the GFC and euro area crisis, …

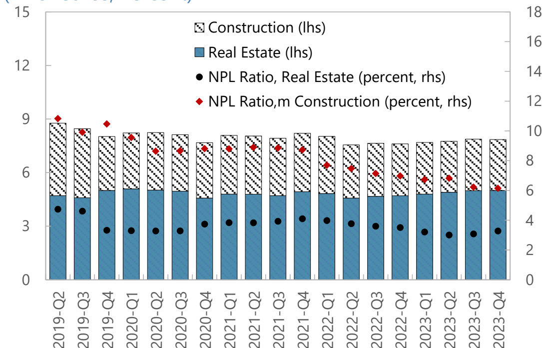
NPL Ratios in the RE and Construction Loan Portfolio
(Percent of gross carrying loans)



Note: CRE loans include loans to the real estate and the construction sector.

… but these ratios have been on a steady decline since 2021.

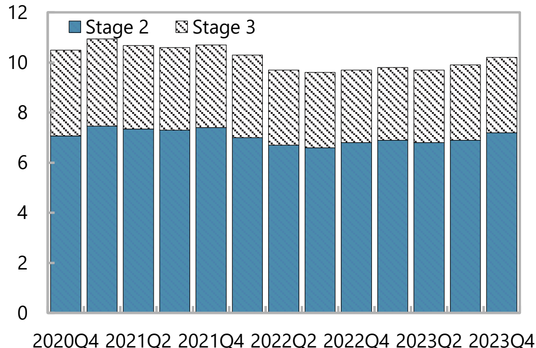
Distribution and NPL Ratio of NFC Loans by NACE Code
(Bil of euros, Percent)



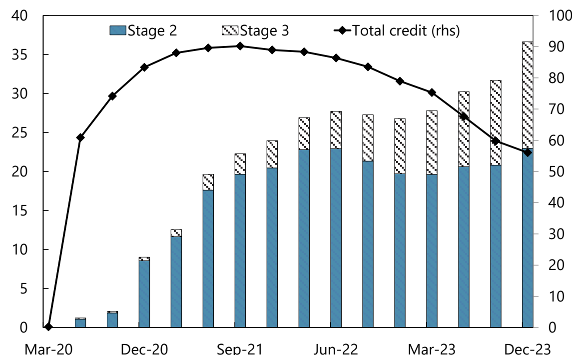
Sources: EBA, BIS, MSCI, INE, Haver Analytics, and IMF staff calculations.

Figure 9. Spain: Banking Sector Performance

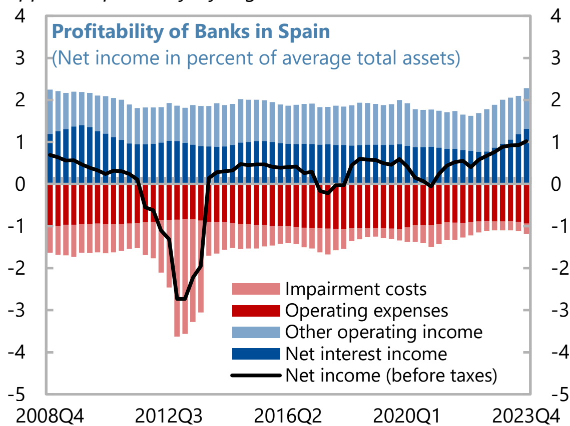
Stage 2 and 3 loans have remained broadly stable.



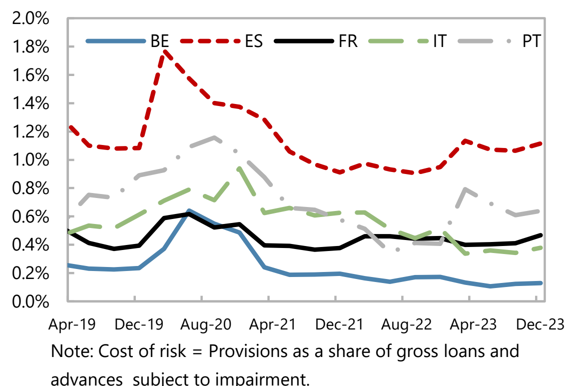
Asset quality among state-guaranteed loans deteriorated, but mainly driven by the downsizing of the portfolio.



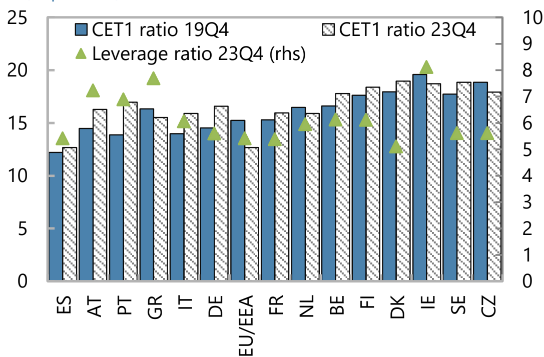
Banking sector profitability has continued to increase, supported primarily by higher net interest income, …



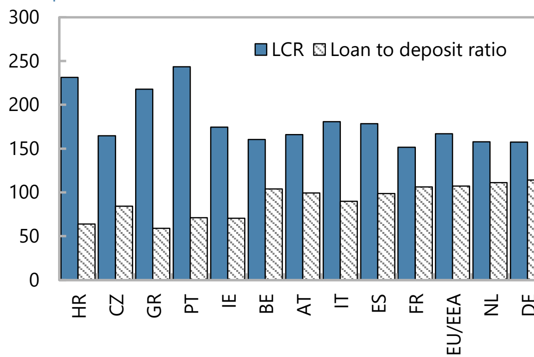
…while cost of risk has stabilized.



Bank capitalization remains below peers on a risk-weighted basis, although it is in line for the leverage ratio.



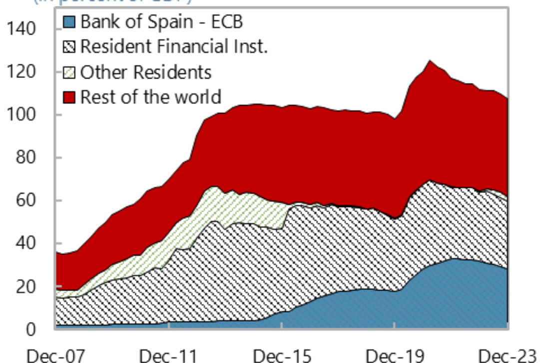
Bank liquidity ratios have declined but remain at comfortable levels.



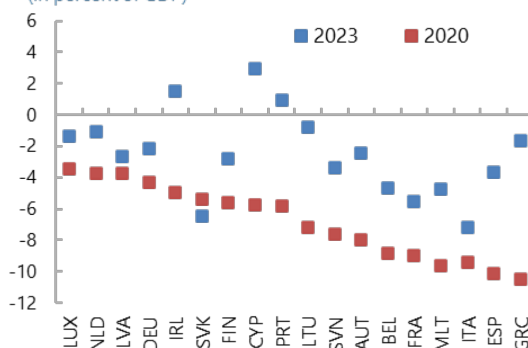
Sources: Bank of Spain, European Banking Authority, and IMF staff calculations.

Figure 10. Spain: Public Finances

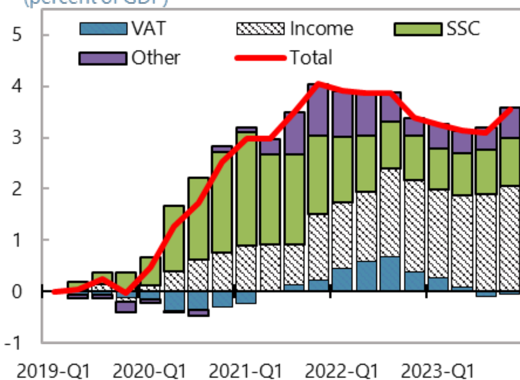
Public debt has declined steadily since 2020, with the holdings of foreign investors shrinking the most.



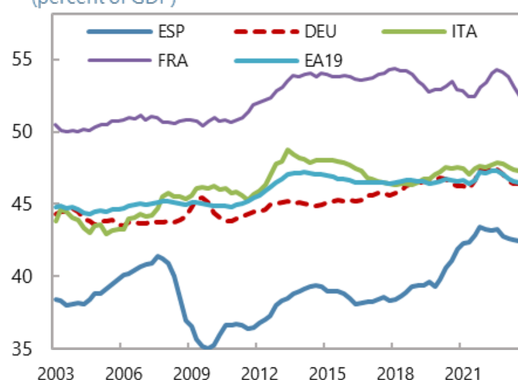
The fiscal balance has improved significantly since its pandemic low.



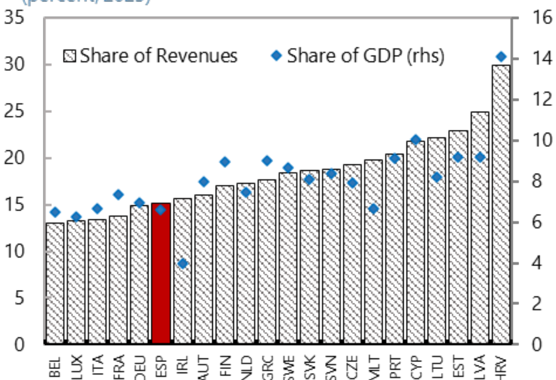
...and the sharp rise in revenues from social security contributions and income taxes persists.



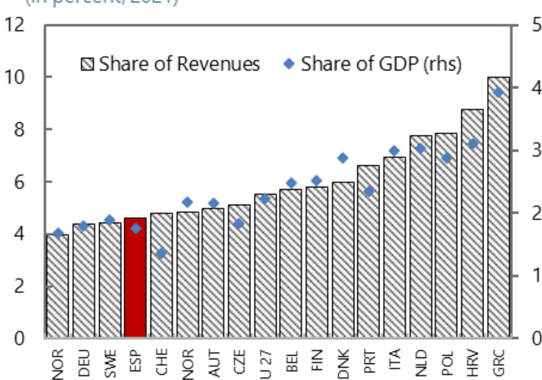
But revenues remain structurally lower than peers in the euro area...



...with room to mobilize further VAT revenues



...and strengthen environmental taxation.

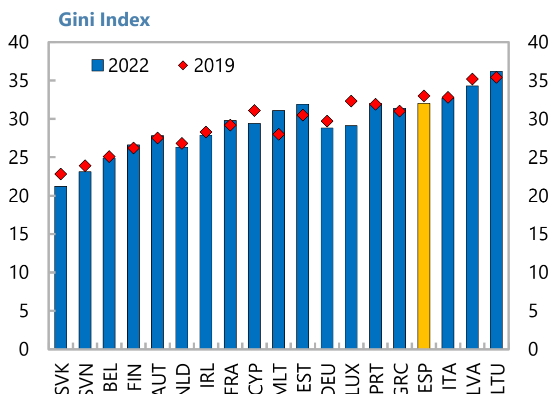


Sources: Eurostat, European Commission, Haver Analytics, Bank of Spain, and IMF staff calculations.

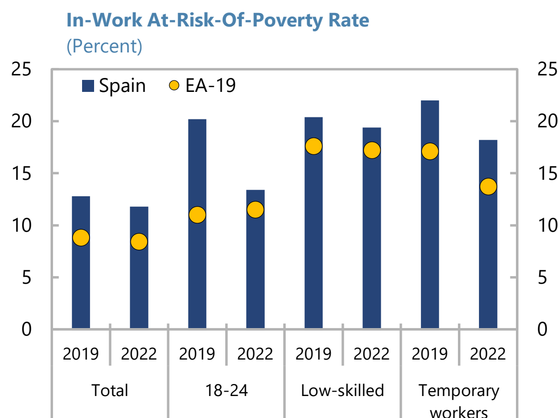
1/ Environmental taxes include taxes on energy (including explicit CO2 taxes and EU ETS), transport, and pollution/resources.

Figure 11. Spain: Selected Social Indicators

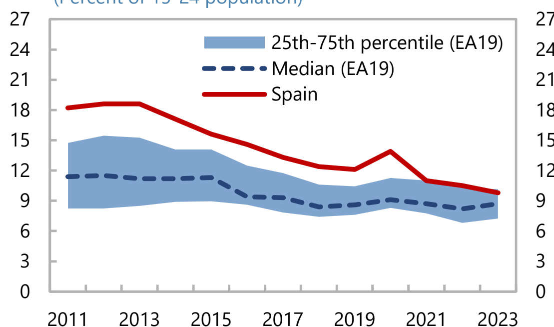
Income inequality has declined slightly, but it remains high compared to most euro area peers.



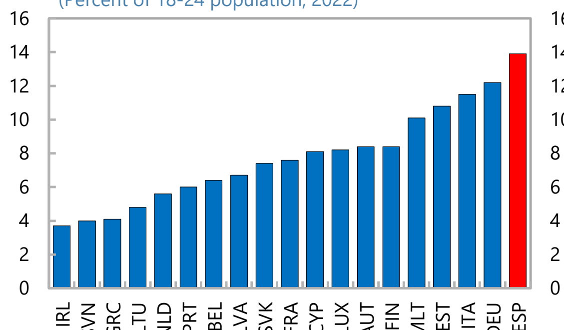
Despite recent improvements, particularly among the young, the share of workers at risk of poverty is still above the euro area average.



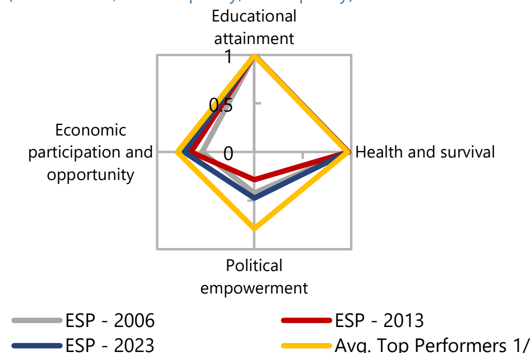
The share of young people who neither work nor study has declined to recent historical lows but is still among the highest in the euro area.



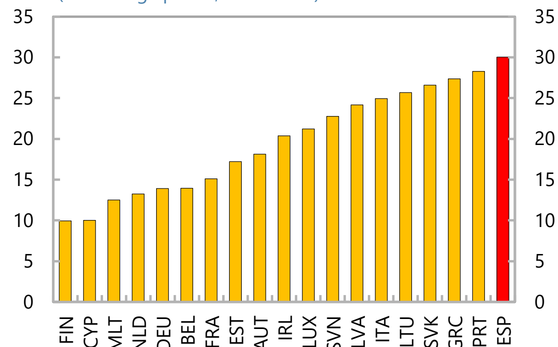
Spain also remains the euro area country with the highest share of early leavers from education and training.



Despite progress in the past 15 years, sizeable gender gaps remain in political empowerment and to a lower extent, in economic participation and opportunity.



The Spanish population is projected to age rapidly in the coming decades, compared to other euro area countries.



Sources: Eurostat, World Economic Forum, and IMF staff calculations.
1/ The top performers in 2023 were Iceland, Sweden, and Finland.

Table 1. Spain: Main Economic Indicators

(Percent change, unless otherwise indicated)

					Projections 1/					
	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
Demand and supply in constant prices										
Gross domestic product	-11.2	6.4	5.8	2.5	2.4	2.1	1.8	1.6	1.6	1.6
Private consumption	-12.3	7.1	4.7	1.8	1.8	1.9	2.3	2.3	2.3	2.3
Public consumption	3.6	3.4	-0.2	3.8	0.9	1.2	0.5	0.4	0.4	0.4
Gross fixed investment	-9.0	2.8	2.4	0.8	4.5	4.8	2.2	1.8	1.6	1.6
Total domestic demand	-9.2	6.7	3.0	1.7	2.2	2.4	1.9	1.8	1.7	1.7
Net exports (contribution to growth)	-2.2	-0.2	2.9	0.8	0.0	-0.2	-0.1	-0.1	-0.1	-0.1
Exports of goods and services	-20.1	13.5	15.2	2.3	3.4	3.1	3.1	3.2	3.2	3.2
Imports of goods and services	-15.0	14.9	7.0	0.3	3.0	4.0	3.6	3.7	3.6	3.6
Real GDP per capita	-11.6	6.5	5.1	2.1	1.2	1.0	0.7	0.6	0.7	0.8
Savings-Investment Balance (percent of GDP)										
Gross domestic investment	20.5	21.6	21.5	20.3	21.0	21.8	21.9	21.9	21.8	21.7
Private	17.8	18.9	18.7	17.4	18.1	18.6	18.8	19.4	19.4	19.3
Public	2.7	2.7	2.8	2.9	2.9	3.2	3.1	2.5	2.3	2.4
National savings	21.1	22.4	22.1	22.9	23.6	24.0	23.9	23.8	23.6	23.5
Private	28.5	26.4	24.0	23.6	23.7	23.7	23.9	24.4	24.2	24.1
Public	-7.4	-4.0	-1.9	-0.7	-0.1	0.3	0.0	-0.7	-0.6	-0.6
Foreign savings	-0.6	-0.8	-0.6	-2.6	-2.6	-2.3	-2.0	-1.9	-1.8	-1.8
Household saving rate (percent of gross disposable income)	17.4	13.8	7.6	11.7	10.4	7.9	7.9	7.9	7.9	7.9
Potential output	-2.5	1.6	1.7	1.9	2.1	2.2	1.8	1.7	1.6	1.6
Output gap (percent of potential output)	-8.5	-4.2	-0.4	0.2	0.4	0.2	0.1	0.0	0.0	0.0
Prices										
GDP deflator	1.1	2.6	4.2	5.9	2.8	2.3	1.7	1.7	1.8	1.8
Headline inflation (average)	-0.3	3.0	8.3	3.4	2.9	2.3	1.9	1.8	1.8	1.8
Headline inflation (end of period)	-0.6	6.5	5.5	3.3	2.5	2.1	1.8	1.8	1.8	1.8
Core inflation (average)	0.6	0.7	5.2	5.8	3.0	2.1	1.8	1.8	1.8	1.8
Core inflation (end of period)	0.1	2.1	6.7	4.6	2.5	2.1	1.8	1.8	1.8	1.8
Employment and wages										
Unemployment rate (percent of total labor force)	15.5	14.9	13.0	12.2	11.8	11.5	11.2	11.2	11.2	11.2
Labor productivity 2/	-5.0	-0.6	2.0	-0.7	1.0	1.1	0.9	1.2	1.3	1.4
Labor costs, private sector	4.0	0.0	2.6	5.6	3.3	3.5	2.8	3.0	3.1	3.1
Employment	-2.9	3.3	3.6	3.1	1.3	0.9	0.8	0.4	0.3	0.2
Labor force	-1.3	2.5	1.4	2.1	0.8	0.6	0.5	0.4	0.3	0.2
Balance of payments (percent of GDP)										
Trade balance (goods and services)	1.4	1.0	1.2	4.1	4.0	3.5	3.2	3.0	3.0	2.9
Current account balance	0.6	0.8	0.6	2.6	2.6	2.3	2.0	1.9	1.8	1.8
Net international investment position	-84.9	-71.0	-60.0	-52.8	-46.5	-41.4	-37.1	-33.8	-30.7	-27.7
Public finance (percent of GDP)										
General government balance	-10.1	-6.7	-4.7	-3.6	-3.0	-2.9	-3.1	-3.1	-2.9	-3.0
Primary balance	-8.1	-4.8	-2.6	-1.8	-0.6	-0.3	-0.4	-0.4	-0.3	-0.3
Structural balance	-4.9	-4.1	-4.5	-3.7	-3.2	-3.0	-3.2	-3.1	-3.0	-3.0
Primary structural balance	-2.7	-2.0	-2.2	-1.3	-0.6	-0.2	-0.2	-0.2	0.0	0.0
General government debt	120.3	116.8	111.6	107.7	105.6	104.4	104.3	104.2	103.7	103.2
Memo item										
Credit to the private sector	2.6	0.6	-0.1	-3.2	0.0	0.5	1.0	2.0	2.0	1.9
Nominal GDP (Millions of euros)	1119.0	1222.3	1346.4	1461.9	1538.0	1606.0	1661.6	1717.9	1777.1	1838.2
Real GDP (Millions of 2015 euros)	1060.0	1127.8	1192.9	1222.8	1251.7	1277.5	1300.0	1321.3	1343.0	1364.9

Sources: IMF, World Economic Outlook; data provided by the authorities; and IMF staff estimates.

1/ The projections incorporate spending financed by the EU Recovery and Resilience Facility (including the grant and the loan component) amounting to about 0.4, 0.9, 1.0, 1.0, 1.0, 0.9, and 0.2 percent of GDP from 2021 to 2027.

2/ Output per full-time equivalent worker.

Table 2a. Spain: General Government Operations 1/

(Billions of euros, unless otherwise indicated)

					Projections 2/					
	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
Revenue	467.6	529.2	574.1	625.7	659.8	688.2	709.3	719.1	743.9	770.2
Taxes	257.1	296.6	330.7	354.6	378.5	391.1	397.0	410.4	424.5	439.2
Indirect taxes	126.7	146.9	160.7	166.0	171.0	178.3	181.8	188.0	194.5	201.2
o.w. VAT	70.7	83.5	94.2	95.9	99.4	101.3	102.9	106.4	110.1	113.8
o.w. Excise	34.6	40.2	42.3	42.1	44.2	48.3	49.6	51.3	53.0	54.8
Direct taxes	125.7	143.5	164.4	183.2	202.5	207.6	209.7	216.8	224.3	232.0
o.w. Private households	102.1	113.9	122.9	135.5	148.9	152.0	156.3	161.6	167.1	172.9
o.w. Corporate	24.6	30.1	38.3	50.4	55.3	57.0	54.9	56.8	58.7	60.7
Capital tax	4.7	6.2	5.6	5.4	5.0	5.3	5.4	5.6	5.8	6.0
Social contributions	162.2	171.7	180.2	196.9	212.2	225.5	240.6	249.9	258.5	268.1
Other revenue	48.3	60.9	63.2	74.2	69.2	71.5	71.7	58.9	60.9	63.0
Expenditure	580.8	611.5	637.8	678.8	705.7	734.7	760.3	772.7	796.3	824.9
Expense	579.8	610.1	637.1	678.7	705.0	734.0	759.6	772.0	795.5	824.1
Compensation of employees	140.6	148.1	154.9	163.4	173.4	179.3	184.7	190.9	197.5	204.3
Use of goods and services	66.4	71.5	79.1	88.0	90.6	94.7	97.8	97.6	100.2	103.6
Consumption of fixed capital	29.1	32.0	37.4	42.6	44.4	50.7	51.2	42.1	41.3	43.7
Interest	25.1	26.2	31.8	36.0	40.5	45.6	49.3	50.9	52.7	54.5
Social benefits	262.2	263.4	267.0	292.7	299.2	308.5	320.3	332.2	343.6	355.5
Other expense	56.3	69.0	66.9	56.0	57.0	55.3	56.4	58.3	60.2	62.5
Subsidies	21.4	17.9	27.0	21.5	19.5	19.5	20.1	20.8	21.5	22.2
Other	34.8	51.1	40.0	34.5	37.5	35.8	36.3	37.5	38.7	40.2
o.w. financial sector support	2.1	1.3	…	…	…	…	…	…	…	…
Net acquisition of nonfinancial assets	1.0	1.3	0.7	0.1	0.7	0.7	0.7	0.7	0.7	0.8
Gross fixed capital investment	30.2	33.3	38.1	42.8	45.1	51.4	51.9	42.8	42.1	44.5
Consumption of fixed capital	29.1	32.0	37.4	42.6	44.4	50.7	51.2	42.1	41.3	43.7
Other non financial assets	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Unidentified measures (cumulative)	0.0									
Gross operating balance	-112.2	-80.9	-63.0	-53.0	-45.2	-45.8	-50.4	-52.9	-51.6	-53.9
Net lending / borrowing	-113.2	-82.3	-63.7	-53.2	-45.9	-46.5	-51.1	-53.6	-52.3	-54.7
Net lending / borrowing (excluding financial sector support)	-111.1	-82.3	-63.7	-53.2	-45.9	-46.5	-51.1	-53.6	-52.3	-54.7
Memorandum items:										
Nominal GDP	1,119.0	1,222.3	1,346.4	1,461.89	1,538.0	1,606.0	1,661.6	1,717.9	1,777.1	1,838.2

Sources: Ministry of Finance; Eurostat; and IMF staff estimates and projections.

1/ Compiled using accrual basis and ESA10 manual, consistent with Eurostat dataset.

2/ Projections from 2023 onwards assume a gradual expiration of temporary energy support measures amounting to 1 percent of GDP in 2024 (reported as added social benefits and lower tax revenues) as well as temporary levies on financial and energy companies and the solidarity tax on large fortunes. Projections incorporate allocation from the EU Recovery and Resilience Facility amounting to about 0.4, 1, 1, 1, 1 and 0.97 percent of GDP in grants from 2021 to 2026 and approximately 0.4 percent of GDP financed by the loan component cumulatively over 2025-2027. Such funds are reflected as receipts in other revenue, and as expenditures in good and services and public investment.

Table 2b. Spain: General Government Operations 1/
(Percent of GDP, unless otherwise indicated)

	2020	2021	2022	2023	Projections 2/ 2024	2025	2026	2027	2028	2029
Revenue	41.8	43.3	42.6	42.8	42.9	42.9	42.7	41.9	41.9	41.9
Taxes	23.0	24.3	24.6	24.3	24.6	24.4	23.9	23.9	23.9	23.9
Indirect taxes	11.3	12.0	11.9	11.4	11.1	11.1	10.9	10.9	10.9	10.9
o.w. VAT	6.3	6.8	7.0	6.6	6.5	6.3	6.2	6.2	6.2	6.2
o.w. Excise	3.1	3.3	3.1	2.9	2.9	3.0	3.0	3.0	3.0	3.0
Direct taxes	11.2	11.7	12.2	12.5	13.2	12.9	12.6	12.6	12.6	12.6
o.w. Private households	9.1	9.3	9.1	9.3	9.7	9.5	9.4	9.4	9.4	9.4
o.w. Corporate	2.2	2.5	2.8	3.4	3.6	3.5	3.3	3.3	3.3	3.3
Capital tax	0.4	0.5	0.4	0.4	0.3	0.3	0.3	0.3	0.3	0.3
Social contributions	14.5	14.0	13.4	13.5	13.8	14.0	14.5	14.5	14.5	14.6
Other revenue	4.3	5.0	4.7	5.1	4.5	4.5	4.3	3.4	3.4	3.4
Expenditure	51.9	50.0	47.4	46.4	45.9	45.7	45.8	45.0	44.8	44.9
Expense	51.8	49.9	47.3	46.4	45.8	45.7	45.7	44.9	44.8	44.8
Compensation of employees	12.6	12.1	11.5	11.2	11.3	11.2	11.1	11.1	11.1	11.1
Use of goods and services	5.9	5.9	5.9	6.0	5.9	5.9	5.9	5.7	5.6	5.6
Consumption of fixed capital	2.6	2.6	2.8	2.9	2.9	3.2	3.1	2.5	2.3	2.4
Interest	2.2	2.1	2.4	2.5	2.6	2.8	3.0	3.0	3.0	3.0
Social benefits	23.4	21.6	19.8	20.0	19.5	19.2	19.3	19.3	19.3	19.3
Other expense	5.0	5.6	5.0	3.8	3.7	3.4	3.4	3.4	3.4	3.4
Subsidies	1.9	1.5	2.0	1.5	1.3	1.2	1.2	1.2	1.2	1.2
Other	3.1	4.2	3.0	2.4	2.4	2.2	2.2	2.2	2.2	2.2
o.w. financial sector support	0.2	0.1	...	...	...	...	...	...	...	...
Net acquisition of nonfinancial assets	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Gross fixed capital investment	2.7	2.7	2.8	2.9	2.9	3.2	3.1	2.5	2.4	2.4
Consumption of fixed capital	2.6	2.6	2.8	2.9	2.9	3.2	3.1	2.5	2.3	2.4
Other non financial assets	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Gross operating balance	-10.0	-6.6	-4.7	-3.6	-2.9	-2.9	-3.0	-3.1	-2.9	-2.9
Net lending / borrowing	-10.1	-6.7	-4.7	-3.6	-3.0	-2.9	-3.1	-3.1	-2.9	-3.0
Net lending / borrowing (excluding financial sector support)	-9.9	-6.7	-4.7	-3.6	-3.0	-2.9	-3.1	-3.1	-2.9	-3.0
Memorandum items:										
Net lending/ borrowing (EDP targets)	...	...	...	...	...	...	...	...	...	...
Primary balance	-8.1	-4.8	-2.6	-1.8	-0.6	-0.3	-0.4	-0.4	-0.3	-0.3
Primary balance (excluding financial sector support) 3/	-7.9	-4.6	-2.4	-1.2	-0.4	-0.1	-0.1	-0.2	0.0	0.0
Cyclically adjusted balance	-5.0	-4.2	-4.5	-3.7	-3.2	-3.0	-3.2	-3.1	-3.0	-3.0
Cyclically adjusted primary balance (excl. fin. sector support) 3/	-2.8	-2.1	-2.2	-1.3	-0.6	-0.2	-0.2	-0.2	0.0	0.0
Primary structural balance 3/	-2.7	-2.0	-2.2	-1.3	-0.6	-0.2	-0.2	-0.2	0.0	0.0
Structural balance	-4.9	-4.1	-4.5	-3.7	-3.2	-3.0	-3.2	-3.1	-3.0	-3.0
General government gross debt (Maastricht)	120.3	116.8	111.6	107.7	105.6	104.4	104.3	104.2	103.7	103.2
Net debt	103.1	101.2	97.4	93.3	91.7	90.7	90.7	90.9	90.8	90.8
Output gap	-8.5	-4.2	-0.4	0.2	0.4	0.2	0.1	0.0	0.0	0.0
EU Recovery and Resilience Facility allocation	...	0.4	1.0	1.3	1.0	1.0	0.9	...	...	...

Sources: Ministry of Finance; Eurostat; and IMF staff estimates and projections.

1/ Compiled using accrual basis and ESA10 manual, consistent with Eurostat dataset.

2/ Projections from 2023 onwards assume a gradual expiration of temporary energy support measures amounting to 1 percent of GDP in 2024 (reported as added social benefits and lower tax revenues) as well as temporary levies on financial and energy companies and the solidarity tax on large fortunes. Projections incorporate allocation from the EU Recovery and Resilience Facility amounting to about 0.4, 1, 1, 1, 1 and 0.97 percent of GDP in grants from 2021 to 2026 and approximately 0.4 percent of GDP financed by the loan component cumulatively over 2025-2027. Such funds are reflected as receipts in other revenue, and as expenditures in good and services and public investment.

3/ Including interest income.

Table 3. Spain: Selected Financial Soundness Indicators

(Percent, unless otherwise indicated)

	2018	2019	2020	2021	2022	2023
Depository institutions						
Capital adequacy: Consolidated basis						
Regulatory capital to risk-weighted assets	15.6	15.9	17.0	17.4	16.7	17.1
Regulatory tier-1 capital to risk-weighted assets	13.7	14.0	14.9	15.2	14.6	14.8
Tier 1 Capital to total assets	6.0	6.1	5.9	5.8	5.5	5.7
Asset quality: Consolidated basis						
Nonperforming loans (in billions of euro)	95	84	74	88	80	82
Nonperforming loans to total loans	3.7	3.2	2.9	2.9	3.1	3.1
Specific provisions to nonperforming loans	63.2	64.8	72.9	63.6	43.2	43.3
Asset quality: Domestic operations						
Nonperforming loans (in billions of euro)	67	54	52	49	40	39
Nonperforming loans to total loans	5.8	4.8	4.4	4.2	3.5	3.4
Specific provisions to nonperforming loans	41.1	41.2	46.4	45.9	45.3	46.6
Exposure to businesses - Construction (in billions of euro)	120	112	108	107	99	93
o/w: Nonperforming (in percent)	10.2	6.7	6.0	5.1	4.9	4.3
Exposure to businesses - Other (in billions of euro)	404	401	446	443	443	422
o/w: Nonperforming (in percent)	6.1	5.2	4.8	4.7	4.1	4.1
Exposure to households - Home purchase (in billions of euro)	491	483	478	483	483	469
o/w: Nonperforming (in percent)	3.9	3.2	2.9	2.7	2.1	2.3
Exposure to households - Other (in billions of euro)	136	140	143	140	141	143
o/w: Nonperforming (in percent)	8.4	7.5	7.2	7.0	5.0	4.7
Earning and profitability: Consolidated basis						
Return on assets	0.9	0.7	0.0	0.9	0.9	1.1
Return on equity	8.1	6.7	-3.2	10.1	9.8	12.1
Earning and profitability: Domestic operations						
Return on assets	0.6	0.6	-0.1	0.6	0.8	1.0
Return on equity	6.7	6.9	-0.7	7.4	10.4	13.4
Funding						
Loans to deposits 1/	98.9	93.3	88.7	84.9	83.2	80.9
Other financial institutions						
Total assets (in percent of GDP)						
Insurance companies and pension funds	29	32	33	32	30	...
Other institutions 2/	63	70	65	63	66	...
Shadow banking activity 3/	20	21	21	21	22	...
Corporate sector						
Debt (in percent of GDP)	132.9	129.0	146.4	142.1	129.3	115.6
Debt to total assets	39.0	36.8	36.9	38.7	37.6	35.4
Liquid assets to short-term liabilities	287.1	296.0	406.4	425.2	378.1	423.5
Household sector						
Debt (in percent of GDP)	63	61	67	62	57	51
Real estate market						
House price (percentage change, end-period)	6.6	3.6	1.5	6.4	5.5	4.2
Housing completion (2007=100)	10	12	14	15	14	14
Property sales (2007=100)	63	63	52	70	76	70

Sources: Bank of Spain; Haver analytics; FSB, Global Shadow Banking Monitoring Report 2017; IMF, Financial Soundness Indicators database and World Economic Outlook database; and IMF staff estimates.

1/ Based on loans to and deposits from other resident sectors.

2/ Include public financial institutions, other financial intermediaries and financial auxiliaries.

3/ Based on FSB's economic-based shadow banking measure.

Table 4. Spain: Balance of Payments

	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
					Projections					
					(Billions of euro)					
Current account	6.9	9.3	8.2	38.0	40.6	36.8	33.0	32.6	32.6	33.7
Trade balance of goods and services	16.1	11.8	16.3	60.3	61.4	56.9	52.8	51.9	52.6	53.3
Exports of goods and services	344.4	417.7	550.3	569.5	593.4	632.4	663.1	695.9	730.9	767.9
Exports of goods	265.6	317.0	392.3	386.4	387.0	415.0	432.5	450.4	468.7	488.0
Exports of services	78.8	100.7	158.0	183.1	206.4	217.5	230.6	245.5	262.1	280.0
Trade of goods balance	-8.7	-23.8	-59.2	-32.7	-38.7	-39.8	-44.8	-50.2	-55.5	-61.9
Imports of goods and services	-328.3	-406.0	-534.0	-509.2	-532.0	-575.6	-610.3	-644.0	-678.3	-714.6
Imports of goods	-274.3	-340.8	-451.5	-419.1	-425.7	-454.8	-477.3	-500.6	-524.2	-549.9
Imports of services	-54.1	-65.2	-82.5	-90.1	-106.4	-120.8	-133.0	-143.4	-154.1	-164.7
Services	24.8	35.6	75.5	93.0	100.1	96.7	97.6	102.1	108.1	115.3
Of which:										
Tourism	8.6	18.5	48.4	59.6	...	...	...	...	...	...
Exports	16.2	29.2	69.2	85.1	...	...	...	...	...	...
Imports	-7.6	-10.7	-20.8	-25.5	...	...	...	...	...	...
Primary income	2.9	9.5	6.4	-9.2	-6.9	-4.7	-3.4	-2.2	-1.4	-0.1
Secondary income	-12.1	-12.0	-14.5	-13.1	-13.9	-15.5	-16.4	-17.1	-18.7	-19.6
General government	-8.4	-7.6	-6.7	-4.6	-5.9	-6.6	-7.3	-11.5	-12.1	-12.7
Other sectors	-3.7	-4.3	-7.8	-8.5	-8.0	-8.9	-9.0	-5.6	-6.6	-6.9
Capital account	5.1	10.8	12.5	15.9	15.1	14.9	14.1	3.0	2.9	2.7
Financial account	7.6	23.6	26.1	60.3	55.7	51.6	47.2	35.6	35.4	36.4
Direct investment	15.9	-17.0	-0.7	-3.9	-4.3	-4.6	-4.6	-4.5	-4.6	-4.6
Spanish investment abroad	49.5	30.8	47.9	29.1	30.4	31.7	32.9	34.2	35.5	36.9
Foreign investment in Spain	33.6	47.8	48.6	33.0	34.7	36.2	37.5	38.8	40.1	41.5
Portfolio investment	77.2	36.4	41.8	-17.0	35.1	44.4	47.1	48.6	50.5	50.9
Financial derivatives	-7.0	1.8	2.1	-3.1	0.0	0.0	0.0	0.0	0.0	0.0
Other investment	-78.1	-8.0	-21.5	78.2	24.9	11.8	4.6	-8.5	-10.6	-9.8
Change in reserve assets	-0.3	10.3	4.4	6.0	0.0	0.0	0.0	0.0	0.0	0.0
Errors and omissions	-4.4	3.4	5.4	6.3	0.0	0.0	0.0	0.0	0.0	0.0
					(Percent of GDP)					
Current account	0.6	0.8	0.6	2.6	2.6	2.3	2.0	1.9	1.8	1.8
Trade balance of goods and services	1.4	1.0	1.2	4.1	4.0	3.5	3.2	3.0	3.0	2.9
Exports of goods and services	30.8	34.2	40.9	39.0	38.6	39.4	39.9	40.5	41.1	41.8
Exports of goods	23.7	25.9	29.1	26.4	25.2	25.8	26.0	26.2	26.4	26.5
Exports of services	7.0	8.2	11.7	12.5	13.4	13.5	13.9	14.3	14.8	15.2
Imports of goods and services	-29.3	-33.2	-39.7	-34.8	-34.6	-35.8	-36.7	-37.5	-38.2	-38.9
Imports of goods	-24.5	-27.9	-33.5	-28.7	-27.7	-28.3	-28.7	-29.1	-29.5	-29.9
Imports of services	-4.8	-5.3	-6.1	-6.2	-6.9	-7.5	-8.0	-8.3	-8.7	-9.0
Primary income	0.3	0.8	0.5	-0.6	-0.4	-0.3	-0.2	-0.1	-0.1	0.0
Secondary income	-1.1	-1.0	-1.1	-0.9	-0.9	-1.0	-1.0	-1.0	-1.1	-1.1
Capital account	0.5	0.9	0.9	1.1	1.0	0.9	0.8	0.2	0.2	0.1
Financial account	0.7	1.9	1.9	4.1	3.6	3.2	2.8	2.1	2.0	2.0
Direct investment	1.4	-1.4	-0.1	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	-0.2
Portfolio investment	6.9	3.0	3.1	-1.2	2.3	2.8	2.8	2.8	2.8	2.8
Financial derivatives	-0.6	0.2	0.2	-0.2	0.0	0.0	0.0	0.0	0.0	0.0
Other investment	-7.0	-0.7	-1.6	5.4	1.6	0.7	0.3	-0.5	-0.6	-0.5
Of which, BdE	-9.6	-2.3	1.3	7.4	1.6	-0.9	-2.0	-2.5	-2.7	-2.7
Change in reserve assets	0.0	0.8	0.3	0.4	0.0	0.0	0.0	0.0	0.0	0.0
Errors and omissions	-0.4	0.3	0.4	0.4	0.0	0.0	0.0	0.0	0.0	0.0
Net international investment position	-84.9	-71.0	-60.0	-52.8	-46.5	-41.4	-37.1	-33.8	-30.7	-27.7
Valuation changes	-4.6	4.8	2.5	-1.6	0.0	0.0	0.0	0.0	0.0	0.0

Sources: Bank of Spain, Haver Analytics, and IMF staff calculations.

Notes: Based on the sixth edition of the IMF's Balance of Payments Manual. Projected grants under the EU Recovery and Resilience Facility (2021-26) are reflected in the Secondary Income and the Capital Account, while projected loans under the EU Recovery and Resilience Facility (2024-2028) are reflected in Other Investment in the Financial Account and the NIIP, and their corresponding interest payments in the Primary Income.

Table 5. Spain: External Debt[1]

	2019	2020	2021	2022	2023Q1	2023Q2	2023Q3	2023Q4
				(Billions of euro)				
Gross External Debt	**2136.9**	**2256.6**	**2341.4**	**2343.6**	**2381.4**	**2379.9**	**2346.7**	**2451.7**
Short-term	792.8	891.7	955.1	1037.7	1027.4	1005.5	972.0	995.4
Long-term	1344.1	1365.0	1386.3	1305.9	1354.0	1374.5	1374.7	1456.3
General government	661.7	681.7	685.7	597.5	614.8	627.4	609.6	652.6
Bank of Spain	485.3	598.3	638.3	636.1	584.3	547.0	525.7	537.4
Other monetary financial institutions	457.9	432.8	453.7	549.3	615.7	641.5	648.4	687.2
Other resident sectors	305.0	306.0	316.0	292.7	294.7	287.3	285.3	301.1
Debt securities	901.5	915.5	926.4	808.4	825.2	847.2	836.5	914.8
Loans, trade credits and other liabilities	264.3	273.0	294.0	299.6	306.8	298.7	297.0	294.5
Deposits	740.5	827.0	858.4	952.5	962.5	942.5	920.8	954.3
Other	3.5	3.4	14.8	15.1	15.0	14.7	14.7	14.7
Direct investment debt liabilities	227.0	237.9	247.7	268.0	271.8	276.8	277.6	273.4
Net External Debt 2/	**941.4**	**982.9**	**949.6**	**830.7**	**832.2**	**806.7**	**774.6**	**787.9**
Short-term	333.1	425.2	437.3	455.9	460.2	431.0	399.0	386.2
Long-term	608.3	557.7	512.3	374.8	371.9	375.7	375.6	401.7
General government	614.1	632.6	641.7	553.5	571.1	584.8	567.6	609.4
Bank of Spain	205.1	286.9	270.5	267.2	211.8	176.0	153.0	146.8
Other monetary financial institutions	63.3	15.4	-6.5	12.1	70.2	68.6	78.8	69.5
Other resident sectors	-22.9	-30.5	-34.1	-90.1	-102.9	-107.2	-107.5	-114.5
Debt securities	483.1	449.4	430.1	283.2	260.3	281.2	276.7	318.0
Loans, trade credits and other liabilities	17.8	28.5	27.9	-0.3	20.1	13.1	18.5	2.6
Deposits	359.4	427.1	414.5	460.8	471.3	429.5	398.2	392.3
Other	-0.7	-0.5	-0.8	-1.1	-1.5	-1.5	-1.5	-1.6
Direct investment debt liabilities	81.8	78.4	78.0	88.0	82.0	84.4	82.7	76.7
				(Percent of GDP)				
Gross External Debt	**171.6**	**201.7**	**191.6**	**174.1**	**162.9**	**162.8**	**160.5**	**167.7**
Short-term	63.6	79.7	78.1	77.1	70.3	68.8	66.5	68.1
Long-term	107.9	122.0	113.4	97.0	92.6	94.0	94.0	99.6
General government	53.1	60.9	56.1	44.4	42.1	42.9	41.7	44.6
Bank of Spain	39.0	53.5	52.2	47.2	40.0	37.4	36.0	36.8
Other monetary financial institutions	36.8	38.7	37.1	40.8	42.1	43.9	44.4	47.0
Other resident sectors	24.5	27.3	25.9	21.7	20.2	19.7	19.5	20.6
Debt securities	72.4	81.8	75.8	60.0	56.5	58.0	57.2	62.6
Loans, trade credits and other liabilities	21.2	24.4	24.1	22.3	21.0	20.4	20.3	20.1
Deposits	59.5	73.9	70.2	70.7	65.8	64.5	63.0	65.3
Other	0.3	0.3	1.2	1.1	1.0	1.0	1.0	1.0
Direct investment debt liabilities	18.2	21.3	20.3	19.9	18.6	18.9	19.0	18.7
Net External Debt 2/	**75.6**	**87.8**	**77.7**	**61.7**	**56.9**	**55.2**	**53.0**	**53.9**
Short-term	26.7	38.0	35.8	33.9	31.5	29.5	27.3	26.4
Long-term	48.8	49.8	41.9	27.8	25.4	25.7	25.7	27.5
General government	49.3	56.5	52.5	41.1	39.1	40.0	38.8	41.7
Bank of Spain	16.5	25.6	22.1	19.8	14.5	12.0	10.5	10.0
Other monetary financial institutions	5.1	1.4	-0.5	0.9	4.8	4.7	5.4	4.8
Other resident sectors	-1.8	-2.7	-2.8	-6.7	-7.0	-7.3	-7.4	-7.8
Debt securities	38.8	40.2	35.2	21.0	17.8	19.2	18.9	21.8
Loans, trade credits and other liabilities	1.4	2.5	2.3	0.0	1.4	0.9	1.3	0.2
Deposits	28.9	38.2	33.9	34.2	32.2	29.4	27.2	26.8
Other	-0.1	0.0	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Direct investment debt liabilities	6.6	7.0	6.4	6.5	5.6	5.8	5.7	5.2

Sources: World Bank Quarterly External Debt Statistics and IMF staff calculations.
1/ Data corresponds to Q4 of each year unless otherwise indicated.
2/ Net external debt is defined as gross external debt minus external assets in debt instruments.

Annex I. External Sector Assessment

<table>
<tr><td colspan="6">Overall Assessment: The external position in 2023 is assessed on a preliminary basis to be moderately stronger than the level implied by medium-term fundamentals and desirable policies. Even though the large negative NIIP was significantly reduced in 2023, strengthening it further will require sustaining relatively high CA surpluses in coming years. While in 2023-24 the CA balance will exceed the norm, this gap is projected to shrink in the medium term, with the CA surplus declining as tourism flows normalize, non-energy imports regain strength—supported by the shift in the economy's growth drivers towards domestic demand, particularly investment which has a high import content—and private saving slowly declines towards pre-COVID levels. A final assessment will be provided in the 2024 External Sector Report.

Potential Policy Responses: The projected CA surplus path will keep reducing the sizeable negative NIIP as needed. Therefore, policies that would divert the CA from such path, including those that would weaken competitiveness and the CA, should be avoided. However, a similar path could be achieved with a better policy mix that keeps the savings-investment balance and the projected CA path broadly unchanged, while supporting growth and preserving fiscal sustainability. Specifically, sustained fiscal consolidation efforts would rebuild fiscal space and raise aggregate saving, while structural reforms—together with investments in strategic areas—could boost growth and raise aggregate investment. Any such industrial policies should be pursued cautiously, remain narrowly targeted to specific objectives where externalities or market failures prevent effective market solutions, and aim to minimize trade and investment distortions. Spain should persist in its efforts to enhance education outcomes, encourage innovation, and reduce energy dependence from abroad. The Recovery, Transformation and Resilience Plan includes investments and reforms in these areas, as well as specific measures to diversify and improve the quality of tourism services, but adequate implementation and ex-post evaluation remain critical for success.</td></tr>
<tr><td>Foreign Asset and Liability Position and Trajectory</td><td colspan="5">Background. The NIIP continued to improve in 2023 and reached -52.8 percent of GDP by the end of the year. This trajectory reflects a larger decrease in gross liabilities compared to that in assets (as a percentage of GDP). Gross liabilities—of which nearly 70 percent correspond to external debt—declined to 248.3 percent of GDP by the end of 2023. Most of the negative NIIP is attributed to the general government and the central bank, with T2 liabilities amounting to 26.2 percent of GDP by December 2023.[1] The NIIP is projected to continue improving in the medium term, supported by sustained CA surpluses and the positive—though temporary—impact of Next Generation EU funds disbursements on the capital account.

Assessment. Despite its projected improvement, the still large negative NIIP comes with external vulnerabilities, including those from large gross financing needs and risks of adverse valuation effects, which could be affected by the evolution of global financial conditions and policy responses. Mitigating factors include the rather long maturity of outstanding sovereign debt (averaging almost eight years) and the limited share of debt denominated in foreign currency (11.9 percent of total external debt).</td></tr>
<tr><td>2023 (% GDP)</td><td>NIIP: −52.8</td><td>Gross Assets: 195.5</td><td>Debt Assets: 95.0</td><td>Gross Liab.: 248.3</td><td>Debt Liab.: 149.0</td></tr>
<tr><td>Current Account</td><td colspan="5">Background. The CA surplus rose significantly from 0.6 percent of GDP in 2022 to 2.6 percent of GDP in 2023. This was driven by a strong performance of services exports (both tourism and non-tourism), and by weak imports (not only due to the decline in energy import prices but also to a low—relative to historical average—elasticity of imports to domestic demand). Higher public saving and weaker private investment—including due to high uncertainty and tight financial conditions—more than offset the rise in public investment and a drawdown of excess private savings generated during the pandemic. Continued strength of services exports and further improvements in the energy goods balance will keep the trade surplus high in 2024. In the medium term, the CA surplus is projected to shrink gradually as tourism inflows normalize and non-energy imports regain strength—supported by the shift in the economy's growth drivers towards domestic demand, particularly investment which has a high import content.</td></tr>
</table>

<table>
<tr><td></td><td colspan="6">Assessment. The 2023 cyclically-adjusted CA balance is 2.8 percent of GDP. IMF staff assess the CA norm to be between 0.1 and 1.7 percent of GDP, with a midpoint of 0.9 percent of GDP, in line with the EBA CA model. The difference between the cyclically-adjusted CA and the CA norm yields a CA gap in the range of 1.1 to 2.7 percent of GDP, with a midpoint of 1.9 percent of GDP. The overall estimated contribution of identified policy gaps is 0.3 percent of GDP, reflecting the positive contributions from a more expansionary fiscal policy stance in the rest of the world relative to Spain and relatively low credit growth (0.4 and 0.2 percent of GDP, respectively), which are only partially offset by the negative contribution from strong social safety nets (-0.3 percent of GDP).</td></tr>
<tr><td>2023 (% GDP)</td><td>CA: 2.6</td><td>Cycl. Adj. CA: 2.8</td><td>EBA Norm: 0.9</td><td>EBA Gap: 1.9</td><td>Staff Adj.: 0.0</td><td>Staff Gap: 1.9</td></tr>
<tr><td>Real Exchange Rate</td><td colspan="6">Background. In 2023, Spain’s CPI- and ULC-based REER remained broadly stable, with changes relative to 2022 average of 0.3 and -0.45 percent, respectively. This followed a period of sustained REER depreciation since 2009, which almost fully reversed the large appreciation during 1999–2008. As of April 2024, the CPI-based REER was 1.0 percent above the 2023 average.
Assessment. The IMF staff CA gap implies a REER gap of –6.6 percent in 2023 (with an estimated elasticity of 0.28 applied). The EBA REER index and level models suggest instead an overvaluation of 3.7 percent and 18.4 percent for 2023, respectively, mostly driven by large unexplained residuals. Consistent with the staff CA gap, the staff assesses the REER to be moderately undervalued, with a midpoint of 6.6 percent and a range of uncertainty of ±2.8 percent.</td></tr>
<tr><td>Capital and Financial Accounts: Flows and Policy Measures</td><td colspan="6">Background. The capital account surplus has remained high due to flows associated with Next Generation EU funds. The financial account balance improved to 4.1 percent of GDP in 2023 (from 1.9 percent of GDP in 2022). The increase in the financial account surplus was largely driven by changes in the Bank of Spain’s balance sheet, which were only partially offset by net outflows in the other components.
Assessment. Large external financing needs leave Spain vulnerable to sustained market volatility and tighter global financial conditions.</td></tr>
<tr><td>FX Intervention and Reserves Level</td><td colspan="6">Background. The euro has the status of a global reserve currency.
Assessment. Euro area economies typically hold low reserves relative to standard metrics, but the currency is free floating.</td></tr>
<tr><td colspan="7">[1] T2 is the settlement system run by the Eurosystem. It settles payments related to the Eurosystem’s monetary policy operations, as well as bank-to-bank and commercial transactions. When banks in Spain send more euros through T2 than they receive overall, the Bank of Spain incurs a T2 liability. The Bank of Spain’s T2 liabilities had increased until recently mostly as a result of the asset purchase program introduced by the European Central Bank in 2015, which technically led the Bank of Spain to purchase assets held by investors with bank accounts abroad.</td></tr>
</table>

Annex II. Risk Assessment Matrix

Source of Risks	Relative Likelihood	Impact if Realized	Policy Response
Global Risks			
Commodity price volatility	**High** A succession of supply disruptions (e.g., due to conflicts, uncertainty, and export restrictions) and demand fluctuations causes recurrent commodity price volatility, external and fiscal pressures in EMDEs, cross-border spillovers, and social and economic instability.	**High** Spain is a net energy importer, with imported products accounting for about 75 percent of total energy needs. A renewed spike in international energy prices would represent a negative terms-of-trade shock with material impact on inflation, real national income, and the current account balance.	• Provide targeted support to vulnerable households and firms to mitigate the impact of higher energy import prices. • If inflation became substantially higher and/or more persistent, greater fiscal policy tightening might be needed. • Further reallocate public investment to competitiveness-enhancing areas, and accelerate structural—most importantly, labor market—reforms that facilitate labor reallocation.
Intensification of regional conflicts	**High** Escalation or spread of the conflict in Gaza and Israel, Russia's war in Ukraine, and/or other regional conflicts or terrorism disrupt trade, remittances, FDI and financial flows, payment systems, and increase refugee flows.	**Medium** Spain has limited direct linkages to the conflict regions but is indirectly exposed via potentially higher import prices and lower trading partners' growth. On the upside, Spain might benefit from a reallocation of tourism flows.	• Same as above.
Deepening geoeconomic fragmentation	**High** Deepening geoeconomic fragmentation. Broader conflicts, inward-oriented policies, and weakened international cooperation result in a less efficient configuration of trade and FDI, supply disruptions, protectionism, policy uncertainty, technological and payments systems fragmentation, rising input costs, financial instability, a fracturing of international monetary and financial system, and lower growth.	**Medium** External demand has been a key driver of Spain's GDP growth since the GFC. Increased geo-economic fragmentation could impede global trade and capital flows and lower Spain's growth. On the upside, Spain can become more integrated into the European value chains after a reconfiguration of trade.	• Let automatic stabilizers play in case the output gap widens and provide targeted support to cushion the impact of external shocks. • Promote public investment and accelerate structural reforms in areas that could facilitate global trade, improve competitiveness and facilitate structural transformation, such as digitalization and infrastructure.
Abrupt global slowdown or recession	**Medium** Global and idiosyncratic risk factors cause a synchronized sharp growth downturn, with recessions in some countries, adverse spillovers through trade and financial channels, and	**Medium** A further growth slowdown of Spain's main trading partners (including other euro area countries, UK, and US) could weaken growth and deter investments.	• Same as above, with automatic stabilizers being allowed to play out more fully in the absence of any hit to potential output. • Accelerate structural reforms that can support productivity and reduce unemployment,

Source of Risks	Relative Likelihood	Impact if Realized	Policy Response
	market fragmentation triggering sudden stops in EMDEs.		especially if the shock is viewed as having a structural component.
Monetary policy miscalibration	**Medium** Amid high economic uncertainty, major central banks loosen policy stance prematurely, hindering disinflation, or keep it tight for longer than warranted, causing abrupt adjustments in financial markets and weakening the credibility of central banks.	**Medium** Persistently high inflation could have a negative impact on domestic demand, leading to a wage-price feedback loop and a further deterioration of confidence. A tight monetary policy for longer than warranted could lead to tighter financial conditions and further deleveraging of the private sector, increase vulnerabilities, lower growth,	• Fiscal policy should avoid adding to inflationary pressures and may need to be tighter. • If monetary policy is tighter than warranted, allow automatic stabilizers to play and if the downturn is severe, consider targeted discretionary stimulus.
Disorderly energy transition	**Medium** Disorderly energy transition. A disorderly shift to net-zero emissions (e.g., owing to shortages in critical metals) and climate policy uncertainty cause supply disruptions, stranded assets, market volatility, and subdued investment and growth.	**Medium** Higher energy prices could have a material impact on domestic inflation and weaken real incomes of household and firms. Heightened climate policy uncertainty could slow the already weak investment momentum.	• Provide targeted fiscal policy support to households and businesses severely affected by energy transition. • Further promote public investment and accelerate structural reforms to improve energy efficiency and facilitate labor reallocation. • Ensure clearer communication of domestic climate policies.
Extreme climate events	**Medium** Extreme climate events. Extreme climate events driven by rising temperatures cause loss of human lives, severe damage to infrastructure, supply disruptions, lower growth, and financial instability.	**Medium** The occurrence of climate-related events (e.g., droughts, heatwaves, wildfires) disrupts economic activity and amplifies inflationary pressures.	• Provide targeted fiscal policy in response to extreme climate events. • Promote public investment and accelerate structural reforms in areas that could improve efficiency, resilience of productive activities, and reallocation away from the harder-hit ones in the event of recurring climate events.
Cyberthreats	**Medium** Cyberattacks on physical or digital infrastructure and service providers (including digital currency and crypto assets) or misuse of AI technologies trigger financial and economic instability.	**High/Medium** Spain has accelerated digital transformation in recent years, reaching one of the highest levels of digitalization among European peers. Widespread use of digital infrastructure makes the financial system as well as the real economy potentially more vulnerable to cyber-attacks.	• Increase public sector resources devoted to handling cyberthreats. • Supervisors should conduct more onsite examinations and increase thematic reviews related to cyber risks. • Involve the Bank of Spain and the National Securities Market Commission in critical financial market infrastructure-related matters.

Source of Risks	Relative Likelihood	Impact if Realized	Policy Response
Domestic Risks			
Prolonged political fragmentation	Medium Tensions related to Catalonia remain high, with positions deeply divided and entrenched.	Medium Prolonged period of uncertainty could hinder the implementation of structural reforms and fiscal consolidation, which could eventually weaken business confidence and weigh on investment and growth.	• In case output gap widens, let automatic stabilizers play provided financing conditions remain favorable. • Formulate and negotiate early a credible medium-term fiscal consolidation path to support investor confidence.
Weak implementation of fiscal commitments and structural reforms or reversal of past achievements	Medium The ability to build political majorities, and thereby to pass structural reforms, is lower in a fragmented parliament. A credible medium-term fiscal plan has yet to be announced.	High Potential inaction or reversal of reforms, as well as uncertainty about medium-term fiscal commitments, could weaken confidence, investment, and employment, adversely impacting public debt dynamics and triggering adverse market reactions.	• Chart a path towards sustained and growth-friendly fiscal consolidation. • Reform the regional financing framework to reduce fiscal risks.
Implementation of EU-funded projects	Medium The size, timing and composition of EU-funded spending to support investments and structural reforms could end up resulting in less economic stimulus than projected.	High Investment under the EU-funded projects is an important driver of near-term economic growth.	• Redouble efforts to ensure efficient coordination, implementation, and oversight of the Recovery, Transformation and Resilience Plan.
Persistent high inflation	Medium Greater second-round effects on increases in unit labor costs, alongside limited room for profit margins to absorb them, could lead to more persistent inflation.	Medium Higher inflation could deteriorate confidence and external competitiveness if sustained over the medium term.	• Provide targeted support to vulnerable households. • Make sure that fiscal policies do not add to inflationary pressures.

Annex III. Sovereign Risk Debt Sustainability Analysis

Public sector gross debt is high at about 107 percent of GDP, and in a no-policy change baseline it stabilizes around 103 percent over the forecast horizon. Fiscal consolidation will be needed to put the debt ratio on a firm downward path and rebuild buffers over the medium term. The projected debt trajectory is susceptible to moderate risk in the medium term. In the long run, population ageing will exert mounting fiscal pressures which, if not addressed early on, would set debt on a sustained upward trajectory.

A. Background

1. Definition and Coverage. Public debt comprises Excessive Deficit Procedure (EDP) debt in the hands of the General Government. The General Government includes the Central Government, Regional Governments, Local Governments, and Social Security Funds. It includes only those public enterprises that are defined as part of General Government under the European System of Accounts. EDP debt is a subset of General Government consolidated debt (i.e., it does not include trade credits and other accounts payable) and the stocks are recorded at their nominal value.

2. Public Debt Developments. Public debt was on a gradually declining path from 2014 to 2019, when it reached 98.2 percent of GDP. In 2020, as a consequence of the sharp economic contraction induced by the pandemic and the sizeable fiscal response, the public debt ratio rose to 120 percent of GDP. From 2021, the debt ratio has decreased steadily, driven by the rebound in economic activity, strong revenue outturns, the gradual phasing-out of COVID support measures, and inflation. The debt reduction continued through late 2022 and 2023, albeit at a slower pace due to the introduction of new fiscal measures to support households and firms against high energy and food prices.

3. Financing Conditions. In the years preceding the pandemic, gross financing needs and borrowing costs gradually improved, supported by fiscal consolidation, accommodative monetary policy, and a steady increase in the maturity of newly issued debt. The 10-year bond yield declined from approximately 6 percent to 0.7 percent over 2012–19, and interest payments on public debt fell to 2.3 percent of GDP. Financing conditions broadly remained favorable during 2020 and 2021 despite an initial tightening at the onset of the pandemic, with the 10-year bond yield averaging 0.36 percent over the period. However, on the back of the ECB's monetary tightening, nominal yields on Spanish government bonds grew steadily during 2021–23, reaching a high of 3.95 percent in October 2023. The spread over the German bund, however, remained contained, averaging 100bps in 2023. Borrowing costs have remained broadly stable in late 2023, as monetary tightening in the euro area stopped and investors' confidence remained strong.

4. Other Factors. The amortization profile of public debt is tilted towards the long term, with an average maturity of 7.9 years. The low share of short-term debt has helped cushion the effect of higher borrowing costs on public finances since 2022. The share of total debt held by the Bank of Spain rose from 18 percent in 2019 to more than 28.5 percent in mid-2022, subsequently falling to

26.7 percent by late 2023 on the back of quantitative tightening of monetary policy.[1] The share held by non-residents also fell from close to 48 percent in 2019 to 42 percent in late 2023, while the share held by resident financial institutions and the non-financial sector fell from 34 to 31 percent.

B. Baseline Scenario

5. Baseline. Debt is projected to decline to 105.6 percent of GDP in 2024 and subsequently stabilize around 103 percent of GDP over the forecast horizon. This trajectory is underpinned by a protracted fiscal deficit and an increase in interest expenditures, which are offset by positive nominal GDP growth. Gross financing needs are projected to remain stable at a high level of around 16 percent of GDP.

6. Assumptions. The baseline scenario is based on medium-term projections that assume the full but gradual winding down of anti-inflationary support measures by the end of 2024 and the expiration of temporary windfall levies in December 2025. The phasing in of higher social security contributions from the 2021–23 reforms are also incorporated. The baseline also assumes the disbursement of grants and loans from the EU Recovery and Resilience Fund. The grants, amounting to about 5.5 percent of GDP, are disbursed over 2021–26 and are fiscally neutral. Approximately €26. billion of loans (31 percent of the total available amount) are assumed to be drawn over 2024–28, of which approximately €6 billion will be used for spending and the remaining sum will be destined to credit guarantee and lending programs. Unlike grants, the loan component entails an increase in the debt-to-GDP ratio of 1.5 percentage points by 2028, which will subsequently shrink gradually as loans are repaid.

C. Risk Assessment

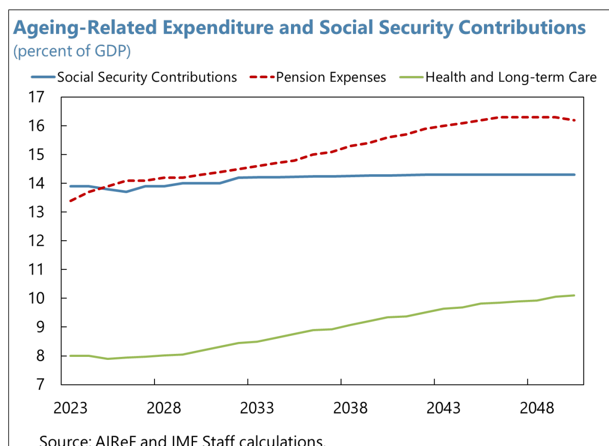
7. Overall assessment. Staff assess the overall risk of debt distress to be moderate. In the medium term, the still high levels of debt and gross financing needs increase the sensitivity of debt dynamics and rollover risk to a potential tightening of credit conditions, lower GDP growth, and a weakening of the fiscal position. In the long term, ageing-related expenditures will exert significant fiscal pressures. Mitigating factors include the high share of debt held by the ECB and domestic investors, as well as the maturity profile tilted towards longer durations.

8. Realism of baseline assumption. Past forecast errors for public debt, the interest rate-growth rate differential (r-g), and other macroeconomic variables do not show systematic bias in past projections. The projected 3-year reduction in debt and the improvement in the cyclically adjusted primary balance are not very high compared to historical experience, as they are lower than the 75th percentiles of the historical distribution among peer countries, although still above the median.

[1] The Bank of Spain's holdings of government debt include monetary policy operations on behalf of ECB.

9. Medium-term risk. The fan chart exercise points to high medium-term distress risk, due to a high debt level and a high probability of non-stabilization under the baseline fiscal path. The gross financing needs exercise signals only moderate medium-term risk, as under the stress scenario financing needs rise further from their already high projected baseline value, albeit not to the levels experienced during the pandemic.

10. Long-term risk assessment. For Spain, demographic trends represent the main source of long-term risk of debt distress, as outlays for pensions and healthcare systems are expected to rise over the coming next decades. Although the estimated magnitude of these fiscal pressures crucially depends on assumptions regarding immigration flows, fertility, labor force participation, unemployment, and productivity growth, ageing-related costs are likely to rise significantly (see text table in paragraph 21). As a result of the expected fall in the working-age population and rise in life expectancy, AIReF projects public expenditures on pensions (net of recent revenue measures), healthcare, and long-term care to rise by approximately 4.5 p.p. of GDP between 2023 and 2050. These additional costs would in small part (approximately 0.6 p.p. of GDP) be offset by lower expenditures for public education. As discussed in the main text, if not addressed, growth in ageing-related outlays could entail a sustained rise in the debt-to-GDP ratio starting from 2035.



11. The 2021–23 pension reforms took measures to address ageing trends by raising the current workers' contribution rate. Importantly, through the Intergenerational Equity Mechanism, a portion of the increased revenues is destined to a reserve fund committed to future pension outlays rather than current expenditures —with disbursements from the fund only allowed after 2033 and with a yearly cap. However, other aspects of the reforms, chiefly the reinstatement of pension benefits' indexation to inflation, entail increased higher future expenditures. While stronger incentives to lengthen working lives and delay retirement were also introduced, their overall fiscal impact remains unclear. Overall, AIReF estimates that benefit expenditures will grow faster than revenues over 2024–50, leading to a widening shortfall starting in 2030. The safeguard clause introduced by the 2023 reform prescribes a tri-annual review conducted by AIReF, starting in 2025. In case the average projected expenditures over 2022–50, net of introduced revenue measures, exceed 13.3 percent of GDP, the review will recommend additional measures to either increase contributions or reduce outlays to be approved by parliament. In case of no political agreement, a gradual increase in contribution rates serves as last-resort option. This mechanism aims to preserve the sustainability of the social security system through regular monitoring of its finances and quasi-automatic adjustments when gaps arise.

Annex III. Figure 1. Spain: Risk of Sovereign Stress

Horizon	Mechanical signal	Final assessment	Comments
Overall	…	Moderate	The overall risk of debt distress is moderate, with low levels of vulnerability in the near term. Under the baseline fiscal policy path, however, medium-term risk is moderate. In the long-term, age-related expenditure pressures pose high risks to debt dynamics.
Near term 1/			
Medium term	Moderate	Moderate	Medium-term risks are assessed as moderate. Under the current fiscal policy path, debt is projected to stabilize at a high level of 103 percent of GDP, making debt dynamics very sensitive to exogenous shocks, a rise in bond yields, or a worsening of the fiscal balance. These concerns are reflected in the high-risk signal from the fan chart exercise. The GFN exercise signals moderate risk, as the rise in gross financing needs from a shock to borrowing capacity would be high but comparable to 2020.
Fanchart	High	…	
GFN	Moderate	…	
Stress test		…	
Long term	…	High	Long-term risk is assessed as high due to the significant pressures on healthcare, long-term care, and pensions outlays driven by population ageing. If not addressed, these pressures will decisively set debt on an upward path (see paragraph 16 of the main text).
Sustainability assessment 2/			Not required for surveillance countries
Debt stabilization in the baseline			Yes

DSA Summary Assessment

Commentary: Spain's overall risk of debt distress is assessed as moderate. The large share of debt held by domestic investors and by the European Central Bank, and the long average maturity are strong mitigating factors. In the medium term, the projected fiscal path stabilizes debt at a high level, increasing the sensitivity of the debt trajectory to lower growth, tighter financial conditions, and a weakening of the fiscal position. The fan chart exercise thus signals a high medium-term risk. Gross financing needs also pose moderate risk but remain contained in the medium term. In the long-run, population ageing constitutes a high risk for debt dynamics. If unaddressed, increasing pensions and health costs will set debt on an upward trajectory starting in the mid-2030s. Further reforms will likely be needed to complement the 2021-2023 pension reforms, to either increase the revenues of the social security system or contain future outlays.

Source: Fund staff.

Note: The risk of sovereign stress is a broader concept than debt sustainability. Unsustainable debt can only be resolved through exceptional measures (such as debt restructuring). In contrast, a sovereign can face stress without its debt necessarily being unsustainable, and there can be various measures—that do not involve a debt restructuring—to remedy such a situation, such as fiscal adjustment and new financing.

1/ The near-term assessment is not applicable in cases where there is a disbursing IMF arrangement. In surveillance-only cases or in cases with precautionary IMF arrangements, the near-term assessment is performed but not published.

2/ A debt sustainability assessment is optional for surveillance-only cases and mandatory in cases where there is a Fund arrangement. The mechanical signal of the debt sustainability assessment is deleted before publication. In surveillance-only cases or cases with IMF arrangements with normal access, the qualifier indicating probability of sustainable debt ("with high probability" or "but not with high probability") is deleted before publication.

Annex III. Figure 2. Spain: Debt Coverage and Disclosures

	CG	GG	NFPS	CPS	Other	Comments
1. Debt coverage in the DSA: 1/		GG (chosen)				
1a. If central government, are non-central government entities insignificant?					n.a.	

2. Subsectors included in the chosen coverage in (1) above:

	Subsectors captured in the baseline	Inclusion	Comments
1	Budgetary central government	Yes	
2	Extra budgetary funds (EBFs)	No	Not applicable
3	Social security funds (SSFs)	Yes	
4	State governments	Yes	
5	Local governments	Yes	
6	Public nonfinancial corporations	No	
7	Central bank	No	
8	Other public financial corporations	No	

(CG: rows 1–3; GG: expected: rows 1–5; NFPS: rows 1–6; CPS: rows 1–8)

3. Instrument coverage:

Currency & deposits	Loans	Debt securities	Oth acct. payable 2/	IPSGSs 3/
chosen	chosen	chosen	missing	missing

4. Accounting principles:

Basis of recording		Valuation of debt stock		
Non-cash basis 4/	Cash basis	Nominal value 5/	Face value 6/	Market value 7/
chosen		chosen		

5. Debt consolidation across sectors:

Consolidated	Non-consolidated
chosen	

Color code: chosen coverage (green); Missing from recommended coverage (red); Not applicable (grey)

Reporting on Intra-government Debt Holdings

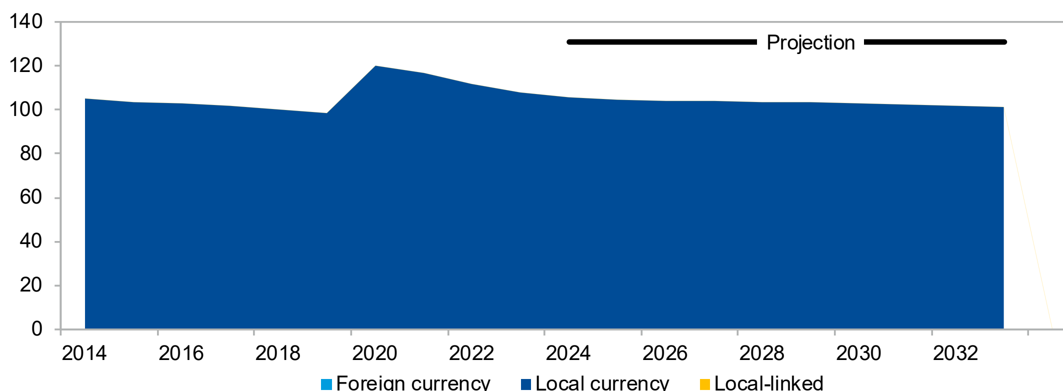
Issuer \ Holder	Budget. central govt	Extra-budget. funds (EBFs)	Social security funds (SSFs)	State govt.	Local govt.	Nonfin. pub. corp.	Central bank	Oth. pub. fin corp	Total
1 Budget. central govt			3.35				421.3		424.65
2 Extra-budget. funds									0
3 Social security funds	116.2								116.2
4 State govt.	198								198
5 Local govt.	6.3								6.3
6 Nonfin pub. corp.									0
7 Central bank									0
8 Oth. pub. fin. corp									0
Total	320.5	0	3.35	0	0	0	421.3	0	745.15

1/ CG=Central government; GG=General government; NFPS=Nonfinancial public sector; PS=Public sector.
2/ Stock of arrears could be used as a proxy in the absence of accrual data on other accounts payable.
3/ Insurance, Pension, and Standardized Guarantee Schemes, typically including government employee pension liabilities.
4/ Includes accrual recording, commitment basis, due for payment, etc.
5/ Nominal value at any moment in time is the amount the debtor owes to the creditor. It reflects the value of the instrument at creation and subsequent economic flows (such as transactions, exchange rate, and other valuation changes other than market price changes, and other volume changes).
6/ The face value of a debt instrument is the undiscounted amount of principal to be paid at (or before) maturity.
7/ Market value of debt instruments is the value as if they were acquired in market transactions on the balance sheet reporting date (reference date). Only traded debt securities have observed market values.

Commentary: Debt coverage is at the general government level. A large fraction of the debt of the governments of autonomous communities is held by the central government through the Fondo de Liquidez Autonómico.

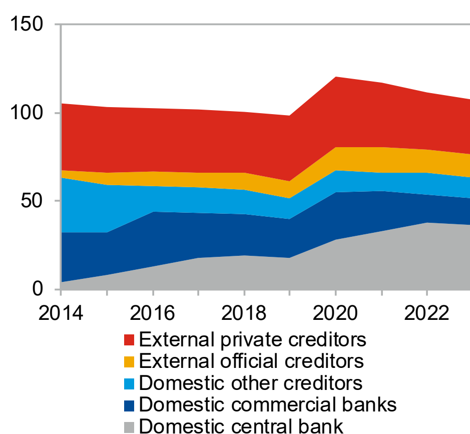
Annex III. Figure 3. Spain: Public Debt Structure Indicators

Debt by Currency (percent of GDP)



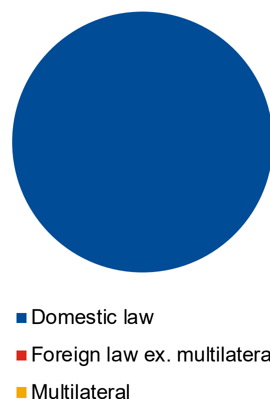
Note: The perimeter shown is general government.

Public Debt by Holder (percent of GDP)



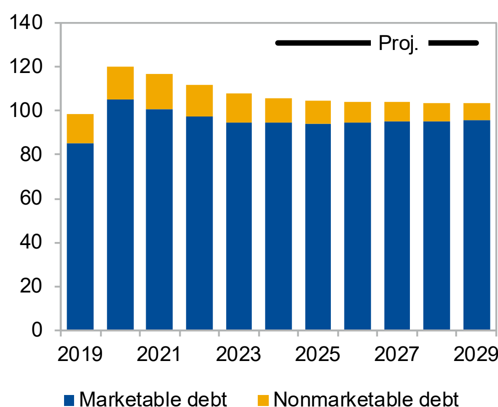
Note: The perimeter shown is general government.

Public Debt by Governing Law, 2023 (percent)



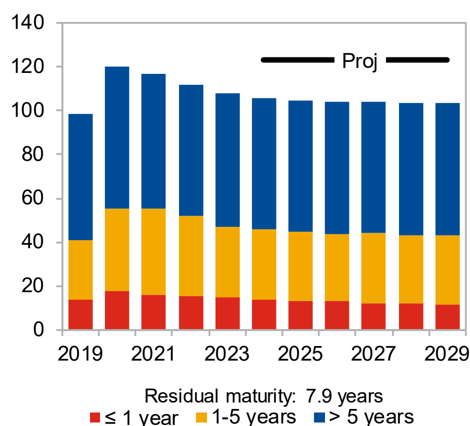
Note: The perimeter shown is general government.

Debt by Instruments (percent of GDP)



Note: The perimeter shown is general government.

Public Debt by Maturity (percent of GDP)



Note: The perimeter shown is general government.

Commentary: Debt is predominantly issued in domestic currency, under domestic law, and is marketable. Domestic creditors and the central bank own more than half of all issued debt. The average residual maturity is close to 8 years.

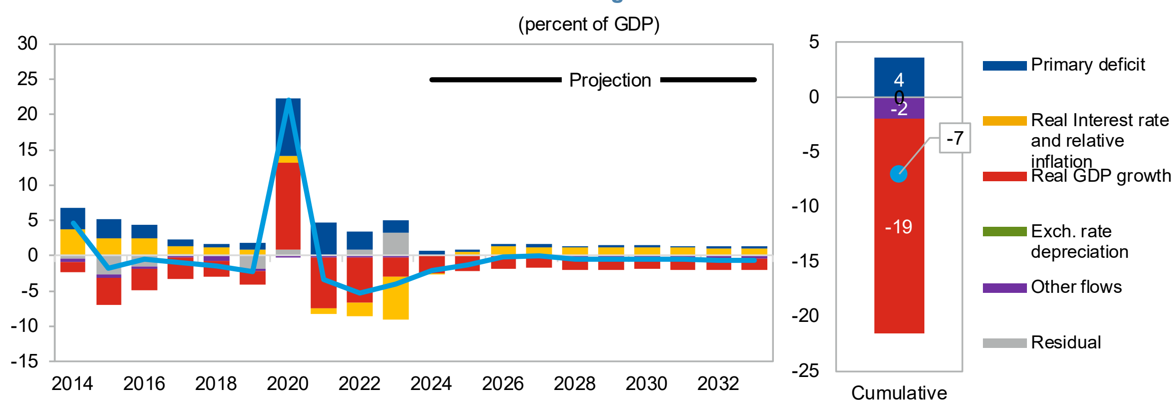
Annex III. Figure 4. Spain: Baseline Scenario

(percent of GDP unless indicated otherwise)

	Actual	Medium-term projection						Extended projection			
	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033
Public debt	107.7	105.6	104.4	104.3	104.2	103.7	103.2	102.8	102.3	101.7	101.1
Change in public debt	-4.0	-2.0	-1.2	-0.1	0.0	-0.5	-0.5	-0.5	-0.5	-0.6	-0.6
Contribution of identified flows	-7.3	-2.0	-1.2	-0.1	0.0	-0.5	-0.5	-0.5	-0.5	-0.6	-0.6
Primary deficit	1.8	0.6	0.3	0.4	0.4	0.3	0.3	0.3	0.3	0.3	0.3
Noninterest revenues	42.2	42.6	42.6	42.4	41.6	41.6	41.6	41.6	41.6	41.6	41.6
Noninterest expenditures	44.0	43.3	42.9	42.8	42.0	41.8	41.9	41.9	41.9	41.9	41.9
Automatic debt dynamics	-8.8	-2.7	-1.6	-0.6	-0.4	-0.5	-0.5	-0.4	-0.5	-0.5	-0.5
Real interest rate and relative inflation	-6.1	-0.2	0.5	1.2	1.2	1.2	1.2	1.2	1.1	1.1	1.1
Real interest rate	-6.1	-0.2	0.5	1.2	1.2	1.2	1.2	1.2	1.1	1.1	1.1
Relative inflation	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Real growth rate	-2.7	-2.5	-2.1	-1.8	-1.7	-1.7	-1.7 .	-1.6	-1.6	-1.6	-1.6
Real exchange rate	0.0	…	…	…	…	…	… .	…	…	…	…
Other identified flows	-0.2	0.1	0.1	0.0	0.0	-0.3	-0.3	-0.3	-0.3	-0.3	-0.4
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
(minus) Interest Revenues	-0.6	-0.3	-0.2	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3
Other transactions	0.4	0.3	0.3	0.3	0.3	0.0	0.0	0.0	-0.1	-0.1	-0.1
Contribution of residual	3.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Gross financing needs	15.3	17.1	16.2	16.4	16.5	16.3	16.3	16.3	16.3	16.3	16.3
of which: debt service	14.1	16.7	16.2	16.3	16.3	16.3	16.3	16.3	16.3	16.3	16.3
Local currency	14.1	16.7	16.2	16.3	16.3	16.3	16.3	16.3	16.3	16.3	16.3
Foreign currency	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memo:											
Real GDP growth (percent)	2.5	2.4	2.1	1.8	1.6	1.6	1.6	1.6	1.6	1.6	1.6
Inflation (GDP deflator; percent)	5.9	2.8	2.3	1.7	1.7	1.8	1.8	1.7	1.7	1.7	1.7
Nominal GDP growth (percent)	8.6	5.2	4.4	3.5	3.4	3.4	3.4	3.4	3.4	3.4	3.4
Effective interest rate (percent)	0.0	2.6	2.8	2.9	2.9	2.9	3.0	2.9	2.9	2.9	2.9

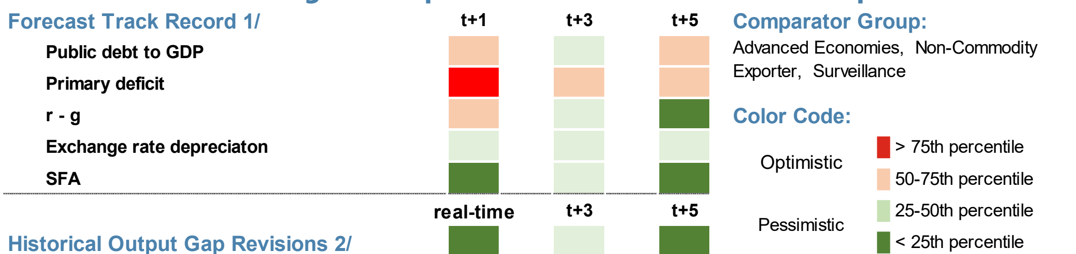
Contribution to Change in Public Debt

(percent of GDP)

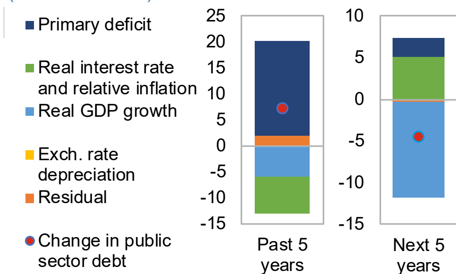


Commentary: Public debt is projected to stabilize over the forecast horizon as the downward contribution of real GDP growth is offset by negative primary balance and interest expenditures.

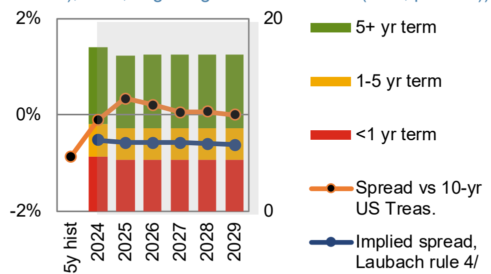
Annex III. Figure 5. Spain: Realism of Baseline Assumptions



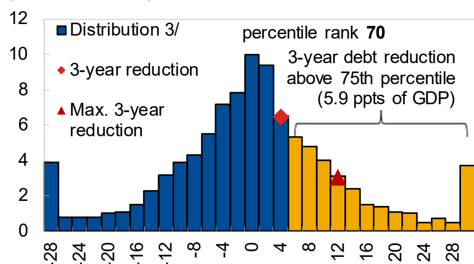
Public Debt Creating Flows (Percent of GDP)



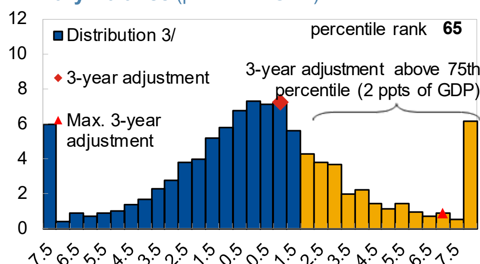
Bond Issuances (bars, debt issuances (RHS, %GDP); lines, avg marginal interest rates (LHS, percent))



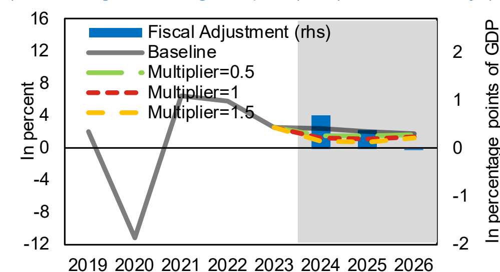
3-Year Debt Reduction (Percent of GDP)



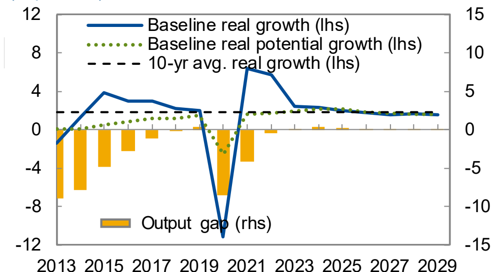
3-Year Adjustment in Cyclically-Adjusted Primary Balance (percent of GDP)



Fiscal Adjustment and Possible Growth Paths (lines, real growth using multiplier (LHS); bars, fiscal adj. (RHS))



Real GDP Growth (in percent)



Commentary: The realism analysis does not show systematic bias in past forecasts. In the last five years, a large primary deficit from the fiscal response to the pandemic and the energy crisis was the main driver of rising debt levels. Over the forecast horizon, a smaller but persistent deficit together higher interest expenditures are offset by positive real growth. The projected 3-year changes in debt and the cyclically-adjusted primary balance are not particularly high compared to historical experience.

Source : IMF Staff.

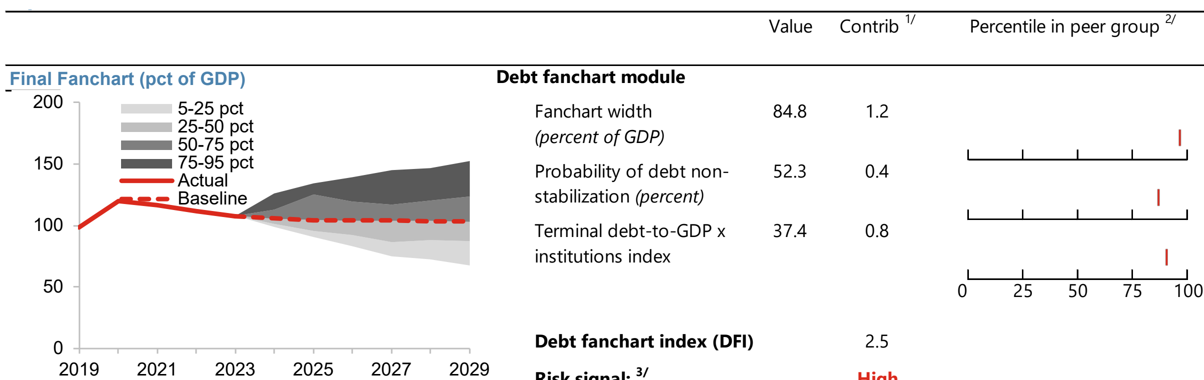
1/ Projections made in the October and April WEO vintage.

2/ Calculated as the percentile rank of the country's output gap revisions (defined as the difference between real time/period ahead estimates

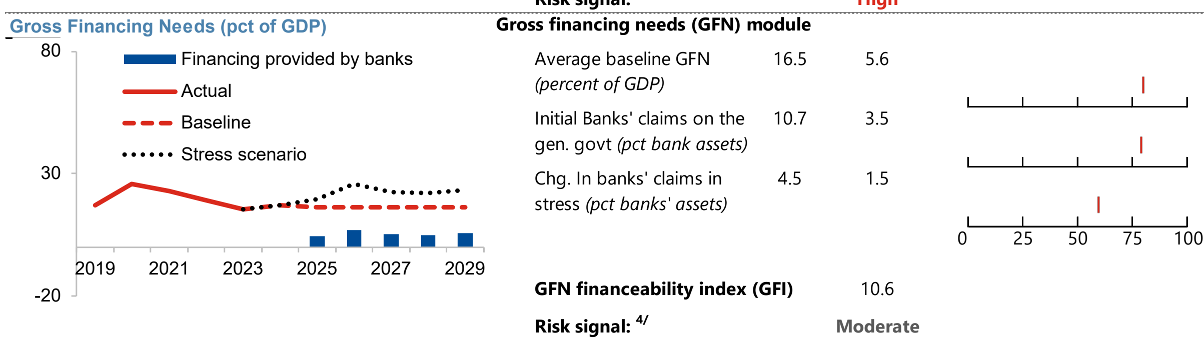
3/ Data cover annual obervations from 1990 to 2019 for MAC advanced and emerging economies. Percent of sample on vertical axis.

4/ The Laubach (2009) rule is a linear rule assuming bond spreads increase by about 4 bps in response to a 1 ppt increase in the projected debt-to-GDP ratio.

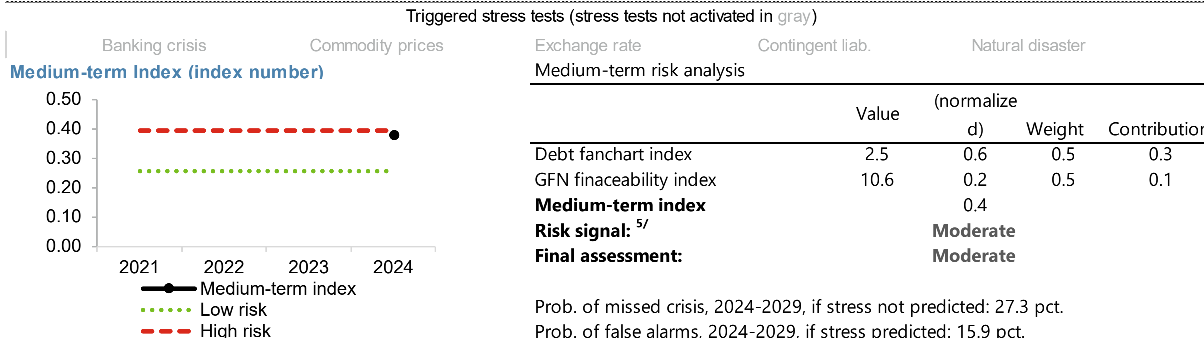
Annex III. Figure 6. Spain: Medium-term Risk Analysis



Debt fanchart module	Value	Contrib [1/]	Percentile in peer group [2/]
Fanchart width *(percent of GDP)*	84.8	1.2	
Probability of debt non-stabilization *(percent)*	52.3	0.4	
Terminal debt-to-GDP x institutions index	37.4	0.8	
Debt fanchart index (DFI)		2.5	
Risk signal: [3/]		**High**	



Gross financing needs (GFN) module	Value	Contrib	Percentile in peer group
Average baseline GFN *(percent of GDP)*	16.5	5.6	
Initial Banks' claims on the gen. govt *(pct bank assets)*	10.7	3.5	
Chg. In banks' claims in stress *(pct banks' assets)*	4.5	1.5	
GFN financeability index (GFI)		10.6	
Risk signal: [4/]		**Moderate**	



Medium-term risk analysis

	Value	(normalized)	Weight	Contribution
Debt fanchart index	2.5	0.6	0.5	0.3
GFN finaceability index	10.6	0.2	0.5	0.1
Medium-term index		0.4		
Risk signal: [5/]		**Moderate**		
Final assessment:		**Moderate**		

Prob. of missed crisis, 2024-2029, if stress not predicted: 27.3 pct.

Prob. of false alarms, 2024-2029, if stress predicted: 15.9 pct.

Commentary: The Fanchart exercise points to high medium-term risk of debt distress, due to a high debt level, adjusted for institutional quality, and a high probability of non-stabilization relative to comparator countries. The GFN exercise signals moderate medium-term risk. However, even under the stress scenario GFN would not rise above levels experienced during the pandemic. No stress tests were triggered.

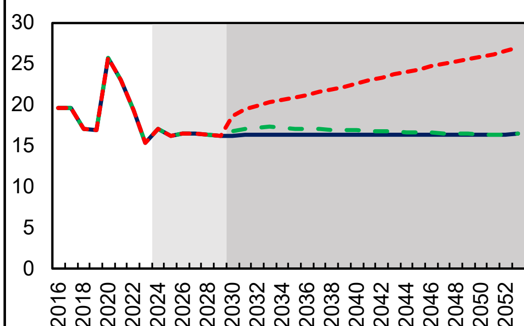
Source: IMF staff estimates and projections.

1/ See Annex IV of IMF, 2022, Staff Guidance Note on the Sovereign Risk and Debt Sustainability Framework for details on index calculation.
2/ The comparison group is advanced economies, non-commodity exporter, surveillance.
3/ The signal is low risk if the DFI is below 1.13; high risk if the DFI is above 2.08; and otherwise, it is moderate risk.
4/ The signal is low risk if the GFI is below 7.6; high risk if the DFI is above 17.9; and otherwise, it is moderate risk.
5/ The signal is low risk if the GFI is below 0.26; high risk if the DFI is above 0.40; and otherwise, it is moderate risk.

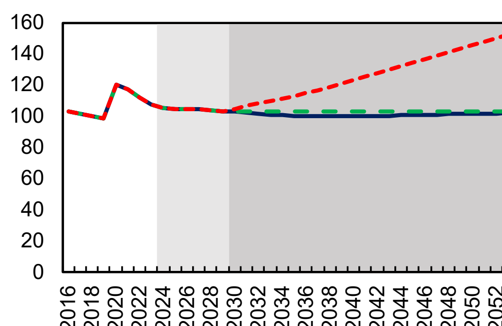
Annex III. Figure 7. Spain: Long-Term Risk Analysis

Projection	Variable	Risk Indication
Medium-term extrapolation	GFN-to-GDP ratio	
	Amortization-to-GDP ratio	
	Amortization	
Medium-term extrapolation with debt stabilizing primary balance	GFN-to-GDP ratio	
	Amortization-to-GDP ratio	
	Amortization	
Historical average assumptions	GFN-to-GDP ratio	
	Amortization-to-GDP ratio	
	Amortization	
Overall Risk Indication		

GFN-to-GDP ratio



Total public debt-to-GDP ratio



Commentary: The overall long-term amortization risk signal is not triggered. Medium-term extrapolations show a stabilization of GFN and debt around 16 percent and 100 percent of GDP, respectively. They only signal a high risk in terms of the amortization level, as sustained GDP deflator growth mechanicaly implies a rise in the nominal value of debt. However, amortization relative to GDP remains stable and the signal is not triggered. Extrapolation based on historical averages for key fiscal (e.g., primary balance, effective interest rates) and macroeconomic (e.g., real growth, inflation) variables implies a high amortization risk. However, this scenario is strongly influenced by the highly exceptional period of the COVID-19 pandemic and thus has limited informative content for the long-term horizon considered here.

Annex IV. Data Issues

Annex IV. Table 1. Spain: Data Adequacy Assessment for Surveillance

Data Adequacy Assessment Rating 1/							
A							
Questionnaire Results 2/							
Assessment	National Accounts	Prices	Government Finance Statistics	External Sector Statistics	Monetary and Financial Statistics	Inter-sectoral Consistency	Median Rating
	B	A	A	A	A	A	A
Detailed Questionnaire Results							
Data Quality Characteristics							
Coverage	B	A	A	A	A		
Granularity 3/	B		A	A	A		
			A		A		
Consistency			A	A		A	
Frequency and Timeliness	A	A	A	A	A		

Note: When the questionnaire does not include a question on a specific dimension of data quality for a sector, the corresponding cell is blank.
1/ The overall data adequacy assessment is based on staff's assessment of the adequacy of the country's data for conducting analysis and formulating policy advice, and takes into consideration country-specific characteristics.
2/ The overall questionnaire assessment and the assessments for individual sectors reported in the heatmap are based on a standardized questionnaire and scoring system (see IMF *Review of the Framework for Data Adequacy Assessment for Surveillance*, January 2024, Appendix I).
3/ The top cell for "Granularity" of Government Finance Statistics shows staff's assessment of the granularity of the reported government operations data, while the bottom cell shows that of public debt statistics. The top cell for "Granularity" of Monetary and Financial Statistics shows staff's assessment of the granularity of the reported Monetary and Financial Statistics data, while the bottom cell shows that of the Financial Soundness indicators.

Rating	Description
A	The data provided to the Fund is adequate for surveillance.
B	The data provided to the Fund has some shortcomings but is broadly adequate for surveillance.
C	The data provided to the Fund has some shortcomings that somewhat hamper surveillance.
D	The data provided to the Fund has serious shortcomings that significantly hamper surveillance.

Rationale for staff assessment. Staff assess the overall data quality as adequate for the Fund's surveillance. Further improvements could include reducing the magnitude of expenditure-based GDP components' revisions, improving GDP data granularity including by publishing separately private and public investment or increasing the number of economic activities reported on the production side, and enhancing the consistency across different data sources (for example, trade data in the national accounts versus in BOP) in preliminary data releases**.**

Changes since the last Article IV consultation. N/A

Corrective actions and capacity development priorities. N/A

Use of data and/or estimates different from official statistics in the Article IV consultation. Staff do not use data different from official statistics in the Article IV consultation.

Other data gaps. The data on execution of NGEU investments remains scarce and published with significant delay. The reporting is not done in national accounts terms

Annex IV. Table 2. Spain: Data Standards Initiatives

Spain adheres to the Special Data Dissemination Standard (SDDS) Plus since February 2015 and publishes the data on its National Summary Data Page. The latest SDDS Plus Annual Observance Report is available on the Dissemination Standards Bulletin Board (https://dsbb.imf.org/).

Annex IV. Table 3. Spain: Table of Common Indicators Required for Surveillance

As of May 8, 2024

	Data Provision to the Fund				Publication under the Data Standards Initiatives through the National Summary Data Page			
	Date of Latest Observation	Date Received	Frequency of Data[6]	Frequency of Reporting[6]	Expected Frequency[6,7]	Spain[8]	Expected Timeliness[6,7]	Spain[8]
Exchange Rates	5-May-24	6-May-24	D	D	D	...	...	...
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	Mar-24	Apr-24	M	M	M	M	1W	1W
Reserve/Base Money	Mar-24	Apr-24	M	M	M	M	2W	2W
Broad Money	Mar-24	Apr-24	M	M	M	M	1M	1M
Central Bank Balance Sheet	Mar-24	Apr-24	M	M	M	M	2W	2W
Consolidated Balance Sheet of the Banking System	Mar-24	Apr-24	M	M	M	M	1M	1M
Interest Rates[2]	Mar-24	Apr-24	M	M	D	...	...	...
Consumer Price Index	Mar-24	Apr-24	M	M	M	M	1M	NLT 2W
Revenue, Expenditure, Balance and Composition of Financing[3]–General Government[4]	Dec-23	Mar-24	Q	Q	A/Q	Q	2Q/12M	1Q
Revenue, Expenditure, Balance and Composition of Financing[3]–Central Government	Feb-24	Apr-24	M	M	M	M	1M	90D
Stocks of Central Government and Central Government-Guaranteed Debt[5]	Mar-24	Apr-24	M	M	Q	M	1Q	1M
External Current Account Balance	Dec-23	Mar-24	Q	Q	Q	Q	1Q	1Q
Exports and Imports of Goods and Services	Feb-24	Apr-24	M	M	M	M	8W	8W
GDP/GNP	Mar-24	Apr-24	Q	Q	Q	Q	1Q	60D
Gross External Debt	Dec-23	Mar-24	Q	Q	Q	Q	1Q	3M
International Investment Position	Dec-23	Mar-24	Q	Q	Q	Q	1Q	3M

[1] Includes reserve assets pledged or otherwise encumbered, as well as net derivative positions.
[2] Both market-based and officially determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[5] Including currency and maturity composition.
[6] Frequency and timeliness: ("D") daily; ("W") weekly or with a lag of no more than one week after the reference date; ("M") monthly or with lag of no more than one month after the reference date; ("Q") quarterly or with lag of no more than one quarter after the reference date; ("A") annual.; ("SA") semiannual; ("I") irregular; ("NA") not available or not applicable; and ("NLT") not later than.
[7] Encouraged frequency of data and timeliness of reporting under the e-GDDS and required frequency of data and timeliness of reporting under the SDDS and SDDS Plus. Any flexibility options or transition plans used under the SDDS or SDDS Plus are not reflected. For those countries that do not participate in the IMF Data Standards Initiatives, the required frequency and timeliness under the SDDS are shown for New Zealand, and the encouraged frequency and timeliness under the e-GDDS are shown for Eritrea, Nauru, South Sudan, and Turkmenistan.
[8] Based on the information from the Summary of Observance for SDDS and SDDS Plus participants, and the Summary of Dissemination Practices for e-GDDS participants, available from the IMF Dissemination Standards Bulletin Board (https://dsbb.imf.org/). For those countries that do not participate in the Data Standards Initiatives, as well as those that do have a National Data Summary Page, the entries are shown as "..."

Annex V. Implementation of 2022 AIV Policy Recommendations

Key Recommendations	Implementation Status
Increase fiscal consolidation efforts from 2024 and onwards to set debt on a firm downward path and achieve a close-to-balanced structural fiscal position by the end of the decade	The authorities have signaled their commitment to steady medium-term consolidation. However, no individual measures have been identified besides the phasing out of energy support measures and the extension of temporary levies on banks and energy companies.
Formulate credible medium-term fiscal consolidation plans (contingent on the state of the economy) to help build the necessary social consensus and anchor expectations.	The authorities currently do not publish a medium-term fiscal plan. However, under the revamped EU economic governance framework they will be required to submit a National Medium-Term Fiscal-Structural plan to the European Commission. Such plan would likely require developing a fully-fledged medium-term fiscal framework.
Implement additional measures to offset the increase in future pension spending resulting from the 2021 pension reform.	The 2023 pension reform introduced several important revenue measures. These include: an increase in contribution rates under the intergenerational equality mechanism (MEI); an increase in the upper bound of the contribution base; a solidarity contribution over the portion of salaries that is above the contribution base; and fiscal incentives to encourage delayed retirement. The reform also established a safeguard mechanism entailing a forward-looking review of the social security system's finances, with the power to prescribe the introduction of corrective measures to ensure their sustainability.
Continue monitoring closely the real estate market and the banking system on the evolvement of financial systemic risks	Bank of Spain regularly publishes data on commercial and residential real estate market prices as well as banking system performance, and a variety of model-based indicators are used to assess financial systemic risks. Data collection regarding foreign investments in real estate can be enhanced given its increasing importance.
Ensure strong implementation of the recently amended debt resolution framework, including allocating sufficient resources for the judicial system	The new Insolvency Law was adopted in September 2022. Current weaknesses in insolvency statistics reporting limits the scope for assessing the dynamics of insolvencies and the impact of the reform. The long-standing issue of insufficient commercial court resources remains to be addressed.

Key Recommendations	Implementation Status
Advance further reforms of the labor market, including revamping ALMPs to improve labor matching efficiency and address skill mismatches.	The Employment Law, which revamps ALMPs, came into force on February 28, 2023, and it is now in the process of being implemented.
Set minimum wage increases in line with productivity growth to avoid losses of competitiveness.	Since the publication of the 2022 Article AIV staff report, the minimum wage was increased twice—in February 2023 by 8 percent and in February 2024 by 5 percent. This decision, which was agreed by the Ministry of Labor and the unions without participation of business representatives, was not set in line with productivity growth but was guided instead by the objective of bringing the net minimum wage closer to the target of 60 percent of average net earnings.
Continue to address housing affordability by providing targeted support to vulnerable households and further expanding housing supply through simplifying land use regulations and accelerating licensing processes at the regional government level.	The housing law (approved in May 2023) and the national housing plan include measures to address rental affordability, including targeted rent support programs for young and low-income people, an increase in taxes on empty properties, and the expansion of the social housing stock. The revised recovery plan also features reforms to streamline urban planning, including reduction of red tape at the regional and local levels. This involves modifying the Law on Land and Urban Rehabilitation; the authorities have already produced a draft law, which they expect to be passed by the end of 2024.
Establish a system of regular, data-driven, outcome-based evaluation of the effectiveness of reforms and investments envisaged in the recovery plan.	Some of the reforms approved recently—such as labor and ALMP reforms—contemplate evaluation of outcomes after a few years of implementation. No evaluation has been made yet.
Carry out systematic and comprehensive data publication on the execution of NGEU-funded investments, including in national account terms.	The data on execution of NGEU investments has improved, though reporting is still not done in national accounts terms.

Annex VI. 2024 FSAP: Key Recommendations

	Recommendation	Addressee	Timing[1]
Systemic Risk Analysis and Monitoring			
1.	Enhance data collection and monitoring of foreign investments in the real estate market.	BdE, CNMV, DGSFP	NT
2.	Create the infrastructure for a more granular cash-flow analysis (as designed by the FSAP) and report regular stress testing results.	BdE	NT
Financial Sector Oversight			
3.	Ensure alignment of resources of supervisory authorities to current and expected future workload	Government, BdE, CNMV, DGSFP	I
4.	Grant full autonomy to CNMV over its recruitment and retention processes and streamline related procedures.	Government, CNMV	I
Macroprudential Policy			
5.	Deploy policies, including but not necessarily limited to, the introduction of a positive neutral countercyclical buffer, to ensure that banks raise capital buffers to be better positioned against downside tail risks.	BdE, AMCESFI	I
6.	Increase the minimum frequency of AMCESFI Council meetings, and raise the profile and transparency of AMCESFI by publishing meeting minutes / summaries and timely Annual Reports.	AMCESFI	I
7.	Review the case for appointing 2 or 3 external members to AMCESFI to strengthen the diversity of perspectives and expertise.	MINECO. AMCESFI	I
8.	Further develop and deepen the macroprudential framework by addressing remaining data and information gaps, as well as by strengthening reporting requirements.	BdE, CNMV, DGSFP, AMCESFI	NT
Supervision and Regulation of Banking LSIs			
9.	Enhance BdE's independence by removing MINECO appeal powers against BdE supervisory decisions and sanctions and limiting the role of government's representatives in the BdE Governing Council.	MINECO	NT
10.	Streamline the offsite monitoring system and apply proportionality in conducting SREPs while performing more frequent and targeted onsite inspections and thematic activities.	BdE	I
11.	Strengthen BdE onsite inspection activities on LSIs' governance and risk management, particularly management of liquidity risk and interest rate risk in the banking book.	BdE	I
Regulation, Supervision and Oversight of FMIs			
12.	Ensure that international supervisory coordination arrangements with other supervisors reflect scope and degree of interconnectedness of BME Clearing, IberClear and their foreign parent company.	CNMV	MT
13.	Ensure timely implementation of CNMV's recommendations.	CNMV	NT
Cyber Security Risk Supervision and Oversight			
14.	Conduct onsite examinations as part of FMI supervision; and conduct more thematic reviews while maintaining short onsite visits to a sample of LSIs. Develop a lighter threat intelligence based red-teaming framework based on TIBER-ES principles.	CNMV, BdE, MINECO	NT
15.	Involve the BdE and CNMV in critical infrastructure related matters, such as designation and compliance assessments.	Government	NT

[1] Timing: I = Immediate (within one year); NT = Near Term (within 1-3 years); MT = Medium Term (within 3–5 years).

	Recommendation	Addressee	Timing
Fintech			
16.	Delegate powers to the Coordination Commission and the regulators to make changes to sandbox operation, streamline administrative processes, and provide greater flexibility to supervisory authorities to use preferred mix of tools.	Government, BdE, CNMV, DGSFP	NT
Financial Integrity			
17.	Complement the National Risk Assessment, ensure accuracy of data stored in centralized beneficial ownership register, and extend AML-CFT risk-based supervisory activities to professional enablers and virtual asset providers.	SEPBLAC, Treasury, BdE, The Registrars' AML Centre, Ministry of Justice	NT
Crisis Management and Financial Safety Nets			
18.	Integrate preventative resolution authority functions (i.e., BdE resolution planning department) and FROB's executive resolution functions for banks	MINECO	I
19.	Improve statutory resolution regime so FROB has resolution power to override shareholders rights, update statutory insolvency creditor hierarchy and enable liquidators to transfer deposit accounts.	MINECO	NT
20.	Establish and operationalize an approach to address liquidity needs in resolution.	BdE	I
BdE – Bank of Spain; CNMV – National Securities Market Commission; MINECO – Ministry of Economy; AMCESFI – the national macroprudential authority; DGSFP – the Directorate-General for Insurance and Pension Funds; SEPBLAC – the Executive Service of the Commission for the Prevention of Money Laundering and Monetary Offenses			

Annex VII. Temporary Levies and Taxes Introduced Since 2022: Current Status and Future Options

A. Context

1. **In response to the sharp rise in energy and food prices in 2021 and 2022, governments around the world enacted fiscal measures to support households and the hardest-hit industries.** Concurrently, in 2022 and 2023, central banks entered a cycle of monetary policy tightening, increasing interest rates to tame inflation. While these developments triggered a global slowdown in the post-pandemic recovery, two sectors faced more beneficial economic consequences. Energy companies saw increased revenues due to high energy prices while—to the extent that the monetary policy pass-through to lending and deposit rates was asymmetric—banks experienced increased net interest margins. Further, the question of who should bear the brunt of the adverse impact of higher energy prices and finance the cost of support measures rose to the fore.

2. **Spanish authorities introduced temporary wealth tax and windfall levies to finance support measures, which amounted to 1 percent of GDP in 2023.** In December 2022 the central government introduced levies (*gravámenes*) on energy companies and financial institutions and a "solidarity tax on large fortunes" of households. In 2023, total revenue from the three measures amounted to € 3.5 billion, referring to business activities and households' wealth in 2022. These measures were initially set to remain in place for 2023 and 2024. However, in December 2023, the authorities extended the two levies through 2025 and suggested the possibility of converting them into permanent taxes, possibly with revised designs. They also signalled that the solidarity tax would remain in place until a broader review of wealth taxation is undertaken in the context of a reform of the financing system of autonomous communities (RDL 8/2023). In the same decree, a deduction from the energy levy for investments in green energy projects—to be defined in the 2024 general budget—was also announced. In the absence of a 2024 budget law, the deduction has not yet been introduced.

3. **While the temporary levies and tax provided an important revenue contribution, the use of windfall taxation should remain limited and temporary.** If extended permanently in their current form, the two levies and the solidarity tax could be particularly distortionary and create uncertainty, which could deter already subdued investment. As such, they do not constitute a sound alternative to more structural revenue-raising tax policy measures. Should the authorities decide to keep such measures as part of their fiscal consolidation plan, a redesign should be considered. In particular, aligning the tax base of the two levies with a clear definition of "excess" profits in the respective sectors would be advisable. As regards the solidarity tax, the authorities would be better off encouraging the autonomous communities to establish a commonly agreed minimum rate of the regional wealth tax instead of establishing an additional wealth tax at the national level. This approach would balance the goals of minimizing distortions across regions and granting fiscal autonomy to the regional governments.

B. Bank Levy

4. The levy on banks, imposes a 4.8 percent tax on the net interest income (NII) and fees of financial institutions operating in Spain. This levy only applies to banks with revenues above the threshold of €800 million in 2019. It received criticism from representatives of domestic financial institutions, banking authorities, and the European Central Bank, citing potential distortionary effects and financial stability concerns. In 2023, referring to the financial year 2022, the levy's outturn amounted to €1.2 billion. Staff estimate that this sum represents approximately 10 percent of banks' profits connected to activities in Spain in 2023—a rather small but non-trivial fraction. Thus, while the levy did not seem to have a significant negative effect on the financial sector, its magnitude is sizable enough that it could factor into banks' future decisions if extended.

5. The current design has several important limitations. The levy's base is defined in terms of NII and fees, rather than profits—which are already taxed at a higher than statutory CIT rate—thus not accounting for the possibility of institutions having high interest margins but low overall profits, and *vice versa*. Higher-risk lending could particularly be discouraged, since its higher average returns would be taxed while its larger loss provisions would not be deductible. Defining banks' fundamental profitability is challenging, and even more so is identifying the extent to which profits are "exceptional" or in excess of normal levels. For instance, on a consolidated basis, Spanish banks' return-on-equity did not experience large increases relative to European peers in 2022-2023 (text figure in Financial Sector Policies section). However, profitability in the domestic market has risen to its highest level since the GFC and, according to the Bank of Spain, the passthrough of the ECB's monetary policy rates to domestic lending and deposit rates was more asymmetric compared to the euro area as a whole over 2021-23, and also with respect to previous tightening cycles in Spain (Bank of Spain, 2023). This would result in comparatively higher net interest margins over this phase of the cycle. A further limitation of the levy is the presence of a (€800 million) revenue threshold, which implies that smaller institutions are exempt regardless of the degree to which their profitability increased in 2022.

6. Should the authorities decide to turn the levy into a permanent tax, several considerations and design improvements are in order:

- First, rather than covering NII, the base of the levy should be aligned to a clear definition of the excess component of profits. So designed, the levy would make a distinction between profits that are high due to market distortions and profits that, even if potentially high, can be justified by conjunctural factors and/or reflect normal returns to capital. Only the former should be included in the base.

- If the levy is expressly meant to have a financial stability motive, or if it is quantitatively large enough to have a tangible impact on banks' operations, then its interaction with macroprudential policies and with counter-cyclical capital buffers should receive careful consideration.

- The redesign of the tax could also include features aimed at supporting key policy objectives. For example, a tax credit could be introduced to reduce banks' liability in proportion to the amount of capital set aside to comply with a positive neutral rate of the counter-cyclical capital buffer (CCyB), should the latter be introduced.

Although the above design features would minimize the levy's distortionary effect, they would likely also decrease its revenue potential, since narrowing the base to well-identified excess profits would automatically reduce tax liabilities.

Design issues notwithstanding, conjunctural developments will likely imply reduce revenues from the levy in coming years. As ECB monetary policy continues to pass through to domestic deposit rates, and enters an easing phase, banks' NII margins would narrow.

C. Energy Company Levy

7. The Spanish authorities introduced a 1.2 percent levy on the net turnover of energy companies operating in Spanish territory for 2023 and 2024. In 2023, the levy collected €1.6 billion in revenues relating to companies' activities in 2022. The measure faced significant criticism from energy companies, with some large conglomerates threatening to shift business and new investment projects to other countries were the levy to be extended. In December 2023, the levy was extended until 2025, but following dialogue with stakeholders, a deduction for investment in renewable energy projects was also announced. In the absence of a budget law for 2024, such deductions have yet to be implemented.

8. The base of the levy does not necessarily capture energy companies' profits, and it lacks a clear definition of the excess component of profits. Moreover, the levy should not be considered an environmental tax, as it does not differentiate between different sources of energy based on their carbon content, nor is it calibrated to address a well-identified negative environmental externality more broadly. However, the proposed deduction for green energy projects may function as a valuable incentive for sustainable energy production.

9. Similar to the bank levy, the energy company levy should remain a time-limited measure in its current design. Should the authorities decide to convert it into a permanent revenue instrument, several considerations would be warranted:

- Rather than focusing on operating balances, the base of the levy should be aligned to a clear definition of the excess component of profits in the energy sector. Such definition should distinguish between profits that are high due to fluctuations in the underlying price of energy, driven by external factors, and excess profits cause by inherent competitive distortions in the domestic market.

- Spain already stands out for its wide range of energy taxes (e.g., preferential VAT rates on different sources of energy, a tax on the value of energy produced, an excise tax on electricity), as well as a complex landscape of environmental taxes administered at different levels of

government. Hence, the interaction of an additional energy-related levy with the tax instruments already in place should be carefully considered, with a particular focus on both economic efficiency and environmental objectives.

- While minimizing the levy's distortionary effect, restricting the base to non-competitive profits would inevitably reduce the measure's revenue potential.

- With energy prices in Europe having mostly normalized since the 2021-2022 spike, the expected revenue of the levy in the foreseeable future is expected to fall below the 2023 outturn, thus providing a smaller contribution to fiscal consolidation efforts.

D. Solidarity Tax on Large Fortunes

10. In December 2022, the central government announced a temporary tax on household wealth, targeted to large estates, known as the solidarity tax on large fortunes. The tax imposes marginal tax rates ranging between 1.7 percent and 3.5 percent on net wealth portfolios of €3 million and higher. The tax base is defined as all household wealth (including real estate) with an allowance of €700 thousand plus an additional €300 thousand for primary residences. In December 2023, the central government announced the extension of the tax.

11. Crucially, the solidarity tax includes a full credit for taxpayers' liability to the pre-existing wealth tax, which is administered and collected by the autonomous community governments. As most communities enforce a wealth tax on their residents, only a small number of very high-net worth taxpayers in each community faced an outstanding liability to the solidarity tax in 2023. The notable exception is the Community of Madrid, which historically has not enforced a wealth tax.[1] As a result, in 2023 the solidarity tax collected €623 million, of which €555 came from residents of the Community of Madrid. The government of the Community of Madrid challenged the tax with Constitutional Court, but the tribunal ruled in favor of the measure (Spanish Constitutional Court 149/2023, judgement of November 7).

12. In December 2023, the Community of Madrid announced a temporary change of its tax code that would re-direct the revenues of the solidarity tax to the regional government instead of the central government. In practice, the provision would charge a regional wealth tax only to residents who would owe any amount of the solidarity tax, which in turn would fully eliminate their ultimate liability of the solidarity tax to the central government. All other taxpayers would remain unaffected by both taxes. This provision would imply a very substantial reduction in the revenue that the central government would collect on the solidarity tax in 2024 and 2025. Furthermore, the Community of Madrid government announced a plan to introduce a series of fiscal benefits, targeted to high-net worth individuals, meant to counterbalance the increased fiscal

[1] In theory, the autonomous community governments cannot abolish the wealth tax. However, they have autonomy in setting its key parameters, such as the base threshold, the tax rates and brackets, and other exemptions and credits. In practice, they thus have the option to forego their collection of the tax in full. In the case of the Community of Madrid, this is achieved by enforcing the tax with default tax rates while providing a tax credit of 100 percent of the taxpayer's liability (known as *bonificación*), which effectively eliminates the wealth tax.

burden from the wealth tax, such as fiscal incentives to set up new firms and hire workers in the region and investment deductions to the regional PIT. If implemented, these additional measures would effectively net out the increased revenues at the general—rather than just central—government level.

13. If well-designed, wealth taxes can be a valuable instrument for revenue mobilization and redistribution, but large heterogeneity in tax rates across regions could have particularly distortive effects. In the context of Spain, where the wealth tax is administered and collected at the autonomous community level, it is important to preserve regional governments' autonomy in conducting fiscal policy while avoiding excessive heterogeneity that could lead to residential choices dictated by tax concerns. If faced with highly unharmonized rates, the creation of a national-level tax that functions as a top-up to the regional tax would be at odds with the original objective of leaving wealth taxation to the purview of autonomous community governments. Cooperation across autonomous community governments to establish a commonly agreed minimum wealth tax rate would constitute a more viable compromise.[2] [3]

[2] Agrawal et al. (2023) find that implementing a minimum wealth tax rate across autonomous communities—with some regions choosing not to impose higher rates—would increase the combined revenue of wealth taxes and PIT for each individual region compared to the current state of play.

[3] A detailed discussion of the design of wealth taxation can be found in a recent IMF How-to-Note (Hebous et al., 2024).

Annex VIII. Lessons From the 35-Hour Working Week Reform in France

In the late 1990s, France adopted a working week reduction reform that aimed to address historically high unemployment and enhance work-life balance.

A. Key Elements

1. The law enacted in June 1998 (*Aubry I*) mandated a reduction of the workweek from 39 to 35 hours in large firms (more than 20 employees) by February 2000 and in small firms by January 2002. A follow-up law enacted in January 2000 (*Aubry II*) introduced more detailed legal provisions, including the definition of working time, overtime hours, working time of managers and minimum wage.

2. Firms that lowered their current employees' working hours by 10 percent and created 6 percent more jobs before January 2000 would receive deductions in their social security contributions.

3. The law sought to reduce the working week by disincentivizing working for more than 35 hours per week. Any hours worked beyond the legal limit of 35 hours would be considered overtime. Overtime hours were capped at 130 per year, with a wage premium of 25 percent (10 percent during the transition period and for small firms) for the first eight hours and of 50 percent for any additional hours.

4. Businesses had to bargain with unions over the hourly wage increase (as well as other working conditions), to make up for the potential loss of income by the employees' decreasing work time. The government offered social security contribution rebates to compensate firms for overtime costs (irrespective of the magnitude of the hours decline and the job creation).

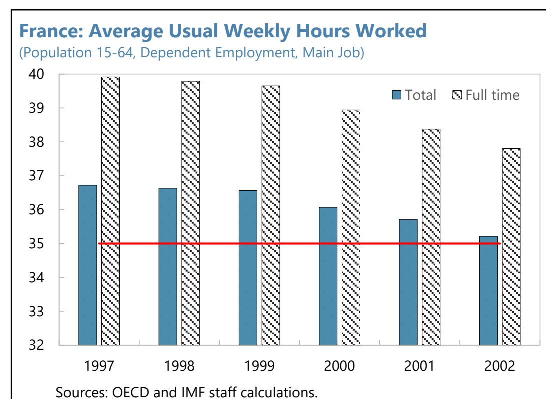
5. The new legislation mandated to keep monthly salaries unchanged for minimum wage workers. This was done by putting in place a *guaranteed monthly remuneration*, which was a lump-sum supplement given out to all minimum-wage workers whose working week was reduced to 35 hours. The level of the monthly guarantee differed across industries according to the precise date of the working time cut and the level of the hourly minimum wage at that time. In such way, the reform generated a variety of minimum wages for a while, introducing unequal pay for workers carrying out comparable tasks depending on the date at which different industries transitioned to the new legal limit. All minimum wages eventually converged upwards, with the government amplifying social contribution reductions to dampen the adverse impact on firms' labor costs and job creation.

6. The reform applied to the private sector only. However, the public sector started implementing the working week reduction as well, though not in a comprehensive and systematic way. Examples of public workers that saw their working week reduced to 35 hours included most central administrations, researchers at main public establishments, judges, and staff at public hospitals. Regarding the latter, the working week reduction was done without creating new jobs,

leading to staff shortages and significant accumulation of debt corresponding to overtime payments (Jamet, 2006, OECD; Askenazy, 2013).

B. Economic Effects

7. Hours worked declined, but the magnitude was smaller than originally predicted. The official working time reduction was 10 percent, but the actual working time reduction was on average 4–6 percent. This is because the law allowed for flexibilities and exceptions in implementation, and, following the transposition in the French law of a European Directive, firms changed the calculation of effective hours worked to minimize overtime pay—such as excluding "unproductive" breaks, extra holidays and training periods from the calculation (Pisani-Ferry, 2000 – Supplement F by G. Cette).



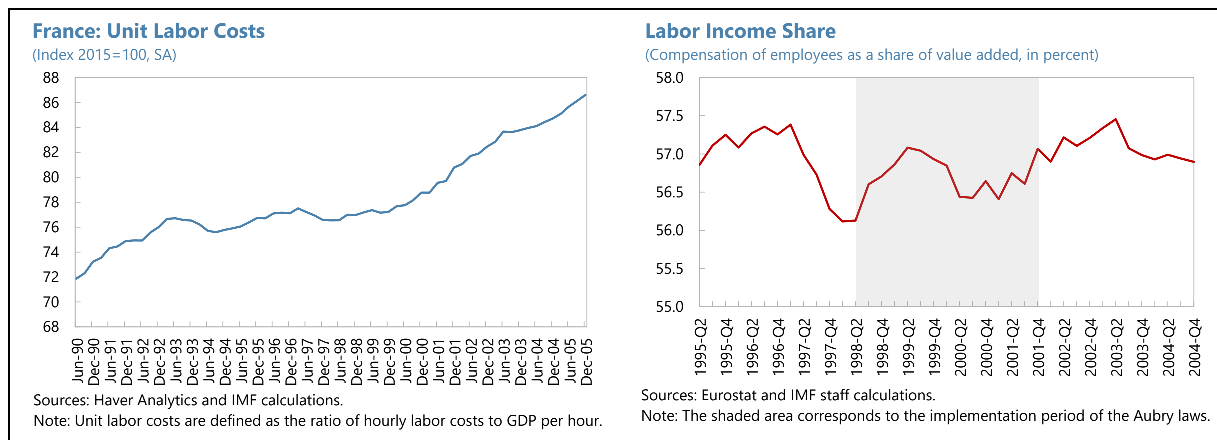
Sources: OECD and IMF staff calculations.

8. The literature provides mixed results on the employment impact of the working week reduction. For the reform to have raised employment, it was necessary that productivity gains (stemming from increased flexibility and reorganization of work) and wage moderation would offset the higher labor costs. Some studies show positive employment effects from the reduced working week (Gubian et al, 2004; Crépon, Leclair and Roux, 2004), while others find the effects to be null or even negative (Estevão and Sá, 2008; Chemin and Wasmer, 2009; Batut, Garnero, Tondini, 2022, based on a panel of European countries). Askenazy, Bloch-London and Roger (2004) highlight that the working-week reduction can only be evaluated in the short run, because—after a change in government and policy plans following the 2002 presidential election—the *Fillon* relaxation measures introduced in 2003, and subsequent amendments to working week conditions, prevented a long-run evaluation of the Aubry laws.

9. The reform increased hourly wages for those jobs whose annual/weekly wage was not reduced proportionally to the working week reduction. This was the case of minimum-wage workers, who had their monthly earnings guaranteed by law. For firms that reduced the working week to 35 hours, labor costs did not increase significantly due to the offsetting effect of reduced social security contributions and the productivity increase. However, companies with minimum-wage workers on their payroll that did not reduce working hours (and thus did not get the social security benefits and productivity gains) ended up experiencing an increase in their costs because of the revaluation of the hourly minimum wage; this may have negatively affected employment of the least qualified employees (Pisani-Ferry, 2000 - Supplement F by G. Cette).

10. The reform generated persistent wage moderation. For workers above the minimum wage, the shift to the 35-hour working week was accompanied by a partial wage freeze for one to three years agreed with the unions (Durand and Martin, 2004, OECD). Wage moderation, reductions in

social security contributions and productivity gains contributed to keep the labor income share in value added broadly unchanged after the reform.



Sources: Haver Analytics and IMF calculations.
Note: Unit labor costs are defined as the ratio of hourly labor costs to GDP per hour.

Sources: Eurostat and IMF staff calculations.
Note: The shaded area corresponds to the implementation period of the Aubry laws.

11. The law allowed for *annualization*, establishing a maximum of 1,600 hours per year (i.e., 35 hours per week, *on average*) that could be distributed based on the firms' needs. This provided firms with more flexibility to respond to cyclical or seasonal fluctuations, while limiting the amount of overtime paid and reducing layoffs in the low season. The liberalization of rigid working-time schedules may have led to some gains in hourly productivity (Durand and Martin, 2004, OECD). At the same time, this created more irregularity in work schedules for employees (Afsa and Biscourp, 2004; Askenazy, 2013). While this, and wage moderation, created dissatisfaction, other elements of the reform were welcome by employees, most notably the increase in leisure and family time (Cette, Dromel and Méda, 2004; Durand and Martin, 2004, OECD).

12. The working week reduction had a significant fiscal cost for the government. To dampen the adverse employment impact of labor cost increases, it compensated companies for the overtime costs via a reduction in social security contributions. Had the reform been fully implemented and effectively reduced the average working week to 35 hours, its direct fiscal cost could have reached about 1 percent of GDP (Askenazy, 2013).

C. Lessons for Spain

13. Overall, the key lessons for Spain from the French experience are the following:

- Employment gains are unclear and possibly small, especially if the working week is cut without reducing (weekly or annual) wages.
- Workers ultimately end up bearing at least some of the costs of the working week reduction—even if wages are not reduced initially, years of wage moderation may follow. As a result, the labor share may ultimately remain broadly unchanged despite an initial increase in hourly wages, as happened in France.

- While the medium-term impact of the reform is difficult to assess in the case of France since the reform was not fully implemented as initially intended, income per capita is likely to decline over the medium term, as productivity gains can make up at most for a small fraction of the reduction in labor input. Under the assumption that the proposed reform would close 50 percent of the working hours gap, effective hours worked would fall by 3 percent. Assuming a unitary elasticity between long-term output to long-term labor input, and productivity gains ranging between 0 and 1/3, income per capita would decline by 2 to 3 percent, all else equal.

- To minimize activity disruptions and enhance the likelihood of productivity gains, social partners should negotiate how to implement any working-time reduction to accommodate the existing wide cross-sector heterogeneity.

- The interplay between working week reduction and the minimum wage needs to be carefully managed, avoiding another sizeable increase in the hourly minimum wage or a large fiscal cost (if social security contributions are cut to mitigate the minimum labor cost shock).

- Implementation in the public sector should be commensurate to the very small gap that exists between the current effective working time and the new legal norm. Implications for the delivery and quality of public services should be carefully considered.

INTERNATIONAL MONETARY FUND

SPAIN

STAFF REPORT FOR THE 2024 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

May 15, 2024

Prepared By European Department

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FUND RELATIONS ____ 2

FUND RELATIONS

(As of April 30, 2024)

Mission: April 2-12, 2024. The Concluding Statement of the mission, published on April 12, 2024, is available at https://www.imf.org/en/News/Articles/2024/04/11/mission-concluding-statement-spain-2024-article-iv-mission.

Staff team: Romain Duval (head), Ana Lariau, Carlo Pizzinelli and Yu Shi (all EUR). Pablo de Ramón-Laca (Alternate Executive Director), Rosa Moral and Irune Solera Lopez (Advisors to the Executive Director) attended the meetings. Yueshu Zhao, Eunmi Park, Miguel De Asis (all EUR) and Natalia Stetsenko (LEG) supported the mission from headquarters.

Country Interlocutors: The mission met with Minister of Economy Carlos Cuerpo, Banco de España Governor Pablo Hernández de Cos, and other senior officials. The mission also met with representatives of the financial sector, labor organizations, think tanks, and political parties.

Fund relations: Spain is on a standard 12-month cycle. The previous Article IV consultation discussions took place during November 2022. The staff report was discussed by the Executive Board on January 18, 2023. The Executive Board's assessment and staff report are available at https://www.imf.org/en/Publications/CR/Issues/2023/01/19/Spain-2022-Article-IV-Consultation-Press-Release-Staff-Report-and-Statement-by-the-528338.

Membership Status: Joined September 15, 1958.

General Resources Account:	**SDR Million**	**Percent of Quota**
Quota	9,535.50	100.00
Fund holdings of currency	7,065.41	72.84
Reserve position in Fund	2,470.21	27.16
Lending to the Fund		

SDR Department:	**SDR Million**	**Percent of Allocation**
Net cumulative allocation	11,966.91	100.00
Holdings	12,379.40	103.68

Outstanding Purchases and Loans:	None	
Latest Financial Arrangements:	None	

Projected Payments to Fund

(SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2024	2025	2026	2027	2028
Principal					
Charges/Interest	0.09	0.09	0.09	0.09	0.09
Total	**0.09**	**0.09**	**0.09**	**0.09**	**0.09**

Financial Sector Assessment Program (FSAP)

The FSAP team met with the Minister of Economy (MINECO) Carlos Cuerpo; Banco de España (BdE) Governor Pablo Hernández de Cos; Comisión Nacional del Mercado de Valores (CNMV) Chair Rodrigo Buenaventura; and other senior officials of the BdE, the CNMV, the Deposit Guarantee Fund, the Directorate General of Insurance and Pension Funds, Spain's Executive Resolution Authority, MINECO, the European Central Bank, and other senior representatives of the public sector, banks, asset managers, auditors and other private sector stakeholders.

Spain is deemed by the Fund to have a systemically important financial sector according to SM/10/235 (9/16/2010), and the stability assessment under the FSAP is part of bilateral surveillance under Article IV of the Fund's Articles of Agreement.

Exchange Rate Arrangements

Spain's currency is the euro. The exchange rate arrangement of the euro area is free floating. Spain participates in a currency union (EMU) with 19 other members of the EU and has no separate legal tender. The euro, the common currency, floats freely and independently against other currencies.

Spain has accepted the obligations of Article VIII, Sections 2(a), 3, and 4 of the IMF's Articles of Agreement, and maintains an exchange rate system free of multiple currency practices and restrictions on payments and transfers for current international transactions, except for restrictions maintained solely for the preservation of national or international security, which have been notified to the Fund for approval in accordance with the Executive Board Decision No. 144–(52/51).