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Article

Correcting the budget deficit; mission possible

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The total general government deficit stood at 4.3% of GDP in 2016 (4.5% including bank restructuring costs), 0.8 pp lower than the 5.1% posted in 2015. Spain therefore met its stability target agreed with the European Commission of 4.6% of GDP. However, this target had been lessened considerably from the 3.6% of the Stability Plan updated in 2016. We must also remember that the economic situation was highly favourable. The whole adjustment was confined to public expenditure, down by 1.5 pp of GDP. Revenue, however, fell by 0.8 pp in spite of the economic recovery, due to the tax reform which, according to government estimates, had a negative impact of around EUR 6.4 billion.

In 2017 the government expects to correct the deficit by a further 1.3 pp, reaching 3.0% of GDP (3.1% including bank restructuring costs). Since the deficit exceeded its target in 2016, this year Spain is starting from a better position and therefore needs to make less effort than expected last August, when the fiscal consolidation path was agreed. The favourable economic situation will also help to bring down the deficit. In spite of the slowdown expected in real GDP growth, higher inflation is likely to push up nominal GDP growth, increasing taxable income and therefore revenue. There are also upside risks regarding the macroeconomic forecasts that form the basis of the central government budget (PGE in Spanish). These predict 2.5% real GDP growth in 2017, a figure at the lower end of the forecasts produced by analysts and other institutions such as CaixaBank Research and the Bank of Spain, which expect a growth rate of 2.8%.1

But we cannot assume the new target will be achieved, in spite of all these favourable factors. On the revenue side, the central government budget expects tax revenue to increase by 7.9% and Social Security contributions by 6.8%, slightly higher figures than those obtained using historical elasticities. At least the data published up to March allow us to be moderately optimistic. VAT revenue has started the year particularly well: up by 8.4% year-on-year in the cumulative figure from January to March.

Regarding expenditure, the government's approval of a state spending limit of EUR 118,337 million, 4.4% below 2016's limit, is a sign that it intends to focus its attention on curtailing expenditure. By item, the budget includes a 1.7% reduction in spending on unemployment and almost zero growth in interest expenditure (0.5%). Both projections for expenditure are higher than those produced by CaixaBank Research, giving the government some margin to offset any deviation in revenue.

Spain's government therefore expects most of the adjustment to be carried out via spending, reducing its share of GDP by 0.9 pp to 41.5%.2 Revenue will also help to bring down the public deficit but to a lesser extent, with a predicted increase of 0.5 pp to 38.3% of GDP. Over the coming years, the budget deficit will continue to fall thanks to contained expenditure and moderately higher revenue, as established in the fiscal strategy contained in the Updated Stability Programme for 2017-2020.

In short, both the end of 2016 and the good economic outlook for 2017 will help to reduce the budget deficit. Hitting the target therefore seems to be a «mission possible».

1. The government has raised its own GDP growth forecast to 2.7% in the Updated Stability Programme 2017-2020.

2. These figures include bank restructuring costs.

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