

**FOR
INFORMATION**

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January 13, 2023

To: Members of the Executive Board

From: The Secretary

Subject: **Spain—Statement by the European Central Bank Representative**

Board Action: Executive Directors' **information**

Additional Information: For the Executive Board discussion on Spain to be held on Wednesday, January 18, 2023.

13 January 2023

**Statement by Rasmus Rueffer (ECB Representative) and Maddalena Perretti (Advisor) on
Spain – 2022 Article IV Consultation
IMF Executive Board Meeting**

18 January 2023

We would like to thank Mr. De Ramon-Laca Clausen, Mr. Lopez, and Ms. Moral Betere for their informative Buff statement and Staff for their balanced Report. We broadly agree with Staff and share many of the main findings, in particular those related to the challenges facing the Spanish economy and priorities ahead. We associate ourselves with the statement of Mr. Buissé and would also like to highlight the following items for emphasis.

We broadly share the IMF staff's assessment of the macroeconomic situation and outlook. ECB staff's macroeconomic projections, finalised in mid-November, are slightly more optimistic than IMF staff's in terms of GDP growth in 2023 and 2024, while also implying somewhat higher inflation in 2023. However, this most likely reflects the incorporation of data between the different cut-off dates.

We also agree with issues highlighted by IMF Staff on economic growth. Spain may be less directly exposed to the fallout from the war in Ukraine than many other euro area countries, but it is indirectly affected, especially as a large net importer of energy. Thus, the Spanish economy faces major headwinds in terms of high energy and rising food prices, reduced real disposable income, lower demand from trading partners, tightening financing conditions and subdued business and consumer confidence. There are at the same time mitigating factors, in particular the recovery of contact-intensive services, numerous government measures to help contain inflation and support incomes and, increasingly, the roll-out of NGEU-related investment. Spain presently seems likely to escape recession and economic growth may recover more quickly this year compared to most other euro area countries. This, however, needs to be seen against the background that Spanish GDP has (unlike the euro area) still not recovered its pre-pandemic level.

Recent data suggest that headline inflation has already peaked in Spain, although core inflation may remain elevated for some time. In this context, we agree with IMF staff that numerous government measures have been successful to mitigate inflation and to support the incomes of the most vulnerable households and firms. In particular, the so-called "Iberian exception" has been successful in breaking the link between electricity and international gas prices. It has also been fiscally neutral as the cost of the measure is borne by consumers and it also curbs to some extent the excess profits of energy providers. Many other measures have also been quite effective, but also in some cases perhaps less well targeted and more fiscally costly.

We agree with IMF staff regarding the need for - and importance of - fiscal consolidation, especially in the current context of normalisation of monetary policy. In this regard we note – and welcome - the recent strength in tax revenue. Like the authorities, we believe this is largely related to changes in behaviour brought about by the benefits of officially registering economic activity at a time in which government support might be needed. In this regard, while we agree with IMF staff that caution is required as to the durability of this shift when making revenue forecasts, to the extent that this change in behaviour and the

related revenue is permanent, it should contribute to an earlier fiscal adjustment.

Turning to the financial sector, we broadly concur with the risk assessment in the staff report. It is our view that Spain does not have exposure to cyclical risks and that exposures to residential real estate risks are low. There is no evidence of significant misalignment in house prices, nor of a deterioration in bank lending standards. As a result, we support the view that this low level of risks does not warrant the activation of macroprudential policy measures at this stage.

We also agree with the need to be cautious about the outlook of the banking sector. We share the view that the Spanish banking system should be resilient to adverse shocks (negative growth shock and tighter financial conditions) as suggested by IMF staff estimates, although Spanish banks' capitalisation is below its peers. Moreover, while credit quality has not deteriorated dramatically so far, we agree that continued monitoring is needed as signs of credit quality deterioration may come with a lag. We also share the view that the deterioration in the macroeconomic outlook and the rise in interest rates will likely erode borrowers' repayment capacity and increase systemic risks in the near term. In that context, we would be interested in Staff's assessment of the recent agreement between the government and the banking sector to provide mortgage relief to the most vulnerable households.

Finally, we also concur with the focus and recommendation of IMF staff in relation to structural reforms. We support the recommendation for data-driven assessments of actions taken in the context of the Recovery and Resilience Plan, as the effective implementation of these plans represent a crucial opportunity to raise productivity and long-term growth. We already see some beneficial effects of the labour market reform of December 2021, notably in relation to the increased share of permanent contracts. However, we think it is still too early to assess the overall impact of this reform. More action may be needed in terms of Active Labour Market Policies to address skills mismatches and to make Public Employment Services more effective in facilitating job matching. We welcome the emphasis of IMF staff on the need to raise productivity and concur with the assessment of action taken and needed. In this regard, the increased share of permanent contracts brought about by the Labour Market Reform should help foster the development of human capital in the workplace. But tackling the high rate of early leavers from education and training is also necessary to provide workers with the skills needed in the modern labour market. We would support the call for further efforts to eliminate regulatory obstacles to firm growth, such as those stemming from size-dependent thresholds in the tax system and from different regional regulations.