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November 9, 2020

Statement by Mr. Poso on Spain
(Preliminary)
Executive Board Meeting
November 11, 2020

We thank staff for their clear and insightful report and Selected Issues paper in the context of Spain's Article IV consultation. We also thank Mr. Moreno, Mr. Lopez, and Ms. Moral Betere for their informative Buff statement. We commend the national and EU authorities' resolve to fight the economic, social, and health consequences of the pandemic.

Spanish society has been severely hit by the COVID-19 pandemic. Policy measures have cushioned the economic and social impact of the shock, but the downturn remains unprecedented due to the strict containment measures and the large weight of service sectors most affected by the pandemic, such as tourism. Short-term work schemes have contained the increase in unemployment compared to previous crises, but job losses have been more pronounced than in other countries due to the high prevalence of temporary contracts. We share staff's view that the policy response should remain supportive until the recovery is firmly underway and should become increasingly targeted as the pandemic recedes to facilitate sectoral reallocation. In this regard, an effective use of the Next Generation EU (NGEU) funds could act as a catalyst for a structural transformation of the Spanish economy, by mobilizing large-scale investments to underpin the digital and green transitions, and by easing the costs of undertaking structural reforms.

Macroeconomic developments

The economic outlook is subject to an unprecedented level of uncertainty and is critically dependent on assumptions about the future evolution of the pandemic. We take note of the Fund's projections, but observe that since the publication of the October WEO, downside risks related to a potential second wave of the pandemic have materialized, and the outlook for 2021 has worsened. We share staff's overall assessment that, under the assumption of a gradual easing of restrictions, the recovery will be protracted. However, given the prevailing uncertainty and the different cut off dates, making comparisons across forecasts is difficult at present. We concur with staff that risks and vulnerabilities have increased and are still assessed to be very substantial, with the balance of risks tilted to the downside. While we agree with the inflation projections, we consider that the outlook for unemployment is somewhat optimistic, as it assumes no significant hysteresis effects. Also, while we support the view that the international investment position of the country is still highly negative and constitutes a vulnerability, we expect that the current account will remain firmly in surplus.

Fiscal Policies

We share staff's view that fiscal support should remain in place until the recovery is firmly underway, while also noting the need to strengthen debt sustainability when the conditions allow. We agree with staff that fiscal support measures, such as short-term work schemes and public loan guarantees, should be flexibly extended and scaled-up if the crisis intensifies. At the same time, we also acknowledge that as the pandemic recedes, these measures should become increasingly targeted, focusing on vulnerable groups and viable firms, while encouraging the needed resource reallocation. As staff, we recognize the need to refocus fiscal policies towards achieving prudent medium-term fiscal positions when economic conditions allow. We note that the Staff Report projects a more favorable trajectory of the government debt-to-GDP ratio than the European Commission in its 2020 Autumn forecast. This is the result of a more positive underlying macroeconomic outlook in the staff projections and the fact that, unlike the Fund, the Commission forecast does not incorporate the impact of the Recovery and Resilience Facility (RRF) in its projections.

Structural Policies

We agree with the structural policy priorities highlighted in the Staff Report, and underscore the importance of using the Next Generation EU (NGEU) plan to support a structural transformation of the economy. We concur with staff that labor market reforms are key to facilitate the needed reallocation of resources. In this regard, we agree with the need to reduce labor market duality, among others, by making permanent contracts more attractive for employers, and to improve active labor market policies and training systems to facilitate the transition from declining activities to expanding sectors. In addition, we consider tackling early school leaving and improving educational outcomes crucial to enhance human capital in the long run, thus improving employability and overall productivity, but also distributional outcomes. We also share staff's view that structural policies should tackle income inequality and social exclusion, promote investments in the green and digital economy, enhance the effectiveness of policies supporting research, development, and innovation, and improve the coordination between different levels of government. We support the authorities' efforts to achieve carbon neutrality by 2050, and welcome staff's discussion of policies to ensure the consistency of recovery and resilience plans with climate goals. As staff, we believe that the NGEU plan could finance the implementation of the various policy priorities and play a pivotal role to jump-start the transformation of the economy, while setting the incentives for undertaking structural reforms. We note that the NGEU plan can mobilize up to 140 bn. EUR for Spain in grants and loans (about 11 percent of Spain´s GDP in 2019), with almost 70 percent of these funds targeting green and digital investments. These resources add to those committed under the EU Budget.

Financial Sector Policies

Financial sector policies should focus on supporting solvent borrowers and avoiding 'cliff effects' from exit strategies. We agree with the Staff Report's overall assessment of the Spanish financial sector, and share the concern that heightened risks will test its resilience. However, we note that the Spanish banking system entered the current crisis in a stronger position than in previous downturns. This, together with large support measures taken by Spanish and European authorities, has allowed the banking system to continue to support the real economy during the crisis. As support measures begin to expire, credit risks could materialize, given that some of the guaranteed loans and payment moratoria have been granted to market segments highly exposed to the impact of the pandemic. In our view, the policy priority remains to support solvent borrowers' ability to repay and safeguard their access to credit. At the same time, both authorities and banks should continue working on exit strategies in order to avoid "cliff-effects" and facilitate debt relief and restructurings of highly indebted but viable firms. In this context, we echo staff's call for a reform of the private debt resolution and restructuring framework and welcome a swift implementation of the EU Directive on restructuring and insolvency. Supervisors need to continue their monitoring and carefully review banks' forward-looking plans for resolving NPLs and ensure resilient capital positions. Regulatory relief measures in the context of the EU framework should facilitate the use of capital and liquidity buffers for lending purposes and loss absorption. Banks need to continue recognizing problem assets in a timely manner, adjusting their ongoing provisioning decisions on precautionary grounds, and following prudent dividend policies. Further cost rationalization would also be appropriate in this challenging environment to maintain bank profitability. Finally, we share staff's positive assessment of the enhanced information sharing between AML/CFT and prudential supervisors.