

The contents of this document are preliminary and subject to change.

GRAY/20/3290

November 9, 2020

**Statement by Mr. Buisse, Mr. Rozan, and Ms. Gilliot on Spain
(Preliminary)
Executive Board Meeting
November 11, 2020**

We thank staff for this comprehensive set of documents and Mr. Moreno, Mr. Lopez, and Ms. Moral Betere for their helpful Buff statement. The Covid-19 pandemic has led to an unprecedented shock to the Spanish economy. We welcome the strong policy support measures, that have cushioned the economic and social impact of the crisis. Fiscal policy is playing a key role to counter the consequences of the pandemic and should be allowed to continue to support households and corporates until the crisis abates. Beyond, addressing challenges including labor market duality, income inequality and the structural transformation of the economy, in line with the authorities' agenda, will be important for medium term prospects. In this regard, a focus should be placed on increasing investment effectiveness in infrastructures, innovation and productivity. The EU Recovery and Resilience Facility in conjunction with the use of EU funds represent a key opportunity to support the authorities' agenda and reinforce Spain's productive capacity and resilience on an equitable and sustainable basis. We associate ourselves with Mr. Poso's statement and wish to offer the following comments for emphasis.

Outlook and risks

The outlook is marked by an unprecedented level of uncertainty. We generally agree with the overall outlook and the deterioration of the balance of risks. The sector-specific analysis done by staff is particularly insightful on the pandemic's effect on public finance, current account and profitability. Like in other countries highly reliant on a few export-oriented sectors, Spain's economy has been largely and unevenly hit by the pandemic, with large disparities across regions. We note that the lack of full-year data for 2020 and the Covid-19 crisis prevented a complete analysis of Spain's external position. We take of the new methodology presented (in Annex VIII) to assess external sustainability and needed relative price adjustment and would be interested in more details, including on the formulation of policy recommendations.

We commend the authorities for the forceful response to the crisis, in particular through employment supporting policies for households and firms and active labor market policies. The introduction of extraordinary benefits for self-employed and several vulnerable groups as well as the Minimum Income Scheme have been essential to help bridge gaps in social policies ensuring greater evenhandedness in social spending. We encourage the authorities to ensure a smooth integration into the existing support tools at the regional levels to enhance the effectiveness of global policy efforts. As the recovery takes hold, careful analysis should continue to ensure that these measures, including the short-time work scheme (ERTE) program or public loan guarantee schemes, gear progressively toward those of the sectors most affected by hysteresis effect ensuring that repayment conditions of those loans remain flexible.

Fiscal policy

In line with last October WEO's main messages, fiscal support should remain in place in order to support the macrostabilization of the economy and compensate the consequences of lockdowns. The report strikes a good balance in emphasizing the need for prolonged fiscal support to fight the pandemic including through a strong support to the health sector while monitoring the evolution of the fiscal sustainability. Gradual fiscal consolidation should only be contemplated once the economic recovery is on sustained strong path with falling unemployment. Meanwhile, priority should be given to the 2021 budget's recovery plan implementation and to a smooth articulation in the use of the €27 billion grant of the EU Recovery and Resilience Facility (RRF) and the REACT-EU funds. In this regard, we welcome the presentation in Mr. Moreno's Buff statement of the 2021 Draft Budgetary Plan' support measures to address structural rigidities, raise productivity while preserving financial sustainability. Government's revenue measures to support the medium-term adjustment needs including the introduction of a digital and financial transactions tax, boosting environmental taxation and fighting against tax fraud and evasion are welcome. We are also very supportive of the authorities' priority reform areas identified to address and accelerate the structural transformation of the economy and share their view that the RRF would be an effective lever to frontload and scale up their reform agenda.

Financial Sector Policies

We agree with the report's overall assessment of the financial sector, though we note that the banking system has entered the crisis in a stronger position than in previous downturns. This being said, areas of prudential oversight and resolution should be strengthened. Given the heightened risks linked to a rise in NPLs, Spanish banks' lower initial CET1 ratio, and the moderately higher exposure to borrowers in vulnerable sectors, continued strong bank supervision of banks' forward-looking plans for resolving NPLs and ensuring resilient capital positions will be important, as emphasized in the authorities' views. We fully concur with staff's recommendations to keep pursuing cost rationalization, invest in technology and contemplate additional consolidation in the banking system in order to address low for longer profitability. We welcome the authorities' commitment to enhance debt restructuring frameworks and insolvency, a topic that is usefully emphasized in the report. We finally strongly echo the authorities' position in favor of the completion of the Banking Union with a common deposit insurance scheme.

Addressing Long-Term Consequences of the Pandemic

The current context provides an opportunity to work proactively on the structural transformation of the Spanish economy, to increase Spain's growth potential and productivity and accelerate the income convergence to its euro area peers. Regarding the introduction of labor reforms to tackle labor market duality, we would like to pinpoint staff's proposal to introduce a single open-ended contract as an interesting option which however should be rather implemented after the macrostabilization phase. *Could staff provide more details on the optimal timeline for such a reform?* We acknowledge in the very interesting *Selected Issues Paper*, the various advantages of single contracts with severance pay rising smoothly with tenure, the combination of those contracts with a separation fund increasing the positive impact on labor market duality mitigation. We would however caution against the potential adverse effects on employees' expected severance payments and number of inefficient layoffs, especially during challenging times. The efficiency in the labor market functioning would benefit from an enhanced gender equality and we welcome actions designed by the government aimed at closing the gender pay gap, revamp the public childcare system and achieve full equalization of maternity and paternity leave. Finally, we strongly support the alignment of the recovery strategy with the country's climate objectives and welcome the objectives and coverage of the 2020 draft bill on Climate Change and Energy Transition as presented in Mr. Moreno's Buff statement.