SPAIN

GDP growth in Spain remained well above the euro area average in 2017, mainly due to robust domestic demand and, to a lesser extent, to a positive contribution from the external sector. Uncertainty related to events in the Catalonian region had not exerted a significantly negative economic impact at the national level by early 2018. Strong economic activity and expenditure restraints narrowed the public deficit to 3.1% of GDP in 2017. Spanish banks' financial situation further strengthened in 2017, with the Banco Popular resolution in June not resulting in any losses for taxpayers or depositors.

Spanish GDP grew by 3.1% in 2017, slightly below the 3.3% in 2016, and recorded the highest growth among the large euro area economies. Domestic demand drove growth, and the external sector contributed positively, supported by dynamic export growth. Still, the oil price recovery and a surge in imports were offset by strong tourism activity, and the current account surplus remained stable at 1.9% of GDP. The international debtor position narrowed to 80.8% of GDP but remains high. Harmonised inflation accelerated to 2.0% from -0.3% in 2016, boosted by energy prices.

Strong activity supported substantial job creation, driving unemployment below 17% by year-end, i.e. 10.4 percentage points below its peak in mid-2013. But the labour market recovery is not yet complete. Youth and long-term unemployment rates, despite falling at double-digit rates, are still high, with the temporary employment rate among the highest in the EU.

The general government deficit decreased in 2017, driven by the positive economic cycle and some expenditure restraint. For the year as a whole, the general government deficit complied with the excessive deficit procedure target of 3.1% for 2017. In 2018, the vigorous macroeconomic performance is expected to result in a further deficit reduction. Uncertainty surrounding support in parliament for a budget for 2018 delayed its submission by the government. The draft 2018 budget eventually reached parliament on 3 April. A Draft Budgetary Plan, reflecting the targets and measures included in the draft budget, was submitted to the European Commission and the Eurogroup in late April, together with the stability programme update. Public debt declined marginally to 98.3% of GDP in 2017 from 99.0% a year earlier.

Political events related to Catalonia raised uncertainty towards year-end, but the impact was more subdued than initially estimated. Investor demand for Spanish government bonds remained resilient, although there was some underperformance vis-à-vis the country's non-core peers in the last quarter of the year. The Spanish Treasury successfully completed the annual funding programme. It raised €137 billion in 2017, exceeding its annual €132.9 billion bond issuance target.

On aggregate, Spanish banks' financial situation continued improving in 2017 despite some limited impact from the resolution of Banco Popular and political uncertainty in Catalonia. Overall, banks remained profitable, capital ratios strengthened, and asset quality improved thanks to the recovery of the economy and the real estate market. Although the NPL ratio for domestic business continued to decline during the year, it remained above the euro area average at 7.8% in December 2017. If one includes the largest banks' business abroad, however, the ratio would be 4.5%, beneath the euro area average of 4.9%. The decrease of credit stock slowed as new lending to the private sector accelerated.

In 2017, Banco Popular was resolved, due to concerns related to its asset quality that triggered a deterioration of its liquidity, and then sold to Banco Santander. The resolution scheme entailed no losses for taxpayers or depositors, and it contributed to strengthening the stability of the banking sector as a whole.

The government, through the Fondo de Restructuración Ordenado Bancaria (FROB), sold 7% of Bankia's shares in December 2017, and the merger between the two remaining state-owned banks was completed in early 2018.

Under its Early Warning System, the ESM continued to assess positively Spain's ability to honour its ESM loan service repayments. In 2017, Spain made two voluntary early repayments of €3 billion in total. Furthermore, the ESM Board of Directors approved on February 2018 a Spanish request to make two additional voluntary early repayments, totalling €5 billion. Nevertheless, given high public debt levels, a credible fiscal strategy, and strong reform momentum are key to reducing the country's vulnerability to adverse shocks.