

REPORT ON THE MAIN BUDGETARY LINES
AND DRAFT BUDGETS OF THE PUBLIC
ADMINISTRATIONS:
2019 DRAFT GENERAL STATE BUDGETS
(Article 17.1 of the LOEPySF).

REPORT 3/19



The Independent Authority for Fiscal Responsibility (AIReF, for its acronym in Spanish) was created with the mission of ensuring strict compliance with the principles of budgetary stability and financial sustainability set out in article 135 of the Spanish Constitution.

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EXECUTIVE SUMMARY

AIReF must evaluate the main budgetary lines and draft budgets in terms of their adaptation to the fiscal targets. In accordance with this mandate, on October 26, in the absence of the draft GSB for 2019, AIReF issued a first assessment of the main budgetary lines of the Public Administrations (PAs) for 2019¹, based on the 2019 Budgetary Plan. Following the approval of the Draft GSB for 2019, this report analyses its content and updates the initial pronouncement on the main budgetary lines of the budgets of the PAs.

In 2019, the Public Administrations must comply with a deficit target of 1.3% GDP, a figure that intuitively seems difficult to achieve insofar as it requires an adjustment of 1.4% from the end of 2018 that the AIReF estimates will be 2.7% GDP, 0.5% above the 2.2% target.

If this forecast is confirmed, which coincides with the baseline scenario that AIReF published in July in the "Report on expected Public Administration compliance with the budgetary stability target, government debt target and expenditure rule: 2018", the adjustment made in 2018 would have been 0.4% GDP compared to the 0.9% set as the target. That report indicated that the measures approved during the processing of the General State Budgets (GSB) had reduced the probability of compliance with respect to the presented draft, from feasible, although very difficult, to unlikely, in line with the assessment that AIReF had made in May on the Update to the Stability Programme of the Kingdom of Spain 2018-2020. Among these measures, it is worth noting the agreement reached between the government and the

¹ [Report on the main budgetary lines of the Public Administrations for 2019](#)

trade unions on increasing the compensation of public employees, which would be implemented gradually in the 2018-2020 period, and the general revaluation of pensions by 1.6% and 3% for minimum and non-contributory pensions, respectively.

With this starting point, doubts were already raised a priori regarding whether an adjustment of 1.4% GDP would be made in 2019, which would mean that the budgetary management measures and decisions would be of sufficient scope to correct the scenario that, under the assumption of no policy change, AIReF set at 2.2% in the study published on July 19, 2018.

This lack of realism in the setting of the target, which is observed both globally and in its distribution by sub-sector, has a perverse effect. As AIReF has pointed out in previous reports, this practice discourages any attempt to get close to a target that is perceived as unattainable, thereby favouring a laxity, which seems to have already been assumed and generally accepted, in the application of the fiscal regulatory framework of the Organic Law on Budgetary Stability and Financial Sustainability (LOEPySF for its Spanish acronym). In addition, the mechanisms foreseen in this law are clearly oriented towards the Territorial Administrations, to the extent that no monitoring and evaluation procedure is envisaged for the Central Administration beyond that carried out by AIReF.

- Macroeconomic scenario:

The macroeconomic environment foreseen by AIReF for 2019 is characterised by solid economic growth (2.4%), in line with 2018, based on the contribution of domestic demand and with a nominal component (GDP deflator) that recovers dynamism, growing to 1.7%, after 2017 and 2018 in which it experienced rates close to 1%.

The tail winds that support the growth of the Spanish economy maintain their traction in the short term. The global economic context and, in particular in the euro zone, seems to point towards an upward movement in the interest rates on debt later than anticipated in 2018. The oil price forecasts expect 2019 to be in line with the values of the end of 2018, around 55-60\$ per Brent barrel, significantly below the 2018 prices (which reached up to 85\$ after the summer). Finally, external demand from the main trading partners has not been significantly affected despite the geopolitical tensions that have been reflected in world trade. The outlook for growth in the euro zone remains at rates close to 2%, with slight downward revisions in the latest updates.

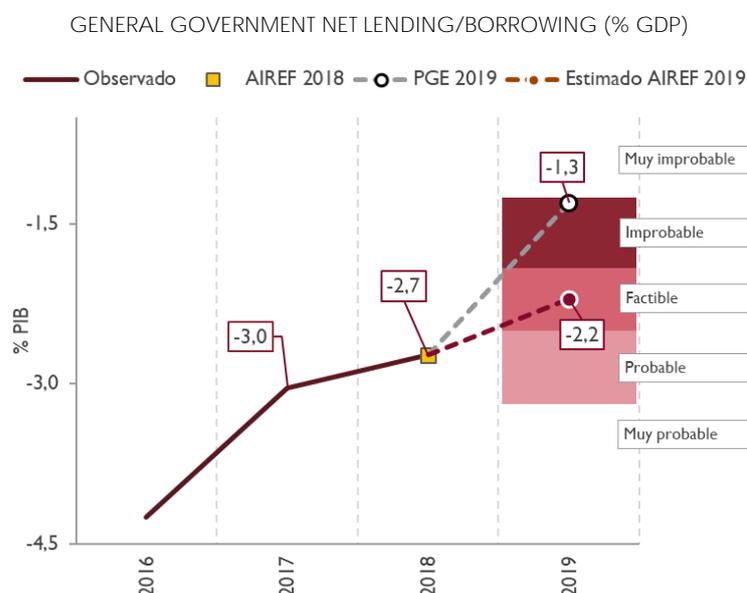
In the short term, two main sources of risk for growth are identified, both on the side of external demand. On the one hand, the intensification of protectionist tensions, associated with lower growth in some of the main players in world trade such as China, may cause an additional drop in world trade and, with that, in Spanish exports. On the other hand, at the European level, there are specific risks linked to Brexit and the situation in Italy.

In this context, AIReF has endorsed the forecasts of the Government's macroeconomic scenario included in the GSB 2019, in its Report on the macroeconomic forecasts of the Draft General State Budgets for 2019, considering it to be prudent overall, based on the exogenous assumptions considered and the policies defined. The assumptions that reflect the risks stemming from the external environment are considered plausible and the composition of growth reasonable, based on a contribution of domestic demand similar to that of the two preceding years, but with a slightly negative contribution from the external sector.

At the budgetary level, the expected economic growth for 2019 and its composition support the evolution of the tax bases of the main taxes and social contributions. On the one hand, the bases of indirect taxes will be favoured by more dynamic prices and robust private consumption, whose growth will continue to rest in the margin offered by its fundamental determinants and the economic policy measures that support the evolution of household disposable income. Direct taxes, as well as social contributions, will favour the growth of compensation of employees, favoured by the positive dynamics of the labour market, with an even more intensive growth in employment, which will be accompanied by a more favourable evolution of wages, positively affected by the increase in the minimum wage and the increase in the salary agreed upon for public employees.

- Stability Target

Following its analysis of the Draft GSB and the information on the main budgetary lines and draft budgets of the Territorial Administrations, AIReF concludes that it is *unlikely* that the PAs will reach the deficit target set, without the deviations that affect the Central Administration (CS) and Social Security Funds (SSF) being counteracted by the surplus of the Local Governments (LGs) not included in the sub-sector target, as in previous years.



Regarding the measures analysed in the Budgetary Plan, AIReF revises the impact of revenue measures downwards, mainly in the CA, due to the reduction in the time period that the new tax figures will be in force. On the other hand, new measures are included that affect SSF contributions and the assessment of the impact on the special regime for self-employed workers of the increase of the minimum wage is revised. On the expenditure side, in addition to the measures already announced in the Budgetary Plan, the GSB include additional expenditure increases, of which the largest amount has an impact on CA investments.

REVENUE MEASURES	GOVERNMENT	AIREF	GOVERNMENT	AIREF
	ESTIMATE	ESTIMATE	T ESTIMATE	ESTIMATE
	DBP19	DBP19	GSB 2019	GSB19
Corporate Income Tax	1,516	(1,408, 1,624)	1,516	(1,408, 1,624)
PIT Increase of rates on higher income	328	(245, 255)	328	(245, 255)
New tax figures	2,050	(966, 1,818)	2,050	(242, 457)
Tax on Financial Transactions	850	(420, 850)	850	(105, 215)
Tax on certain Digital Services	1,200	(546, 968)	1,200	(137, 242)
Green taxation (Hydrocarbons Tax)	670	(649, 693)	670	(487, 518)
VAT	-53	-53	-77	(-55, -61)
Heritage Tax	339	(0-8)	339	(0, 0)
Fight against fraud	828	(350, 570)	828	(275, 420)
TOTAL CA IMPACT	5,678	(3,565, 4,915)	5,654	(2,601, 3,214)
Maximum contribution bases Increase of 7%		(1000, 1,100)	850	(800, 900)
Minimum wage. Minimum bases General Regime	1,500	(550, 650)	1,279	(550, 650)
Special Self-employed Workers Regime Measures		(950, 1,050)	6	(0, 12)
Quota for professional contingencies			456	(426, 486)
Additional contributions local police forces			254	(224, 284)
Others			154	(124, 184)
TOTAL SSF IMPACT	1,500	(2,500, 2,700)	2,999	(2,124, 2,516)

EXPENDITURE MEASURES	GOV ESTIMATE DBP19	AIReF ESTIMATE DBP19	GOVERNMENT ESTIMATE GSB 2019	AIReF ESTIMATE GSB19
Revaluation of pensions to the CPI and increase of minimum and non-contributory pensions to 3%	736	843	588	588
Measures quantified jointly in the Budgetary Plan	1,318	1,318	1,633	1,435
Measures listed in the Budgetary Plan and quantified in the additional information	425	725	492	812
Increases in expenditure included in the GSB 2019 not expressly identified in the Budgetary Plan			2,415	2,415
TOTAL MEASURES	2,479	2,886	5,128	5,250

- Expenditure Rule and Fiscal Policy Stance

The estimate made by AIReF based on the information contained in the budgets of the different Public Administrations points to a basically neutral fiscal policy for 2019, once adjusted for the effect of the cycle, in line with what has been done since 2013.

By sub-sectors, however, the situation is mixed. If we compare the evolution of sub-sector expenditure with respect to the reference rate adjusted for regulatory revenue measures, compliance by the CA and the LGs can be observed, unlike the Autonomous Regions and particularly the SS, which presents growth rates well above the reference rate (2.7%) even once adjusted for the revenue measures implemented in 2019. It should be noted that Social Security is not subject to compliance with the national expenditure rule, unlike in the case of the European rule, but its analysis is added to get an idea of the behaviour of the General Government (GG).

The European expenditure rule, in addition to referring to the performance of the GG, is more restrictive than the national rule and would imply a contractionary fiscal policy, with the aim of converging to a balanced structural balance, through a permitted expenditure growth of 0.6%, well below medium-term growth. This contained evolution of GG expenditure would imply a correction of around € 12,000M against the forecast included in the draft budgets of the different sub-sectors.

Analysis by sub-sectors

- Central Administration

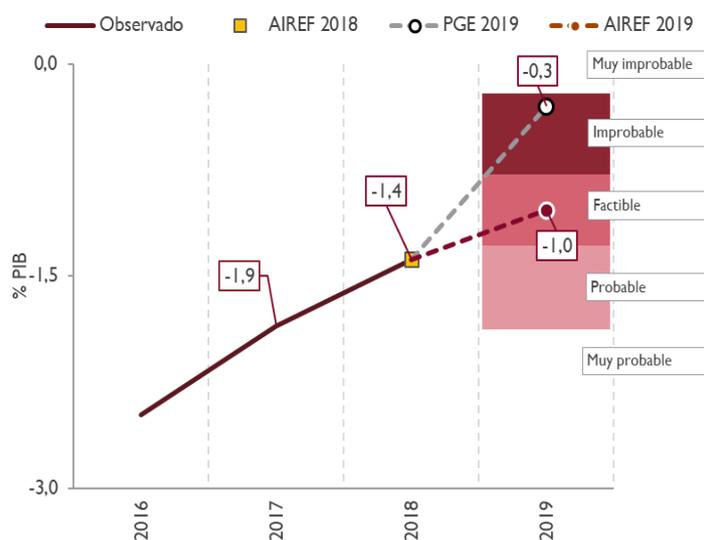
The CA has to make an adjustment of 1.1% GDP. The uncertainty about the collection potential of the new tax figures, the delay in the implementation of these and other pending revenue measures that require legal support, and the impact in 2019 of expenditure measures adopted in this year and the

previous one, make it *unlikely* that the necessary adjustments will be made to achieve its objective.

The CA's revenue will increase its weight over GDP, both due to the macroeconomic evolution and the effect of the measures adopted. The forecasts for tax revenue included in the GSB represent a growth of 9.5% compared to 7.6% estimated by AIReF. The main difference is due to the estimated impact of the measures, particularly the new tax figures. Expenditure maintains its weight over GDP despite the measures adopted. CA expenditure grew by 4.1% compared to 2018, excluding non-recurring items, whose growth was 5.3%.

As in previous years, the absence of national accounting adjustments prevents the reconciliation of the budgetary balance and the national accounting balance. However, the amount that these adjustments would have to meet to comply with the target is far above its historical execution.

CENTRAL ADMINISTRATION: NET LENDING/BORROWING



- Social Security Funds

AIReF considers the SSF scenario reaching a deficit level similar to that reached in 2018 to be the most likely scenario, making the 2019 target of 0.9% GDP *very unlikely*.

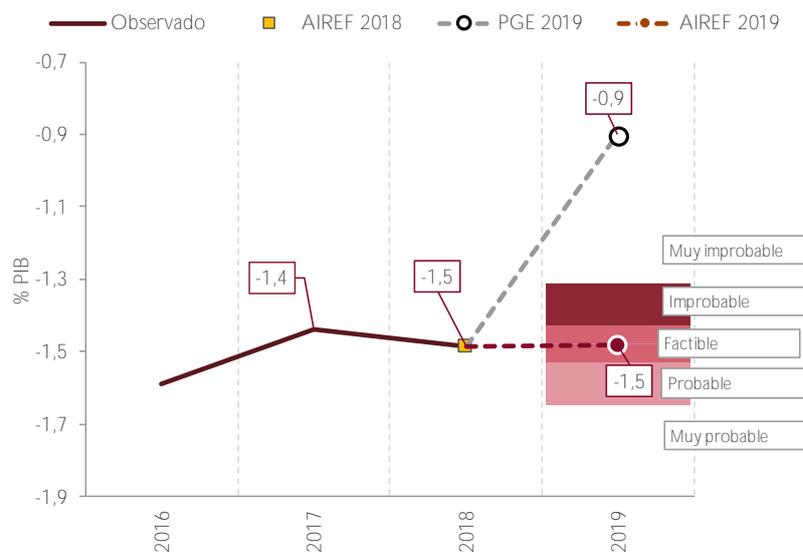
The expenditure and revenue forecasts present aggregate figures in line with AIReF's estimates. In terms of revenue, it is worth noting the impact of the

measures approved in the Royal Decree-Law of December. Including the effect of the economic cycle, AIReF's estimates envisage a growth of social contributions slightly lower than that included in the Draft GSB.

Social Security pensions grow by 5.6% in the Draft GSB, in line with AIReF's estimate, including the effect of the measures. Likewise, the expenditure on unemployment benefits contained in the Draft GSB is very close to that considered most likely by AIReF.

National accounting adjustments are also not included in this sub-sector, which makes it impossible to reconcile the budgetary balance and the national accounting balance. However, the amount that these adjustments would have to meet to comply with the target is far above its historical execution.

SOCIAL SECURITY FUNDS: NET LENDING/BORROWING

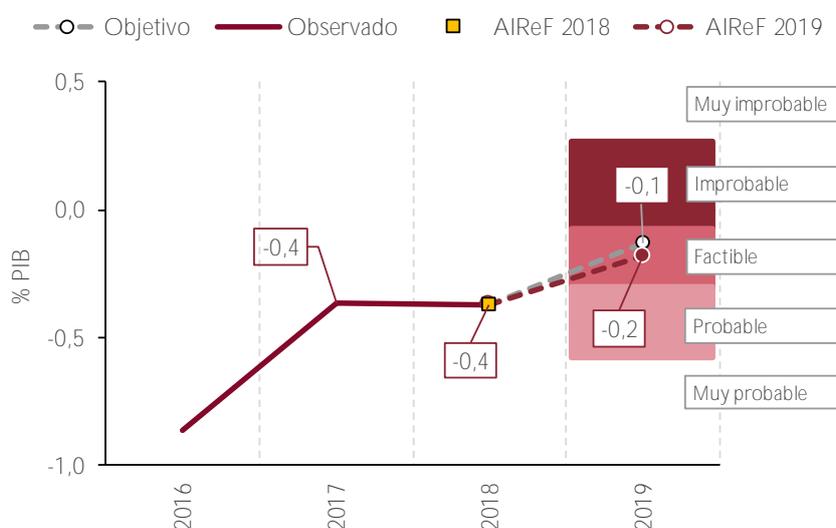


- Autonomous Regions

The *Autonomous Regions* will have to make an adjustment of more than 0.2% GDP that is deemed *feasible* since the neutralisation of the negative effects of the VAT Immediate Information System is expected in the settlement of the 2017 system revenue received this year. With the current information, AIRcF forecasts that in 2019 revenue will increase its weight over GDP by more than 0.1%, conditioned mainly by the revenue of the regional financing system and expenditure experiencing a certain reduction in its weight, allowing a balance close to the stability target to be reached.

Although, in relation to the stability target, both the sub-sector and the majority of the Regions are converging towards balance, there are very different individual situations and the risk of non-compliance with the expenditure rule is generalised, essentially as a result of the expected evolution in expenditure.

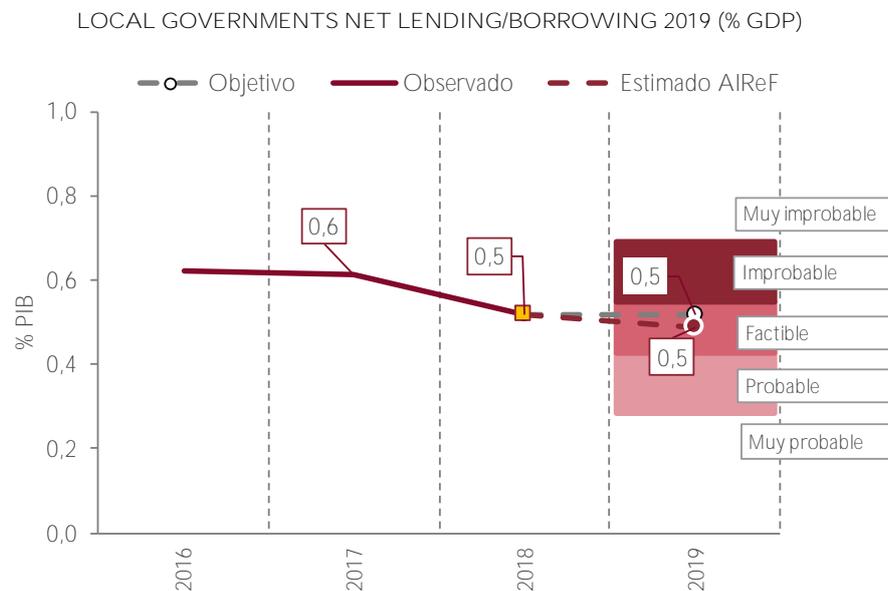
AUTONOMOUS REGIONS. NET LENDING/BORROWING 2019 (% GDP)



- Local Governments

It is very likely that the local sub-sector will reach the balance target in 2019, with a surplus that AIRcF estimates will be around 0.5% GDP, replicating the expected result for 2018.

AIRcF estimates that revenue will grow by around 3%, while expenditure shows a growth of almost 4% driven by the approved measures to extend the scope of financially sustainable investments for the purposes of the expenditure rule.



Recommendations

AIReF recommends:

1. That the legislative processing of the revenue measures and their eventual implementation be accelerated, in order to minimise the collection loss in 2019.
2. That, in the processing of the GSB, the existence of fiscal spaces that would allow the foundations to be laid in 2019 for a process of medium-term convergence, in which the Stability Programme Update (2019 - 2022) to be presented in April is anchored, is evaluated.
3. That, in the execution of the budget, levers that can offer the results of the public spending review that AIReF is carrying out and whose results will be published throughout 2019 are used.
4. That the fiscal targets are configured as the annual realisation of a revisable multi-year plan based on the results obtained in each of the budgetary years that make it up.
5. The setting of the annual target of the PA sector should follow a bottom-up approach based on targets that take into account the fiscal situation of each of the sub-sectors, which will facilitate its monitoring and enforcement, thus providing greater credibility to the current fiscal framework.

Likewise, AIRcF reiterates recommendations made in previous reports related to the articulation of a follow-up procedure of the Central Administration and Social Security, which specifically includes the degree of implementation of the measures and the realisation of budgetary management decisions aimed at the containment of budgetary execution and the inclusion of relevant information in the Draft GSB in order to reconcile the budgetary result with the stability target.

1 INTRODUCTION

The Organic Law on Budgetary Stability and Financial Sustainability (LOEPySF for its Spanish acronym) and the Law on the Creation and Regulation of AIReF lay down the mandate that the AIReF shall prepare a report on the Draft General State Budgets (GSB) and the main budgetary lines of the Autonomous Regions and Local Governments (LGs). AIReF must publish, before October 15, a report on the Draft GSB and the main budgetary lines of the territorial administrations from the perspective of their compliance with the expenditure rule and the budgetary stability and government debt targets.

In accordance with this mandate, on October 26, in the absence of the Draft GSB for 2019, AIReF issued a first assessment on the main budgetary lines of the Public Administrations (PAs) for 2019² based on the 2019 Budgetary Plan. With the information available on the Budgetary Plan for 2019 presented in October and the additional information provided by the different administrations in their main budgetary lines for 2019, AIReF issued a first pronouncement on the forecasts for 2019 of the General Government (GG), with an overall analysis and by each sub-sector, which was partially completed in the regional sphere with the publication of the individual reports of ten Regions on December 21.

Following the approval of the Draft GSB for 2019, this report analyses its content and updates the initial pronouncement on the main budgetary lines of the PAs. On January 11 the Council of Ministers approved the Draft GSB for 2019, which was presented to the Parliament on January 14 for its parliamentary process.

² [Report on the main budgetary lines of the Public Administrations for 2019](#)

Once the Draft GSB for 2019 is presented, AIReF assesses its content from the perspective of its compliance with the fiscal rules. Likewise, based on this document and other new available information, the assessment made on October 26 on the budgetary lines is updated, both for the GG and for each of the sub-sectors.

Subsequently, AIReF will complete the analysis of the territorial sub-sectors by issuing the individual reports on the Regions that have not been published to date and with a more extensive report on the LGs. The assessment of the Regions and LGs included in this report will be completed, at the regional level, with the publication of the individual reports on the budgetary lines for 2019 of the six Regions pending evaluation³. At the local level, a more extensive report will be published that will include the individualised analysis of the 21 large LGs and the 3 Provincial Councils of the Basque Country, in addition to the local corporations with significant risks in terms of sustainability according to AIReF's selection and qualification methodology.

³This refers to the Autonomous Regions of Castile and Leon, Castile-La Mancha, Catalonia, Aragon, the Basque Country and La Rioja. The individual report on the draft budget of Valencia is not issued, since the information was sent to AIReF once the budget was approved. For this reason, it will be analysed when AIReF makes its pronouncement on the initial budgets.

2 PURPOSE AND SCOPE

The main purpose of this report is to evaluate the Draft GSB for 2019 from the perspective of compliance with the three fiscal rules defined in the LOEPySF. AIREF prepares this report with the Draft GSB for 2019, completed with additional information received, and with this data it evaluates the compliance of the Central Administration (CA) and Social Security Fund (SSF) sub-sectors with the budgetary stability and government debt targets, as well as the expenditure rule.

As in previous years, the evaluation of the Draft GSB for 2019 has been conditioned by:

1. The lack of an initial budget in national accounting terms and reconciliation of the budgetary balance with the stability target. The Draft GSB for 2019 does not include information on the national accounting adjustments that have to be added to the budgetary balance. This information had been published since 2003 among the budgetary documentation⁴, but stopped being published from the GSB for 2017. Likewise, the Economic and Financial Report of Social Security had been publishing information in national accounting headings until 2017. This lack of information, contrary to Community regulations and the principle of transparency foreseen in the LOEPySF (Articles 6 and 27), significantly affects AIREF's analysis, insofar as it prevents the reconciliation of the budgetary forecasts with the budgetary stability target that is measured in national accounting terms.
2. The non-inclusion of information regarding compliance with the expenditure rule and the debt target of the CA. The Draft GSB for 2019, as in

⁴Both in the Economic Financial and Report and in the yellow paper for the Presentation of the GSB

previous years, makes no mention of the expenditure rule for the CA and, on the other hand, only refers to the government debt target of the GG but it does not include any mention of compliance with the debt target of the CA. This lack of information is again contrary to the principle of transparency foreseen in the LOEPySF (Articles 6 and 27).

In addition, there is still a lack of greater transparency in the obligations and potential risks of the CA. Although it can not be classified as a scope limitation, the GSB do not include information on possible liabilities that CA must face arising from contingent liabilities.

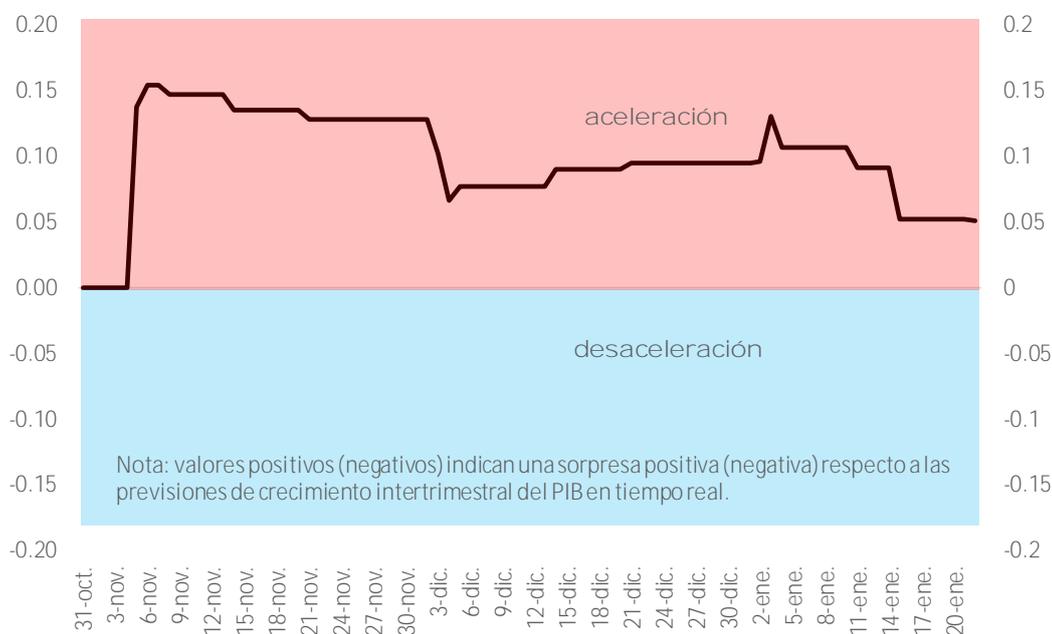
This report also aims to update the evaluation of the main budgetary lines of the territorial sub-sectors, as well as of the GG in relation to compliance with the fiscal rules. In order to have an overview of the fiscal position of the nation as a whole as well as each and every one of the sub-sectors that comprise it, the compliance of the main budgetary lines with the fiscal rules is also assessed, both for the GG and for the Regional and LG sub-sectors, according to the information included in the Draft GSB for 2019 and other information available since the publication of the previous report on October 26.

3 BUDGETARY STABILITY TARGET AND EXPENDITURE RULE

3.1. Macroeconomic environment

AIReF expects a growth rate in 2019 similar to that of 2018. The latest available information points to a quarter-on-quarter growth of 0.7% at the end of 2018, which would have a significant carryover effect for the inertial evolution of GDP over the whole of this year. AIReF's baseline forecast for the evolution of GDP stands at 2.5% in 2018 and 2.4% in 2019. The tail winds that support the growth of the Spanish economy maintain their traction in 2019. Although it is expected that the stimuli that have sustained growth in recent years will tend to disappear in the medium term, in the short term they remain a relevant factor.

THERMOMETER OF THE SPANISH ECONOMY, GROWTH SURPRISES



The global economic context and, in particular in the euro zone, seems to point towards an upward movement in the interest rates on debt later than anticipated in 2018.

The oil price forecasts expect 2019 to be in line with the values of the end of 2018, around 55-60\$ per Brent barrel, significantly below the 2018 prices (which reached up to 85\$ after the summer).

Finally, external demand from the main trading partners has not reduced significantly despite the geopolitical tensions that have been reflected in world trade. The outlook for growth in the euro zone remains at rates close to 2%, with slight downward revisions in the latest updates.

AIReF has endorsed the forecasts of the Government's macroeconomic scenario included in the Draft GSB for 2019, considering that the macroeconomic scenario envisaged by the Government is prudent overall, based on the exogenous assumptions considered and the policies included. The expected evolution for 2019 is based on an improvement in the contribution of domestic demand, alongside a consolidation of a negative contribution of external demand. The composition of growth is considered reasonable, based on a contribution of domestic demand similar to that of the two preceding years, but with a slightly negative contribution from the external sector in line with AIReF's internal forecasting models.

For private consumption, following the negative surprise of the second quarter, recovery of its quarter-on-quarter growth was confirmed in the third, which is expected to continue for the coming quarters, relying on the margin offered by its fundamental determinants and the economic policy measures that support the evolution of disposable household income. Its annual progress is expected to be 2.4% in 2018 and 2.2% in 2019.

In turn, public consumption will continue to evolve positively, but below aggregate growth, with rates close to 2% in 2018 and 1.5% in 2019. The formation of productive capital will maintain its dynamism, although it has substantially reduced its progress in the third quarter, with year-on-year rates of over 8% expected for both the final stretch of 2018 and the beginning of 2019. The support of domestic demand and the maintenance of good financing conditions and the use of self-financing shown by companies are a support for its progress.

Thanks to the recovery of the residential segment supported by the maintenance of favourable credit conditions, investment in construction will continue to record progress around 5% in 2019.

A negative contribution from the external sector to aggregate growth is expected. The expected year-on-year growth for exports in the coming quarters is reduced after surprisingly contractionary figures for the third quarter of 2018, standing at around 2% for the whole of 2018 and with a slight rebound in 2019 due to a slight gain in the market shares for Spain and the end of the exchange rate appreciation process. For imports, the situation is similar, although greater progress is expected, around 3% -4%.

On the price side, the GDP deflator is projected to increase by 1.7% in 2019, implying a slight downward revision in line with the observed decrease in the price of oil. With respect to the inertial scenario foreseen by AIRcF in October 2018, the expected price of the Brent barrel for 2019 in the futures market has been revised substantially downwards by almost 20%. As a consequence, the GDP deflator forecast for 2019 has been corrected downwards by 0.2 percentage points (from 1.9%), explaining most of the revision for the components of domestic demand. In this way, the deflator forecasts for 2019 for private consumption and, to a lesser extent public consumption, have decreased by 0.5 and 0.1 percentage points, respectively. In turn, the forecast of the deflator of investment in construction has also been revised downwards substantially (-1.3 percentage points) with respect to October 2018, in line with more contained dynamics of the real estate market.

Finally, in the short term, risks stemming from the global growth scenario and from the main partners of the Spanish economy are identified, which would imply a lower contribution from external demand. In the short term, there are two main sources of risk to growth. On the one hand, the intensification of protectionist tensions, associated with lower growth in some of the main players in world trade such as China, may cause an additional drop in world trade and, with that, in Spanish exports. On the other hand, at the European level, there are specific risks linked to Brexit and the situation in Italy. The departure of the United Kingdom from the European Union, initially scheduled for March 2019, is at one of the most sensitive moments since the referendum in 2016, due to the British Parliament's rejection of the agreement negotiated between the Government of the United Kingdom and the European Union. To this, we must add the uncertainty in the markets linked to the political and institutional evolution in Italy. Both risks deserve special attention and monitoring due to the possible impact they could have in the short term.

3.2. General Government

AIReF evaluates the probability that the main budgetary lines and draft budgets presented by the Public Administrations allow for compliance with the budgetary stability target set at 1.3% GDP for 2019. The Government has twice proposed a new path of budget stability targets with a deficit of 1.8% for 2019 that has not been approved by the Senate. In addition, the Government has proposed the amendment of the LOEPySF, so that Congress has the capacity to reverse the rejection of the Senate. However, this legal change is pending in Parliament, so the analysis of the budgets must be carried out with respect to the stability target of 1.3% GDP set in July 2017.

TABLE I. BUDGETARY STABILITY TARGET

Lending (+) Borrowing (-) as % GDP	Year-end 2016	2017 CM Agreement	Year-end 2017	2018 CM Agreement	2018 AIReF	2019 CM Agreement	2019 AIReF
Central Administration	-2.6	-1.1	-1.9	-0.7	-1.4	-0.3	-1.0
Social Security	-1.6	-1.4	-1.5	-1.1	-1.5	-0.9	-1.5
Autonomous Regions	-0.9	-0.6	-0.3	-0.4	-0.4	-0.1	-0.2
Local Corporations	0.6	0.0	0.6	0.0	0.5	0.0	0.5
Regions and LGs	-0.3	-0.6	0.3	-0.4	0.1	-0.1	0.3
General Government	-4.5	-3.1	-3.1	-2.2	-2.7	-1.3	-2.2

Reaching this target requires a reduction of 1.4 % GDP compared to the estimated end of 2018, which is very unlikely. In October 2018, AIReF prepared a report on the 2019 Budgetary Plan submitted to the European Commission, which took a deficit of 1.8% GDP as a reference. AIReF considered it feasible

to reach this level, but without scope to assume deviations in the impact of the measures, warning of the possibility of having to take additional measures. The assessment of the budgets with respect to a deficit target 0.5% GDP lower than that taken as reference in the Budgetary Plan, the delay in the implementation of the revenue measures that require legal support and the new measures to increase expenditure included in the Draft GSB move the public deficit away from the 1.3% target, whose achievement is considered highly unlikely.

The delay in the implementation of any of the revenue measures included in the Budgetary Plan reduces the expected impact by 0.1% GDP. The bills that regulate the creation of the Tax on Certain Digital Services and the Tax on Financial Transactions foresee their entry into force three months after their publication in the Official State Gazette, for which it has been estimated that, as a maximum, they will roll out their effects on the last quarter of the year, reducing their impact to one third of their initial assessment. The tax on hydrocarbons will have a lesser effect since it will come into force with the approval of budgets. And, finally, certain measures to combat fraud will be limited in their effects until the laws that implement them are approved.

Other measures of the Budgetary Plan are already in force, albeit with amendments with respect to what was initially proposed. The increase in the minimum wage, the salary increase of public employees and the revaluation of pensions are already in force, as well as the increase of the maximum contribution bases and the measures on the General Regime of Self-Employed Workers. However, there have been changes in the evaluation of some of them. On the one hand, the cost of updating pensions in 2018 is lower when taking the 1.7% CPI as a reference instead of the 1.8% foreseen in the Budgetary Plan. On the other hand, the rise in the maximum contribution bases has been set at 7% compared to the 10% initially considered by AIR^eF and the modifications of the Special Regime of Self-Employed Workers do not envisage an increase in the minimum bases in line with that of the Minimum Wage. This lower collection is partially offset by changes in contributions for Workplace accidents, which were not included in the Budgetary Plan.

The Draft GSB includes additional expenditure measures with respect to those included in the Budgetary Plan amounting to 0.2% GDP. In addition to what was announced in the Budgetary Plan, the Draft GSB includes other additional measures, among which it is worth noting the increase in investment in railway infrastructures.

TABLE I. REVENUE MEASURES FOR 2019: BUDGETARY PLAN **AND AIReF'S ASSESSMENT**

REVENUE MEASURES	GOVERNMENT	AIReF	GOVERNMENT	AIReF
	ESTIMATE	ESTIMATE	ESTIMATE	ESTIMATE
	DBP19	DBP19	GSB 2019	GSB19
Corporate Income Tax	1,516	(1,408, 1624)	1,516	(1,408, 1624)
PIT Increase of rates on higher income	328	(245 , 255)	328	(245 , 255)
New tax figures	2,050	(966, 1,818)	2,050	(242, 457)
Tax on Financial Transactions	850	(420 , 850)	850	(105 , 215)
Tax on certain Digital Services	1,200	(546 , 968)	1,200	(137 , 242)
Green taxation (Hydrocarbons Tax)	670	(649 , 693)	670	(487 , 518)
VAT	-53	-53	-77	(-55, -61)
Heritage Tax	339	(0-8)	339	(0 , 0)
Fight against fraud	828	(350, 570)	828	(275, 420)
TOTAL CA IMPACT	5,678	(3,565 , 4,915)	5,654	(2,601 , 3,214)
Maximum contribution bases Increase of 7%		(1000 , 1,100)	850	(800 , 900)
Minimum wage. Minimum bases General Regime	1,500	(550 , 650)	1,279	(550 , 650)
Special Self-employed Workers Regime Measures		(950 , 1,050)	6	(0 , 12)
Quota for professional contingencies			456	(426 , 486)
Additional contributions local police forces			254	(224 , 284)
Others			154	(124 , 184)
TOTAL SSF IMPACT	1,500	(2,500 , 2,700)	2,999	(2,124 , 2,516)

TABLE I. EXPENDITURE MEASURES FOR 2019: BUDGETARY PLAN AND AIReF'S ASSESSMENT

MEASURES	GOV ESTIMATE DBP19	AIReF ESTIMATE DBP19	GOVERNMENT ESTIMATE GSB 2019	AIReF ESTIMATE PGE19
Revaluation of pensions to the CPI and increase of minimum and non-contributory pensions to 3%	736	843	588	588
Pension revaluation to CPI		518	263	263
Increase of minimum and non-contributory pensions		325	325	325
Measures quantified jointly in the Budgetary Plan	1,318	1,318	1,633	1,435
Improve minimum and agreed level of dependency.		515	515	515
SS caregiver contributions		0	315	315
Recover subsidy for those older than 52 years		323	323	242
Paternity leave of 5 to 8 weeks		300	300	225
Minimum income		180	180	138
Measures listed in the Budgetary Plan and quantified in the additional information	425	725	492	812
Increased funding for scholarships	150	150	150	150
Aid for school materials	50	50	50	50
Meal aid	25	25	25	25
Increase in Science and R+D+i line items	150	150	217	217
Support for the production and promotion of film productions in different languages	20	20	20	20
Gender Violence Pact increase	20	20	20	20
Depopulation offices	10	10	10	10
Elimination of co-payment		300		320
Increases in expenditure included in the GSB 2019 not expressly identified in the Budgetary Plan			2,415	2,415
Increase in items for Development Cooperation			109	109
Increase in items for actions in favour of immigrants			94	94
Increase in items on housing actions			198	198
Creation of the Heating Rate Subsidy			80	80
Increase in items on transportation subsidies			234	234
Increase in the ADIF high-speed contributions and conventional ADIF			1,700	1,700
TOTAL MEASURES	2,479	2,886	5,128	5,250

AIReF's estimates include the latest available information regarding the end of 2018, which does not alter its baseline deficit scenario of 2.7% GDP, but it does alter the evolution of some revenue and expenditure items. The new budgetary execution data, as well as the advance settlement contained in the GSB, have been incorporated into AIReF's estimates. First, it should be noted that a deficit of 2.7% GDP in 2018 remains the baseline scenario, although with some changes in its composition. The collection data have been higher than expected in Corporate Income Tax, while the VAT collection forecasts have been revised downwards. On the expenditure side, the impact on the investment heading of the revenues from the re-tendering of toll motorways is modified. The estimated impact of the returns for the ruling on the deduction of maternity benefits has also been incorporated. Finally, the impact of the reversal of the Aigües Ter Llobregat concession did not end up taking place in 2018.

AIRcF estimates that, in 2019, revenue will grow by 5.4% compared to 2018, reaching 39.2% GDP. This would mean an increase of 0.5% with respect to the previous year. On the one hand, direct taxes will increase by 0.1% GDP compared to the end of 2018, reaching 10.7% GDP. This increase is mainly explained by the macroeconomic evolution, since the regulatory changes tend to offset each other. On the other hand, indirect taxes will grow by 5.6% driven by both regulatory changes and the evolution of their bases, increasing their weight over GDP by 0.1% to reach 11.9%. Social contributions will also grow above GDP, by 6.5%, representing 12.7% GDP, driven by measures adopted before the end of 2018. Finally, property income and other revenue will grow below GDP, after the strong increase of 2018 driven by dividends received by the State and revenue from EU funds. Both items show a more moderate evolution in 2019.

On the other hand, expenditure over GDP would tend to decrease slightly with respect to the estimated closure for 2018, standing at 41.4% GDP. AIRcF estimates that public expenditure will reduce its weight over GDP by 0.1%, the main causes being the moderation in the growth of public consumption and the decrease in interest expenditure.

Public consumption will grow by 3.9% in 2019, driven mainly by compensation of employees, and reducing its weight over GDP by 0.1% down to 16%. As a result of the application of the agreement with the unions, AIRcF expects a growth in compensation of employees of around 3.9% in 2019, compared to 3.3% in 2018. For 2019, the Agreement with the unions foresees a growth of 2.65%, which is derived from an increase of 2.4% consistent with a GDP growth of 2.3% and an additional growth of the wage bill of 0.25%. In the case of the Central Administration, a further 300 million euros of wage drift are included in the agreement for the equalisation of salaries of the State law enforcement agencies. Regarding the number of personnel, AIRcF assumes an increase of around 1% stemming from the effect of the provisions on the replacement rate contained in the GSB for 2018 and 2019 and that would begin to be noticed in 2019. As a result, AIRcF's estimates would entail the stabilisation of the weight of compensation of employees over GDP. On the other hand, intermediate consumption would continue to grow below 3% and, therefore, below nominal GDP. Lastly, social transfers in kind would maintain growth similar to that of 2018, of 3.7%.

The largest increase recorded in 2019 is for social transfers in cash due to the rise in pensions. This heading includes the effect of most of the measures of both the Budgetary Plan and the GSB for 2018. In particular, it is affected by the increase in pension expenditure, the extension of paternity leave, the

improvement of dependency and the unemployment benefit for people over 52 years of age. The combination of the measures adopted together with the trends of these items represents an increase of 0.3% GDP in this heading.

The reduction of interest will continue in 2019, with its weight over GDP falling 0.2% down to 2.3%. The interest heading is the only one that has fallen compared to 2018, both in nominal terms and in weight over GDP. The savings in terms of interest expenditure are felt as the Public Treasury issuance portfolio is renewed, and issues made during the crisis are replaced by others with lower marginal rates. Furthermore, the situation of the global economy and the latest statements of the governor of the ECB avert the possibility of a rebound of rates due to changes in monetary policy, although it could be affected by some of the political risks identified in the report on the macroeconomic forecasts.

Gross capital formation in 2019 will be maintained despite the fact that the **impact of the State's financial liability** for toll motorways in 2018 is not reproduced. Although this impact of almost 0.2% would lead to a decrease in the heading, public investment is driven by the Draft GSB for 2019, mainly in the chapter on investment in railway infrastructures. The rest of sub-sectors will also increase their investment, although at a lower rate than the Central Administration.

Subsidies and other current expenditures evolve in a very contained manner, maintaining their weight over GDP at 3.3%. On the one hand, this section includes a decrease in non-recurring items such as the monetisation of deferred tax assets, while others such as payments for the Asset Protection Schemes of the Deposit Guarantee Fund are maintained at similar levels. On the other hand, some measures such as the increase in scholarships have an impact on this item. Finally, the volume stands of the contributions to the EU stand out, which in 2019 will maintain a slightly higher level than the previous year, growing in line with the EU budget which would register a much lower growth than in 2018.

The analysis by sub-sectors is again affected by the lack of realism in the setting of the targets, which makes the implementation of the existing fiscal framework difficult. To the uncertainty about the deficit target of the GG, we must add that stemming from a distribution by sub-sectors that does not recognise the real situation of each sub-sector. On the one hand, the LGs will continue to show a surplus result, while the Social Security Funds register a **structural deficit as stated in AIR^eF's Opinion published on January 9**. This situation hinders coherence between the different fiscal rules and the

monitoring of compliance. The following sections detail the analysis of each sub-sector.

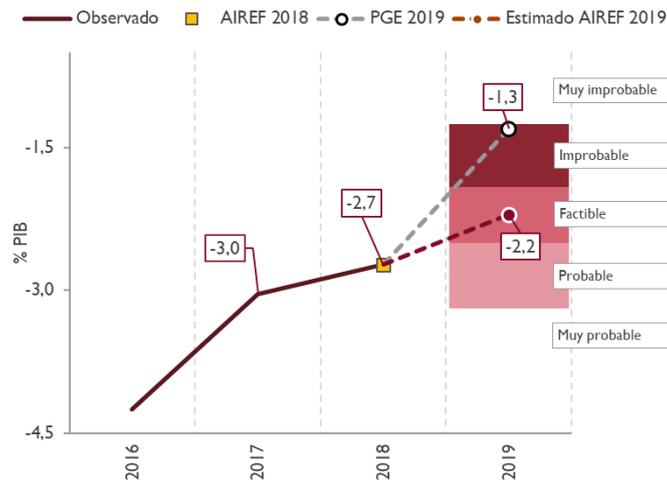
TABLE I. RATING OF THE PROBABILITY OF COMPLIANCE 2019

	Budgetary Stability Target
Central Administration	Unlikely
Social Security	Very unlikely
Autonomous Regions	Feasible
Local Corporations	Feasible*

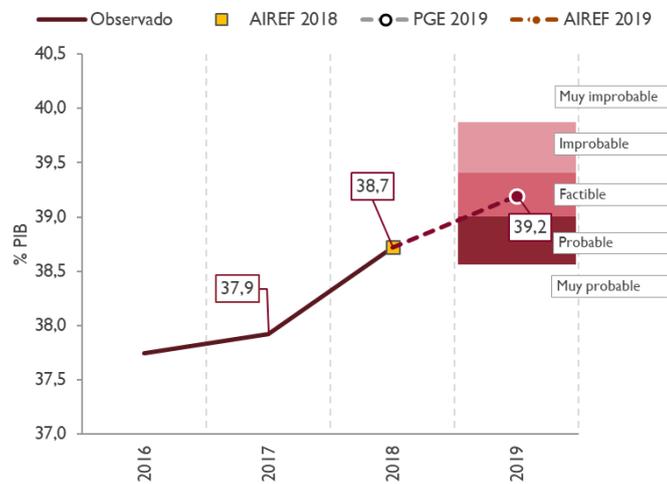
(*) Probability of surplus greater than or equal to 2018.

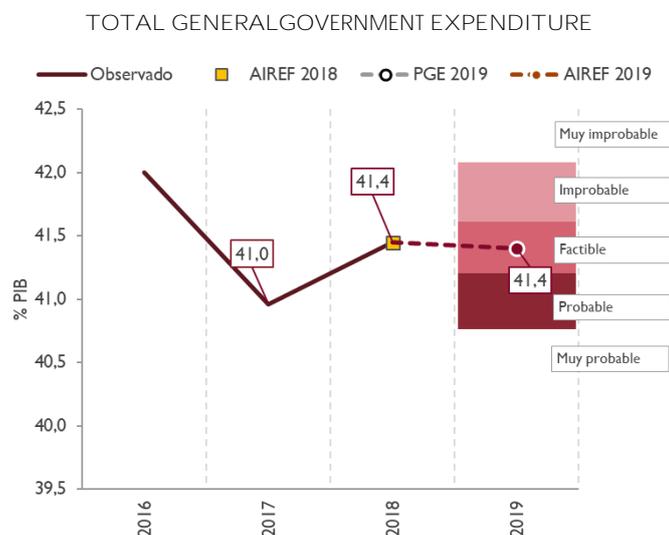
GENERAL GOVERNMENT

NET LENDING/BORROWING



TOTAL GENERAL GOVERNMENT REVENUE





3.3. Central Administration

AIRcF considers it unlikely to achieve the budgetary stability target of 0.3% GDP for 2019. To achieve this deficit, the CA would have to reduce the deficit by 1.1% GDP by the end of 2018. This adjustment is considered unlikely to be achieved given the forecasts made by AIRcF based on the revenue and expenditure included in the Draft GSB. The CA is the sub-sector that most reduced its deficit in 2017 and 2018; however, it is also the one that showed the greatest deviation from the approved target for both years.

The revenue and expenditure forecasts in the Draft GSB for 2019 are considered realistic overall. However, some differences are identified in the case of revenue that essentially stem from the different estimated impact of the measures, mainly in the new tax figures. In line with what happened in 2018, the revenue forecasts included in the Draft GSB are considered realistic, as analysed in the following section, and the expenditure forecasts estimated by AIRcF based on the budgetary data are prudent.

As in previous years, the absence of national accounting adjustments prevents the reconciliation of the national accounting balance and the budgetary balance. 0 shows the reconciliation of the State budgetary balance with the national accounting balance included in the Draft GSB for 2013-2016, and the exercise of estimating the national accounting adjustments necessary to meet the 2017, 2018 and 2019 deficit targets is carried out, years for which these adjustments are not available. As noted in the aforementioned table, these adjustments, in the absence of incorporating the possible surplus/deficit of the Organisations, would be much higher than those foreseen in the Draft GSB of previous years, even taking into account

that the adjustment stemming from deferrals of the settlements of the Regions and LGs (0.4% GDP) is exhausted in 2017.

EQUIVALENCE BETWEEN THE STATE BUDGETAET BALANCE AND THE NATIONAL ACCOUNTING BALANCE OF THE CA AS %GDP 2013/201 9

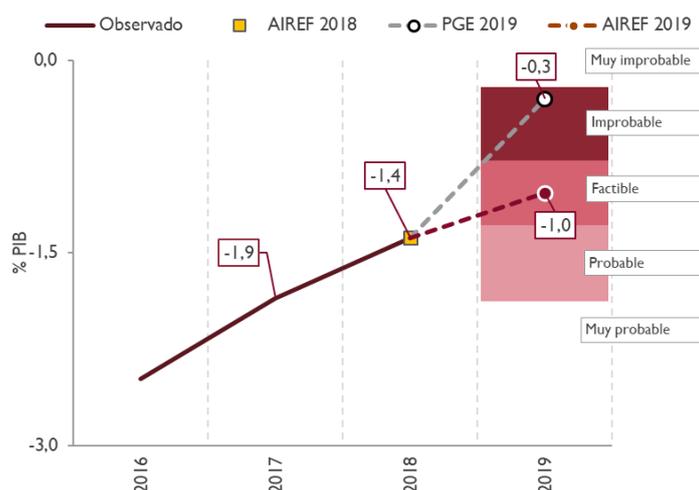
Initial budgets	2013	2014	2015	2016	2017	2018	2019
Non-financial revenue	11.7	12.2	12.2	11.8	11.5	11.6	12.3
Non-financial expenditure	15.3	15.7	14.8	13.8	13.3	12.9	13.1
Non-financial surplus (+)/deficit (-) of the Budget	-3.6	-3.5	-2.6	-2.0	-1.8	-1.3	-0.8
National Accounting Adjustments	-0.2	-0.2	-0.3	-0.2	0.7	0.6	0.5
National accounting adjustments net of settlements	0.3	0.3	0.2	0.2			
Lending (+) Borrowing (-) TARGET	-3.8	-3.7	-2.9	-2.2	-1.1	-0.7	-0.3

Source: Economic-Financial Report of the GSB

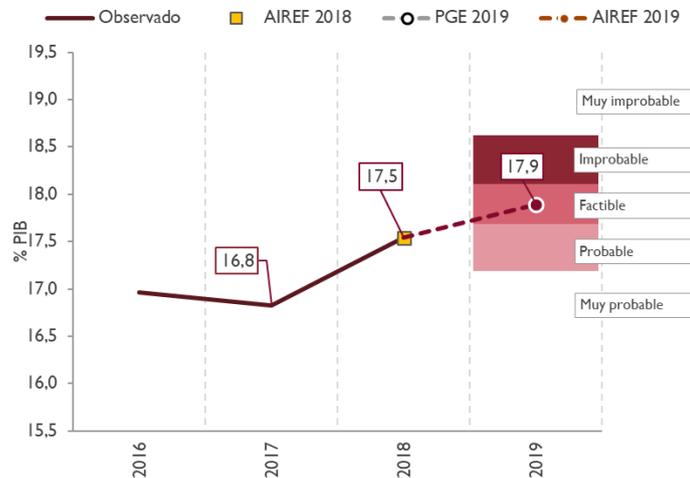
AIReF's forecasts for the CA imply national accounting adjustments equivalent to 0.3% GDP. AIReF prepares its forecasts directly in national accounting terms based on data from previous years, information provided by the Ministry of Finance and the information included in the GSB. This estimate in national accounting terms for 2019 implies adjustments in national accounting of 0.3% GDP, more in line with historical execution data.

CENTRAL ADMINISTRATION

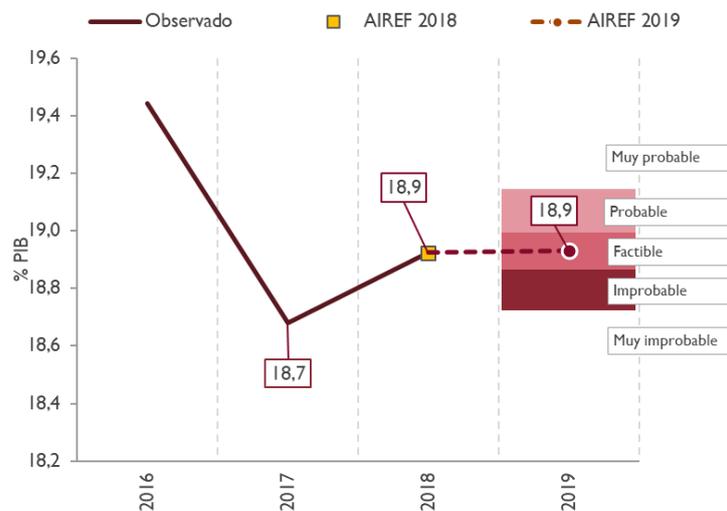
NET LENDING/BORROWING



CENTRAL ADMINISTRATION REVENUE



CENTRAL ADMINISTRATION EXPENDITURE



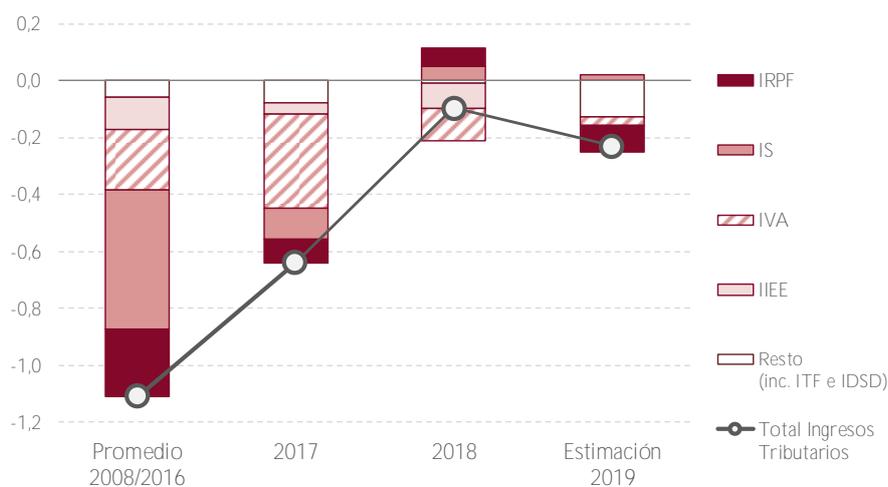
Non-financial revenue forecast

Overall, the behaviour of the tax bases in 2018 resulted in an increase in collection of 7%. The tax bases of the main taxes are expected to grow by 5.8% in 2018. This growth is mainly due to the good evolution of salaries (income base) and prices (expenditure base), which has translated into a 7% growth in tax revenue in 2018.

However, tax revenue **registered an amount of around € 2,500M below the budgeted amount**. This deviation observed in 2018 is lower than the average observed in the 2008-2017 period that stood above € 15,000M, including Social Security contributions for which there is hardly any deviation. 0 shows the

deviation or budgeting error, which is calculated by comparing the revenue forecasts included in the budgets, with the collection actually made after discounting the positive or negative impact of the regulatory measures approved on collection following the approval of the GSB for each year.

REVENUE DEVIATION WITH RESPECT TO THE APPROVED BUDGET (*)



(*) *Ingresado (sin impacto de medidas aprobadas con posterioridad a los PGE) - Presupuestado*
 Positiva: *Presupuestado < Ingresado*
 Negativa: *Presupuestado > Ingresado*

The deviation mainly occurs in VAT and Special Taxes, while the revenue from Personal Income Tax (PIT) would have grown above the budgeted amount. A lower collection is expected in VAT, of approximately 1,500 M € compared to the budgeted amount. By analysing the possible causes for this deviation, it does not seem to be justified by worse behaviour of the bases, which are expected to grow at a rate of 5.6%, but rather the effect of the collection mechanism and in particular to a higher rate of returns. With regard to special taxes, it is expected that for 2018 an amount €1 billion lower than that budgeted will be collected due to a worse than expected evolution of hydrocarbon, tobacco and electricity consumption. Finally, better PIT performance of close to € 400 M is expected, in addition to the good performance of the bases, the good results of the annual declaration and the rise in the average effective rate derived from the best salaries and pensions.

For 2019, AIRcF estimates a tax revenue growth of 7.6% compared to the 9.5% foreseen in the GSB. The tax growth has been broken down into three components when analysing the feasibility of budgetary forecasts. First, the closing figures of 2018 were reconciled, identifying the carryover effect caused by the differences between the figures included in the Draft GSB for 2019 and AIRcF's own estimates. Secondly, the "regulatory" effect was

separated, not only including those measures included in the Draft GSB but also those derived from other regulations, mainly the budgets of previous years, or the execution of judgements, which have an effect in 2019. And, finally, once the above mentioned effects had been filtered, the evolution explained by the economic cycle (macro component) was identified.

BREAKDOWN OF THE CHANGE IN TOTAL TAX REVENUE

Tax revenues	2018 year-end	AIReF estimates	2019 Draft GSB
Draft Budgets (% var.)	7.0		9.5
AIReF Estimate (% var.)	7.6	7.6	
<i>Breakdown of growth:</i>			
(1) Carryover effect 2018			0.6
(2) Regulatory effect	1.8	2.9	4.0
(3) Macro effect	5.8	4.7	4.9

Regarding the carryover effect, AIReF expects a year-end **for 2018 of some € 1 billion** higher than that presented in the Draft GSB. In overall terms, the Draft GSB for 2019 foresees an increase in total tax revenue before transfer of 9.5% compared to the end of 2018 (7.3 if the effect of the IIS is excluded), but starting from a lower revenue level. This positive carryover effect in 2019 entails a boost of approximately 0.6 p.p. to be able to reach the figures included in the Budgetary Project.

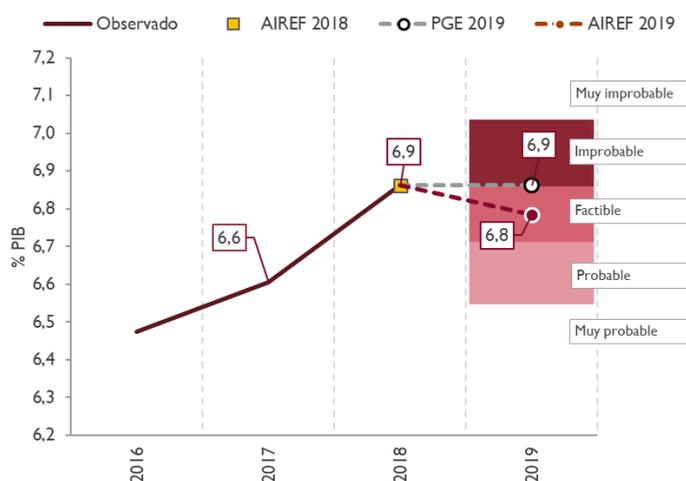
The cyclical evolution of the tax revenue included in the Draft GSB is in line with AIReF's forecasting models, with the greatest discrepancy in the valuation of the measures with impact in 2019. In global terms, these measures, either those included in the Draft GSB or others stemming from other regulations or enforcement of judgements, according to AIReF's estimates, would deduct approximately 1 p.p. of the expected 9.5%. AIReF considers that, overall, the cyclical evolution of tax revenue included in the Draft GSB is in line with its forecasting models, although growth could be more moderate.

The main tax figures and each of these effects are analysed below one by one.

AIReF considers it unlikely to achieve the collection foreseen for PIT. The Draft GSB envisages an increase in PIT before transfer of 4.9% with respect to the end of 2018.

- Carryover effect: AIReF estimates that at the end of 2018 it will be greater than that foreseen in the Draft GSB due to differences in the temporal imputation of maternity/paternity returns in cash according to the latest information provided by the Ministry of Finance. This would explain 0.5 p.p. of the total increase of 4.9%.
- Regulatory effect: With respect to the regulatory changes included in the GSB for 2018, AIReF considers a lower impact than initially expected (See detail in ANNEX 1). Likewise, the increase in collection due to the changes included in the Draft GSB for 2019 would be lower due to the transfer of part of its effects to the following year.

PERSONAL INCOME TAX



- Macro effect: AIReF considers that the growth of revenue from PIT derived from the cycle is slightly overestimated in the Draft GSB. The growth derived from this component in the Draft GSB amounts to just over 6%, one point above the evolution foreseen by AIReF's forecasting models. To assess the feasibility of the effect of the cycle, AIReF has estimated it broken down into three parts; that explained by the evolution of the bases, that justified by the increase in the average rates and that motivated by the effect of the collection mechanism. According to AIReF's forecasting models, the tax bases would explain a growth of just over 4%. This growth will be based on an improvement in both public and private salaries for which an increase is foreseen with respect to the increase already observed in 2018 of approximately 1 p.p., also supported by the revaluation of pensions. Regarding the expenditure component, although it continues to maintain positive rates, a deceleration is estimated with respect to 2018 of approximately 0.5%, which will reduce the effect of the rise in wages. Due to the fact

that the growth component of the bases is essentially wage inflation, the aforementioned effect must be added to the progressiveness inherent to the PIT that raises the average rates. There is therefore an amplifying effect on the wage increase, raising not only the base but also affecting the average rates. Regarding the effect caused by the collection mechanism of the tax itself (rate of refunds, application of deferrals, change in the amount of the instalment settled, etc ...) it has been estimated to be slightly negative in contrast to the strong impact of the previous year.

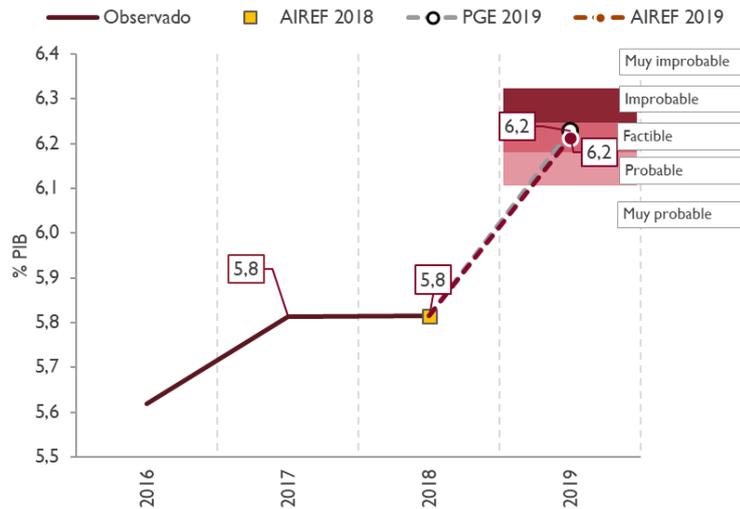
BREAKDOWN OF THE PIT CHANGE

PIT	2018 year-end	AIRcF estimates	2019 Draft GSB
Draft Budgets (% var.)	7.0		4.9
AIRcF Estimate (% var.)	7.5	3.0	
<i>Breakdown of growth:</i>			
(1) Carryover effect 2018			0.5
(2) Regulatory effect	-0.5	-2.2	-1.9
(3) Macro effect (a)+(b)+(c)	8.0	5.1	6.2
Evolution of bases (a)	4.9	4.1	
Evolution of rates (b)	1.3	1.4	
Effect of collection mechanism (c)	1.8	-0.4	

The collection of VAT foreseen in the GSB is considered to be feasible. In the budgets VAT increases by 11.7% (20.2% if exclusively the State's revenue is taken into account after discounting the financing system). These rates are reduced if the effect of the IIS on VAT is excluded (see box 1), standing at 5.1% and 6.5% respectively.

- Carryover effect: AIRcF considers that the end of 2018 is very tight, so the carryover effect is barely noticeable.

VALUE ADDED TAX



- Regulatory effect: More than half of the expected increase in VAT collection is justified by the change in the Immediate Information System (IIS). AIReF is in line with the Government's estimates regarding the regulatory component, except for the underlying doubts regarding collection foreseen by the measures to prevent tax fraud, which represent a discrepancy of 0.3% with respect to the Government's estimate. See detail in ANNEX 1.
- Macro effect: Regarding the cyclical component, which would represent a growth of 4.6% by 2019, the Draft GSB estimate is in line with AIReF's models. Although the tax bases decelerate by almost 1%, they remain robust and exceed 4%, offsetting the lower contribution of prices, the good performance of expenditure on new housing by households and the greater propensity to consume stemming from the extra disposable income of households due to salary and pension increases. According to AIReF's forecasting models, the tax bases would explain a growth between 4 and 5% of the tax, with no expected effect from a change in the average rates (caused by a possible re-composition effect of basic necessities with lower rates towards luxury goods, with a higher rate) and with a practically neutral effect of the collection mechanism.

BREAKDOWN OF THE CHANGE IN VAT

VAT	2018 year-end	AIReF estimates	2019 Draft GSB
Draft Budgets (% var.)	10.2		11.7
AIReF Estimate (% var.)	10.3	11.3	
<i>Breakdown of growth:</i>			
(1) Carryover effect 2018			0.1
(2) Regulatory effect	5.8	6.6	6.9
(3) Macro effect (a)+(b)+(c)	4.5	4.6	4.7
Evolution of bases (a)	5.6	4.5	
Evolution of rates (b)	0.0	0.0	
Effect of collection mechanism (c)	-1.1	0.1	

BOX 1. EFFECT OF THE MODIFICATION OF THE FILING DEADLINE PROVIDED FOR IN THE VAT IMMEDIATE INFORMATION SYSTEM (IIS)

Background:

Royal Decree 596/2016 was approved in December 2016, on the immediate information system (IIS) for VAT, in force from 1-7-2017. Essentially, from a financial point of view, it means that VAT taxpayers file with the AEAT (Spanish Tax Revenue Agency) 10 days later each month, which meant that the collection for December 2017 took place in January 2018.

For this reason, in 2017 the State collected 11 months of VAT (4,150 million less). However, in national accounting terms, it had no effect because a positive adjustment was made to the collection for the month that was missing. For its part, the Territorial Administrations (TAs), both the Regions and the Local Corporations (LCs) were not affected since the 2017 instalments of the Financing System (FS) were set over 12 months.

In 2019, the settlement of the FS of the TAs for 2017 must take place. This settlement, in the case of VAT, is in favour of the State for over 2,000 million, as a result of which the actual collection (11 months) was lower than that foreseen in the calculation of the instalments (12 months).

Modification of the filing deadline in the VAT-IIS in 2019:

In 2019 the State will re-establish the filing deadlines existing prior to the 2016 Royal Decree.

In financial terms, this recovery is neutral for both the GG and the CA and the sub-sectors of TAs, in relation to the situation that would have existed if the Royal Decree had not been approved in 2016:

- Thus, in the CA the cash collection for 2019 will be 13 months, but, as in 2017, it will not affect the State's revenue in national accounting terms, since an adjustment will be made, which will be negative this time due to the additional month (4,595 million).
- In the case of the TAs, the instalments of the 2019 FS are calculated with those 13 months and, therefore, will be increased by more than 2,000 million, which will offset the lower settlement that occurs in 2017.

This neutrality in financial terms, however, is not so with respect to the different headings of the State's revenue and expenditure budget that reflect the funding to the TAs by the FS, as a result of the effect that occurs in other

components of the latter other than VAT, which vary according to the evolution of tax revenue from PIT, VAT and State Special Taxes (Stamp tax):

– In the Regions:

- The Sufficiency Fund: is reflected, when positive, in the State's expenditure budget as a transfer to the Regions and, when it is negative, in the State's revenue budget as a transfer from the Regions.
- The transfer between the State and the Guarantee Fund, whose balance is reflected as transfers from the State's expenditure budget to the Regions, if it is in favour of them, and in the State's revenue budget, otherwise.
- The Convergence Funds that are reflected in the State's expenditure budget as a transfer to the Regions.

– In the case of the LGs:

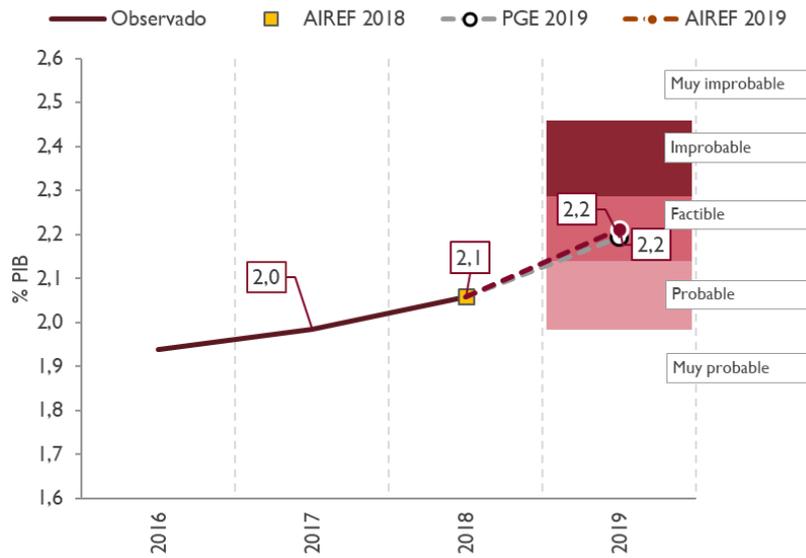
- The Supplementary Fund and the Share of National Revenue are reflected as a transfer on the State's expenditure budget.

Therefore, if we compare the State's current revenue and expenditure budget for 2019 with the one that would have been submitted if the 2016 regulation (which is intended to be amended) had not been approved, the State's revenue budget collects about 1,300 million more in transfers from the TAs, according to AIReF's estimates, than it would have if the regulation had not been approved. This amount is offset, for the most part, with an increase in transfers to the TAs that are included in the State's expenditure budget, with respect to those that would have been collected had the 2016 regulation not been approved.

The collection of Corporate Income Tax (CIT) provided for in the Draft GSB for 2019 is considered feasible. The budgets for 2019 foresee a growth of 14.1% in the CIT in line with AIReF's forecast.

- Carryover effect: In relation to the end of 2018, AIReF considers it to be above that of the Draft GSB due to an adjustment in the last month stemming from the rate of returns, which helps to explain approximately 3% of the 14% by which the tax grows according to the Draft GSB.

CORPORATE INCOME TAX



- Regulatory effect: The effect considered by the Budgets and that estimated by AIReF are practically the same. The small difference of 0.8 p.p. is due to a different valuation of the measures against tax fraud included in the Budgetary Plan. See detail in ANNEX 1
- Macro effect: The effect of the economic cycle estimated by the Government, between 3 and 4%, would be less than estimated by AIReF. AIReF's estimates stand at a rate of approximately 5%, broken down into a growth of the base of just over 6%, reduced by 1.1 p.p. due to the effect of the collection mechanism.

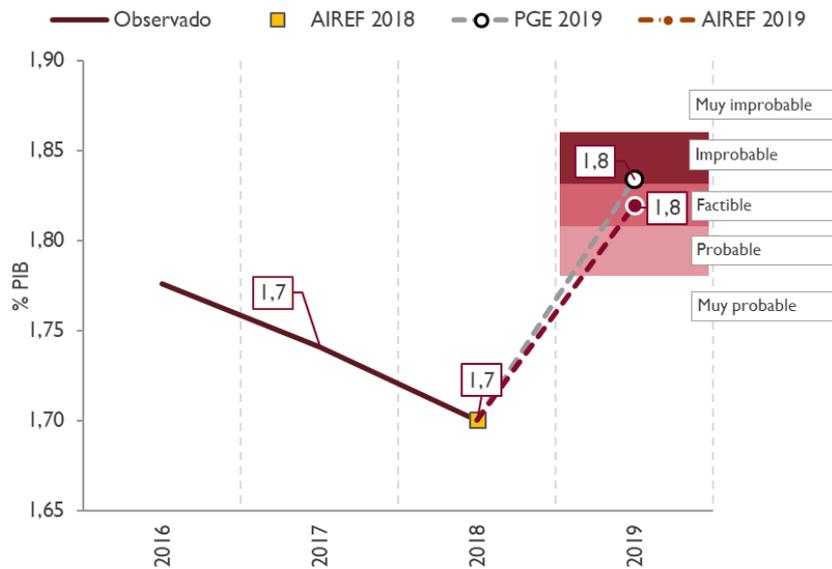
BREAKDOWN OF THE CHANGE IN CIT

Corporate Income Tax	2018 year-end	AIReF estimates	2019 Draft GSB
Draft Budgets (% var.)	4.5		14.1
AIReF Estimate (% var.)	7.3	12.0	
<i><u>Breakdown of growth:</u></i>			
(1) Carryover effect 2018			3.0
(2) Regulatory effect	0.0	6.7	7.5
(3) Macro effect (a)+(b)+(c)	7.3	5.3	3.5
Evolution of bases (a)	11.4	6.4	
Evolution of rates (b)	9.6	0.0	
Effect of collection mechanism (c)	-13.7	-1.1	

AIReF considers it unlikely to achieve the budgetary forecast for Special Taxes (ST) due to the delay in the entry into force of the increase in the Tax on Hydrocarbons. The Draft GSB for 2019 foresees a growth of 11.8% (14.7% for the State), well above the 1.5% experienced by these taxes in 2018. To analyse this strong increase, using the previous approach, the carryover, regulatory and macro effects are broken down.

- Carryover effect: AIReF's year-end estimate is lower than that included in the Draft GSB by approximately € 100M, which would imply a negative carryover effect, that is, in the case of confirming a lower year-end figure it would be more difficult to reach the figure included in the Draft GSB.

SPECIAL TAXES



- Regulatory effect: The regulatory changes explain most of the expected increase in the collection of special taxes. In particular, the increase in the tax on hydrocarbons would explain practically 10 p.p. of the increase. AIReF considers approximately 90% of the regulatory impact included in the Draft GSB to be feasible, abiding by the difference that the increase foreseen in the 2019 GSB will not be in force for the entire year. See detail in ANNEX 1.
- Macro effect: The macro component of the increase in these taxes is in line with AIReF's forecasting models. The bases of special taxes depend on the real evolution of the economy and represent a growth of 2.5%. Regarding the effect of the average rates and collection mechanism, in the absence of measures (included in the regulatory component), they have been considered practically neutral.

BREAKDOWN OF THE CHANGE IN ST

Special taxes	2018 year-end	AIReF estimates	2019 Draft GSB
Draft Budgets (% var.)	1.5		11.8
AIReF Estimate (% var.)	1.1	11.5	
<i><u>Breakdown of growth:</u></i>			
(1) Carryover effect 2018			-0.5
(2) Regulatory effect	0.0	9.1	9.9
(3) Macro effect (a)+(b)+(c)	1.1	2.5	2.4
Evolution of bases (a)	2.2	2.4	
Evolution of rates (b)	0.3	0.0	
Effect of collection mechanism (c)	-1.4	0.1	

AIReF considers it unlikely to achieve the 16.4% growth in other tax revenues due to differences in the expected impact of the new tax figures. The other tax revenues include non-resident income tax, environmental taxation, other taxes budgeted in chapters I and II, and levies and other tax revenue. In addition, this section will include two new figures that are expected to be introduced into the Spanish legal system. Therefore, it should be borne in mind that the assessment of the regulatory component of revenue of this nature is essential for compliance with fiscal targets.

- Carryover effect: With respect to the end of 2018, AIReF's estimates and the year-end in the Draft GSB are practically coincident, so it is not expected that there will be a carryover effect due to the year-end.
- Regulatory effect: AIReF considers that collection for the new tax figures will be very limited. The impact of the entry into force of the Tax on Financial Transactions and on Certain Digital Services has reduced with respect to what is included in the Budgetary Plan. The draft regulations for both taxes have just begun their processing in Parliament. In addition, both include a period of three months from their approval for the entry into force of the tax and will require further regulatory development. Consequently, it has been considered that it would only be valid for one quarter in 2019. See detail in ANNEX 1
- Macro effect: Regarding the evolution of the cycle, AIReF almost coincides with the evolution given in the Draft GSB.

BREAKDOWN OF THE CHANGE IN OTHER TAX REVENUES

Other tax revenue	2018 year-end	AIReF estimates	2019 Draft GSB
Draft Budgets (% var.)	4.6		16.4
AIReF Estimate (% var.)	4.6	0.8	
<i>Breakdown of growth:</i>			
(1) Carryover effect 2018			0.0
(2) Regulatory effect	0.0	-3.6	12.2
(3) Macro effect	4.6	4.4	4.3

This evolution in cash terms of the main figures translates, in national accounting terms, into CA tax revenues that will grow by 5.7%, increasing their weight over GDP by 0.3% to 14.6%. Regarding the adjustments to be made to transform the tax collection figures to national accounting figures, the most noteworthy are the expected effect of the change of the IIS on VAT, which will not be reflected in national accounting terms, the adjustment for the returns requested related to maternity/paternity, which will not affect the revenue from PIT since they are accounted as a higher expenditure, and the effect caused by the lag between the accrual and the cash in the suspension of the tax on the production value electricity. On the other hand, it is also necessary to take into account that in national accounts the part of PIT assigned to the Regions is accounted for directly in said sub-sector. All these adjustments will lead to an increase in tax revenues in national accounting terms in the CA, according to AIReF's estimates, of 5.7% over the previous year.

Regarding the other non-tax revenues of the CA, without including the effect of transfers between PAs, AIReF expects an increase of 3.5%. For this type of revenue a growth of approximately 4% is expected in Sales in national accounting terms, which account for 20% of this type of revenue, almost 5% for property income that includes both income received from interest (with a growth above 6%) and dividends (close to 3%) and represent almost 30% of this revenue. This section also contains the revenue from social contributions, which represent 30%, with an expected growth of 0.5% and both current and capital transfers, which grow at a rate of almost 7%, driven by the increase in transfers expected to be received from the EU.

Non-financial expenditure forecast

The non-financial expenditure foreseen in the Draft GSB for 2019 includes an increase of 7.5% with respect to the advance settlement of 2018 published in the Draft GSB. The State's non-financial expenditure foreseen in the Draft GSB for 2019 increases by 4% with respect to the GSB for 2018, but by 7.5% with respect to the provisional end of 2018, with a non-execution percentage close to 3%. In budgetary terms, this growth represents €11,477M more non-financial expenditure by the State than in 2018. The increases include staff costs with a growth of 4.3%, representing €718M more expenditure, an increase in interest in cash terms of €1,376M and an increase in current transfers of €5,994M mainly to finance civil servants' pensions, dependency, family protection, scholarships and transport subsidies for non-peninsular residents. The State's non-financial expenditure, discounting the expenditure of the Financing System of the Territorial Administrations, exceeds the non-financial expenditure limit approved in July 2018 at €2,164M. This is the amount of the budgetary appropriations to meet payment commitments corresponding to special modernisation programmes that have no impact on national accounts.

AIR^{CF} estimates that non-financial expenditure in national accounting terms will remain stable as a percentage of GDP throughout 2019 and will grow by around 4.1%. After years of negative variation rates, in 2018 the advance settlement published in the Draft GSB reflects a 5% growth in non-financial expenditure compared to 2017. However, it must be borne in mind that this year there are specific operations that will not be repeated or will not be repeated in the same magnitude, such as the imputation of the expenditure for the State's financial liability (SFL) for the reversal of the concessions of toll motorways, the impact of the conversion of DTAs or the materialisation of asset protection schemes. In homogeneous terms, without considering the effect of these one-off measures, the growth of 2018 would be close to 5.3%.

BREAKDOWN OF THE VARIATION OF NON-FINANCIAL EXPENDITURE

AIRcF forecasts (CA Expenditure)	% Var
Compensation of employees	4.5%
Increase of 2.4% with the agreement with Trade Unions	
Wage equalisation of the State Law Enforcement Agencies with independent police forces	
Progressive increase of payroll to 2021	
Interest	-2.3%
Reduction of 0.1% GDP	
Conservative estimate of the GSB	
Social benefits other than transfers in kind	5.1%
Civil servants' benefits increased to 5.8% in line with the GSB	
Increase of 2.4% in the negative taxes	
Rest of current expenditure	4.4%
Increases in Current International Cooperation, Transport subsidies and scholarships in line with the GSB	
Transfers between PAs	5.9%
Particular increase in transfers to the TAs	
Increase in transfers to the SSF	
Gross Fixed Capital Formation (without SFL in 2018)	23.3%
Moderate growth of investments of the Ministries	
Strong increase of conventional ADIF investments (€1,400M)	
Containment in the delivery of Defence Modernisation Programmes	

According to AIRcF's estimates, compensation of employees will grow by 4.5%. This increase includes the agreement between the Government and the trade unions on public employment with a salary increase of 2.4%, wage equalisation with the regional police forces and a payroll that increases moderately. The increase in the number of staff is estimated at 0.8%, in line with the provisions of the GSB. With regard to a situation in which salaries will be updated in accordance with the CPI used for the revaluation of pensions (1.7%), this agreement represents an increase in expenditure of €166M. The increase in the contribution bases will also have an effect, albeit moderate, in the expenditure on remuneration insofar as the group of officials included in the Social Security System is still limited.

The reduction in the financial burden of the debt for 2019 continues, which, according to AIRcF's estimates, could result in a 2.3% reduction in interest expenditure. The Draft GSB for 2019 does not include the estimate of interest

in national accounting terms that was traditionally included in the budgetary documentation. The forecast in budgetary or cash terms is considered conservative, since it supposes an increase in the State's financial expenditure on interest of €1,376M with respect to the end of 2018 published in the Draft GSB.

AIR^eF estimates that the benefits of civil servants will experience a growth of 5.8% in line with the budgetary forecasts. The strong increase in expenditure on civil servants responds both to the measures adopted to improve pensions with an increase of 1.6%, and to the expected increase in the number of pensioners. In addition to civil servants, the heading "Social benefits other than transfers in kind" incorporates the negative taxes from deductions for maternity and paternity, large family and dependent family member with a disability that are expected to increase by 2.4% as a result of the measures adopted on PIT in 2018.

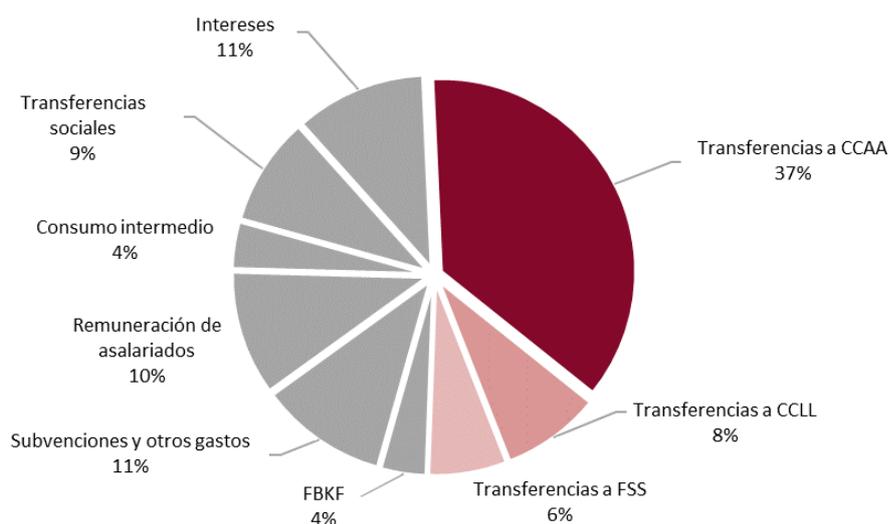
Intermediary consumption, social transfers in kind and subsidies maintain their weight over GDP while the rest of current expenditure increases. Intermediary consumption and social transfers in kind increased above the reference rate as a result of the incorporation of €177M for electoral costs and a €234M increase in transport subsidies in the Draft GSB for 2019. These growths, however, maintain the level of expenditure on these items in terms of GDP. On the other hand, the subsidies in which the settlement of the tariff deficit is incorporated maintain a growth in line with the reference rate. The remaining current expenditure includes part of the measures adopted in the Draft GSB, such as the increase in expenditure for Current International Cooperation and the increase in scholarships.

The contributions to the EU present some margin in the Draft GSB. According to the information from the EU draft budget, Spain's allocation would be € 500M lower. AIR^eF estimates a growth in national accounting terms of 2.2% with respect to the advance settlement published for 2018. In national accounting terms it is necessary to take into account the adjustments of each year, information that is not available, so it is not possible to determine the growth of the contribution to the EU budget in homogeneous terms. However, according to the EU budget, the Spanish contribution will maintain its weight over GDP with respect to 2018.

Transfers between Public Administrations, in national accounting terms, increase 0.2% GDP. The heading of transfers between the PAs includes the transfers made by the CA to other PAs and represents more than 51% of its non-financial expenditure. The GSB for 2019 allow an estimate to be made of

an increase stemming from the greater transfer that the CA makes to the Regions and LGs, of 6.4%, while the transfers to the Social Security System increase by 4% to finance the increase of the guaranteed minimum wage and agreed level of dependency, and the increase in the expenditure on non-contributory benefits. The Draft GSB include a transfer in support of the sustainability of the Social Security System for € 850M. This transfer began in 2018 with an allocation of €1,334M and does not meet the State's financing obligations for the System's non-contributory benefits; rather its purpose is to contribute to the sustainability of the System. In addition to the transfer, in 2019 the State granted a loan to Social Security amounting to €15,164M, which in 2018 was €13,830M.

DISTRIBUTION OF CA NON-FINANCIAL EXPENDITURE



The Gross Formation of Fixed Capital, without taking into account the impact of the SFL in 2018, grows 23.3% with a strong increase in conventional ADIF investments. The growth of real investments foreseen in Chapter 6 of the Draft GSB is 4.6% with respect to the settlement forecast of 2018. In national accounting terms, in addition to the budgeted investments, military deliveries must be considered, as well as the investments of the public business sector that are consolidated with the State, such as ADIF conventional investments and the effect that the SFL is expected to have in 2018 due to the reversal of the concession of the toll motorways. As a percentage of GDP, expenditure on investments (GFCF) in national accounting is slightly reduced, since the non-repetition of the SFL in 2019 is offset by higher investments in Conventional ADIF. On the other hand, military investments impact on national accounting at the time of delivery of the asset, regardless of the payments made during the year. In this sense, the anticipated deliveries reported by MINHAC (Ministry

of Finance) are lower than budgeted expenditure, and show moderate growth.

BREAKDOWN OF AC INVESTMENTS IN NATIONAL ACCOUNTING

Investment	AIReF forecast 2018	AIReF forecast 2019	%Variation
Ministry of Development	1,902	1,968	3.5
Conventional ADIF	848	2,244	164.5
Military deliveries	1,000	1,147	14.7
Rest of investments	3,528	3,613	2.4
Total without SFL	7,279	8,972	23.3
SFL	1,800	0	
TOTAL	9,079	8,972	-1.2

Investment aid and other transfers maintain their weight over GDP with a lesser effect of the one-off measures foreseen in 2019 that offset increases in other items. These headings include contributions to certain public companies, the conversion of deferred tax assets (DTAs) into tax credits, the materialisation of asset protection schemes (APS) and financial aid. It also includes the return of PIT from previous years corresponding to maternity and paternity benefits, which is double compared to the estimate made by AIReF for 2018. In these items the increases foreseen in the contributions to the public companies and the return of the PIT are offset with the smaller effect of the DTAs and the anticipated APS.

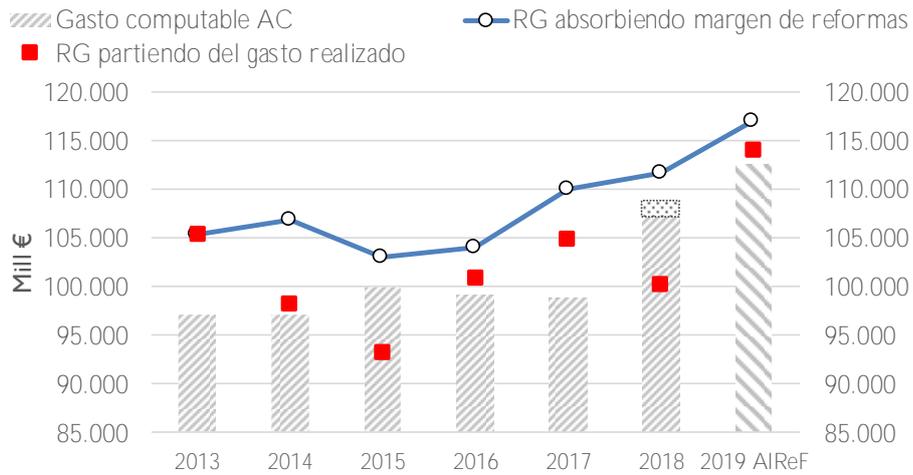
Central Administration expenditure rule

The Draft GSB for 2019 does not include any information related to compliance with the expenditure rule. AIReF has indicated in its reports that the draft budgets need to be adapted to the reference rate approved for that year, which makes it necessary for the Draft GSB to include all the necessary information.

Despite the growth in computable expenditure above the reference rate established at 2.7% for 2019, the regulatory changes to increase revenue will allow the CA to comply with the expenditure rule. With the information available and the estimates made by AIReF, it is observed that the computable expenditure for 2019 will grow above the approved reference rate. This growth is mainly focused on the compensation of employees derived from the agreement between the Government and the trade unions included in the Draft GSB, the increase in expenditure on civil servants' benefits, and to a lesser extent, the increase in transport subsidies, scholarships and current

international cooperation. On the other hand, the permanent regulatory measures included in the Draft GSB and considered permanent, are valued at € 2,260M higher collection⁵ which allows for compliance with the expenditure rule this year.

CA COMPUTABLE EXPENDITURE AND COMPLIANCE WITH EXPENDITURE RULE

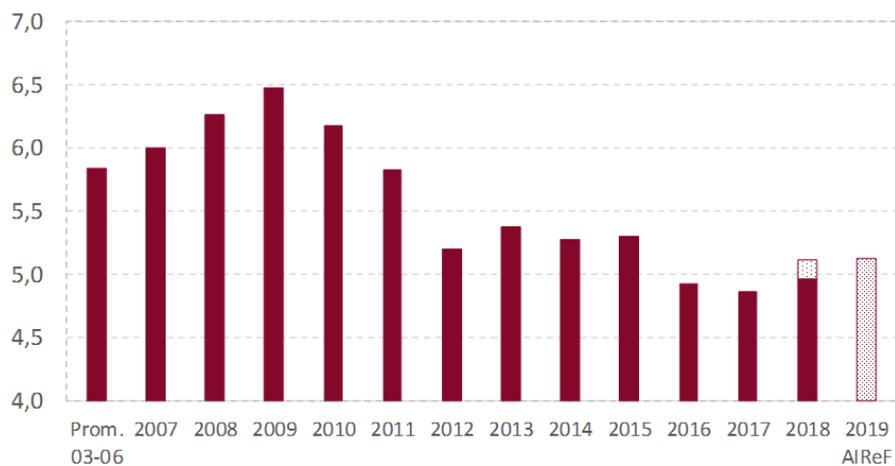


Source: 2013-2017 Report on compliance with IGAE targets For 2018 and 2019 AIReF's estimate

Given that more than 51% of CA expenditure is destined to making transfers to other PAs, the discretionary expenditure margin is reduced. This discretionary expenditure has recorded significant reductions throughout the years of fiscal consolidation. In 2018, the available expenditure increases mainly as a result of the improvement of salaries and the increase in investments, even without taking into account the SFL for toll motorways, this level is maintained in 2019 with an additional growth of public consumption and investments and other capital transfers.

⁵ Without including measures to combat fraud in the category of regulatory change with permanent effect on collection.

EVOLUTION OF CA EXPENDITURE WITHOUT PA TRANSFERS, INTERESTS, CIVIL SERVANTS AND EU CONTRIBUTION (% GDP)



3.4. Social Security Funds

AIReF considers compliance with the target of 0.9% GDP to be unlikely, with the most probable scenario being a deficit similar to that reached in 2018. Compliance with the legally approved target would require the SSF to make an adjustment of 0.6 % GDP over the -1.5% GDP that it reached in 2018, an adjustment that is considered very unlikely to be reached given the forecasts made by AIReF based on the revenue and expenditure included in the Draft GSB.

The revenue and expenditure laid down in the Draft Social Security Budget are considered realistic overall and present a budgetary deficit of 1.5%. 0 shows the conciliation of the budgetary balance of the SSF with the national accounting reached in the years 2014 to 2018, considering AIReF's forecasts for the latter year and estimating the national accounting adjustments necessary to achieve the target of 0.9% GDP. If we consider the smallest adjustment of the last 5 years, it would result in a deficit similar to that of 2018 as in AIReF's most probable scenario.

EQUIVALENCE BETWEEN THE BUDGETARY BALANCE AND THE NATIONAL ACCOUNTING BALANCE OF THE SSF AS %GDP 2014/2019

	(% GDP)					
Budgetary execution*	2014	2015	2016	2017	2018	2019
Non-financial revenue (RR)	14.9	14.4	13.4	13.2	13.0	13.5
Non-financial expenditure (OR)	15.9	15.4	14.9	14.6	14.4	15.0
Non-financial surplus (+)/deficit (-)	-1.0	-1.1	-1.5	-1.4	-1.5	-1.5
National Accounting Adjustments	0.0	-0.1	-0.1	-0.1	0.0	0.6
Lending (+) Borrowing (-)**	-1.0	-1.2	-1.6	-1.5	-1.5	-0.9

* For 2018 and 2019 initial budget

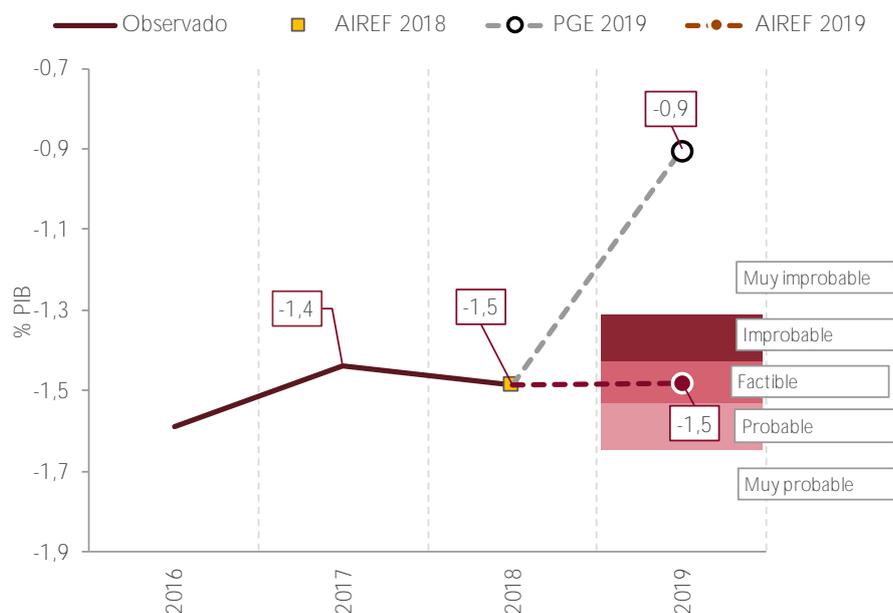
** Deficit reached in NA of 2014 to 2017, for 2018 AIReF expected deficit and for 2019 deficit target.

The Social Security revenue entered in the Draft GSB is in line with AIReF's forecast. Revenue from transfers from the CA to the SSF grew by 3%, with an increase of €446M. This increase focuses on the increase in expenditure on dependency and family benefits. It should be noted that SEPE and FOGASA now do not receive a transfer from the State and that, with their own resources, the GSB foresees a balanced budgetary situation.

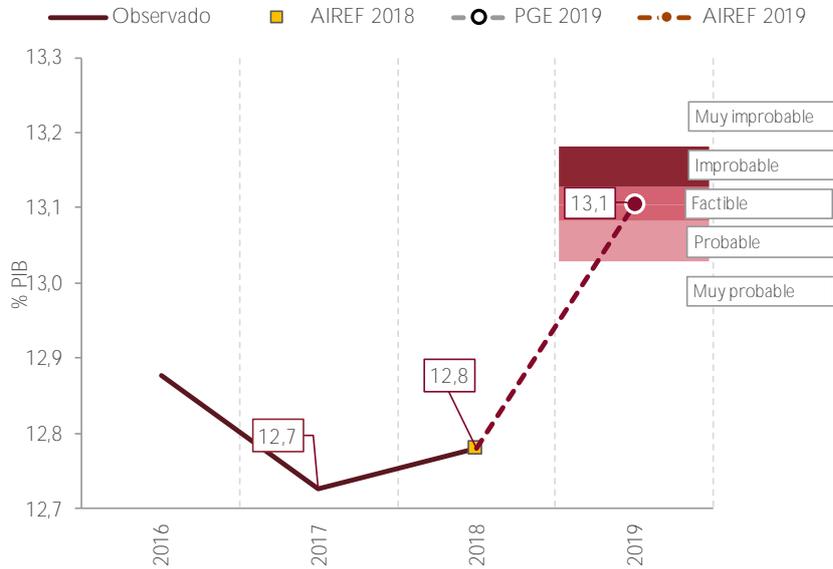
The forecast of SSF expenditure in the Draft GSB is in line with AIReF's estimates. In AIReF's most probable scenario, social benefits other than transfers in kind increase more than in 2018 and above nominal GDP. Thus, both expenditure on pensions and expenditure on unemployment benefits increase their weight over GDP.

SOCIAL SECURITY FUNDS

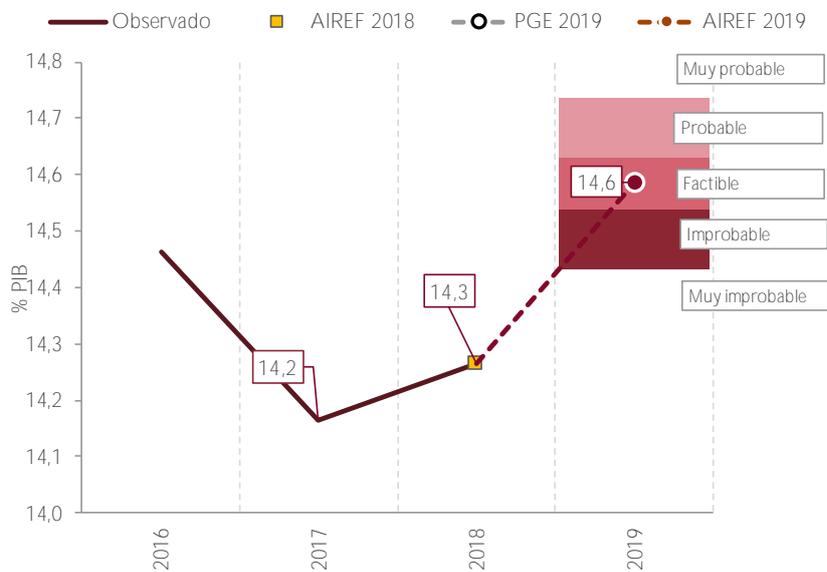
LENDING/BORROWING



SSF REVENUE



SSF EXPENDITURE



3.4.1. Analysis by agents

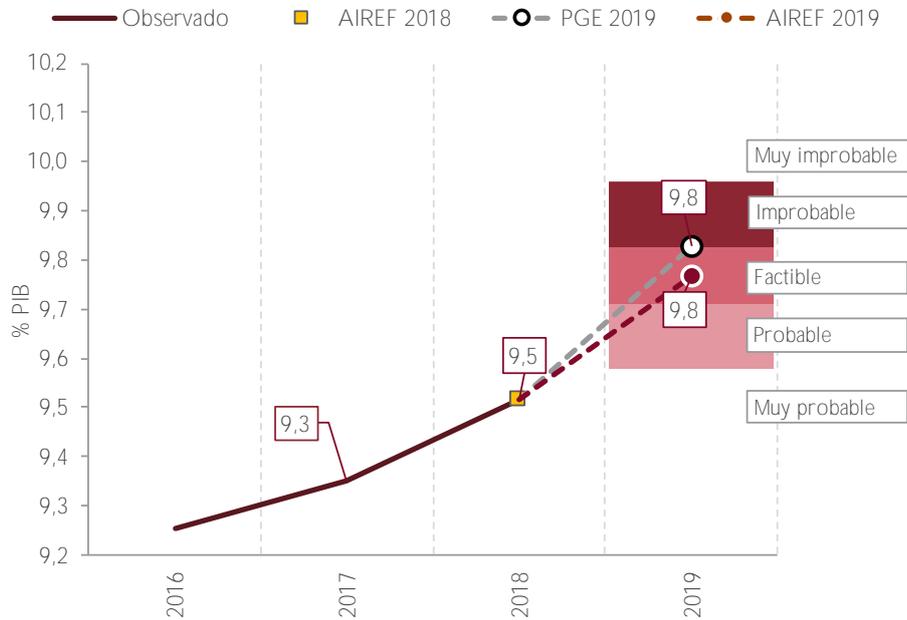
Social Security System

The deficit of the Social Security System will be at a level similar to that of 2018. The Draft GSB foresees revenue from contributions that grow at a rate close to 7.5%, well above the growth forecast for nominal GDP due to the expected impact of the measures adopted. According to AIREF's estimates, which incorporate the latest published data, it is considered unlikely to reach the

level of contributions foreseen in the GSB, although the difference is much lower than in previous years, standing at €500M, as seen in 0.

AIRcF's estimates envisage a growth of social contributions slightly lower than that included in the Draft GSB, mainly due to the impact of the measures. The growth pattern observed in 2018 continues, with a higher contribution attributable to the contribution bases rather than to employment. The estimate of the contribution growth explained by the economic cycle, 5.2%, is similar to that included in the Draft GSB. However, the impact of discretionary measures with effect on contributions, valued at 3,000 million euros by the Government, is 700 million higher than that foreseen by AIRcF. The discrepancy is concentrated in the higher collection from the minimum base of those employed under the general regime, estimated at 1,300 million by the Government, due to the higher contributions of the employed, workers subject to agreement and training contracts below the new minimum base, of 1,050 euros per month, as well as the carryover effect on employees with higher bases but closer to the minimum. On the other hand, the Royal Decree-Law 28/2018 on the revaluation of pensions could increase collection by 1,500 million. This regulation includes a growth of the maximum contribution base of 7%, well above the 1.4% of last year. Despite affecting a limited percentage of contributors, the evolution of this figure has a significant effect on the total amount collected. Royal Decree-Law 28/2018 also includes an increase in collection of 450 million for the increase of the minimum rate for professional contingencies and a neutral impact of the modifications of the base and the tariff of the special regime for self-employed workers (RETA). See [Error! No se encuentra el origen de la referencia.](#) with the detail of measures.

SOCIAL SECURITY CONTRIBUTIONS

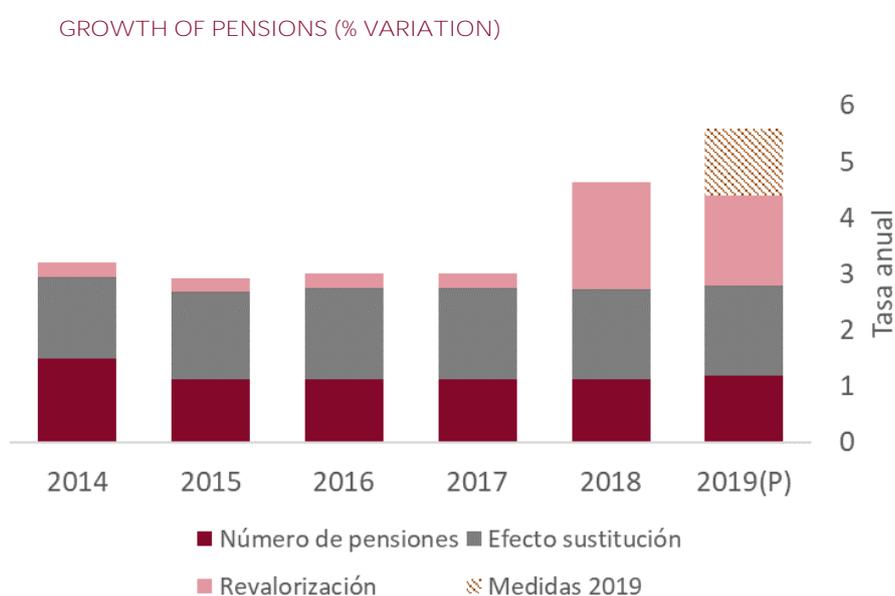


DEVIATION OF SOCIAL CONTRIBUTIONS WITH RESPECT TO THE BUDGET. AS %GDP



The pension expenditure of the Draft GSB grows in line with AIREF's estimate, including the effect of the measures. Expected pension expenditure increases in an inertial manner to 4.4%, with a 1.2% growth in the number of pensions, a replacement effect of new pensions over cancellations of 1.6% and an

expected revaluation of 1.6%. To this growth we must add the impact of measures such as the increase in the percentage to be applied to the widowhood pension from 56% to 60% in January 2019, with an estimated impact for 2019 of about 1,000 million⁶. On the other hand, the compensation for the deviation between 1.6% and the average of the last twelve year-on-year rates of the CPI until November 2018 (1.7%) which is estimated at 260 million euros. Finally, the revaluation of minimum and non-contributory pensions to 3%, with an estimated impact of 325 million euros.



For the other benefits, an evolution similar to that of the Draft GSB is estimated, except for Temporary Disability. The recovery of employment and affiliation has led to growth rates of this benefit of over 10% between 2015 and 2018. The Draft GSB foresees a slowdown, with growth below 2% for 2019, much lower than the 5% forecasted by AIRcF, which represents a difference of almost 300 million. The measures taken to enable INSS (National Social Security Institute) medical inspectors to review temporary disability will have a limited impact estimated at 33 million. On the other hand, the rest of the measures, such as the three-week extension of paternity leave, valued at 300 million euros, and the increase in child allowance for vulnerable families, with an estimated impact of 180 million euros, will begin to be applied once the GSB have been

⁶ It is estimated that approximately two thirds of this increase is recovered through greater transfers from the State as it affects non-contributory pensions or those that incorporate minimum income supplements, so the effect on the System's deficit is less than the increase in total expenditure

approved, so the final expenditure is prorated in the proportion of the year in which they will be in force.

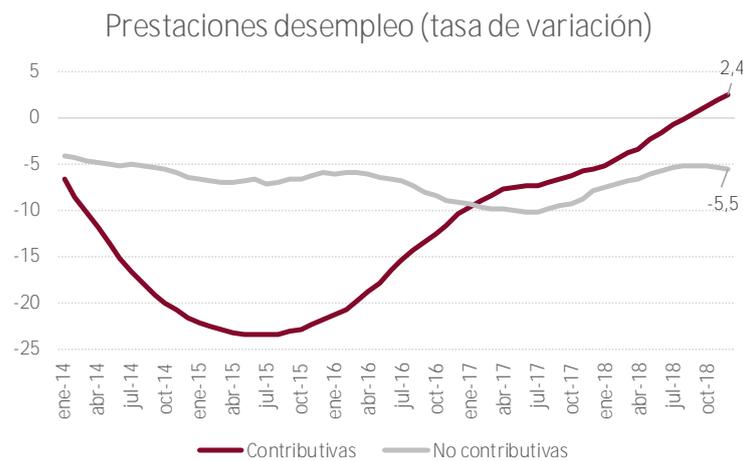
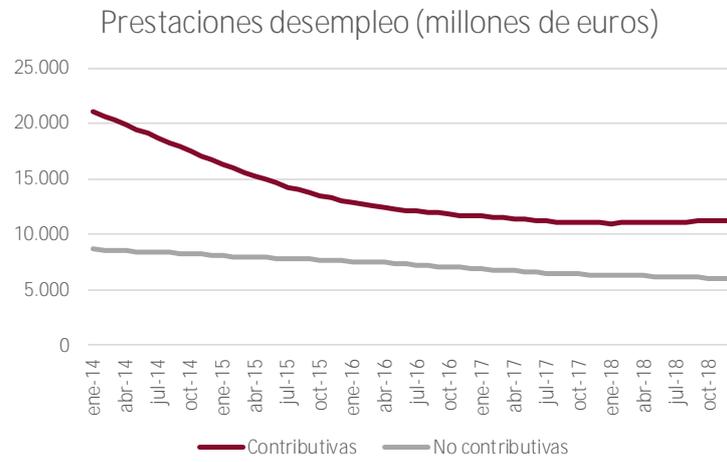
The Draft GSB for 2019 foresees a provision from the Reserve Fund of €3,693 million and the granting of a loan by the Central Administration of €15,164 million. The loan amount is higher than the one finally granted in 2018 at €1,334M. As of December 2018, the Reserve Fund accumulated approximately €5,000M compared to the more than €8,000M of a year ago. Once the €3,693M expected for 2019 had been settled, the Fund's balance was €1,300M.

State Public Employment Service (SEPE) and Wage Guarantee Fund (FOGASA)

The Draft GSB foresees a budgetary balance situation of the SEPE, in contrast to the surplus of 0.1% GDP estimated by AIReF. The difference is mainly due to a more pessimistic forecast of revenue from contributions by the Draft GSB. The projected growth in the Draft GSB of 2.8% would also be inconsistent with the Social Security System contributions forecast and with the discretionary measures adopted. In any case, the Public State Employment Service and the Wage Guarantee Fund may be financed with their own resources and will not receive transfers from the State.

Expenditure on unemployment benefits contained in the Draft GSB is very close to that considered most likely by AIReF. An increase is expected in expenditure on contributory benefits and the progressive stabilisation of expenditure on non-contributory benefits, which is at levels not seen since 2009. The main measure in this area is the reinstatement of the subsidy for people over 52 years of age, with an estimated impact of 323 million euros. As in the benefits of the Social Security system dependent on the approval of the Budget, AIReF takes into account only three quarters of the estimated impact as it understands that the measures will take effect in April.

EVOLUTION OF EXPENDITURE ON UNEMPLOYMENT BENEFITS. (MOVING AVERAGE 12 MONTHS)



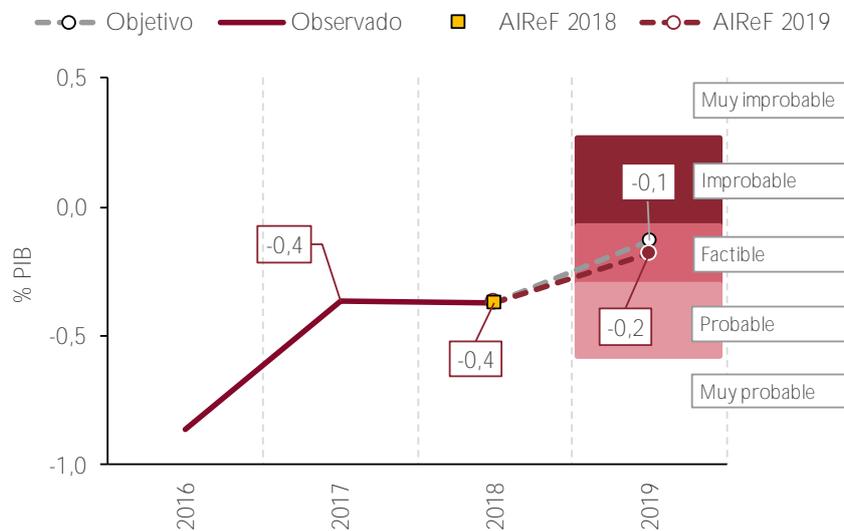
3.5. Autonomous Regions

In general, the assumptions and, therefore, the valuation shown for the sub-sector in the report of October 26, are maintained. With the presentation of the Draft GSB for 2019 and the available information, the main assumptions considered in the previous assessment are confirmed⁷ and a revenue and expenditure situation for the Regions is envisaged, similar to the baseline scenario considered by AIReF to date.

⁷The assumptions regarding the target of - 0.1% GDP and the obtaining of some additional financing system resources are confirmed by the neutralisation of the effect of the VAT-IIS, but not that of the imputation of Aguas Ter-Llobregat (ATL) to 2018

AIReF considers it *feasible* for the Regional sub-sector to reach the target set of -0.1% GDP in 2019. The deficit expected by AIReF at the end of 2018 for all Regions, slightly lower than 0.4% GDP, means that compliance with the target of -0.1% GDP in 2019 requires an approximate adjustment of just above 0.2%. With the current information, AIReF forecasts that in 2019 revenue will increase its weight over GDP by more than 0.1% and that expenditure will experience a certain reduction in its weight, allowing a balance close to the stability target to be reached.

LENDING/BORROWING REGIONS (% GDP)



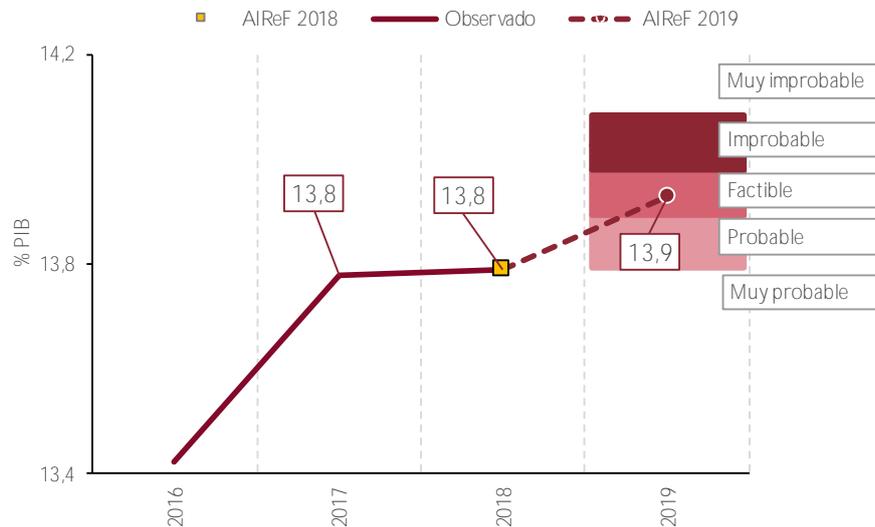
The evolution of revenue, mainly conditioned by the resources of the regional financing system, is estimated to allow an increase in its weight over GDP of a little over 0.1% for the sub-sector as a whole. This forecast is somewhat lower than that of the Regions, mainly due to discrepancies in the resources coming from the State⁸ and in the funds to be received from the EU. On the other hand, the financing system's resources, which represent more than 60% of total revenue, grow 6% over the 2018 figure. These resources will be affected by the reversal in 2019 of the amendment of the standard on the Immediate Information System (IIS) of VAT with effect from 2017.

⁸ Especially in Valencia, which as usual, registers 1,325 million current revenue from the State not reported or recognised in the draft resources from the State

VARIATION OF FINANCING SYSTEM RESOURCES UNDER GENERAL TAX REGIME 2019/2018. IMPACT OF THE VAT-IIS.

Variación recursos SFA 2019/2018 (tasa variación)			Variación de los recursos SFA 2019/2018 sin la norma del SII del IVA de 2016 (tasa variación)		
Entregas a cuenta	Liquidación 2017	Recursos totales	Entregas a cuenta	Liquidación 2017	Recursos totales
10%	-31%	6%	7%	3%	6%

REGIONAL REVENUE (% GDP)

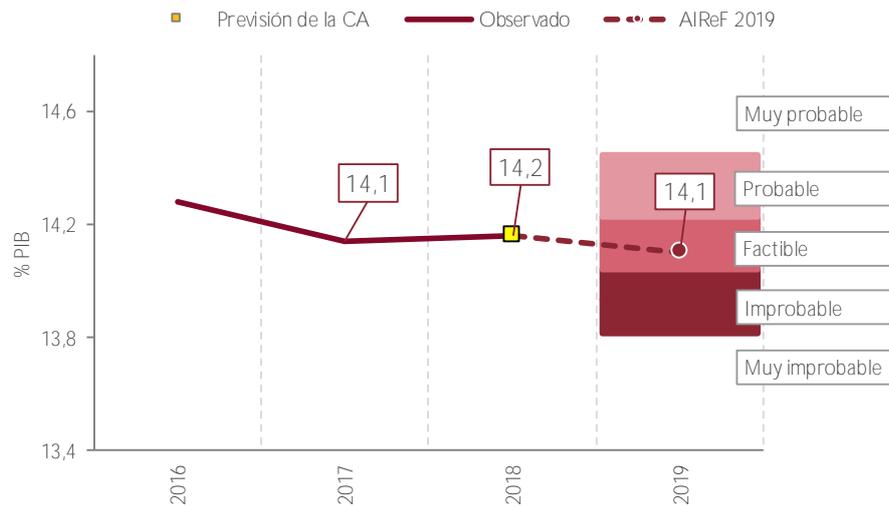


AIReF estimates an evolution of current expenditure close to 4%, similar for capital expenditure, with a slight decrease, overall, in its weight over GDP. The current expenditure forecasts are slightly higher than the regional estimates that generally consider a more moderate impact of the personnel measures agreed at the national level⁹. These measures mean that, even without specific measures to increase expenditure by the regions, current expenditure growth is expected to be higher than in previous years. On the contrary, as usual, AIReF estimates lower growth of capital expenditure, more adjusted to

⁹The approval of the Royal Decree-Law 24/2018 on the Public Sector pay rise, the elimination in the educational context of some of the measures of Royal Decree-Law 14/2012 or the greater expenditure in the educational context stemming from the renewal of retired personnel subject to MUFACE (General Spanish Civil Service Mutual Insurance Company) with new staff subject to the general Social Security regime

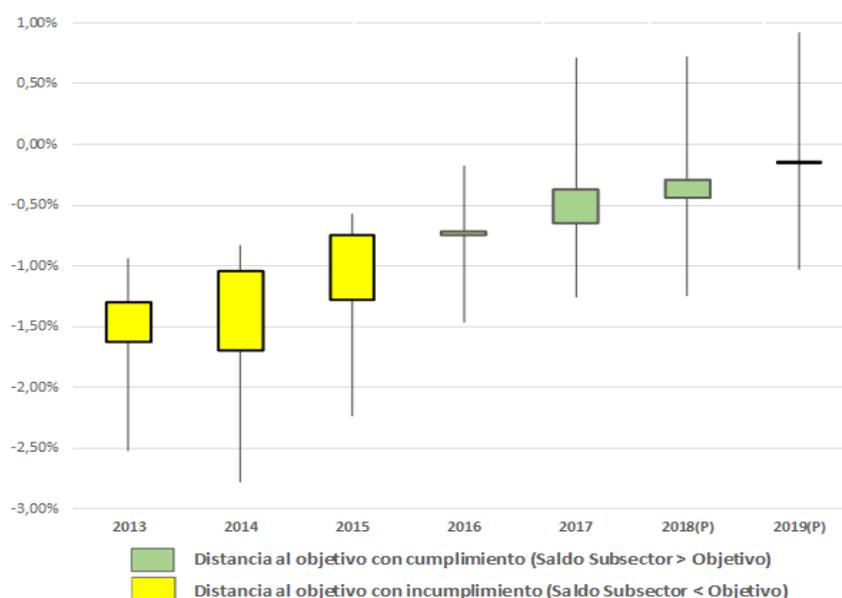
the execution of investment, which is usually recorded at the end of each year.

REGIONAL EXPENDITURE (% GDP)



The Regional sub-sector is on a path of compliance with the stability target and of convergence to balance with a consolidated gap between the Regions with the best and worst balance. In recent years, there has been a distance of almost 2% GDP between the Regions with the best and worst balance, and this gap is not expected to reduce in 2018 and 2019. Thus, although most of the Regions, like the sub-sector, are already in a situation close to the target, it is observed that the positions of several Regions are very far apart: some, with a much more favourable position and, others, with clear difficulties for convergence. At the same time, since 2017 there has been an increasing trend in expenditure, whose variation rates are approaching the positive evolution recorded by revenue.

RANGE BETWEEN REGIONAL BALANCES AND DISTANCE FROM THE SUB-SECTOR BALANCE TO THE TARGET (% GDP). DATA 2013-2017. **AIReF'S** FORECASTS 2018-2019



In relation to the expenditure rule, AIReF estimates a moderate risk of non-compliance both in the sub-sector and individually. As a result of the expected evolution in expenditure, at least 3% in current expenditure, which accounts for 90% of regional spending, AIReF considers that the computable expenditure in 2019 could exceed the reference rate of 2.7%, which shows a moderate risk of non-compliance with the expenditure rule for the sub-sector, and, in general, at the individual level.

3.6. Local Governments

It is very likely that the local sub-sector will reach the balance target in 2019, with a surplus of 0.5% GDP, replicating the expected result for 2018. In its Report of October 26 2018, AIReF analysed the main budgetary lines of the Local Governments (LGs) sub-sector for 2019, estimating that, in 2018 as well as in 2019, the local surplus could be close to 0.5% GDP. The information contained in the Draft GSB and the data published subsequently have not significantly altered AIReF's baseline scenario (see 0).

In the various reports issued by AIReF during 2018, the year-end forecast for the local sub-sector for that year was 0.5% GDP, 0.1% less than that recorded in previous years. Mainly due to the increase in investment expenditure

resulting from making the expenditure rule of the LGs more flexible¹⁰, AIRcF estimates that the balance recorded in 2018 will be 0.1% less than the balance obtained in recent years of 0.6% GDP. In this sense, in July 2018 AIRcF made an estimate of the economic impact that placed the amount of additional expenditure between 500 and €3,000M. However, the limitations stemming from the procedures required by the contracting regulations, limit the maximum estimated impact of these measures, placing it around € 1,000M.

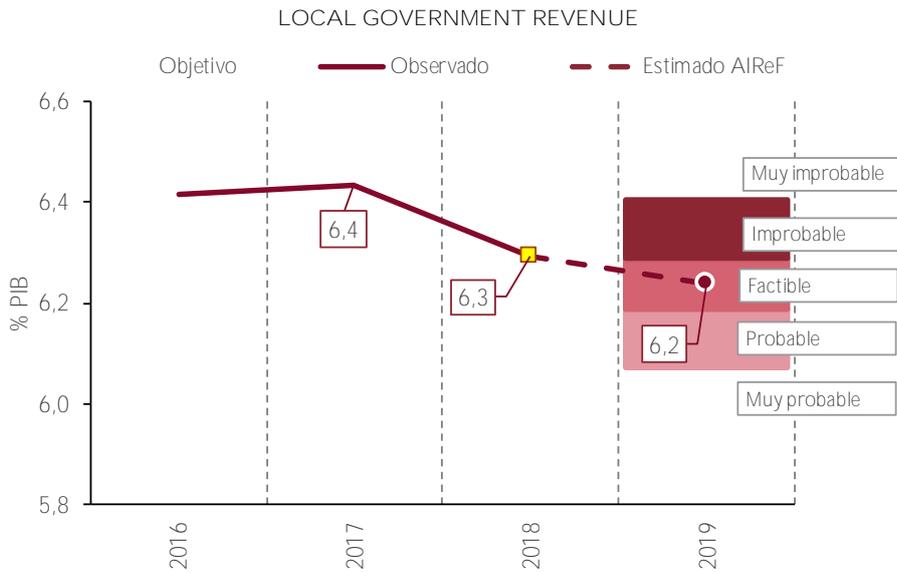
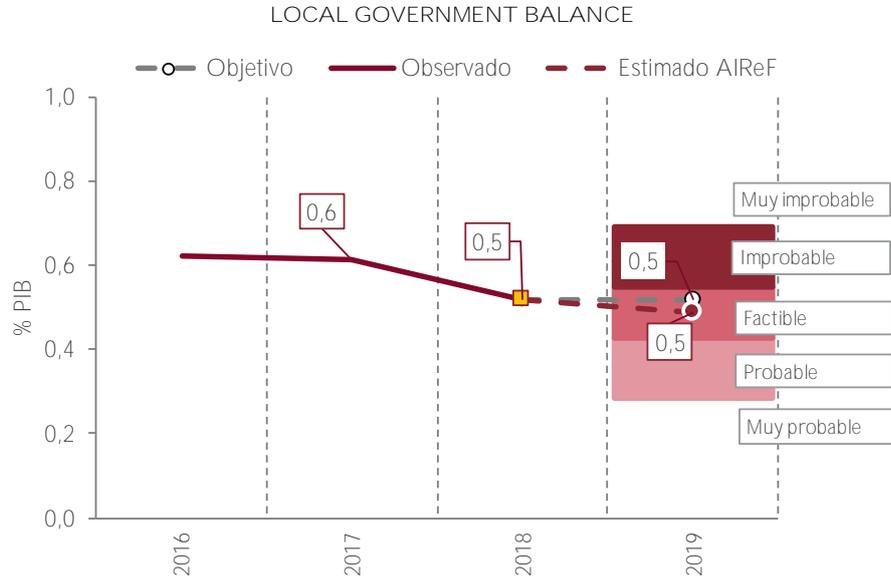
The latest financial information published by the Bank of Spain on the evolution of debt and deposits of the LGs in 2018 point to this result. The LGs' deposits continue to rise and have reached levels above €27,000 million, 4,000 more than at the beginning of the year, and financial debt reduces figure at the beginning of the year by almost €1,000 million. The combination of both trends corroborates AIRcF's estimates of obtaining a local surplus in 2018 and 2019 of around 0.5% GDP.

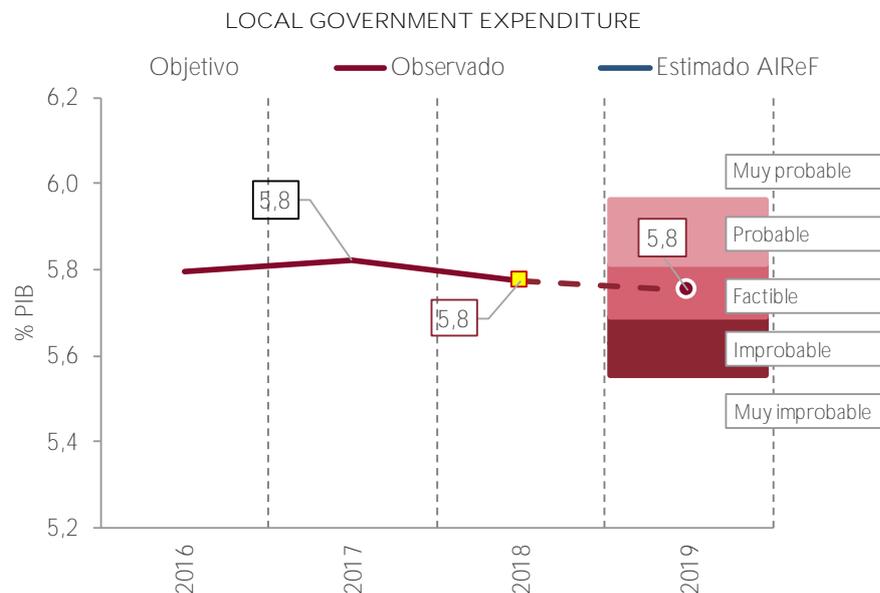
From the analysis of the 2019 budgetary data reported by the LGs, AIRcF concludes that the surplus of the LG sub-sector will stand at around 0.5% GDP in 2019. AIRcF has made use of the data that the LGs communicate to the MINHAC on the main budgetary lines of the draft budgets for 2019, which have a high degree of representativeness (around 60% of entities with an affected population of more than 80% of the total national population), and has carried out a coherence analysis of said data with a plausible estimate of revenue and expenditure, situating the local surplus at around 0.5% GDP.

This surplus forecast for the LG sub-sector is consistent with the data of the 24 large LGs analysed individually, which represent almost 30% of the overall local surplus in the average of the last 3 years closed. AIRcF has analysed the budgetary information submitted by the 21 LGs that are monitored individually according to their population and the size of their budget. In addition, this report includes, for the first time, the evaluation of the 3 Provincial Councils of the Basque Country, whose state-assisted taxes represent 25% of the revenue of the local sub-sector. The analysis of the data provided by these 24 local governments confirms the estimates made for the sub-sector as a whole.

¹⁰Royal Decree-Law 1/2018, of March 30, by which the allocation of the surplus of the local governments for financially sustainable investments is extended for 2018 and the objective scope of these is amended.

LG SUB-SECTOR (AS %GDP)





AIReF estimates that revenue will grow by around 3%. On the revenue side, AIReF forecasts a growth of the main municipal taxes of around 3% (mainly Property Tax as the main source of LG revenue), an increase in the transfers received from other PAs (mainly financing system resources) greater than 5% and an increase in the revenue of the Provincial Councils for state-assisted taxes of around 4% on average. (See 0).

2018-2019 VARIATION OF LOCAL REVENUE

Ingresos CCLL .Variación interanual 2018-2019 (estimaciones AIReF)	
Recursos Diputaciones Forales. De los cuales:	4%
IVA (un 40% del total ingresos forales)	5%
Resto	4%
Impuestos locales (fundamentalmente IBI)	3%
Recursos del Sistema de Financiación	5%
Resto de Ingresos (12% ingresos CCLL)	3%
Total Ingresos	3%

On the expenditure side, growth will be almost 4%. The measures approved on extending the scope of the expenditure rule¹¹ (it is estimated that they increase investment by around 23% with respect to the last figure observed) and the measures to increase staff wages and replace the workforce

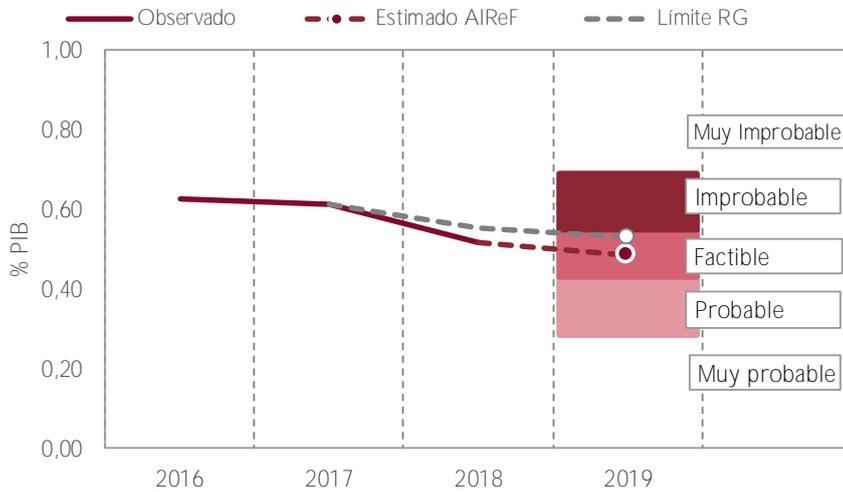
¹¹Increase in investment expenditure in 2019 due to the extension to this year of the IFS initiated in 2018 and the extension of the possible expenditure to be included in this concept (Royal Decree-Law 1/2018 and the Draft General State Budget Law).

(expected to grow by 3% over the estimates for 2018), push local expenditure upwards in 2019. In addition, given that local public services are closely related to the population, the decrease of this in the period from 2012 to 2017 allowed the LGs to stabilise their expenditure and this will contribute to generating recurring surpluses. For the first time since 2012, in 2018 and 2019 the increase in the population pushes local expenditure slightly upwards and will affect the decrease in the surplus. These increases could be mitigated by the non-consolidation in electoral years of the higher expenditure of the previous year, of around 3% on average, according to the data observed in the large LGs individually assessed by AIReF.

The approval of the proposed amendment to the LOEPySF could reduce the local surplus by at least 0.2%, an impact that in practice could be limited by the administrative contracting process. AIReF has estimated the possible economic impact of this proposal, based on the data from the 2017 settlement and seeing how many LGs meet the eligibility criteria established in the proposal. The resulting scenarios allow us to conclude that the additional expenditure that this regulatory amendment could generate would range **between 2,000 and 4,000€**, which would imply a reduction of the final balance of between 2% and 4% GDP. However, due to the delays involved in complying with the administrative contracting procedure, the maximum estimated impact of these measures is not expected to be likely.

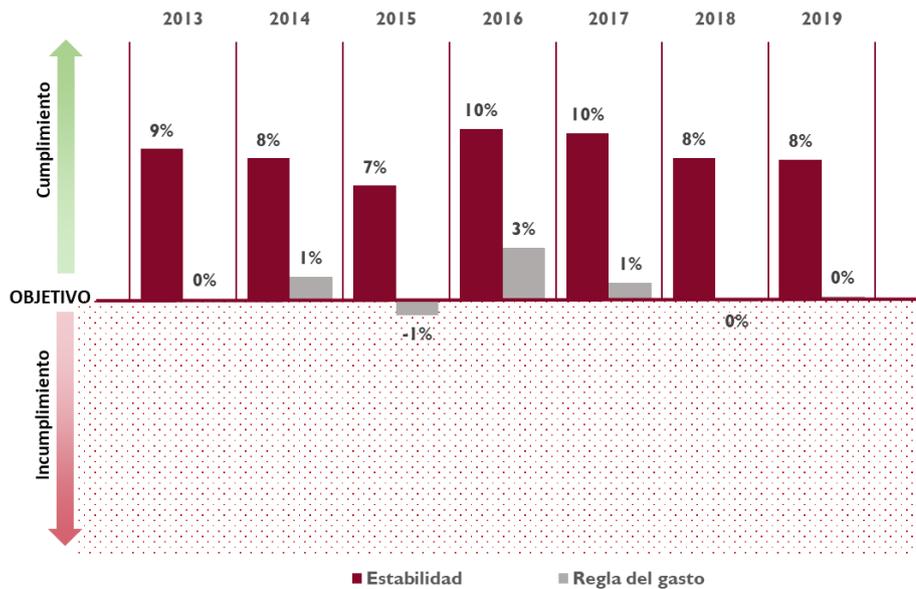
AIReF estimates that a surplus of slightly above 0.5% GDP would make it possible for the LG sub-sector to comply with the expenditure rule. The estimates made by AIReF on compliance with the expenditure rule suggest that the minimum lending capacity that would enable compliance with both fiscal rules is slightly above 0.5% GDP. For this reason, if AIReF's estimates of local surpluses are confirmed, compliance with this rule would present risks that would be offset in the event of the slowdown in expenditure in the election year. Box 2 summarises the main milestones taken into account in calculating the expenditure rule since 2013, as well as the main measures in the pipeline.

LENDING CAPACITY OF THE LG SUB-SECTOR THAT ENABLES COMPLIANCE WITH THE EXPENDITURE RULE IN 2018 AND 2019



0 shows the evolution of the joint compliance with these fiscal rules and the positive margin (compliance) or negative (non-compliance) of each of them on the annual target.

JOINT COMPLIANCE WITH THE STABILITY TARGET AND EXPENDITURE RULE 2013-2017 LG SUB-SECTOR AND AIREF'S ESTIMATES FOR 2018 AND 2019 (AS MARGIN OVER TARGET AND AS PERCENTAGE OVER NON-FINANCIAL REVENUE)



Note: In 2018 and 2019, the estimated margin of possible compliance or non-compliance with the target is very small, so the percentage it represents over non-financial revenue is slightly higher or lower than 0%.

BOX 2. MAIN MILESTONES ON THE CALCULATION OF THE EXPENDITURE RULE OF THE LGS

- Year 2014: The new Sixth Additional Provision of the LOEPySF was approved, which makes it possible for the LGs that meet certain demanding eligibility conditions to allocate part of the surplus obtained to the realisation of certain investments classified as financially sustainable (IFS). These investments are excluded from the calculation of the expenditure rule. This possibility may be extended to subsequent years if authorized by the GSB Law of each year, a possibility that has become effective all subsequent years.

The required conditions are determinants of a healthy situation: Comply with the limits required to arrange new debt operations, have obtained surplus and positive cash surplus the previous year, guarantee the non-generation of a deficit in the current year via debt amortisation and comply with the legal average payment period.

- Year 2015: In addition, the MINHAC changed the interpretation criteria for the calculation of this rule by establishing the base year as the last year and not the last compliant year, which allows the consolidation of the excess expenditure of non-compliant years (PEFEL2 application manual for the preparation and sending of economic-financial plans to the MINHAC).

- Year 2018: The demands for greater flexibility of this rule determined the approval of a Royal Decree-Law, in March 2018, expanding the catalogue of expenditure items that can be qualified as IFS and, in addition, extends the possibility of realisation to the following year.

In December 2018, the approval of Royal Decree-Law 21/2018, once again expanded the type of IFS to include expenditure on public housing. This regulation has not obtained validation from Congress, which is why it is not in effect at present.

In addition, in 2018 the proposed Organic Law concerning the amendment of criteria for the application of the expenditure rule, purports that the non-application of the expenditure rule to those LGs that comply with the principles of budgetary stability (understood as the maintenance of a surplus position or budgetary balance), and financial sustainability (understood as the maintenance of a level of indebtedness below 110% of current revenue and an average payment period to suppliers of less than 30 days), would be a definitive step in the amendment of this rule.

- Year 2019: The Draft GSB for 2019 has once again amended the concept of IFS by incorporating current expenditure linked to the promotion of employment, when directly related to investment projects or the provision of services of local interest or local cooperation programmes, into the catalogue of expenditure.

4 GOVERNMENT DEBT

4.1. Evaluation of the Government Debt Targets of the Draft Budget

The Draft GSB for 2019 foresees compliance with the debt target for the General Government (GG) in 2018 and 2019. The debt targets for the 2018-2019 period were set in the Agreement of the Council of Ministers (ACM) of 7 July 2017, both for the GG sector (97.6% and 95.4% GDP, in 2018 and 2019) and for the different sub-sectors, as can be seen in 0. The Draft GSB for 2019 foresees compliance with the target for the GG sector, both in 2018 and in 2019, projecting a debt path of 96.9% and 95.4%, respectively.

DEBT TARGETS (EDP AS % GDP)

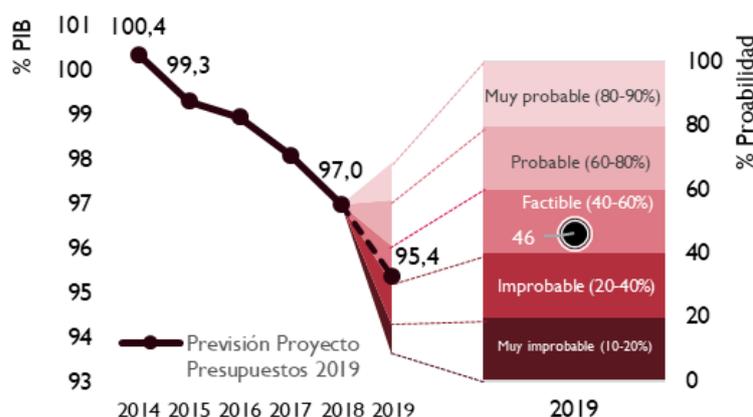
Deuda PDE	2017	2018	2019	2020
Administración Central y Seguridad Social	72,0	70,8	69,5	67,6
Comunidades Autónomas	24,1	24,1	23,3	22,4
Entidades Locales	2,9	2,7	2,6	2,5
Total AAPP	99,0	97,6	95,4	92,5

AIReF considers the debt projections outlined by the Draft GSB for 2019 to be feasible and compliant with the debt target. According to its internal forecasts, AIReF considers it feasible to achieve a debt-to-GDP ratio equal to or lower than that projected by the Government in the Draft GSB for 2019. Given that the Government's projections implied compliance with the approved targets, the path of the targets is also considered feasible in light of AIReF's models, with the values falling

within the central interval of the forecasting scenario, as can be seen in the following figure.

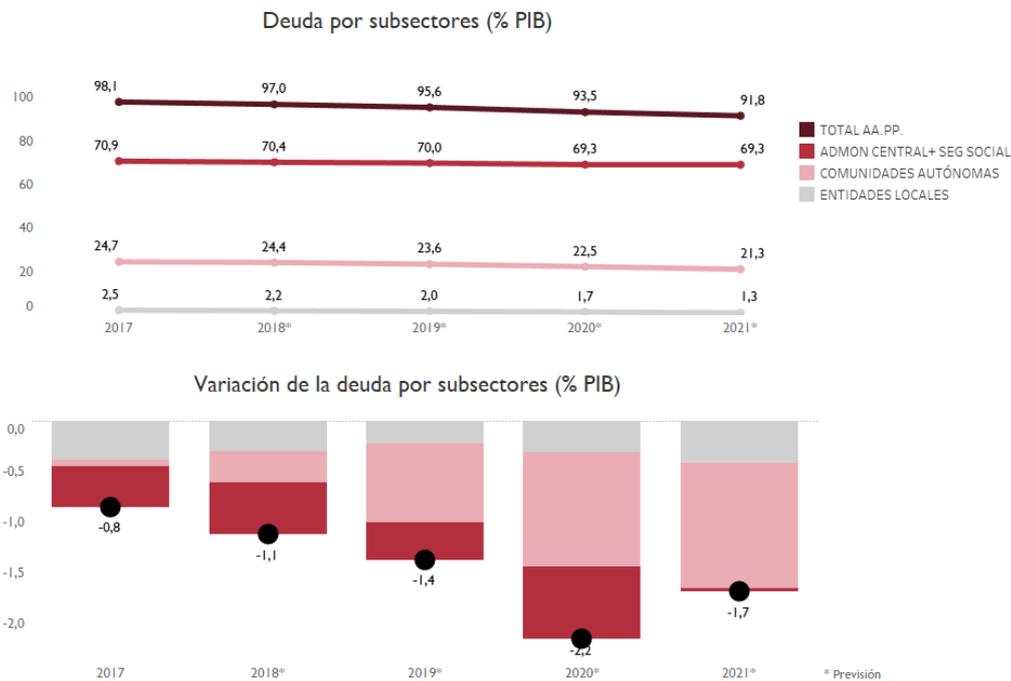
FORECASTS OF THE DRAFT GSB FOR 2019 AND PROBABILITY OF COMPLIANCE

- 1 The Draft GSB for 2019 assumes compliance with the debt target for 2019
- 2 Reaching a debt-to-GDP ratio equal to or lower than that projected in the Draft GSB for 2019 is considered feasible...



When broken down by sub-sectors, the LGs stand out as the only one whose forecasts are below the approved target. The Draft GSB for 2019 does not detail a forecast of the debt-to-GDP ratio broken down by sub-sector, which prevents from an individual evaluation of the same. However, AIRcF's internal forecasts can be used to assess compliance with the approved targets. According to this exercise, the LG sub-sector stands out as the only one whose target is below the central path of AIRcF's projections, although neither the Central Administration nor the Autonomous Regions show a significant deviation with respect to the targets (see the following figure).

DEBT FORECASTS BY SUB-SECTORS



4.2. Debt sustainability

Beyond the situation in 2019, the Draft GSB does not contain a mid-term sustainability analysis exercise. AIReF reiterates that the analysis of government debt should consider a medium-term horizon and not limit itself to the risk of non-compliance with the debt target for the current year. A more detailed overall analysis of debt sustainability and the implications of compliance with the fiscal rules can be found in [AIReF's Debt Monitor](#).

Although the Draft GSB forecasts a reduction in the debt-to-GDP ratio in line with the approved annual targets, this correction is not linked to a medium-term target and is not consistent with the requirements contained in the Organic Stability Law regarding the pace of debt correction. Despite the fact that the Spanish economy has experienced almost 5 years of sustained growth and enjoyed an environment of historically low interest rates, the government debt-to-GDP ratio has practically not fallen since its historic peak. Thus, in the third quarter of 2018 (98.3%) this was practically at the same level recorded in the first quarter of 2014 (98.1%), despite the fact that in this period the economy experienced nominal cumulative growth of 16.5%. The current Draft GSB posits "*reinforcing the decreasing path that began in 2014*", a reduction

that is quantified at 1.5% GDP in 2019, to put the ratio at 95.4%. This projection does not comply with the reduction required in the 1st Transitional Provision of the LOEPySF (whereby the debt path should be reduced by at least 2% GDP per year when real growth or expenditure grows above two percent).

The generation of sufficient fiscal space to respond to future pressures requires a more intense debt reduction, which not only rests on the denominator effect, but is backed by a more rapid and sustained improvement in the structural fiscal position. Given the high stock of current debt, close to historical highs in relation to GDP, it is necessary to reduce it decisively in order to generate fiscal spaces that allow for response to future adverse shocks. This extreme is even more significant if we incorporate the expenditure pressure from contingent liabilities such as the ageing of the population. Indeed, the increase in expenditure forecasts associated with pensions in a scenario of revaluation of the same to the CPI (maintenance of purchasing power) would be between 2% and 4% GDP, depending on the associated macro and demographic assumptions. This expenditure pressure could be reduced, without detracting from the coverage rate (average pension over average salary) through a deepening of the parametric system reforms that began in 2011.¹²

¹² For more details see the Opinion on the sustainability of Social Security: [Opinion on the sustainability of the Social Security System](#)

5 FISCAL POLICY STANCE

A public deficit below 3% GDP in 2018 and with prospects of maintenance below that figure in 2019 would allow the Spanish economy to formally exit the European Excessive Deficit Procedure (EDP) this year, remaining subject to the preventive arm of the Stability and Growth Pact (SGP). Given the prospects of passing to preventive monitoring, the ECOFIN of July 13 approved the fiscal adjustment to be carried out by Spain in 2019: a reduction of the public deficit over GDP of the GG sector, in structural terms, of 0.65% GDP and which, according to the Commission's calculations, would be consistent with a growth rate of the computable expenditure of the GG of 0.6%¹⁴.

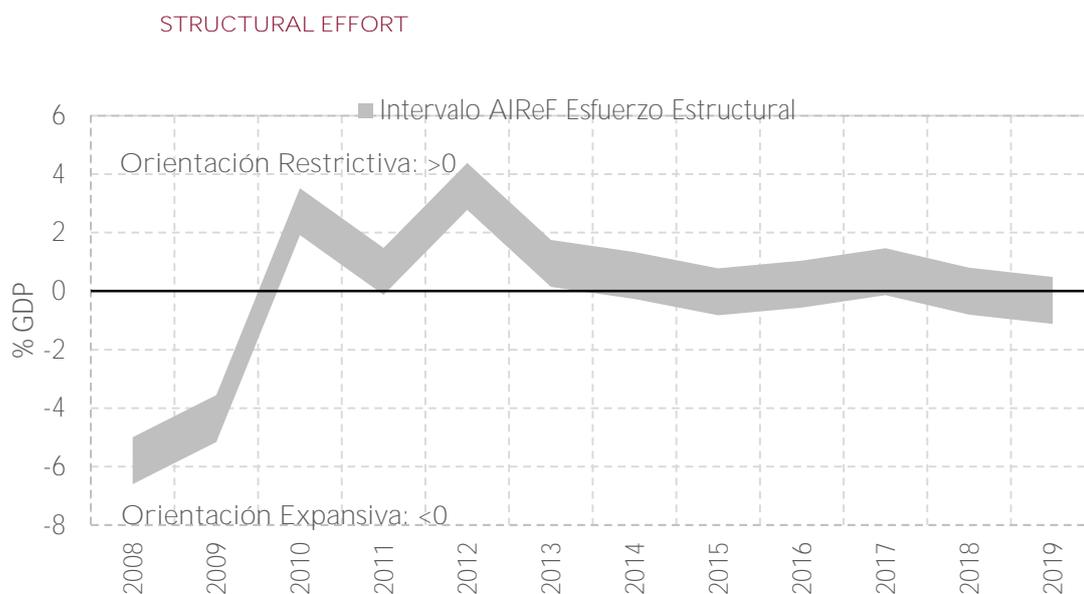
AIReF's estimate points to a practically neutral structural effort in 2019, in line with what has been done since 2013. AIReF has made an ex ante estimate of this structural effort according to the Commission's approach (see box 3), with 3 differences: i) its own series of non-recurring measures for 2017-2019 is used; ii) the output gap is estimated using AIReF's own methodology, considering that, within the limitations of estimating the potential, it is better suited to the specificities of the Spanish economy; and iii) the uncertainty associated with both the cyclical position and the evolution of public finances is incorporated, an essential point when dealing with ex ante estimates.¹⁵ This estimate would

¹³ Recommendation of the Council of 13 July 2018 regarding the 2018 National Reform Programme of Spain and issuing an opinion of the Council on Spain's Stability Programme for 2018

¹⁴ Adjustments are necessary in the event that the public deficit over GDP, in structural terms, exceeds the target level set by the national authorities, the so-called Medium Term-Objective (MTO), and/or the government debt is above 60% GDP. In the Spanish case, according to the autumn estimates for 2019, both conditions are present since the structural balance would be -3.1% GDP (against an MTO equal to the budgetary balance) and the debt would be 96.2% GDP.

¹⁵ AIReF. Working Paper 2/2018. [Estimation of the output gap of the Spanish economy](#)

point to a practically neutral effort for 2019 in line with that made since 2013. The results of said ex ante estimate are shown in 0, where it can be seen how the confidence intervals indicate that the structural effort in 2019 would be practically neutral. In any case, the structural effort required by ECOFIN (0.65%) does not fall within the confidence intervals.



BOX 3. ESTIMATION OF THE STRUCTURAL EFFORT WITH THE EUROPEAN COMMISSION'S METHODOLOGY

The structural effort is defined as the first difference of the structural component of the public deficit:

$$\text{Structural effort} = \text{Structural balance}_t - \text{Structural balance}_{t-1}$$

Where the structural balance (SB) is defined as the public balance adjusted for the effect of the economic cycle and discounting one-off and non-recurrent measures (NRM). I.e. it is obtained as a residual, discounting two components from the observed public balance (PB): the impact of the cycle (CB) and the non-recurrent measures (NRM).

$$SB = PB - CB - NRM$$

The first component, the cyclical balance (CB), is determined by applying a semi-elasticity to the output gap (OG) (ϵ):

$$CB = OG * \epsilon$$

Where the OG, which measures the cyclical position of the economy, is defined as the difference between the observed GDP and the potential GDP as a percentage of potential GDP. The Commission estimates the potential GDP using a methodology, based on the production function, which was adopted by ECOFIN in 2002.

And the *semi-elasticity* summarises the impact of the output gap on public finances. The semi-elasticities used by the Commission are based on a methodology developed by the OECD and agreed upon in the output gap working group (OGWG). For Spain, the current estimated value is 0.597¹⁶.

The second component, non-recurring measures, approximates those measures that, because they have a one-off effect, do not affect the underlying position of public finances. In order to identify these measures, the Commission has published general principles with the aim of making the criteria applied in the supervision transparent.

Source: Vade Mecum on the Stability and Growth Pact, 2018 Edition. Institutional Paper 075/March 2018.

The Commission and the Council are aware of the limitations of this approach to discretionary effort, which is why they add flexibility to their interpretation and assessment of compliance. The main constraints come from the methodology for estimating the impact of the cycle on public deficit and

¹⁶ European Commission. January 2019. [Report on Public Finances in EMU](#).

uncertainty about the cyclical position and the evolution of public finances¹⁷. Therefore, in practice, a more complex and less mechanistic evaluation of the requirements of the Pact is carried out.¹⁸ On the one hand, there are permitted margins of deviation (0.5% GDP in a year or 0.25% GDP in two consecutive years).

In this context, it seems necessary to complete this approach, aggregate and subject to limitations, with an analysis disaggregated by sub-sectors, through the assessment of compliance with the national expenditure rule. The assessment of compliance with the national expenditure rule, defined in the Organic Law on Budgetary Stability and Financial Sustainability, allows a detailed "bottom-up" approach, exploiting the information contained in the budgetary documents of the different sub-sectors, both with respect to the evolution of expenditure as well as discretionary revenue measures. The comparison of the evolution of expenditure in the sub-sectors with respect to the potential growth rate in the medium term (reference rate) allows a disaggregated assessment of the fiscal policy stance.

Compliance with the expenditure rule by sub-sector is mixed, although at an aggregate level the expenditure of the Administrations subject to the rule (CA, Regions and LGs) is below the permitted reference rate. Of the three sub-sectors subject to the national expenditure rule, it is worth noting the compliance of the CA and the LGs against the non-compliance of the Regions. In effect, the evolution of Regional expenditure is above the reference rate once adjusted for the regulatory revenue measures, unlike the CA which does not exhaust the margin provided by the revenue increases or the LGs whose expenditure evolves below the reference rate of 2.7%, as can be seen in 0. At the aggregate level, considering the three sub-sectors as a whole, the evolution of expenditure is within the limits allowed by the expenditure rule, once the reference rate has been corrected upwards thanks to the discretionary revenue measures implemented in 2019.

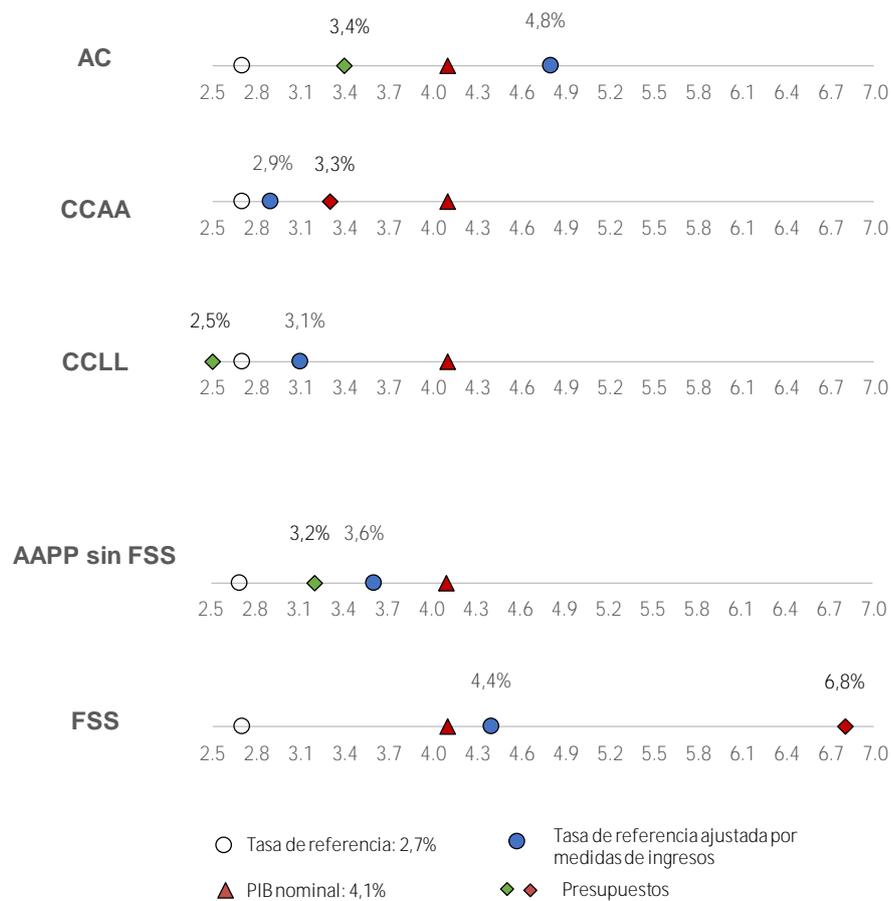
The Social Security Funds present growth rates well above the reference rate (2.7%) even once adjusted for the revenue measures implemented in 2019. In the case of the Social Security Funds, their expenditure evolves significantly above the adjusted reference rate of the regulatory measures implemented

¹⁷ AIRcF. Report 45/18. "[Report on the main budgetary lines of the Public Administrations 2019](#)".

¹⁸ The uncertainty about the estimates of the output gap of the Spanish economy led to the amendment of the fiscal efforts for 2019 resulting from the mere application of the community methodology. The mechanical application would have required a structural adjustment of 1% GDP compared to the 0.65% finally adopted.

in the GSB for 2019 (6.8% against 4.4%). It should be noted that Social Security is not subject to compliance with the national expenditure rule, unlike in the case of the European rule, but its analysis is added to get an idea of the behaviour of the GG.

EVOLUTION OF COMPUTABLE EXPENDITURE AND THE REFERENCE RATE



Source: AIReF and Ministry of Finance

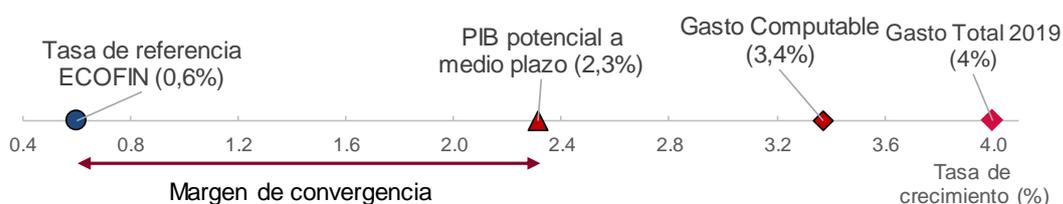
The European expenditure rule allows a broader view, as it refers to the behaviour of the GG sector, although it is worth mentioning that it is more restrictive than the national rule. The calculation of the "expenditure benchmark" or European expenditure rule refers to the GG sector and presents complementary information that allows for an assessment of the nature of the fiscal policy stance and its fit with the ECOFIN recommendation (see box 4 for more details on its calculation). Another difference between the European rule and the national rule is that it takes into account the distance

of the structural balance with respect to a medium term balance level (MTO or *Medium Term Objective*).

The calculation of the "expenditure benchmark" performed by AIReF points to an increase in expenditure above the reference rate in 2019. To allow the MTO to be reached, the reference rate at which the expenditure can evolve (2.3% from the European Commission's calculations) is corrected markedly downwards by a margin called a margin of convergence, to reach 0.6%. This contained evolution of GG expenditure would imply a correction of around €12,000M compared to the forecast included in the draft budgets of the different sub-sectors.¹⁹ Although the correction of the structural deficit is a desirable target to strengthen debt sustainability and the resilience of public accounts in the face of adverse shocks, its rate should be feasible, with a medium-term vision and anchored in a debt target.

In the GG sector, expenditure evolves at rates similar to the nominal growth of the economy. The evolution of total expenditure at 4% in 2019 is in line with the nominal growth of the economy, forecasted at 4.1% (see 0), thus confirming the marker of an approximately neutral policy that came from the structural effort approach.

EUROPEAN EXPENDITURE RULE: EXPENDITURE BENCHMARK



Source: AIReF

¹⁹ In order to calculate the expenditure benchmark, AIReF follows the Commission's methodological approach by incorporating its own series of non-recurring expenditure measures and regulatory revenue changes.

BOX 4- CALCULATION OF THE "EXPENDITURE BENCHMARK" WITH THE EUROPEAN COMMISSION'S METHODOLOGY

The application of the "expenditure benchmark" indicator depends on the situation of the Member States with respect to their MTO. In the case of Spain, which has not reached its MTO, the annual growth of public expenditure must be lower than the growth compatible with the MTO (which is equal to the growth of potential GDP in the medium term) in a certain margin of convergence set by the Commission.

The method of calculating the "expenditure benchmark" is based on total public expenditure excluding: interest payments, spending on EU programs financed with community funds, the cyclical component of unemployment expenditure and public investment in the current year, conversely adding the average of the previous 4 years.

Computable expenditure_t

$$\begin{aligned}
 &= \text{Total expenditure}_t - \text{Interest}_t - \text{EU Programme Expenditure}_t \\
 &- \text{Cyclical unemployment expenditure}_t - \text{Public investment}_t \\
 &+ \text{Public investment}_{t-3 \text{ a } t}
 \end{aligned}$$

The computable expenditure is also corrected for the one-off expenditure items and the regulatory revenue changes, thus obtaining the net computable expenditure:

Net computable expenditure_t

$$\begin{aligned}
 &= \text{Computable expenditure}_t - \text{one-off expenditure}_t \\
 &- \text{revenue regulatory changes}_t
 \end{aligned}$$

The increase in expenditure in each year, for the purposes of applying the "expenditure benchmark", is obtained as the growth rate of the net computable expenditure with respect to the computable expenditure:

Expenditure growth_t

$$= \frac{\text{Net computable expenditure}_t - \text{Computable expenditure}_{t-1}}{\text{Computable expenditure}_{t-1}}$$

The expenditure growth must be lower than the "expenditure benchmark", which, as has been indicated, depends on the growth of potential GDP in the medium term and the margin of convergence, in order to comply with the expenditure rule.

Source: Vade Mecum on the Stability and Growth Pact, 2018 Edition. Institutional Paper 075/March 2018.

6 RECOMMENDATIONS

New recommendations

In the Report on the Main Budgetary Lines of the Public Administrations for 2019, published on October 26, AIRcF pointed out that the measures proposed in the Budgetary Plan presented a series of uncertainties related to their implementation and execution. These uncertainties mainly affected the revenue measures, since a large part of them required legislative processing, either in the parliamentary debate process of the draft General State Budgets or in their own laws, as in the case of the creation of the new tax figures. Consequently, AIRcF warned that the materialisation of any of the identified risks could require the adoption of additional measures, given that it was perceived to be difficult to reach the deficit of 1.8% envisaged in the Plan.

Indeed, the delay in the implementation of some of the revenue measures included in the Budget Plan has already been confirmed. Thus, the bills that regulate the creation of the tax on digital services and the tax on financial transactions foresee their entry into force three months after publication in the Official State Gazette, therefore it has been estimated that at most they will have their effects in the last quarter of the year, reducing their impact to one third of the initial assessment. Similarly, the amendment of the tax on hydrocarbons and certain anti-fraud measures will be limited in effect until the GSB are approved by Parliament

For this reason, AIRcF recommends:

1. *That the legislative processing of the revenue measures and their eventual implementation be accelerated, in order to minimise the collection loss in 2019.*

Also, given the expected deviation from the stability target set, AIReF warns that there are no margins for this to increase in the parliamentary process, but, on the contrary, it would be necessary to reach agreements that allow progress in the process of medium-term convergence that are not appreciated in the Draft GSB.

In its report of October 26, AIReF recommended the development of a medium-term fiscal strategy, which would envisage permanent deficit reduction measures, anchored in a credible debt reduction path, making use of the Stability Programme Update (2019-2022) that will take place in April.

As the first year of this scenario is 2019, AIReF recommends:

-
2. *That, in the processing of the GSB, the existence of fiscal spaces that would allow the foundations to be laid in 2019 for a process of medium-term convergence, in which the Stability Programme Update (2019 -2022) to be presented in April is anchored, is evaluated.*
 3. *That, in the execution of the budget, the levers offered by results of the spending review that AIReF is carrying out, and whose results will be made public soon, are used.*
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In previous reports, AIReF has pointed out that the lack of realism in the setting of targets reduces the enforceability of the fiscal framework which, moreover, takes into account neither the cause nor the margin of deviation.

It is therefore necessary that the targets are realistic, both overall and in the disaggregation by sub-sectors, and that they are integrated into a medium-term budgetary framework consistent with a solid debt reduction path.

For this reason AIReF recommends:

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4. *That the fiscal targets are configured as the annual realisation of a revisable multi-year plan based on the results obtained in each of the budgetary years that make it up.*
 5. *The setting of the annual target of the PA sector should be based on a bottom-up approach based on targets that take into account the fiscal situation of each of the sub-sectors, which will facilitate their monitoring and enforcement, thus providing greater credibility to the current fiscal framework.*
-

Reiterated recommendations

For the Central Administration, the LOEPySF does not foresee a preventive procedure similar to that in place for the Territorial Administrations in the event of appreciating risks of deviation.

AIRcF reiterates the recommendation made in the report on the Draft GSB for 2017, which indicated that the perception of a lower level of "accountability" by the Central Administration could erode the degree of commitment of other Public Administrations regarding compliance with their fiscal targets.

For this reason, AIRcF once more recommends that:

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- 1. That a procedure for monitoring the Central Administration and Social Security be articulated, specifically including the degree of implementation of the measures and the realisation of budgetary management decisions aimed at containing the execution of the budget. This monitoring must be carried out with the greatest possible transparency, sending the reports prepared to Parliament and AIRcF.*
-

On the other hand, in the same report, AIRcF warned that for the first time information regarding the national accounting adjustments had not been included in the Draft GSB for 2017 and that this lack of information prevented from the determination of whether the budget was presented adjusted to compliance with the target set since the difference between this and the deficit contained in the Budget was of 0.7% GDP. For this reason, it was considered essential that the information related to the aforementioned adjustments be included urgently in the Draft GSB for 2017. This recommendation was reiterated in the report on the Draft GSB for 2018, which was presented in these same terms. In response to these recommendations, the Ministry of Finance responded that the Central Administration and Social Security's execution data were published on a monthly basis in national accounting terms, which, in their opinion, would lead to a budget in national accounting terms in the future. However, they also pointed out the difficulty of having the necessary information available to convert the budget to national accounting terms at the time of presentation.

AIReF understands that, despite the difficulties, it is essential to have a budget expressed in national accounting terms, at least including the adjustments that allow the reconciliation of the budgetary result with the stability target.

Since the Draft GSB for 2019 does not include the national accounting adjustment again, AIReF once more recommends:

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2. *That the following is included in the Draft GSB:*
 - a. *information on national accounting adjustments that allow reconciliation of the budgetary balance with the lending or borrowing in terms of ESA 2010.*
 - b. *information on those entities that, although not public entities, are included in the Central Administration sub-sector for the purposes of ESA 2010 and the balance resulting from lending or borrowing of the Central Administration Bodies.*
 3. *That the Draft GSB for next year includes an initial budget in national accounting terms of the Central Administration and Social Security Funds.*
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ANNEX 1. IMPACT OF REGULATORY CHANGES

En millones de euros

IRPF			
Impacto de los cambios normativos previstos en el Proyecto PGE 2019			
Descripción	Impacto Proyecto PGE2019	Valoración AIRcF	Observaciones
Incremento tipos IRPF rentas más altas	328	(245 , 255)	(1)
Lucha contra el fraude: Reforzar la lista de morosos.	110	(25 , 50)	(1), (2)
Impacto en 2019 por cambios normativos PGE 2018			
Descripción	Impacto PGE 2018	Valoración AIRcF	Observaciones
Elevar mínimo exento y ayudas familiares	-1.100	(-690 , -800)	(3)
Impacto en 2019 por sentencias			
Descripción	Efecto caja 2019	Valoración AIRcF	Observaciones
Devoluciones pendientes del impuesto pagado en las prestaciones por maternidad y paternidad	-900	(-1280 , -1330)	(4)
TOTAL	-1.562	(-1700 , -1825)	

(1) Medida valorada en el Informe sobre las Líneas Fundamentales de los Presupuestos de las Administraciones Públicas 2019 (26 de octubre de 2018) (DBP 2019).

(2) El impacto de la medida estimado por AIRcF ha sido recortada respecto al DBP 2019 por el retraso de la entrada en vigor de la

(3) Se ajusta su impacto al que ya se ha observado, en parte, en el 2018.

(4) Se estima un descenso en la recaudación del IRPF por las devoluciones de maternidad/paternidad que se pagarán en 2019, estimadas en unos 400M€ por las de los años 2014-2015; 600M€ por las de 2016-2017 y 300 por las de 2018 que se devolverán en la

In millions of €

PIT			
Impact of regulatory changes provided for in the Draft GSB for 2019			
Description	Impact Draft GSB2019	AIReF's evaluation	Remarks
Increase of personal income tax rates on higher	328	(245 , 255)	(1)
Fight against fraud: Strengthen list of defaulters	110	(25 , 50)	(1), (2)
Impact in 2019 due to regulatory changes GSB 2018			
Description	Impact 2018 GSB	AIReF's evaluation	Remarks
Raise minimum exempt and family aid	-1,100	(-690 , -800)	(3)
Impact in 2019 due to judgements			
Description	Cash effect 2019	AIReF's evaluation	Remarks
Outstanding returns of the tax paid for maternity and paternity leave benefits	-900	(-1280 , -1330)	(4)
TOTAL	-1,562	(-1700 , -1825)	

(1) Measure assessed in the Report on the Main Budgetary Lines of the Public Administrations 2019 (26 October 2018) (DBP 2019).

(2) The impact of the measure estimated by AIReF has been cut back with respect to the 2019 DBP due to the delay in the entry into force of the measure.

(3) Its impact is adjusted to what has already been observed, in part, in 2018.

(4) A decline in the collection of PIT is estimated due to maternity/paternity leave returns to be paid in 2019, estimated at about €400M for 2014-2015; €600M for 2016-2017 and 300 for 2018 that will be returned in the settlement of the tax.

In millions of €

Corporate Income Tax			
Impact of regulatory changes provided for in the Draft GSB for 2019			
Description	Impact Draft GSB2019	AIReF's evaluation	Remarks
Limitation of the exemption due to double international deduction until 95% of its amount and establishment of a minimum rate on the tax base	1,776	(1650 , 1902)	(1)
Discounted rate for SMEs	-260	(-260 , -242)	(1)
Fraud prevention: Limitation of cash payments	109	(25 , 50)	(1), (2)
Fraud prevention: International best practices	250	(100 , 135)	(1), (2)
TOTAL	1,875	(1533 , 1809)	

(1) Measure assessed in the Report on the Main Budgetary Lines of the Public Administrations 2019 (26 October 2018).

(2) The impact of the measure estimated by AIReF has been cut back with respect to the 2019 DBP due to the delay in the entry into force of the measure.

In millions of €

Special taxes			
Impact of regulatory changes provided for in the Draft GSB for 2019			
Description	Impact Draft GSB2019	AIReF's evaluation	Remarks
Green taxation: increase in the rates on diesel fuel	670	(487 , 518)	(1), (2)
Impact in 2019 due to regulatory changes GSB 2018			
Description	Impact 2018 GSB	AIReF's evaluation	Remarks
Homogenisation of the regional rate and change in State rate	1,363	(1321 , 1405)	(3)
TOTAL	2,033	(1807 , 1924)	

(1) Measure assessed in the Report on the Main Budgetary Lines of the Public Administrations 2019 (26 October 2018).

(2) The impact of the measure estimated by AIReF has been cut back with respect to the 2019 DBP due to the delay in the entry into force of the measure.

(3) The effect of the change to the State rate valued at about €1000M will have no effect on the deficit as it will be offset through transfers between PAs

In millions of €

VAT			
Impact of regulatory changes provided for in the Draft GSB for 2019			
Description	Impact Draft GSB2019	AIReF's evaluation	Remarks
Reduction of rates on veterinary services, feminine hygiene products and e-books	-77	(-55 , -61)	(1), (2)
Fight against fraud: Limitation of cash payments	109	(25 , 50)	(1), (2)
Fight against fraud: International best practices for prevention	250	(100 , 135)	(1)
Change in the Immediate Information System (IIS)	4,595	(4365 , 4825)	(3)
Impact in 2019 due to regulatory changes GSB 2018			
Description	Impact 2018 GSB	AIReF's evaluation	Remarks
Reduction VAT rate on film	-41	(-39 , -43)	(1)
TOTAL	4,836	(4396 , 4906)	

(1) Measure assessed in the Report on the Main Budgetary Lines of the Public Administrations 2019 (26 October 2018) except the impact of the reduction in rates on e-books, that is €24M.

(2) The impact of the measure estimated by AIReF has been cut back with respect to the 2019 DBP due to the delay in the entry into force of the measure.

(3) Regulatory change that does not affect the accounting of the tax in National Accounting terms

In millions of €

Other tax revenue			
Impact of regulatory changes provided for in the Draft GSB for 2019			
Description	Impact Draft GSB2019	AIReF's evaluation	Remarks
Tax on certain Digital Services	1,200	(137 , 242)	(1), (2)
Tax on Financial Transactions	850	(105 , 215)	(1), (2)
Impact in 2019 due to regulatory changes GSB 2018			
Description	Impact 2018 GSB	AIReF's evaluation	Remarks
Environmental taxation: Abolition of the tax on the production value of electricity over two quarters	-800	(-679 , -751)	
TOTAL	1,250	(-438 , -294)	

(1) Measure assessed in the Report on the Main Budgetary Lines of the Public Administrations 2019 (26 October 2018).

(2) The impact of the measure estimated by AIReF has been cut back with respect to the 2019 DBP due to the delay in the entry into force of the measure.