

# REPORT ON THE GENERAL GOVERNMENT SECTOR INITIAL BUDGETS FOR 2019

REPORT 11/19





Independent Authority  
for Fiscal Responsibility

The Independent Authority for Fiscal Responsibility (AIReF by its Spanish acronym) 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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# CONTENTS

<b>1</b>	INTRODUCTION .....	15
<b>2</b>	PURPOSE AND SCOPE .....	17
<b>3</b>	BUDGETARY STABILITY TARGET AND EXPENDITURE RULE .....	19
3.1	Macroeconomic scenario .....	19
3.2	General Government sector .....	21
3.3	Central Administration .....	27
3.3.1	Non-financial revenue forecast .....	29
3.3.2	Tax on cash accounting before transfer to the Territorial Administrations.....	31
3.3.3	Non-financial expenditure forecast .....	35
3.4	Social Security Funds .....	41
3.4.1	Analysis by agents.....	43
3.5	Autonomous Regions .....	48
3.6	Local Governments.....	54
<b>4</b>	GOVERNMENT DEBT .....	59
<b>5</b>	RECOMMENDATIONS .....	62
5.1	Central Administration and Social Security Funds .....	62
5.2	Territorial Administrations .....	64



## EXECUTIVE SUMMARY

Within 1 April, AIReF has the legal mandate of evaluating the initial budgets of the Public Administrations (PAs) from the perspective of their adaptation to the fiscal targets, focusing its assessment on the main budgetary lines and draft budgets previously reported on, in accordance with its organic law. In the case of the PAs that have not approved their budgets the assessment has been carried out with respect to the effects of the budgetary carryovers.

On 28 January 2019, AIReF issued its report on the draft General State Budgets (GSB) and the main budgetary lines of the PAs for 2019, thereby completing the analysis of the Budgetary Plan carried out on 26 October. In said report AIReF noted the lack of realism of the target of -1.3% GDP, which required an adjustment of 1.4 points to be made from the end of 2018, which AIReF estimated at -2.7% GDP at the time.

Having analysed the new information, AIReF continues to consider the achievement of the target of -1.3% GDP to be unlikely for the General Government (GG), although it has revised the deficit estimated for 2019 slightly downwards, placing its baseline scenario at -2.1% GDP, 0.1% below its previous forecast.

The changes in AIReF's assessment with respect to the estimate made in the previous report are primarily due to the non-approval of the GSB for 2019, and the inclusion of the latest execution data published, including the end of 2018 that finally stood at -2.6%.

The non-approval of the GSB for 2019 has meant that a significant part of the measures contained in the Budgetary Plan and in the draft GSB have not been put in place, with a net positive effect on the deficit. However, the revenue measures of the Social Security Funds, the revaluation of pensions and the wage increase for public employees had already entered into force before the presentation of the draft GSB before Parliament.

TABLE OF REVENUE MEASURES: GOVERNMENT'S AND AIREF'S ESTIMATE

REVENUE MEASURES	Gov Estimate DBP 2019	AIReF Estimate DBP 2019	Gov Estimate GSB 2019	AIReF Estimate GSB 2019	AIReF Estimate Extension 2019
Corporate Income Tax	1.516	1.516	1.516	1.516	0
PIT Increase of rates on higher income	328	250	328	250	0
<b>New tax figures</b>	<b>2.050</b>	<b>1.397</b>	<b>2.050</b>	<b>349</b>	<b>0</b>
Tax on Financial Transactions	850	640	850	160	0
Tax on certain Digital Services	1.200	757	1.200	189	0
<b>Green taxation (Hydrocarbons Tax)</b>	<b>670</b>	<b>670</b>	<b>670</b>	<b>503</b>	<b>0</b>
<b>VAT</b>	<b>-53</b>	<b>-53</b>	<b>-77</b>	<b>-58</b>	<b>0</b>
Heritage Tax	339	8	339	0	0
Fraud prevention	828	460	828	348	0
<b>TOTAL CA IMPACT</b>	<b>5.678</b>	<b>4.248</b>	<b>5.654</b>	<b>2.908</b>	<b>0</b>

Maximum contribution bases Increase of 7%		1.000	850	850	850
Minimum wage. Minimum bases General Regime	1.500	600	1.279	600	600
Special Self-employed Workers Regime Measures		1.000	6	6	6
Quota for professional contingencies			456	456	456
Additional contributions local police forces			254	254	254
Others			154	154	154
<b>TOTAL SSF IMPACT</b>	<b>1.500</b>	<b>2.600</b>	<b>2.999</b>	<b>2.320</b>	<b>2.320</b>

Note: CA (Central Administration) and SSF (Social Security Funds)

TABLE OF EXPENDITURE MEASURES: GOVERNMENT'S AND AIREF'S ESTIMATE

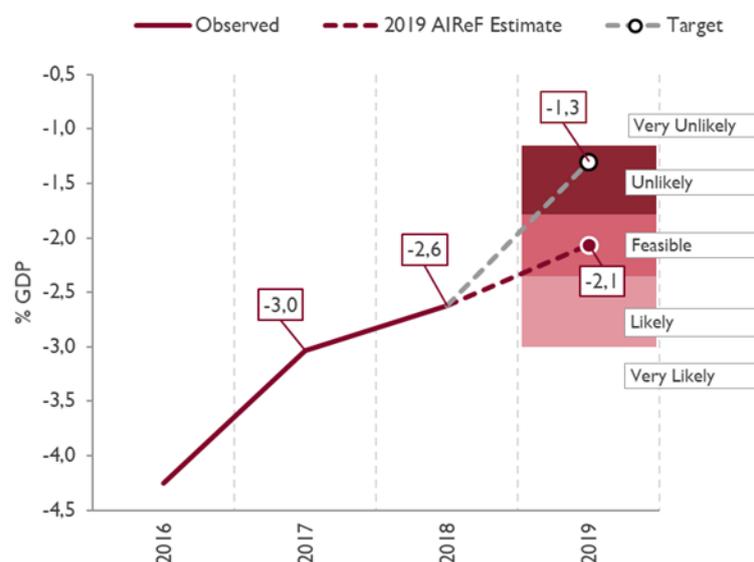
EXPENDITURE MEASURES	Gov Estimate DBP 2019	AIReF Estimate DBP 2019	Gov Estimate GSB 2019	AIReF Estimate GSB 2019	AIReF Estimate Extension 2019
<b>Revaluation of pensions to the CPI and increase of minimum and non-contributory pensions to 3%</b>	<b>736</b>	<b>843</b>	<b>588</b>	<b>588</b>	<b>588</b>
<b>Measures quantified jointly in the Budgetary Plan</b>	<b>1.318</b>	<b>1.318</b>	<b>1.633</b>	<b>1.435</b>	<b>920</b>
Improve minimum and agreed level of dependency		515	515	515	0
SS caregiver contributions		0	315	315	315
Recover subsidy for those older than 52 years		323	323	242	242
Paternity leave of 5 to 8 weeks		300	300	225	225
Minimum income		180	180	138	138
<b>Measures listed in the Budgetary Plan and quantified in the additional information</b>	<b>425</b>	<b>725</b>	<b>492</b>	<b>812</b>	<b>0</b>
<b>Increases in expenditure included in the GSB 2019 not expressly identified in the Budgetary Plan</b>			<b>2.415</b>	<b>2.415</b>	<b>0</b>
<b>TOTAL MEASURES</b>	<b>2.479</b>	<b>2.886</b>	<b>5.128</b>	<b>5.250</b>	<b>1.508</b>

In addition, in the first few months of the year the Government approved, by Royal Decree-Law, part of the expenditure measures quantified in the Budgetary Plan and included in the draft GSB for a total amount of 1,633 million. AIReF had already reduced the impact of these measures by 200 million in 2019, since their entry into force had been delayed until the second quarter of the year according to the budget processing calendar. Following

the approval of the Royal Decree-laws, the final amount is estimated at 920 million, due to not having developed the measure to improve dependency that was included in the draft GSB in the amount of 500 million euros.

Another factor that has contributed to reducing the deficit estimate for 2019 has been the incorporation of published closing data for 2018 that presented a GG deficit of around 0.1% less than AIReF's forecasts. In net terms, this difference was mainly caused by the better behaviour of social security contributions and revenue from the European Structural Funds.

GENERAL GOVERNMENT NET LENDING/BORROWING (% GDP)



### Analysis by sub-sectors

The analysis by sub-sectors shows a certain "stagnation" of the fiscal scenario, in which it is easy to anticipate the results that will be obtained in at least three of the sub-sectors. The Local Governments (LGs) will maintain their surplus at around 0.5% GDP; the Autonomous Regions, with some exceptions, will be situated close to budgetary balance, and Social Security will replicate the deficit of 1.4%/1.5% GDP of previous years. Only the Central Administration (CA) presents a greater uncertainty due to the link between tax revenue and the economic cycle. This situation is only altered by the effect of non-recurring operations, especially court rulings, and the higher or lower revenue from the European Union that, as long as it is not in line with expenditure execution, could have a very significant in some Regions.

In this sense, AIReF estimates that in 2019 only the CA will reduce its deficit with respect to the end of 2018, maintaining the level recorded last year in the

other sub-sectors. This adjustment, which could reach 0.5% GDP, is reduced to 0.3% if we exclude the non-recurring operations of both years.

#### ADJUSTMENT OF THE 2018-2019 DEFICIT (% GDP)

Lending (+) Borrowing (-) as % GDP	Year-end 2017	Year-end 2018	2019 Objective	2019 AIReF closing
Central Administration	-1,9	-1,5	-0,3	-1,0
<i>Non-recurrent operations</i>	-0,2	-0,5		-0,3
<i>Deficit without non-recurrent operations</i>	-1,7	-1,0		-0,7
Social Security	-1,5	-1,4	-0,9	-1,4
<i>Autonomous Regions</i>	-0,3	-0,2	-0,1	-0,2
<i>Local Corporations</i>	0,6	0,5	0,0	0,5
Regions and LGs	0,3	0,3	-0,1	0,3
General Government	-3,1	-2,6	-1,3	-2,1

On the other hand, the assessment made on 28 January is generally maintained, while the Social Security forecasts improve by 0.1%.

#### COMPARISON OF AIREF'S CLOSING FORECAST FOR 2019

Lending (+) Borrowing (-) as % GDP	January Report	Current Report
<b>Central Administration</b>	-1,0	-1,0
<b>Social Security</b>	-1,5	-1,4
<b>Autonomous Regions</b>	-0,2	-0,2
<b>Local Corporations</b>	0,5	0,5
<b>Regions and LGs</b>	0,3	0,3
<b>General Government</b>	-2,2	-2,1

AIReF carried out its assessment and analysis while considering a scenario of funding flows between administrations in line with that included in the budgets of the Territorial Administrations (TAs), which provide for similar financing system resources to those reported in July, complemented by those derived from the neutralisation of the effect that the Immediate Information System (IIS) for VAT, adopted in 2017, has on the settlement of these resources<sup>1</sup>.

However, given the uncertainty about whether any measures aimed at offsetting the impact of the VAT-IIS rules will be implemented, the probability of compliance with the stability target if this does not happen is assessed.

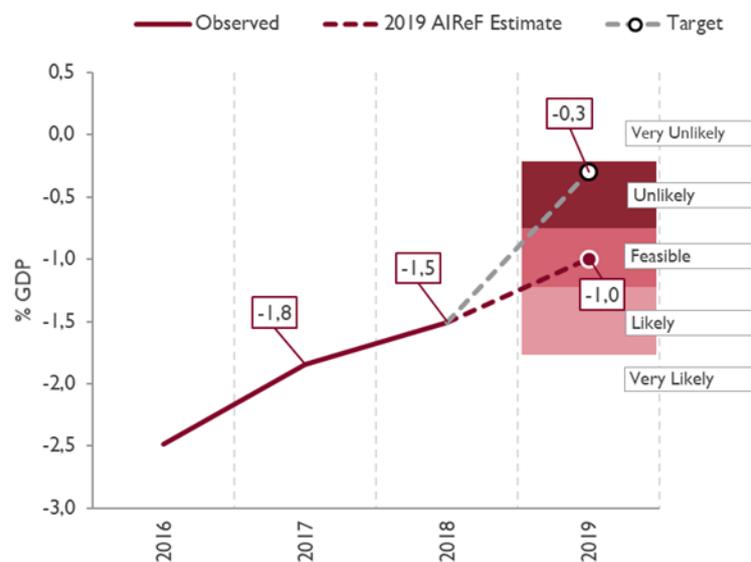
<sup>1</sup> See Box 1 of the [Report on the main budgetary lines and draft budgets of the PAs: draft GSB for 2019](#)

- Central Administration

A deficit of 1.0% GDP with a slight improvement of less than 0.1% GDP with respect to that envisaged in the January report is forecasted. Therefore, the achievement of the stability target of -0.3% GDP for 2019 remains unlikely.

Despite the fact that the end of 2018 was worse than expected at the time of preparing the previous report, mainly due to the imputation of non-recurring operations, the improvement of the balance occurs as it is precisely this sub-sector in which the effects of the non-approval of the GSB are concentrated, which has meant a substantial downward revision in their revenue estimates and, to a greater extent, of expenditure estimates.

CENTRAL ADMINISTRATION NET LENDING/BORROWING (% GDP)

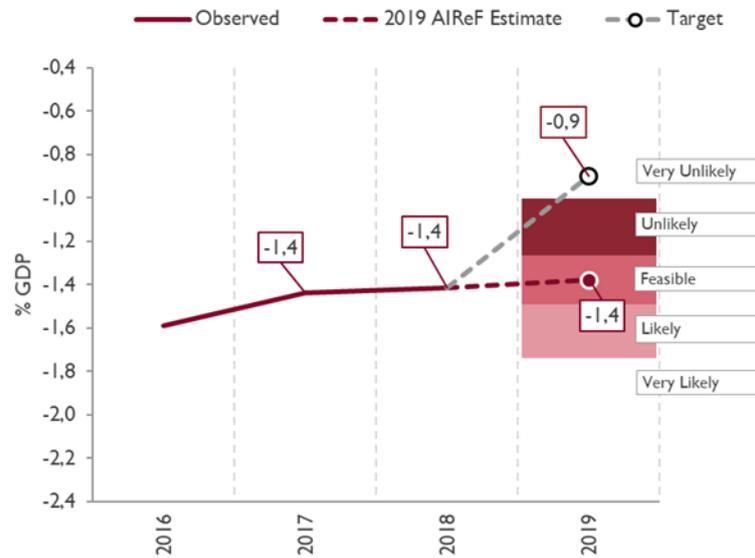


- Social Security Funds

A slight improvement in the closing forecasts of the SSF sub-sector with respect to the previous report is expected, going from -1.5% GDP to -1.4%, a similar deficit to that achieved in 2018. According to these forecasts, the target of -0.9% GDP for 2019 remains highly unlikely.

This positive variation derives from the published closing data for 2018 which were more favourable than expected, mainly due to the good evolution of contributions, which have led to a lower starting deficit level. In addition, in the context of the SSF, there have been no changes in the impact assessment of the measures in force despite the non-approval of the GSB.

SOCIAL SECURITY FUNDS NET LENDING/BORROWING (% GDP)

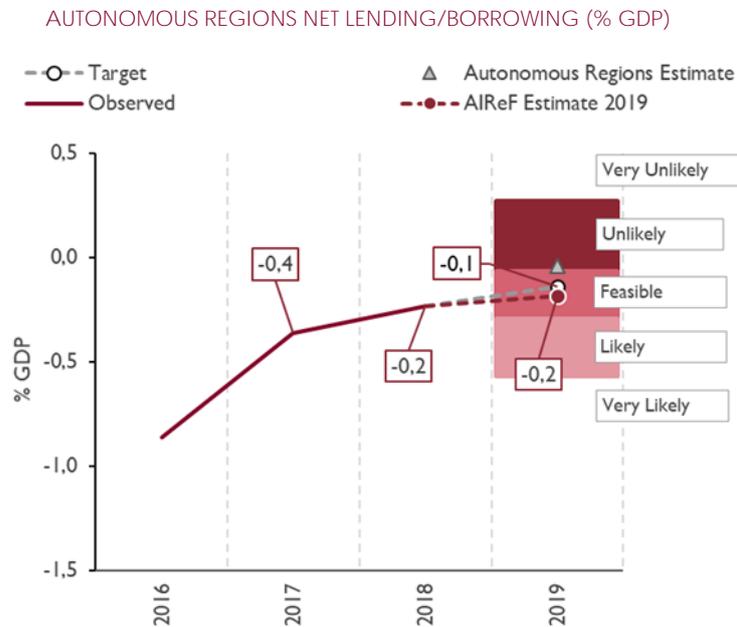


- Autonomous Regions

With a slight improvement with respect to the January report, AIReF still considers compliance with the stability target of -0.1% GDP to be feasible, with a baseline scenario that is maintained at the -0.2% estimated in the previous report under the assumption of a funding scenario in line with that envisaged in said report.

This invariance is due to the fact that the regional forecasts for 2019 do not feature substantial changes with respect to the main budgetary lines and draft budgets and that the improvement at the end of 2018 is only partially

translated to 2019, also remaining offset by other factors in a significant portion.



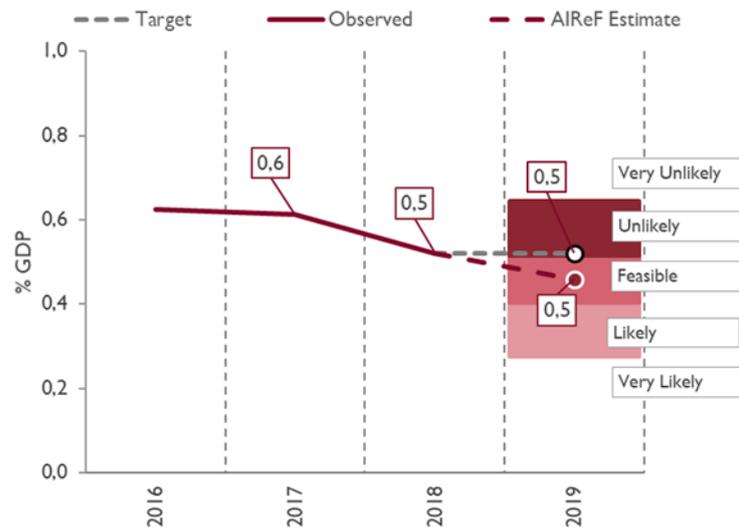
- Local Governments

AIReF believes that it is very likely that the local sub-sector will comply with the balance target in 2019, as it is feasible to achieve a surplus of around 0.5% GDP, slightly lower than in 2018. The assessment of the January report, under the assumption of a State funding scenario in line with that envisaged in the report, is therefore maintained.

There have been no significant changes in the budgets with respect to the main budgetary lines and draft budgets, nor in the 2018 closure published, although both the revenue forecasts of the financing system and the expected expenditure on investments have been revised downward, conditioned by the regulation of financially sustainable investments, whose carryover to 2019 did not occur until March (Royal Decree-Law 10/2019, of 29 March).

Regarding the expenditure rule, the forecasts of the Report on the Main Budgetary Lines and Draft Budgets are maintained in all sub-sectors, except in the CA in which an improvement is observed due to the lesser expenditure derived from the budgetary carryover.

LOCAL GOVERNMENTS NET LENDING/BORROWING (% GDP)



## Recommendations

AIReF recommends:

1. That the setting of budgetary stability targets for the 2020-2022 period is underpinned by a government debt reduction pathway, which translates into a fiscal strategy that includes an analysis of the evolution of the structural balance in the medium term. At the same time this future planning must take into account the European framework and the margin available in 2019.
2. To publish the analysis and information that serves as a basis for determining the path of the stability targets and debt for the GG and for each of the sub-sectors.
3. That the MINHAC:
  - establishes a procedure for the application of article 32 of the Organic Law on Budgetary Stability and Financial Sustainability (LOEPySF) to the TAs that includes a repayment schedule that takes into consideration the liquidities and financial costs associated with early repayment of the debt.
  - promotes the regulatory amendments that detail the competences of the LGs' financial guardianship bodies, and specify whether it is this body or another that should verify the calculations of compliance with the fiscal rules made by local intervention boards or equivalent bodies in the LGs of their territory.
  - specifies the consequences of the finding of errors in the calculation of the fiscal rules, as well as the consequences for the guardianship body

*or responsible body, in the event of not properly exercising these functions.*

In addition, two recommendations addressed to the MINHAC that have been reiterated in previous reports, and that AIRcF considers relevant for the effectiveness of the fiscal rules, remain active.

Finally, in this report AIRcF sets out the provisional main findings from the analysis of the Regions and the LGs, which will be included, along with the corresponding recommendations, in the individual reports to be published in the near future.



# 1 INTRODUCTION

The Organic Law on Budgetary Stability and Financial Sustainability (LOEPySF) **and AIReF's Regulation envisage** that AIReF must prepare a report on the initial budgets of the Public Administrations (PAs). Within 1 April of each year, AIReF must prepare a report on the initial budgets of the PAs from the perspective of their adaptation to the expenditure rule and budgetary stability and government debt targets, mainly concerning any variations detected with respect to the report on the main budgetary lines and draft budgets. With the information available on the Budgetary Plan for 2019 presented in October and the additional information from the various administrations in their main budgetary lines for 2019, AIReF issued a first pronouncement on the General Government (GG) sector's forecasts for 2019<sup>2</sup>. Subsequently, on 28 January 2019 AIReF updated its assessment in a new report once the draft General State Budget for 2019 had been presented before Parliament<sup>3</sup>.

Following the rejection of the draft GSB for 2019 in Parliament, this report analyses the impact of the budgetary carryover and updates the initial pronouncement **on the PAs' budgets**. On 11 January the Council of Ministers approved the draft GSB for 2019, which was presented before Parliament on 14 January for parliamentary procedure. Subsequently, the Parliament approved amendments put forward, so the draft was returned to the Government. Then the Government announced the dissolution of the Parliament and the calling of general elections for April 28 2019. As the previous report was drawn up on the basis of the information contained in the draft GSB, once it was rejected and most of the initial budgets of the Territorial Administrations (TAs) were approved, this report analyses the impact of the budgetary carryovers in the Central Administration (CA) and the TAs without an approved budget, and updates the January pronouncement **on the TAs' forecasts for 2019** on the basis of this information and the approved budgets.

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

<sup>3</sup> [Report on the draft GSB and the main budgetary lines of the Public Administrations for 2019.](#)



# 2

## PURPOSE AND SCOPE

The main purpose of this report is to assess the initial budgets with regard to any variations observed with respect to the information analysed in previous reports. AIReF prepares this Report with the State budget carried over from 2018 to 2019, completed with the measures adopted by the Government and the additional information received, and evaluates the adaptation of the Central Administration and Social Security Funds (SSF) sub-sectors to compliance with the budgetary stability and government debt targets, as well as to the expenditure rule. In the case of the Regions and LGs, the analysis was carried out by comparing the information in the initial budgets for 2019 with the information analysed in the reports on the main budgetary lines, except in those Regions and LGs with budgets carried over.

AIReF issues a pronouncement on the situation of the PAs and each of the sub-sectors, which will be completed in the context of the territorial administrations with additional individual reports. This report analyses the 2019 forecasts for the GG, globally and broken down for each sub-sector. The assessment presented in this report for the Regional and LG sub-sectors will be supplemented, for the Regions, with the publication of the individual reports on the initial budgets for 2019; and for the LGs, with a more extensive report with the individual analysis of the 21 large LGs and 3 Provincial Councils of the Basque Country, in addition to the local entities with significant sustainability risks, according to AIReF's methodology for selection and rating.

The analysis has been conditioned by similar constraints to those identified in the reports on the draft GSB and the main budgetary lines:

1. The lack of initial budgets in national accounting terms and reconciliation of the budgetary balance with the stability target. The GSB for 2018 and its carryover do not include information on the national accounting adjustments to be added to the budgetary balance. This information has been published since 2003 between the budgetary documentation<sup>4</sup>, but stopped being published from the GSB for 2017. In addition, Social Security's

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<sup>4</sup> Both in the Economic and Financial Report and in the yellow paper for Presentation of the GSB

Economic and Financial Report published information in national accounts headings until 2017. This lack of information, contrary to EU law and the principle of transparency laid down in the LOEPySF (articles 6 and 27), significantly affects AIReF's analysis, in so far as it prevents the budgetary forecasts being reconciled with the budgetary stability target, which is measured in national accounting terms.

2. The non-**inclusion of information concerning the CA's compliance with the expenditure rule and the debt target**. As in previous years the GSB for 2018 and its carryover do not mention the expenditure rule for the CA and only refers to the government debt target of the GG without including any reference to the CA's achievement of the debt target. This lack of information is again contrary to the principle of transparency laid down in the LOEPySF (articles 6 and 27).

On the other hand, although the advance GG closing data for 2018 is already known, there is no information on the expenditure rule in that period. On 29 March 2019 the advance GG national accounts closing data for 2018 was published, as well as the first execution data for 2019, January for the consolidated data of the Central Administration, Social Security Funds and Regions and February for the State and the Tax Agency's collection on hand. This information has been incorporated into the analysis of the fiscal rules in 2019. However, the published data on the end of 2018 only provide figures in relation to the administrations' net lending/borrowing, without being accompanied by information about the expenditure rule.

# 3 BUDGETARY STABILITY TARGET AND EXPENDITURE RULE

## 3.1 Macroeconomic scenario

In January AIReF endorsed the macroeconomic scenario for 2019 associated with the draft General State Budget. Based on its internal forecasts and making use of the latest data available, including the evolution of the futures markets, AIReF endorsed the official macroeconomic scenario, associated to the GSB for 2019. AIReF considered the macroeconomic scenario to be prudent overall. The assumptions that reflected the risks arising from the external environment were considered plausible and the composition of growth was considered reasonable, underpinned by a contribution of domestic demand similar to that of the previous two years, but with a slightly negative contribution of the external sector.

In the past two months, there have been no significant changes in the macroeconomic context for 2019. In relation to its report on the macroeconomic forecasts of the GSB for 2019 from January, AIReF does not observe any significant changes in the macroeconomic scenario for 2019. The latest short-term information available points to a quarter-on-quarter growth of 0.7% and 0.8% in the first and second quarter of 2019, respectively. As can be seen in figure 1, AIReF's thermometer, reflecting the evolution of the economy at the beginning of the year, points to virtual stabilisation around 0.7%.

**The AIReF's baseline growth forecast for 2019 has been slightly** affected by the revision of the Quarterly National Accounts, from 2.4% to 2.3%. The revision of the Quarterly Accounts published by the National Statistics Institute (INE) on 29 March has corrected the first quarters upward of 2018 and the last quarter downwards, with a positive impact on the whole year, with GDP growth from 2.5 to 2.6%. For 2019, however, the downward revision of growth at the end of 2018 has had a negative impact through a lower carryover effect. In particular, with no changes to the rest of assumptions regarding the evolution of the economy in 2019, the revision of the growth of the fourth quarter of 2018 from 0.7% to 0.6% entails 0.1%

less growth in 2019. AIReF has adjusted its forecast of real growth for 2019 in this vein, going from a 2.4% in its baseline path to 2.3%, as can be seen in figure 2.

The projected evolution for 2019 remains underpinned by a dynamic domestic demand, with a gradual recovery of the nominal component. The composition of growth envisaged by AIReF for 2019 remains anchored in a solid domestic demand, with a substantial contribution of private consumption, favoured by the policies to increase household income that have entered into force in 2019. The continuation of the expansionary cycle that began in 2014 implies a progressive accumulation of inflationary and wage pressures, supported in 2019 by the Minimum Wage increase adopted (see figure 2, which reflects the expected evolution of the GDP deflator).<sup>5</sup> In turn, the external sector, will consolidate its slightly negative contribution throughout 2019, as envisaged in previous reports, based on a weaker external demand.

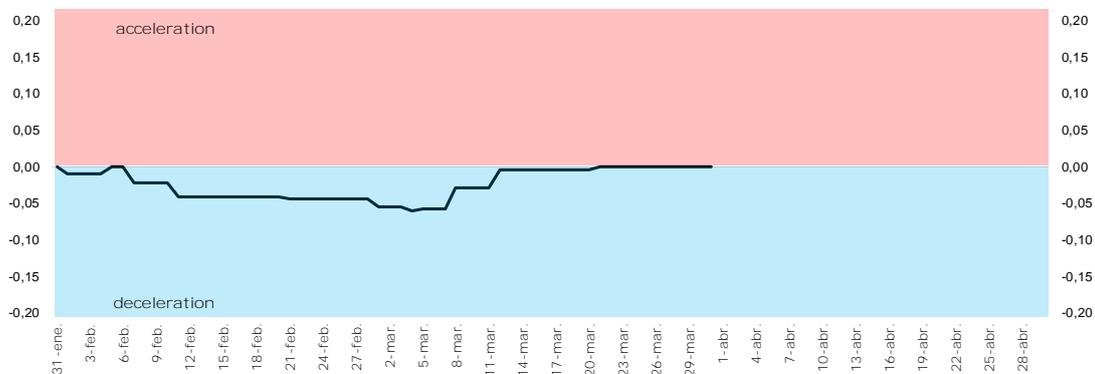
Finally, in the short term, the identification of risks carried out in the report on the GSB remains in effect, with precedence given to those arising from a more anaemic scenario of global growth and growth of the main trading partners of the Spanish economy. In the short term, there are still two main sources of risk for the Spanish economy. On the one hand, a slowdown in world trade, linked to an intensification of protectionist tensions, added to a lower growth in some of the main players in world trade such as China. On the other hand, at European level, it is worth noting the enormous uncertainty that surrounds the final stage of the departure of the United Kingdom from the European Union together with specific risks of contagion in the face of a deterioration in the Italian macro-fiscal scenario. Both risk scenarios deserve special attention and follow-up due to their possible impact in the short term.

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<sup>5</sup> It should be noted that the drop in crude oil prices poses a deflationary pressure that helps to contain increases in the price indices.

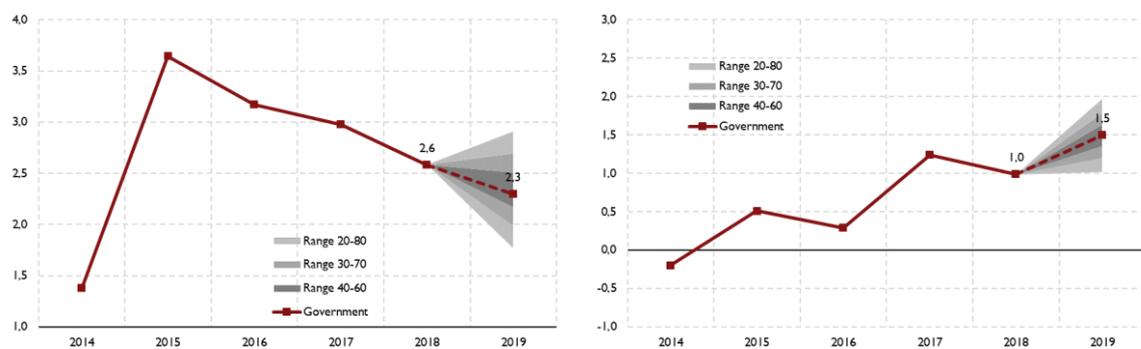
FIGURE 1. THERMOMETER OF THE SPANISH ECONOMY, GROWTH SURPRISES

Initial estimate for 2019Q1 growth (31<sup>st</sup> Jan 2019): 0.73%



Note: positive (negative) values signal a positive (negative) surprise with respect to nowcasted GDP figures. Series have been seasonally and calendar adjusted.

FIGURE 2. REAL GDP AND GDP DEFLATOR, 2019 (VAR. %).



Source: Datastream and AIReF's calculations.

### 3.2 General Government sector

AIReF still considers it unlikely that the stability target set at -1.3% GDP for 2019 will be complied with, while it forecasts a deficit lower than that estimated in the January report. Having analysed the carryover of the GSB and the information on the initial budgets of the TAs, AIReF estimates a deficit of 2.1% GDP for 2019. In this sense, while AIReF has improved prospects for this year by 0.1% GDP, it continues to consider compliance with the budgetary stability target set at -1.3% GDP to be unlikely.

FIGURE 3. TOTAL GENERAL GOVERNMENT

FIGURE 3.A. NET LENDING/BORROWING (% GDP)

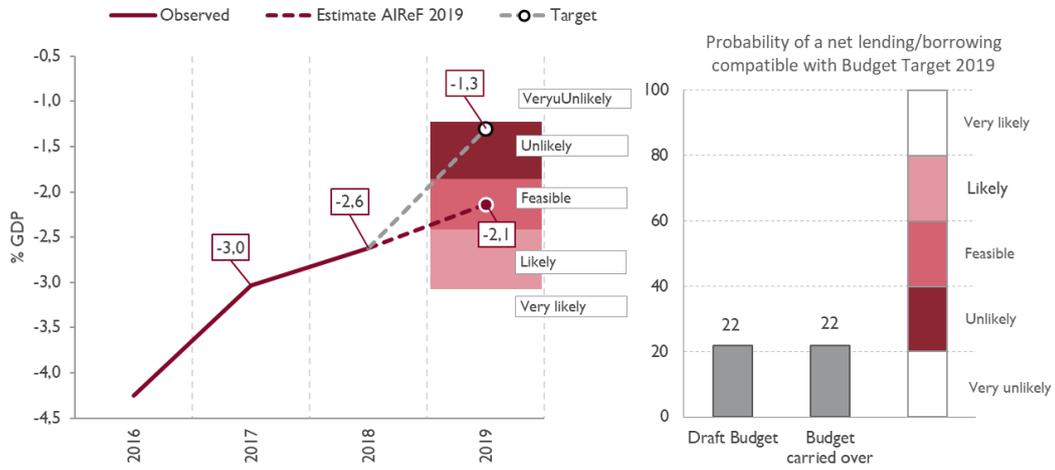


FIGURE 3.B. REVENUE (% GDP)

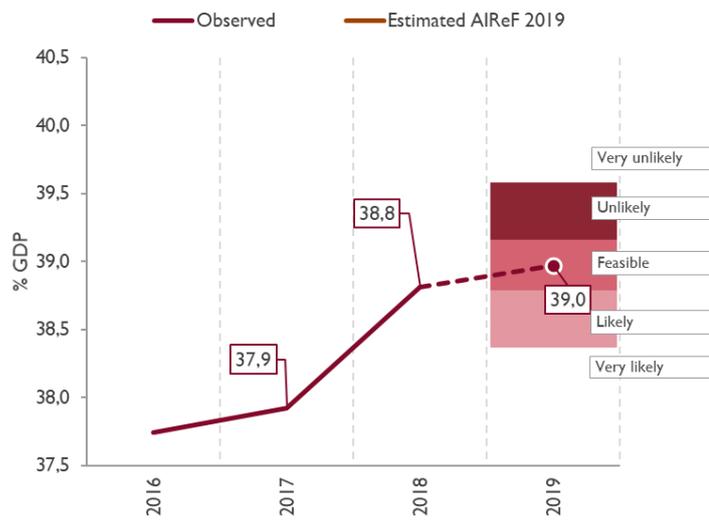
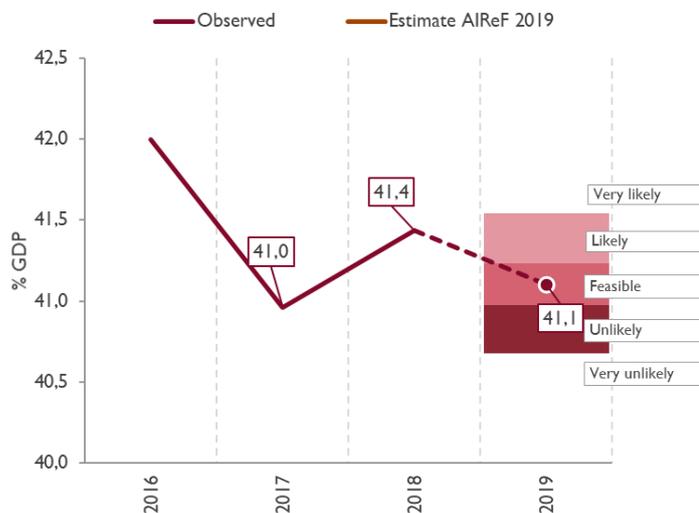


FIGURE 3.C. EXPENDITURE (% GDP)



AIReF estimates that in 2019 the PAs will reduce the deficit by 0.5% GDP. This reduction will be 0.3% GDP if we discount non-recurrent operations. In 2018, non-recurrent operations have had an impact of 0.5% GDP on the deficit. Of these, those relating to Corporate Income Tax and the State's financial liability for the reversal of several toll motorways (SFL) will not be replicated in 2019. Excluding non-recurrent operations in 2018 and 2019, the PAs' deficit reduction will be 0.3% GDP.

TABLE 1. BUDGETARY STABILITY TARGET

Lending (+) Borrowing (-) as % GDP	Year-end 2016	2017 CM Agreement Dec 2016	Year-end 2017	2018 CM Agreement July 2017	Year-end 2018	2019 CM Agreement July 2017	2019 AIReF
Central Administration	-2,6	-1,1	-1,9	-0,7	-1,5	-0,3	-1,0
Social Security	-1,6	-1,4	-1,5	-1,1	-1,4	-0,9	-1,4
Autonomous Regions	-0,9	-0,6	-0,3	-0,4	-0,2	-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	0,3	-0,1	0,3
General Government	-4,5	-3,1	-3,1	-2,2	-2,6	-1,3	-2,1

TABLE 2. NON-RECURRENT ITEMS WITH IMPACT ON THE DEFICIT

GENERAL GOVERNMENT SECTOR	2017	2018	2019
Deficit (%GDP)	-3,1	-2,6	-2,1
<i>Non-recurrent items*</i>			
Toll motorways		2.357	
Tax credits payable	512	1.073	500
APS Payments	797	1.788	1.648
Financial aid	508	78	
Ruling on Corporate Income Tax		702	
Maternity rebate		622	725
Estimated expenditure of interest on non-recurrent items		400	
Non-recurrent revenues from Corporate Income Tax		-1.600	
Non-recurring expenditure in Regions (various rulings; 2018 and 2019: AND, CVA, BAL)	629	992	315
Non-recurrent revenues in Regions (2018: settlement of EU Funds PO 07-13; 2019: extraordinary rev AST and CVA)		-507	-184
Non-recurring expenditure LGs (reclassification app and other)	108	35	
Non-recurrent items	2.554	5.940	3.004
Non-recurrent items (% of GDP)	0,2	0,5	0,2
PA deficit without non-recurrent items (% GDP)	-2,9	-2,1	-1,8

\* When positive, greater deficit; when negative, lower deficit

Source: AIReF estimate based on information published by IGAE and AEAT

**The changes in AIReF's** assessment with respect to the previous report stem from three fundamental factors. AIReF has identified three main causes for the variation of 0.1% GDP with respect to its assessment in the previous report: those arising from the parliamentary proceedings of the draft budgets of the PAs; the latest execution data published, both with respect to the end of 2018 and the first few months of 2019; and, to a lesser extent, the revision of the macroeconomic environment and its impact on revenue.

First, the non-approval of GSB has meant that many of the measures envisaged have not been implemented, which has led to a downward revision of the revenue and expenditure scenario:

- It is expected that no revenue measures will be implemented in 2019, reflected in the Budgetary Plan, for an amount that AIReF estimated at 2,908 million. The revenue measures within the scope of the SSF have entered into force, but the same has not happened with the CA's tax policy measures. Thus, bills governing the creation of the Tax on Certain Digital Services and the Tax on Financial Transactions have had their processing slowed with the calling for elections. Similarly, the amendments to Corporate Income Tax (CIT), Personal Income Tax (PIT), Value Added Tax (VAT) and the Tax on Hydrocarbons were rejected with the draft GSB. As a result, AIReF assumes no impact from these measures in its baseline scenario for 2019.

TABLE 3. REVENUE MEASURES FOR 2019: BUDGETARY PLAN AND AIREF'S ASSESSMENT

REVENUE MEASURES	Gov Estimate DBP 2019	AIReF Estimate DBP 2019	Gov Estimate GSB 2019	AIReF Estimate GSB 2019	AIReF Estimate Extension 2019
Corporate Income Tax	1.516	1.516	1.516	1.516	0
PIT Increase of rates on higher income	328	250	328	250	0
New tax figures	2.050	1.397	2.050	349	0
Tax on Financial Transactions	850	640	850	160	0
Tax on certain Digital Services	1.200	757	1.200	189	0
Green taxation (Hydrocarbons Tax)	670	670	670	503	0
VAT	-53	-53	-77	-58	0
Heritage Tax	339	8	339	0	0
Fraud prevention	828	460	828	348	0
<b>TOTAL CA IMPACT</b>	<b>5.678</b>	<b>4.248</b>	<b>5.654</b>	<b>2.908</b>	<b>0</b>
Maximum contribution bases increase of 7%		1.000	850	850	850
Minimum wage. Minimum bases General Regime	1.500	600	1.279	600	600
Special Self-employed Workers Regime Measures		1.000	6	6	6
Quota for professional contingencies			456	456	456
Additional contributions local police forces			254	254	254
Others			154	154	154
<b>TOTAL SSF IMPACT</b>	<b>1.500</b>	<b>2.600</b>	<b>2.999</b>	<b>2.320</b>	<b>2.320</b>

- On the expenditure side, of the forecasts of the Budgetary Plan valued by AIReF at 5,250 million, the measures in force only have an estimated impact of 1,508 million. The wage increase of public employees and the revaluation of pensions have been in force since the start of the year. In addition, the Government has recently approved the payment of social security contributions to caregivers, the recovery of the subsidy for those aged over 52 years along with other changes in their eligibility requirements, the extension of paternity leave and the increase in non-contributory benefits for dependent children. The rest of the measures to increase expenditure in the Budgetary Plan and the draft GSB would not enter into force in 2019.

TABLE 4. EXPENDITURE MEASURES FOR 2019: BUDGETARY PLAN AND AIReF'S ASSESSMENT

EXPENDITURE MEASURES	Gov Estimate DBP 2019	AIReF Estimate DBP 2019	Gov Estimate GSB 2019	AIReF Estimate GSB 2019	AIReF Estimate Extension 2019
Revaluation of pensions to the CPI and increase of minimum and non-contributory pensions to 3%	736	843	588	588	588
Pension revaluation to CPI		518	263	263	263
Increase of minimum and non-contributory pensions		325	325	325	325
Measures quantified jointly in the Budgetary Plan	1.318	1.318	1.633	1.435	920
Improve minimum and agreed level of dependency.		515	515	515	0
SS caregiver contributions		0	315	315	315
Recover subsidy for those older than 52 years		323	323	242	242
Paternity leave of 5 to 8 weeks		300	300	225	225
Minimum income		180	180	138	138
Measures listed in the Budgetary Plan and quantified in the additional information	425	725	492	812	0
Increased funding for scholarships	150	150	150	150	0
Aid for school materials	50	50	50	50	0
Meal aid	25	25	25	25	0
Increase in Science and R+D+i line items	150	150	217	217	0
Support for the production and promotion of film productions in different languages	20	20	20	20	0
Gender Violence Pact increase	20	20	20	20	0
Depopulation offices	10	10	10	10	0
Elimination of co-payment		300		320	0
Increases in expenditure included in the GSB 2019 not expressly identified in the Budgetary Plan			2.415	2.415	0
Increase in items for Development Cooperation			109	109	0
Increase in items for actions in favour of immigrants			94	94	0
Increase in items on housing actions			198	198	0
Creation of the Heating Rate Subsidy			80	80	0
Increase in items on transportation subsidies			234	234	0
Increase in the ADIF high-speed contributions and conventional ADIF investments.			1.700	1.700	0
<b>TOTAL MEASURES</b>	<b>2.479</b>	<b>2.886</b>	<b>5.128</b>	<b>5.250</b>	<b>1.508</b>

Second, the incorporation of closing data for 2018 into the analysis has resulted in a slight improvement in the estimate for 2019. Provisional data from the end of 2018 put the deficit at 2.6%. Although the deviation from AIReF's forecasts was

less than 0.1% GDP, the composition of revenue and expenditure and the breakdown by sub-sectors presents some differences:

- On the revenue side: it is worth noting the better behaviour of social security contributions and income from the European Structural Funds, which have especially impacted the Regions and that will be transferred in part to 2019, except for those corresponding to the liquidation of the previous Operating Programme.
- On the expenditure side: there has been lower expenditure on social benefits of the SSF with respect to that envisaged by AIReF. To the contrary, it would be necessary to add the impact of non-recurrent items amounting to 0.1% GDP, the materialisation of which was not known at the time of preparing the previous report.

Thirdly and lastly, the incorporation of the new macroeconomic data and the revision of the forecasts has a limited impact on revenues. As noted in the previous section, changes in estimates with respect to the previous report have been relatively minor and largely stem from the revision of 2018 data. These changes are transferred to the evolution of revenue through their impact on the bases, with a result limited in its amount and differentiated by tax figures as described below. In addition, the revision of the 2018 GDP and the forecast for 2019 has a denominator effect that raises the weight of revenue and expenditure over GDP by approximately 0.1%.

At the sub-sector level, AIReF maintains its assessment regarding the probability of compliance with the stability target in all sub-sectors. As indicated in previous paragraphs, the observed variations with respect to the January report have very little effect, barely 0.1% GDP, in which in AIReF's assessment stands at 2.1% GDP. This is as a result of the fact that variations in some headings are compensated by others, almost entirely counteracting the positive effects or lower deficit with negative effects or higher deficit. The closing forecasts of the SSF and the CA improve slightly, with those of the TAs remaining constant, without the recorded changes modifying the general assessment of compliance in any sub-sector or in the GG sector.

TABLE 5. RATING OF PROBABILITY OF COMPLIANCE 2019

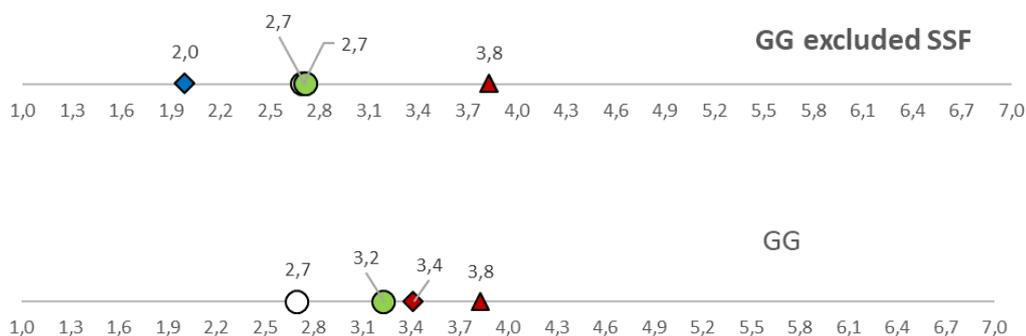
	Budgetary Stability Target
<i>Central Administration</i>	Unlikely
<i>Social Security</i>	Very unlikely
<i>Autonomous Regions</i>	Feasible
<i>Local Corporations</i>	Feasible*

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

Regarding compliance with the expenditure rule, differing behaviour among sub-sectors is maintained, although the lower expenditure as a result of the carryover of the GSB changes the situation with respect to the previous report. The main change with respect to the previous report is concentrated in the CA as a result of the lower growth of computable expenditure and the effect of policy measures. The Regions are not expected to comply with the expenditure rule and the LGs could comply, although it would be difficult. The aggregate computable expenditure of these sub-sectors is expected to comply with the expenditure rule. The decrease in the CA's computable expenditure offsets the growth of the rest of sub-sectors, making the aggregate of the CA, Regions and LGs comply with the expenditure rule. The policy measures to increase revenue of the Regions and LGs offset the effect of the CA's measures.

Considering the computable expenditure of the SSF, the GG sector grows slightly above the adjusted reference rate of revenue measures. Although the expenditure rule does not apply to the SSF, an approximation to the rule envisaged in the EU legislation would achieve a growth computable expenditure of 3.4%, slightly above the adjusted reference rate of measures and below nominal GDP.

FIGURE 4. COMPLIANCE WITH THE EXPENDITURE RULE



### 3.3 Central Administration

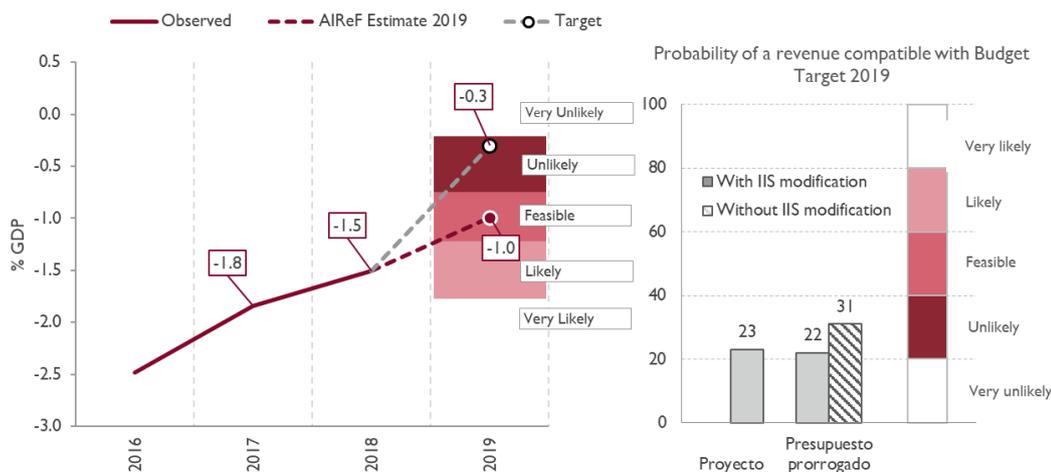
AIRcF continues to consider it unlikely to achieve the stability target of -0.3% GDP for 2019. To achieve this deficit, the CA would have to reduce the deficit by 1.2 % GDP compared to the end of 2018. It is considered unlikely that this adjustment will be achieved given AIRcF's forecasts based on the revenue and expenditure included in the GSB carryover and the measures that have been adopted by the Government. The CA is the sub-sector that most reduced its deficit in 2017 and 2018 and the only one that is expected to reduce it in 2019. Despite this, it is also the one that most deviated from the approved target. With respect to the forecast of the previous report, the CA's deficit would be reduced by less than 0.1% GDP.

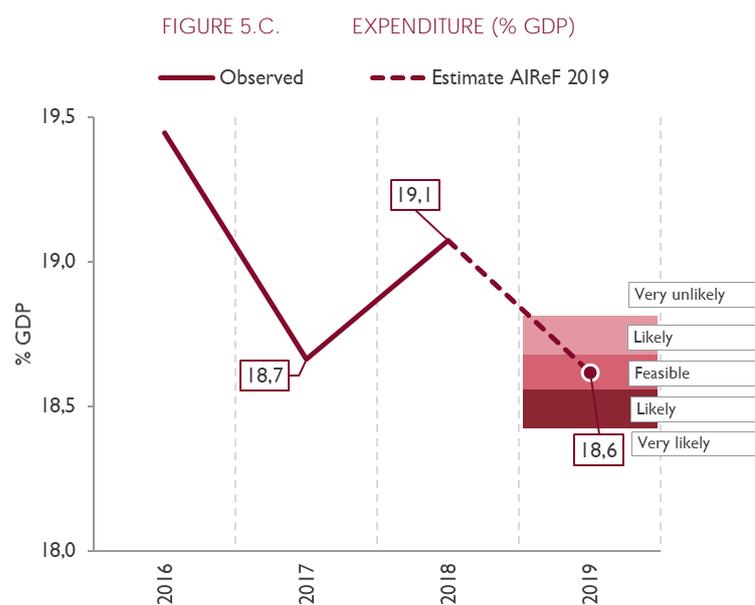
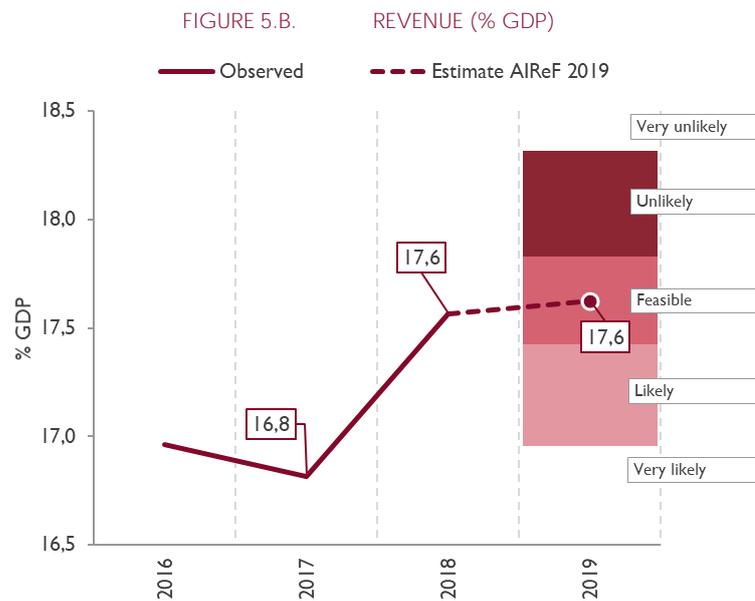
The rejection of the draft GSB for 2019 substantially alters the revenue and expenditure estimates. The forecast of the CA's revenue for 2019 is reduced by 0.3% with respect to the previous report, to 17.6% GDP. This reduction in revenue is mainly explained by the absence of measures both creating new taxes and amending CIT, PIT and the Tax on Hydrocarbons. On the other hand, the expenditure estimate is reduced by 0.3%, due to the non-application of the expenditure increases envisaged in the draft GSB for 2019 and the existence of various non-recurrent operations in 2018 that are not repeated in 2019. In this way, in AIReF's baseline scenario expenditure would be 18.6% GDP.

**The closing data for 2018 have raised the CA's deficit by 0.1% GDP, mainly due to non-recurrent items.** Revenue has been revised by less than 0.1%, while expenditure has increased by 0.2% with respect to the forecast contained in the report on the GSB. To the extent that these changes mainly relate to non-recurrent operations, these new data have a limited impact on the estimates for 2019.

FIGURE 5. CENTRAL ADMINISTRATION

FIGURE 5.A. NET LENDING/BORROWING (% GDP)





### 3.3.1 Non-financial revenue forecast

**In national accounts the CA's revenue maintain its weight over GDP at 17.6%.** In 2019, most of the headings maintain an increase with respect to 2018, in line with nominal GDP. However, there are two opposite effects; on the one hand, the unfavourable evolution of CIT deducts 0.1% from the weight of revenue over GDP, on the other, the impact of the measures approved by the GSB for 2018 that primarily affect the Tax on Hydrocarbons also add 0.1%, offsetting both effects. The changes with respect to the previous report are concentrated in the tax revenue analysed in more detail below, both in cash and national accounting terms before transfers to the territorial administrations. Regarding the

CA's other non-tax revenue, excluding the effect of the transfers between PAs, AIReF does not estimate substantial modifications with respect to the report on the GSB.

AIReF estimates a growth of tax revenue before transfer to the TAs of 4.3%, almost 2% less than its previous forecast of 6.1%. The non-approval of the GSB would deduct 1.4% from the growth envisaged in the previous report. The rest of the deviation, which represents 0.4% lower growth, is justified by the incorporation of new information.

TABLE 6. EVOLUTION OF TAX REVENUE BEFORE TRANSFER TO THE TAS

Growth in % var. 2019/2018	AIReF Estimate Draft GSB (1)	Effect of measures not approved by the Draft (2)	New information effect (3)	AIReF Estimate Initial budgets (4)= (1) - (2) - (3)
PIT	4,0	-0,3	0,3	3,9
VAT	4,6	-0,1	-0,1	4,4
CT	11,4	-6,7	-5,1	-0,4
ST	11,4	-2,5	1,8	10,7
NRIT	2,7	0,0	-2,2	0,5
Others	13,1	-4,6	-1,4	7,1
<b>TOTAL</b>	<b>6,1</b>	<b>-1,4</b>	<b>-0,4</b>	<b>4,3</b>

Of the main taxes, CIT and Special Taxes are the most affected by the rejection of the GSB, cutting their growth by a 6.7, and 2.5 percentage points, respectively. The rejection of the GSB has prevented the entry into force of the amendment to CIT, the rise of the diesel rate in the Tax on Hydrocarbons and the marginal rates in PIT. On the other hand, the calling for elections has slowed the draft regulations of the new tax figures proposed in Parliament: the Tax on Certain Digital Services and the Tax on Financial Transactions, which is reflected in the table in the growth of the "others" heading. The non-approval of these measures explains 0.2% of the 0.3% GDP reduction in the forecast of the CA's revenue, since it entails a lower estimated revenue of 2,908 million euros.

The rest of the deviation, which entails 0.4 p.p. lower growth, is justified by the incorporation of new information. On the one hand, the new macroeconomic data explain a slight modification of the forecast of the bases. On the other hand, the new collection data and tax refunds explain changes in the collection mechanism that affect CIT to a larger extent. There have also been changes in the way in which some of the non-recurrent items are accounted for. Specifically, the refunds for maternity leave are accounted for as a greater expenditure between 2018 and 2019, although most of the cash impact will occur in 2019. On the other hand, a court ruling for a very significant amount that was not known in the previous report is imputed in national accounts as a return of CIT in 2018 and therefore will only impact the tax on cash accounting in 2019.

### 3.3.2 Tax on cash accounting before transfer to the Territorial Administrations.

The behaviour of the tax bases in 2018 resulted in an increase in collection of 7.6%, in line with the year-end forecasted in the Report on the draft GSB. The tax bases of the main taxes grew by 6.1% in 2018, 0.3% above the growth expected in the previous report mainly as a result of the good evolution of wages (revenue base) and prices (expenditure base). Following the approach of the previous report, the growth of tax on cash accounting, has been broken down into two components, on the one hand, the "regulatory" component, and, on the other hand, the "macro" component, or explained by the economic cycle<sup>6</sup>. In order to allow the comparability of the estimates of both reports the impact of those measures that did not end up being approved through the draft GSB for 2019 was isolated, in order to have two homogeneous figures that allow the change caused by the new information available to date to be analysed, once this effect had been eliminated. Once this effect is eliminated the differences between the estimate presented in the previous report and the current estimate are analysed.

AIRcF considers a greater growth of the expected collection from PIT with respect to the previous report, from 3.0% to 3.6%. The main difference with respect to the previous estimate can be found in the macro component as growth is expected to be 0.4 p.p. higher than in the report on the draft GSB, essentially due to a more optimistic estimate of the amount of the tax difference of the statements of tax due in 2018 and to a greater contribution of the effective rates as a result of improving wages at the end of the year, offset by a slight downward variation of the estimate in the bases. The effect of the refunds for maternity benefits has been revised upward according to the latest published data, which is reflected in the variation in the regulatory effect.

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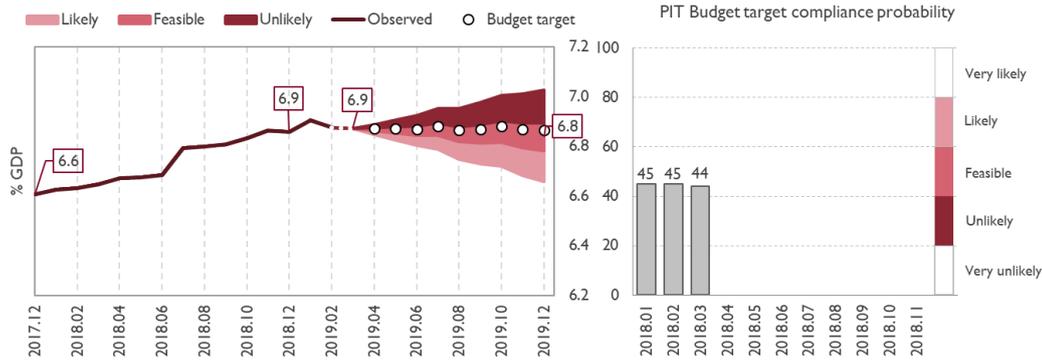
<sup>6</sup> The "macro" effect is broken down into three parts: (1) the evolution of the bases, explained by macroeconomic changes, (2) the evolution of rates, justified by the progressivity of each tax, and (3) the evolution of the collection mechanism, motivated by a change in the tax refunds, application of postponements, changes in the tax difference, etc...this is the last component in which imputation differences may occur between the cash and national accounting criteria.

TABLE 7. BREAKDOWN OF THE CHANGE IN PIT

PIT	2018 year-end	AIReF Estimate Draft GSB 2019 (*)	AIReF estimates 2019
Total (% var.)	7,6	3,0	3,6
<i>Breakdown of growth:</i>			
(1) Regulatory effect	-0,5	-2,2	-1,9
(2) Macro effect (a)+(b)+(c)	8,1	5,1	5,5
Evolution of bases (a)	5,2	4,1	3,6
Evolution of rates (b)	1,0	1,4	1,9
Effect of collection mechanism (c)	1,8	-0,4	0,1

(\*) AIReF Estimate in the Report on the Draft GSB 2019 eliminating the effect of the measures not approved

FIGURE 6. PERSONAL INCOME TAX



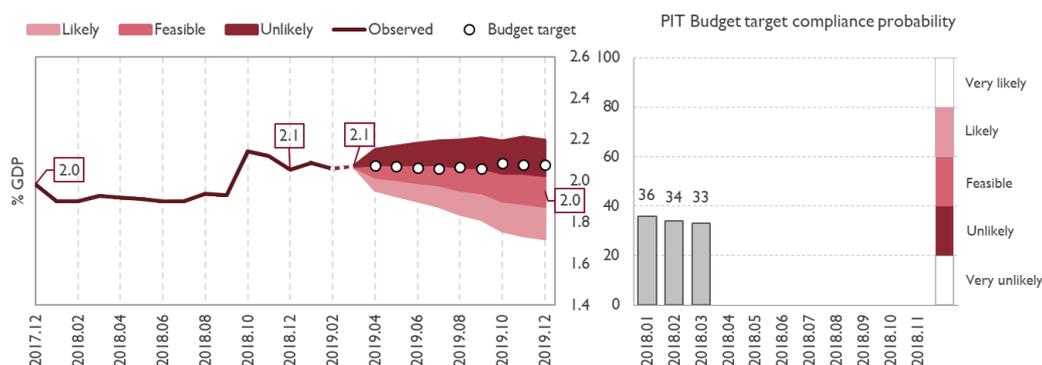
On the contrary, the expected collection of CIT decreases by more than 6 p.p. with respect to that expected in the previous report. The drop-in collection is due to several factors. On the one hand, the execution of the judgement issued in January according to which a lower collection by €700 million is expected, and which would reduce the growth previously expected by 2.8% and on the other, the incorporation of new information relating to refunds, which would imply a reduction of 3.6% of the previous growth. This increase in refunds is a result of the extraordinary revenues that occurred with the second instalment payment of 2018 and that, according to information from the Tax Agency, was due to the fact that five major consolidated groups declared benefits that accounted for more than double than in the same period of 2017. Accordingly, it is considered that these revenues are non-recurrent and that they would result in an increase in future refunds. This is partially reflected in cash in 2019 and 2020, but in national accounts all the impact would occur in 2019.

TABLE 8. BREAKDOWN OF THE CHANGE IN CIT

Corporate Income Tax	2018 year-end	AIRcF Estimate Draft GSB 2019 (*)	AIRcF estimates 2019
Total (% var.)	7,3	5,3	-1,1
<i>Breakdown of growth:</i>			
(1) Regulatory effect	0,0	0,0	-2,8
(2) Macro effect (a)+(b)+(c)	7,3	5,3	1,7
Evolution of bases (a)	12,8	6,4	8,1
Evolution of rates (b)	2,0	0,0	1,2
Effect of collection mechanism (c)	-7,5	-1,1	-7,6

(\*) AIRcF Estimate in the Report on the Draft GSB 2019 eliminating the effect of the measures not approved

GRÁFICO 1. CORPORATE INCOME TAX



The collection of VAT is also revised downwards, cutting the growth envisaged in the report on the draft GSB for 2019 by 0.7 p.p. The new available information does not imply a change in the forecast of the bases or in the average rates, with the changes being centred on a lower contribution in the collection mechanism component caused by a larger amount of refunds expected in 2019. AIRcF's forecasts envisage a scenario in which a change to the Immediate Information System (IIS) is approved, which would mean, in cash terms, higher revenue in 2019 of about €4,590 million, justifying more than half of the expected increase in the collection of the tax. Excluding this modification of the IIS, VAT collection would grow by 3.9% compared to the 4.7% previously estimated.

TABLE 9. BREAKDOWN OF THE CHANGE IN VAT

VAT	2018 year-end	AIReF Estimate Draft GSB 2019 (*)	AIReF estimates 2019
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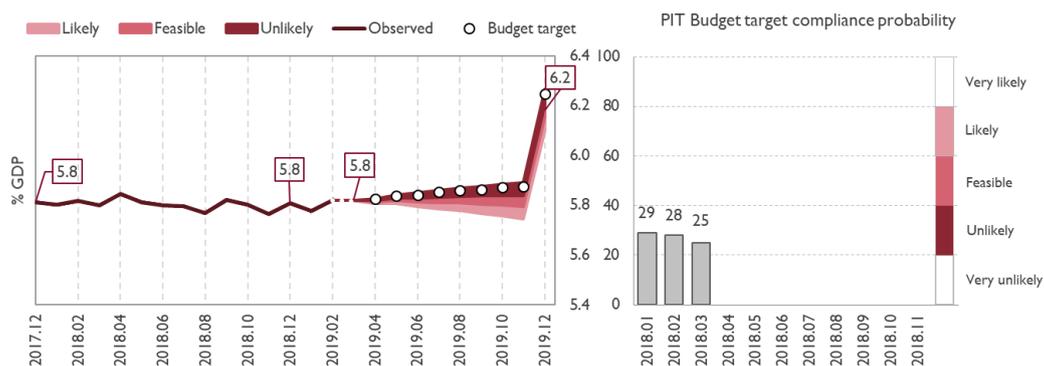
Total (% var.)	10,3	11,2	10,5
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Breakdown of growth:

(1) Regulatory effect	5,8	6,5	6,5
(2) Macro effect (a)+(b)+(c)	4,5	4,7	3,9
Evolution of bases (a)	5,6	4,6	4,5
Evolution of rates (b)	-0,1	0,0	0,0
Effect of collection mechanism (c)	-1,1	0,1	-0,6

(\*) AIReF Estimate in the Report on the Draft GSB 2019 eliminating the effect of the measures not approved

GRÁFICO 2. VALUE ADDED TAX



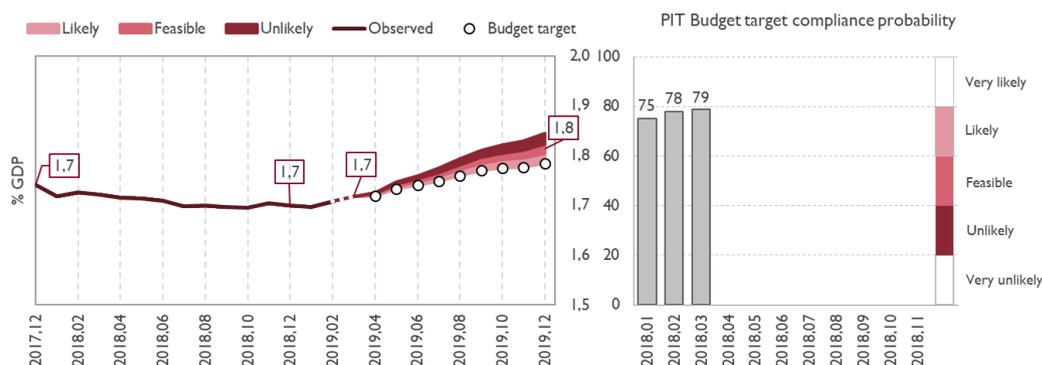
AIReF improves the forecast of the collection of Special Taxes (ST) by more than 1%. This improvement is produced by a greater contribution of the collection mechanism in the set of these taxes and in particular in the tax on Tobacco Products. This revision is due to the incorporation of new collection data to February 2019.

TABLE 10. BREAKDOWN OF THE CHANGE IN ST

ST	2018 year-end	AIRcF Estimate Draft GSB 2019 (*)	AIRcF estimates 2019
Total (% var.)	1,1	9,1	10,8
<i>Breakdown of growth:</i>			
(1) Regulatory effect	0,0	6,6	6,6
(2) Macro effect (a)+(b)+(c)	1,1	2,5	4,2
Evolution of bases (a)	6,8	2,4	2,3
Evolution of rates (b)	-4,6	0,0	0,3
Effect of collection mechanism (c)	-1,1	0,1	1,6

(\*) AIRcF Estimate in the Report on the Draft GSB 2019 eliminating the effect of the measures not approved

FIGURE 7. SPECIAL TAXES



### 3.3.3 Non-financial expenditure forecast

AIRcF estimates that the rejection of the draft GSB will reduce the CA's expenditure growth from 4.1% to 1.4%. The carryover means that some of the expenditure increases envisaged in the draft GSB will not materialise, although those approved will be implemented through other legal rules. In addition, it should be noted that in 2018 there were specific operations that will not be repeated or will not do so in the same magnitude in 2019. In homogeneous terms, without considering the effect of these non-recurrent items, 2019 growth would be close to 2.2%.

TABLE 11. BREAKDOWN OF THE VARIATION OF NON-FINANCIAL EXPENDITURE

AIReF forecasts (CA Expenditure)	Validity	% Var Report GSB	Current % Var
Compensation of employees		4,5%	4,5%
Increase of 2.4% with the agreement with Trade Unions	Yes		
Wage equalisation of the State Law Enforcement Agencies with independent police forces	Yes		
Progressive increase of payroll to 2021	Yes		
Interest		-2,3%	-2,8%
Reduction of 0.1% GDP	Yes		
Conservative estimate of the GSB	Yes		
Social benefits other than transfers in kind		5,1%	4,9%
<b>Civil servants' benefits increased to 5.8% in line with the GSB</b>	Yes		
Increase of 4.4% in the negative taxes	Yes		
Rest of current expenditure		4,4%	0,9%
Current international cooperation, Transport subsidies and frozen scholarships.	No		
Increased electoral expenditure	No		
Current and capital transfers between PAs		5,6%	4,3%
Particular increase in transfers to the TAs	Yes		
Increase in transfers to the SSF	No		
Gross Fixed Capital Formation (without SFL in 2018)		23,3%	-0,9%
Moderate growth of investments of the Ministries	No		
<b>Strong increase of conventional ADIF investments (€1,400M)</b>	No		
Containment in the delivery of Defence Modernisation Programmes	Yes		

Investments are strongly affected by the budgetary carryover and by the incidence of non-recurrent items in 2018 that are not repeated in 2019. The draft GSB for 2019 included a strong increase in gross capital formation that was concentrated in railway investment. The rejection of the budgets means that in 2019 this heading will go from growing by 23.3% to declining by 0.9%, excluding the effect of non-recurrent items. The reduction of investments also translates into less capital transfers due to the reduction in the contribution to *ADIF - Alta Velocidad*. If we include the effect of non-recurrent items, gross capital formation will fall by 19.5% in 2019. In 2018 the State's Financial Liability (SFL) for bailing out toll motorways entails an increase in Gross Capital Formation of 686 million euros, in addition to 1,114 million euros as a capital transfer. In addition, 557 million are imputed in 2018 for investments made by highway concessionaires. Finally, 342 million for the reversion of the A1 motorway, which is also recorded as a revenue for the same amount. None of these three elements are repeated in 2019.

Investment aid and capital transfers have been revised since the previous report based on the information published on year-end. This heading includes significant non-recurrent items, that either have no equivalent in 2019 or their impact is smaller. In particular they have a lower impact in 2019 compared to 2018: payments for Asset Protection Schemes; the tax credits payable which will

fall from 1,073 million euros in 2018 to approximately 500 million in 2019 and the impact of the SFL for toll motorways stated above, which is 1,114 million euros in 2018 that is not repeated in 2019. To the contrary, the amount of PIT refunds for maternity rises compared to 2018 and the previous forecast according to data published in February.

The rest of expenditure items present lower growth rates than the draft GSB. This lower growth is primarily due to the fact that measures such as an increase in grants, subsidies to transport and current international cooperation provided for in the GSB will not enter into force. Conversely, the increase in intermediate consumption due to the electoral expenditure is maintained despite not being provided for in the carryover, due to the fact that the corresponding budgetary amendment has already been processed under the Contingency Fund. In addition, the expected contribution to the EU is maintained, as AIRcF considers that the amendments necessary to meet the forecasts of the EU's budget will be carried out regardless of the carryover of the GSB.

**Compensation of employees and civil servants' benefits are not affected by the** carryover since they were regulated by Royal Decree Law. Both the rise of public employees' salaries and the revaluation of civil servants' pensions have been in force since the beginning of the year, as they were regulated by Royal Decree-law in December 2018, so they have not been affected by the rejection of the draft GSB. According to AIRcF's estimates, compensation of employees will grow by 4.5% as reflected in the report on the GSB. For its part, civil servants' benefits will experience a growth of 5.8% according to AIRcF's estimates and in line with the forecast included in the draft GSB that was rejected. The rest of the heading "Social benefits other than transfers in kind" is only marginally affected by the increase in the negative taxes due to deductions for maternity and paternity leave, large family and dependant family member with disability in PIT, which were amended in the GSB for 2018.

The estimate of interests was updated according to the latest execution data and the end of 2018, not presenting significant deviations from the previous report. The evolution of this item is not contingent upon the approval of the GSB, but on the Treasury's emission strategy and the evolution of interest rates and inflation. As a result, the changes are due to the new data incorporated into the analysis. In the case of the end of 2018, it is worth noting the imputation of expenditure on interest for non-recurrent items that would not have an equivalent in 2019. Accordingly, only an upward revision was made in accordance with the execution data until February.

The rejection of the draft GSB makes updating the transfers between PAs difficult. In the case of the Regions, it affects the updating of instalment payments and the entry into force of the amendment to the VAT Immediate Information System

(IIS), although AIReF assumes that these changes will be implemented before the end of the year. Conversely, it is considered that there will be no transfers arising from the conventions that were included in the draft GSB. With respect to transfers to the SSF, AIReF has considered the transfers included in the carryover, less than those contained in the draft GSB because the carryover does not provide for the improvement of the guaranteed minimum for dependency. The transfers estimated by AIReF mean maintaining the weight over GDP compared to 2018. However, in the absence of changes in the VAT-IIS, transfers to the TAs would be lower by 0.2% GDP than in 2018.

In the absence of changes to the VAT-IIS, **the CA's deficit would be reduced by 0.2% GDP**, although the target would continue to be unlikely. The amendment of the deadline for companies subject to the IIS to enter self-settlements represents an increase of revenue on hand in 2018, but does not have an effect in national accounting terms. However, this revenue on hand does imply greater instalment payments for the TAs. As a result, transfers to the TAs would be 0.2% GDP lower than those of 2018, while revenue would remain unchanged.

### Box. Budgetary carryover

The budgetary legislation envisages automatic carryover of the General State Budget in the event that it is not approved before 1 January. Under these circumstances, the previous budget's appropriations are automatically considered as the appropriations of the current budget, excluding those corresponding to programmes or actions that end in the year whose budget was carried over or for obligations that will be cancelled in the same.

The GSB has been extended on 8 occasions, in 1978, 1982, 1995, 2011, 2016, 2017, 2018 and 2019.

To adjust the budgetary appropriations and regulate aspects that are usually set out in the articles of the GSB, in the case of budgetary carryover it is usual for Governments to adopt, by Royal Decree-Law, urgent measures to regulate the management of expenditure during the carryover period.

In 2018 two Royal Decree-Laws were adopted that, on the one hand, made it possible to adapt the carried over budget to the agreements already adopted in the field of compensation of employees and revaluation of pensions and, on the other hand, included additional measures that were envisaged in the rejected draft GSB:

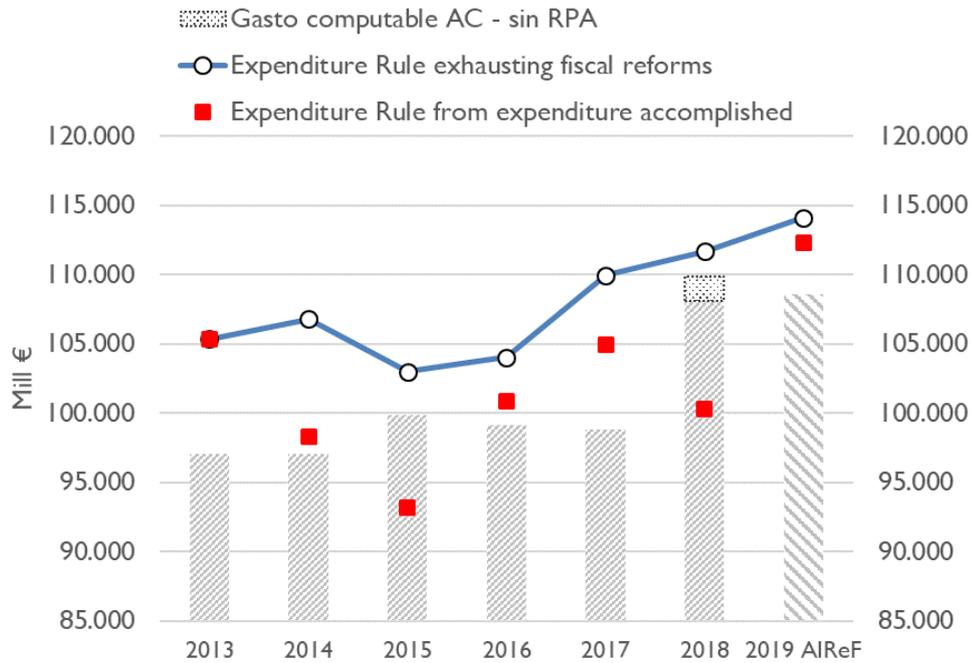
- Royal Decree-Law 24/2018, of 21 December, approving urgent measures in the field of compensation in the public sector in order to be able to apply the agreement reached with the Trade Unions to compensation of employees
- Royal Decree-Law 28/2018, of 28 December, for the revaluation of public pensions and other urgent measures in social, labour and employment matters.

In March 2019 two other Royal Decree-Laws were adopted with social measures that will also have an impact on the expenditure carried over (Royal Decree-Law 6/2019, of 1 March, urgent measures to guarantee equal treatment and equal opportunities between women and men in employment and occupation and Royal Decree-Law 8/2019 of 8 March on urgent measures for social protection and the fight against job insecurity in the working day).

The computable expenditure is reduced by 1.2% compared with the end of 2018, therefore complying with the expenditure rule. With the available information and AIRcF's estimates it can be observed that the computable expenditure for 2019 is reduced by 1.2% compared to the growth of 2.7% that the reference rate approved for 2019 would have allowed. The growth of compensation of employees and expenditure on civil servants' benefits is offset by the lower investments due to the non-repetition in 2019 of the SFL and the lower impact of DTAs compared to 2018. On the other hand, the permanent policy measures

considered by AIReF that include the impact in 2019 of the measures taken in 2018 on PIT, will entail a lower collection of 580 million euros.

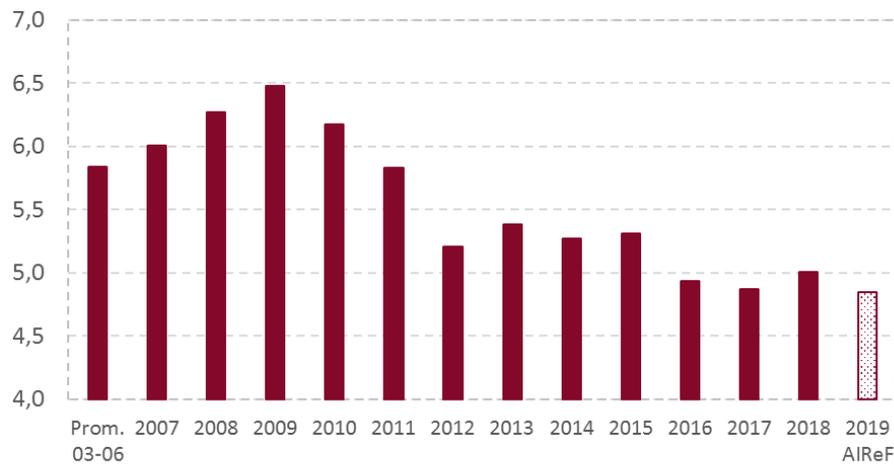
FIGURE 8. CA COMPUTABLE EXPENDITURE AND COMPLIANCE WITH THE EXPENDITURE RULE



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

**Almost 52% of the CA's expenditure is allocated to making transfers to other PAs,** therefore the margin of discretionary expenditure is reduced. This discretionary expenditure has recorded significant reductions over the years of fiscal consolidation. In 2018 the discretionary expenditure increased primarily due to the improvement in employee compensation and the increase in investments, even without taking into account the SFL for toll highways. This level is reduced in 2019 as a result of the carryover of the GSB and lower impact of certain non-recurrent measures such as the materialisation of the tax credits due.

FIGURE 9. EVOLUTION OF THE CA'S EXPENDITURE WITHOUT TRANSFERS TO THE PAS, INTEREST, CIVIL SERVANTS AND EU CONTRIBUTIONS (%GDP) WITHOUT SFL



### 3.4 Social Security Funds

AIReF continues to consider it unlikely to achieve the target of 0.9% GDP, with a deficit similar to that achieved in 2018 being the most likely scenario. Compliance with the legally approved target would require the SSF to make an adjustment of 0.6% GDP on the -1.5% GDP reached in 2018, an adjustment that is considered to be very unlikely.

**The 2018 deficit was almost €900 million lower than anticipated** in the previous report. This result was partially due to a better behaviour of contributions than expected and a lower expenditure on benefits. Both effects cause an upwards levelling effect in 2019, in relation to the previous report.

In 2019 AIReF expects an evolution of SSF revenue and expenditure as highlighted in the previous report, since practically all measures in the Budgetary Plan have been approved by Royal Decree-Laws. The dynamism of contributions driven by the measures makes revenue grow above 6%. On the expenditure side, social benefits accelerate the pace of growth with rates above 5%. Thus, both pension expenditure and expenditure on unemployment benefits increase their weight over GDP.

FIGURE 10. SOCIAL SECURITY FUNDS

FIGURE 10.A. NET LENDING/BORROWING (% GDP)

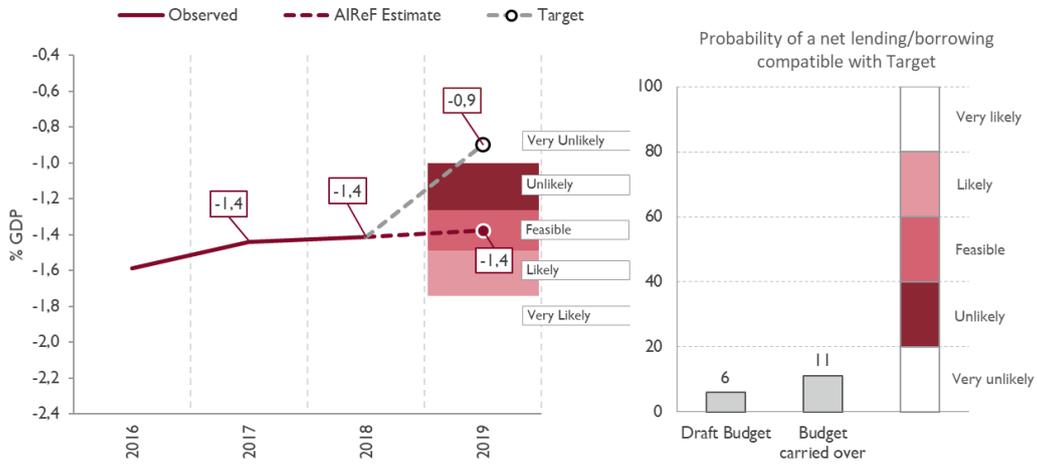


FIGURE 10.B. SSF REVENUE (%GDP)

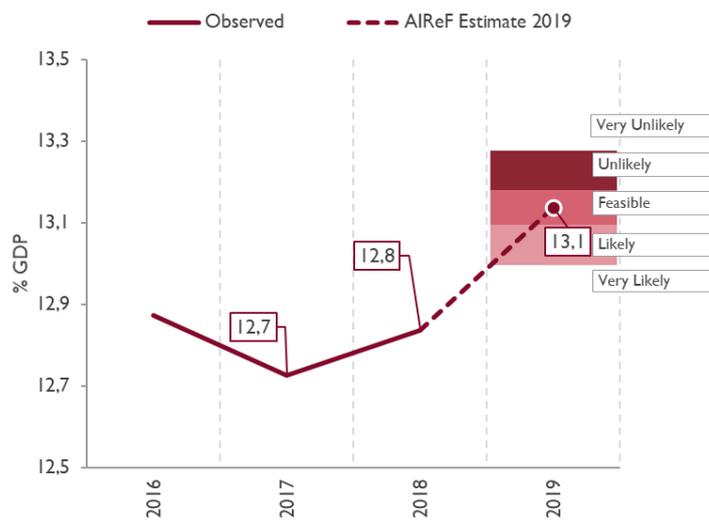
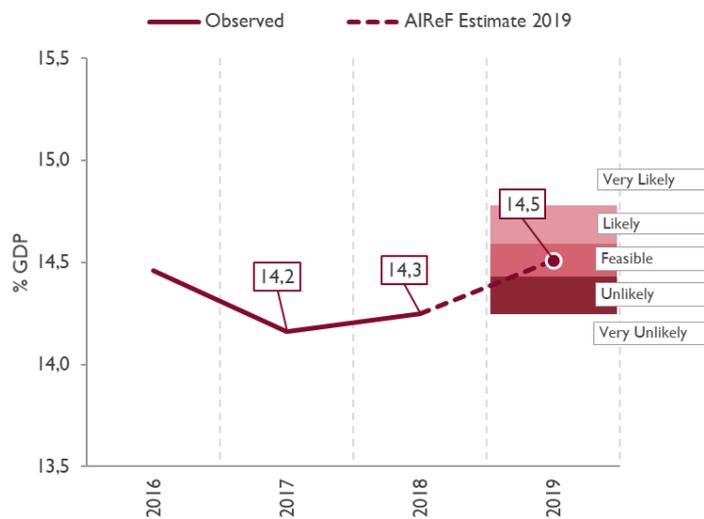


FIGURE 10.C. SSF EXPENDITURE (%GDP)



### 3.4.1 Analysis by agents

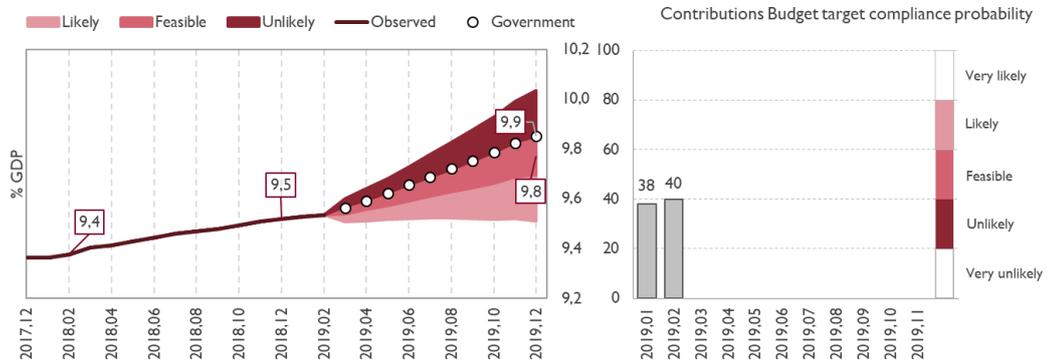
#### Social Security System

In 2019 the Social Security System deficit will stand at a level similar to that of 2018. AIRcF expects that the Social Security system will close 2019 with a deficit of 1.5% GDP, compared with the 1.6% expected in the last report. The difference is explained by the levelling effect of €500 million euros in revenue from contributions in 2018.

AIRcF's envisage a growth of the Social Security system's social contributions similar to that of the previous report and slightly lower than envisaged by the Government, mainly due to the impact of the measures. AIRcF expected growth of revenue from contributions of 6.9%, below the 7.5% forecasted by the Government. According to AIRcF's estimates, which incorporate the latest published data, it is considered feasible to achieve the level of contributions expected by the Government, with a difference much lower than previous years, standing around €500 million.

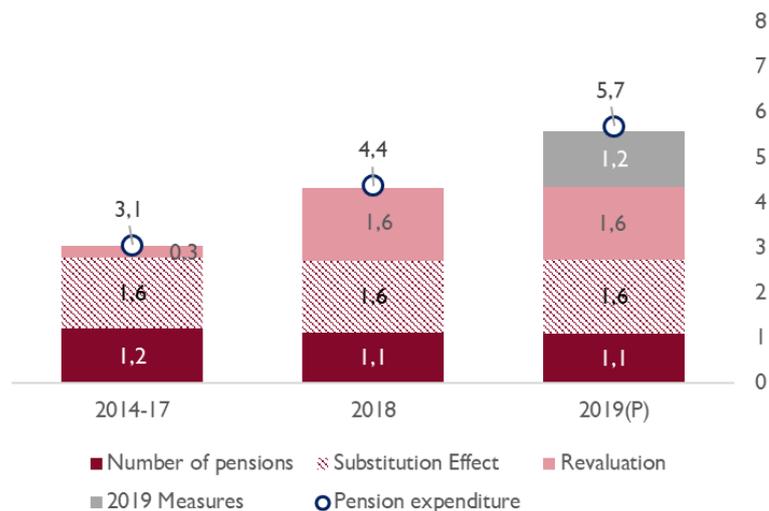
The growth pattern observed in 2018 continues, with a greater contribution attributable to contribution bases than employment. The estimate for the growth of contributions explained by the economic cycle, 5.2%, is similar to that in the Draft GSB. However, the impact of discretionary measures with an effect on contributions, valued at 3,000 million euros by the Government, is 700 million higher than that envisaged by AIRcF. The discrepancy is concentrated in the greater collection from the minimum contribution base of those employed under the general tax regime, stemming from the greater contributions of employees, workers subject to agreements and training contracts below the new minimum base, of 1,050 euros per month, as well as the carryover effect on employees with bases above but close to the minimum. The Government estimates an impact of 1,300 million euros compared to 600 million expected by AIRcF. On the other hand, the Royal Decree-Law 28/2018 on the revaluation of pensions could increase collection by 1,500 million, according to the Government's estimates endorsed by AIRcF. This policy 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 magnitude is of significant importance for the total amount raised. Royal Decree-Law 28/2018 also includes an increase in collection of 450 millions due to the increase in the minimum rate for professional contingencies and a neutral impact of changes to the base and the rate of the special regime for self-employed workers (RETA). See table 4 with detail of the measures.

FIGURE 11. SOCIAL SECURITY CONTRIBUTIONS (%GDP)



**AIReF’s forecast for pension expenditure in 2019 is similar to the previous report** including the effect of the measures. The expected pension expenditure grows in an inertial manner to 4.4% with a growth in the number of pensions of 1.2%, a substitution effect of new pensions over pension 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 of 56% to 60% in January 2019, with an estimated impact of about 1,000 million for 2019<sup>7</sup>. On the other hand, the compensation for the deviation of the CPI for 2018, between the 1.6% agreed and the average of the last twelve year-on-year rates of the CPI until November 2018 (1.7%), is estimated at 260 million euros. Finally, the revaluation of minimum and non-contributory pensions at 3% has an estimated impact of 325 million euros.

FIGURE 12. PENSION GROWTH (% VARIATION)



<sup>7</sup> It is estimated that approximately two thirds of this increase is recovered via higher from the State as it affects non-contributory pensions or pension that include supplementation benefits, therefore the effect on System's deficit is less than the total expenditure increase

For the rest of the benefits an evolution similar to that of the last report is estimated. The IGAE (General Intervention Board of the State Administration) does not present a breakdown of benefits other than those in kind, therefore the evolution of these items, which are estimated with budgetary execution data, are not known, considering that in temporary disability the cash data have not incorporated the last monthly instalments of the year in 2018. The recovery of employment and affiliation has led to growth rates of this benefit above 10% between 2015 and 2017. As in the previous report, it is estimated that temporary disability benefits grew by 8.5% in 2018 and will do so by 5% in 2019. The measures taken to enable the INSS (National Social Security Institute) medical inspectors to review temporary disability will have a limited impact, estimated at 33 million. Moreover, the three-week extension of paternity leave, adopted in the Royal Decree-Law 6/2019<sup>8</sup>, is valued at 225 million euros, and the increase in the child allowance for vulnerable families, regulated by Royal Decree-Law 8/2019<sup>9</sup>, has an estimated impact of 180 million euros. This impact is lower than expected by the Government for the whole 2019, due to the fact that these measures will be in force for the last three quarters of the year.

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<sup>8</sup> Royal Decree-law 6/2019, of 1 March, on urgent measures to guarantee equal treatment and equal opportunities between women and men in employment and occupation.

<sup>9</sup> Royal Decree-law 8/2019, of 8 March, on urgent measures for social protection and the fight against job insecurity in the working day

### Box. Assessment of the measures affecting Social Security Funds

To assess the SSF budgetary measures the statistical sources of the Secretary of State for Social Security and of the State Public Employment Service (SEPE) have been used. In some cases the estimated budgetary impact of past reforms similar to the measures currently adopted was used. For those cases in which it is necessary to know the number of affiliates or pensioners who contribute or receive a certain amount the Continuous Professional Life Sample of the Directorate General for the Management of Social Security was used. In the case of social aid, the INE's Living Conditions Survey was used.

Revenue:

First, Social Security's maximum contribution base increased by 7%, from €3,804 to €4,070 per month. Contributors at the maximum base will rise to approximately one million people in 2019, of which 30% have a base between the maximum base of 2018 and that of 2019, which on average amounts to €3,954. Taking into account that the contribution rate is around 30%, the estimated revenue from this measure is €850 M.

Second, the minimum contribution base has increased by 22.3%, from €859 to €1,050, in parallel with the minimum wage increase. Of the 1.1 million contributors at the minimum base, 72% have a base lower than €1,050, with an average of €869. As a result, estimate collection amounts to €500 M. To this we must add the carryover effect on employees with higher bases but close to the minimum, which is estimated at €100 M, therefore the aggregate impact of this measure is €600 M.

Third, in the Special Regime for Self-employed Workers (RETA) an increase in the minimum base of 1.3% has been approved, which is neutralised by the reduction of the average rate from 30.7% to 30%, so the estimated net impact is virtually zero.

Expenditure:

First, regarding pensions, pensioners have been compensated for a CPI growth of 1.7%, above the 1.6% revaluation applied in 2018. This extraordinary payment amounts to some €263 M. To this we must add the impact of revaluing the minimum and non-contributory pensions at 3%, with an estimated impact of €326 M.

Second, reinstating the special convention in the Social Security system for non-professional caregivers assumes a transfer from the State to Social Security of €315 M. In the case of a transfer between sectors, the consolidated public

deficit for 2019, is not affected although in the future more pension entitlements will be generated.

Third, reinstating the unemployment benefit for people aged over 52 years has an annual impact of 323 million, calculated from the existing beneficiaries aged between 52 and 54 years in 2012, adjusted by the cycle.

Fourth, the increase in paternity leave from 5 to 8 weeks has an estimated cost of €300 M. It is extrapolated based on the cost of increasing from 4 to 5 weeks in 2017 (€100 M).

Finally, the increase in the child allowance for vulnerable families has been estimated at €180 M from the simulation performed with the LCS microdata for 2017.

The last three measures were approved by Royal Decree-Law in March and entered into force in April, therefore only three-quarters of the estimated annual impact was considered.

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

AIRcF continues to estimate that the SEPE will close 2019 with a surplus of 0.1%, compared to the situation of budgetary balance envisaged by the Government. The difference is mainly due to a more pessimistic forecast of revenue from contributions by the Draft GSB. The 2.8% growth envisaged in the Draft GSB would also be inconsistent with the forecast of contributions of the Social Security system and with the discretionary measures adopted. In any case, the State Public Employment Service and the Wage Guarantee Fund may be financed with their own resources and will not receive transfers from the State.

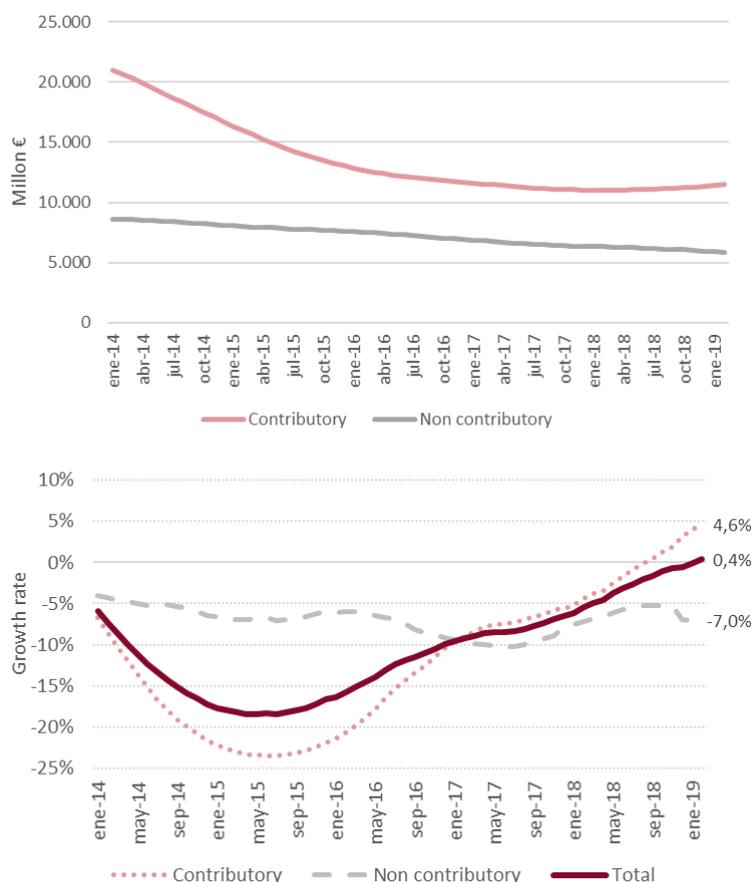
**AIRcF's forecast for expenditure on unemployment benefits is maintained very close to that considered in the report on the Draft GSB for 2019.** An increase in expenditure on benefits of approximately 4% is expected, explained by the acceleration in the growth of contributory benefits and by the gradual stabilisation of expenditure on non-contributory benefits, which reaches a minimum close to that of 2009. The main measure in this area is the reinstatement of the subsidy for people aged over 52 years, adopted in Royal Decree-Law 8/2019<sup>10</sup>, with an estimated impact of 242 million euros. The impact estimated by

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<sup>10</sup> Royal Decree-law 8/2019, of 8 March, on urgent measures for social protection and the fight against job insecurity in the working day

AIR eF is lower than that estimated by the Government due to the fact that the measure will be in force from April and not for the whole year.

FIGURE 13. EVOLUTION OF EXPENDITURE ON UNEMPLOYMENT BENEFITS (MOVING AVERAGE 12 MONTHS)



### 3.5 Autonomous Regions

The rating of the previous report is maintained under similar regional financing assumptions, with it being considered feasible for the Regions to comply with the stability target of -0.1% GDP, although with a greater margin as the forecasts for 2019 have improved slightly. Under assumptions about the regional financing system's resources that the Regions will receive similar to those considered in the previous report, the conclusions are maintained, with some improvement stemming from the end of 2018. Thus, compliance with the stability target in 2019 can be considered feasibly, with less tension than the observed in the report on the main budgetary lines.

However, without the modification of the entry deadline foreseen in the VAT Immediate Information System (IIS), compliance with the stability target is unlikely. The measure aimed at amending the entry deadlines for the VAT-IIS

could entail around 0.2% GDP more resources for the Regions, neutralising the negative impact that this rule had on the 2017 settlement that will be carried out in 2019 of the regional financing system's resources. If this measure does not end up being carried out, although the situation varies by Regions, the sub-sector as a whole would have difficulties in achieving a deficit of -0.1%.

On the other hand, the *moderate* risk of non-compliance with the expenditure rule is maintained, with a low feasibility of achieving a balance that is compatible with compliance with the two fiscal rules. With the constraints arising from the lack of information on the end of 2018, the risk observed in the report on the main budgetary lines is accentuated in principle by the expected developments in EU funds, while, in the opposite direction, it could be mitigated by the reduction of expenditure associated with non-recurrent operations and by the possibility allowed by the recently approved Royal Decree-Law 10/2019 of making financially sustainable investments that are excluded from the calculation of the rule.

**The changes in the factors that determine AIReF's assessment on the expected deficit in 2019** act in opposing directions, which means that the conclusions of the report on the main budgetary lines are maintained. There are no significant changes in the budgets or updated estimates of the Regions with respect to the draft budgets or main budgetary lines. In turn, the favourable end of 2018 transfers its effect to 2019 for the part not arising from non-recurrent operations, approximately 0.1%. However, the carryover of the GSB and the revision of the macro scenario has corrected AIReF's revenue and, to a lesser extent, expenditure forecasts downward. The net effect of these factors means that, with respect to the forecasts of the main budgetary lines, the sub-sector's estimates for 2019 have improved by just under 0.05% GDP, standing at a similar result.

FIGURE 14. AUTONOMOUS REGIONS (% GDP)

FIGURE 14.A. REGIONAL NET LENDING/BORROWING (% GDP)

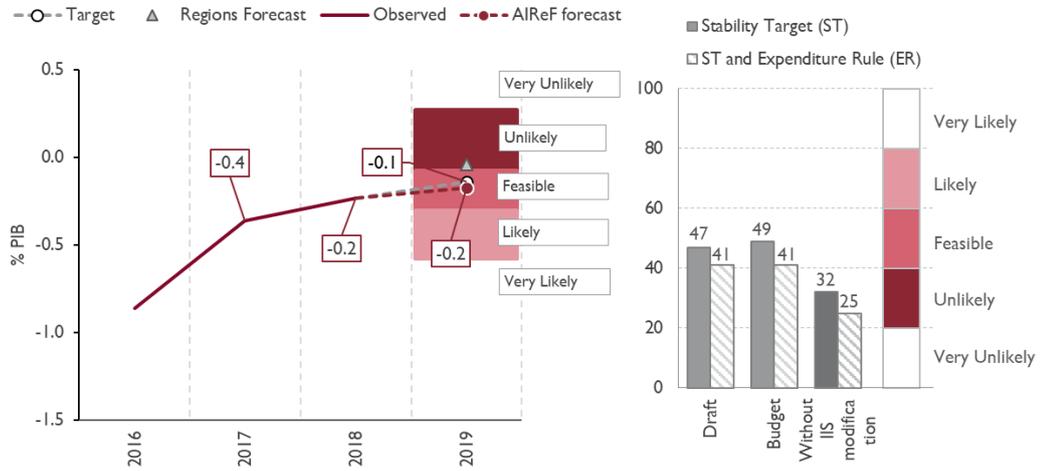


FIGURE 14.B. REGIONAL REVENUE (% GDP)

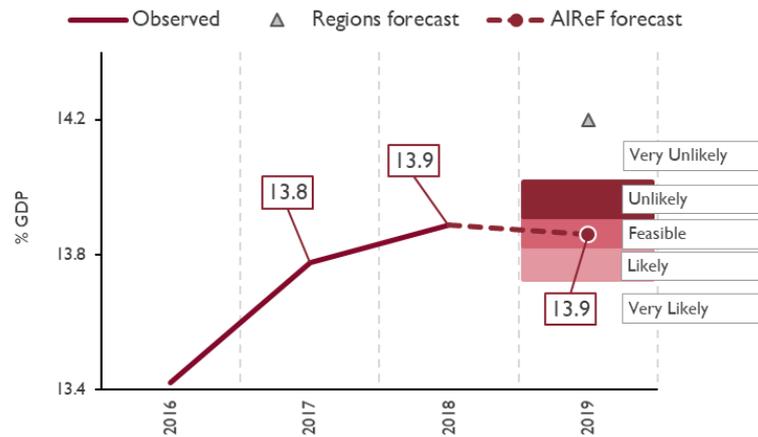
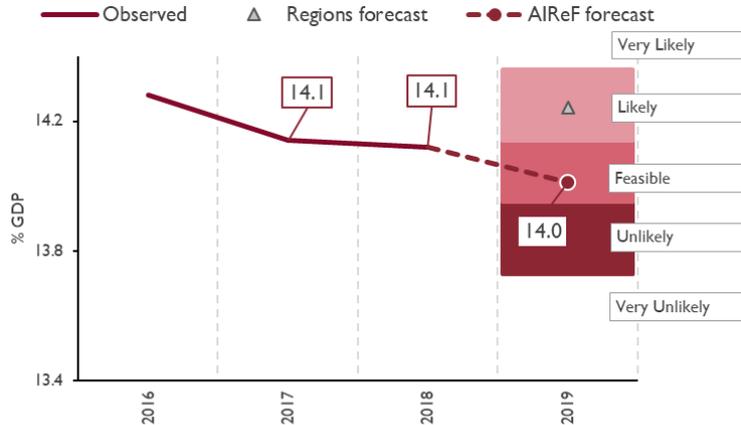


FIGURE 14.C. REGIONAL EXPENDITURE (% GDP)



With the current information, AIReF has revised the revenue forecast of the Regions estimated in the report on the main budgetary lines slightly downward,

remaining below Regional estimates. There are no significant changes, as a whole, to the forecasts of the Regional budgets for 2019, which continue to forecast a revenue level much higher than expected by AIRcF due to discrepancies in the resources from the State (especially in Comunitat Valenciana's budget) and EU funds. The positive evolution of revenues recorded at the end of 2018 not derived from one-off operations improves the forecasts for 2019 by 0.05% with respect to the main budgetary lines. However, AIRcF has corrected the January estimate of revenue from transfers to the Regions contained in the draft GSB downward due to conventions and other concepts, as well as the estimate of system resources, due to the revision of the macroeconomic scenario, with lower revenue by almost 0.1% GDP due to these concepts.

Thus, **Regions' revenue would** maintain, with a slight drop, their weight over GDP compared with the end of 2018. Under the previous considerations, the Regional sub-sector's revenue would grow above the 3.5% of 2018, maintaining the weight over GDP. The financing system's resources would grow close to 6% above the figure of 2018, an increase that would be reduced by the rest of the resources as significant revenue items that were recorded as one-offs in 2018 have not been replicated: 500 million in favour of the Canary Islands from investment agreements of previous years, which, by judgement of the Supreme Court, the State must pay to the Region; and the liquidation of EU funds for the operational programme 2007-2013.

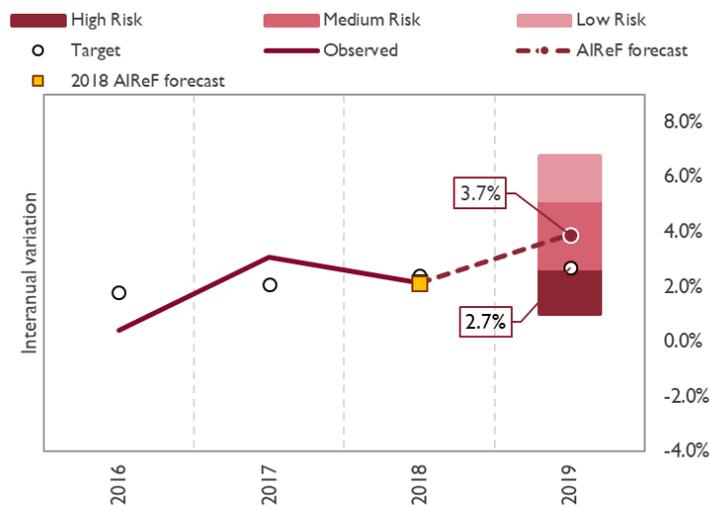
**Moreover, the Regions' expenditure forecasts** for 2019 are reduced with respect to the report on the main budgetary lines. The Regions' updated budgets and forecasts do not contain substantial changes compared to the information of the draft budgets or main budgetary lines on which reports were prepared. However, the end of 2018 reveals a favourable evolution of expenditure in the Regional field, since, while as a whole they have reached a level similar to that expected in the previous report, that amount reflects a greater volume of expenditure derived from one-off operations that will not be replicated in 2019. This circumstance and the downward correction of the forecasts of certain Regional expenditure items, decreasing the expected funding from the State, decreases the amount expected for the Regions' expenditure in 2019.

**As a result, the Regions' expenditure would reduce its weight over GDP by around** 0.1% with respect to 2018. Expenditure a whole would grow below 3.5% compared to the level of 2018, losing more than 0.1% of its weight over GDP. The expected increase in expenditure, above 3%, is slightly higher than estimated by the Regions and, conversely, as usual, a lower figure of investments and other uses of capital is estimated, which would have a zero growth overall, conditioned by not replicating the level of non-recurrent operations recorded in 2018.

With regard to the expenditure rule in the Regions, with the constraints arising from the lack of information in this regard at the end of 2018, the sub-sector's moderate risk of non-compliance is maintained for 2019. Although to date there are no data available for the calculation of the expenditure rule for 2018, current information allows us to maintain the conclusion expressed in the report on the main budgetary lines: the expected growth in expenditure, of around 3.5%, means that there is a risk that computable expenditure in 2019 would grow above the reference rate of 2.7%.

The known changes in the factors that affect the calculation of the expenditure rule act in opposing directions. The expected fall in EU funds in 2019, due to the liquidation of the previous operating programme obtained in 2018 not being replicated, would accentuate the risk observed by AIReF in the previous report. On the contrary, the lower amount of expenditure on non-recurrent operations in 2019 reduces this risk. In addition, the recent Royal Decree-Law 10/2019, of 29 March, regulates the extension to 2019 of the standard that allows financially sustainable investments that are excluded from the computation of the expenditure rule to be made. While the upcoming electoral proceedings could delay the start-up of these investments, and, therefore, limit their impact, a favourable effect on the expenditure rule of the Regions is expected in 2019.

FIGURE 15. EXPENDITURE RULE - REGIONS



AIReF carries out a preliminary analysis, by Regions, of their individual situation that would be reflected in a detailed manner and definitively in the individual reports on the budgets for 2019 issued in this regard. The general conclusions on the Regional sub-sector included in this report, based on the individualised information available for each Region, have been obtained from the preliminary assessment of the fiscal situation of each Region. This assessment will be reflected, and updated, in the individual reports that are issued on the budgets for 2019 of each Region, which will present the detailed analysis of each of them.

The forecasts regarding compliance with the stability target for 2019 are maintained for most of the Regions. The conclusions of the reports on the main budgetary lines regarding the probability of compliance with the stability target are maintained, with some improvement, in most of the Regions. There are no changes except in Asturias, Extremadura, Navarre and the Basque Country, which have improved their rating; and in La Rioja, whose rating worsened. Moreover, the first pronouncement on Comunitat Valenciana's compliance with the fiscal rules for 2019 is issued, which was unable to be reported on in the report on the main budgetary lines due to lack of information within the deadline. In this Region the probability of compliance with the stability target for this year is very unlikely, given the deficit recorded in 2018 essentially as a result of the high expenditure growth. This evolution of expenditure could be maintained in similar terms in 2019 due to the measures contained in its Regional budget.

Furthermore, risks of non-compliance with the expenditure rule are maintained in all Regions. The analysis of the available information allows us to appreciate that the risks of non-compliance identified in the reports on the main budgetary lines are maintained, accentuated in some cases, such as in the Balearic Islands; and mitigated in others, as in the case of Andalusia. In the case of Comunitat Valenciana, the preliminary analysis suggests a high risk of non-compliance with the expenditure rule.

TABLE 12. TABLE 13. PRELIMINARY ANALYSIS BY REGIONS ON COMPLIANCE WITH FISCAL RULES IN 2019. COMPARISON WITH PREVIOUS REPORTS

AUTONOMOUS REGIONS	Probability of compliance with 2019 stability target of -0.1% GDP		Risk of non-compliance with the 2019 expenditure rule of 2.7%	
	Reports on Main Budgetary Lines 2019	Preliminary assessment of initial budgets 2019	Reports on Main Budgetary Lines 2019	Preliminary assessment of initial budgets 2019
Andalusia	Feasible	Feasible	High risk	Moderate risk
Aragon	Unlikely	Unlikely	Moderate risk	Moderate risk
Asturias	Feasible	Likely	Moderate risk	Moderate risk
Balearic Islands	Feasible	Feasible	Low risk	Moderate risk
Canary Islands	Very likely	Very likely	Moderate risk	Moderate risk
Cantabria	Feasible	Feasible	Moderate risk	Moderate risk
Castile and Leon	Unlikely	Feasible	Moderate risk	Moderate risk
Castile La Mancha	Unlikely	Unlikely	Moderate risk	Moderate risk
Catalonia	Feasible	Feasible	Moderate risk	Moderate risk
Extremadura	Very unlikely	Unlikely	Moderate risk	Moderate risk
Galicia	Likely	Likely	Moderate risk	Moderate risk
Madrid	Likely	Likely	Moderate risk	Moderate risk
Murcia	Very unlikely	Very unlikely	Moderate risk	Moderate risk
Navarre	Likely	Very likely	Moderate risk	Moderate risk
Basque Country	Likely	Very likely	Moderate risk	Moderate risk
Rioja	Likely	Feasible	Moderate risk	Moderate risk
Valencia	-	Very unlikely	-	High risk
Total Regions	Feasible	Feasible	Moderate risk	Moderate risk

### 3.6 Local Governments

AIReF still considers it to be very likely that the local sub-sector will reach the stability target in 2019, as it is feasible to maintain the surplus of 0.5% GDP, although slightly below that obtained in 2018. Both in the Report of October 2018 and the Report of January 2019, where AIReF analysed the main budgetary lines of the PAs, it was considered likely that the Local Government (LG) sub-sector would reach, both in 2018 and in 2019, a surplus of around 0.5% GDP, slightly reducing the deficit obtained in 2017 and previous years.

The information on non-financial transactions at the end of 2018, published by the IGAE in late March, has corroborated **AIReF's forecasts for that year**. This information allows the LG sub-sector's surplus to be placed at 0.52% GDP, almost 0.1% a lower than that obtained in 2017, 0.61% GDP, the result of a year-on-year expenditure increase of more than double the revenue increase. This result is also consistent with the latest financial information published by the Bank of Spain on the evolution of the LGs' debt and deposits on the same date. In 2018, the LGs' deposits stood slightly above €27,000 million, €4,000 million more than earlier in

the year, and the financial debt has been reduced by more than €3,000 million (almost a 10% decrease), standing below €26,000 million.

In addition, the end of 2018 **has confirmed AIRcF's estimates for 2019, with a slight** deterioration in expected revenue from other administrations with respect to the previous year. AIRcF's revision of the macroeconomic scenario has slightly reduced the forecasts of the financing system's resources to be received by the LGs in 2019 with respect to those contained in the draft GSB. Similarly, the data reported by the LGs to MINHAC (Ministry of Finance) on the initial budgets for 2019 (with almost 70% representativeness of the total number of entities) indicate that the local surplus at year-end could stand around 0.5% GDP.

The forecasts would worsen if the impact of the VAT-IIS **on the financing system's** resources is not neutralised. The closing estimates for 2019 may be affected downwards, around 0.05% GDP, on the assumption that the standard containing the change in the entry deadline of the VAT-IIS is not approved.

AIRcF also confirms its estimates for 2019 of revenue and expenditure of around 3% and 4%, respectively. On the revenue side, AIRcF expects a growth of the main headings of municipal taxes of around 2% from 2018 to 2019, and a year-on-year increase in the transfers received from other PAs (Mainly the financing system's resources) of around 5%, minimally worsening the forecasts of the previous report. On the expenditure side, the estimated growth is almost 4%, primarily as a result of the increase in current expenditure, mainly on compensation of employees and staff replacement due to the impact in 2019 of the measures adopted in 2018.

This local surplus forecast is consistent with the data provided to AIRcF by the 24 large LGs individually analysed, which, on average, represent around 30% of the overall result. AIRcF has conducted a preliminary analysis of the information submitted by the 24 LGs subject to individual monitoring according to the size of their budget and affected population. These LGs hope to obtain an aggregate surplus of between 25% and 30% of the total expected for the total sub-sector at the end of 2019, with a slight reduction compared to what was observed in 2018. These data confirm the estimates of the whole sub-sector of a slight reduction in the surplus.

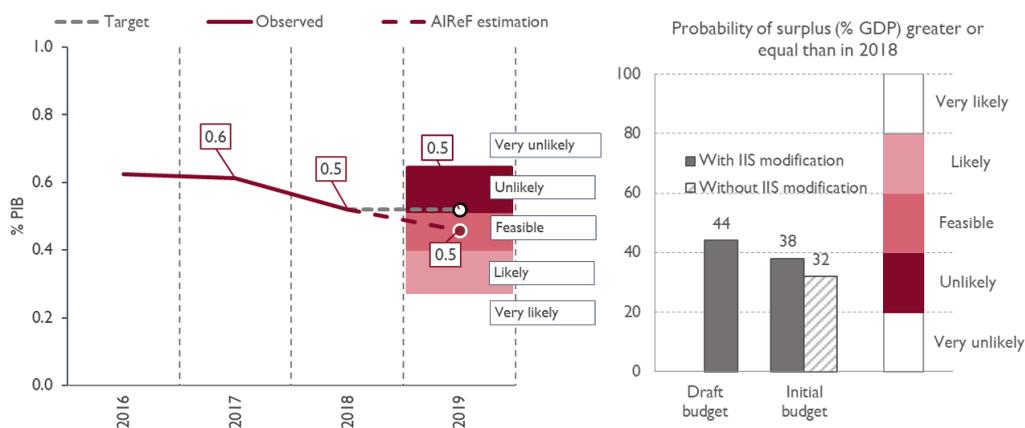
However, as AIRcF has already revealed in previous reports, in the LGs the forecasts contained in the preparation phases of the budget are not a good indicator of the results that will be obtained at year-end. This is because these entities adjust both documents to the balance set as the target, which suggests the existence of concealed surpluses. This is why AIRcF's closing forecasts for each year improve those reported in the initial stages of the fiscal year by the LGs.

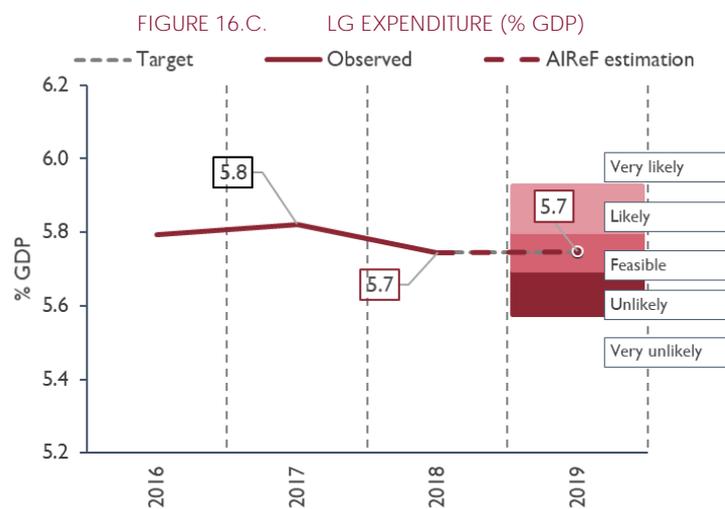
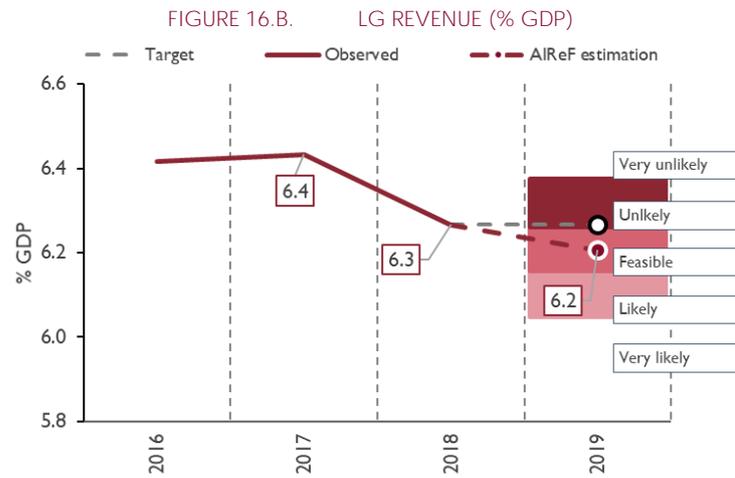
On the other hand, there are uncertainties in the evaluation of the local sub-sector's stability target and expenditure rule in 2019, arising from the impact that the realisation of financially sustainable investments (IFS) could have on compliance with both rules. On 30 March 2019 a Royal Decree-law extending the allocation of the surplus of the Regions and local corporations (LCs) to IFS to 2019 was published in the Official State Gazette (BOE). The implementation of these investments will be conditioned, at the local level, by the constitution of the new local governments to come out of the forthcoming elections, therefore the delay that this may entail means that AIReF estimates that its amount in 2019 will not exceed that of 2018. This fact mainly generates uncertainties in the large LGs as it is these that make investments of this type financed by surpluses generated in previous years to a larger extent.

In addition, as indicated in the Report of January 2019, there are demands to make the expenditure rule more flexible at the local level, which would have a significant impact if approved. These demands were for its elimination for sound LCs, the increase of expenditure programmes and years in which these investments could be made. If some of these initiatives were approved in 2019 the expected results at year-end could be significantly reduced (between 0.2 and 0.4% GDP according to AIReF's estimates).

FIGURE 16. LOCAL GOVERNMENTS

FIGURE 16.A. NET LENDING/BORROWING (% GDP)

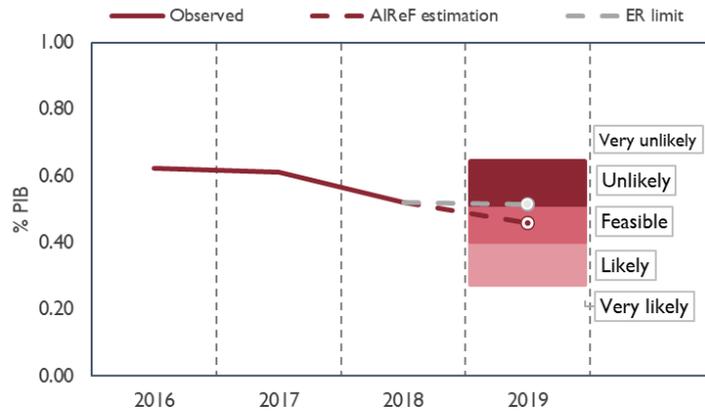




AIRcF continues to estimate that a surplus of around 0.5% GDP would allow the LG sub-sector to comply with the expenditure rule in 2019. AIRcF's estimates on compliance with the expenditure rule suggest that the minimal lending capacity that compliance with both fiscal rules would allow, should stand at around 0.5% GDP. If AIRcF's local surplus estimates are confirmed, compliance with this rule would be very difficult, therefore it would present risks that would be mitigated if the slow-down of expenditure in election year materialised.

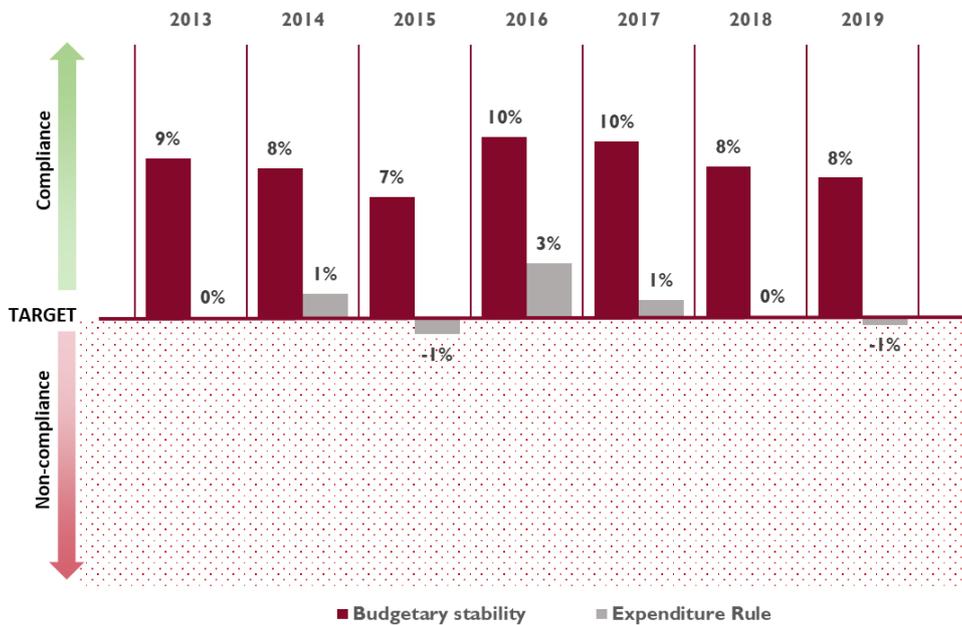
The following figure shows the lending capacity necessary for the LG sub-sector to comply with both fiscal rules at the end of 2019, estimating it to be feasible if the surplus reaches 0.5% GDP.

FIGURE 17. LENDING CAPACITY OF THE LG SUB-SECTOR THAT ENABLES COMPLIANCE WITH THE EXPENDITURE RULE AT THE END OF 2019 (%GDP)



Moreover, the following figure shows the evolution of the joint compliance with these fiscal rules and the positive margin (compliance) or negative (non-compliance) of each of them over the annual target.

FIGURE 18. LG SUB-SECTOR JOINT COMPLIANCE WITH THE STABILITY TARGET AND EXPENDITURE RULE 2013-2018 AND AIREF'S ESTIMATES FOR 2019 (BY MARGIN ON THE TARGET AND BY % OF NON-FINANCIAL REVENUE FOR STABILITY AND NON-FINANCIAL EXPENDITURE FOR EXPENDITURE RULE)



Note: In the years 2018 and 2019 the estimated margin of possible compliance or non-compliance with the expenditure rule is very limited, so the percentage that this represents over the limit is slightly higher or lower than 0%.

# 4 GOVERNMENT DEBT

## Debt sustainability

**In line with AIReF's forecasts, the GG sector complied with the debt target in 2018.** At the end of 2018, the debt-to-GDP ratio for the GG sector stood at 97.2%, which was 0.4% below the target. In line with AIReF's projections in its previous report, compliance was not homogeneous at sub-sector level, observing compliance with the target in the CA and SSF and LGs (70.8% and 2.1% compared to 70.8% and 2.7%, respectively). For the Regions a change in the targets set is expected (24.1%)<sup>11,12</sup>, which is expected to lead to compliance with the same.

For 2019 compliance with the debt target continues to be expected for the GG sector, although more difficult to achieve than in 2018. With the new information available and considering the impact of the budgetary carryover, for the current year it continues to be expected that the debt targets will be achieved for the GG sector and once again with unequal distribution between sub-sectors.

**In line with the analysis conducted in AIReF's** previous report, the debt of the CA and the SSF will reach 69.8% GDP in 2019, slightly above the target. This percentage represents a debt reduction equivalent to 0.6% GDP compared to the end of 2018, in line with the deficit reduction expected for the CA and SSF. However, this reduction will not be sufficient to comply with the target set at 69.5% GDP.

Regarding the Regional sub-sector, **AIReF continues to forecast the Regions'** compliance with the debt target for 2019, therefore it maintains the conclusions contained in the report on the main budgetary lines. As mentioned by AIReF in previous reports<sup>4</sup> the broad definition of the debt targets by the flexible and unrestrictive target setting system generally means

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<sup>11</sup> [Report on the main budgetary lines and draft budgets of the Public Administrations: GSB 2019](#)

<sup>12</sup> The debt targets for the 2018-2019 period were set by the Agreement of the Council of Ministers (ACM) of 7 July 2017.

that compliance with this fiscal rule is expected and, therefore, in 2019 as well, as long as this system is maintained.

The PAs should allocate the surplus obtained in 2018 to reduce debt in compliance with article 32 of the LOEPySF. The generation of surpluses should allow the debt level to be reduced and progress to be made toward financial sustainability. While surpluses have been generated for a long time at the local level, for the Regions it is a more recent phenomenon, increasing from four Regions in 2017 to six in 2018. AIReF believes that it is important that these surpluses are used to pay off debt and, in this regard, in its report on the main budgetary lines it asked for clarification on the allocation of the surplus. However, AIReF understands that this article should be applied at a time when the liquidities are available to carry out the early repayment and to the extent to which this reduction does not lead to higher financial costs.

**According to AIReF's estimates, at the end of 2019** the debt-to-GDP ratio of the LGs could fall below 2%, broadly complying with the target of 2.3%. The latest data published by the Bank of Spain reported a reduction of more than 3,000 million euros, placing the local debt-to-GDP ratio at 2.1% in 2018 (target set for the year 2021). AIReF estimates that, if the consolidation of the local surplus around 0.5% GDP is confirmed in 2019, the local debt could be slightly below 2% GDP. As previously highlighted in several of AIReF's reports, these surpluses are largely being immobilised in bank deposits that amount to over €27,000 million at the end of 2018. Thus, the net liquid financial assets debt of the LGs was negative at the end of 2018 and is expected to be around -0.5% at the end of 2019.

For the fourth year in a row the reduction observed in the debt-to-GDP ratio continued to be consistent with what is required by the Organic Law on Stability. It is expected that in 2019 this situation will be repeated. As has been noted previously, the 1st Transitional Provision of the LOEPySF requires that the debt-to-GDP ratio should be reduced by at least 2% GDP per year when real growth or expenditure grow above 2%. 2018 was the fourth consecutive year with economic and expenditure growth rates above 2%. However, the debt-to-GDP ratio of the PAs did not reduce by more than 2% GDP in any of these years, with the mean reduction being approximately 0.8 percentage points per year. As in its January report AIReF expects that, once again, this regulation will not be complied with in 2019.

Compliance with the debt targets does not ensure financial sustainability. The stock of existing debt is very high and remains close to its historical peak of the last 100 years. In these circumstances, the action margin of fiscal policy is very limited compared to negative shocks or greater expenditure pressures and therefore is a risk for sustainability in the medium to long term. If the debt

targets are not set in relation to a medium term anchor that ensures debt reduction at secure levels, compliance with the targets alone does not guarantee financial sustainability.<sup>13</sup> In this way, and as with the previous draft GSB, the current budgetary carryover involves a delay in the necessary fiscal consolidation process that ensures the realistic arrival at more secure debt levels.

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<sup>13</sup> Cuerpo, C. and Rodríguez, L, [\*Some elements for a revamped fiscal framework for Spain\*](#), WP 03/2018, AIRcF

# 5 RECOMMENDATIONS

## 5.1 Central Administration and Social Security Funds

### New recommendations

The report on the GSB for 2019 recommended the acceleration of the legislative processing of the revenue measures and the search for fiscal space within the framework of a medium-term budgetary planning given the expected deviation from the stability target set. The current political context, and the rejection of the draft GSB, make it difficult for measures with a substantial impact on the fiscal result of 2019 to be adopted in the second half of the year. Despite this, it remains necessary to seek fiscal space that allows convergence toward the budgetary stability targets, considering the entire time horizon available since the start of the legislature therefore, AIReF focuses its recommendation on the setting of budgetary stability targets and the debt target for the years 2020-2022 that have to be set in the first half of the year, both for the GG sector and for each of the sub-sectors. The start of new legislature and step towards the preventive arm of the Stability and Growth Pact, are an opportunity to define a medium-term fiscal strategy for 2019-2022.

AIReF has previously recommended the need to design a medium-term fiscal strategy, which includes measures to ensure financial sustainability and anchored in a credible debt reduction path. The setting of consistent and adequately supported targets is a fundamental requirement for useful budgetary monitoring at the different levels of administration. In previous reports AIReF has noted that the lack of realism in setting targets reduces the enforceability of the fiscal framework which, moreover, neither takes into account the cause nor the margin of deviation.

On the other hand, the return to the preventive arm of the Stability and Growth Pact (SGP) requires special attention to the evolution of the structural balance that must converge to the medium-term objective (MTO) established for Spain. In the same line, our own LOEPySF sets limitations to the structural deficit that, until now, have not been incorporated into the little information

published on the stability target and its distribution by sub-sector. AIRcF believes that in this new stage framed by the beginning of legislature and because we are in the preventive arm of the SGP a medium-term fiscal strategy should be defined.

For this reason, AIRcF recommends that:

1. *The setting of budgetary stability targets for the 2020-2022 period is underpinned by a government debt reduction pathway, which translates into a fiscal strategy that includes an analysis of the evolution of the structural balance in the medium term. At the same time this future planning must take into account the European framework and the margin available in 2019.*
2. *To publish the analysis and information that serves as a basis for determining the path of the stability targets and debt for the GG and for each of the sub-sectors.*

These recommendations will be monitored through the MINHAC, due to its significant role in the target setting process.

#### Live recommendations

The LOEPySF does not provide for a preventive procedure for the CA similar to that existing for the TAs in the event of observing risks of deviation. AIRcF has recommended to the MINHAC on numerous occasions that it should establish a procedure for monitoring the CA and SSF in order to detect risks and to be able to adopt measures for the early correction of deviations. In particular, it was recommended that it should establish a procedure that specifically includes the degree of implementation of the measures and the completion of budgetary management decisions aimed at the containment of budgetary execution. In addition, this monitoring must be carried out with the greatest possible transparency, sending the reports prepared to Parliament and AIRcF.

The MINHAC believes that it is complying with this recommendation, therefore it is not necessary to take any additional action. It understands this to be the case in relation to the CA and SSF to the extent that it regularly publishes the execution of the accounts of the various administrations and the State Tax Administration Agency values the impacts associated with changes in traditional tax figures and those newly created.

However, AIRcF considers that it is not sufficient and that it is necessary to carry out a specific procedure beyond the automatic prevention measurements set out in article 18.1 of the LOEPySF. In addition, AIRcF warns that the perception of a lower level of "accountability" by the CA could erode the

degree of commitment of other PAs with regard to compliance with their fiscal targets.

For this reason, AIReF considers that this recommendation must be kept in place and be reflected as such on its web page.

## 5.2 Territorial Administrations

### New recommendations

- **Recommendations on the application of the LOEPySF**

In the current context in which there is a GG debt level close to 100% GDP, debt sustainability should be at the centre of fiscal policy. In this sense, it is a priority to use the levers established by the fiscal framework to move forward on the path of debt reduction and compliance with the principle of financial sustainability.

While surpluses have been generated for a long time at the local level, for the Regions it is a more recent phenomenon, increasing from four Regions in 2017 to six in 2018. As a result of the progressive recovery of the economy and the consequent soundness of public accounts, there is an increasing number of Regions that generate surpluses, therefore article 32 of the LOEPySF begins to be applicable to this sub-sector, requiring this surplus to be allocated to reducing debt, after having deducted the Financially Sustainable Investments which are regulated outside the provisions of this law.

However, sometimes the surplus generated in national accounting terms does not correspond to the Region's liquidity and the early repayment can cause early termination costs or other associated financial costs.

AIReF understands that within the framework established in article 32 of the LOEPySF with respect to the amount of debt reduction, there is scope to determine the time at which this reduction has to materialise.

As a result, AIReF recommends that the MINHAC:

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3. *Establishes a procedure for the application of article 32 of the LOEPySF to the TAs that includes a repayment schedule that takes into consideration the liquidities and financial costs associated with early repayment of the debt.*
- 

- **Progress of the recommendations regarding the Regions' compliance with the 2019 fiscal targets**

At the regional level, the Regions' delay in sending information has led AIReF to perform an assessment, in this report, of the whole of the sub-sector and

anticipate individual estimates on a provisional basis, which will subsequently be supplemented with a more detailed analysis for each of the 17 Regions, which will include the recommendations deemed necessary, where appropriate.

In the report on the main budgetary lines for 2019 published last January, the recommendations were aimed at compliance with the deficit target and the expenditure rule at the end of the year for those Regions in which it was not considered feasible to comply with the deficit target or in which there was risk of non-compliance with the expenditure rule.

In this regard, Extremadura and Murcia were recommended, on the one hand, to avoid measures that would jeopardise compliance with the fiscal rules and, on the other hand, Aragon, Castile and Leon and Castile-La Mancha were recommended to take actions aimed at offsetting the upward trend of their expenditure. In addition, both Extremadura and Andalusia were recommended to take measures for the correct measurement and monitoring of computable expenditure growth, which in the case of Andalusia should include mechanisms for immediate expenditure correction that complement those already in place.

While Aragon and Castile-La Mancha have followed the recommendations, the Regions of Extremadura and Murcia did not comply. However, for the latter two Regions the recommendations were maintained since, with the current estimates, it is considered highly unlikely that they will comply with the stability target in 2019. Finally, although Castile and Leon has not responded to the recommendation, it ceases to be in force since the Region has improved its valuation from unlikely to feasible. All this without prejudice to the fact that in the individual report, once the analysis is completed, these recommendations could be further developed, or additional recommendations could be included.

In relation to Comunitat Valenciana, there has not been a pronouncement on its main budgetary lines, as pointed out in the section on the regional sub-sector. However, in the preliminary assessment of this Region it is considered to be highly unlikely to comply with the deficit target and there is a high risk of non-compliance with the expenditure rule. Therefore, in the individual analysis of this Region, specific recommendations will be made regarding the risks observed.

- Recommendations for the LGs

In previous reports, AIReF has made several recommendations to the MINHAC within the framework of its powers as a director and coordinator in the field of fiscal rules.

These recommendations were particularly intense in the LG context, given how numerous (more than 13,000 corporations) and heterogeneous (both in size of their budgets and affected population) this level of administration is, which provides even more impetus to the need to homogenise the interpretation of the rules, in order to avoid differing applications that may lead to situations of unequal treatment. The MINHAC has welcomed these recommendations and has reported the actions taken to date, as well as its commitment to progress in this area in the future. In particular, in order to improve and adapt the exercise of the financial guardianship functions of the LGs, which are carried out by bodies of the Region itself or of the Provincial Councils in 9 Regions, in the case of the Basque Country, this Ministry has reported its plan to draft general action protocols in order to facilitate the work of the financial guardianship bodies.

To the same end, AIReF has recommended that the MINHAC intensify the monitoring, control and early warning actions necessary to ensure compliance with the fiscal rules. In this sense, the MINHAC has indicated the required actions or adjustment plans to the LGs that have not complied with a fiscal rule, to redirect the situation or to adopt measures that will ensure compliance.

Delving into the need for progress in this regard, on several occasions AIReF has noted deficiencies in the verification of compliance with the fiscal rules by some LGs with origin both in financial or budgetary accounting, and in the translation of this information to national accounting terms. These calculations are the responsibility of the local intervention boards or equivalent control bodies, which prepare the compliance reports at the different stages of the budget cycle according to which the application of the corrective and coercive measures established by the Law is determined. These calculations should be verified by the respective guardianship bodies, given the implications arising from them and the general functions assigned to these bodies regarding the monitoring of the fiscal rules of the LGs protected.

*As a result, AIReF recommends that the MINHAC:*

4. *Promotes the regulatory amendments that detail the competences of the **LGs' financial guardianship** bodies, and specify whether it is this body or another that should verify the calculations of compliance with the fiscal*

*rules made by local intervention boards or equivalent units in the LGs of their territory.*

5. *Specifies the consequences of finding errors in the calculation of the fiscal rules, as well as the consequences for the guardianship body or responsible body, in the event of not properly exercising these functions.*
- 

- **Progress of the recommendations regarding compliance with the 2019 fiscal targets by the LGs individually analysed**

At the regional level, in this report AIRcF performs an assessment of the whole of the sub-sector that will be completed shortly with the issue of a supplementary report that contains the individual assessment of the 24 large LGs and 24 corporations in which medium-term sustainability problems have been detected. Said report will detail the individualised recommendations deemed necessary.

Without prejudice to the above, the preliminary analysis of the individual assessment enables us to anticipate that, with the current information on the provisional close of 2018 of the 24 large LGs, the city councils of Barcelona, L'Hospitalet de Llobregat, Seville and Vigo are at risk of non-compliance with the fiscal rules. For this reason, AIRcF will recommend that, if confirmed at the definitive year close, they will have to approve an Economic Financial Plan (EFP) with measures that will affect 2019.

Furthermore, for some LGs with medium-term sustainability risks, with greater structural problems than annual compliance with these rules, but that present risks of compliance with the fiscal rules in 2019, AIRcF recommended that, at least, they should adjust their policies to such compliance, given that the new generation of negative balances negatively affects the situation of unsustainability of their finances. In the absence of completing the analysis this risk is appreciated in the city councils of Jaén, Parla, Navalcarnero, Los Barrios and Almonte.

In the report on the main budgetary lines for 2019 published last January, the city councils of Valencia and Gijón and their financial guardianship bodies were recommended to apply the graduality of the LOEPySF since they had not approved the EFP within the time limits. These recommendations are maintained in force since the situation is the same to date.

- **Live recommendations**

At the regional level, in its report on the main budgetary lines for 2019 AIRcF also recommended that the MINHAC intensify the monitoring, control and early warning actions necessary to ensure compliance with the fiscal rules by the Regions.

The MINHAC considers that it already complies with this recommendation and lists a series of actions taken for this control and monitoring: analysis of their draft budgets, monthly follow-up of their budgetary execution and design and analysis of the content of the EFP. In addition, as an early warning mechanism it notes that, if risk of non-compliance with the fiscal rules is detected, letters of formal notice are sent communicating the appreciation of said risks and requesting the provision of information on measures to be taken.

AIReF agrees that all these actions carried out by the MINHAC contribute to compliance with the fiscal rules, but considers that there are not sufficient and that the levers offered by the LOEPySF are not being used to enforce the fiscal rules. This is demonstrated by the fact that the MINHAC has never activated the prevention mechanisms requested by AIReF when, in early stages of the budget cycle, there was already a clear risk of deviation, which eventually resulted in non-compliance.

AIReF considers that the enforceability of the fiscal rules is an essential element for the effectiveness of the rules and stresses the need to strengthen prevention, where monitoring and control are critical. Therefore, given the importance of this recommendation for the smooth operation of the fiscal framework, AIReF considers that it should remain in force within the category of recommendations that the AIReF has described as live, and that it publishes as such on its web page.

President of AIReF

A handwritten signature in black ink, appearing to read 'JL Escrivá', with a horizontal line underneath.

José Luis Escrivá