

REPORT ON THE MAIN BUDGETARY LINES OF THE 2020 BUDGETS OF THE PUBLIC ADMINISTRATIONS

REPORT 63/19





Autoridad Independiente
de Responsabilidad Fiscal

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.

AIReF Contact:

C/José Abascal, 2, 2º planta. 28003 Madrid, Tel. +34 910 100 599

Email: Info@airef.es.

Web: www.airef.es

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EXECUTIVE SUMMARY

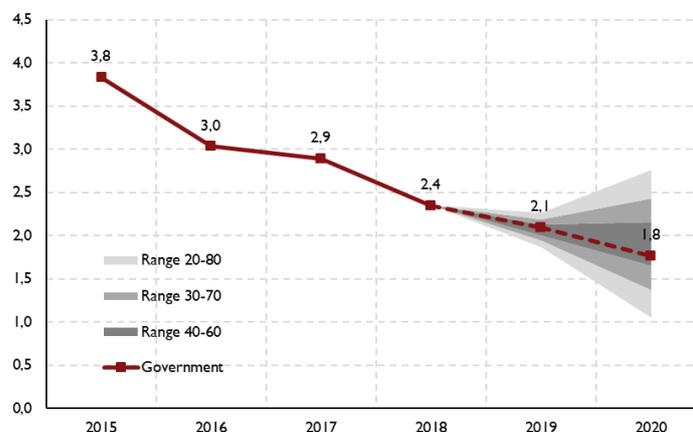
This report analyses the macroeconomic and fiscal scenario of the 2020 Budgetary Plan sent to the European Commission on 15 October. Current legislation provides that the Independent Authority for Fiscal Responsibility (AIReF) must prepare a report before 15 October on the draft budgets and main budgetary lines of the Public Administrations (PAs). If the General State Budget is not presented, the Budgetary Plan is configured as the major milestone of Spain's fiscal strategy for 2020. Therefore, AIReF prepares a report on the macroeconomic forecasts underlying the 2020 Budgetary Plan as well as its budgetary scenario.

Since the publication of the previous report in July there have been changes in the economic and fiscal situation and new information has been published, notably the revision of the National Accounts series conducted by the National Statistics Institute (*INE* for its Spanish acronym) and by General Intervention Board of the State Administration (*IGAE* for its Spanish acronym) within the framework of the European Statistical Programme. This review has led to significant changes in both the macroeconomic variables and the accounts of the PAs, which affect the analysis of the Budgetary Plan.

- **Assessment of the macroeconomic scenario**

AIReF endorses the Government's macroeconomic forecasts included in the 2020 Budgetary Plan. The GDP scenario presented in the Budgetary Plan is in line with AIReF's forecasts, falling in the middle of its interval. In addition, AIReF believes that the Government has behaved prudently in the preparation of its forecasts as it presents a scenario with no policy change, consistent with the current situation of a caretaker government; and as it made the effort to incorporate the significant impact of the revision of the National Accounts series conducted by the *INE* into its analysis. The basic assumptions underlying the macroeconomic scenario accompanying the 2020 Budgetary Plan are considered feasible. With regard to the 2019-2022 Stability Programme Update, the external environment included in the Budgetary Plan has deteriorated, in line with the forecasts of the European Central Bank and other international agencies.

REAL GDP, RATE OF CHANGE (%)



The downward revision of world growth, growth for the Spanish export markets and of the euro zone should be emphasised. On the contrary, the Government's assumptions relating to short and long-term interest rates now entail greater support to growth. The rates have been revised downwards, in line with the evolution of the forward curve, although the existence of a negative differential with respect to long-term market expectations on the rates should be noted. Finally, the expectations on the evolution of the price of oil are conservative, standing above the most recent forecasts of various international agencies, as well as the crude oil quotes on the futures markets. In this sense, the sluggish trend of oil prices forecasted by the main international agencies could imply a reduction in the cost of imports and a containment in price indices with respect to the Government's baseline scenario.

The composition of growth is considered plausible, characterised by a progressively dominant contribution of domestic demand, and a positive contribution, although sluggish, of the external sector, in line with the statistical review of the National Accounts published by the INE at the end of September (RE2019). Thus, the path envisaged for 2020 in the Budgetary Plan entails a growth pattern in line with previous years, supported by domestic demand as the main driver and with a progressive maturation of the economic cycle in the medium term, to then converge with its potential growth. The evolution of private consumption gains momentum in 2020 with respect to the figure for 2019. This dynamic is in line with AIReF's forecast, although slightly below in 2020. This forecast is based on the evolution and contribution of its main determinants, with the impact of the statistical review essentially limited to 2019. The main variables that support the evolution of private consumption effectively anticipate a sustained growth, although slower in the coming

years, even assuming a certain upturn in precautionary saving as suggested by recent data reviewed by the INE. The productive investment envisaged for both 2019 and 2020 in the Budgetary Plan is above AIReF's forecasts, particularly in 2019, in which two quarters have already been observed and where the economic information does not allow us to anticipate a rise in line with the Government's forecasts. The Government forecasts an investment in construction for 2020 in line with AIReF's forecasts, with modest rates compared to the recent historical pattern, confirming a profile of more balanced growth for the economy. The Government's public consumption forecast establishes a markedly slower path in 2020, which contrasts with AIReF's forecast, which maintains rates in line with 2019. Finally, as regards the external sector, the expected evolution of imports for 2020 incorporates a trajectory in line with the dynamics of domestic demand, compared to the values in 2019, where there is a decoupling that leads to a positive contribution from the external sector well above the historical average. These values are in line with AIReF's forecasts, maintaining a slightly positive contribution of the external sector to GDP growth in 2020.

- **Assessment of the budgetary scenario**

The Budgetary Plan places the deficit for 2020 at 1.7% GDP, which would entail a reduction of 0.8% in the 2019-2020 period. This result is in line with AIReF's baseline scenario, although there are differences in the distribution of the correction throughout the period.

NET LENDING/BORROWING 2020 AND ADJUSTMENT PATH IN % GDP

Lending (+) Borrowing (-) as % GDP	2018	Government forecast		AIReF's baseline scenario	
		2019 2nd EC Notification	2020 Budgetary Plan	2019	2020
Central Government (CG)	-1,3	-0,8	(.)	-0,7	-0,6
Social Security Funds (SSF)	-1,4	-1,4	(.)	-1,3	-1,3
Regions	-0,3	-0,3	(.)	-0,5	-0,2
Local Governments (LGs)	0,5	0,4	(.)	0,4	0,4
General Government (GG)	-2,5	-2,0	-1,7	-2,1	-1,7
Non-recurrent operations	0,3	0,2	0,1	0,5	0,2
GG without non-recurrent operations	-2,2	-1,8	-1,6	-1,6	-1,5

(.) Not available

AIReF believes that this result could be achieved with a level of revenue and expenditure 0.1% higher than the Government's forecasts in both cases.

AIReF places the revenue level at 39.7% GDP, taking into account the new macroeconomic scenario, which assumes a slowdown compared to the Report on the Stability Programme Update (SPU 2019-2022) and detracts a little over 0.1% GDP from the revenue estimate made at that time. The differences

compared to the Budgetary Plan can mainly be seen in the distribution by headings which includes, in AIReF's opinion, an optimistic forecast of taxes on income and wealth that is offset by a conservative estimate of income of other types, mainly taxes on production and imports.

On the expenditure side, AIReF's baseline scenario estimates that these would represent 41.4% GDP in 2020, 0.1% higher than the percentage reflected in the Budgetary Plan, and with a greater relative weight of current expenditure compared with the Government's forecasts.

Although the Budgetary Plan does not provide the breakdown by sub-sectors on this occasion, AIReF believes that the Local Governments (LGs) and the Social Security Funds (SSF) will maintain a result similar to that of 2019 and that the rest of the sub-sectors will reduce their deficit, 0.1% in the case of the Central Government (CG) and 0.3% in the Autonomous Regions.

AIReF's estimates imply, as in the Budgetary Plan, a no-policy-change scenario which, however, includes a revaluation of pensions with the CPI, a rise of public employees' salaries according to the agreement with the trade unions and the implementation of some of the recommendations arising from the Spending Review announced last April in the SPU 2019-2022. In this regard, it should be noted that AIReF considers the Government's quantification of the effects of these recommendations to be tight, while it has doubts about the final impact, which will depend on the speed with which the necessary procedural and policy changes can get off the ground.

As a starting point for the evaluation of the Budgetary Plan for 2020 covered by this report, AIReF has revalued the year 2019 with the latest information available, revising its forecast of a deficit upwards by 0.1% GDP. This update is due to the statistical review of the national accounts to which reference has been made above, the impact of the new macroeconomic scenario and the incorporation of new information from the PAs, both on execution for the current year and on the end of 2018.

None of these changes have a high impact when considered individually, but all of them revise AIReF's deficit estimates downwards to 2.1% GDP.

On the one hand, the review of the accounts of the PAs alters the starting point for the estimates for 2019, with a slightly negative net effect on the deficit.

In addition, changes in the macroeconomic scenario, coupled with the statistical review of its variables, also have an impact on the estimates for 2019 because this new macroeconomic scenario results in lower collection, which affects the expected deficit by a little less than 0.1% GDP.

Finally, AIReF's forecasts incorporate new information published since July, as well as information provided by the different administrations. Although the changes with positive and negative effects in the deficit tend to be offset, the net result is an increase in the deficit also less than 0.1% GDP.

NET LENDING/BORROWING 2019 IN % GDP

Lending (+) Borrowing (-) as % GDP	2018	2019		
		AIReF July Rep.	AIReF Current	2nd EC Notific.
Central Government	-1,3	-0,6	-0,7	-0,8
Social Security Funds	-1,4	-1,3	-1,3	-1,4
Regions and LGs	0,2	-0,1	-0,1	0,1
<i>Regions</i>	-0,3	-0,5	-0,5	-0,3
<i>Local Governments</i>	0,5	0,4	0,4	0,4
General Government	-2,5	-2,0	-2,1	-2,0

By sub-sector, the CG worsens its forecast by around 1,000 million, 0.1% GDP, with respect to the report on expected compliance with the targets published in July, standing at 0.7% of GDP. This evolution is mainly explained by an increase in net terms of around 700 million in transfers to the Regions compared to what AIReF forecasted in July, which improves the balance, but in a much lower proportion (around 300 million), given that the transfers arising from the financing system, for the most part, were already considered by the Regions in their budgets and, therefore, do not entail higher revenue, and others – (National Fund for Energy Efficiency-) are linked to the realisation of expenditure. The balance of the LGs is also worsened by 600 million, while the SSF do not under significant changes.

- **Expenditure rule**

The Budgetary Plan refers to compliance with the EU expenditure rule but does not include information about the national expenditure rule provided for in the Organic Law on Budgetary Stability and Financial Sustainability (LOEPySF for its Spanish acronym). For 2019 compliance with the national expenditure rule is similar to that forecasted in the July report, with the CG being the only administration to comply due to the effect of non-recurring expenditure and the situation of budgetary carryover. For 2020, compliance improves, with the CG, regional and LG sub-sectors growing at the reference rate envisaged in the report on the situation of the Spanish economy and with less impact of non-recurring operations than recorded in 2019.

- **Debt sustainability**

As in the past four years, the Budgetary Plan foresees a reduction in the debt-to-GDP ratio. AIReF considers the debt projection of the Budgetary Plan to be unlikely for 2019 and only just feasible for 2020. After five years of strong economic growth and historically low interest rates, the debt-to-GDP ratio has practically not decreased. The drop observed in the interest rates has led to a significant reduction in the debt burden. This saving is a great opportunity to accelerate the pace of deleveraging.

- **Fiscal Policy Stance**

In July 2019 the ECOFIN Council agreed to the closure of the Excessive Deficit Procedure that Spain had opened since 2009, therefore it began to apply the preventive arm of the Stability and Growth Pact that is more demanding in terms of fiscal effort. The Budgetary Plan expects non-compliance with the annual fiscal consolidation of 0.65% GDP required for 2019 and 2020 and computable expenditure growth limited to 0.6% in 2019 and 0.9% in 2020. AIReF's estimates ratify this non-compliance, despite estimating a lower structural deficit than estimated in the Budgetary Plan.

- **Recommendations**

AIReF makes a series of recommendations on transparency due to the revision of the National Accounts series:

To the INE:

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- According to the general principles of the INE's revision policy, in particular principle 15, it should fulfil its own requirements of transparency and information to users by implementing a transparent communication policy and an active policy for the review of National Accounts data, which reflects the European best practices, through:
 - ✓ the publication and dissemination of the existing methodological guides on the procedure for preparation of the National Accounts;
 - ✓ the adaptation of the dissemination of the data review to the national and European budget calendars;
 - ✓ the improvement of the communication of the reviews, including comparative exercises that allow the end user of the statistics to understand the motivation and scope of the reviews.
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To the IGAE:

- In general, any changes, either by a statistical review or the introduction of new data, should always be accompanied by the issue of an explanatory note on the changes made.
 - In particular, the methodological note on the statistical review to be published should include a description and quantification of the effect of the changes, separating those arising from the update of information sources from those caused by the application of the methodological changes of the statistical review of this year.
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In addition, the need to devise a strategy that envisages a medium-term view anchored in a credible debt reduction path remains, so **AIReF keeps the following recommendations in place:**

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- The setting of budgetary stability targets for the 2020-2022 period should be underpinned by a government debt reduction path, which translates into a fiscal strategy that includes an analysis of the evolution of the structural balance in the medium term.
 - The analysis and information that serves as a basis for determining the path of the stability targets and debt for the General Government and for each of the sub-sectors should be published.
 - The fiscal strategy should consider the European framework and offer information relating to compliance.
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As the data for a rigorous assessment of the rise in the minimum wage may not be available for AIReF and other researchers, **AIReF keeps the following recommendations in place:**

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- The Ministry of Labour, Migrations and Social Security and the Ministry of Economy and Business should conduct an assessment of the effects of the rise in the minimum wage for 2019 based on the most rigorous methodologies and if necessary using the collaboration of external evaluators and publishing the results and the methodology used.
 - They should make the administrative data needed to replicate this and perform other evaluations available to researchers and institutions, always safeguarding the necessary confidentiality of the personal data of the subjects.
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