

Report on Initial Budgets of the General Government

**AIReF ESTIMATES THAT GDP WILL GROW BY 6.6% IN
2021 AND THE PUBLIC DEFICIT WILL FALL TO 7.6% OF
GDP**

- The Independent Authority for Fiscal Responsibility (AIReF) worsens its growth estimate for this year as a result of the severity of the health crisis and the revision of the impact of the Recovery Plan
- It improves its public deficit forecast by just over 0.3 percentage points as a result of the contrasting effects of the new macroeconomic scenario, the latest measures to combat the pandemic and the most recent information
- The expected improvement in the balance is unevenly distributed among the different General Government sub-sectors: the balance of the Central Government worsens, while that of the Autonomous Regions and Local Governments improves
- AIReF estimates that the debt will stand at 118.7% of GDP in 2021 and warns of the risks of dependence on borrowing conditions and of an ageing population
- AIReF maintains its recommendation to design a realistic and credible medium-term fiscal strategy that guarantees the sustainability of the General Government

The Independent Authority for Fiscal Responsibility (AIReF) today published on its website the Report on the Initial Budgets of the General Government for 2021, in which it updates its macroeconomic and fiscal estimates. AIReF estimates that GDP will grow by 6.6% in 2021 and the public deficit will fall to 7.6% of GDP, slightly over 0.3 points less than the estimate contained in the Report published last November.

In the Report, AIReF notes that, more than one year after it began, the pandemic continues to shape the economic situation and the public accounts, and a high degree of uncertainty remains as to how it will evolve in the future. However, the institution states that the progress made in vaccines suggests that the health crisis will be resolved in 2021. Uncertainty also remains about the implementation of the Recovery, Transformation and Resilience Plan (RTRP), both in terms of the details of its implementation and the ability to deploy its effects in 2021.

AIReF's new macroeconomic scenario entails a downward revision of expected growth for 2021 to 6.6%, down from the 8.2% in the central scenario prepared in the autumn of 2020. This revision is mainly the result of two factors: the continued

severity of the health crisis and the revision of the macroeconomic impact of the RTRP, which will take longer to implement than initially expected.

Specifically, AIReF notes that the latest information reveals that the recovery was cut short in the last quarter of 2020 and it indicates that the available information suggests a contraction in GDP in the first quarter of 2021. For its part, the macroeconomic impact of the RTRP this year is lowered from 2.7 points of GDP to 1.6 points in the absence of knowledge about specific projects.

As regards the Budget, AIReF estimates a General Government deficit of 7.6% of GDP in 2021 in its central scenario, thus lowering its forecast by just over 0.3 points compared with the November report. The revision is explained by the new macroeconomic scenario, which entails a one-point worsening of the deficit; the new government measures to alleviate the effects of the pandemic, which together with the changes in the processing of the Budgets imply a worsening of one additional point; and the incorporation of new budgetary information, which offsets the other two factors with a reduction of the deficit by 2.3 points compared with the previous report. Finally, AIReF continues to assume a neutral effect of implementation of the RTRP on the deficit in 2021.

Thus, after closing 2020 with a General Government deficit of 11%, AIReF estimates that the economic recovery, the gradual withdrawal of the measures to combat the pandemic, the absence of significant non-recurring elements such as the reclassification of the SAREB and the tax changes included in the Draft General State Budget lead to a reduction in the deficit of 3.3 points of GDP in 2021.

In this scenario, AIReF forecasts that revenue will grow by 5.8% in 2021, to stand at 40.4% of GDP, 43.3 % if RTRP revenue is included. This level would be 0.7 points higher than that forecast in the previous report. For its part, expenditure will stand at 48% in 2021, without including the RTRP, compared with the 47.6% forecast in the previous report. In addition, AIReF continues to assume execution of RTRP-related expenditure as set out in the Draft General State Budget, which will drive the growth in expenditure to 5.3%, according to AIReF, to reach 50.9% of GDP.

By sub-sector, AIReF has increased the deficit forecast of the Central Government by just over 0.4 points as a result of the new measures approved, to stand at 6% of GDP. In contrast, it maintains the estimate of the deficit of the Social Security Funds at 1.5% of GDP and improves the forecast for the Regional Governments and Local Governments by 0.4 points as a result of incorporating the 2020 year-end data. Under the new estimate, the deficit of the Autonomous Regions would grow to 0.4% in 2021 after closing 2020 at 0.2%, while the Local Governments would record a surplus in 2021 of 0.3% of GDP, after closing 2020 with the same surplus.

Sustainability

AIReF notes in the Report that the halt in activity and the increase in borrowing needs resulting from the COVID-19 crisis have led to a sharp rise in the public deficit, which in turn has brought about a permanent increase in the ratio of public debt to GDP to 120%, its highest value of the last 100 years. AIReF projects a reduction of 1.3 points in 2021, to 118.7% of GDP.

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The institution identifies major risks and challenges to the medium and long-term sustainability of the public accounts and points to the possibility that the crisis will have permanent effects on the productive fabric. This would be compounded by greater dependency on favourable borrowing conditions, such as those currently in place, and the known challenge of an ageing population and the increased expenditure on pensions, which, if not financed with additional revenue, will result in a very significant increase in debt from historically very high levels.

Recommendations

In this context, AIR^eF once again insists on the need to design a credible and realistic medium-term fiscal strategy that guarantees the sustainability of public finances, although it is essential in the short term to tackle the economic, health and social emergencies that this crisis poses. Furthermore, and in line with other recommendations on high frequency data, it considers that a new recommendation should be made on the need to maintain or increase the reporting obligations of the General Government in a context of suspended fiscal rules.

AIR^eF also makes two new recommendations with the aim of guaranteeing the sustainability of Local and Regional Governments. On the one hand, it considers that the debt of the Autonomous Regions should be adjusted to their real financing and liquidity needs and actions should be promoted to monitor the main fiscal indicators of the Local Governments by supervisory bodies.