

Report on the General Government Budgetary Execution, Public Debt and Expenditure Rule 2021.

AIReF BELIEVES THAT NOW IS A GOOD TIME TO CLARIFY THE FISCAL SCENARIO FOR REGION AND LOCAL ADMINISTRATIONS

- The Independent Authority for Fiscal Responsibility (AIReF) insists on the need for a credible and realistic medium-term fiscal strategy which integrates the macroeconomic and fiscal implications of the implementation of the investments and reforms provided for in the Recovery, Transformation and Resilience Plan (RTRP)
- It maintains the macroeconomic scenario unchanged with respect to the Report on the Stability Programme Update (SPU), against a backdrop of major questions about international tourism and the macroeconomic impact of the RTRP
- The very partial information available hints at the existence of downside risks in the boost associated with the RTRP in 2021, which AIReF estimated at 1.5 percentage points
- For its central scenario, it estimates a General Government deficit of 7.9% of GDP in 2021, 0.1 points higher than that included in the previous report and below the 8.4% of GDP forecast by the Government at the end of April in the SPU.
- It forecasts an improvement in the deficit of the Social Security Funds of just under 0.2 points, to 1.6% of GDP; while for the Autonomous Regions, the forecast stands at 0.5% of GDP, over 0.1 points higher than in the previous report
- Both the Central Government (CG) and the Local Governments (LGs) have a slightly higher deficit, without the revision for either of them reaching 0.1 points of GDP.
- The high level of public debt places the sustainability of public finances in a highly vulnerable position, which also affects the Autonomous Regions.

The Independent Authority for Fiscal Responsibility (AIReF) today published the Report on the General Government Budgetary Execution, Public Debt and Expenditure Rule 2021 on its website, in which it highlights the opportunity for the Government to set a clear medium-term fiscal scenario that will allow the Territorial Administrations to adequately plan their budgetary decisions. The Institution keeps alive its recommendation to develop a medium-term fiscal strategy since, despite the suspension of fiscal rules, supervision continues. The

Independent Authority for Fiscal Responsibility (AIReF) thus insists that this strategy should be credible and realistic and should integrate the macroeconomic and fiscal implications of implementation of the investments and reforms provided for in the Recovery, Transformation and Resilience Plan (RTRP). In its report, it maintains the macroeconomic scenario unchanged with respect to the [Report on the 2021-2024 Stability Programme Update \(SPU\)](#), published in May, and points to an increase of 0.1 points in the GG deficit to 7.9% of GDP. AIReF highlights that at the end of the period, public debt will stand at around 112.4% of GDP, which places the public finances in a highly vulnerable position. The high level of debt and the expected worsening of the fiscal balance over the coming years also place the sustainability of the Autonomous Regions in a position of greater vulnerability.

In this report, AIReF updates its fiscal forecasts and keeps the macroeconomic scenario unchanged against a backdrop in which major questions remain in relation to the reactivation of international tourism and the macroeconomic impact that the RTRP will have in the second half of the year. With regard to the fiscal scenario, the deficit of the General Government as a whole will stand at 7.9% of GDP in 2021. This revision is the result of incorporating into its forecasts the new information available, both on implementation to date and that provided directly by the various GG sub-sectors.

Macroeconomic scenario

The information received since the date of the previous report offers mixed signals. On the one hand, the progress made in vaccinating the adult population in Spain and other neighbouring countries and the removal of restrictions on mobility have led to a strong reactivation of the economy. This is reflected in indicators of both business and consumer confidence, which have reached high values in historical terms, and in those relating to industrial production, world trade in goods and exports. Even the indicators related to service activities have performed well, although international tourism still remains at several levels below that recorded prior to the health crisis. The quick reaction of economic activity has led many agencies and institutions to revise expected growth upwards for 2021.

As a counterweight, the very partial information available hints at the existence of downside risks in the boost associated with the RTRP in 2021, which AIReF estimated at 1.5 percentage points. Furthermore, the increase in infections recorded in recent days both in Spain and in the main source countries for inbound tourism might endanger the recovery of international tourism over the summer months, which is a key factor for sustaining the intensity of the recovery that is incorporated into AIReF's scenario in the second half of the year.

In these circumstances, the Institution has decided to leave the GDP growth forecasts unchanged in 2021, and only make changes to the composition of growth to reflect the most recent available information. In September, with more comprehensive information, the overall macroeconomic outlook will be revised with the aim of determining the degree of realism of the Government's macroeconomic forecasts contained in the draft budget for 2022.

Fiscal scenario

For its central scenario, AIReF estimates a General Government deficit of 7.9% of GDP in 2021, 0.1 points higher than that included in the previous report and below the 8.4% of GDP forecast by the Government at the end of April in the SPU. This increase is the result of the interaction of various factors that have raised the deficit, such as the adoption of new measures and the implementation recorded, which are largely offset by others that have acted in the opposite direction, such as the positive evolution of tax collection in the early months of the year.

Along the same lines, the information provided by the General Government sub-sectors has made it possible to produce a forecast that is more in line with the reality of the implementation of the REACT EU funds, abandoning the assumption of deficit neutrality in 2021. AIReF assumes for this year execution of expenditure of under 80% of the funds allocated to the Autonomous Regions and, to a greater extent, a lower allocation of revenue, which will be offset in subsequent years. On the other hand, AIReF continues to consider that the effect of the implementation of the RTRP will be neutral on the deficit in 2021, although it transfers part of the implementation forecast for 2021 in the previous report to later years.

Revenue, excluding the RTRP, will amount to 41.4% of GDP, a rise of 8.5% on 2020, and slightly less than 0.1 points lower than the forecast in the previous report. Although the macroeconomic scenario has not changed significantly, the positive evolution of tax collection in the early part of the year has led to an increase, mainly in the collection forecasts for corporate income tax, social security contributions, VAT and Special Taxes. In the opposite direction, the impact of changes in electricity taxation has been incorporated, which, in the case of the Tax on the Value of Electricity Production, would be offset by a lower transfer to the electricity system. In addition, in accordance with the certification forecasts of the Autonomous Regions, AIReF considers a lower estimate of revenue from the REACT EU funds, which would be carried over to the following years. Finally, including the RTRP, revenue would stand at 43% of GDP.

Expenditures, excluding the RTRP, will stand at 49.4% of GDP, slightly less than 0.1 points higher than the forecast in the previous report. Firstly, the implementation data available to date have led to an increase in expenditure under certain headings, such as remuneration of employees, the Minimum Living Income and gross fixed capital formation to incorporate the impact of SAREB's ordinary activities. Similarly, the forecasts now include some non-recurring elements not initially forecast as a result of several court judgments. Secondly, the impact of the new measures adopted by the different governments has been included, such as those adopted by the Autonomous Regions in the area of support for companies and healthcare spending.

The compensation for the revaluation of pensions in 2021 below inflation has also been transferred to 2022. Thirdly, AIReF updates the forecast implementation of the expenditure linked to the REACT EU funds, which would stand at under 80% of the funds allocated to the Autonomous Regions forecast in the previous report. These funds provide for the financing, among other actions, of measures to mitigate the effects of the pandemic in the fields of health, education, social services and support to companies. Finally, the forecasts for the implementation of expenditure linked to RTRP investments have been reduced, bringing total expenditure to 50.9% of GDP, including the RTRP.

Sustainability

The significant increase in the stock of public debt resulting from the crisis, on top of the previous high level, places the sustainability of public finances, both of the General Government as a whole and of the Autonomous Region sub-sector, in a highly vulnerable position. In both cases, a gradual and sustained reduction of the public deficit towards structural equilibrium is required in order to bring the debt back to pre-pandemic levels over the coming decade. For the General Government as a whole, maintaining a structural deficit similar to that of 2024, i.e. between 3.5% and 4.5% of GDP over the long term would stabilise the debt-to-GDP ratio at levels significantly over 100%.

With regard to the Autonomous Regions, the simulations carried out indicate that at least two decades will be necessary to reach the reference limit of 13%. In particular, in contrast with the scenarios projected by AIReF prior to the crisis, where the level of 13% would be reached by around 2035, this limit is not forecast to be reached prior to 2044, even if the budgetary balance of the sub-sector as a whole is maintained.

AIReF estimates a slight reduction in the debt ratio at the end of 2021 to 25.5% as a result of strong expected growth, as the estimate of fiscal deterioration in the sub-sector as a whole is maintained. The increase in the debt ratio will be uneven across the different regions: Valencia, the Balearic Islands and Murcia would be the regions recording the largest increases in their debt in 2021 compared with 2019. In 2021, no region will meet the 13% reference limit, although the Canary Islands, Madrid and the Basque Country would be the regions closest to the legal reference rate.

The current expectations of a lasting low interest rate environment offer greater room for manoeuvre to address the return to a balanced structural budget in a gradual manner that is not detrimental to growth. However, high debt levels suggest that a medium-term consolidation strategy should be designed as soon as possible.

Recommendations

In this context, AIReF once again insists on the need for a credible and realistic medium-term fiscal strategy. As it indicated in the report on the SPU, the Government should complete the medium-term fiscal strategy to achieve a level of deficit that is sufficient to steer the debt towards more sustainable paths that will reduce the vulnerability of the Spanish economy.

This implies extending the time horizon of the strategy set out in the Stability Programme and integrating into it the macroeconomic and fiscal implications of implementation of the investments and reforms provided for in the RTRP.

In this regard, AIReF considers that planning is essential for the various administrations to adopt their respective budgetary decisions with a strategic and medium-term vision. It is therefore necessary to provide the Autonomous Regions and Local Governments with predictability for when they draw up their 2022 budgets and fiscal strategies, which is complicated as there are still many unknowns. The upcoming meetings of the *Consejo de Política Fiscal y Financiera* (Fiscal and Financial Policy Council - CPFF)

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and the *Comisión Nacional de la Administración Local* (National Commission for Local Administration - CNAL) are an opportunity for defining these elements and allowing their participation in decision making.