EXECUTIVE SUMMARY

The Independent Authority for Fiscal Responsibility (AIReF) has the legal mandate to report on the budgetary execution, public debt and expenditure rule of the General Government (GG) in 2021. Along with this report, AIReF also publishes the individual reports on each Autonomous Region and the supplementary report on the Local Governments (LGs). As the fiscal rules for 2021 are suspended, the analysis focuses on the General Government's budgetary and sustainability forecasts. In this context, AIReF's fiscal supervision takes on greater importance as a guarantor of the sustainability of the General Government.

AIReF gave its opinion on the fiscal position in 2021 of all the General Government sub-sectors at the start of April in its report on the initial budgets, which included reports on the Autonomous Regions (ARs) and the Local Governments (LGs). Following that, with a medium-term outlook, it issued its report on the Stability Programme Update at the start of May. At that time, AIReF's central scenario estimated a reduction in the deficit to 7.8% of GDP by 2021, on the basis of GDP growth of 6.6%.

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 Recovery, Transformation and Resilience Plan (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 AIReF incorporating into its forecasts the new information available, both on execution to date and that provided directly by the various General Government sub-sectors.

How has the macroeconomic scenario evolved?

The macroeconomic scenario underlying the budgetary projections presented in this report remains unchanged from that presented in the report on the Stability Programme Update (SPU) in May this year.

The information received since the date of the report on the Stability Programme Update in May gives 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 for 2021 upwards.

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 pp. 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 in 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, AIReF has decided to leave the GDP growth forecasts unchanged in 2021, and only make changes in its composition to reflect the most recent information available. 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.

How has AIReF modified its budget forecasts?

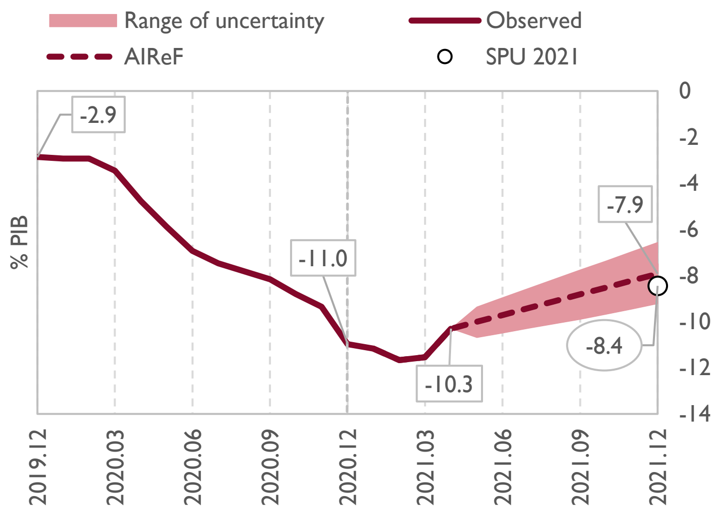
For its central scenario, AIReF estimates a General Government deficit of 7.9% of GDP in 2021, 0.1 points higher than that included in the previous report and below the 8.4% of GDP forecast by the Government at the end of April in the Stability Programme Update. This increase is the result of the interaction 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 2021 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. In addition, AIReF continues to consider that the effect of implementation of the RTRP will be neutral on the deficit in 2021, although it transfers to later years part of the implementation forecast for 2021 in the previous report.

Revenue, excluding the RTRP, will amount to 41.4% of GDP, a rise of 8.4% 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 primarily led to an increase 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.

Expenditure, 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 compensation 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 rulings. 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 or 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.

EVOLUTION OF THE BALANCE OF THE GENERAL GOVERNMENT



What changes have taken place at the sub-sector level?

Compared with the previous report, the forecast for the deficit of the Social Security Funds has improved by a little under 0.2 points, to stand at 1.6% of GDP. In contrast, in the Autonomous Regions, influenced by the lower forecast for revenue from REACT-EU, the forecast stands at 0.5% of GDP, over 0.1 points higher than in the previous report. Therefore, both the Central Government (CG) and the Local Governments (LGs) have a slightly worse deficit, without the revision for either of them reaching 0.1 points of GDP. Therefore, the CG will record a deficit of 6.1% of GDP, while the LGs maintain a forecast surplus of 0.3% of GDP.

GENERAL GOVERNMENT BALANCE

		AIReF estimate	
	SPU (Government)	SPU Rep.	July Rep.
GG	**-8.4**	**-7.8**	**-7.9**
CG	-6.3	-6.1	-6.1
SSFs	-1.5	-1.8	-1.6
ARs	-0.7	-0.4	-0.5
LGs	0.0	0.3	0.3

What are the implications from a sustainability point of view?

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 in around 2035, this limit is not forecast to be reached prior to 2044, even if the budgetary equilibrium of the sub-sector as a whole is maintained.

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.

What recommendations does AIReF make in this context?

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 Stability Programme Update, the Government should complete the medium-term fiscal strategy for achieving 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.