

Appearance before Finance Committee of Congress

CRISTINA HERRERO, “THE NEW MEASURES CRISTINA HERRERO, “THE NEW MEASURES WILL INCREASE THE DEFICIT IN 2022 BY 0.5% OF GDP”

- The President of AIReF insists that the Stability Programme offers the opportunity to define a medium-term fiscal strategy that will realistically and credibly ensure the financial sustainability of the General Government
- She reiterates that the Stability Programme's macroeconomic scenario is feasible, but that some risks are already materialising, and therefore AIReF will re-evaluate its forecasts in the next Report, in line with most analysts
- She notes that the Government's fiscal path is similar to that of AIReF, although it will also be revised in July to incorporate the new measures announced, which will have an impact on the 2022 deficit
- AIReF continues to insist on the need for a medium-term fiscal strategy that integrates the investments and reforms of the RTRP
- She highlights that sustainability is at the heart of the ECOFIN guidance, which has already incorporated certain quantitative elements in the 2023 guidance

The President of the Independent Authority for Fiscal Responsibility (AIReF), Cristina Herrero, appeared today before the Finance Committee of the Congress of Deputies to explain the Report on the Stability Programme Update, published by the Institution in May. Since the publication of the report, new measures have been adopted that will increase the deficit in 2022 by 0.5% of GDP over the previous forecast.

Cristina Herrero began her speech by highlighting that the Report was again carried out in an extremely uncertain and highly changing context, in which, however, a medium-term vision on the economic and fiscal outlook and on the broad lines of economic policy is essential so that public action is not an additional source of uncertainty. In this regard, she insisted that the Stability Programme Update offers the opportunity to define a medium-term strategy integrating the reforms and investments set out in the Recovery, Transformation and Resilience Plan (RTRP) without foregoing revisions in the event of unexpected changes or new shocks.

AIReF considers that the macroeconomic scenario of the Stability Programme is feasible and as such endorsed it on April 29th. In fact, the differences between the Government's macroeconomic scenario and that of AIReF are very small. However, Cristina Herrero stressed that the endorsement took place in a context of major uncertainty in which risks with a negative impact predominate, which are higher than usual.

Among the risks, the President of AIReF highlighted the pandemic, China's zero-COVID strategy, the invasion of Ukraine, the bottlenecks, the shortage of raw materials and the

energy crisis, the execution of the RTRP and a greater intensity and persistence of inflation, which might generate loss of competitiveness and second-round effects, as well as an increased tightening of monetary policy.

Since the Report was published in May, there is no sign of a reduction in risks, and some are even materialising. In particular, pressures on global value chains persist and the intensity of inflationary pressures lead markets to predict a faster and more intense normalisation of financing conditions. Inflation is also being passed on to the entire consumer basket, although no major transfer to collective bargaining wages has been noted. However, there are elements that point to the possibility of a scenario with persistent wage inflation.

In addition, the scant information on the RTRP shows that investments are still low. All this will lead to a re-evaluation in AIReF's next few reports, in line with most analysts, who are revising their growth forecasts downwards and their inflation forecasts upwards.

At a fiscal level, AIReF estimates a reduction in the General Government deficit over the period to 3% of GDP in 2025, 0.1 points higher than that forecast by the Government, which maintains the reference rates of one year ago despite much more favourable year-end 2021 figures than expected. In particular, AIReF estimates that in 2022 there will be a sharp reduction in the deficit due to the withdrawal of COVID measures and economic recovery. In 2023, the reduction will be moderate and in 2024 and 2025, there will be a slowdown in the reduction of the deficit.

By sub-sector, AIReF forecasts a lower deficit of the Central Government and higher deficit of the Social Security Funds and the Autonomous Regions, and a higher surplus of the Local Governments.

For its part, public debt will fall in the forecast horizon (2022-2025) thanks to nominal growth, which will be the main factor in the reduction of debt in the short term. The deflator will make a very significant contribution while the public deficit will continue to contribute to the increase in debt. AIReF projects a reduction in the debt-to-GDP ratio of 9.6 points in 2025, to 108.8%, and considers the Government's projection in the Stability Programme to be feasible.

New measures

Since the publication of the Report, new measures have been adopted that will increase the deficit in 2022 by 0.5% of GDP over the previous forecast. Therefore, AIReF will also update its budgetary forecasts for 2022 in the next report to be published in mid-July. The measures to mitigate the effects of the energy crisis entail an increase in the deficit of 1% of GDP in 2022.

Although the Government scenario suggests a convergence of the deficit to the Stability Pact threshold (3% of GDP) in 2025 and a path of debt reduction, AIReF believes that there are still elements that make it advisable to have a medium-term strategy that will strengthen the underlying position of public finances and reduce vulnerability to adverse environments. It therefore maintains its live recommendation to the Ministry of Finance to establish a medium-term fiscal strategy that will act as fiscal guidance and will realistically and credibly ensure the financial sustainability of the General Government.

In this regard, Cristina Herrero highlighted that sustainability is at the heart of the ECOFIN guidance. Although the quantitative rules have been replaced by guidance, for 2023 certain quantitative elements have already been incorporated and point to adjustment paths after 2023. In particular, a prudent fiscal path has been recommended for Spain, with growth in nationally-financed current expenditure lower than potential GDP, which, if applied, would lead to a deficit lower than the forecasts of AIReF and the Government. Beyond 2023, it recommends a credible and gradual debt reduction path.

In addition, AIReF makes a new recommendation on the need to allocate the revenue that materialises above the forecast and the temporary revenue towards accelerating the necessary reduction in the structural deficit and to avoid increases in expenditure or reductions in revenue of a structural nature that do not have funding that is also structural. And another recommendation on the importance of evaluating the impact of the measures already adopted in terms of efficiency, effectiveness and redistributive impact before deciding, where necessary, on their possible extension.

These recommendations are in addition to those made in the endorsement of the macroeconomic outlook on the need to publish the information on the execution of the RTRP in national accounting terms, to provide more information for the endorsement of the macroeconomic forecasts and to sign a memorandum of understanding in order to make the endorsement process more transparent and efficient.