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Appearance before Budget Committee in Senate

## CRISTINA HERRERO PRESENTS IN THE SENATE THE REPORTS ON THE MAIN LINES OF THE PUBLIC ADMINISTRATIONS' BUDGETS

- On October 4th, AIReF endorsed the macroeconomic outlook that accompanies the Budgets as it considered the nominal GDP growth forecast by the Government to be feasible, although it warned of predominating risks in 2023
- The most recent employment data are relatively robust, but growth in services and manufacturing industries are slowing, confidence is not rebounding and core inflation and food prices are still rising
- AIReF considers that the Budgets have significant deficiencies that diminish their informative quality and power as planning tools
- It estimates a GDP deficit of the GG of 3.3% in 2023, without taking into account the potential extension of the measures. In the medium term, the deficit will stabilise at between 0.2 and 0.3 points above the 3% limit of GDP set without additional measures
- AIReF also reports on the Budgetary Plan, which provides for two scenarios with the same deficit path, and compliance with the recommendation from Brussels, which limits the spending increase and could be met if the measures are not extended
- Cristina Herrero reviews the recommendations included in the reports and asserts that she has received unsatisfactory responses from the GG

The President of the Independent Authority for Fiscal Responsibility (AIReF), Cristina Herrero, appeared today before the Budget Committee of the Senate to present the Reports on the Main Lines of the Budgets of the General Government, published by AIReF over the course of October. Specifically, on October 4<sup>th</sup>, AIReF published the [endorsement](#) of the macroeconomic forecasts of the 2023 Budgets, on [October 18<sup>th</sup>](#) the Report on the Budgets of the Central Government and Social Security, on [October 25<sup>th</sup>](#) the Budgets of the sub-sectors of the Autonomous Regions (ARs) and Local Governments (LGs) and the General Government as a whole and on October 28<sup>th</sup>, the individual reports of the [ARs](#) and [LGs](#).

AIReF endorsed the macroeconomic scenario that accompanied the 2023 Budgets as it considered the nominal growth forecast by the Government to be feasible – the most important variable for the purposes of the budgetary dynamic in the short term - despite the differences with real growth. However, it indicated that in 2023 downside risks for growth will predominate, particularly in terms of energy security and the downward growth revision in Europe, the persistence of inflation, the risks of the de-anchoring of

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inflation expectations and the implementation risks of investments in the Recovery, Transformation and Resilience Plan (RTRP).

With a view to assisting the medium-term economic planning that AIReF considers essential, the institution framed its forecasts in a medium-term scenario that expects the economy to resume a path of growth in the spring of 2023 and recover similar levels of activity to prior to the pandemic by the end of 2023 or start of 2024. In this scenario, real GDP will grow by 4.4% in 2022, 1.5% in 2023, 2.7% in 2024, 1.8% in 2025 and 1.6% in 2026. The European Commission, in turn, which published its autumn forecasts a few weeks ago, expects growth for Spain of 4.5% in 2022, 1% in 2023 and 2% in 2024.

Since the publication of the reports, new macroeconomic data have emerged, although there is still scant information for the fourth quarter of 2022. The employment data have been relatively robust but growth in services and manufacturing industries have slowed. For their part, the confidence indicators have not rebounded due to the impact of the price shocks on real disposable income of citizens. The CPI, in turn, has slowed its rate of year-on-year growth, but core inflation and food prices remain on an upward path.

On October 18<sup>th</sup>, during her appearance before the Congress of Deputies, Cristina Herrero indicated that the 2023 Budgets – the main economic policy instrument of the Government - presented significant deficiencies that diminished their informative quality and power as planning tools. These deficiencies also weaken its accountability function. In her opinion, the uncertainties of the present time should not detract from the purpose of the Budget, which has mechanisms to manage it.

Among these deficiencies, the President of AIReF stated that the annual accounts are based on a revenue forecast that does not include the most recent information for 2022, does not include measures that will foreseeably be adopted for a potentially high amount, they continue not to provide information in national accounting terms, deficiencies persist in the endorsement process and are not framed within a medium-term fiscal strategy.

As regards the fiscal scenario, the reports presented over the course of October are once again drafted in a context of suspended fiscal rules, with national and European approaches designed to guarantee the sustainability of the public finances and focus the measures on responding to the crisis. Against this backdrop, AIReF supervises the consistency with these approaches. For the GG as a whole, AIReF's forecasts for 2023 stand below the reference rate (-3.9% of GDP), estimating a deficit of 3.3% of GDP in 2023, after closing 2022 at 4.6%. This amounts to a deficit reduction of 1.3% without an extension or the adoption of new measures. In the case of extending the measures currently in force, the deficit in 2023 will stand at similar levels to those of 2022. AIReF also presented the medium-term fiscal forecasts, which provide for a public deficit that stabilises between 0.2 and 0.3 points above the GDP limit of 3%. In its opinion, the margin to reduce the deficit without additional measures will be exhausted in the medium term.

By subsector, the reference rate may be achieved by the Central Government if the measures are not extended, but will be difficult for the Social Security System to achieve. In the case of the ARs, AIReF estimates that the deficit will remain below the

reference rate (-0.3%) due to the revenue from the financing system, while Local Governments will record a higher surplus than the one set (0.1%), for the same reason. In 2023, AIReF forecasts a smaller Central Government and AR deficit than the Government and a higher Social Security deficit. It also expects the LGs to record a higher surplus.

### **Budgetary Plan and recommendation from Brussels**

In the reports, AIReF also assesses the Budgetary Plan sent by the Government to Brussels, which presents two scenarios with the same deficit path and without considering the impact of the measures on the macroeconomic scenario. According to AIReF, Scenario 2 presents a closer picture of the reality of the public finances, albeit with a lower level of spending than estimated by AIReF. In addition, the two scenarios included in the Budgetary Plan share the same macroeconomic scenario, which could lead to some internal inconsistencies.

Furthermore, it assesses the compliance with the European fiscal recommendation that limited the increase in primary current expenditure. In its opinion, the increase set out in the GG Budgets could be compatible with the recommendation without new measures, but should all of them be extended in 2023, growth would stand at 6.5%, clearly above the 5% estimated by the European Commission. As regards the focus of the measures, AIReF observes that, as a whole, there is a certain degree of emphasis on the most vulnerable, although high-income households absorb a significant part of the cost of the measures. In income-related terms, the amount allocated to low-income households accounts for 17%, while this percentage stands at 1% for high-income households.

Finally, AIReF indicates in its reports that the overall tone of fiscal policy in 2023 will be expansive if the boost associated with the NGEU funds materialises and estimates that, without additional measures, there will be a slowdown in the rate of debt reduction in the medium term to stabilise at 108.8% of GDP.

### **Recommendations**

Cristina Herrero reviewed the recommendations included in the reports published in October, which have now been responded to by the General Government, although the result is unsatisfactory according to the President of AIReF. When the endorsement was issued on October 4<sup>th</sup>, AIReF recommended that the institution should participate earlier on in the endorsement process. She also reiterated the recommendation to have sufficient information available on the measures to be included in the economic scenario and the revenue and expenditure path, and regulate the endorsement process through an agreement.

In the report issued on October 18<sup>th</sup>, AIReF issued new recommendations to adequately structure the budgetary process and resolve the deficiencies in the Budgets. It also reiterated the recommendation on informative transparency in national accounting terms. And it included a new recommendation in the report of October 25<sup>th</sup> aimed at the Ministry of Finance and Civil Service for it to define reference rates for each administration taking into account their starting point, such that while they should be demanding, they should also be feasible. It also reiterated the recommendation that

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the Budgetary Plan should incorporate all the measures provided for by the Government and the impact of the REACT-EU funds and RTRP.