

REPORT ON THE DRAFT BUDGET AND MAIN BUDGETARY LINES OF THE GENERAL GOVERNMENT: 2023 GENERAL STATE BUDGET

REPORT 49/22

October 18th, 2022



Autoridad Independiente
de Responsabilidad Fiscal



The mission of the Independent Authority for Fiscal Responsibility, AAI (AIReF) is to ensure strict compliance with the principles of budgetary stability and financial sustainability enshrined in Article 135 of the Spanish Constitution.

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EXECUTIVE SUMMARY

The Independent Authority for Fiscal Responsibility, AAI (AIReF) has to issue a report on the draft General State Budget for 2023 (GSB). Previously, AIReF issued on October 4th its endorsement of the macroeconomic forecasts at the request of the Government. This report analyses the draft General State Budget for 2023 (GSB) presented on October 6th. Therefore, it focuses on the sub-sectors of the Central Government and the Social Security Funds. AIReF will subsequently issue a report on the situation of the General Government (GG) as a whole once it has analysed in detail the content of the Budgetary Plan that the Government submitted to the European Commission on October 15th, as well as that of the other sub-sectors. AIReF will also publish the individual reports on the Autonomous Regions (ARs) and the Local Government (LG) sub-sector.

It should be noted that application of fiscal rules remains suspended in 2023. However, AIReF's fiscal oversight remains fully in force, becoming even more important as a guarantor of the sustainability of public finances.

The macroeconomic scenario of the GSB for 2023

On October 4th, AIReF endorsed the Government's macroeconomic scenario that accompanies the 2023 GSB. AIReF considers that the nominal GDP growth that has served as the basis for drawing up the budgets is likely, although there are downside risks to real growth. AIReF also highlights the lack of information on the measures included in the budget and on the degree of effective implementation of the RTRP at the time of the endorsement, which makes it difficult to properly assess the Government's macroeconomic scenario in the current circumstances.

The Government's scenario projects real GDP growth of 4.4% in 2022 and 2.1% in 2023, while in nominal terms growth would fall from 8.6% in 2022 to 6% in 2023. For its part, the growth of the GDP deflator dips slightly from 4% in 2022 to 3.8% in 2023. AIReF's diagnosis on the basis of its own forecasting scenarios reveals that the nominal GDP growth estimates lie within the central range of the probability intervals estimated by AIReF, while the estimates for real growth are in the high range.

Compared with AIReF's scenario, the Government's macroeconomic outlook assumes significant growth in investment and exports. This is unlikely in the context of uncertainty, high energy prices and deterioration in our main export markets, which is not adequately reflected in the technical assumptions of the Government's scenario. In addition, the Government's scenario assumes that wage increases will moderate, which entails risks if workers try to regain some of the purchasing power lost in 2022.

Moreover, AIReF believes that there are significant sources of uncertainty associated with the recent escalation of geopolitical tensions with Russia, doubts about the security of energy supply at reasonable prices, the persistence of inflation and its effects on the purchasing power of households and on the financing conditions of the economy, among other factors, which pose risks to real GDP growth and to inflation.

Budgetary scenario

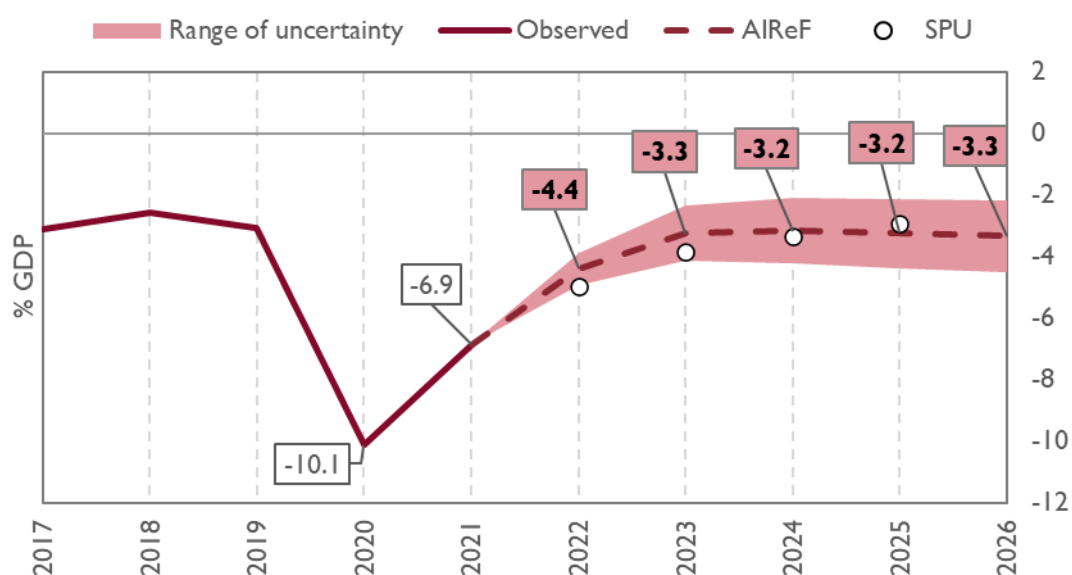
AIReF estimates a deficit of 3.3% of GDP for the GG as a whole in 2023, without including any extension of the measures and without incorporating the information contained in the Budgetary Plan. After closing 2022 with a deficit of 4.4% of GDP, the deficit would fall by 1.1 points if the measures to mitigate the energy crisis were not extended. In both years, AIReF's estimates are below the reference rates set by the Government of 5% for 2022 and 3.9% for 2023. The trend that began with the suspension of fiscal rules of presenting lax reference rates that do not realistically and transparently reflect the state of public finances thus continues. This is not conducive to reducing the structural deficit even when allowed by the economic and fiscal situation.

The GSB forecasts do not include the possible extension of the measures adopted over 2022 to mitigate the effects of the energy crisis and the Russian invasion of Ukraine. AIReF has therefore applied the same assumption to ensure the comparability of the scenarios. However, given that the macroeconomic scenario does not assume that 2023 will see the alleviation of the circumstances that gave rise to the adoption of these measures, it is logical to think, as the Government has stated, the measures will be extended with a scope and duration that will be decided even before the end of the

parliamentary passage of this draft GSB. Therefore, the deficit estimate of 3.3% of GDP for 2023 would rise according to the horizon and scope of the extension or extensions that are adopted over the year, and as a result of any new measures that may be adopted depending on the evolution of the economic and geopolitical situation. As an indicator of the magnitude of the potential impact of these extensions, the annual cost of the measures in force amounts to 1.3% of GDP. Consequently, if all the measures are extended for the whole year, the GG deficit would reach 4.6% of GDP.

In the medium term, AIReF estimates that the GG deficit will stabilise at around 3.2% of GDP, with a slight upturn in 2026 to 3.3% of GDP. Assuming the measures adopted on both the expenditure and revenue sides are temporary, once the current crisis is over, the margin for reducing the deficit without additional measures is exhausted. This results in a level above the 3% limit set in the Stability and Growth Pact.

EVOLUTION OF THE NET LENDING/BORROWING OF THE GG



Source: AIReF and IGAE

Central Government

After analysing the GSB, AIReF estimates a deficit of 3% of GDP for the CG in 2023, without including the extension of the measures, after reaching 3.2% in 2022. These forecasts are below the reference rate set by the Government for the CG of 3.8% for 2022 and 3.2% for 2023. In this regard, it should be noted that AIReF estimates a smaller reduction in the deficit in 2023, 0.2 points of GDP compared with the 0.6 points of the Government.

The tax revenue forecasts contained in the draft GSB are below AIReF's estimates, thus continuing the trend observed since the fiscal rules were

suspended. AIReF's higher forecast mainly stems from the estimated 2022 year-end figure, which is slightly offset by a more contained evolution in 2023. AIReF estimates higher revenue of 0.6 points of GDP, mainly in Personal Income Tax (PIT), Value Added Tax (VAT) and Corporate Income Tax (CIT). In addition, this revenue would be 1.8 points higher than that included in the previous GSBs. For 2023, the forecast difference is reduced to 0.5 points of GDP due to the fact that AIReF estimates growth in tax revenue of 7.2% compared with the 7.7% included in the GSB.

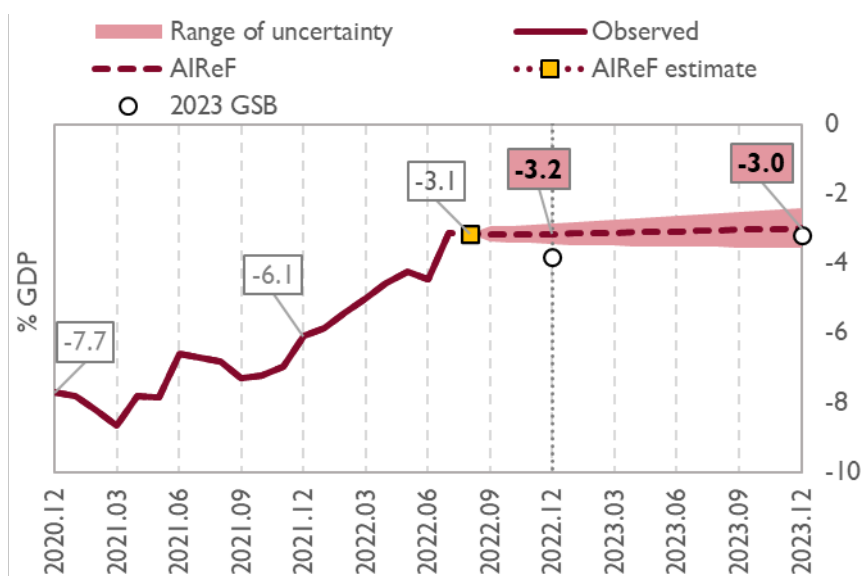
Excluding the impact of both the reversal of the temporary measures in 2022 and the new measures in 2023, the growth in tax revenue in cash terms would be 4.7%. This growth is mainly supported by PIT, with net growth of 7.7%, driven by the increase in pensions and the increase in public and private wages. This growth will be reduced to 6.6% due to the impact of the measures on withholdings on work and income from business activities. In addition, underpinned by inflation, VAT will grow by 7.2%, 4.9% without including the reversal of the 2022 measures. For its part, the cash collection of CIT falls by 4.9% compared with 2022 as a result of the growth in applications for refunds in the 2022 annual tax return.

Although the GSB still does not include information in national accounting terms, AIReF makes its own estimates to translate the budgetary forecasts of the GSB into the national accounting headings. On the one hand, the revenue of the CG will reach 19.3% of GDP in 2023, without including the RTRP, with a level similar to that of 2022 as a result of the financing systems of the territorial administrations. This figure includes the new temporary levies on financial institutions and the energy sector.

On the other hand, the weight of expenditure excluding the RTRP as a proportion of GDP will fall to 22.2%, as the GSB for 2023 does not include the measures to mitigate the effects of the energy crisis. This means that all headings grow except intermediate consumption and subsidies and other expenditure. The fastest growing headings include compensation of employees due to wage increases, interest as a result of the rise in interest rates and social transfers in cash due to the increase in civil servant pensions.

In budgetary terms, the State's non-financial expenditure limit grows by 1.1% compared with 2022, which rises to 1.9% if the Next Generation EU funds are excluded. If we also consider the extraordinary transfers to other administrations in 2022 that are not repeated in 2023, the expenditure ceiling rises by 6.3% in like-for-like terms, which amounts to €9bn. This increase is mainly earmarked for interest (€1.1bn), civil servant pensions (€2.5bn), compensation of employees (€1.2bn) and capital transfers (€1.9bn).

EVOLUTION OF CENTRAL GOVERNMENT BALANCE

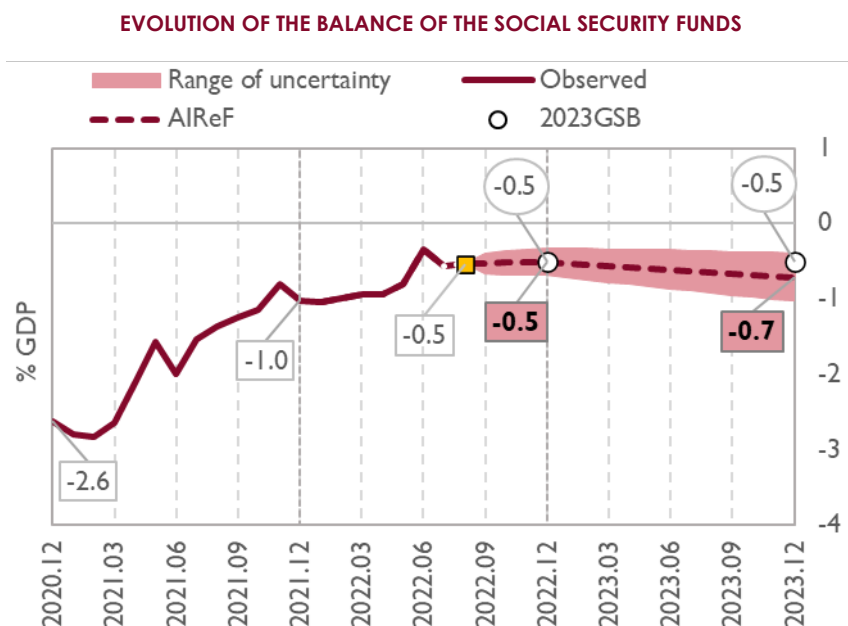


Source: AIReF and IGAE

Social Security Funds

AIReF estimates a deficit in 2023 of 0.7% of GDP in the Social Security Funds, after reaching 0.5% in 2022. While in 2022 this forecast is in line with the Government's reference rate, in 2023 it is 0.2 points higher. The increase in the deficit is mainly explained by the increase in pensions with the 2022 CPI, which according to AIReF's macroeconomic scenario will stand at 8.9%. As a result, pension expenditure will grow by 11.2% in 2023, €17.3bn more than in 2022. In addition, unemployment spending will rise by 1.5% in 2023 after falling by 23.9% in 2022. Overall, the expenditure of the SSFs will amount to 16.9% of GDP, 0.4 points higher than in 2022.

SSF revenue will stand at 16.2% of GDP in 2023, with growth of 6.8%. Social contributions will grow by 8% as a result of the evolution of the labour market and especially of wages, the implementation of the Intergenerational Equity Mechanism and the increase in the maximum contribution bases. Transfers from the CG will continue to grow in compliance with the recommendations of the Toledo Pact, although those earmarked for the SEPE disappear.



Source: AIReF, IGAE, Social Security and SEPE

Evaluation of the Specific Recommendation of the European Council on fiscal matters

The Country Specific Recommendations adopted this year set a quantitative reference for fiscal policy in 2023 for high-debt countries, such as Spain. In particular, Spain is recommended to limit the increase in nationally financed current primary public expenditure below medium-term potential growth.

For the GG as a whole, AIReF forecasts growth in current primary expenditure net of revenue measures of 3.6% in 2023, which would fall within the range defined for the evaluation of the Council's fiscal recommendation.

However, if all measures are extended for the whole of 2023, the evolution of current primary expenditure of the GG would be clearly above the range of compliance with the recommendation. The additional cost of the extension of the measures would imply an increase in current primary expenditure net of revenue measures of almost 7% per year in 2023, well above the references compatible with compliance with the fiscal recommendation.

Debt sustainability

In a context of high nominal growth, the debt ratio remains on a downward path, which AIReF expects to continue in the coming years. Specifically, for 2023, AIReF estimates a reduction in the debt ratio of 7.2 points of GDP compared with the 2021 level, mainly supported by the growth in nominal GDP (15.3 points), where the deflator will play a very significant contribution (8.7).

The public deficit will continue to contribute significantly to the increase in debt.

In the medium term, the projection of a primary deficit that will remain stable at around 1%, together with declining nominal growth and an increasing financial burden, gradually translates into a slowdown in the pace of reduction in the debt ratio, until it stabilises at 108.5% of GDP in 2026.

It should be noted that in 2022 there was already a turning point in the evolution of debt financing costs in the context of a general tightening of monetary policy.

Recommendations

The GSB still does not provide information in national accounting terms, which hampers analysis of the budget and its consistency with other documents such as the Budgetary Plan submitted to the European Commission. In addition, the year-end forecasts for 2022 are unrealistic both in terms of revenue and balance, thus undermining the forecasts for 2023. While prudence in the preparation of budgets is advisable, a realistic starting point for proper budget planning is necessary. Another fundamental element that hampers the proper analysis of this budget is the lack of specific information on the possible extension of the measures adopted to mitigate the effects of the energy crisis. In this regard, AIReF has been warning since its creation through its reports and opinions of the repeated shortcomings of the draft GSBs, which are exacerbated in this year. For this reason, AIReF recommends to the Government that next year the draft State Budget should recover its central role as an instrument of fiscal and economic policy and an element of design, planning, execution, control and supervision of the activity of the public sector.

Furthermore, although it would have been more appropriate to include information on the measures in the GSB and/or the Budgetary Plan, AIReF recommends that the Government incorporate and publish in any extension of the measures an evaluation of their effectiveness and efficiency that specifies the conditions that trigger their extension or withdrawal both at the time of their approval and in the future. This would make it possible to integrate the measures into a medium-term national fiscal strategy that provides predictability and reconciles the preservation of economic growth and the reduction of the structural deficit with the aim of bringing public debt back to less vulnerable levels and ensuring long-term sustainability. Finally, AIReF once again recommends that the GSB should incorporate information in national accounting terms.

These recommendations are in addition to those made in the endorsement of the macroeconomic outlook of October 4th. Specifically, AIReF made a new recommendation for the Ministry of Economic Affairs to consult AIReF on the Report on the Situation of the Spanish Economy that serves as the basis for the GG budgets. It also repeats the need to have information on the budgetary and fiscal measures included in the macroeconomic scenario and the degree of execution of the RTRP in national accounting terms. Finally, it reiterates the need for the endorsement process to be regulated by a memorandum of understanding.

1. INTRODUCTION

On October 4th, the Council of Ministers approved the draft General State Budget for 2023 (2023 GSB). Following its approval by resolution of the Council of Ministers, the draft 2023 GSB was presented to Parliament on October 6th. It is currently in Congress for its passage through Parliament. The Government expects it to be approved before the end of the year for entry into force on January 1st, 2023.

On the same day, AIReF published its endorsement of the macroeconomic projections underpinning the draft 2023 GSB. The law on the establishment of AIReF provides that AIReF must issue a report on the macroeconomic forecasts incorporated in the draft budgets of all General Government sub-sectors, indicating whether it gives its endorsement. To this end, AIReF endorsed the macroeconomic scenario that accompanies the draft 2023 GSB as it considers that both the GDP growth path and the inflation forecasts are feasible, although there are significant downside risks in the case of the former.

In this report, AIReF completes the analysis of the macroeconomic forecasts made for the published endorsement. AIReF notes that the Government's nominal growth estimate is in the central range of the probability intervals of its scenario. However, it perceives downside risks to the real growth of 2.1% which the Government forecasts for 2023. AIReF also considers the Government's price forecasts, which put the GDP deflator at 3.8% in 2023, to

be reasonable. In this report, AIReF publishes its full forecasts, which suggest real growth for 2023 of 1.5% and an increase in the GDP deflator of 4.3%.

In the endorsement issued on the macroeconomic forecasts of the draft 2023 GSB, AIReF makes three recommendations. On the one hand, it makes a new recommendation for the Ministry of Economic Affairs to consult AIReF on the Report on the Situation of the Spanish Economy that serves as the basis for the GG budget. On the other hand, it reiterates the need for information on the budgetary and fiscal measures included in the macroeconomic scenario, as well as the need for the endorsement process to be regulated by a memorandum of understanding.

AIReF also has the legal mandate to report on the draft GSB and the main lines of the budgets of the Autonomous Regions (ARs) and the Local Governments (LGs) with regard to whether they are in line with fiscal rules. The Organic Law on Budgetary Stability and Financial Sustainability and the Law on the Establishment of AIReF and its implementing regulation set out AIReF's mandate to report on the draft GSB and the main budgetary lines of the GG with regard to whether they are in line with the spending rule and budgetary stability and public debt targets.

This report evaluates the draft 2023 GSB and, subsequently, AIReF will issue its opinion on the main budgetary lines of the GG as a whole, as well as of the ARs and LGs. The content of this report aims to analyse the draft 2023 GSB, which involves the assessment of the CG and SSF sub-sectors. Once the information from the 2023 Budgetary Plan and the information collected on the territorial governments has been analysed, AIReF will report on the main budgetary lines of the ARs and LGs and, from an overall perspective, it will provide an analysis of the GG as a whole.

For 2023, the suspension of fiscal rules continues at both an EU and national level. On July 26th, 2022, the Council of Ministers requested that the escape clause be maintained in 2023, in line with the European Commission's decision to also maintain the safeguard clause of the Stability and Growth Pact for 2023. The aim is to give countries greater flexibility in dealing with the crisis resulting from the invasion of Ukraine. Parliament considered that the exceptional circumstances existed to maintain the suspension of fiscal rules in 2023 on September 22nd, following a report from AIReF with the same conclusion dated July 29th¹.

¹ [AIReF Report on the Existence of Exceptional Circumstances 2023](#)

This is the third time that Parliament has found that the circumstances provided for in Article 11.3 of the Organic Law on Budgetary Stability and Financial Sustainability for the suspension of fiscal rules are present. On two previous occasions and always following a report from AIReF, Parliament considered that the extraordinary emergency situation existed. Firstly, on October 20th, 2020 for 2020 and 2021 as a result of the pandemic and, secondly, on September 13th, 2021, it voted to maintain the escape clause for 2022. In this context, the fiscal rules have been suspended for the period 2020-2022, which is extended to 2023.

The Government set deficit reference rates for the General Government for 2023. On July 26th, the Council of Ministers set a reference deficit rate for 2023 for the GG as a whole and for each one of the sub-sectors (see Table 1). This reference matches the deficit forecast for 2023 included in the 2022-2023 Stability Programme Update published in April, except for the distribution by sub-sector, as it gives greater margin to the ARs and LGs, to the detriment of the CG. In this regard, 0.2% of GDP more deficit is allocated to the ARs, which is assumed by the CG, and 0.1% of lower surplus to the LGs.

TABLE 1. GENERAL GOVERNMENT REFERENCE DEFICIT FOR 2023 (% GDP)

	(%GDP)
	Reference rate for 2023
Central Government (CG)	-3.2
Autonomous Regions (ARs)	-0.3
Local Governments (LGs)	0.1
Social Security Funds (SSFs)	-0.5
General Government (GG)	-3.9

Failure to comply with the reference rates does not imply the application of the corrective measures of the Organic Law on Budgetary Stability and Financial Sustainability. These references constitute an indicative deficit for each and every one of the General Government sub-sectors. Therefore, these reference deficits are not a restriction and any failure to comply with them does not lead to application of the corrective measures provided for in the Organic Law on Budgetary Stability and Financial Sustainability. No references have been set with regard to debt and expenditure, which are the other fiscal variables on which the debt target and expenditure rule, respectively, act.

The evaluation set out in this report is performed from a macroeconomic and budgetary perspective. For this purpose, the analysis is divided into six main blocks. Following this introduction, Section 2 sets out the content and scope of the report. Section 3 completes the analysis carried out in the issuance of the endorsement of the macroeconomic scenario of the draft 2023 GSB, highlighting the main macroeconomic risks. Section 4 then conducts an in-depth analysis of the evolution of revenue and expenditure of the CG and SFFs. This section is completed with the main measures and an analysis of the contingent liabilities and fiscal risks for 2023. Section 5 provides an analysis of the evolution of public debt and assesses the challenges for the sustainability of public finances. Finally, Section 6 presents the recommendations emerging from the analysis conducted.

2. PURPOSE AND SCOPE

The purpose of this report is to assess the draft 2023 GSB from the perspective of whether it is in line with the reference deficit set by the Government. AIReF prepares this report mainly using the information set out in the draft 2023 GSB, in addition to other available information. It focuses on assessing compliance with the reference deficit rates of the CG and the SSFs, in addition to completing the analysis of the macroeconomic forecasts underpinning the draft 2023 GSB carried out for the published endorsement. In addition, AIReF estimates the rate of change in eligible expenditure for the purposes of the expenditure rule and the debt-to-GDP ratio for the purposes of debt sustainability, in order to show the evolution of these fiscal variables.

The scope of the report has been conditioned by the lack of information in national accounting terms and by the great uncertainty resulting from the current economic and geopolitical context:

1. **The absence of an initial budget in national accounting terms and the reconciliation of the budgetary balance of the draft GSB with the reference deficit in national accounting terms.** The draft 2023 GSB does not include information on national accounting adjustments. This information was published from 2003 among the budgetary documentation, but stopped being published as from the 2017 GSB. Furthermore, the Economic and Financial Report of the Social Security published information in national

accounting headings until 2017. This lack of information, contrary to EU legislation and the principle of transparency provided for in the Organic Law on Budgetary Stability and Financial Sustainability (Articles 6 and 27) significantly conditions AIReF's analysis. In addition to failing to publish the adjustments, an initial budget expressed in national accounting terms is also not published either. This makes it extremely difficult to ensure consistency and coherence between the various budget planning documents such as the GSB, the Budgetary Plan and the Stability Programme Update, as noted by AIReF in its Opinion on Fiscal Transparency in the General Government².

- 2. Lack of transparency on the degree of execution of the Recovery, Transformation and Resilience Plan (RTRP) in national accounting terms.** The only information on the execution of the RTRP in national accounting is that published at year-end. In addition, this is very incomplete since it only includes the total amount executed by the GG as a whole, but without a breakdown by national accounting headings or by the sub-sectors involved in its execution. From a macroeconomic point of view, this lack of information is a limitation in terms of knowing which funds are reaching the final recipient and, therefore, which are having an effect on the economy. From a fiscal point of view, it also limits the analysis of the evolution of the revenue and expenditure that are not related to the RTRP and that constitute the ordinary activity of the GG. This affects the projections of revenue and expenditure in national accounting terms for 2023.
- 3. The great uncertainty caused by the energy crisis and the war in Ukraine.** Two years after the outbreak of the pandemic in March 2020, the Spanish economy has been hit by a succession of global supply shocks that have shifted the focus of uncertainty from the health sector to the supply side of the economy and the energy and price crisis. The development and economic implications of these shocks are difficult to predict. Therefore, AIReF's opinion remains conditioned by the major uncertainty resulting from the current economic and geopolitical context and the estimates made should be treated with greater caution than usual.
- 4. The lack of information on the possible extension of the measures to mitigate the effects of the energy crisis and the war in Ukraine.** The GSB does not contain information on the possible extension of the measures adopted over 2022 both in terms of scope, duration and conditions for their continuation or reversal. Given the significant impact of these measures on

² [AIReF Opinion on Fiscal Transparency](#)

public finances, this lack of information undermines the analysis of the public accounts. Insofar as the central scenario of both the Government and AIRcF assumes partial or total continuation of the circumstances that gave rise to approval of the measures, it seems highly likely that all or some of the measures will be extended for a certain period of time.

Furthermore, the draft 2023 GSB does not contain a full and up-to-date list of fiscal risks that may affect the deficit for the year. Greater transparency would be desirable. Although it may not be classified as a limitation on the scope, the GSB does not include information on possible liabilities faced by the CG resulting from contingent liabilities, such as court rulings, information on public-private partnerships and non-performing loans. AIRcF currently considers that there are greater fiscal risks than before the pandemic as, in addition to those arising from the administration's ordinary activity, there are also those generated by COVID and, currently, by the energy crisis and the war in Ukraine.

3. MACROECONOMIC SCENARIO

3.1. Introduction

AIReF endorsed the macroeconomic outlook that accompanies the 2023 GSB on October 4th. The purpose of the endorsement is to verify that the budgetary revenue and expenditure forecasts are based on reasonable macroeconomic variables within the current uncertainty regarding the national and international context. For these purposes, the relevant variables are not only real growth and employment, but also the composition of growth and variables expressed at current prices. In fact, the growth of GDP, demand and private consumption in nominal terms are the variables that are most closely related to budget revenues, with elasticities that in recent years have been above their historical average. Inflation also determines the cost of some inflation-indexed budget items, such as pension expenditure.

AIReF believes that the nominal GDP growth that has served as the basis for preparation of the Budget is likely, although there are downside risks to real growth. The Government's scenario projects real GDP growth of 4.4% in 2022 and 2.1% in 2023, while in nominal terms growth would fall from 8.6% in 2022 to 6% in 2023. For its part, the growth of the GDP deflator falls slightly, from 4% in 2022 to 3.8% in 2023. The diagnosis made by AIReF on the basis of its own forecasting scenarios reveals that the nominal GDP growth estimates are in the central range of the probability intervals estimated by AIReF, while the real growth forecasts are in the high range. Compared with AIReF's scenario, the Government's macroeconomic outlook assumes significant growth in

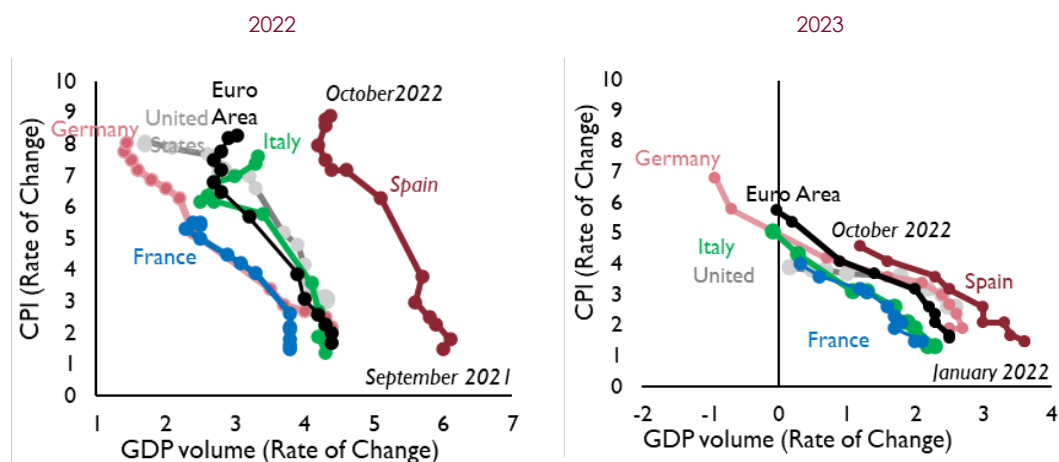
investment and exports, which is unlikely in the context of uncertainty due to the escalation of geopolitical tensions, doubts about the security of energy supply at reasonable prices and deterioration of our main export markets.

In addition, AIReF considers that there are significant sources of uncertainty associated with geopolitical tensions, the energy crisis, the persistence of inflation and its effects on the purchasing power of households and on the financing conditions of the economy, among others, which pose risks to real GDP growth and to inflation. This report firstly describes (Section 3.2) the most recent developments in the global environment which, on this occasion, fundamentally condition the macroeconomic scenario of the 2023 GSB and the corresponding risks. It also describes the recent evolution of the Spanish economy, which is the starting point in the macroeconomic scenario. Section 3.3 presents the macroeconomic scenario prepared by AIReF which serves as a basis for assessing the degree of realism of the Government's forecasts in the following section. Finally, the main risks existing in the short and medium term are analysed. In addition, two boxes are presented: the first box presents the medium-term macroeconomic scenario prepared by AIReF; the second box incorporates an estimate of the impact of the successive packages of measures implemented with the purpose of mitigating the effects of the energy crisis on household income and inflation.

3.2. External conditions and recent evolution of the Spanish economy

Economic activity and global growth prospects have deteriorated significantly in the second half of 2022 and inflation continues to record unexpected rises. The global economy continues to be marked by geopolitical tensions, the energy crisis and the persistence of high inflation rates, which are causing a notable fall in the purchasing power of households and a tightening of financing conditions that are faster than expected a few months ago. Most analysts and forecasting institutions have continued to revise growth projections downwards for the second half of 2022 and 2023, while inflation forecasts are revised upwards (FIGURE 1).

FIGURE 1. GROWTH-INFLATION FORECASTS FOR 2022 AND 2023. (YEAR-ON-YEAR RATE OF CHANGE)



Source: Consensus Forecasts

The most recent forecasts from the IMF suggest that the slowdown in growth will be widespread in 2023. Around one third of the countries for which the IMF presents forecasts will experience a contraction in activity in 2022 or 2023. The United States has been the first major economy to record a technical recession in 2022, which was partly associated with very erratic stock and import figures. Despite the deterioration of some recent indicators - such as the PMIs - the ongoing strength of the labour market, the rise in wages by around 5% and the rise in core inflation lead us to expect a further tightening of the Federal Reserve's monetary policy and a slowdown in economic activity in 2023 (TABLE 2). In the case of China, a significant weakening of its growth has been observed over 2022, triggered by its zero-COVID strategy and weaknesses in the real estate sector. The IMF projects that China's GDP will grow by around 4% in 2023, a far cry from the growth of over 6% recorded a few years ago.

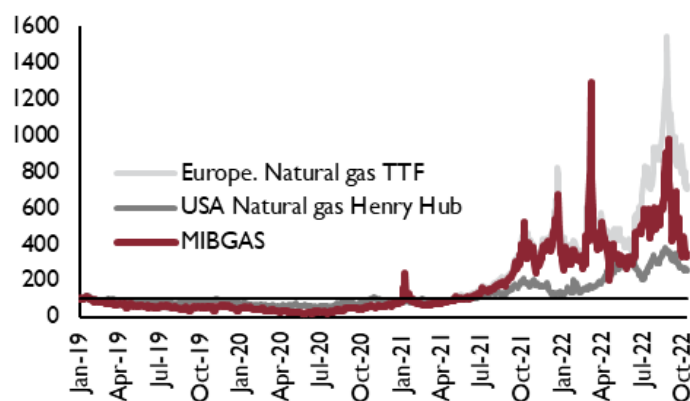
TABLE 2. EVOLUTION OF FORECASTS FOR THE CHANGE IN GDP FOR 2022 AND 2023

	January 2022		April 2022		July 2022		October 2022		Revision Oct-Jan	
	2022	2023	2022	2023	2022	2023	2022	2023	2022	2023
World	4.4	3.8	3.6	3.6	3.2	2.9	3.2	2.7	-1.2	-1.1
USA	4.0	2.6	3.7	2.3	2.3	1.0	1.6	1.0	-2.4	-1.6
China	4.8	5.2	4.4	5.1	3.3	4.6	3.2	4.4	-1.6	-0.8
EMU	3.9	2.5	2.8	2.3	2.6	1.2	3.1	0.5	-0.8	-2.0
Germany	3.8	2.5	2.1	2.7	1.2	0.8	1.5	-0.3	-2.3	-2.8
France	3.5	1.8	2.9	1.4	2.3	1.0	2.5	0.7	-1.0	-1.1
Italy	3.8	2.2	2.3	1.7	3.0	0.7	3.2	-0.2	-0.6	-2.4
Spain	5.8	3.8	4.8	3.3	4.0	2.0	4.3	1.2	-1.5	-2.6

Source: International Monetary Fund

The slowdown in economic activity is becoming more pronounced in the euro area due to the war and the energy crisis caused by Russia. The escalation of tensions with Russia has led to the definitive closure of the gas supply through Nord Stream 1, although other gas pipelines are still open, with 20% of the level of gas supplied by Russia to Europe before the war. Liquefied Natural Gas (LNG) imports have largely replaced imports³ from Russia and gas reserves at the end of September stood at around 90% of installed capacity on average in the EU. This fact, together with the containment of energy demand⁴, leads to the expectation that widespread energy rationing will not be required in the coming winter. However, energy markets remain very tight and in this context gas prices will remain high, as can be seen from the contracts traded on futures markets. This poses difficulties for electro-intensive industries (chemicals, steel, etc.). Specifically, gas prices in the European reference markets have dipped slightly, in a context of extreme volatility, although they remain over five times higher than those recorded in mid-2021 (FIGURE 2). The recent announcement of a cut in oil production by OPEC could further strain energy markets. In addition, the security of energy supply is currently the main source of economic risk for European economies, as discussed in the section on risks.

FIGURE 2. PRICE OF GAS. INDEX 100 = 1 JANUARY 2019



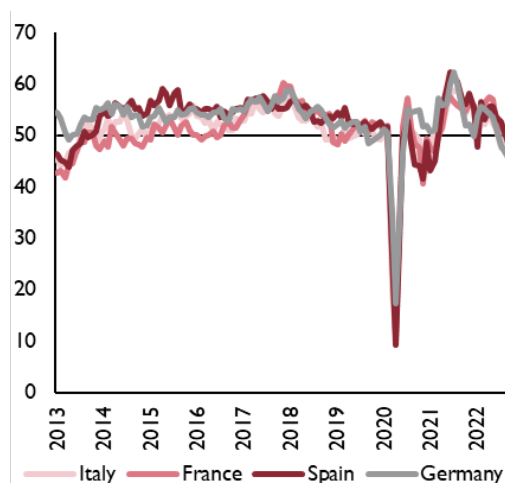
³ Based on Bloomberg data, CaixaBank Research estimates that in September 2022 monthly imports from Russia had fallen by 8 billion cubic meters (bcm) compared with the same month of the previous year, while the increase in LNG imports has been 5.8 bcm. [The outlook for gas supplies in Europe: a balancing act \(caixabankresearch.com\)](https://www.caixabankresearch.com/en/analysis/the-outlook-for-gas-supplies-in-europe-a-balancing-act)

⁴ Some of the largest European gas consumers, such as Germany, France and the Netherlands, have reduced their gas consumption by over 5% compared with the historical average and in industry there are even greater falls, of 15%, in an environment of lower activity caused by high prices. [Gas Market Report, Q4-2022 – Analysis - IEA](https://www.iea.org/reports/gas-market-report-q4-2022)

Sources: Refinitiv and MIBGAS

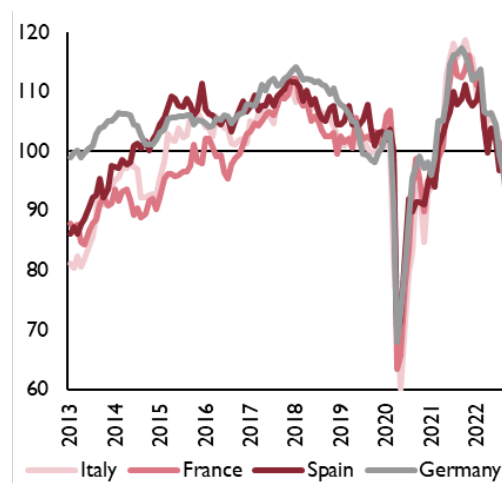
High gas prices, households' loss of purchasing power as a result of high inflation and deteriorating financing conditions mean that the IMF's most recent forecasts point to a very moderate increase in GDP in the euro area in 2023 and a contraction in Germany and Italy. After a first half of the year in which economic activity in the euro area performed surprisingly well due to the recovery in demand for social services and tourism following the removal of mobility restrictions, the worsening of more recent indicators suggests a slowdown or even contraction in GDP in the second half of 2022. In particular, the composite PMI confidence index for the euro area fell for the second consecutive month in September to 48.1 pp, below the 50-point level, pointing to a contraction in growth in that period. Furthermore, high inflation rates are causing a significant deterioration in the purchasing power of households in all European economies, while the escalation of geopolitical tensions has placed their confidence levels close to those reached in the strictest lockdown during the pandemic. In this context, the IMF has revised downwards the growth of this area for 2023 to 0.5%. Among the large economies, the IMF projects a contraction of 0.3% in Germany - where production expectations for electro-intensive industries show similar falls to those recorded during the first months of lockdown - and in Italy (-0.2%), while Spain and France are expected to grow at rates of 1.2% and 0.7%, respectively, according to this institution.

FIGURE 3. PMI COMPOSITE INDEX (MANUFACTURING AND SERVICES)



Source: S&P Global

FIGURE 4. ECONOMIC SENTIMENT INDEX



Source: European Commission.

While the global slowdown eases tensions in value chains and in markets for some raw materials, high inflation rates persist in most countries. The strong recovery in global demand that was seen as mobility restrictions were lifted, along with the zero-COVID policy in China, caused pressures in commodity

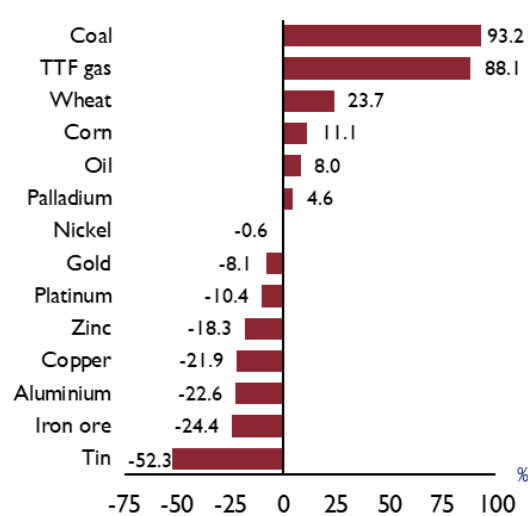
markets and disruptions in value chains that were exacerbated by the energy crisis following the war in Ukraine and which brought inflation to levels not seen in decades. Although the slowdown in global demand has recently led to a reduction in bottlenecks and raw material prices - with the exception of gas, which remains at historically high levels despite recent falls, and coal - inflation has continued to record unexpected rises.

FIGURE 5. GLOBAL SUPPLY CHAIN PRESSURE INDEX



Source: Federal Reserve Bank of New York, Global Supply Chain Pressure Index

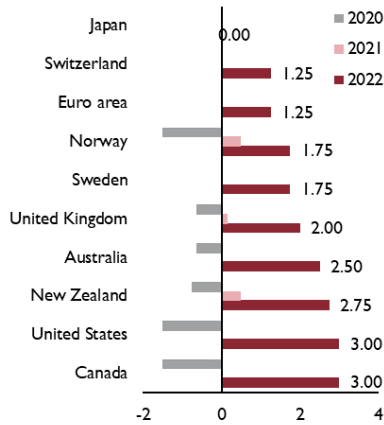
FIGURE 6. CUMULATIVE CHANGE IN RAW MATERIAL PRICES COMPARED WITH JANUARY 2022 (€).



Source: Refinitiv

The persistence of inflation has led to a rapid and synchronised cycle of interest rate hikes at a global level, greater stock market volatility, rising yields on bond markets and appreciation of the dollar. Most central banks have accelerated the pace of interest rate hikes and announced additional rises in order to avoid a de-anchoring of inflation expectations and possible price-wage spirals. The speed and intensity of the US Federal Reserve's hikes has led to a 19.3% appreciation of the dollar since mid-2021. This makes European economies' energy bills even more expensive and adds to inflationary pressures. European stock markets have also seen widespread falls over recent weeks and Government bond yields have risen sharply. The yield on the ten-year bond stood at around 3.5% in mid-October in the case of Spain and 5% in Italy and the United Kingdom. The latter has seen its financial stability threatened following the announcement of a fiscal stimulus plan that contradicted the Bank of England's tight monetary policy.

FIGURE 7. ANNUAL CHANGE IN CENTRAL BANK RATES, ADVANCED ECONOMIES



Source: Refinitiv

FIGURE 8. YIELD ON PUBLIC DEBT AS OF OCTOBER 14TH, 2022 (IRR IN %)

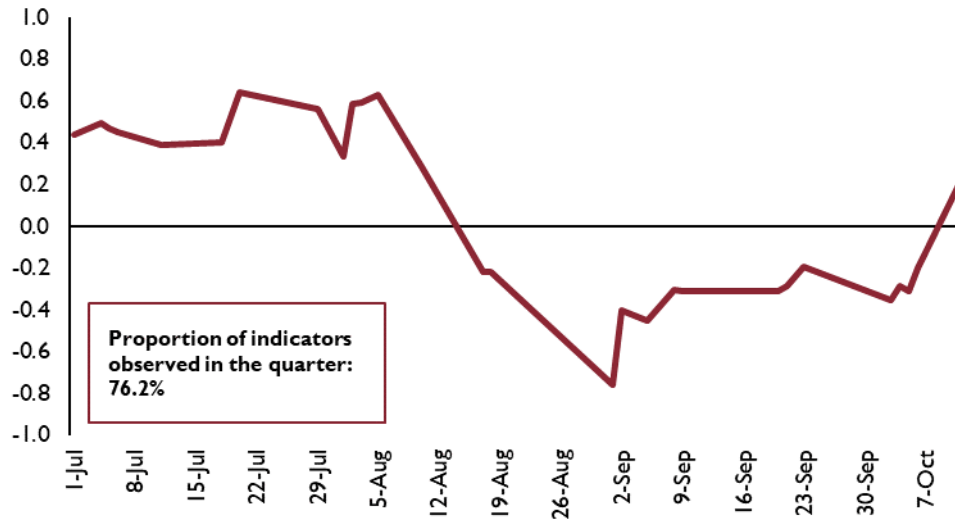
	Yield on Sovereign Debt				
	1 year	3 years	5 years	10 years	30 years
Germany	1,87	1,90	2,12	2,36	2,41
France	2,02	2,22	2,42	2,96	3,29
Belgium	2,12	2,12	2,45	3,02	3,45
Portugal	1,93	2,17	2,70	3,44	3,96
Spain	2,36	2,37	2,82	3,54	4,03
Italy	2,44	3,42	3,88	4,80	4,66

Source: Refinitiv

Recent evolution of the Spanish economy

The recovery of the Spanish economy slowed down in the third quarter of the year. Like the euro area, the Spanish economy recorded unexpected rises in the second quarter of the year, after a first quarter marked by the coronavirus, strikes in the transport sector and the outbreak of the invasion of Ukraine. This favourable performance was due to the expansion of tourism and the recovery of leisure, entertainment and catering activities, which benefited from increased health security. This was coupled with the positive performance of goods exports. However, although Spain is less exposed to cuts in energy supply compared with other European economies, the high costs of electricity, the weakening of our export markets and the tightening of the financing conditions of the economy have slowed down the process of economic recovery, as reflected in the economic indicators for the third quarter of the year. In fact, the MIPred model points to a stagnation or slight growth in activity in that period.

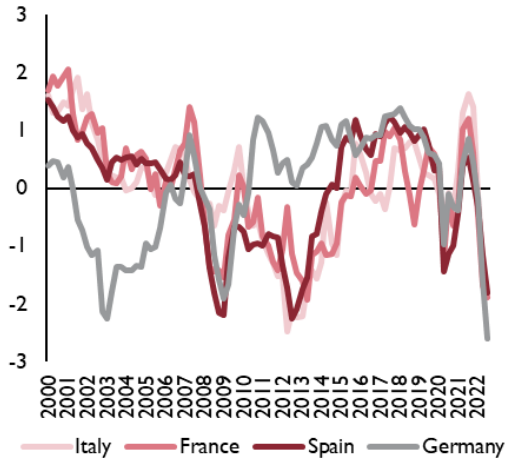
FIGURE 9. AIREF'S MIPRED MODEL. ESTIMATE OF THE QUARTER-ON-QUARTER RATE OF CHANGE IN GDP IN TERMS OF VOLUME. THIRD QUARTER 2022.



Source: Prepared by AIREF.

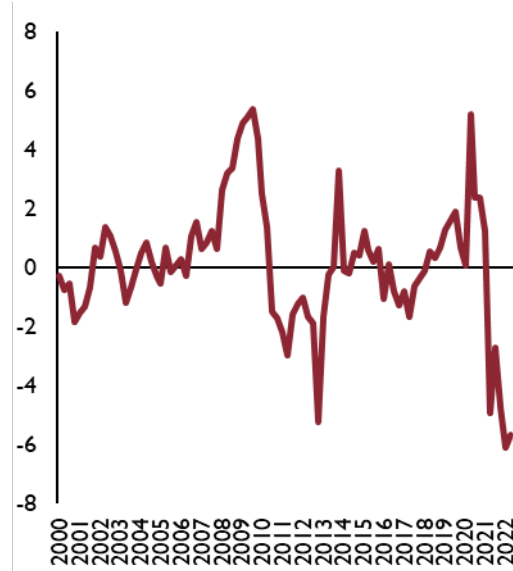
The persistence of high inflation rates has led to a significant deterioration in the purchasing power of households and industrial activity. Despite the favourable performance of employment in the first half of the year, the deterioration in the purchasing power of Spanish households as a result of the fall in real wages is high. The first half of 2022 saw a contraction in real compensation per employee of close to 6%, which is very high by historical standards - exceeding the fall of 5.2% recorded in the fourth quarter of 2012. In addition, consumer confidence has deteriorated to levels similar to those observed in the months of strict lockdown at the start of the pandemic, and the tightening of financing conditions is reflected in a weakening of private consumption and housing demand. On the supply side, the energy crisis and uncertainty have resulted in a fall in industrial activity, especially in electro-intensive industries, while investment expectations are deteriorating.

FIGURE 10. CONSUMER CONFIDENCE INDICATOR (STANDARDISED)



Source: Ministry of Economic Affairs and Digital Transformation

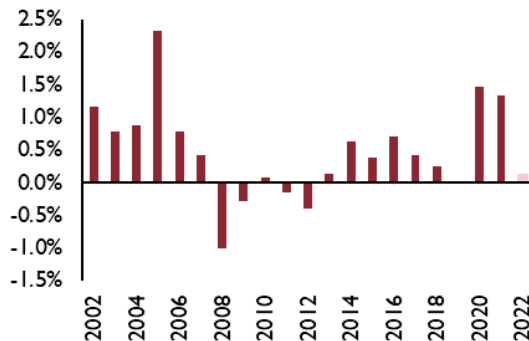
FIGURE 11. REAL COMPENSATION PER EMPLOYEE FOR SPAIN (YEAR-ON-YEAR RATE OF CHANGE)



Source: National Statistics Institute

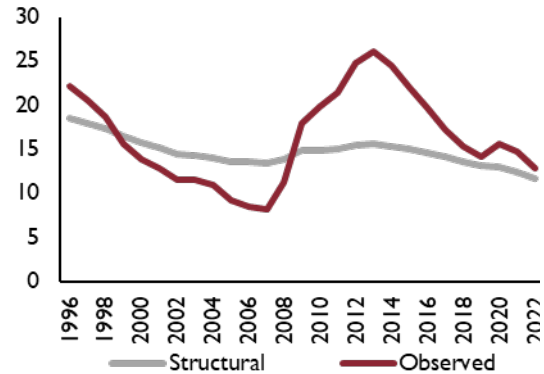
Job creation shows signs of slowing down in the third quarter. The first half of the year was characterised by intense job creation. In particular, in the months of May and June, social security affiliations recorded very high rises in historical terms, reaching an average of 20,348,330 people in the last month, an increase of 4.26% compared with June 2019 and 800,000 more than before the pandemic. The unemployment rate fell to 12.5% in the second quarter, the lowest rate since 2008. However, the labour market has lost momentum in the third quarter, with a quarter-on-quarter growth in affiliations of 0.12% in that period, which is weak in historical terms, despite good data in September. The stagnation in economic activity and the deterioration in production expectations are being passed on to the demand for employment, without these factors being offset by real wage compression.

FIGURE 12. QUARTER-ON-QUARTER RATE OF CHANGE IN AFFILIATION IN THE THIRD QUARTER OF EACH YEAR



Source: Social Security and INE

FIGURE 13. EVOLUTION OF THE UNEMPLOYMENT RATE (% OF ACTIVE POPULATION).



In qualitative terms, the labour reform has reduced temporary employment. Since the entry into force of the 2021 labour reform, there has been a sharp reduction in recruitment flows and, in particular, in temporary contracts. At the same time, permanent contracts and, in particular, permanent seasonal contracts have gained weight in the flow of contracts. As a result, the temporary employment rate has fallen sharply in terms of both LFS employees (22.3%) and social security affiliations (17%).

FIGURE 14. PERCENTAGE OF SOCIAL SECURITY AFFILIATIONS WITH TEMPORARY OR TRAINING CONTRACTS

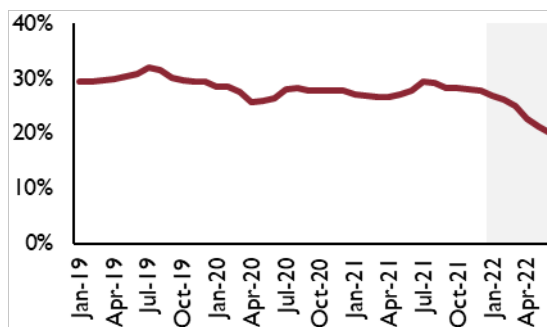
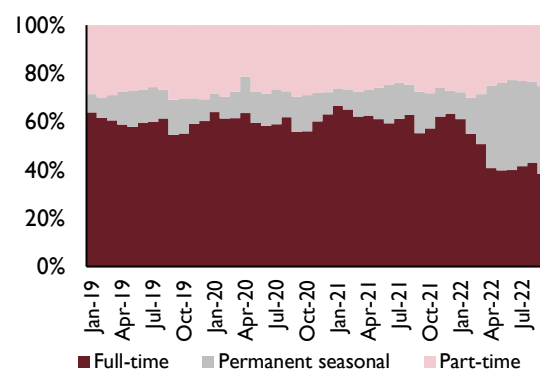


FIGURE 15. MONTHLY FLOW OF PERMANENT CONTRACTS

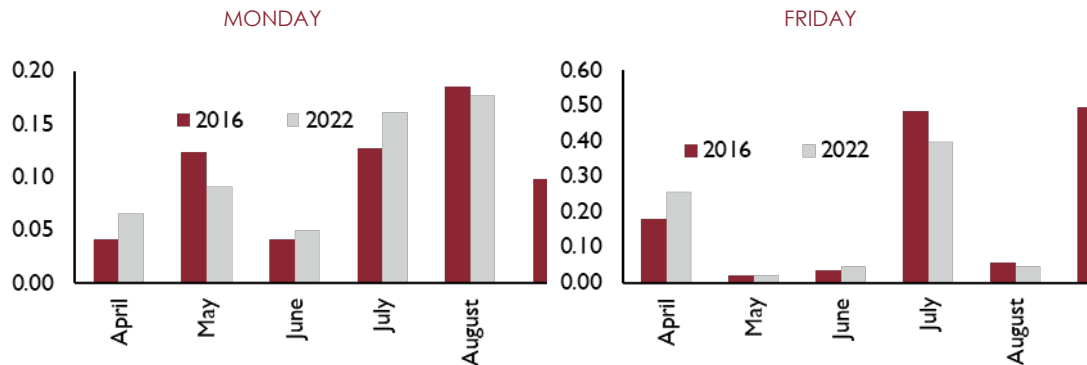


Source: Social Security, Ministry of Economic Affairs and Digital Transformation and State Public Employment Service.

However, there is still high labour turnover. Daily data on Social Security affiliation continue to show high volatility, with sharp upward changes in employment on the first day of the week and of the month and sharp falls on the last day of the week and the month. For example, the volatility, measured by the standard deviation of the rate of change of daily affiliation on Mondays and Fridays, has been similar since April of this year, when the reform measures related to employment contracts came into force, to that of 2016, a year with

a similar monthly and weekly cycle as 2022. This volatility in daily affiliation suggests that high labour turnover is maintained.

FIGURE 16. STANDARD DEVIATION OF THE DAILY RATE OF CHANGE IN AFFILIATION



Source: Social Security.

Wage increases remain contained, with no significant second-round effects for the time being. Available information on wage developments suggests that wage increases are being contained, despite persistently high inflation rates. The wage increases agreed in the collective bargaining agreements with economic effects in 2022 stood at 2.6% in September for all agreements and 2.88% for the agreements signed in 2022. Company agreements show a more intense increase up to September, 3.94%, but below inflation. Average compensation in large companies is also growing below core inflation. These contained wage increases suggest that second-round effects are not currently occurring. However, over 2022 there was a significant increase in the number of workers covered by wage guarantee clauses, which could lead to a greater pass-through of CPI rises to wages in the coming months.

FIGURE 17. CHANGES IN PRICES AND WAGES (YEAR-ON-YEAR RATE OF CHANGE)

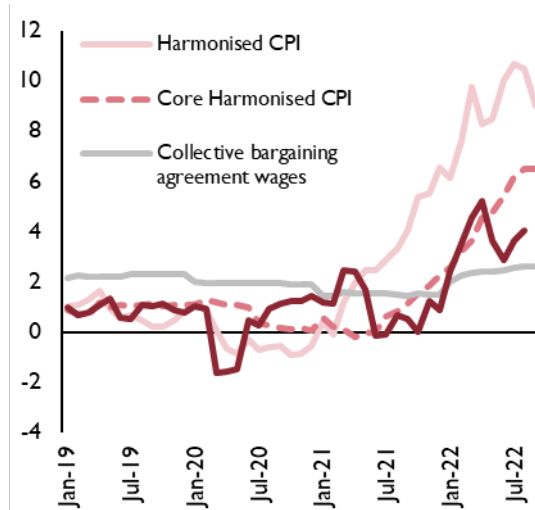
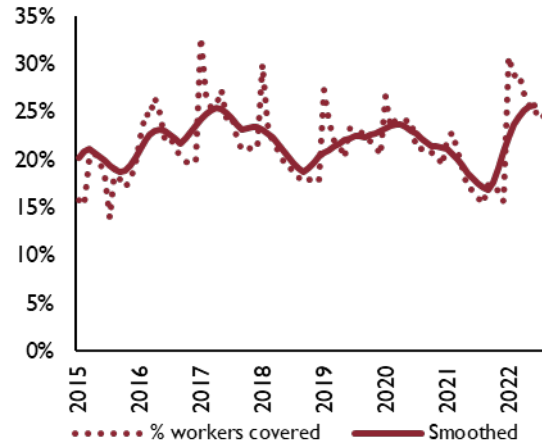


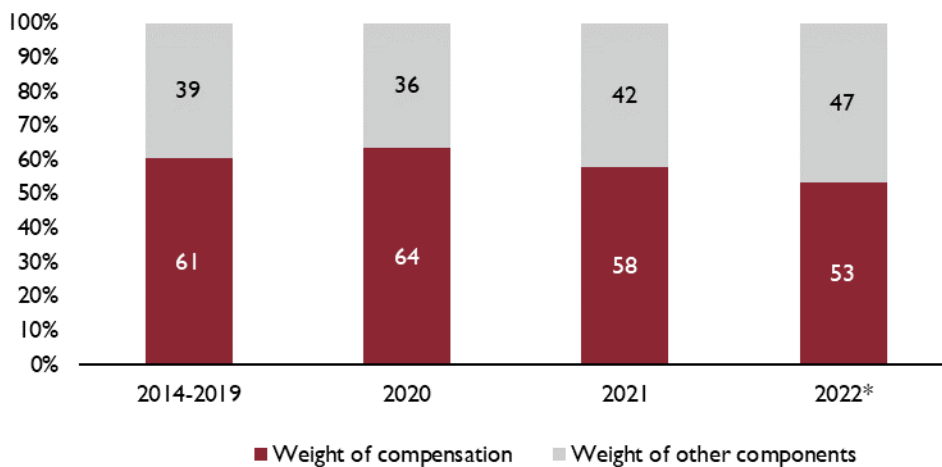
FIGURE 18. COVERAGE OF WAGE GUARANTEE CLAUSES (% WORKERS COVERED)



Source: National Institute of Statistics, State Agency of Tax Administration and Ministry of Labour and Social Economy

Although the evolution of company margins is subject to measurement difficulties, the most recent figures from the Tax Agency point to a fall in the share of labour in total production costs. In this regard, the data of the Tax Agency in the statistics of Sales, Employment and Wages in Large Companies and SMEs (VESGEP) offers aggregated information from the VAT returns and withholdings on work income of companies considered large for tax purposes and SMEs in the form of public limited companies and limited liability companies. These data show a decrease in the weight of wages over the total costs of production factors since the pandemic.

FIGURE 19. FACTOR COST WEIGHTS



Source: AEAT

As for prices, despite the moderation of the last two months, inflation remains at very high rates, at 8.9% in September. The recent containment of inflation is largely due to the evolution of energy prices, which dampened the extraordinary growth of recent months. Some of the measures implemented to mitigate the impact of the energy crisis on inflation have contributed to this moderation, as discussed in Box 2. Core inflation also moderated to 6.2% in September, with falls in price increases in almost all components - non-energy industrial goods and services - with the exception of processed food. In the case of services, particularly noteworthy is the strong progress maintained by the leisure, catering and tourism component in the context of the expansion of demand after the removal of the mobility restrictions imposed as a result of the pandemic. In addition, there has been a noteworthy increase in the inflation of processed and unprocessed foods, to stand at 12.8% and 13.8%, respectively, in September. When analysing inflation at a disaggregated level, the percentage of HICP items showing inflation above 4% remains very high, at 64% in September. On the whole, it is still too early to say that core inflation is at a turning point in its evolution. In addition, although in September the different price trends in Spain and the rest of the European countries caused the inflation gap with the euro area to be negative, the average for the year remains quite high. Therefore, the risk of loss of competitiveness of the Spanish economy remains latent.

FIGURE 20. HEADLINE HICP. YEAR-ON-YEAR GROWTH AND CONTRIBUTIONS.

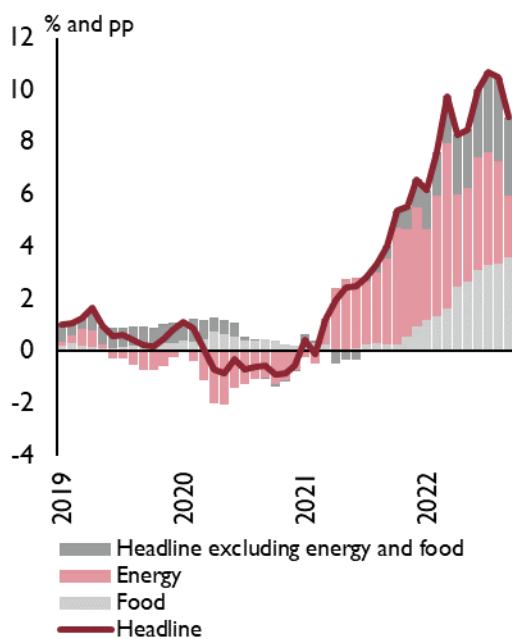
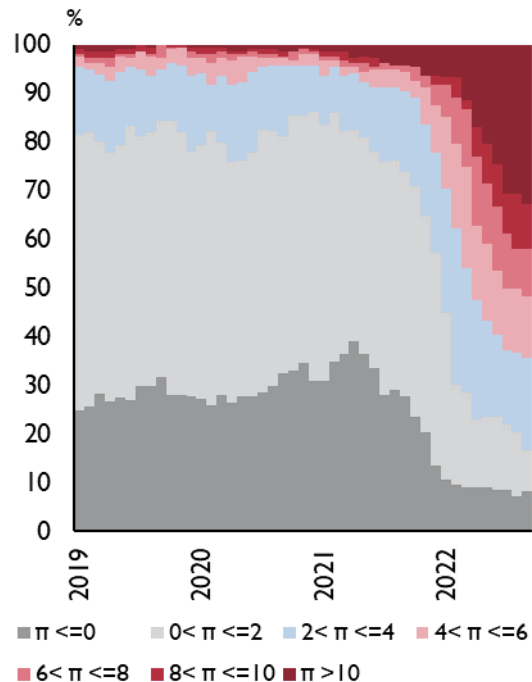
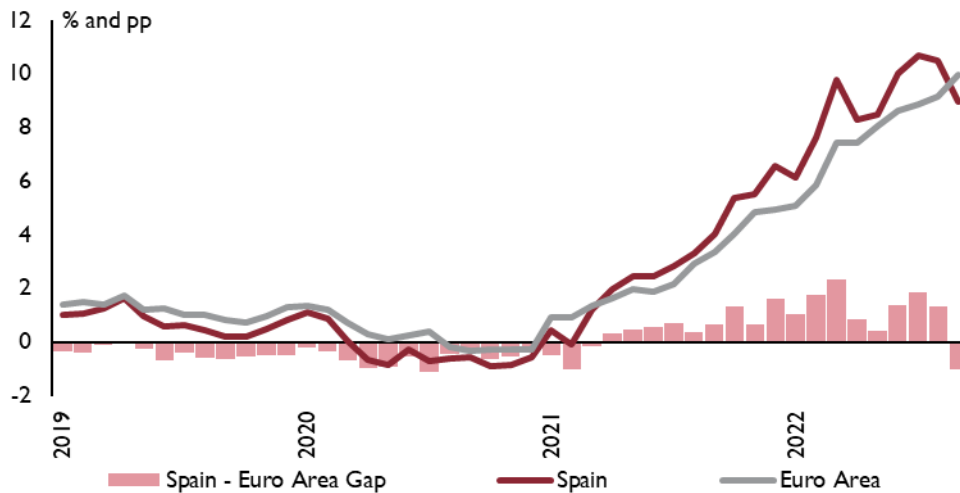


FIGURE 21. HICP SUB-CLASSES IN EACH GROWTH INTERVAL.



Sources: Eurostat and INE

FIGURE 22. HEADLINE HICP OF SPAIN AND EURO AREA



Sources: Eurostat and INE

3.3. AIReF's macroeconomic scenario (2022-2023)

In this section, AIReF presents its macroeconomic scenario for 2022 and 2023.

This scenario constitutes the basis for judging the degree of likelihood of the Government forecasts accompanying the 2023 GSB in Section 3.4. In addition, AIReF presents in this report a full macroeconomic scenario up to 2026 (see Box 1) in order to help medium-term economic planning, which it considers essential in this uncertain environment and whose publication it has repeatedly recommended to the Government.

AIReF has substantially revised its forecasts for real growth downwards for 2023.

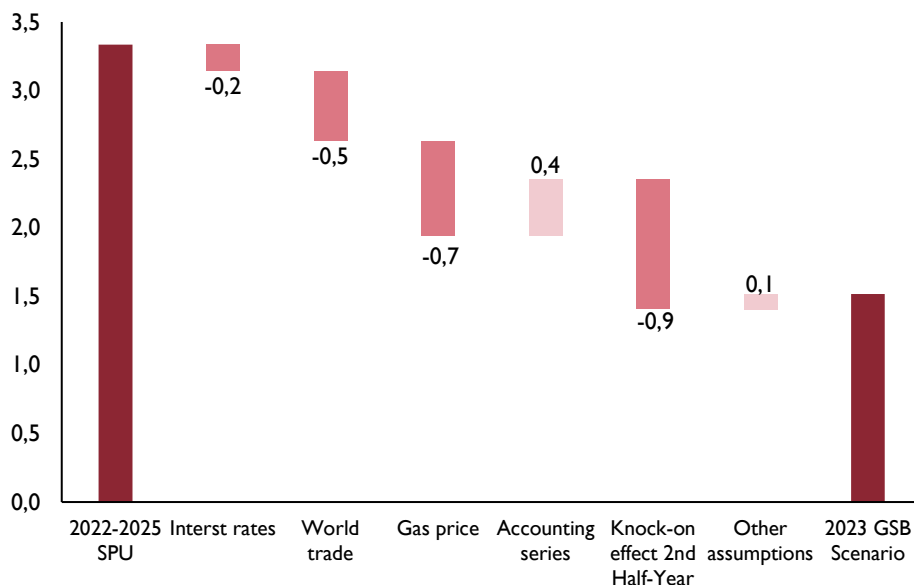
The escalation of tensions with Russia and the energy crisis, the deterioration of our main export markets, high inflation rates and high commodity prices translate into more negative external assumptions for 2023. This is in addition to the knock-on effect on 2023 resulting from the downward revision of expected growth in the second half of 2022, when AIReF expects stagnation or even a moderate decline in economic activity in the final months of the year. Consequently, AIReF revises its forecasts for 2023 downwards. In particular, the GDP growth forecast for 2022 rises by 0.2 percentage points (pp) to 4.4%, due to the revision of the national accounting series in the first half of the year, while the growth forecast for 2023 is reduced by 1.8 pp, to 1.5%⁵.

⁵ The last forecast published by AIReF for 2023 was that of [the Report on the 2022-2025 Stability Programme Update](#), while for 2022 the last forecast was published in its [Report on Budgetary Execution, Public Debt, and the Expenditure Rule of the General Government 2022](#). However, in the [Report on the existence of the exceptional circumstances referred to in Article 11.3 of Organic Law 2/2012, of April 27th, on](#)

The main causes of this revision can be grouped into three blocks (see Figure 23):

- Firstly, the energy crisis has led to a deterioration in the growth prospects of the main advanced economies and a further increase in gas prices. All this, together with the rise in the interest rate forecast, means a general worsening of the technical assumptions on which this new macroeconomic scenario is based, leading to a downward revision of 2023 growth of 1.4 pp compared with AIReF's scenario of May 2022.
- This is in addition to the worsening growth prospects for the second half of 2022, which, as they have a strong knock-on effect on 2023, subtract 0.9 points from expected GDP growth for that year.
- In the opposite direction, the revision of the national accounting data available for the first half of 2022 positively influences the 2023 growth forecast, contributing 0.4 pp.

FIGURE 23. SOURCES OF THE REVISION OF AIREF'S MACROECONOMIC OUTLOOK FOR 2023



Source: Prepared by AIReF.

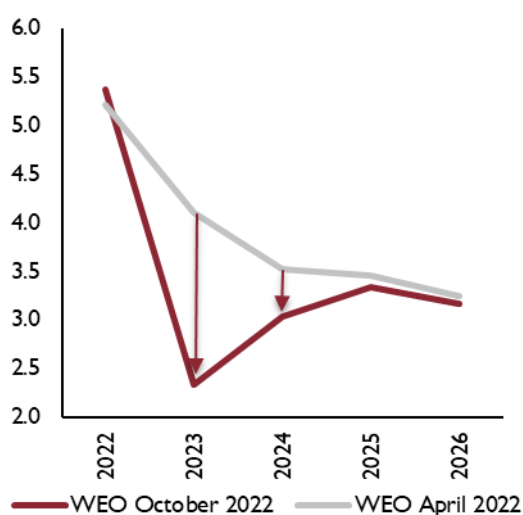
AIReF's scenario incorporates a slowdown in all the components of national demand with the exception of public consumption. In particular, the deterioration in the purchasing power of households and confidence suggests that growth in private consumption is expected to moderate to 1.5% (compared with 1.7% in 2022). Household spending on housing will be further contained by the increase in mortgage interest rates, reflected in a lower

[budgetary stability and financial sustainability](#). AIReF noted that its most recent estimates suggested GDP growth of around 2% for 2023.

increase in construction investment (4.4% in 2023, compared with 5.6% in 2022). This is despite the fact that public works could maintain a positive performance associated with the rollout of the Recovery, Transformation and Resilience Plan (RTRP), whose contribution to growth is set out in Box 1. Moreover, high production costs and high levels of uncertainty and the slowdown in external and domestic demand will lead to companies remaining cautious about expanding their production capacity. This will be reflected in some moderation of investment (to 2.7%, down from 5.1% in 2022). Overall, domestic demand will contribute 1.7 pp to growth, compared with 1.9 p. in 2022 (see Table 4).

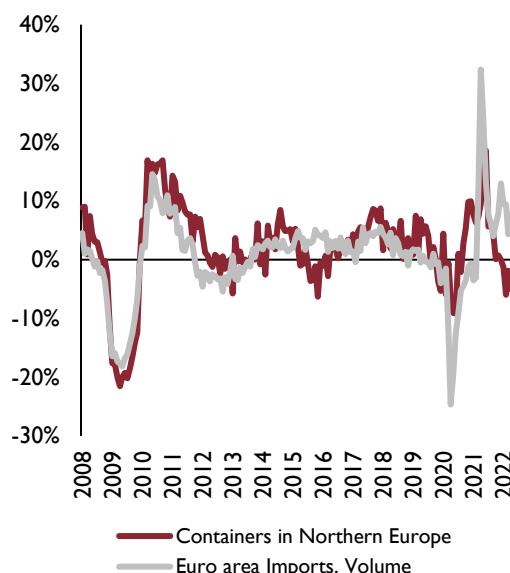
External demand will contribute negatively to growth in 2023. The contribution of external demand forecast by AIReF stands at -0.2 pp, compared with 2.5 pp in 2022. This fact reflects the slowdown in exports, which in AIReF's macroeconomic scenario is the main determinant of the slowdown in GDP in 2023. The reason for this lies in the slower growth of Spain's export markets (Figure 24). The above is despite the fact that AIReF also projects a significant moderation in imports associated with the weakening of domestic demand.

FIGURE 24. GROWTH OF SPAIN'S EXPORT MARKETS (YEAR-ON-YEAR RATE OF CHANGE, %)



Source: IMF, Haver and AIReF

FIGURE 25. SEA CONTAINER TRAFFIC IN NORTHERN EUROPE AND REAL IMPORTS FROM THE EURO AREA (YEAR-ON-YEAR RATE OF CHANGE)



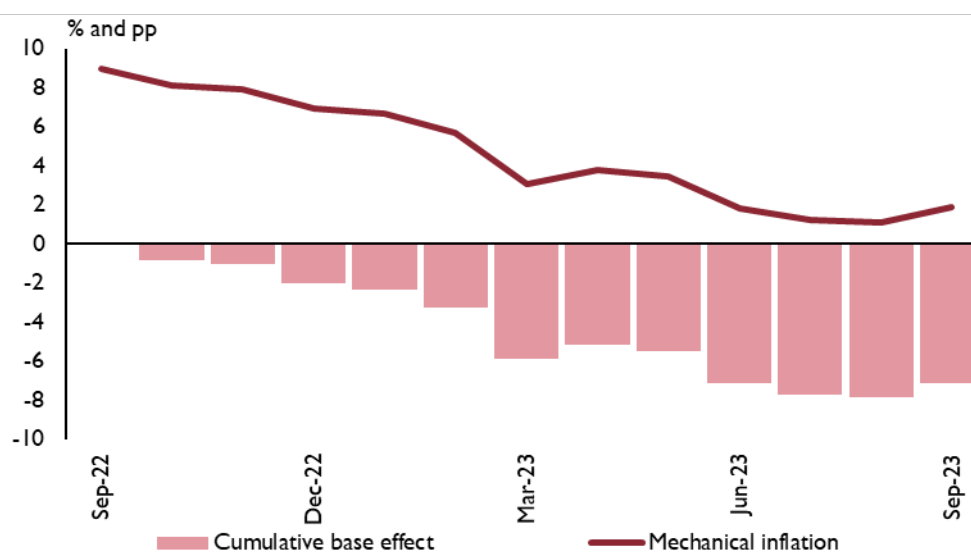
Source: RWI and CPB

In this context, AIReF predicts a significant slowdown in employment and that the unemployment rate will remain stable at 12.8%, slightly above the structural unemployment rate. The weakening of activity will be reflected in lower employment growth (0.3% in 2023, compared with 2.9% in 2022). However, the slowdown in employment will be lower than the slowdown in

activity, as companies in difficulty can continue to rely on job-retention schemes, allowing some recovery in apparent productivity.

As regards prices, AIReF projects a decrease in inflation to 3.9% in 2023, compared with the 8.9% expected for 2022 as a whole and an acceleration in compensation per employee. The reduction in inflation in 2023 is supported by several conditioning factors. Firstly, the significant negative base effects that, if the current levels of energy prices and other components are maintained, could subtract around 6 pp from the inflation expected in 2022 (Figure 26). In addition, some commodity prices have fallen recently, although they remain above historical levels and the effects will be mitigated by the depreciation of the euro against the dollar. There are also signs of easing tensions in global supply chains. Beyond these external factors, the dynamics underlying companies' production prices, determined by the pass-through of the increase in companies' costs to their sales prices and the expected evolution of wages, lead to the expectation that high inflation rates, of 3.9%, will be maintained. It should be stressed that this inflation forecast incorporates the assumption that the measures implemented by the Government to mitigate the impact of the energy crisis on inflation - in particular, the gas cap and the reductions in VAT and energy taxes - will be extended in 2023, as the conditions that led to their introduction (high inflation with a strong impact on household purchasing power) remain in place. If this were not the case, the inflation forecast could be around 1-1.5 pp higher according to AIReF's calculations, standing at over 5% in 2023 (see Box 2).

FIGURE 26. CUMULATIVE BASE EFFECTS AND MECHANICAL IMPACT ON INFLATION.



Source: National Statistics Institute and AIReF.

AIReF expects an acceleration in compensation per employee in 2023. Although there are currently no second-round effects on wage negotiations,

which remain very contained, the percentage of agreements incorporating wage review clauses is rising over 2022. In addition, wages can be expected to recover some of the purchasing power lost in 2022, according to their historical pattern of behaviour. Therefore, AIReF projects an increase in compensation per employee of 5.8% in nominal terms, compared with 2.8% in 2022. This would imply an increase in real terms of 1.9%, according to AIReF's scenario, after the 6% drop estimated for 2022. Accelerating wages would also slow down the fall in inflation in 2023.

3.4. Assessment of the macroeconomic scenario of the GSB for 2022

3.4.1. The technical assumptions in the GSB scenario

The technical assumptions used by the Government in drawing up its macroeconomic scenario entail downside risks to growth and upside risks to inflation. As discussed above, geopolitical tensions, the energy crisis and the tightening of the economy's financing conditions have led to a deterioration in the growth prospects of the main advanced economies, which is reflected in successive downward revisions of expected growth for 2023. In this context, the assumptions about the growth of European economies and about Spain's export markets in the Government scenario come from the forecasting exercise prepared by the ECB at the beginning of September, just before the Russian gas supply was cut off. Since then, there has been a marked deterioration in the prospects for global growth, which is particularly intense in Spain's main export markets and, in particular, in Germany and Italy.

In addition, gas prices in the futures markets for 2023 are higher than those included in the Government's assumptions. Although volatility in recent months has been high, at the time of the Endorsement, natural gas futures for 2023 were around €150/MWh in the national market, while as of the date of this report, they were around €133/MWh, compared with €118.8/MWh in the scenario of the 2023 GSB. This assumption is key in the forecasting scenarios of the European economies and also of the Spanish economy, despite the fact that our lower dependence on Russian gas compared with other European countries and LNG imports enhances supply security. In contrast, the rest of the assumptions about interest rates or oil prices are aligned with market expectations.

TABLE 3. ASSUMPTIONS OF THE GOVERNMENT'S MACROECONOMIC OUTLOOK FOR THE 2023 GSB

	2021	2022	2023
Short-term interest rates (three-month Euribor)	-0.5	0.2	2.0
Long-term interest rates (10-year government bonds, Spain)	0.3	2.5	3.5
Exchange rate (\$/€)	1.2	1.1	1.0
Growth in world GDP, excluding the euro area	6.4	2.9	3.0
GDP growth in the euro area	5.2	3.1	0.9
Spanish export markets	9.3	11.7	4.3
Oil price (Brent, \$/barrel)	70.7	101.8	96.9
Natural gas price (€/MWh)	47.4	114.5	118.8

Source: Ministry of Economic Affairs and Digital Transformation

3.4.2. Comparison of AIReF's scenario and the 2023 GSB scenario

The following table shows the comparison and composition of the macroeconomic outlooks of AIReF and the Government. As can be seen, the Government's macroeconomic scenario assumes real GDP growth of 4.4% in 2022 and 2.1% in 2023. By component, this slowdown is based on a lower contribution of the external balance to growth which, after contributing 2.9 pp in 2022, would have a negative contribution in 2023 (-0.3 pp). According to the Government's forecasts, this performance would be partially offset by the evolution of domestic demand, which would contribute 2.4 pp in 2023 compared with 1.5 pp in 2022, due to the expansion of gross fixed capital formation, especially in construction. Private consumption would maintain moderate growth rates in both years. This scenario of moderate growth would be accompanied by an increase in full-time equivalent employment of 0.6%, while the unemployment rate would fall in 2023 to 12.2% of the active population - compared with the 12.8% that the Government expects on average for 2022. Regarding prices, the Government's scenario envisages a slight reduction in the GDP deflator in 2023 to 3.8%, compared with the 4% expected for 2022, in a scenario of a sharp deceleration of the private consumption deflator. Consequently, nominal growth would stand at 8.6% in 2022 and 6% in 2023 according to the Government's scenario.

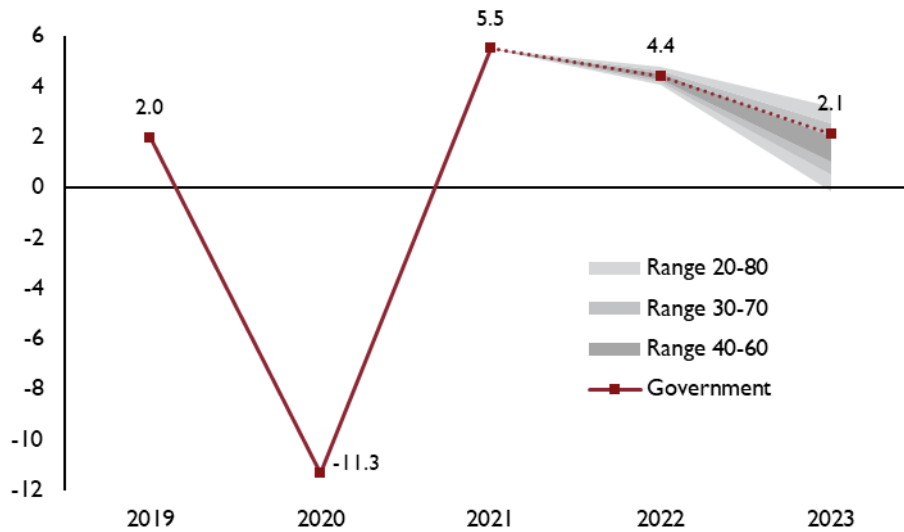
TABLE 4. MACROECONOMIC OUTLOOK FOR 2022-2023.

Year-on-Year Rates of Change	2021	2022	2023	2022	2023
Private Domestic Final Consumption Expenditure	6,0	1,5	1,3	1,2	1,3
General Government Final Consumption Expenditure	2,9	-0,9	0,8	-1,0	0,4
GFCF	0,9	5,5	3,9	5,1	7,9
<i>GFCF Equipment and Cultivated Assets</i>	6,5	5,1	2,7	6,6	9,5
<i>GFCF Construction and Intellectual Property</i>	-1,5	5,6	4,4	4,5	7,2
Domestic Demand*	5,2	1,7	1,7	1,5	2,4
Exports of Goods and Services	14,4	16,9	2,5	17,9	7,3
Imports of Goods and Services	13,9	9,6	3,0	9,9	8,2
External Balance*	0,3	2,7	-0,2	2,9	-0,3
Gross Domestic Product	5,5	4,4	1,5	4,4	2,1
Nominal Gross Domestic Product	7,9	8,2	5,9	8,6	6,0
Gross Domestic Product Deflator	2,3	3,6	4,3	4,0	3,8
Consumer Price Index	3,1	8,9	3,9	-	-
Full-Time Equivalent Employment	6,6	2,9	0,3	2,9	0,6
Unit Labour Cost	0,3	1,3	4,6	0,5	2,3
Productivity per Full-Time Employee	-1,0	1,5	1,2	1,5	1,5
Compensation per Employee	-0,7	2,8	5,8	2,1	3,8
Unemployment Rate (% of Active Population)	14,8	12,8	12,8	12,8	12,2
Household and NPISH Savings Rate (% Gross Disposable Income)	13,6	8,5	8,7	-	-

Source: National Statistics Institute, Ministry of Economic Affairs and Digital Transformation and AIReF

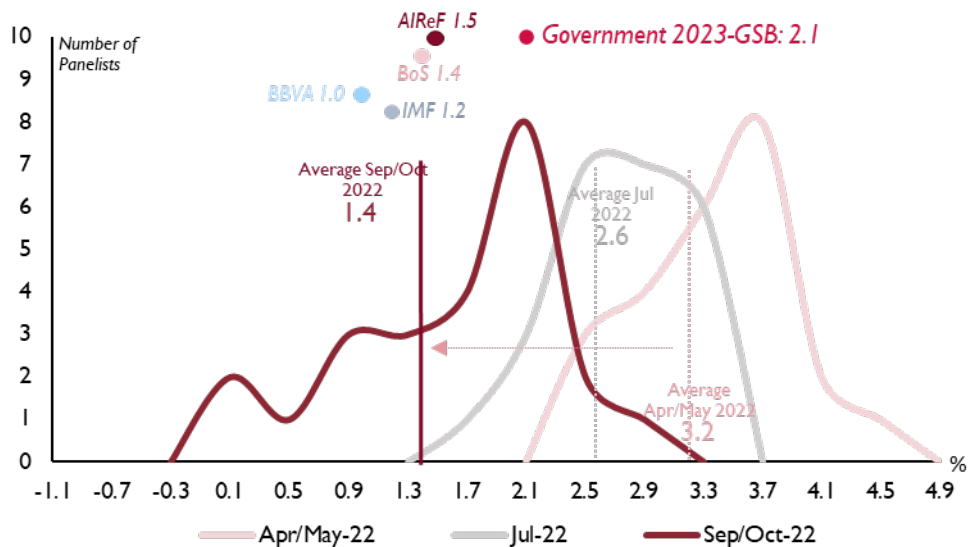
The Government's real GDP forecast for 2023 is in the optimistic part of AIReF's confidence intervals, while those for 2022 are in the central range. In 2022, both the Government and AIReF expect growth of 4.4%, which means a significant slowdown in quarter-on-quarter GDP growth rates in the second half of the year. However, the Government estimates that GDP could reach a growth rate of 2.1% in 2023, a value that lies in the upper part of the probability bands estimated by AIReF, which forecasts 1.5%. It also lies in the upper part of the range of estimates that are being received on the expected real growth in 2023 (Figure 28).

FIGURE 27. RATE OF CHANGE OF GDP IN TERMS OF VOLUME (%)



Source: INE, Ministry of Economic Affairs and Digital Transformation and AIReF

FIGURE 28. COMPARISON OF GDP GROWTH FORECASTS IN TERMS OF VOLUME FOR 2023



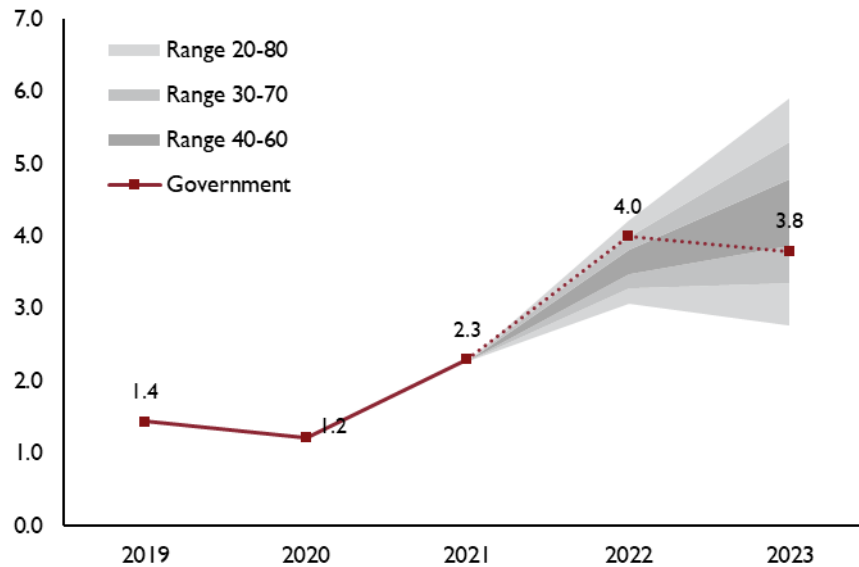
Source: forecasting panels, BBVA Research, International Monetary Fund, Bank of Spain and AIReF

Note: The averages and distributions have been calculated using only those entities that had issued new forecasts in September.

With regard to the GDP deflator, the Government expects an evolution that lies at the upper end of AIReF's confidence interval for 2022 and at the lower limit of AIReF's central range for the following year. The Government's forecast regarding the GDP deflator, although somewhat high for 2022 according to AIReF's confidence bands, is at the lower limit of the central range in 2023. This leads to a reduction in the optimistic bias observed in the forecasts for real growth for determining the nominal variables that are incorporated in the

preparation of the Budget. AIReF expects a slight acceleration in the GDP deflator (from 3.6% in 2022 to 4.3%), in a context of accelerating compensation per employee and ongoing high domestic price rates.

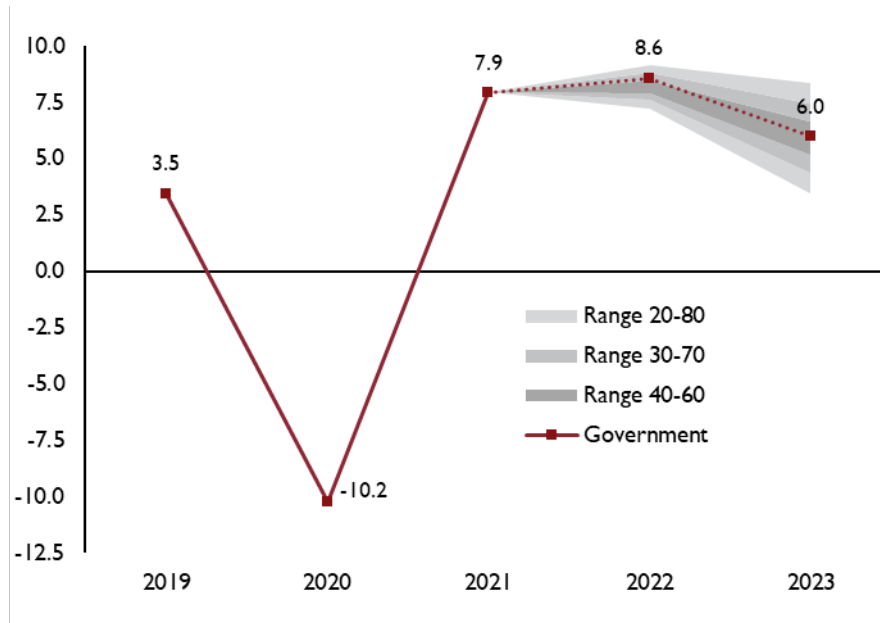
FIGURE 29. RATE OF CHANGE IN THE GDP DEFLATOR (%)



Source: INE, Ministry of Economic Affairs and Digital Transformation and AIReF.

As a result of the forecast growth of GDP in volume terms and its deflator, the growth of nominal GDP expected by the Government stands at the optimistic end for 2022 and in the central range in 2023. The Government's forecast for nominal GDP growth for 2023, a key variable in assessing the feasibility of meeting the budget targets, is in the central range of the probability bands as it is only 0.1 points higher than AIReF's forecast (5.9%). The similarity in the estimates of the nominal growth of the economy is one of the criteria that support AIReF's endorsement of the macroeconomic outlook as it is the nominal variables that determine tax revenue to a greater extent, as is currently the case.

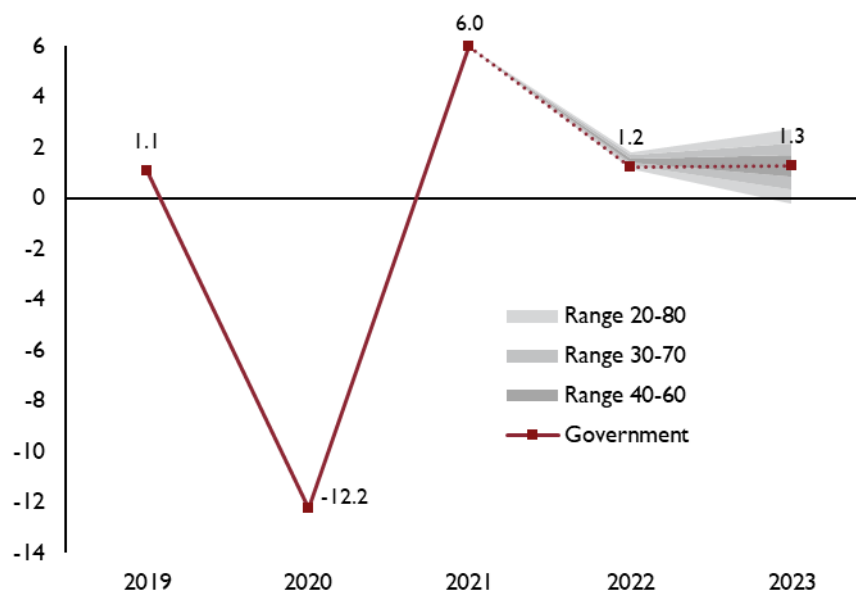
FIGURE 30. RATE OF CHANGE IN NOMINAL GDP (%)



Source: INE, Ministry of Economic Affairs and Digital Transformation and AIReF.

The private consumption estimated in the Government's macroeconomic outlook for 2022 falls within the prudent range of AIReF's estimate, while the estimate for 2023 falls in the central interval. The Government's forecast of private consumption in 2022 implies a contraction in the second half of the year, in contrast with the stagnation assumed by AIReF. In 2023, the Government and AIReF forecasts for private consumption growth in volume terms are practically identical.

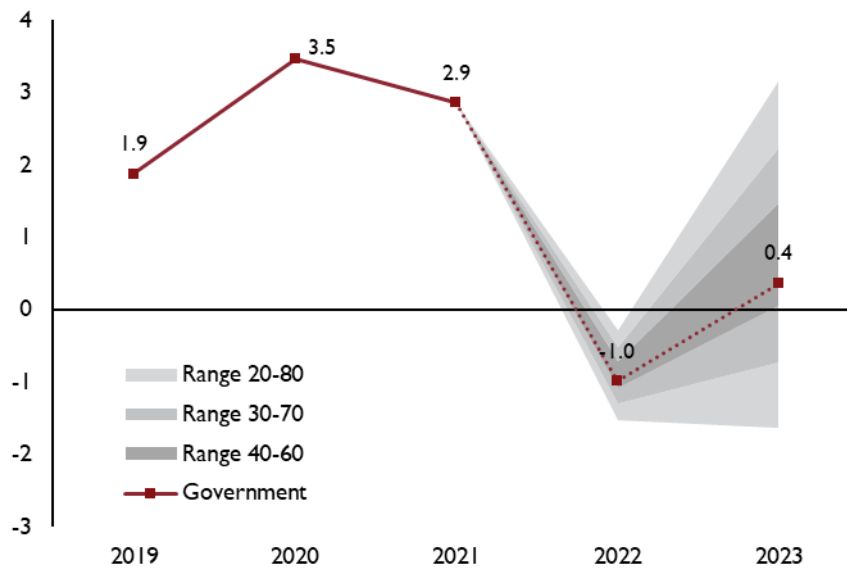
FIGURE 31. RATE OF CHANGE IN PRIVATE CONSUMPTION IN TERMS OF VOLUME (%)



Source: INE, Ministry of Economic Affairs and Digital Transformation and AIReF.

The Government's forecast of the final consumption expenditure of the GG lies in the central part of AIReF's probability bands in both 2022 and 2023. Both AIReF and the Government expect an increase in public consumption in real terms, following the contraction in 2022.

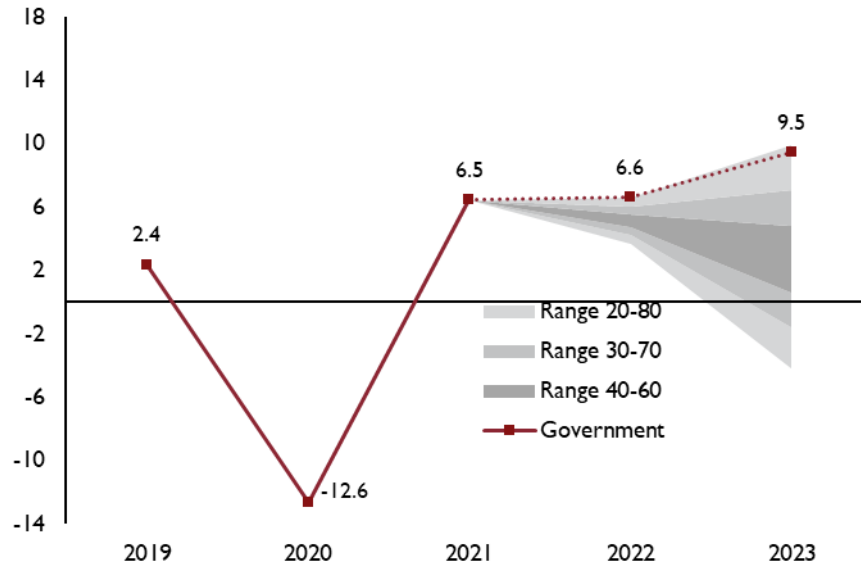
FIGURE 32. RATE OF CHANGE IN PUBLIC CONSUMPTION IN TERMS OF VOLUME (%)



Source: INE, Ministry of Economic Affairs and Digital Transformation and AIReF.

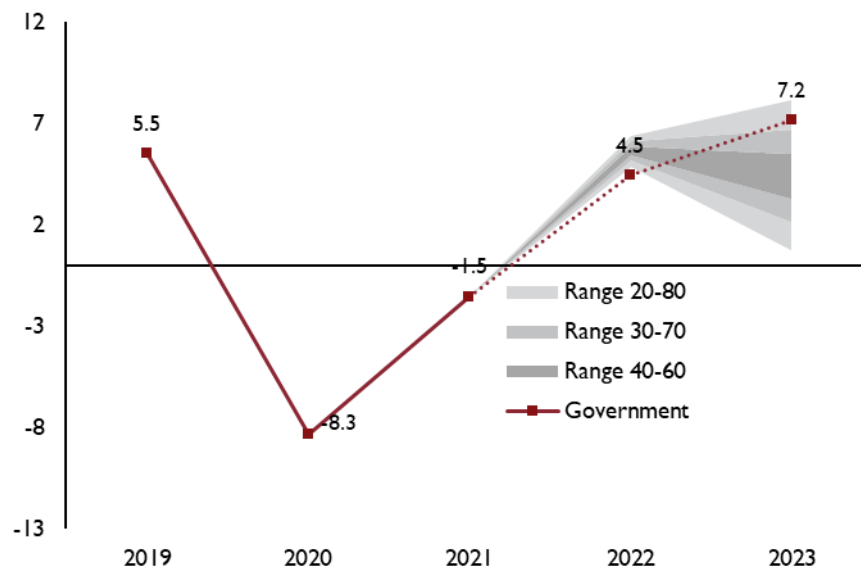
With regard to investment as a whole, the Government's estimates for both years would fall within the ranges estimated by AIReF in 2022 and at the upper end of the confidence intervals for 2023. In 2022, while the estimate for gross capital formation in capital goods and cultivated assets is somewhat optimistic in relation to AIReF's forecast, the estimate for investment in construction and intellectual property assets is prudent as it is below the ranges estimated by AIReF. However, in 2023, the Government's forecasts of both components would lie at the upper end of the confidence interval.

FIGURE 33. RATE OF CHANGE IN GFCF IN EQUIPMENT AND CULTIVATED ASSETS IN TERMS OF VOLUME (%)



Source: INE, Ministry of Economic Affairs and Digital Transformation and AIReF.

FIGURE 34. RATE OF CHANGE IN GFCF IN CONSTRUCTION AND INTELLECTUAL PROPERTY IN TERMS OF VOLUME (%)

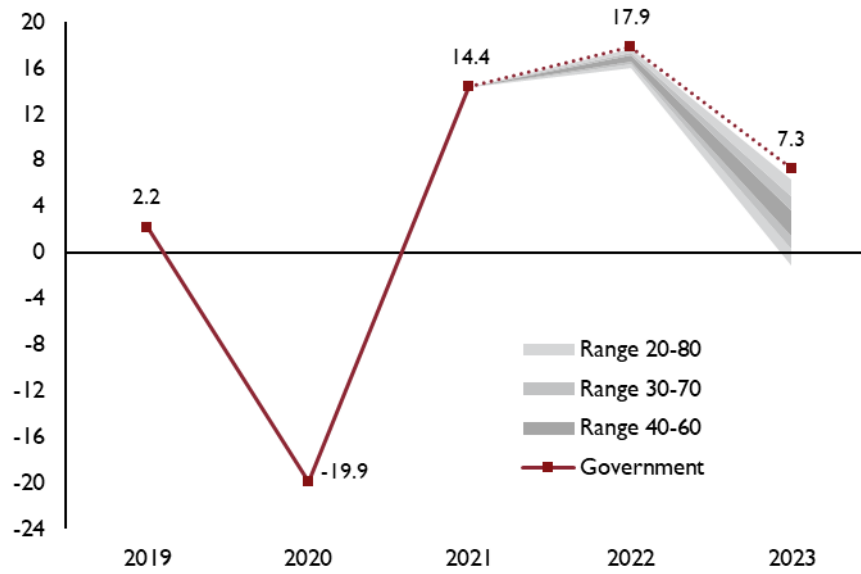


Source: INE, Ministry of Economic Affairs and Digital Transformation and AIReF.

The Government's projections for the contribution of the external sector to GDP growth are similar to AIReF's in 2023 and slightly optimistic in 2022. The Government's forecasts for exports of goods and services are above the upper limit of the confidence intervals estimated by AIReF in both 2022 and 2023. This

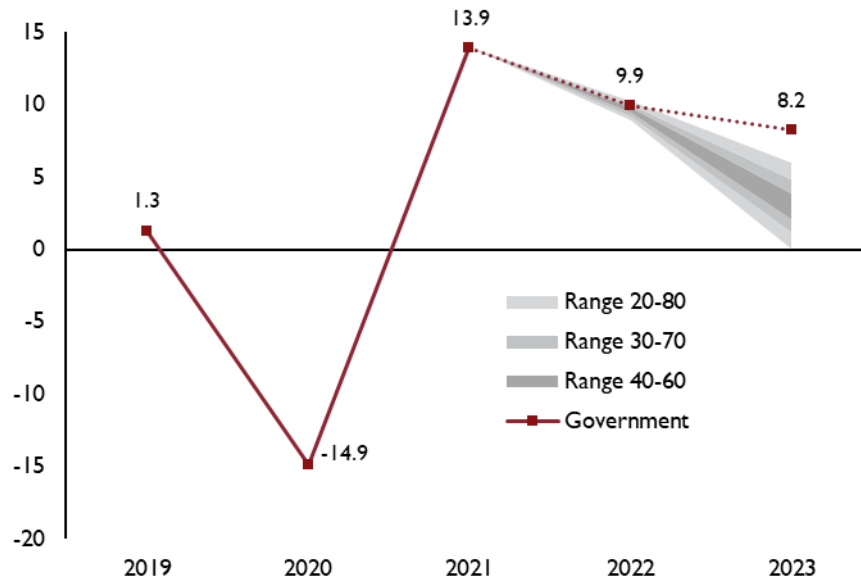
is also the case for the forecasts for imports of goods and services, which means that the projection for the contribution of the external sector to GDP growth by the Government is close to AIRcF's, as it is 0.4 points higher in 2022 and 0.1 points lower in 2023.

FIGURE 35. RATE OF CHANGE IN EXPORTS OF GOODS AND SERVICES IN TERMS OF VOLUME (%)



Source: INE, Ministry of Economic Affairs and Digital Transformation and AIRcF.

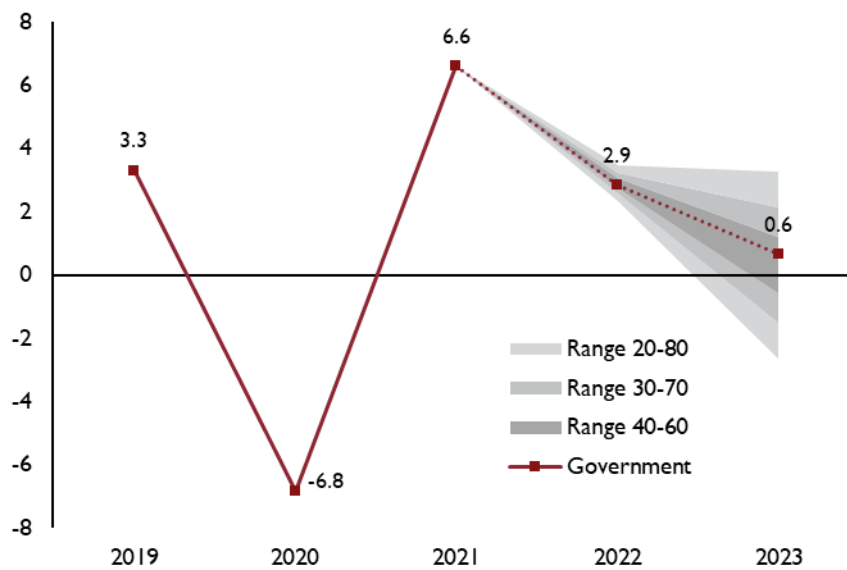
FIGURE 36. RATE OF CHANGE IN IMPORTS OF GOODS AND SERVICES IN TERMS OF VOLUME (%)



Source: INE, Ministry of Economic Affairs and Digital Transformation and AIRcF.

The Government's employment forecasts in terms of full-time equivalent jobs do not show any significant discrepancies from AIReF's forecasts. For 2022, the forecast of the growth in full-time equivalent employment is identical to that estimated by AIReF, and for 2023, the Government expects somewhat higher job creation, but within AIReF's central forecast interval. There is a certain discrepancy in the forecast of the unemployment rate as the Government estimates that it would fall by 0.6 pp in 2023, while AIReF considers that it would remain stable.

FIGURE 37. RATE OF CHANGE IN FULL-TIME EQUIVALENT EMPLOYMENT (%)



Source: INE, Ministry of Economic Affairs and Digital Transformation and AIReF.

FIGURE 38. COMPENSATION PER EMPLOYEE (%)

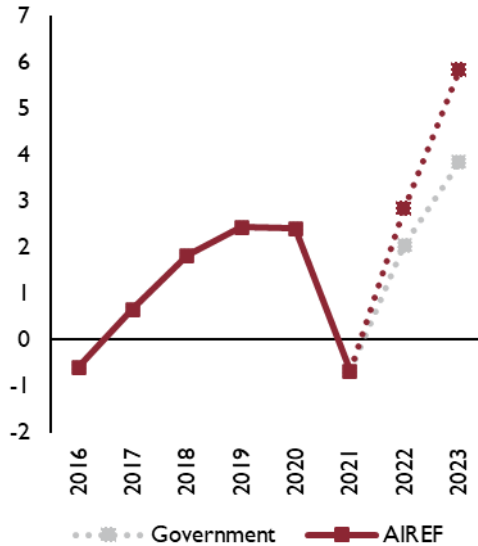
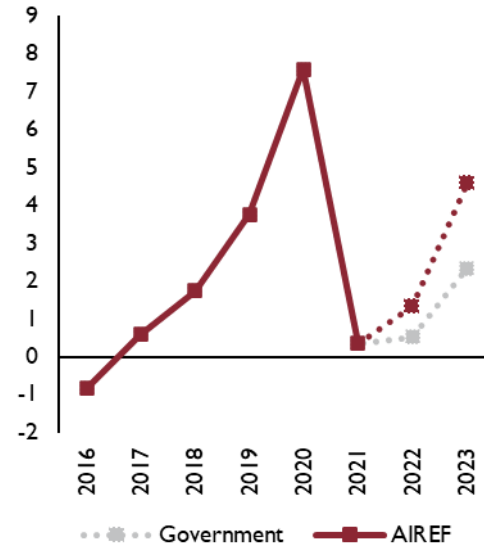


FIGURE 39. UNIT LABOUR COST (%)



Source: INE, Ministry of Economic Affairs and Digital Transformation and AIRcF.

Compared with the Government's scenario, AIRcF estimates a lower impact on economic growth associated with the Recovery, Transformation and Resilience Plan (RTRP). The estimates recently presented by the Ministry of Economic Affairs and Digital Transformation suggest that, since the start of 2021, the Plan would have increased economic growth, based on a strong effect on agents' expectations. The materialisation of calls for investment would have been taking over from the impact on expectations over 2022 and 2023. The above is in addition to the impact of the implemented reforms, which according to the Ministry would raise GDP in 2022 by 0.6 points, and by almost 1.3 points in 2023. According to these estimates, the RTRP would have increased the overall level of GDP by 0.7 pp in 2021, 1.9 pp in 2022 and 2.8 pp in 2023, compared with a scenario without the Plan. In contrast, AIRcF estimates that in 2021 the impact would have been limited, of approximately 0.2 pp due to the delayed materialisation of the investments, while an impact of 0.8 pp in 2022 and 2 pp in 2023 on the level of GDP is estimated compared with a scenario without the Plan (see Box 1). Unlike the Government, AIRcF does not consider that the Plan could have had a major impact on agents' expectations nor has it incorporated in its estimates the potential impact associated with the reforms implemented and, in particular, with the labour market reform, until a complete diagnosis is available based on evidence of its effects on the capacity to create jobs and the nature of the employment created. Finally, information in national accounting terms is not yet available to approximate the rate at which the investments associated with the RTRP are materialising.

3.5. Risk analysis

The security of gas supply in the European Union faces unprecedented risks in view of the escalating geopolitical tensions. So far, all forecasting scenarios for the European economies are based on the assumption that no widespread rationing of energy demand will be necessary in the coming months. This scenario is a consequence of the high levels of accumulated reserves, but it requires a reduction in the demand for energy by European households and companies at rates similar to or higher than the current ones. It also requires the Russian gas supply through gas pipelines other than Nord Stream 1, and the supply of LNG, to be maintained, and the weather this coming winter not to be very adverse. In this regard, more adverse scenarios cannot be ruled out given the recent escalation of tensions with Russia and the threats to essential energy supply infrastructures. Adverse weather, lower energy demand containment or a total cut-off in the supply of Russian gas or LNG may make rationing measures necessary in 2023 and especially for the winter of 2024. In any case, gas prices will remain at very high levels in this context, putting the production of electro-intensive sectors at risk. In Germany, for example, the production expectations of the most energy-intensive industries such as the steel or chemical industries have fallen back to levels not observed since the weeks of strictest lockdown during the pandemic. In this context, the set of measures that some European economies are introducing to mitigate the impact of the energy crisis on economic activity could mitigate the fall in their activity. However, in the case of those aimed at reducing prices, they also carry the risk of reducing incentives to save energy.

The tightening of monetary policy, which is taking place in a synchronised but uncoordinated manner in a context of global slowdown, carries externalities whose implications are difficult to measure and risks to financial stability. Never in recent history has there been such a sharp and widespread increase in interest rates by all central banks. This process may have strong externalities between countries whose implications are difficult to project in the current context and entail risks for financial stability. In this regard, on September 22nd, the European Systemic Risk Board (ESRB) adopted a general warning "on vulnerabilities in the Union financial system", addressed to the European Union and the national supervisory authorities, warning of an increase in the likelihood of tail risks materialising as a result of the most recent geopolitical tensions⁶. Globally, there is a risk that the rapid and sharp increases that are

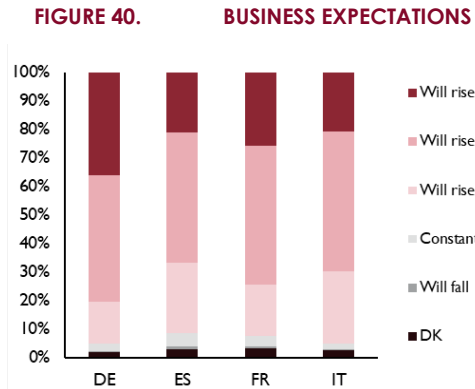
⁶ See the document

https://www.esrb.europa.eu/pub/pdf/warnings/esrb.warning220929_on_vulnerabilities_union_financial_system~6ae5572939.en.pdf.

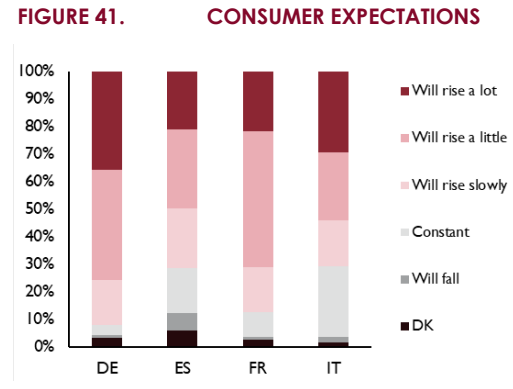
taking place across the board may eventually result in a widespread recession, given the strong interrelationship between the different economies. In foreign exchange markets, the rapid hikes in interest rates by the US Federal Reserve have led to an appreciation of the dollar, which raises the energy bill and the cost of importing other commodities for European economies - as commodities are mainly traded in dollars. However, it also improves price competitiveness *vis-à-vis* markets outside the euro area. The context of a slowdown in activity and persistently high inflation rates increases the difficulties of coordination between fiscal and monetary policy, as has been shown in the United Kingdom where an expansive fiscal policy has unleashed instability in debt markets and has required emergency intervention by the Bank of England. Emerging and developing countries also face many questions related to both financial and exchange rate stability and food and energy supply security in a context of increased competition for sources of supply.

At a domestic level, the deterioration in households' purchasing power and confidence is another source of downside risks. The containment of wage rises in a context of high energy prices and widespread increases in inflation is leading to a marked deterioration in households' income and purchasing power. These effects are heterogeneous in nature and affect lower-income families to a greater extent, given the composition of their consumption baskets. The above is in addition to the rapid increase in mortgage interest rates that is taking place and that might be accentuated if expectations of interest rate hikes by central banks are confirmed. In this context, household spending may be more subdued than expected, resulting in an increase in precautionary savings.

Regarding prices, inflation is expected to decelerate in 2023 due to base effects from energy and continued wage moderation. Despite these downward factors, it will be necessary to monitor the possible de-anchoring of household and business expectations. In the next 12 months, 20.9% of Spanish households expect prices to increase significantly, twice as many as in the autumn of 2019. In addition, an examination of CPI sub-indices reveals how the persistence of price increases has increased across the board. However, the largest rises and persistence can be seen in food products, which show less downward rigidity.

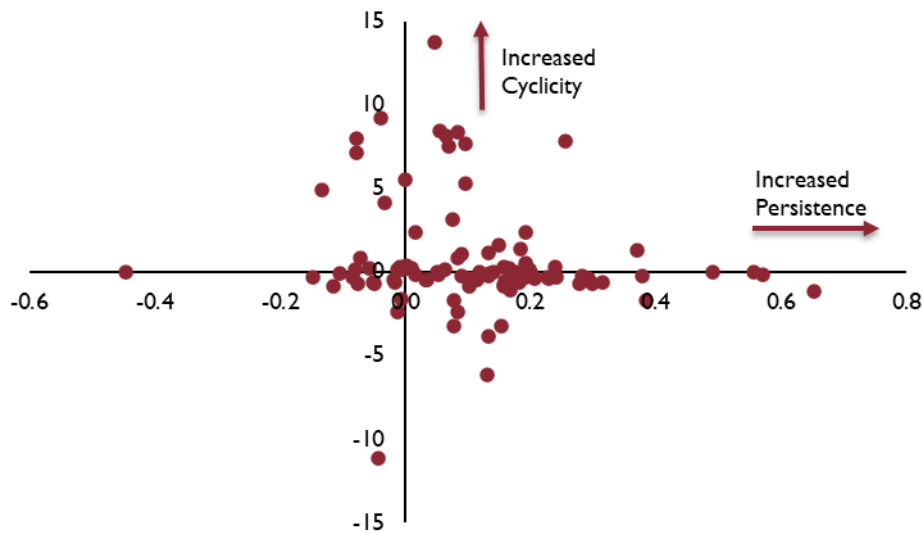


Source: ECB



Source: European Commission.

FIGURE 42. CYCLICALITY AND PERSISTENCE OF CPI SUB-INDICES



Source: Prepared by AIRcF based on INE data⁷

⁷ Each point represents the change in the coefficients of the CPI baskets to three digits of two regressions. On the one hand, to measure persistence, the change in the coefficient of an AR(1) with the sample until 2020:03 and then, to measure cyclicity, the change in the coefficient (with sampling until 2020:03 and after) of a regression on a lag of the difference between unemployment and trend unemployment.

BOX 1. THE SPANISH ECONOMY IN THE MEDIUM TERM

AIReF presents a full macroeconomic scenario up to 2026 in order to help medium-term economic planning, which it considers essential in this uncertain environment and whose publication it has repeatedly recommended to the Government. According to AIReF's forecasts, the Spanish economy is expected to show a more accelerated growth pattern towards the end of 2023 and especially in 2024. Economic growth would be driven by domestic demand, with the performance of private consumption and investment, which would regain strength in 2024, proving to be significant.

2022-2026 MACROECONOMIC OUTLOOK

Year-on-Year Rates of Change	2021	2022	2023	2024	2025	2026
Private Domestic Final Consumption Expenditure	6,0	1,5	1,3	2,7	2,0	1,8
General Government Final Consumption Expenditure	2,9	-0,9	0,8	1,1	0,8	0,9
GFCF	0,9	5,5	3,9	5,3	3,2	2,2
<i>GFCF Equipment and Cultivated Assets</i>	6,5	5,1	2,7	9,9	5,8	3,6
<i>GFCF Construction and Intellectual Property</i>	-1,5	5,6	4,4	3,4	2,0	1,6
Domestic Demand*	5,2	1,7	1,7	2,9	2,0	1,7
Exports of Goods and Services	14,4	16,9	2,5	2,7	1,5	1,3
Imports of Goods and Services	13,9	9,6	3,0	3,0	1,9	1,5
External Balance*	0,3	2,7	-0,2	-0,1	-0,2	-0,1
Gross Domestic Product	5,5	4,4	1,5	2,7	1,8	1,6
Nominal Gross Domestic Product	7,9	8,2	5,9	5,0	3,9	3,4
Gross Domestic Product Deflator	2,3	3,6	4,3	2,2	2,0	1,8
Consumer Price Index	3,1	8,9	3,9	2,0	2,1	2,0
Full-Time Equivalent Employment	6,6	2,9	0,3	1,5	0,9	0,6
Unit Labour Cost	0,3	1,3	4,6	2,4	1,6	1,1
Productivity per Full-Time Employee	-1,0	1,5	1,2	1,2	0,9	1,0
Compensation per Employee	-0,7	2,8	5,8	3,6	2,6	2,2
Unemployment Rate (% of Active Population)	14,8	12,8	12,8	12,2	11,8	11,5
Household and NPISH Savings Rate (% Gross Disposable Income)	13,6	8,5	8,7	8,5	8,1	7,3

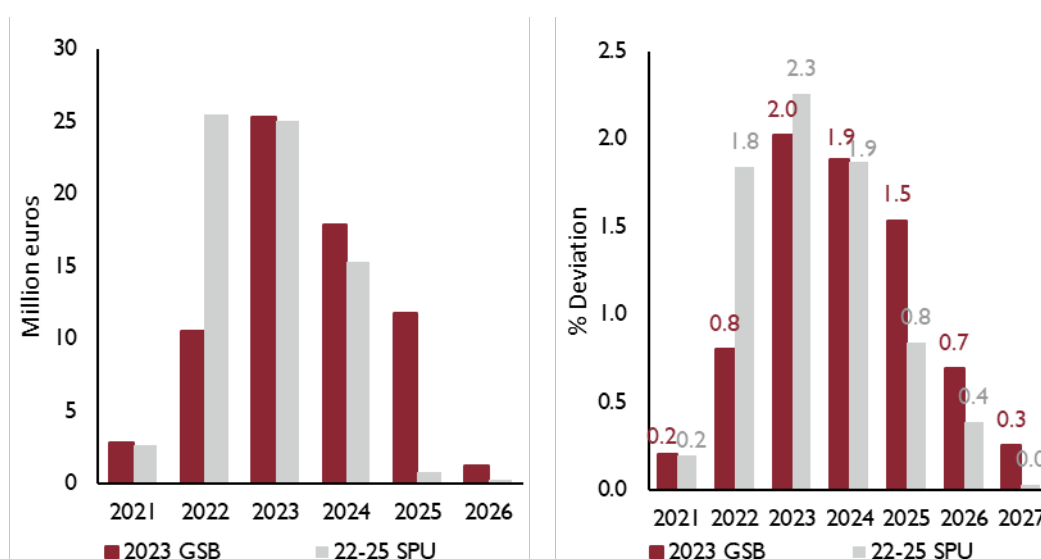
*Contribution to GDP Growth

This scenario assumes that the Spanish economy would resume a path of recovery in the spring of 2023 and recover to pre-pandemic levels of activity in the first quarter of 2024. Growth would be supported by reduced uncertainty associated with the energy crisis and by the gradual improvement in the growth of European economies, which would contribute to the improvement in exports and investment. For its part, the improvement in household confidence and their continued high savings rate in relation to the historical average would support the growth in their spending on

consumption and housing. Finally, after several years of moderation, investment in equipment would gain significant momentum in 2024, supported by the rollout of the Recovery, Transformation and Resilience Plan (RTRP) and the improvement in business confidence. This scenario starts from a crucial hypothesis that over 2023 the energy crisis will be resolved and its effects on economic activity inflation will diminish. This assumption is subject to high risks, as discussed in Section 3.5.

With regard to the impact of the RTRP, AIRcF has updated its estimate of the schedule for the ultimate spending of the RTRP funds and the expected macroeconomic impact according to that distribution. The result assumes that the impact of the Plan on growth is delayed over time compared with the expectations of previous years. Specifically, an impact of 0.2 pp in 2021 is currently estimated, which would increase to 0.8 pp in 2022 and 2 pp in 2023 on the level of GDP compared with a scenario without a Plan. A similar impact on the level of GDP is estimated for 2024 as in 2023, and thereafter it is expected to decrease until it practically disappears in 2027. To understand why the impact runs out, it should be remembered that GDP is a flow that reflects the production of an economy in a given period of time, so that only permanent increases in the productive capacity of the economy have a permanent impact on its level. In this regard, it should be pointed out that AIRcF's estimate does not include the possible effects resulting from reforms that might have a more sustained impact over time, such as the labour reform, until a complete and evidence-based diagnosis of their effects on the economy's job creation capacity and the nature of the employment created is available.

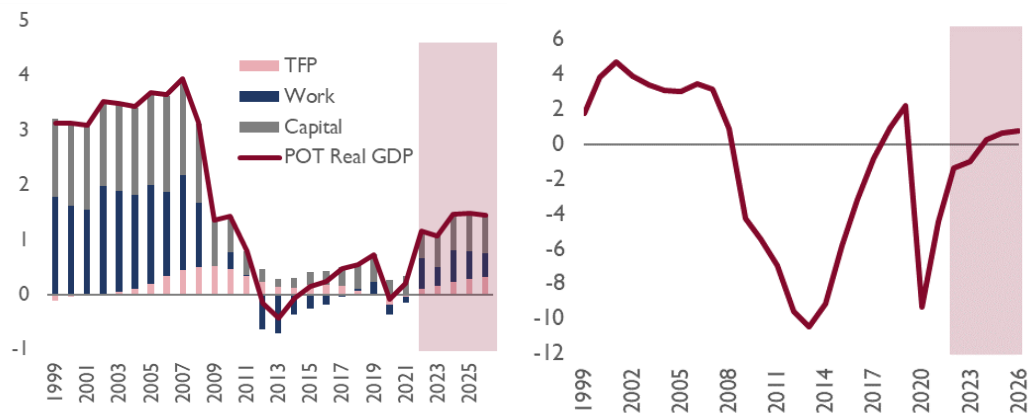
ESTIMATED DISTRIBUTION OF FUNDS (€M) OF RTRP AND ITS IMPACT ON GDP (% DEVIATION FROM A NON-RTRP SCENARIO)



In this medium-term scenario, estimated average potential growth over the 2022-26 horizon stands at 1.3%, very similar to the average for the Spanish economy over the last two decades (1.2%). The main drivers of this potential growth according to the production function approach are the labour factor (0.5 pp) and capital (0.6 pp). The dynamics of population ageing and participation in the labour market explain the lower dynamism attributable to the labour factor at the end of the estimation horizon.

This sets a path of closing the output gap from 1% of potential GDP in 2023 gradually until a certain cyclical balance is achieved in 2024 with an output gap of 0.3%. This cyclical profile of closing the output gap is relatively robust to other modelling alternatives and to the estimations of other international bodies.

BREAKDOWN OF POTENTIAL REAL GDP GROWTH AND OUTPUT GAP



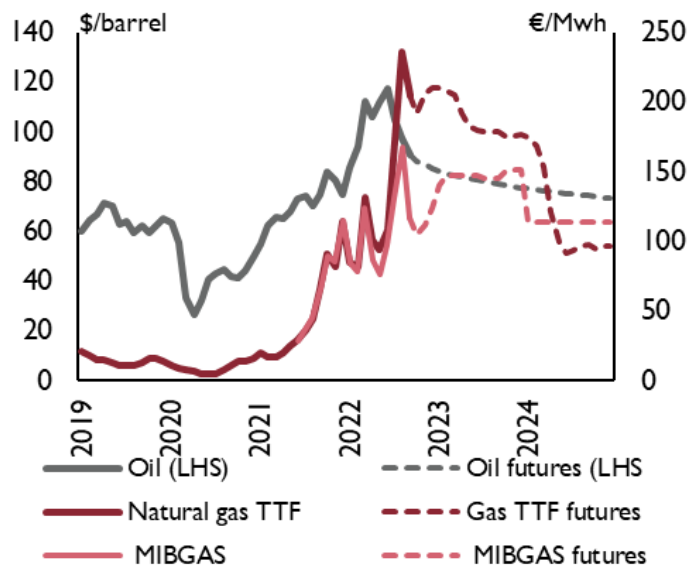
Source: Prepared by AIReF on the basis of the agreed common methodology of the European Union

BOX 2. THE RESPONSE TO THE ENERGY CRISIS

Since mid-2021, the price of natural gas in the main international markets has maintained an upward path, which has been particularly intense in the case of European countries. This path was aggravated by the invasion of Ukraine in February 2022 and the progressive reduction of gas supply from Russia to Germany and other European countries, up to the total suspension at the end of August.

In September, the announcement by the European Union of measures to cushion the impact of the energy crisis has led to a moderation in gas prices. In particular, the proposal for emergency intervention by the EU in energy markets to lower demand and contain the rise in prices, together with the observation that European countries have been able to achieve high reserve levels for the coming winter, has had a sharp impact on gas futures in Europe, with prices falling substantially. However, in historical terms, prices remain very high and futures point to these high values being maintained over 2023.

OIL AND NATURAL GAS PRICE



Source: Refinitiv and MIBGAS

This rise in gas prices is proving crucial in determining energy costs for European households and businesses and is proving to be a very negative supply shock for all European economies. This is because the price in the wholesale market is determined by the cost of the technology that enters the market last, which allows supply and demand to be matched and which

is more expensive than the energy sources that have entered before. In Spain, the marginal technology is usually hydroelectric (54.9% in 2021)⁸. However, the decision whether or not to produce in hydroelectric power plants depends on the opportunity cost of using water as opposed to the possibility of doing so at another time, which, in turn, is mainly determined by the cost of combined cycle power plants that use natural gas and whose production cost is higher than that of other technologies such as nuclear, hydraulic or renewables. Therefore, the price of natural gas ends up determining the price of electricity in the pool and, ultimately, the Voluntary Price for the Small Consumer (Spanish acronym: PVPC), a regulated tariff linked to the pool price.

To cushion the impact of the energy crisis, most governments have been adopting a series of measures aimed at containing price rises and their pass-through to consumers. The measures implemented by the Spanish Government (see the Budget section) include:

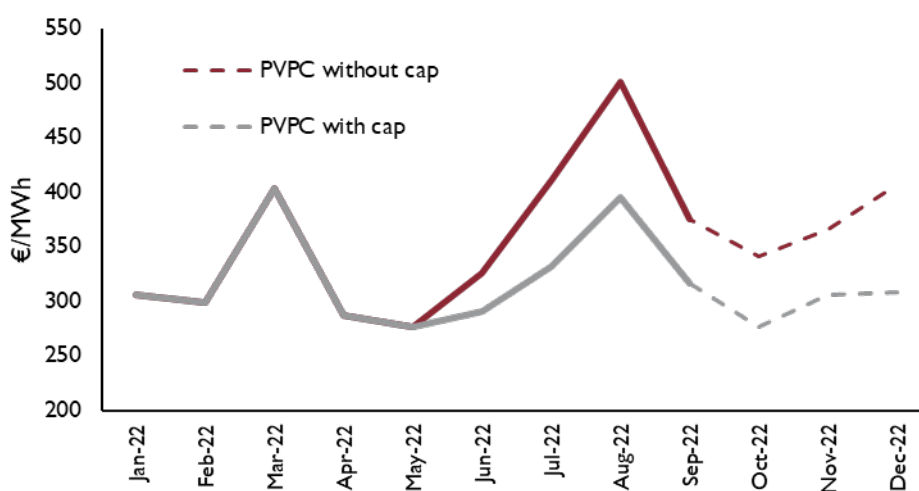
- Reductions in electricity taxation. In June 2021, the rate of the special tax on electricity was reduced and the rate of VAT was reduced from 21% to 10% for small consumers. These measures have been extended and are currently in force until December 31st, 2022. In the case of VAT, an additional reduction to 5% was approved in June 2022.
- Reduction of taxation on gas. As from October 1st, 2022, the gas VAT rate has been reduced to 5%.
- In September 2021, a limit of 15% was established for the increase of the Gas Tariff of Last Resort in the quarterly revisions, a measure that has been extended until January 1st, 2023.
- In April 2022, a rebate of 20 eurocents per litre of fuel, which is applied to the final sales price with taxes, was introduced.
- In May 2022, a production cost adjustment mechanism was introduced to reduce the electricity wholesale price based on a limitation on the price of gas used for electricity generation. This adjustment mechanism - the “Iberian mechanism” - establishes a cap for the price of gas used for electricity generation in Spain and Portugal of €40/MWh from June to December 2022, with a monthly increase of €5 to reach €65/MWh in May 2023, the date on

⁸ European Commission (2022). State Aid SA. 102454 (2022/N) – Spain and SA.102569 (2022/N) - Portugal – Production cost adjustment mechanism for the reduction of the electricity wholesale price in the Iberian market

which it will no longer be applied. The mechanism entered into force on June 15th, 2022.

The initial assessment of the effect of the gas cap carried out by AIRcF (see Box 1 of the Report on Budgetary Execution, Public Debt and the Expenditure Rule 2022) suggested that it would generate a reduction in the Voluntary Price for the Small Consumer in 2022 of 19.5%, which would translate into a reduction in the inflation rate of 0.8 percentage points in 2022, during the period the measure is in force, compared with a scenario without the measure. The reassessment of the effect that the gas cap has had in the three months that it has been in force is in line with the initially calculated impact. Thus, it is estimated that the gas cap would have reduced the PVPC by 17.2% between June 15th and September 30th, compared with a scenario without the measure. On average, considering the evolution of gas prices from June to September and MIBGAS futures until the end of the year, it is estimated that the reduction in PVPC would be 18.4%, which would translate into 0.76 pp less growth in the CPI during the period the measure is in force in 2022.

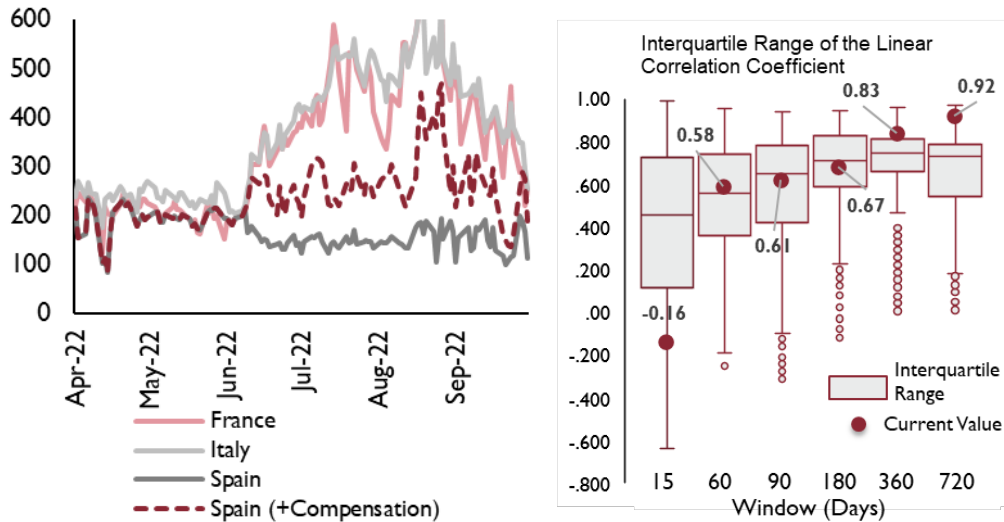
EVOLUTION OF THE PVPC IN THE BASELINE NO-MEASURE SCENARIO (€/MWh)



Source: AIRcF

Since the introduction of this measure, the spot price of the wholesale electricity market in Spain, after including the adjustment cost, seems to have been decoupled from that of France, Italy and Germany. In fact, after three months of the Iberian mechanism being in force, the simple linear correlation between the daily variations in the gas price in France and Spain for the shortest time window has become negative, while a positive correlation was observed for longer windows. In addition, a large number of negative outliers are recorded for longer windows.

ELECTRICITY PRICE ON THE WHOLESALE MARKET (€/MWh) AND SIMPLE LINEAR CORRELATION COEFFICIENT BETWEEN THE DAILY DIFFERENCES OF THE SPANISH AND FRENCH MARKETS



Source: Refinitiv, OMIE and AIRcF

To approximate the impact of all the measures in response to the energy crisis, a scenario is proposed in the Oxford Economics model, in which the following disturbances are incorporated with respect to a scenario without measures:

- Reduction in indirect taxation resulting from the reduction in VAT on electricity and gas and the special tax on electricity.
- Reduction in the gas price due to the limit to the increase in the Tariff of Last Resort in the quarterly revisions of said tariff.
- Rebate of 20 eurocents per litre of fuel for vehicles.
- Decrease in the price of electricity of 18.4% due to the effect of the Iberian gas mechanism.

According to the results of the model, all these measures considered as a whole would have had a positive impact on GDP in 2022 of about 0.6 pp compared with a scenario in which they had not been taken. In addition, it is estimated that inflation in 2022 as a whole will be 1.5 pp lower than if these measures had not been implemented, with an estimated maximum intensity in the third quarter of 2022 of 2.3 pp. Unlike other estimates that only estimate the direct impact of the measures, *ceteris paribus*, these results when calculated with an econometric model incorporate the possible dynamic response of all agents to the implemented measures.

3.6. Ex-post evaluation of the Government's forecasting errors

European legislation, and its implementation at a national level, includes the need for forecasts to be subject to periodic evaluations. Directive 2011/85/EU on requirements for budgetary frameworks of the Member States provides that macroeconomic and budgetary projections are to be assessed on a regular and unbiased basis, on the basis of objective criteria. In addition, Article 14 of Organic Law 6/2013 on the establishment of the Independent Authority for Fiscal Responsibility specifies that the report on macroeconomic forecasts will include an assessment of the existence of significant biases in the forecasts.

In compliance with the aforementioned regulations, AIRcF in its first annual report on macroeconomic forecasts included a detailed analysis of the possible existence of systematic errors and significant biases, and a comparison between different institutions. For the purposes of the analysis, the forecast error was defined as the difference between the predicted value for the current year and the following year, contained in the report on the Stability Programme Update, published between March and May of each year, and in the Yellow Paper of the General State Budget, which is generally drawn up between September and October of each year, and the observed value, understood as the first performance of the Quarterly National Accounts. The analysis took into account the forecasts contained in the corresponding reports published from 2011 to 2021.

The information to assess the Government's forecast errors has not changed as the full figures for 2022 are not yet available and the results of the previous report remain valid. The conclusions of the evaluation carried out in the report on the 2022-2025 Stability Programme Update⁹ remain valid:

- There are no significant biases in the forecasts made by the Government over the last four years.
- The Government systematically underestimates public consumption, to a greater extent in the estimates for the following year.
- There is also an optimistic tendency in the Government's forecasts of private consumption for the current year.
- Exports, imports and gross fixed capital formation are the variables that contribute most to the errors made in estimating GDP.

⁹ [AIRcF Report on the 2022-2025 Stability Programme Update](#)

4. BUDGETARY SCENARIO

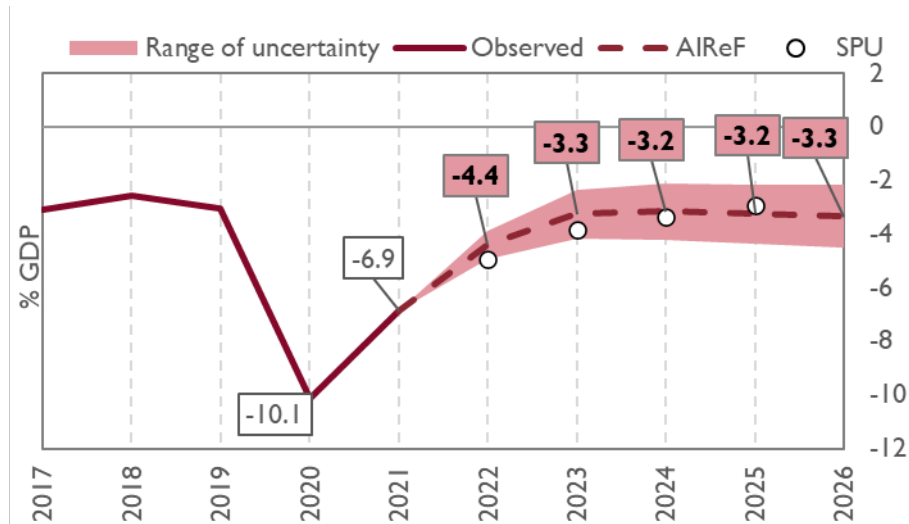
AIReF estimates a deficit of 3.3% of GDP for the GG in 2023, after closing 2022 with a deficit of 4.4% of GDP. In both years, AIReF's estimates are below the reference rate set by the Government, 5% for 2022 and 3.9% for 2023. To ensure consistency with the GSB forecasts, AIReF's 2023 forecasts do not include the possible extension of the measures. Therefore, the reduction of the deficit of 1.1 points would only materialise if the measures to mitigate the energy crisis were not extended.

If all measures are extended for the whole year, the GG deficit would reach 4.5% of GDP. Since the macroeconomic scenario does not assume that the circumstances that gave rise to the adoption of these measures will disappear in 2023, it is logical to assume, as the Government has stated, that the measures will be extended with a scope and duration to be decided even before the end of the processing of this draft GSB. Therefore, the deficit estimate of 3.3% of GDP for 2023 would be increased depending on the horizon and scope of the extension(s) to be adopted over the year, as well as due to any new measures that might be adopted depending on the evolution of the economic and geopolitical situation. As an indicator of the magnitude of the potential impact of these extensions, the annual cost of the measures in force amounts to 1.3% of GDP.

In the medium term, AIReF estimates that the GG deficit will stabilise at around 3.2% of GDP, with a slight upturn in 2026 to 3.3% of GDP. Assuming the temporary nature of the measures adopted on both the expenditure and

revenue side, once the current crisis is over, the margin for reducing the deficit without adopting additional measures is exhausted, resulting in a level above the 3% limit set in the Stability and Growth Pact. The analysis of the medium term will be presented in more detail in the next report, which will also incorporate information from the Budgetary Plan.

FIGURE 43. EVOLUTION OF THE NET LENDING/BORROWING OF THE GG

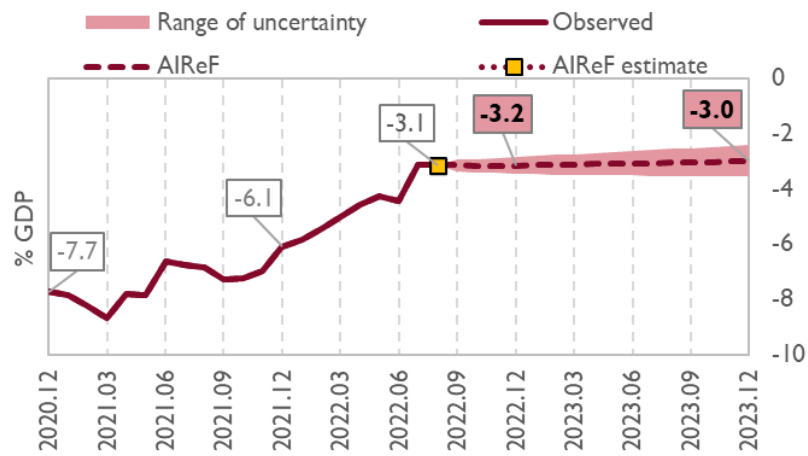


Source: AIReF and IGAE

4.1. Central Government

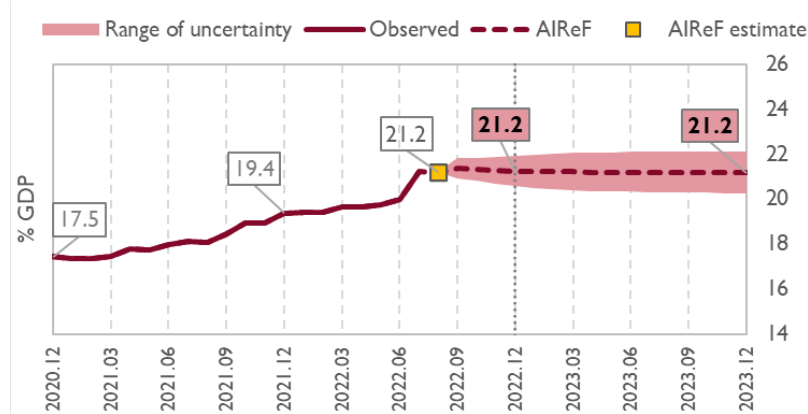
After analysing the 2023 GSB, AIReF revises its forecast of the Central Government deficit for 2023 to 3%, 0.2 points lower than estimated for 2022. The forecasts for both years are below the reference rates set by the Government. AIReF updates the estimates for the accounts of the Central Government by including the information of the 2023 GSB. The deficit estimate for both 2022 and 2023 is lower than the reference rates set by the Government, which are set at 3.8% for 2022 and 3.2% for 2023. In order to maintain the same assumption that has been made in the preparation of the 2023 GSB, AIReF does not include the extension of the measures to combat the energy crisis in its analysis.

FIGURE 44. NET LENDING/BORROWING OF THE CG



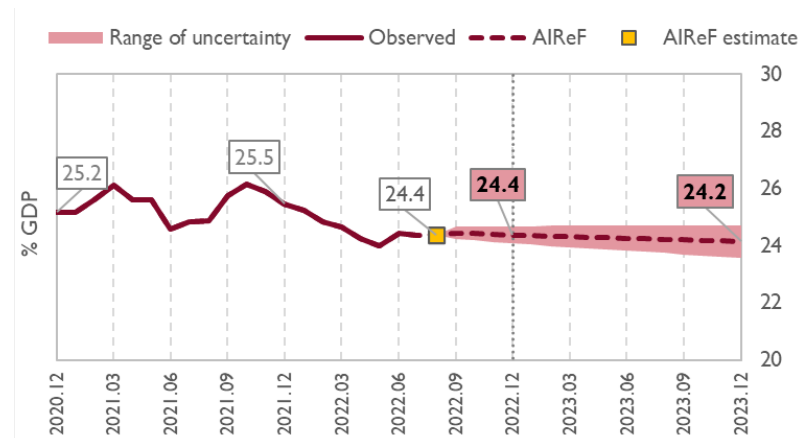
Source: AIReF and IGAE

FIGURE 45. EVOLUTION OF CENTRAL GOVERNMENT REVENUE



Source: AIReF and IGAE

FIGURE 46. EVOLUTION OF CENTRAL GOVERNMENT EXPENDITURE



Source: AIReF and IGAE

4.2. Evolution of Central Government revenue

AIReF estimates that tax collection, before the transfer to territorial governments, stands at 19.2% and 19.5% of GDP in 2022 and 2023, compared with the 18.6% and 18.9% presented in the 2023 GSB. The main difference between the two estimates focuses on the year-end 2022 forecast, which translates into a weight that is 0.6 points higher at the end of the year. In 2023, AIReF estimates that revenue will grow at a rate of 7.2% compared with the 7.7% estimated in the 2023 GSB, which reduces the gap to just over 0.5 points of GDP in 2023. By tax category, the largest deviations occur in PIT and VAT, for which AIReF's year-end 2022 estimates are 0.3 points and 0.2 points higher, which are maintained in 2023. Regarding Corporate Income Tax, AIReF's estimates are lower than those of the Government at the end of the analysed period. However, there are divergences in the time distribution, with increases in collection in 2022 and falls in 2023, the reverse of the expectations in the draft GSB. There are no significant differences in the case of Special Taxes. Finally, with respect to other revenue, the divergences occur due to the different assessment of the evolution of the Tax on the Value of Electricity Production. A detailed analysis of the forecast evolution of the main tax categories of the ordinary regime, before their transfer to the Autonomous Regions and Local Governments in terms of collection and their subsequent transfer to national accounts is given below. The forecasts for 2023 have been made incorporating the tax collection known up to August 2022.

TABLE 5. TAX REVENUE IN CASH TERMS BEFORE TRANSFER TO TERRITORIAL GOVERNMENTS: DRAFT 2023 GSB VS AIREF (% GDP)

	2022			2023		
	2023 GSB	AIReF	Difference	2023 GSB	AIReF	Difference
TAX REVENUE(*)	18.6	19.2	0.6	18.9	19.5	0.5
PIT	8.0	8.4	0.3	8.1	8.4	0.3
CIT	2.0	2.2	0.2	2.1	2.0	-0.1
VAT	6.2	6.4	0.2	6.2	6.4	0.2
STs	1.6	1.6	0.0	1.6	1.6	0.0
Other	0.8	0.8	0.0	0.9	1.0	0.1

Note: With reference to the GDP estimated in the 2023 GSB and AIReF in each case respectively

Source: AIReF and draft 2023 GSB

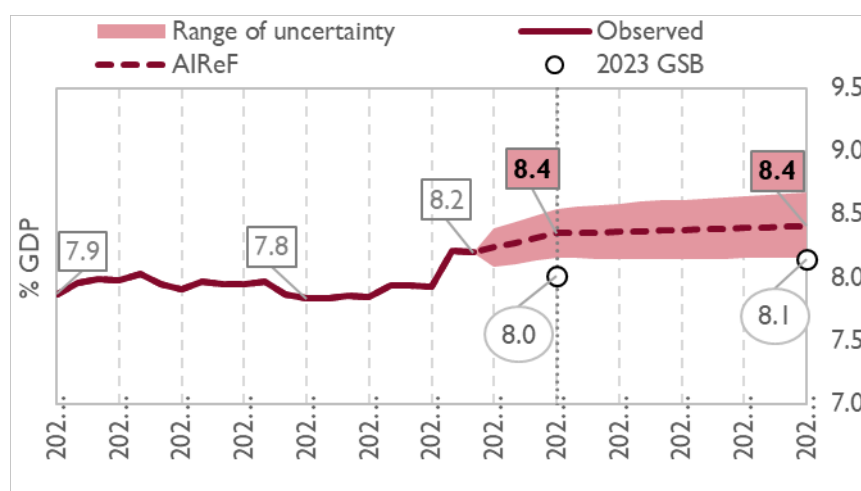
The differences in growth rates for 2023 would be largely explained by the differences between the macroeconomic scenario of AIReF and that of the GSB, although not in the case of the year-end forecast. If we introduce the

Government's macroeconomic scenario in AIReF's revenue forecasting models, we obtain a year-end estimate higher than that included in the GSB and closer to that forecast by AIReF. This lack of realism of the year-end forecasts is also evident when compared with the collection data published up to August. In the case of PIT, the collection between September and December would have to be €300m lower than that recorded in 2021. This is unlikely due to the fact that part of the remaining collection depends on the annual tax return, which has been much higher than that of the previous year, and withholdings have been high. In addition, the collection of VAT between September and December would have to be €1bn lower than in the same period of the previous year in a context of high inflation. In contrast, the Government's macroeconomic scenario in AIReF's revenue models offers revenue growth rates in line with the 7.7% projected in the GSB.

4.2.1. PIT

AIReF forecasts that the weight of PIT as a proportion of GDP will stand at 8.4% in 2022 and 2023, compared with the 8% and 8.1% forecast in the draft 2023 GSB. In 2022, PIT has been driven mainly by the growth in private employment. After incorporating the latest available information that includes the tax due less tax relief, withholdings and advance payments of the 2021 income tax campaign, the highest on record, AIReF expects better results at year-end 2022, which raise its weight over GDP by 0.6 points compared with 2021. This figure is also maintained in 2023, the year in which it forecasts a more moderate evolution than that included in the draft GSB.

FIGURE 47. EVOLUTION OF REVENUE FROM PERSONAL INCOME TAX (% GDP)

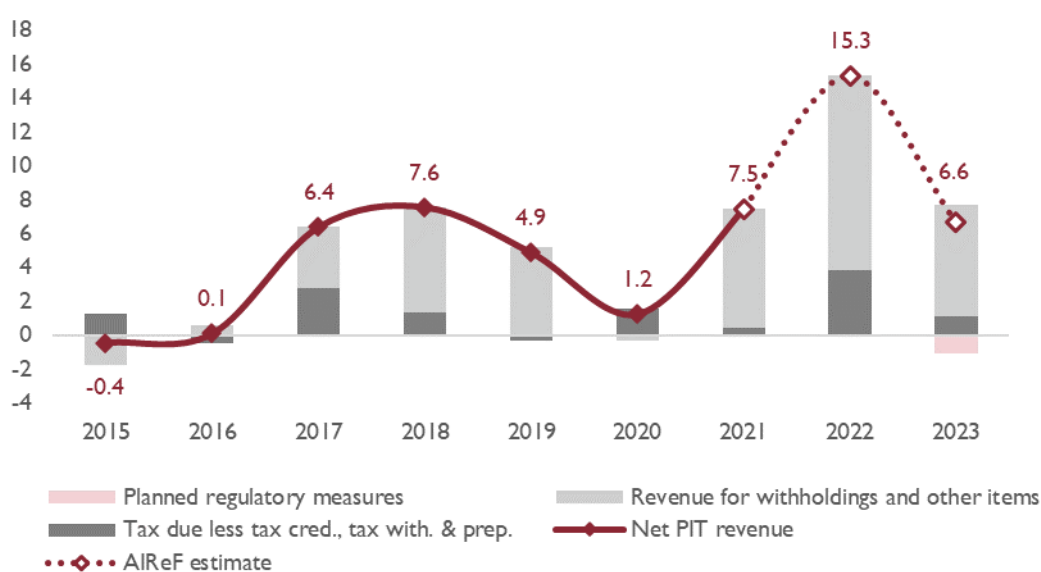


Source: AIReF, AEAT and 2023 GSB

AIReF forecasts PIT growth of 15.3% and 6.6% in 2022 and 2023, respectively, compared with the 11.1% and 7.7% of the draft 2023 GSB. The expected

increase in 2023 of 6.6 points is determined by withholdings and other revenue, which will grow by more than compensation of employees due to the effect of the increase in pensions. The tax due less tax relief, withholdings and advance payments will add 1.1 points of increase due to the growth of income not subject to withholding¹⁰, driven by the dynamism of income linked to leased properties and capital gains in 2022. This increase will be offset by the impact of the increase in the reduction in income from work introduced in the draft 2023 GSB (see Section 4.8.1 Revenue Measures included in the 2023 draft General State Budget), which results in a decrease in growth of 1.1 points.

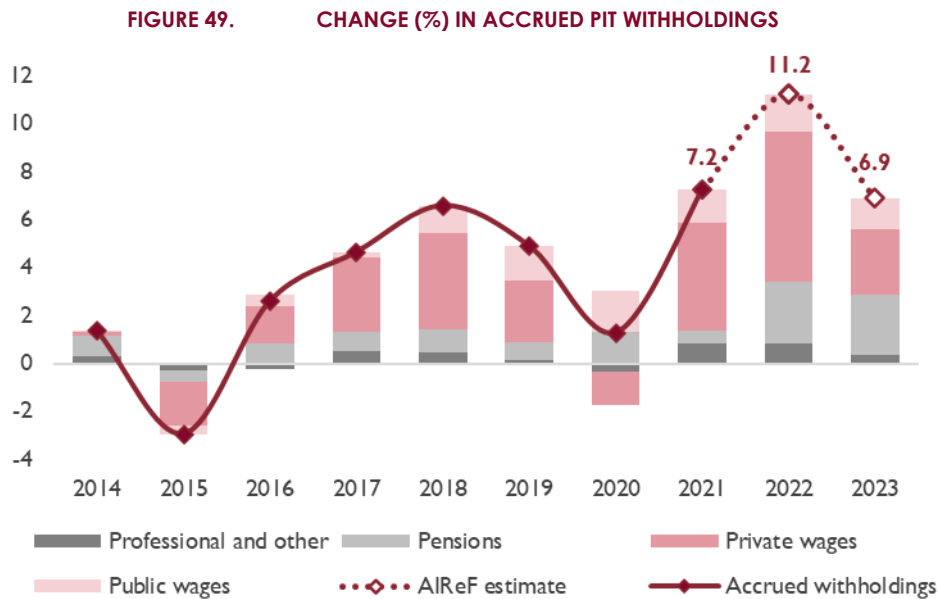
FIGURE 48. CONTRIBUTION TO THE GROWTH OF CASH PIT BY COMPONENT (% CHANGE)



Source: AEAT and AIRcF

Withholdings on work will grow with differentiated trends between the public, private and pension sectors. For 2023, withholdings on private wages and pensions will be the main driver of growth in PIT, with a contribution of 2.7 and 2.5 points, respectively. In the case of private wages, the increase in withholdings in 2022 is mainly due to the increase in the number of earners after the pandemic, while in 2023 it will be based more on wage growth. In addition, the increase in withholdings on pensions will be the result of their increase in line with the inflation forecast for 2022. For their part, public wages, which include the increase announced in the draft GSB for 2022 and 2023, will add 1.3 points to the growth in withholdings on work in the last year.

¹⁰ Income related to leased properties, capital gains and investment income.



Source: AEAT and AIReF

PIT will grow by 15% and 6.3% in national accounting terms in 2022 and 2023.

A lower adjustment from cash to national accounting is expected in 2022 compared with 2021 due to a larger time lag between the cash and the accrual of the first few months of each year. Since in 2021 these first few months were still affected by the pandemic, as they are shifted in national accounting terms to 2020, the changes compared with those obtained in cash terms are softened.

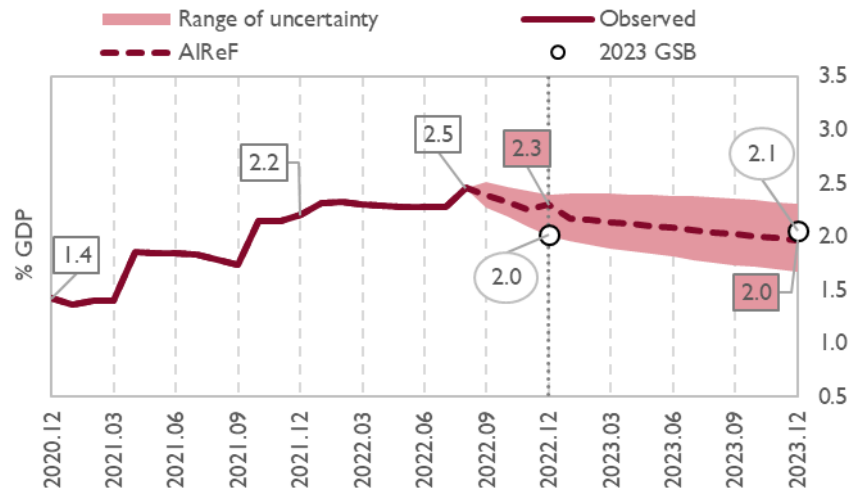
4.2.2. Corporate Income Tax

AIReF estimates higher revenue from Corporate Income Tax than the draft GSB for year-end 2022 and lower revenue for 2023, standing at 2.2% and 2% of GDP, respectively, compared with the 2% and 2.1% estimated by the Government.

The evolution of the tax base has been linked to the macroeconomic variable that best reflects how this tax category behaves, the gross operating surplus, and takes into account the data observed. Up to August, the collection of the first instalment was higher than in 2021, despite exceptional revenues of €1.1bn being included at that time. It also records a decrease in refunds for those corresponding to the 2020 campaign, filed in 2021, although they will be offset by exceptional refunds linked to the payment of a court ruling and DTAs for amounts of about €1.1bn and €1.2bn, respectively. The tax due less tax relief, withholdings and prepayments accrued in the 2021 return, filed in July 2022, has been exceptionally high. This results in an increase in 2022 revenue and an increase in refund applications. AIReF estimates that most of these

applications will be shifted to the following year, thus reducing revenue in 2023.

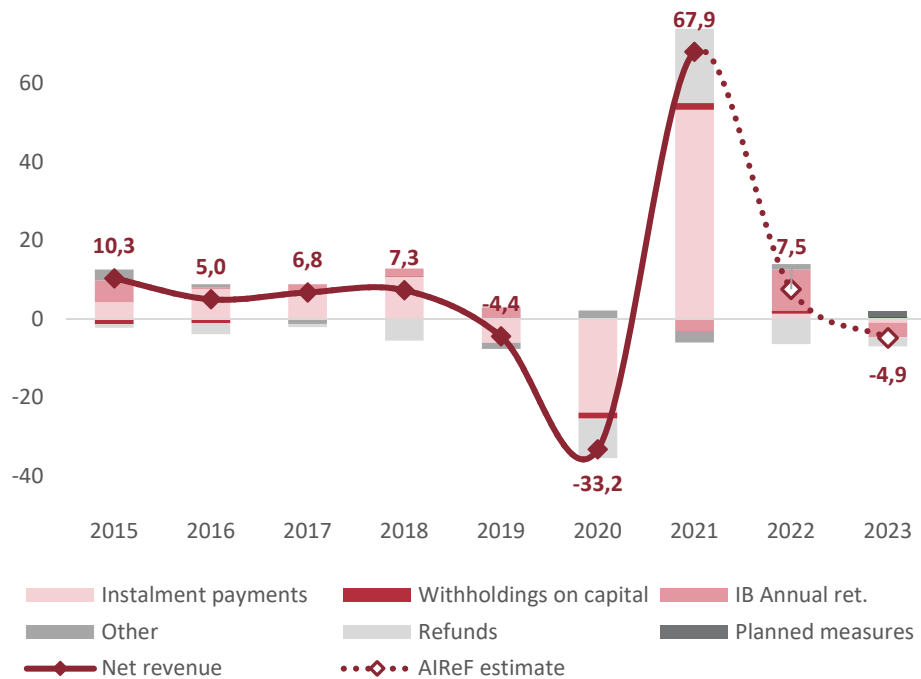
FIGURE 50. CHANGE IN REVENUE FROM CORPORATE INCOME TAX (% OF GDP)



Source: AIReF, AEAT and 2023 GSB

In terms of growth rates, Corporate Income Tax will grow by 7.5% in 2022 and fall by 4.9% in 2023, which contrasts with the drop of 0.5% in 2022 and the growth of 7.7% in 2023 considered in the draft GSB. In any case, this tax presents the greatest degree of uncertainty for year-end 2022, since the result of the second and third instalment payments, which account for most of the collection, is not yet known. The main contribution to growth in 2022 will be revenue from the previous year's annual return, partially offset by higher refunds in 2022. In addition, growth in instalment payments is expected to moderate. In 2023, the main contribution to growth will be determined by the impact of setting the minimum rate at 15% and the reduction of the rebate for the housing lease regime, both measures introduced in the draft 2022 GSB that will be reflected for the first time in July of next year when the settlement corresponding to 2022 is filed. With regard to the new measures adopted in the draft 2023 GSB (see Section 4.8.1 Revenue Measures included in the 2023 draft General State Budget), AIReF considers that they will mainly take effect from 2024 onwards as this is the year in which the 2023 return will be filed.

FIGURE 51. CONTRIBUTION TO GROWTH BY COMPONENTS OF CIT (% CHANGE)



Source: AIReF and AEAT

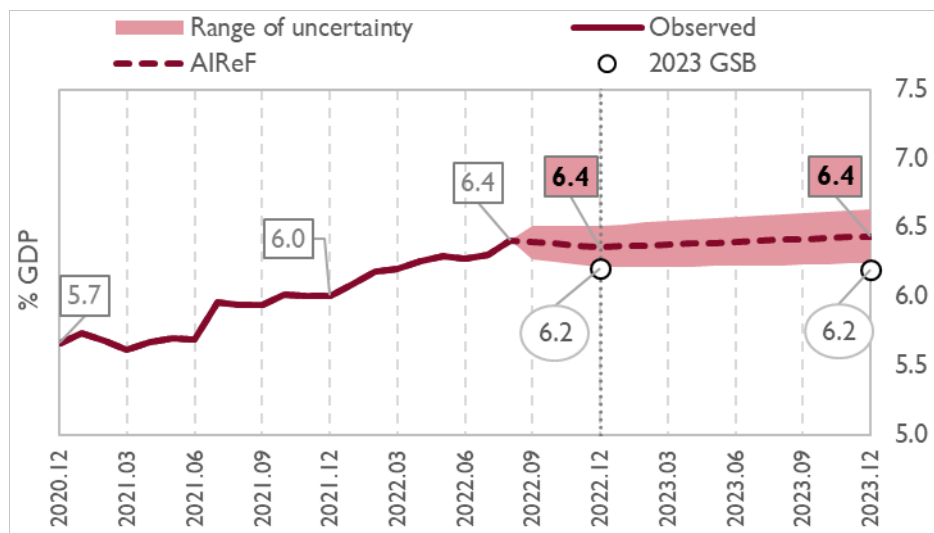
In national accounting terms, CIT will fall by 2.8% in 2022 and record an increase of 2.3% in 2023, contrary to what is observed in cash terms. In national accounting terms, refund applications for the previous year are recorded in the year in which they are submitted, while in cash terms a significant part is carried over to the following year. This leads to a time lag between the evolution in cash and in national accounting. Thus, in 2022, the refunds applied for in 2022, relating to 2021, are recorded in national accounting terms. These have been greater than those requested in 2021, leading to a fall in revenue. For 2023, AIReF forecasts a drop in refunds applied for, which explains the growth in national accounting terms. In national accounting terms, the negative effect of the court ruling and the DTAs are recorded as higher expenses in the year of accrual, 2022 for the court ruling and 2021 for the DTAs.

4.2.3. VAT

AIReF estimates a weight of VAT as a proportion of GDP of 6.4% for 2022 and 2023, 0.2 points higher than forecast for both periods in the draft GSB. In addition to a more optimistic year-end for 2022, higher growth is projected for 2023, resulting in a year-on-year increase of 14.5% and 7.2%, respectively, compared with the 12.2% and 5.9% forecast by the Government. The accumulated collection up to August is 20% higher than that of 2021 for the

same period. This is due to the improvement in consumption compared with 2021 and the increase in prices, despite the reduction in rates adopted to mitigate the rise in the price of energy products (see Section 4.8.2 Measures for Energy Crisis and Ukraine War). More moderate growth is expected at the end of the year due to the comparison with months of significant recovery in 2021. AIRcF's forecasting models readjust the imbalances observed since the pandemic in the evolution of the VAT tax base with respect to domestic demand in nominal terms, so that for 2023 the base is projected to grow less dynamically than domestic demand.

FIGURE 52. EVOLUTION OF VAT REVENUE (% GDP)



Source: AIRcF, AEAT and 2023 GSB

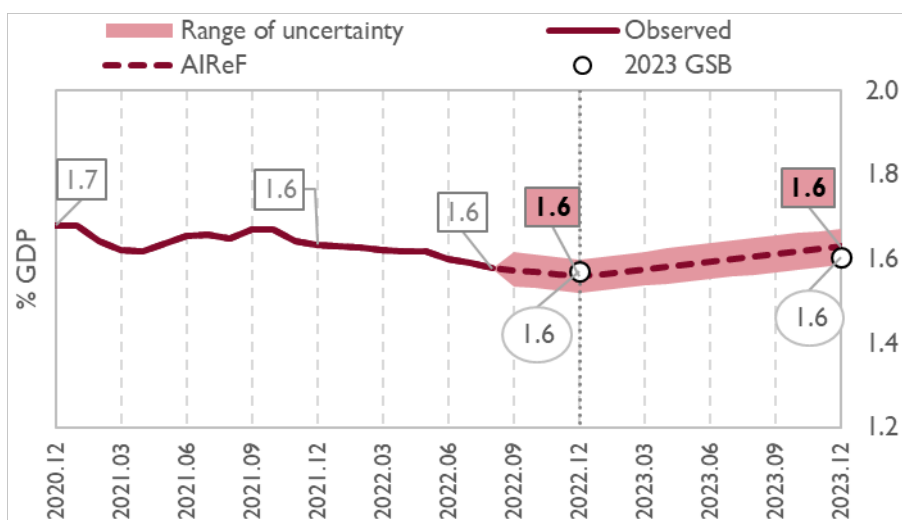
The VAT growth rate in national accounting terms stands at 12.9% and 6.2% for 2022 and 2023, respectively. The shift of taxes to their month of accrual transfers the revenues of the months of January and February to the previous year, with a notable impact in 2021, given that the collection of VAT in these first two months was still greatly affected by the pandemic. On the other hand, the forecast evolution leads to an accrual for these periods that is higher than that of the previous year. Therefore, the shift of the refunds to the year that they are applied for in balances the higher revenues of each period with their higher refunds. As a result, growth rates are softened in national accounting terms.

4.2.4. Special Taxes

AIRcF estimates that Special Taxes will remain at 1.6% of GDP in 2022 and 2023, in line with the draft GSB. The expected growth of Special Taxes as a whole will reach 3.3% in 2022 and 10.7% in 2023, compared with the 4.4% and 8.2% forecast by the Government. So far this year, collection has grown by 4.2% on

2021, driven mainly by the recovery of the Hydrocarbon Tax, which was the tax most affected by the pandemic and despite the impact of the reduction in the rate of the Special Tax on Electricity, in force throughout 2022 (see section on measures). AIReF estimates lower growth at the end of 2022 due to the comparison with the last few months of 2021 in which the collection on hydrocarbons recorded greater recovery. For 2023, the expected growth will increase exceptionally due to the end of the reduction in the rate on electricity. Excluding the Special Tax on Electricity, the evolution of STs as a whole is in line with that of real GDP. In national accounting terms, STs as a whole will grow by 3.3% and 10.8% in 2022 and 2023, practically the same as in cash terms, as there are no differences between the two accounting concepts for these taxes.

FIGURE 53. EVOLUTION OF REVENUE FROM SPECIAL TAXES (% GDP)



Source: AIReF, AEAT and 2022 GSB

4.2.5. Other tax revenue

According to AIReF's forecasts, other tax revenue will account for 0.8% and 1% of GDP in 2022 and 2023, compared with the 0.8% and 0.9% included in the draft GSB. The evolution of other tax revenue will be influenced by various factors. Refunds of €450m in Non-Resident Income Tax are expected to occur in 2022 under Court Ruling 1581/2019. In 2023, the reactivation in that year of the Tax on the Value of Electricity Production, suspended until 31/12/2022 (see Section 4.8.1 Revenue Measures included in the 2023 draft General State Budget), will result, according to AIReF's estimates, in about €3bn, associated with three quarters since the first one corresponds to the accrual of 2022, when the suspension was still in place. In 2023, the entry into force of the Tax on Single-Use Plastics is also noteworthy. This will result in an additional €280m

corresponding to the accrual of three quarters during the first year that it is in force.

4.2.6. Other revenue

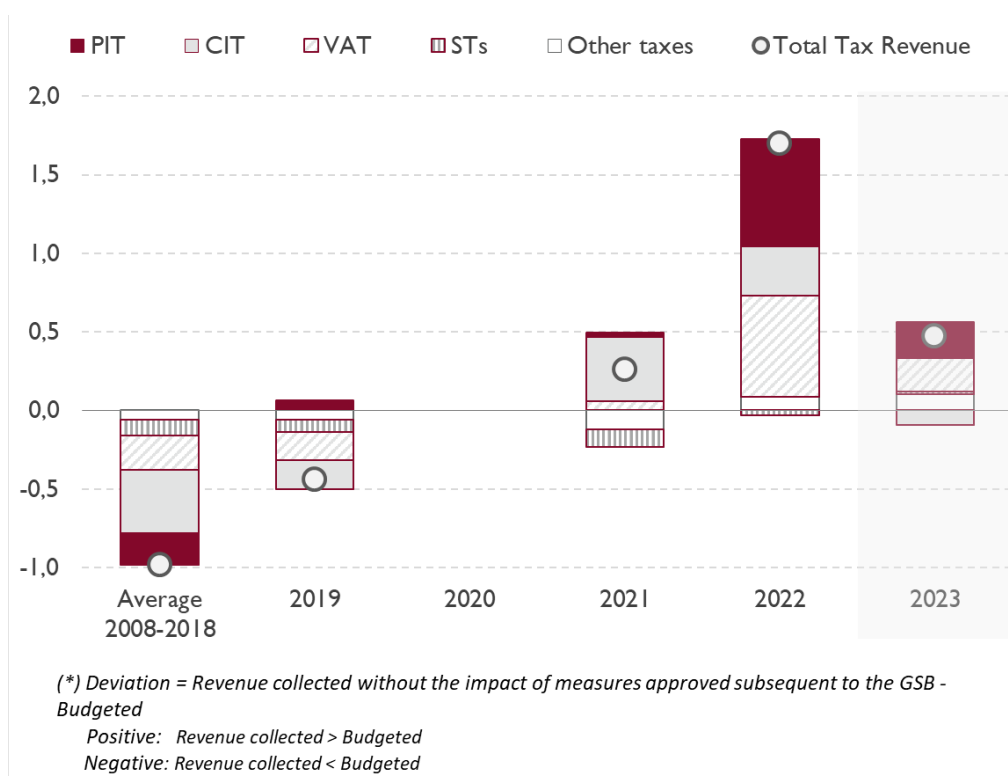
For other revenue, excluding NGEU funds, AIRcF forecasts a weight of 2.4% and 2.5% of GDP in 2022 and 2023. This revenue includes revenue from property income and current and capital transfers from abroad. This income will increase exceptionally in 2023 and 2024 as a result of the revenue from the new taxes on financial institutions and energy companies. In addition, AIRcF estimates that the social contributions of the Central Government will maintain their weight at 0.7% of GDP in 2022 and 2023, 0.1 points less than in 2021.

4.2.7. Deviations in the budgetary estimate

According to AIRcF's forecasts, tax revenue in 2023 will be higher than the amount forecast in the 2023 GSB, with a deviation of 0.5 points of GDP above the budgeted amount. This deviation would be lower than that estimated for year-end 2022, which would exceed this year's Budget by around 1.8 points of GDP. The following figure shows the deviation or budgeting error of recent years, which is calculated by comparing the revenue forecasts of the budget of each year with the actual amount collected, after deducting the impact of the regulatory measures approved after the Budget. For 2023, it is estimated that the most important deviations will be in PIT and VAT, around 0.2 points of GDP for each tax above the budgeted amount, which will be partially offset by a negative deviation of 0.1 points in Corporate Income Tax.

The bias in the income forecasts seems to be related to the application of fiscal rules, with two phases of deviations observed. A first pre-pandemic phase, with fiscal targets and rules in place, where revenue collected was generally lower than budgeted. It could be assumed that this negative difference was due to the fact that the obligation to comply with fiscal rules at the time of budgeting provides an incentive to overestimate the tax revenue expected to meet these targets. And a second phase, from 2021, without fiscal rules, in which actual revenue is higher than budgeted. These positive differences could be due to the fact that the suspension of fiscal rules and their replacement by somewhat lax reference rates reduces the incentives to overestimate revenue in the budgeting process, while favouring the strategic behaviour of having a revenue margin that, so far, has made it possible to offset the measures adopted over the year without endangering compliance with said references.

FIGURE 54. DEVIATION OF REVENUE WITH REGARD TO APPROVED BUDGET (*)



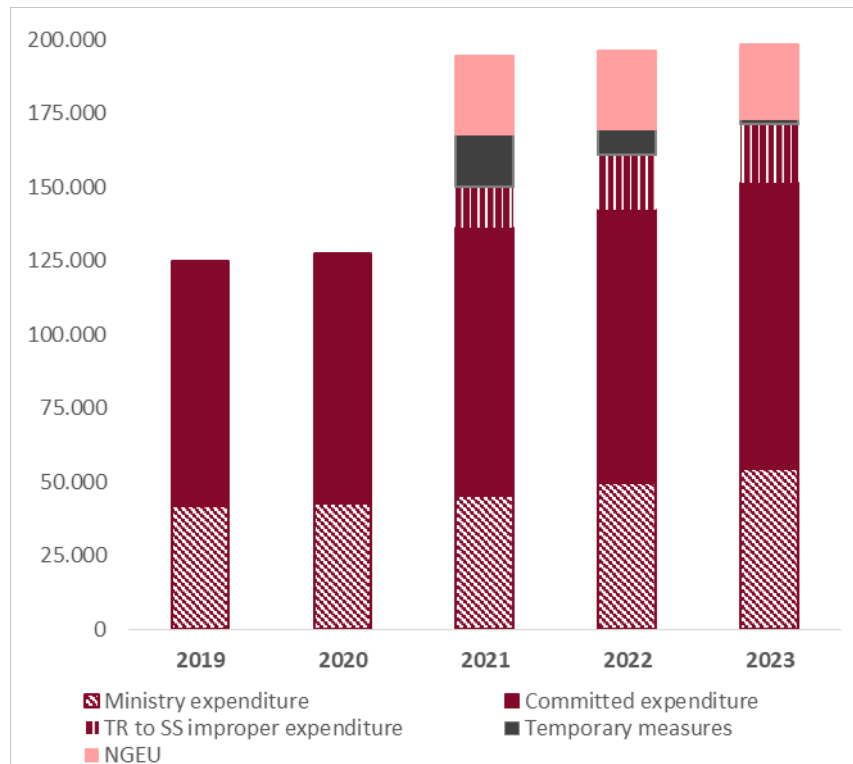
Note: With reference to the AIRcF-estimated GDP in each year

Source: AIRcF, 2022 GSB and 2023 GSB

4.3. Non-financial expenditure limit

The 2023 non-financial expenditure limit (NFEL) consolidates the increase of the last two years and is 1.1% higher than in 2022, despite the reduction of extraordinary transfers to other sub-sectors. The incorporation of the NGEU and other extraordinary temporary transfers associated with the pandemic caused a sharp increase in the NFEL set in 2021 and 2022. The NFEL (also known as expenditure ceiling) approved in 2021 was 52% higher than the level prior to the outbreak of the pandemic. This strong growth was maintained in 2022, where the NFEL surpassed the 2021 level by 0.9%. In both cases, the increase was driven by the incorporation into the expenditure ceilings of the amounts of the extraordinary European funds of the NGEU and the extraordinary transfers for the other sub-sectors (funds for ARs and LGs and transfers to the SSFs for unemployment) with the aim of addressing the serious economic and social crisis resulting from the pandemic.

FIGURE 55. EVOLUTION OF THE NFEL 2019-2023



Source: Prepared by AIReF based on the information published by the Ministry of Finance and Civil Service

Unlike the expenditure ceiling of 2021 and 2022, the 2023 NFEL hardly incorporates expenditure on extraordinary transfers. Specifically, the 2023 NFEL incorporated €26.84bn of expenditure as a result of the pandemic (€25.16bn for the NGEU and €1.68bn for the extraordinary transfer to the LGs). The 2022 NFEL was €35.26bn (€26.36bn for the NGEU and €8.9bn for the extraordinary transfers for the ARs and LGs as well as to the SSFs to finance unemployment). The 2021 NFEL was €44.51bn (€26.56bn million for the NGEU and €17.95bn for extraordinary transfers). It should be noted that the expenditure ceiling for 2023 does not include temporary measures stemming from the energy crisis. The Government plans to process them, as the case may be, as soon as the package of measures approved in 2022 has expired.

After excluding NGEU expenditure and extraordinary transfers caused by the pandemic, the 2023 NFEL of the ordinary State activity rises by €10.5bn compared with 2022. In order to know the increase in expenditure to meet the ordinary activity of the State, it would be necessary to discount the expenditure resulting from the NGEU and the exceptional transfers made to other sub-sectors to address the crisis. This makes it possible to compare the growth in the 2023 NFEL with respect to the previous year without being distorted by the temporary expenditure that has driven such a high increase

in the expenditure ceiling in recent years. Thus, the expenditure ceiling for 2023 amounts to €171.38bn, €10.5bn higher than in 2022.

For comparative purposes, if we eliminate the increase resulting from the State taking on “improper” expenditure, the 2023 NFEL will grow by 6.3%, a rise of around €9.01bn. Of this increase of €10.5bn, €1.49bn is due to the gradual assumption by the State of the financing of this expenditure considered “improper” by the Social Security¹¹. The remaining €9.01bn represents the increase in the expenditure ceiling in homogenous terms with the 2022 expenditure ceiling. This increase is chiefly earmarked for interest (€1.1bn), civil servant pensions (€2.51bn), compensation of employees (€1.2bn) and capital transfers (€1.9bn).

Therefore, this higher expenditure ceiling implies a significant decrease in temporary extraordinary expenditure in favour of an increase in structural expenditure. The weight of NGEU spending and other extraordinary transfers in the NFEL falls from accounting for 23% in 2021 to 14% in 2023. Therefore, taking into account the composition of the expenditure contained in the 2023 expenditure ceiling, the State is significantly increasing its structural expenditure, which should be accompanied by a permanent increase in revenue in order to fund it.

Since 2016, in the draft 2017 GSB, the Government has not published details on the national accounting adjustments necessary to reproduce the calculation of the expenditure limit. To calculate the non-financial expenditure limit, it is necessary to estimate the national accounting adjustments, which allow the equivalence between the budgetary balance and the balance expressed in national accounting to be shown (see Box on Non-financial expenditure limit¹²). The estimate of these adjustments must be published in the GSB (Articles 6 and 27 of the Organic Law on Budgetary Stability and Financial Sustainability). Despite this legal obligation and AIReF's repeated recommendations in the same regard, the Ministry of Finance has not published the details of these adjustments since the 2017 GSB.

This prevents adjustments from being properly monitored when they are a factor of possible deviation from the deficit target. Accounting adjustments are important insofar as they are a factor of possible deviation from the deficit target or reference rate (see Box on national accounting adjustments).

¹¹ In 2021, the process of transferring the financing of this expenditure from the Social Security to the State began in compliance with the first recommendation of the Toledo Pact, with an amount of €13.93bn, which will culminate in 2024 with an amount of €22.57bn, a figure that will be consolidated from that year.

¹² [AIReF Report on the Main Budgetary Lines and draft Budget of the GG 2022](#)

Execution of the GSB may lead to a deviation from the target deficit not only as a result of lower and/or higher than initially budgeted non-financial revenue and/or expenditure, but also as a result of national accounting adjustments other than those initially expected.

AIReF carries out the analysis of the 2023 expenditure ceiling from the perspective of how revenue forecasts and national accounting adjustments affect compliance with the reference deficit of 3.2% of GDP. To perform this exercise, AIReF compares its own forecasts with those of the Government, leaving the rest of the variables constant. Firstly, it compares its own revenue forecast with that contained in the draft 2023 GSB. Secondly, it makes its own estimate of the national accounting adjustments with the available information and compares it with the Government's forecast. Although this forecast is not published in the draft 2023 Budget, the amount can be deduced from the difference between the approved expenditure ceiling and the other elements involved in its calculation since they are all known except the adjustments. Finally, it should be taken into account that, for the calculation of the deficit forecasts in the different assumptions analysed, AIReF's GDP for 2023 is used, which is slightly lower than the Government's.

AIReF estimates differ from the forecast for revenue and national accounting adjustments contained in the draft 2023 GSB by 0.6% of GDP and 0.3% of GDP, respectively. The Ministry of Finance estimates non-financial State revenue, including NGEU funds, of 13.6% of GDP for 2023, 0.6% of GDP lower than AIReF's forecast of 14.3% of GDP (Assumption 1 of Table 6). In contrast, the Government's national accounting adjustments forecast is 1.1% of GDP, 0.3% of GDP higher than those calculated by AIReF (Assumption 2 of Table 6). Therefore, the higher national accounting adjustments considered by the Government partially offset the lower revenue estimate contained in the draft 2023 GSB (Assumption 3 of Table 6). This explains why, despite the significant difference in revenue estimates, the Government's deficit forecast is only 0.2% of GDP higher than that of AIReF.

TABLE 6. NON-FINANCIAL EXPENDITURE LIMIT CALCULATED BY THE MINISTRY OF FINANCE AND CIVIL SERVICE AND EXERCISE FOR APPROXIMATING THE CALCULATION OF THE NON-FINANCIAL EXPENDITURE LIMIT AND ITS IMPACT ON THE PROJECTED DEFICIT (% GDP)

		Assumption 1	Assumption 2	Assumption 3
	Ministry of Finance and Civil Service	Deficit resulting from AIReF revenue and GDP forecasts	Deficit resulting with AIReF forecast of NA adjustments and GDP	Deficit resulting from AIReF forecast of revenue, NA adjustments and GDP
1. 2023 deficit	3.2	2.7	3.5	3.0
2. Revenue forecast	13.6	14.2	13.7	14.2
3. National Accounting adjustments	1.1	1.1	0.8	0.8
4. Expenditure FS TAs	3.2	3.3	3.3	3.3
5. Special defence programmes	0.4	0.4	0.4	0.4
6. Non-Fin. Exp. Lim. (6)=(1)+(2)+(3)-	14.3	14.3	14.3	14.3

Note: The GDP used in assumptions 1, 2 and 3 is that estimated by AIReF

Source: Draft 2023 GSB and AIReF forecasts

NATIONAL ACCOUNTING ADJUSTMENTS

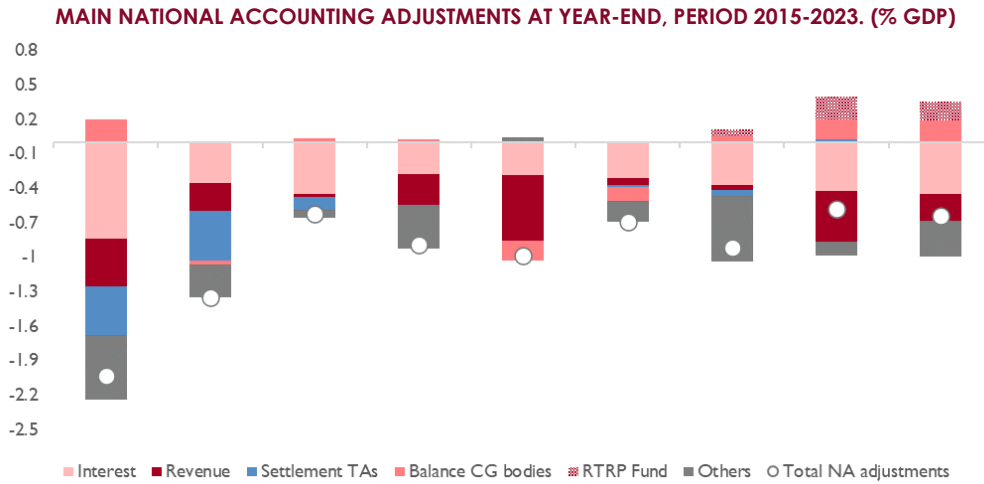
What are they?

These are the differences in the measurement of non-financial revenue and expenditure between budgetary accounting and national accounting. Therefore, their calculation makes it possible to convert the State's budgetary balance into the CG's net lending/borrowing in national accounting terms.

National accounting criteria differ from the budgetary methodology in various aspects. The main difference is in the criterion for recording expenditure and revenue such that while national accounting applies a general, economic accrual criterion, the budgetary accrual criterion is more closely related to a cash criterion. Furthermore, there are financial operations in the budget that are considered non-financial by national accounting and *vice versa*. Therefore, in the Budget these operations do not have an impact on the public deficit, but they do have an impact for national accounting purposes and *vice versa*. Finally, there are also differences in the subjective scope of application since while in national accounting the relevant thing is the economic activity carried out, in budgetary accounting the legal configuration of the entity prevails.

In recent years, the main national accounting adjustments were made in relation to interest, revenue, negative settlements of the territorial administrations resulting from the financing system¹³ and the balances of Central Government bodies.

¹³ This adjustment has been of major quantitative importance in previous years due to the negative settlements for 2008 and 2009, resulting from the Great Recession.



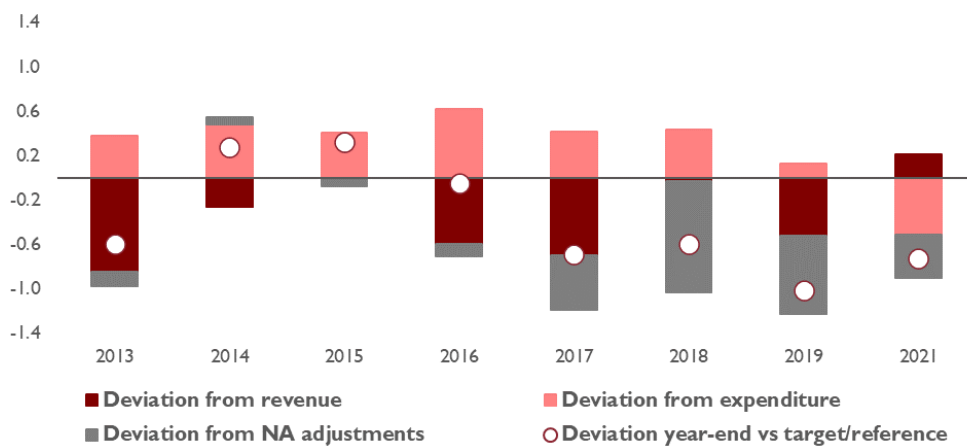
Source: Second EDP 2022 notification and AIRcF forecast for 2022 and 2023.

Why are they important?

Accounting adjustments are important insofar as they are a factor of possible deviation from the deficit target. The execution of the GSB may lead to a deviation in revenue and/or non-financial expenditure from those initially budgeted, which will result in a deviation from the target deficit. However, this deviation may also come from national accounting adjustments other than those initially expected.

Since the 2017 GSB, the accounting adjustments that might allow reconciliation of the budgetary balance with the deficit in national accounting terms are not published. From that point on, national accounting adjustments went from having little impact on the deviation from the deficit target to having a significant impact.

BREAKDOWN OF THE DEVIATION FROM THE DEFICIT TARGET. PERIOD 2013-2021, EXCEPT 2020 (% GDP)



Note: 2020 is not included, given the distortion in the data due to the exceptional nature of the pandemic.

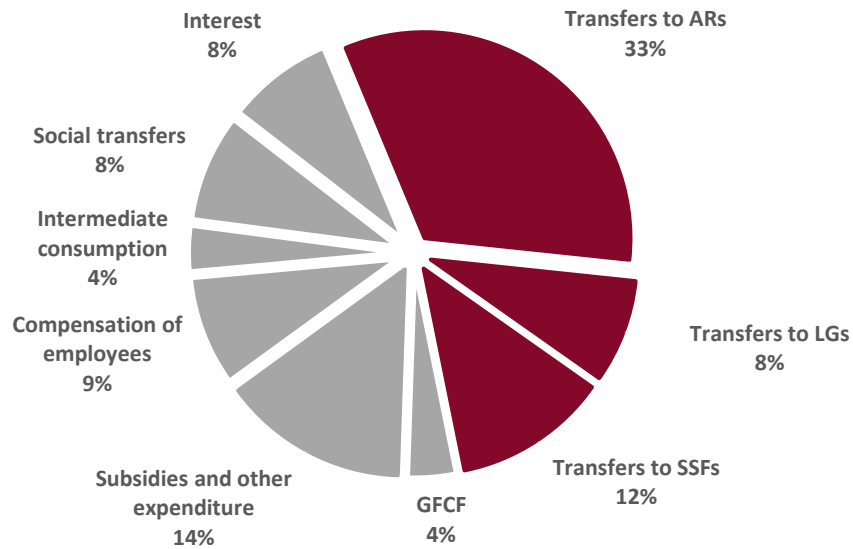
In order to prevent deviations in the achievement of the deficit target through national accounting adjustments, it is essential for them to be published in the GSB so as to provide transparency to these adjustments and allow appropriate oversight of their implementation.

4.4. Central Government expenditure

AIRcF forecasts that expenditure, excluding the RTRP, in 2023 will reduce its weight in GDP by 1.3 points, to 22.3%. This decrease is mainly due to the fact that while 2022 expenditure includes spending measures amounting to 0.9% of GDP to mitigate the effects of the energy crisis, the possible extension of all or part of these measures are not included in the 2023 GSB. This implies that all headings grow except for intermediate consumption and subsidies and other expenditure. Among those that grow the most are compensation of employees due to wage increases, interest as a result of the hike in interest rates and social benefits in cash as a result of the increase in civil servant pensions. If RTRP expenditure is taken into account, expenditure would amount to 24.1% of GDP in 2023, with a reduction of only 0.3 points compared with 2022.

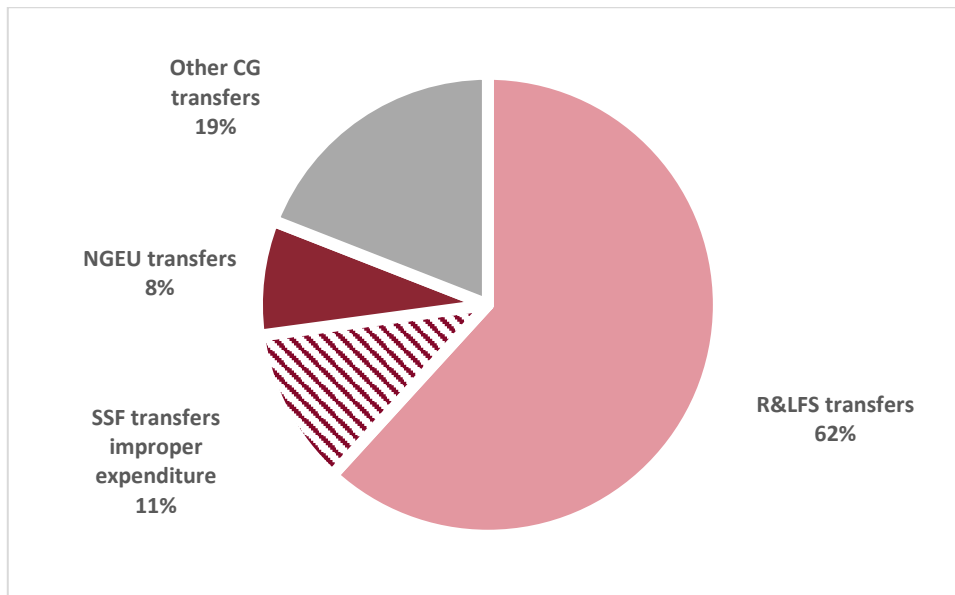
The largest expenditure of the CG is transfers to other GG sub-sectors, which account for 55% of the total in 2023. The largest component of this item is the transfers for the regional and local financing system, which rise by 10.2% for the ARs and 5.6% for the LGs in 2023. In addition, the State is increasing transfers to the SSF sub-sector as it is gradually taking on the financing of expenditure deemed “improper” as a result of the commitment assumed in the Toledo Pact. Another relevant factor explaining the importance of this expenditure is the channelling by the CG of a major part of the RTRP funds to other sub-sectors via transfers.

FIGURE 56. DISTRIBUTION OF NON-FINANCIAL EXPENDITURE OF THE CG 2023



Source: AIReF

FIGURE 57. BREAKDOWN OF THE COMPOSITION OF THE TRANSFERS OF THE CG 2023

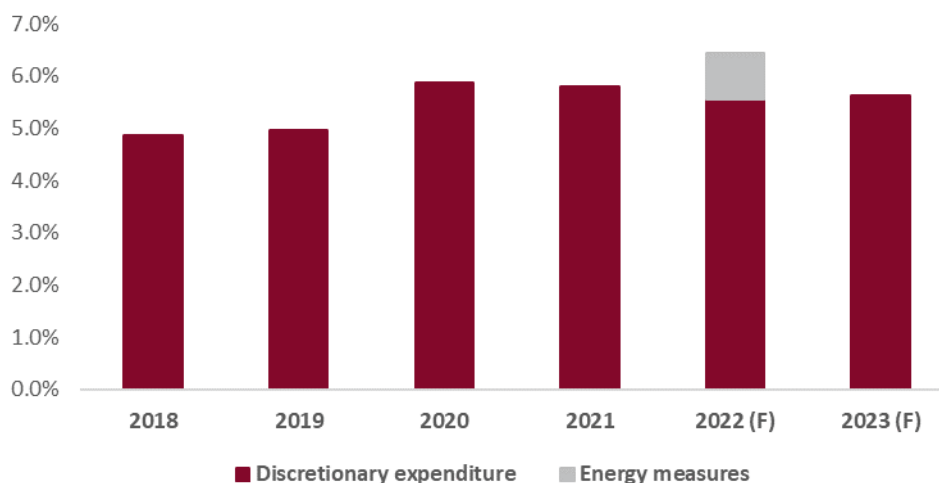


Source: AIReF

AIReF estimates that the discretionary expenditure of the CG will fall in 2023 by 0.8% of GDP compared with 2022. This fall can be explained, firstly, by the fact that in 2022 the Government adopted large discretionary spending measures to mitigate the effects of the energy crisis that are not incorporated into 2023 expenditure. The second explanation is the forecast increase in 2023 of non-

discretionary expenditure, such as interest, civil servant pensions and transfers for the regional and local financing system.

FIGURE 58. EVOLUTION OF CG EXPENDITURE WITHOUT GG TRANSFERS, INTEREST, CIVIL SERVANT PENSIONS AND EU CONTRIBUTION (% GDP)



Note: Does not include major non-recurring operations or the RTRP

Source: IGAE and AIReF

According to AIReF's estimates, compensation of employees will grow by 3.7% compared with 2022. This growth incorporates the improvement in public remuneration approved by the General Bargaining Committee of the Civil Service, which results in a fixed wage increase of 2.5% for 2023. AIReF also considers the additional increase of 0.5% conditional on the CPI, given that it expects that the sum of the 2022 Harmonised CPI and the leading September 2023 Harmonised CPI will exceed 6%, which will allow its application in October 2023 by means of a resolution of the Council of Ministers. However, it does not consider for 2023 the other additional 0.5% increase linked to nominal GDP in 2023 being greater than or equal to the 5.9% included in the economic outlook accompanying the 2023 GSB. This is because it will be measured in 2024 and, therefore, if this condition is met, it will be an expenditure affecting the compensation of employees in that year. In addition to the price increase, AIReF estimates a 1% increase due to the increase in the workforce and the expected wage drift. Finally, it should be mentioned that the growth in compensation of employees takes place on the vested compensation of 2022, which includes the new additional increase of 1.5%, which is added to the increase of 2% approved in the 2022 GSB.

AIReF estimates a fall of 0.1 points in intermediate consumption in 2023 to 0.8% of GDP, while the weight of social transfers in kind remains at 0.2% of GDP. The reduction in intermediate consumption, despite the increase in electoral spending expected for 2023, is mainly due to the fact that the intermediate

consumption for 2022 incorporates a large part of the increase in military spending approved by a resolution of the Council of Ministers on July 5th, 2022, with no equivalent increase for 2023. For their part, transfers in kind rise by 6.3%, although they maintain their weight as a proportion of GDP. This increase is driven by the rise in the price of sea and air transport tickets for non-mainland residents and higher expenditure on care for refugees, the amount of which has increased as a result of the war in Ukraine.

The draft GSB forecasts a growth in transfers between GG sub-sectors without the RTRP of 2.2%. As this increase is lower than expected GDP growth, their weight as a proportion of GDP falls to 12%. The increase in this item in 2023 is determined by the higher transfers to the territorial administrations from the regional and local financing system, as well as the increase in transfers to the SSF sub-sector to finance expenditure considered "improper" and spending on dependency care. This increase is partly offset by the disappearance of the extraordinary transfers granted to the territorial administrations in 2022 due to the VAT management system (SII) and the reduction in the transfer relating to the negative settlement of 2020, which will only be made to the LGs in relation to the part postponed to 2023, as well as the disappearance of the transfer to the SSFs for unemployment. As a new aspect, a significant part of the increase in the transfers granted to the ARs is the spending for primary care and mental health, amounting to €500m, and the school 4.0 programme, amounting to €300m.

Interest expenditure will increase by 6.4% in 2023, maintaining its weight in the 2% of GDP forecast for 2022. The increase in interest expenditure is due to the tightening of financing conditions caused by the interest rate hikes approved over 2022. However, the pass-through of interest rate increases will be slower due to the high duration of the debt portfolio (between eight and ten years).

AIRcF forecasts that Gross Capital Formation, without the RTRP, will remain at 0.7% of GDP in 2023. Gross Capital Formation growth is estimated at 10.2% compared with 2022, without taking into account the expenditure associated with the RTRP. One of the factors explaining this increase in national investment is the higher expected military spending in 2023. Regarding other increases in investment spending, AIRcF has incorporated them into its scenario with a level of execution lower than the historical average due to the difficulty in absorbing these investments plus those of the RTRP in the same year.

In 2023, expenditure on subsidies and other expenditure is expected to fall by 17.6% as the measures are not included in the GSB. The expected reduction is mainly in expenditure on subsidies, but also in other capital transfers. The former as a consequence of measures related to the energy crisis and Ukraine approved in 2022 and largely recorded as expenditure on subsidies, with no

equivalent in 2023 except for the maintenance of free multi-journey tickets which have been included in the draft 2023 GSB. At any event, the evolution of this item may change if new measures are adopted along the lines of the previous ones. As for the latter, due to the lower expected expenditure in 2023 resulting from non-recurring operations, especially due to the impact in 2022 of court rulings such as that of Telefónica for an estimated value of €1.7bn and the expected allocation of the standardised guarantees of the ICO Ukraine guarantee line for €600m.

Within the CG, a State deficit of 3.2% of GDP and a surplus for CG bodies of 0.2% of GDP is estimated. Without taking into account NGEU Funds, for the State, which receives approximately 80% of the revenue of the sub-sector, revenue in national accounting terms is expected to rise by 0.1% in 2023. The revenue of the Bodies is expected to grow by 1.9%, with current revenue rising by 2.1% and capital revenue by only 0.9%. Regarding expenditure, an increase of 0.3% is expected for the State in 2023, which, above all, is marked by the absence of energy measures in 2023 and, in the opposite direction, by the increase in expenditure on interest, civil servant pensions and transfers of the territorial financing system. For its part, the estimated increase in expenditure for the CG bodies stands at 0.4%, slightly higher than that of the State, given that the impact of the absence of energy measures in 2023 affects the bodies less than the State.

According to AIReF's forecast, eligible expenditure for the purposes of the expenditure rule would fall in 2023 by around 0.8% compared with 2022, but would rise by around 7% if the measures were extended. One of the main reasons for this reduction is the absence of temporary measures to combat the energy crisis in the 2023 GSB. This results in a fall in eligible expenditure in 2023 compared with 2022, which does contain these measures for an amount equivalent to 0.9% of GDP. If we deducted these temporary expenses, the eligible expenditure would rise by around 7%. Another factor contributing to the reduction in eligible expenditure in 2023 is the fact that it does not include some spending rises in 2023, such as interest and transfers due to the regional and local financing system. In addition, this reduction could have been greater were it not for the expected revenue decrease in 2023 due to permanent tax reforms that, for the purposes of calculating the rule, would increase eligible expenditure in 2023 by 0.1% of GDP. Finally, it is important to bear in mind that RTRP and REACT-EU expenditure falls outside the expenditure rule.

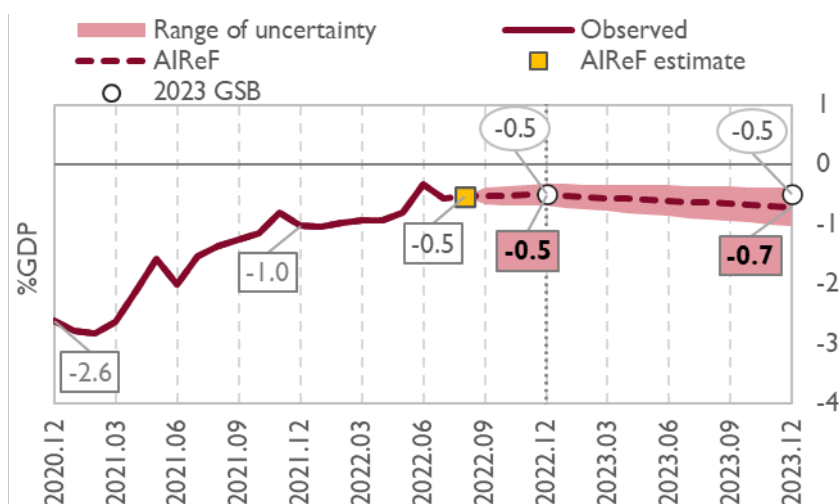
4.5. The 2023 GSB of the Social Security Funds

AIReF estimates a deficit of 0.7% of GDP in 2023 for the Social Security Funds (SSFs), 0.2 points above the Government reference rate, after closing 2022 with a deficit of 0.5% of GDP. The increase in the deficit in 2023 is mainly explained by the increase in pensions in line with the 2022 CPI, which AIReF now estimates at 8.9%. This increase in expenditure is mitigated by the increase in revenue, both from contributions due to the entry into force of the Intergenerational Equity Mechanism and from transfers due to the decisions taken in the Toledo Pact.

The weight of revenue over GDP will increase by 0.2 points in 2023, to 16.2%, due to the impact of the entry into force of the Intergenerational Equity Mechanism and the increase in the maximum contribution bases. In addition, transfers rise in 2023 due to the resolution of the Toledo Pact aimed at financing the “improper” expenses of the SSFs, which implies a transfer of the structural deficit from the Social Security to the CG.

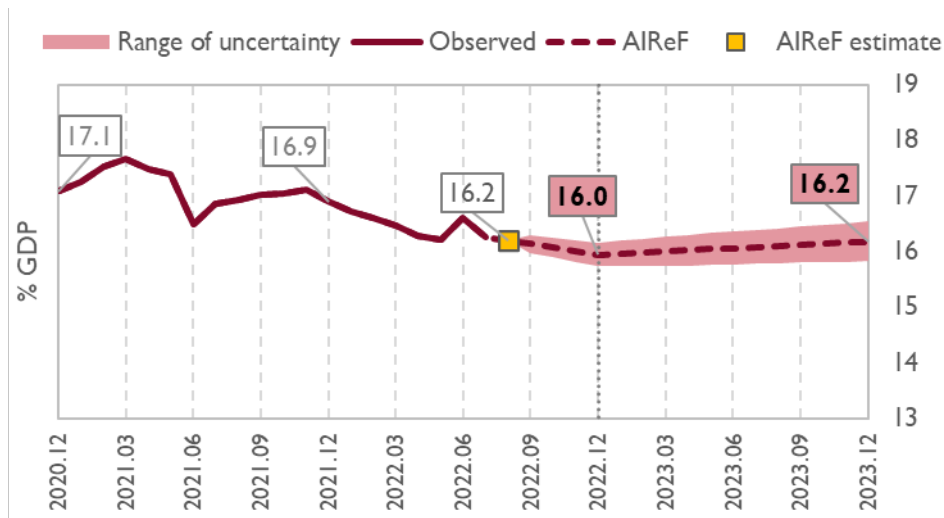
Expenditure increases its weight over GDP by 0.4 points in 2023, to 16.9%, mainly due to the increase in pensions in line with the CPI of the previous year, estimated at 8.9%. This decision leads to pension expenditure rising by 0.6 points of GDP in 2023. This is mitigated by the reduction in expenditure on temporary incapacity due to COVID-19 and due to the denominator effect on other items.

FIGURE 59. EVOLUTION OF THE BALANCE OF THE SOCIAL SECURITY FUNDS



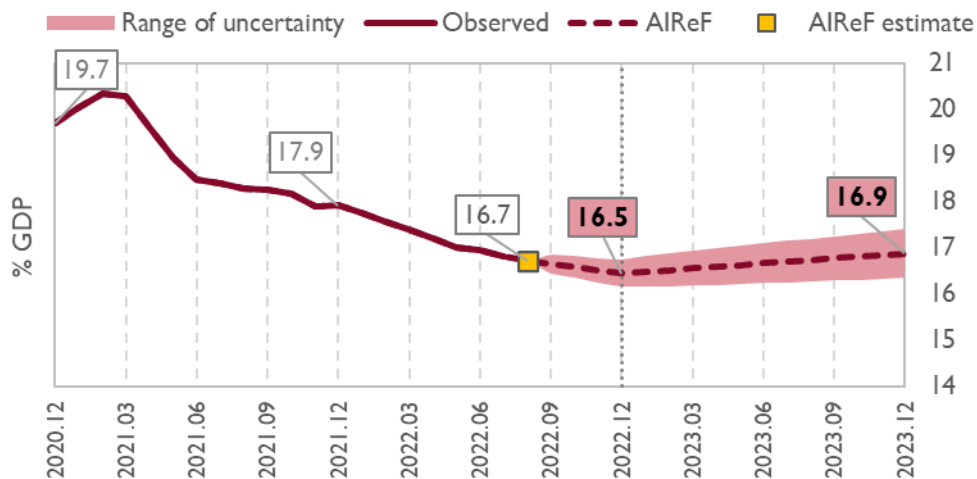
Source: AIReF, IGAE, Social Security and SEPE

FIGURE 60. EVOLUTION OF THE REVENUE OF THE SOCIAL SECURITY FUNDS



Source: AIReF, IGAE, Social Security and SEPE

FIGURE 61. EVOLUTION OF THE EXPENDITURE OF THE SOCIAL SECURITY FUNDS



Source: AIReF, IGAE, Social Security and SEPE

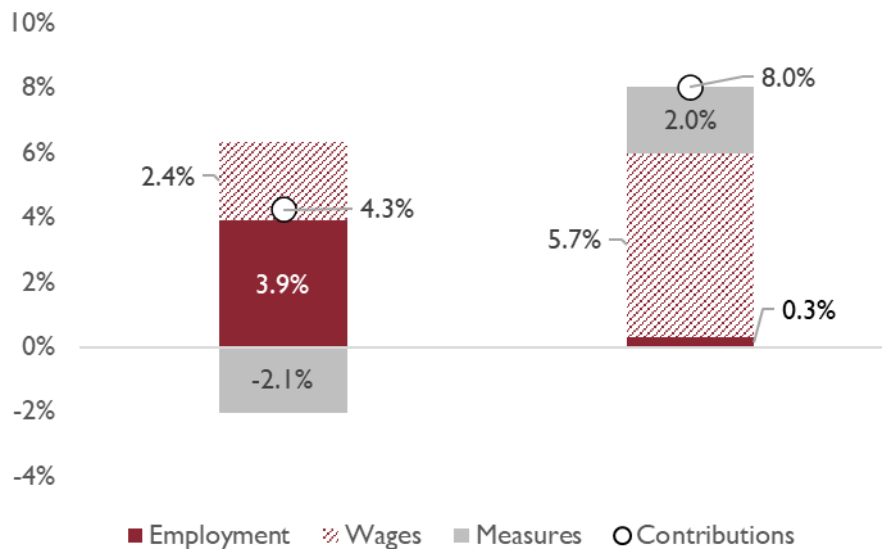
4.6. Evolution of Social Security revenue

AIReF estimates that social contributions in national accounting terms will rise by 8% in 2023 to reach 13.1% of GDP, from a weight of 12.9% in 2022. The 2023 GSB indicates a growth rate in Social Security contributions higher than that estimated by AIReF, but the combined weight of SSS and SEPE contributions in 2023 would be 0.2 points below that estimated by AIReF. This is due to the fact that the rate is estimated with respect to what was budgeted in the 2022 GSB, not the execution forecast. AIReF considers that the final execution will be greater than that budgeted the previous year. AIReF includes both the impact of the Intergenerational Equity Mechanism and the increase in the

contribution bases in its projections. The assessment of the impact of both measures is in line with that of the Government.

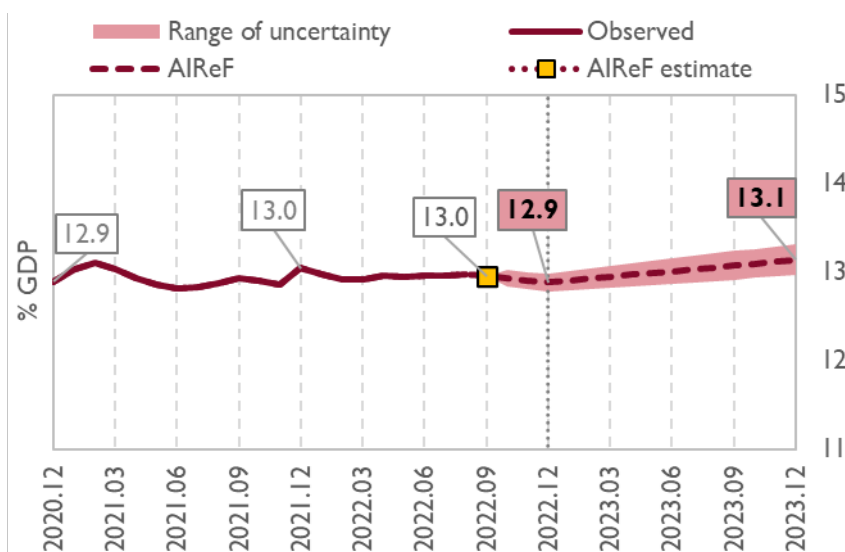
The increase in contributions in 2023 is mainly based on the increase in wages and the measures adopted. While in 2022 both employment and wages explain the growth of contributions, 3.9 points due to employment and 2.4 points due to wages, with the measures having a negative impact, in 2023 a very small contribution of employment is expected, with almost all growth due to wages and the approved measures. Employment remains the key driver of the recovery in 2022, while the removal of COVID-19 measures takes its toll on the growth of contributions. For 2023, the expected slowdown in real growth results in the growth in contributions coming from wages, affected by inflation, and the approved measures. The measures for both years include those approved prior to the crisis and in the 2021 and 2022 GSBs, as well as the removal of measures aimed at mitigating the effects of the pandemic. The former include the increase in the contributions of non-professional carers, beneficiaries of the allowance for people over 52 years of age, the impact of the rise in the Minimum Living Income on total contributions and the increase in the contribution rate and minimum base of self-employed workers. For 2023, the entry into force of the Intergenerational Equity Mechanism and the increase in the maximum contribution bases are also included.

FIGURE 62. BREAKDOWN OF GROWTH IN SOCIAL CONTRIBUTIONS



Source: AIRcF, IGAE and Social Security

FIGURE 63. EVOLUTION OF THE CONTRIBUTIONS OF THE SOCIAL SECURITY FUNDS



Source: AIReF, IGAE, Social Security and SEPE

This evolution does not affect the various agents of the Social Security Funds equally. The SSF deficit has fallen by 0.5 points of GDP in 2022, with around half of the reduction corresponding to the SSS and the other half to the SEPE. Proportionally, the SEPE reduces its deficit to a greater extent, as a result of both a reduction in the cost of COVID measures and the positive evolution of the labour market. For 2023, the deficit rises by 0.2 points, which fully corresponds to the SSS mainly due to the increase in pensions, with the SEPE slightly improving its balance.

TABLE 7. BALANCE OF THE SOCIAL SECURITY FUNDS BY AGENT (% GDP)

	2021	2022	2023
SSFs	-1.0	-0.5	-0.7
SSS	-1.1	-0.9	-1.1
SEPE	0.1	0.3	0.4

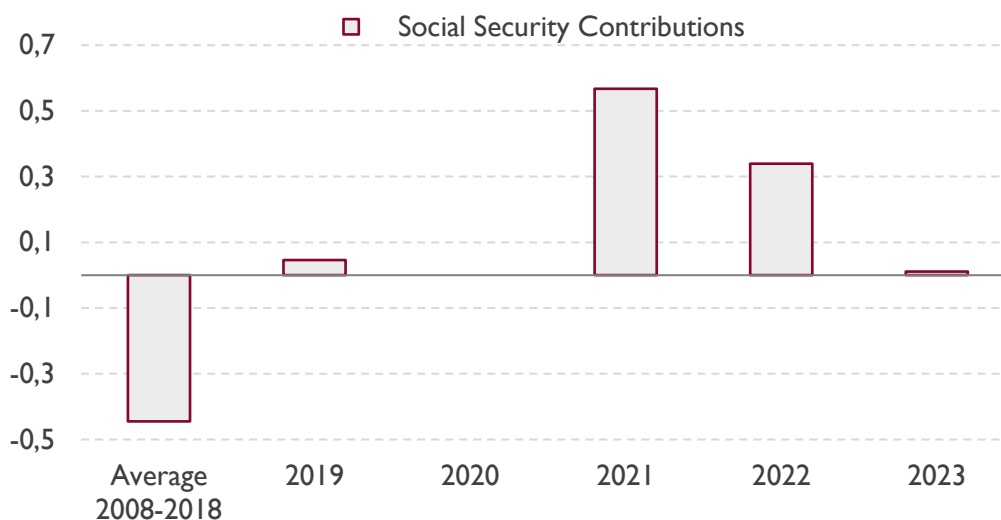
Source: AIReF, Social Security and SEPE

Deviations in Social Contributions from the Budget

The social contributions of the SSS in 2023 will record a slightly higher amount than forecast in the draft GSB by around €200m according to AIReF's estimates. This deviation, apart from being positive, is much lower than the average negative deviation of over 0.4 points of GDP for the period 2008-2018. This maintains a trend of positive deviations that began in 2019, especially the deviation of over five points in 2021. For 2022, AIReF, based on budget execution so far, estimates an upward error of more than 0.3 points. The

following graph shows the deviation or budgeting error, which is calculated by comparing the revenue forecasts included in the budget with the actual collection after deducting the positive or negative impact on collection of any legislative measures approved subsequent to approval of the GSB for each year.

FIGURE 64. DEVIATION: RECEIVED WITH RESPECT TO THE APPROVED BUDGET (*)



(*) Deviation = Revenue collected without the impact of measures approved subsequent to the GSB - Budgeted

Positive: Revenue collected > Budgeted

Negative: Revenue collected < Budgeted

Source: AIRcF and Social Security

4.7. Evolution of Social Security expenditure

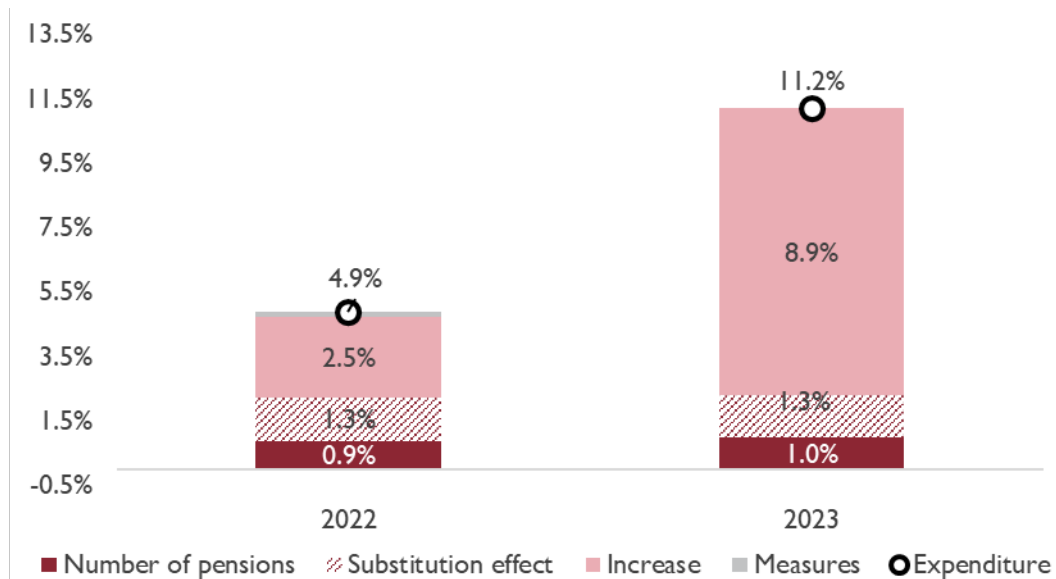
4.7.1. Social transfers in cash

AIRcF forecasts that social transfers in cash will reach a weight over GDP of 15.6% in 2023, after ending 2022 with a weight over GDP of 15.2%. After the reduction in 2022 of 1.4 points of GDP as a result of the reversal of COVID-19 measures, in 2023 there will be growth of 8.3%, 0.3 points of GDP. This heading includes three types of measures: firstly, the impact of the measures taken since 2020 due to COVID-19, which will, as they disappear, affect both 2022 and 2023; secondly, that of other expenditure measures approved since 2019 but which extend their effects to 2022, the measures included in the 2022 GSB and the measures announced to enter into force in 2023. Noteworthy among the former is the removal in 2022 of unemployment benefits linked to the job-retention schemes and the benefit for cessation of activity and the disappearance in 2023 of expenditure on temporary incapacity for work,

which are the COVID-19 crisis measures that account for the highest expenditure. With regard to the 2019 measures, a residual effect in 2022 of unemployment benefit for people over 52 years of age is expected. The measures approved in the 2022 GSB that are included are the increase in the IPREM (Public Multiple-Effect Income Indicator) by 2.5% and the increase in minimum and non-contributory pensions and the Minimum Living Income (MLI) of 3%. The latest measures announced include the rise in the MLI to the rate of inflation in 2022 and the rise in the IPREM by 3.6%.

AIRcF estimates a 11.2% increase in pension expenditure in 2023. This figure is identical to that presented in the 2023 GSB for the growth of contributory pensions. AIRcF estimates growth of 4.9% for 2022 as the number of pensions will rise by 0.9% instead of the 1% previously considered due to a combined effect of the increase in deaths due to heat waves and a reduction in new people claiming over the year, which perhaps reflects a certain effect of the pension reform. The substitution effect remains at 1.3% while the increase was 2.5%. The increases in non-contributory and minimum pensions included in the 2022 GSB, as well as the temporary rise in non-contributory pensions of 15% approved in RDL 6/2022 and RDL 14/2022 are included as measures. For 2023, the increase will be based on the CPI of the previous year, as approved in the pension reform, so it would stand at 8.9% according to AIRcF's forecasts. For 2023, AIRcF initially estimates growth in the number of pensions (1%) and a substitution effect (1.3%) resulting from our pension expenditure projection model.

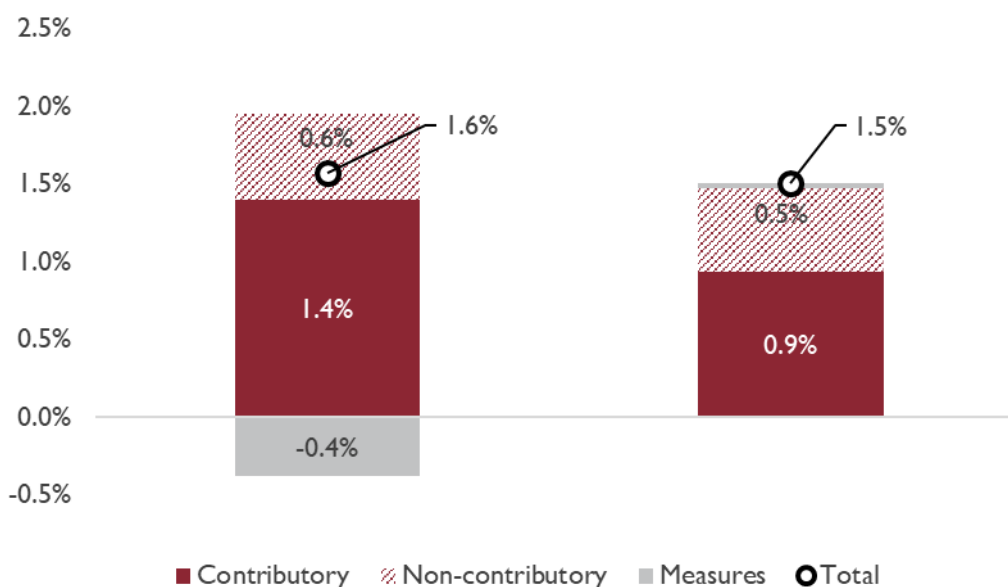
FIGURE 65. GROWTH IN PENSION EXPENDITURE. AIREF PROJECTIONS (% CHANGE)



Source: Social Security and AIRcF

Unemployment benefits fall from 2.2% of GDP in 2021 to a weight of 1.6% of GDP in 2022 and 1.5% in 2023, 0.1 points lower in 2022, but in line with the figure published in the 2023 GSB for that year. The decrease in 2022 is mainly due to the virtual disappearance of the cost of job-retention schemes. In addition, it also includes non-extraordinary measures approved prior to the crisis, such as the subsidy for people aged over 52 and the increase in the national minimum wage. Finally, the cost of the measures included in the GSB for both years has been included, specifically the increase in the IPREM of 2.5% in 2022 and 3.6% in 2023. The estimate for 2022 is based on the budgetary execution of the SEPE. For the remaining months of the year, assumptions are made on the evolution of the coverage rate and the average benefit for contributory and non-contributory benefits. For 2023, the trend is considered to be in line with AIReF's forecast for unemployment. This estimates that employment will remain somewhat stagnant and therefore the reduction in the weight of unemployment is mainly due to a denominator effect.

FIGURE 66. EVOLUTION OF UNEMPLOYMENT EXPENDITURE % OF GDP. AIReF'S FORECASTS (% CHANGE)



Source: SEPE and AIReF

The other items under this heading are also affected by the removal of the COVID-19 measures, with their weight falling by 0.2 points in 2023. The reduction is mainly due to the disappearance in 2023 of the expenditure on certain measures associated with the health crisis. In particular, expenditure on Temporary Incapacity for Work, which includes the cost of sick leave due to infection and quarantine of the COVID-19 virus. In addition, this heading includes the Minimum Living Income (MLI), and AIReF also includes its increase in line with the CPI as provided for in the 2023 GSB.

4.7.2. Other expenditure

AIRcF considers that other expenditure of the Social Security Funds will not change its weight over GDP in 2023. This means that AIRcF considers that, following the disappearance of the exemptions of contributions for job-retention schemes and the benefit for the cessation of activity, subsidies return to their pre-pandemic weight over GDP.

4.8. Impact of the measures on the General Government accounts

The GSB does not include the extension of measures to mitigate the consequences of the energy crisis for 2023. It does however contain certain permanent and temporary revenue measures. The price spiral caused by the energy crisis has led the Government to adopt three packages of revenue and expenditure measures approved during 2022 to address estimated inflation amounting to €15.77bn, which run until December 31st, 2022. The Government has announced the possibility of an extension for 2023 of all or part of these measures for a period also to be defined. This situation undermines the forecasts and the analysis of the public accounts to the extent that they do not include the higher expenditure or lower revenue that will occur, even though their amount remains unknown for the time being. In addition, the adoption of new measures with respect to those of 2022 cannot be ruled out.

4.8.1. Revenue measures included in the 2023 draft General State Budget.

The revenue measures included in the GSB will add 0.2 points to the weight of revenue over GDP in 2023. The positive impact is due to the establishment of the temporary levies on the profits of the financial and energy sectors, due to the structural measures approved in the 2022 GSB¹⁴ that will have an impact on the revenues of 2023 as this will be the year in which the settlements of Personal Income Tax and Corporate Income Tax relating to 2022 will be submitted and due to the entry into force of the new Tax on Single-Use Plastics from January 1st, 2023¹⁵. In the opposite direction, the new measures adopted

¹⁴ Measures adopted in the 2022 GSB:

- PIT: Reduction of the contribution limit to pension plans from €2,000 to €1,000
- CIT: Establishment of a minimum rate of 15% on the tax base and reduction to 40% of the rebate for the housing lease regime.

¹⁵ The new Tax on Single-Use Plastics begins to accrue in January 2023, with an initial effect on the April cash figure of the same year.

in the 2023 draft Budget will reduce PIT revenue as a result of the increase in the reduction in income from work and the minimum taxation and, marginally, due to the reduction to 5% of the VAT rate on female hygiene products. The impact of the increase in the Tax on Capital Income and the reductions for self-employed PIT and the Corporate Income Tax rate for small businesses are deferred to 2024, as this is the year in which the corresponding settlements relating to 2023 are submitted. It should be noted that the measures that will contribute most to the increase in revenue are temporary. In particular, the establishment of temporary levies on financial institutions and energy companies, which will jointly add €3.5bn to tax collection in 2023 and 2024. For their part, the impact of the limitation on offsetting losses in Corporate Income Tax and the new Solidarity Tax on large fortunes, valued at €2.44bn and €1.37bn, respectively, is almost entirely shifted to 2024 and 2025. Overall, the temporary revenue measures will reach their maximum impact in 2024 and will expire in 2026.

**TABLE 8. REVENUE MEASURES INCLUDED IN THE DRAFT 2023 GENERAL STATE BUDGET IN CASH
TERMS: AIREF ESTIMATE**

Revenue measures in cash terms: AIREF estimate									
Total annual impact									
Measure	Source	2023		2024		2025		2026	
		€m	% GDP	€m	% GDP	€m	% GDP	€m	% GDP
Structural revenue measures		-463	0,0	-1.232	-0,1	-1.232	-0,1	-1.232	-0,1
PIT		-1.141	-0,1	-1.712	-0,1	-1.712	-0,1	-1.712	-0,1
Reduction of the contribution limit to pension plans from 2,000 to 1,500.	22GSB	149	0,0	149	0,0	149	0,0	149	0,0
Increase in taxation on capital income	23GSB	0	0,0	204	0,0	204	0,0	204	0,0
Increase in reduction of work income and minimum taxation.	23GSB	-1.290	-0,1	-1.881	-0,1	-1.881	-0,1	-1.881	-0,1
Reduction in modules income and increase in reduction in ded. expenses	23GSB	0	0,0	-184	0,0	-184	0,0	-184	0,0
Corporate Income tax		421	0,0	129	0,0	129	0,0	129	0,0
Establishment of a minimum rate of 15% of the taxable income.	22GSB	400	0,0	400	0,0	400	0,0	400	0,0
Reduction to 40% of allowance under housing rental regime	22GSB	21	0,0	21	0,0	21	0,0	21	0,0
Reduction in the rate for small businesses	23GSB	0	0,0	-292	0,0	-292	0,0	-292	0,0
VAT		-24	0,0	-24	0,0	-24	0,0	-24	0,0
Reduction rate to 5% on female hygiene products	23GSB	-24	0,0	-24	0,0	-24	0,0	-24	0,0
OTHER		282	0,0	375	0,0	375	0,0	375	0,0
Tax on single-use plastics:	Law 7/2022	282	0,0	375	0,0	375	0,0	375	0,0
Temporary revenue measures		3.694	0,3	7.210	0,5	3.485	0,2	-39	0,0
PIT		-50	0,0	-99	0,0	-80	0,0	-39	0,0
Deductions for housing rehabilitation.	RDL 19/2021	-50	0,0	-99	0,0	-80	0,0	-39	0,0
CIT		244	0,0	2.439	0,2	2.195	0,1	0	0,0
Limitation on offsetting losses in consolidated groups.	23GSB	244	0,0	2.439	0,2	2.195	0,1	0	0,0
OTHER		3.500	0,1	4.870	0,1	1.370	0,0	0	0,0
Temporary Lev y Financial Institutions	In process	1.500	0,1	1.500	0,1	0	0,0	0	0,0
Temporary Lev y Energy Companies	In process	2.000	0,1	2.000	0,1	0	0,0	0	0,0
Solidarity tax on large fortunes	In process	0	0,0	1.370	0,1	1.370	0,1	0	0,0
TOTAL		3.231	0,2	5.978	0,4	2.253	0,2	-1.271	-0,1

Source: Government and AIREF estimates

4.8.2. Measures for energy crisis and Ukraine war

AIREF estimates the impact of the measures of the National Response Plan for the economic and social consequences of the Russian war, approved by the Government over the year, at 1.2% of GDP for 2022. AIREF's estimate of the impact of the measures to combat the energy crisis resulting from Russia's invasion of Ukraine includes those included in the three RDLs approved to date for this purpose, namely RDL 6/2022 of March 29th, RDL 11/2022 of June 25th and RDL 14/2022 of August 1st. The report on budgetary execution, public debt and the expenditure rule, published on July 15th, already took into account

the measures adopted in the first two RDLs, with an impact of more than 0.6 points of GDP. Subsequently, on August 1st, RDL 14/2022 was approved. This legislation approves new measures, including a supplement to the study scholarships and grants and the free use of Renfe's local- and medium-distance transport passes up to December 31st. These new measures entail an additional higher cost of almost 0.2 points of GDP. A further 0.4 points must be added to this due to various revenue measures approved so far this year.

For 2023, the Government has announced the adoption of new measures and/or the partial or total extension of those already approved this year, which could result in an additional deficit of 1.3% of GDP. Noteworthy among these measures due to its impact is the extension of the fuel price rebate, which would have an annual cost of €6.77bn, or almost 0.5 points of GDP. Only the free-of-charge nature of Renfe's local- and medium-distance transport passes has been included in the Budget.

With regard to revenue, the measures adopted to alleviate energy prices will result in a revenue reduction of around €4bn at the end of 2022 in national accounting terms. As with expenditure, these measures are intended to be temporary, established until December 31st, 2022. In 2022, reductions in the rate of VAT on energy products and reductions in the rate of the Special Tax on Electricity have been applied. In the case of VAT, the measures have intensified their effect over the year, with the extension of the reduction in the rate of electricity from 10% to 5% from July 2022 and the approval of the reduction in the rate of natural gas, firewood and pellets since September. Overall, the VAT reductions at the end of 2022 will result in a revenue reduction in national accounting terms of around €2.1bn. AIReF estimates that extending the current reductions in VAT on energy products by an additional year would have a negative impact of just over €3.1bn on revenue in 2023. With regard to the reduction in the rate of the Special Tax on Electricity (from 5% to 0.5%), revenue in 2022 will fall by almost €2bn, with a similar effect if extended to 2023, although part of its effects would be transferred to 2024.

**TABLE 9. IMPACT OF MEASURES IN RESPONSE TO THE ENERGY CRISIS IN NATIONAL ACCOUNTING
TERMS: AIREF ESTIMATE**

AIReF			
Impact of the CG measures adopted in response to the energy crisis			
Impact in National Accounting terms (€m)	Measures until 31-Dec -2022	Extension until 31-Dec -2023	
	2022	2023	2024
Revenue Measures	-4.051	-5.038	-172
VAT:			
Reduction of electricity rate to 10% (RDL 12, 17 & 29 /2021 & 6/2022) & to 5% since July (RDL 11/2022)	-1.955	-2.280	
Reduction in gas rate to 5% (RDL 17/2022)	-151	-806	
STs Electricity rate reduction (RDL 17, 29/2021 & 6/2022)	-1.944	-1.952	-172
Expenditure Measures	11.721	13.490	
Fuel rebate	4.531	6.774	593
Sectoral support	3.522	3.587	
Direct support for individuals	540	540	
Other support for individuals	1.928	2.588	
Support for refugees	1.200		
TOTAL	-15.772	-18.528	
TOTAL (% GDP)	-1,2	-1,3	
Other			
Tax on the Value of Electricity Production: Suspension (RDL 12, 17, 29/2021 & 6/2022)	-3.780	-3.762	-1.088

Source: Government and AIReF estimates

The suspension of the Tax on the Value of Electricity Production until the end of 2022 results in a reduction in revenue of about €3.8bn. The suspension of the Tax on the Value of Electricity Production is applied from the third quarter of 2021 until December 31st, 2022. The increase in electricity prices implies that the revenue for this tax would have risen from about €300m to around €1bn per quarter. Therefore, AIReF estimates its impact in 2022 at €3.78bn, and its possible extension to 2023 at €3.82bn. However, part of the impact of each year corresponds to the suspension of the previous year due to the transfer of the revenue of the fourth quarter to the cash figure of the first quarter of the

following year. It should be noted that the revenue from the Tax on the Value of Electricity Production is affected by the transfer from the Budget of the State Secretariat for Energy to the National Commission on Markets and Competition (Spanish acronym: CNMC), with a neutral effect on the deficit. However, in 2022 it has generated a negative impact of about €1.3bn, due to the transfer being made despite the suspension of the tax. For 2023, AIReF's forecasts on the Tax on the Value of Electricity Production again assume neutrality on the deficit.

4.9. Contingent liabilities and fiscal risks

In the current macroeconomic context, the risk of defaults on ICO guarantees, both from COVID and the war in Ukraine, remains and might have an impact in 2023 and/or the following years. Early materialisation in the CG deficit of the forecast potential losses over the life of the ICO guarantees (standardised guarantees) amounted to around €4.3bn in 2021 for the COVID guarantees. A total of €600m is expected to be allocated in 2022 for those granted as a result of the war in Ukraine. However, the risk of further allocations to the deficit remains as the actual amount of defaults exceeds the potential amount. In this regard, high inflation and the expiry on June 30th of the grace period for loans heightens the risk of defaults, which would be partly offset by the extension of the maturity of the guaranteed loans, as well as by the recent reform of the bankruptcy law, which includes mechanisms to avoid insolvency proceedings or minimise their impact.

In addition, there remains a risk that a worse macroeconomic scenario than that considered in the fiscal projections will materialise and affect the 2023 deficit. The macroeconomic scenario underpinning the 2023 deficit forecasts remains subject to a great deal of uncertainty. In addition to the persistence of problems related to bottlenecks in manufacturing production and in logistics and the increase in commodity prices, there is also inflation, the rise in interest rates, the worsening of the purchasing power of households and uncertainty as a result of the escalation of geopolitical tensions with Russia resulting from the war in Ukraine. This high level of uncertainty regarding the macroeconomic scenario is compounded by the risk of a lower-than-planned pace of RTRP execution and by COVID-19, which, albeit to a lesser extent, remains a determining factor for the economic situation. All these elements remain key in the evolution of certain variables such as employment, wages, private consumption and gross operating surplus, which will affect the final path of tax revenue and contributions, as well as unemployment and interest expenditure, with an impact on the deficit for the year.

In addition, there are other fiscal risks without a macroeconomic origin, mainly related to the enforcement of court rulings. According to the information published in the CSA account for 2021, it is worth highlighting the case of ACESA, which could amount to an additional €3.09bn on the compensation paid by the State in 2021 given the discrepancies regarding the final amount claimed. In addition, the dispute over renewable energies remains open. In this regard, although the Government considers it unlikely that it will have to compensate the applicant companies, the amount of the unfavourable awards totals €1.18bn, and therefore it is a risk that remains alive and that may affect the accounts for the coming years.

Risks whose amount is repeatedly unknown and for which no information is provided may also have an impact on the 2023 accounts. On the one hand, there is no information on the possible impact of the risks assumed by public-private partnership contracts or loans granted by General Government subsectors that might prove to be doubtful receivables. On the other hand, the investments in defence modernisation programmes are underway and involve a significant volume of expenditure with a major impact on the deficit. This amount is now more relevant because of the Government's commitment to NATO to increase military spending to 2% of GDP by 2029. However, no information is published on the planning of these military deliveries and their impact on the public deficit.

Therefore, more transparency would be desirable in relation to contingent liabilities that may affect the accounts for 2023 and following years. The GSB should have a section with complete, up-to-date and quantified information on the main contingent liabilities that might have a significant impact in the year to which they refer. This information should also be completed with reference to the risks that have already materialised, their allocation over time and their final impact on the deficit so as to monitor these risks, which, as shown in practice, have a very significant impact on the public accounts.

5. EVALUATION OF COMPLIANCE WITH THE FISCAL RECOMMENDATION. GOVERNMENT DEBT, RECENT EVOLUTION AND PROJECTIONS

5.1. Evaluation of compliance with the fiscal recommendation

Activation of the escape clause, both in the field of national legislation and the Stability and Growth Pact, temporarily suspends fiscal rules, but not the supervision of fiscal policy, which must continue to ensure that its design and planning are governed by a series of principles. The Communication of the European Commission “Fiscal policy guidance for 2023”, published on March 2nd, 2022, established five principles. In particular, at a national level it established the need to: (i) ensure debt sustainability through a fiscal adjustment – gradual and high-quality – and preserving economic growth; (ii) foster investment and promote sustainable growth; (iii) promote medium-term fiscal adjustment strategies; and (iv) for high-debt countries, stabilise and reduce public debt ratios by controlling current expenditure net of discretionary revenue measures.

The Country-Specific Recommendations (CSRs) adopted this year set a quantitative reference for fiscal policy in 2023 for high-debt countries, such as Spain¹⁶. Specifically, it is recommended that Spain should limit the increase in nationally financed current primary public expenditure below medium-term potential growth. And this should be done taking into account the temporary and specific aid in favour of the households and companies most vulnerable to the rises in energy prices and the refugees caused by the war in Ukraine.

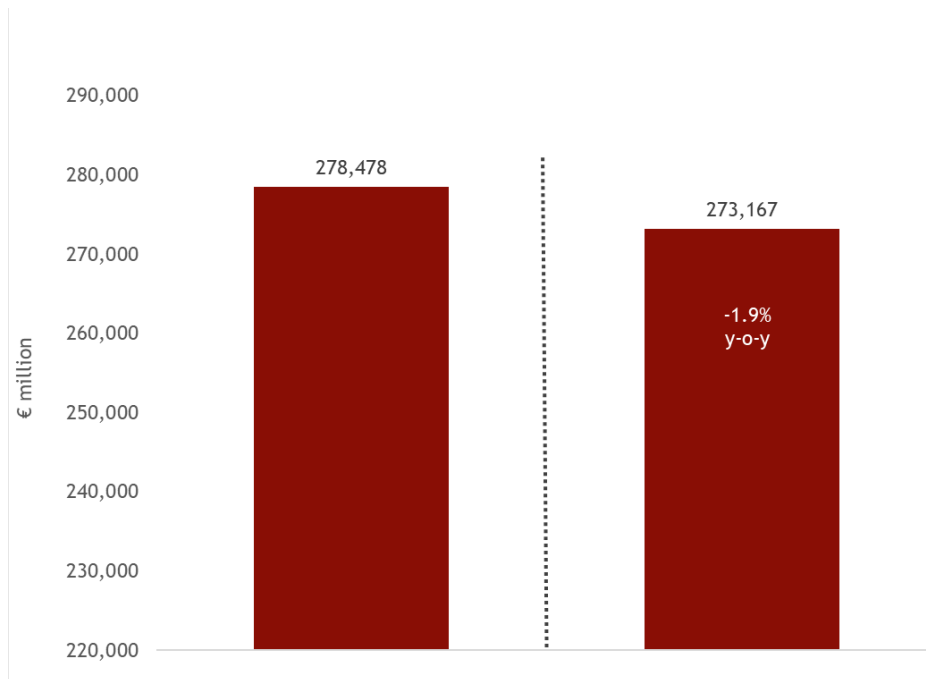
When assessing compliance with the CSR in fiscal matters in the current circumstances, the deflator chosen to calculate the current primary expenditure reference is crucial. For the purposes of this report, two possible GDP deflators are taken as a reference. On the one hand, in the past the European Commission took the contemporary deflator forecast at the time the CSRs were adopted to establish the medium-term nominal potential rate. On the other hand, in the current context of strong volatility of prices and the GDP deflator, it could be argued that it is necessary to take the most recent forecast as price pressures may also be passed on to Government expenditure and revenue. According to AIReF's estimates, these two deflator options yield a range for the evaluation of the CSR in 2023 of between 3.1% and 5.1%. Another possible option would be to use the medium-term reference for monetary policy, 2% inflation, which would result in a reference similar to the first option. In the absence of clarification by the European Commission on which deflator it will use in its assessment, AIReF's assessment uses both scenarios¹⁷.

With regard to the Central Government, AIReF estimates a drop in current primary expenditure net of revenue measures in 2023. In the absence of the approval of new measures or the extension of those already adopted, the relevant fiscal variable for assessing the fiscal CSR would fall by -1.9%. This change is clearly below the evolution of the Spanish economy's nominal potential GDP in the medium term.

¹⁶ See Council Recommendation on the 2022 National Reform Programme of Spain and delivering a Council opinion on the 2022 Stability Programme of Spain <https://data.consilium.europa.eu/doc/document/ST-9754-2022-INIT/es/pdf>

¹⁷ Medium-term potential GDP growth is approximated on the basis of the ten-year average centred on 2022 (0.9%) and the GDP deflators used correspond, firstly, to that forecast by AIReF for 2023 in the last report on the Stability Programme Update (2.3%) and that forecast by AIReF for 2023 at the time of publication of this report (4.3%).

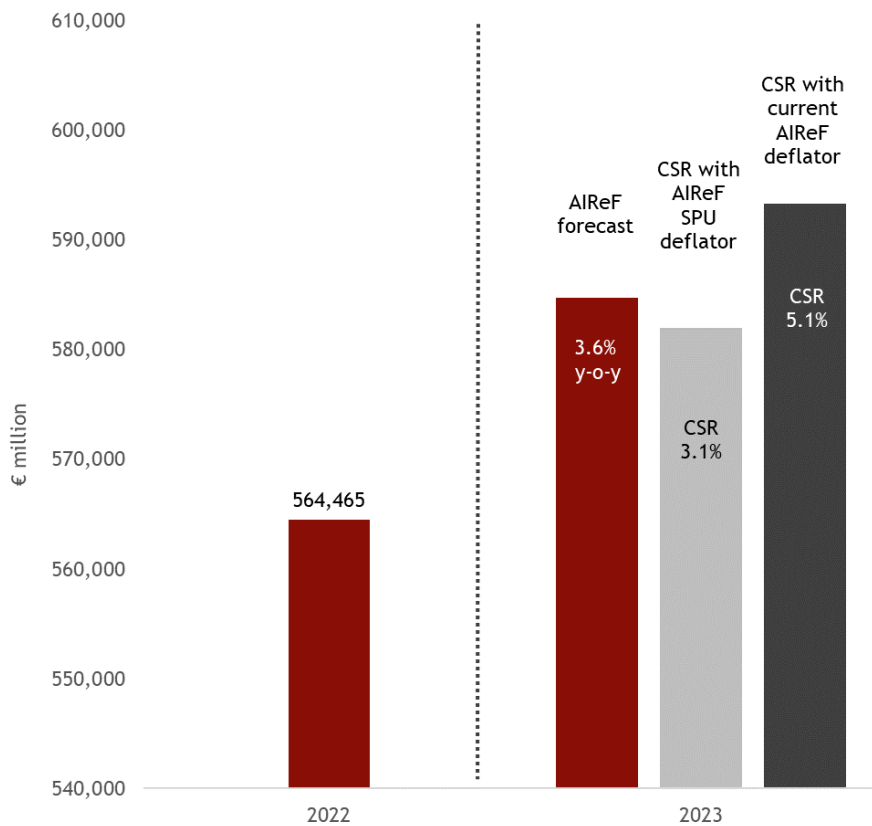
FIGURE 67. CURRENT PRIMARY EXPENDITURE NET OF REVENUE MEASURES, CENTRAL GOVERNMENT



Source: AIReF

For the GG as a whole, AIReF forecasts higher growth of current primary expenditure net of revenue measures in 2023. The current estimates project an increase of 3.6% that would fall within the range defined above for the evaluation of the fiscal CSR.

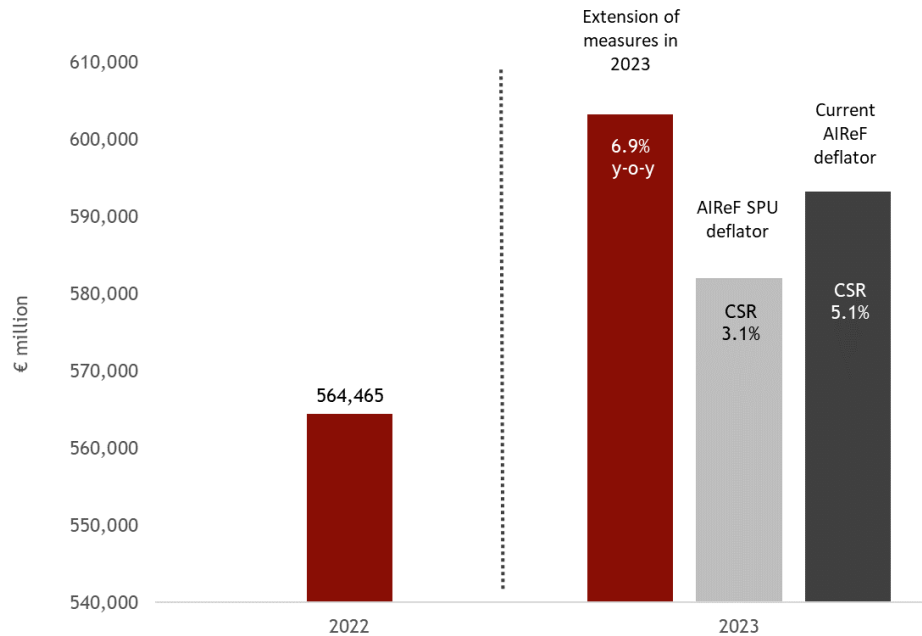
FIGURE 68. CURRENT PRIMARY EXPENDITURE NET OF REVENUE MEASURES. COMPARISON WITH THE FISCAL CSR, GG AS A WHOLE



Source: AIReF

However, if all the measures were extended for the whole of 2023, the evolution of current primary expenditure of the GG would be clearly above the range of compliance with the fiscal CSR. The additional cost of the extension of the measures would mean an increase in current primary expenditure net of revenue measures of almost 7% per year in 2023, which is well above the two references compatible with compliance with the fiscal recommendation.

FIGURE 69. CURRENT PRIMARY EXPENDITURE NET OF REVENUE MEASURES IN A SCENARIO OF EXTENSION OF MEASURES IN 2023. COMPARISON WITH THE FISCAL CSR, GG AS A WHOLE



Source: AIReF

In this context and in order to assess compliance with the recommendation, the targeted nature of the measures adopted must be analysed in order to determine that they are temporary and targeted towards the households and companies most vulnerable to energy price rises. In this regard, preliminary work by AIReF (which will be completed and published shortly) shows evidence that the measures adopted are managing to reduce the heterogeneous impact that inflation has among households of different income levels, showing a certain degree of targeting towards the most vulnerable.

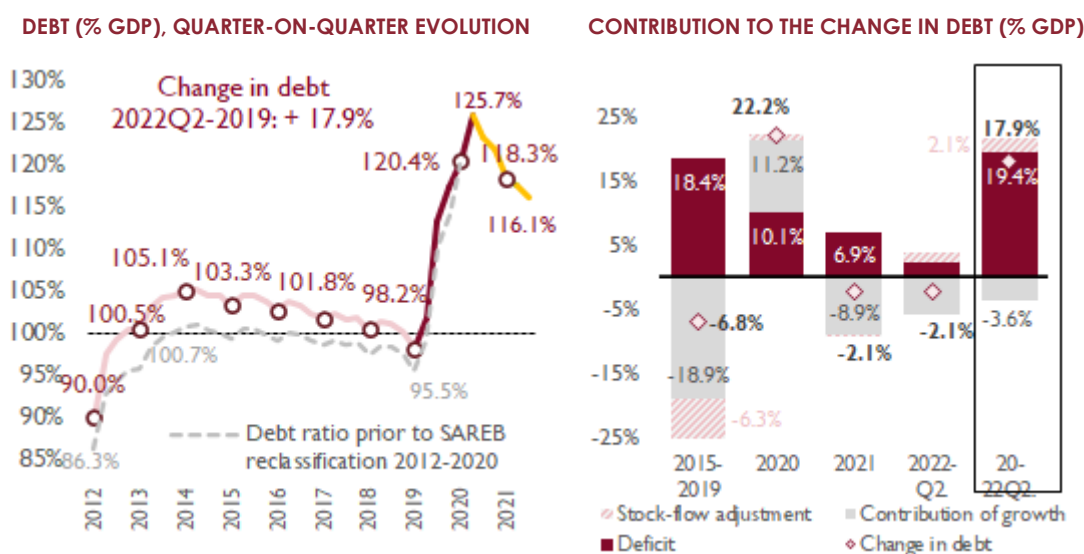
5.2. Public Debt: Recent evolution and projections

Following the sharp increase caused by the COVID-19 crisis, the debt ratio has recorded a period of five straight quarters of falls to stand at 116.1% of GDP in the first half of 2022. The debt-to-GDP ratio peaked at 125.7% in the first quarter of 2021, an increase of 27.5 points on the pre-pandemic level. Since that turning point, it has recorded five consecutive quarters of falls, which amount to a total of 9.6 points, bringing the ratio to 116.1% of GDP in June 2022. The net increase compared with the end of 2019 is 17.9 points.

This significant cumulative reduction in recent quarters is mainly due to the denominator effect, given the strong upturn in economic activity and prices. In nominal terms, public debt has continued to grow, adding €48.13bn in the

first two quarters of 2022, to reach a new all-time high of €1.48tn. GDP, the denominator of the ratio, has already stopped contributing negatively to the increase in the ratio resulting from the pandemic, with the public deficit causing almost all the change. At a sub-sector level, the largest increase in the debt ratio has taken place in the Central Government and the Social Security Funds. The debt ratio of the LGs has remained stable, while that of the ARs has recorded a slight increase.

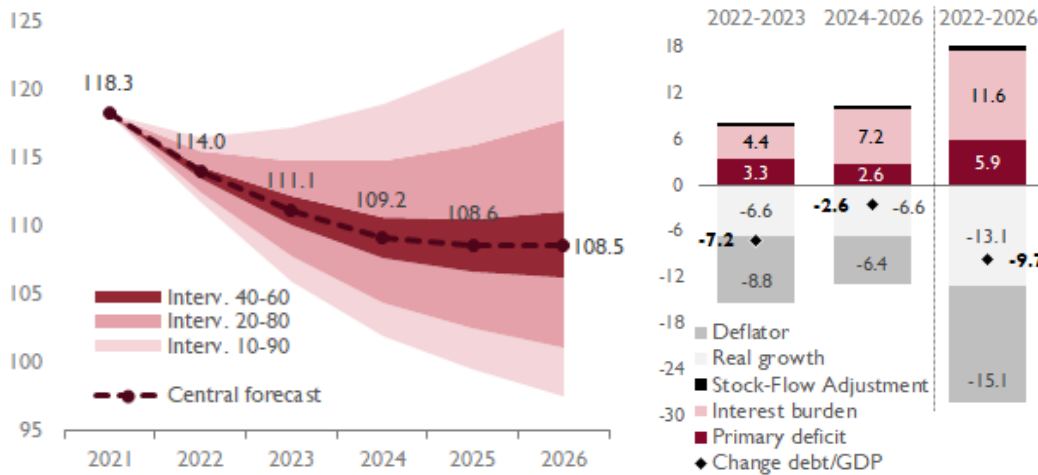
FIGURE 70. EVOLUTION OF DEBT AND CONTRIBUTIONS TO THE CHANGE



Source: Bank of Spain, INE and AIReF.

For 2023, AIReF estimates a reduction in the debt ratio of 7.2 points of GDP compared with the 2021 level. The reduction in the ratio will be mainly supported by the growth in nominal GDP (15.3 points), where the deflator will play a very significant contribution (8.7). The Government deficit will continue to contribute significantly to the increase in debt, with a financial burden that will rise in absolute terms, but will remain contained relative to GDP, despite worsening financing conditions, due to the sharp increase in nominal GDP.

FIGURE 71. DEBT FORECAST (% GDP) AND CONTRIBUTION TO CHANGE

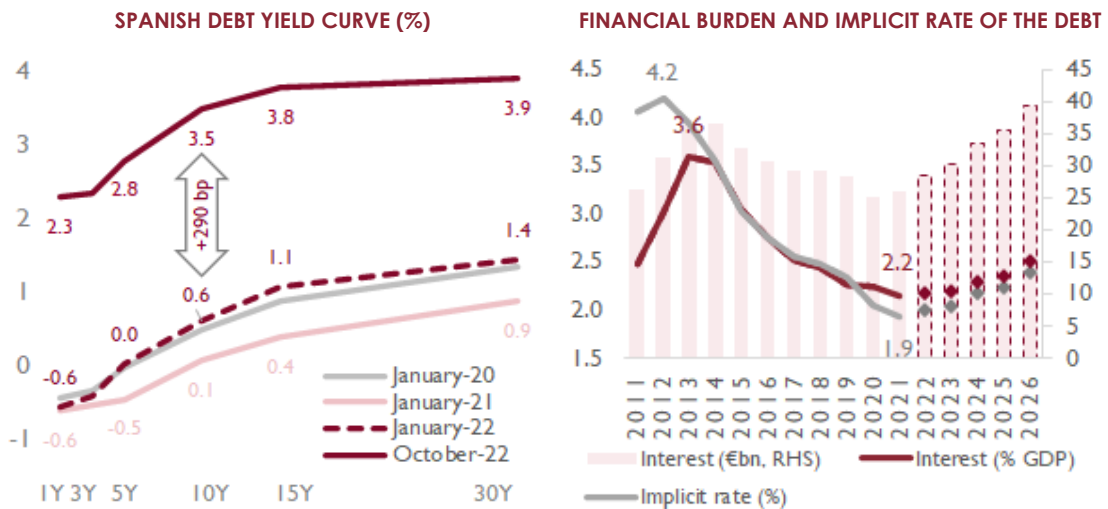


Source: AIRcF

The pace of reduction in the debt ratio is projected to slow down in the medium term for it to stabilise at 108.5% of GDP. The projection of a stabilised primary deficit of around 1%, together with decreasing nominal growth and an increasing financial burden, translates into a slowdown in the rate of reduction in the debt ratio, which in 2026 will be practically zero with a stabilised ratio of 108.5% of GDP

In 2022, there was a turning point in the evolution of debt financing costs. Despite higher borrowing needs stemming from the pandemic, the low yields recorded in all sovereign debt issuance maturities in 2020 and 2021 even placed the cost of the debt at its all-time low, with an average rate of new issues practically at zero. This low interest scenario has turned sharply in 2022, when central banks around the world have had to react with historic rate hikes in an attempt to curb much higher and more persistent inflation than initially expected. Debt markets have quickly incorporated this scenario with year-to-date rises of more than 250 basis points across all segments of the yield curve. The deterioration in financing conditions will gradually begin to have an impact on the evolution of the debt service, with interest and repayments that will increase. However, the increase in percentage of GDP will not be very significant in the short term.

FIGURE 72. DEBT INTEREST RATES AND FINANCIAL BURDEN



Source: Refinitiv, IGAE and AIReF

The significant stock of public debt resulting from the health crisis, on top of the previous high level, places the sustainability of public finances in the medium term in an extremely vulnerable position. The favourable evolution, both in the last year and in the short-term projection, of the denominator of the debt ratio should not mask the need to achieve a path of budgetary rebalancing in the medium term that allows greater fiscal space to be generated in an environment of great uncertainty and demographic pressures.

In this regard, the increase in expenditure that is structural, and therefore not linked to the need to adopt temporary measures to mitigate the effects of the successive crises, means a loss of the opportunity to make progress on the sustainability of public debt provided by higher revenue linked to an inflationary context. There is a clear need to adopt temporary and targeted measures to alleviate the successive crises that have been going on since 2020. However, there is an increase in structural spending that is reducing the chances of placing debt on a sustainable path in a context of tightening financing conditions that raise the opportunity cost of maintaining high levels of public debt.

6. RECOMMENDATIONS

6.1. New recommendations

On several occasions, AIReF has recommended that the Government should establish a medium-term strategy to provide fiscal guidance and realistically and credibly ensure the financial stability of the General Government. The current evolution of the economic, social and geopolitical context once again highlights the need and desirability of this strategy.

The energy crisis and the increase in inflation exacerbated by Russia's invasion of Ukraine have once again placed the global, European and Spanish economies in a difficult situation to manage, which has led to the adoption of extraordinary measures to mitigate the effects of the crisis. In addition, inflation has led to a tightening of monetary policy with the consequent increase in interest rates. Spain is particularly vulnerable to this due to its high level of public debt.

In this context, the GSB for 2023 has several weaknesses related to budget planning. Firstly, the General Budgetary Law states that the GSB will be framed in multi-year budgetary scenarios that constitute the programming of the activity of the State public sector. In a context such as the current one, it will undoubtedly be necessary to specify at least the overall amount of the measures that may be adopted in the event of various scenarios contingent on the macroeconomic evolution, clarifying the assumptions and limits under which certain measures will be activated. However, even in the short term

there are weaknesses, since the year-end 2022 forecasts, at least in terms of revenue, are not realistic, resulting in a higher deficit than forecast by AIReF in 2022. This means that an inadequate starting point is used for setting the 2023 fiscal policy. Secondly, as usual, no information is presented in national accounting terms, which makes it difficult to analyse its consistency with other elements of budgetary planning such as the Stability Programme and the Budgetary Plan. Finally, the GSB does not include the extension of the measures to mitigate the effects of the energy crisis. This is despite the fact that the macroeconomic scenario does not include the disappearance of the circumstances that led to implementation of the measures and the Government has announced that it will extend them even before the end of the processing of the GSB. While it is true that the changing economic and geopolitical situation requires flexibility, there may be ways in which this can be incorporated into budgetary planning.

The design of the fiscal strategy implies setting medium-term targets and goals and, at the same time, providing for actions and fiscal margins to achieve them. This planning should make it possible to reconcile the preservation of economic growth and the reduction in the structural deficit in order to bring public debt back to less vulnerable levels and ensure long-term sustainability. The necessary flexibility can be built in by defining the scenarios in which the measures to mitigate the crisis will be extended, as well as the elements that will support the reduction of the structural deficit when allowed by the economic situation.

The existence of planning allows for informed decision-making and provides certainty to economic agents. This would generate greater confidence in the Spanish economy, providing additional support for economic growth.

Within the budgetary process, the GSB is the main instrument of economic policy both from a design point of view and subsequently for its implementation and control and supervision of public sector performance. Since its creation, AIReF has been warning through its reports and opinions of the repeated shortcomings of the draft GSBs, which have been exacerbated this year.

More specifically, in line with AIReF's recommendation in the Report on the Stability Programme Update, it would have been appropriate for the GSB and the Budgetary Plan to have set out information on the conditions that must be met for the partial or total extension of the measures or, if not, their reversal. These conditions should refer, firstly, to the fulfilment of the initial objectives of each measure by means of an evaluation of its efficiency and effectiveness. Secondly, having verified that the measures meet the objectives for which they were adopted, it would be necessary to specify the circumstances, such

as activity level, energy prices or other reference variables, that would allow their withdrawal or lead to their extension.

However, it is still possible to incorporate this information and conditioning factors when the decision announced by the Government on the validity of the current measures or the adoption of additional measures takes place.

For this reason, AIReF **makes the following recommendations to the Government:**

- 1. In the next fiscal year, the draft General State Budget should recover its central role as an instrument of fiscal and economic policy and an element of design, planning, execution, control and supervision of the activity of the public sector***
- 2. It should incorporate and publish in any extension of the measures an evaluation of their effectiveness and efficiency and specify the conditions that trigger their extension or withdrawal both at the time of their approval and for the future. This will allow the measures to be integrated into a realistic and credible medium-term national fiscal strategy to achieve a sufficient deficit level to bring the debt back to more sustainable levels that will reduce the vulnerability of the Spanish economy***

6.2. Live recommendations¹⁸

In its report on the draft GSB for 2017, AIReF first alerted that no information had been included relating to national accounting adjustments, which made it impossible to determine whether the Budget was presented in line with the target set and it was recommended that the Ministry of Finance and Civil Service should urgently include information relating to said adjustments. This recommendation was subsequently repeated in the respective reports on the draft GSBs for 2018 to 2022, which were presented in the same terms.

In its reply, the Ministry of Financing Civil Service argues that the adjustments are published in line with EU legislation in the EDP (Excessive Deficit Protocol) notification that is made on a half-yearly basis.

¹⁸ This section sets out recommendations made in previous reports which, even though the Ministry of Finance and Civil Service has explained the reasons why it deviates from compliance with the recommendations, AIReF considers them important for achieving the effectiveness and credibility of fiscal rules and a robust fiscal framework, which it believes is not guaranteed by the usual system and practices. It therefore considers that these recommendations remain in force, they are “live recommendations” and it urges the Ministry of Finance and Civil Service to comply with them. Should this not be the case, it is not necessary to once again explain the reasons for deviating from them, unless they are no longer the same.

AIReF considers that it is not sufficient for national accounting adjustments to be published in EDP notifications, as these reflect adjustments in the implementation of revenue and expenditure, but not the adjustments forecast in the initial Budget, which is when the GSB is drawn up and approved. These adjustments during execution do not allow for the reconciliation of the approved Budgets with the stability target. Neither do they make it possible to know from the start the forecasts of the adjustments so as to allow them to be properly overseen, bearing in mind that the national accounting adjustments are a factor of possible deviation with regard to the deficit target.

As indicated in this report (see section on the non-financial expenditure limit), since the GSB does not include the accounting adjustments that would allow reconciliation of the budgetary balance with the deficit in national accounting terms, these adjustments have gone from having a fairly insignificant impact to having a notable impact on the deviation from the deficit target. In addition to this is the increase in the amount of the national accounting adjustments due to the existence of the RTRP funds, as a consequence of the adjustments necessary to record the RTRP revenue and expenditure in the national accounts.

Therefore, as the draft 2023 GSB once again fails to include national accounting adjustments, AIReF insists that these adjustments should be made transparent and included in the GSB. In addition to being a legal obligation (Articles 6 and 27 of the Organic Law on Budgetary Stability and Financial Sustainability), this is essential for determining whether the Budget is in line with the deficit target (or a reference as is the case of the 2023 GSB) and to prevent deviations from the target through the route of national accounting adjustments.

For this reason, **AIReF recommends:**

3. That the following be included in the draft GSB:

a. information on national accounting adjustments to reconcile the budget balance net borrowing or lending in terms of ESA 2010.

b. information on those entities which, although not of a public nature, are included for the purposes of ESA 2010 in the Central Government sub-sector and on the balance resulting from the net lending or borrowing of Central Government Bodies.

4. That the draft GSB for next year should include an initial budget in national accounting terms for the Central Government and the Social Security Funds.

6.3. Recommendations contained in the endorsement of the macroeconomic forecasts

On October 4th, AIReF published the endorsement of the macroeconomic forecasts of the 2023 GSB, which contained the recommendations that are set out below and which have already been forwarded to the recipient administrations.

- 1. Firstly, AIReF made a new recommendation for the Ministry of Economic Affairs and Digital Transformation to consult AIReF on the Report on the Situation of the Spanish Economy prepared by that Ministry as provided for in Article 15.5 of Organic Law 2/2012, of April 27th, on Budgetary Stability and Financial Sustainability.** This Law establishes that the Ministry of Economic Affairs and Digital Transformation will prepare an annual report, after consulting the Bank of Spain and taking into account the forecasts of the European Central Bank and the European Commission. This report is the basis for setting the budgetary stability and public debt targets which constitute the first step in the preparation of the draft General Government Budget, which have to be in line with these targets. This report, which is drawn up around June or July, contains an estimate of the multi-year economic scenario that serves as a basis for drawing up the GSB and which many administrations take as a starting point for preparing their own macroeconomic and budgetary scenarios. Therefore, AIReF should be able to issue its opinion given that two or three months later it has to endorse the macroeconomic scenario when the budgets are already drawn up.
- 2. AIReF reiterated to the Ministries of Economic Affairs and Digital Transformation and of Finance and the Civil Service the need to have more information on the budgetary and fiscal measures incorporated into the macroeconomic scenario in order to increase the rigour of the endorsement process.** The purpose of AIReF's endorsement is to verify that the fiscal scenario is based on realistic macroeconomic forecasts. Therefore, given the interrelations between the macroeconomic outlook and the fiscal scenario, AIReF believes that making an endorsement with greater rigour would require an understanding of the revenue and expenditure path that accompanies the Government's macroeconomic outlook and having greater detail on the fiscal measures that it intends to incorporate into the Budget.
- 3. Finally, AIReF reiterated to the Ministry of Economic Affairs and Digital Transformation the need for the process of endorsing the macroeconomic forecasts to be regulated by an agreement between the parties.** Most EU

countries have signed and published a “Memorandum of Understanding” between the Government and the independent fiscal institution in order to agree on the necessary procedures, deadlines and exchanges of information during the process of endorsing the macroeconomic forecasts. With the aim of making the process of endorsing the macroeconomic framework more transparent and efficient, AIReF reiterates its recommendation to the Government to regulate, in line with usual practice in peer countries, the flow and timing of the exchange of information through an agreement or “memorandum of understanding”.

The President of AIReF

A handwritten signature in blue ink, consisting of a large, stylized initial 'C' followed by the name 'Herrero Sánchez' in a cursive script.

Cristina Herrero Sánchez

ANEXO I. ERROR CORRECTION MODELS

LONG-TERM EQUATION	PRIVATE CONSUMPTION	SHORT-TERM EQUATION	
Gross disposable income of households and NPISHs (volume) (log)	0.4261	Gross disposable income of households and NPISHs (volume) (dlog)	0.0764
Household financial wealth. Volume (log)	0.0967	Total household credit. Volume (dlog)	0.1161
Household wealth. Volume (log)	0.0936	Employment rate (differences)	0.0059
Total household credit. Volume (log)	0.0511	Dummy 2013q1	-0.0104
Long-term interest rates Real (levels)	-0.0042	Long-term error	-0.2430
Constant	1.5492	Constant	0.0022
<i>Sample 2000Q1-2019Q4</i>			
INVESTMENT IN EQUIPMENT			
GDP Volume (log)	0.8623	GDP Volume (dlog)	2.7969
Relative unit labour costs (log)	-0.4220	Capacity utilisation (differences)	0.0078
Lending to resident companies. Balance. Real (log)	0.1779	Long-term interest rates Real (differences, lagged two periods)	-0.0069
Capacity utilization (levels)	0.0284	Dummy 2013q1_2014q2	0.0209
Effective corporate tax rate * Dummy before 2008q1	-0.1230	Dummy 2016q3	-0.0443
Effective corporate income tax rate * Dummy after 2008q1	-0.1351	Dummy 2018q2	0.0728
		Long-term error	-0.2309
		Constant	-0.0091
<i>Sample 1995Q1-2019Q4</i>			
INVESTMENT IN CONSTRUCTION			
Price of Square Metro Housing INE. Real (log)	0.1812	Price of Square Metro Housing INE. Real (dlog)	0.1310
Unemployment rate (levels)	-0.0219	Unemployment rate (differences)	-0.0135
Lending to households Housing. Volume (log)	0.1862	Lending to households Housing. Volume (dlog)	0.1659
Household financial wealth. Volume (log)	-0.1154	Dummy 1999q1	-0.0375
Construction Industry Climate Index (levels)	0.0005	Dummy 2009q2	-0.0365
Constant	3.9391	Dummy 2014q1	0.0463
		Dummy 2009q4 2012q2	-0.0210
		Long-term error	-0.4563
		Constant	0.0025
<i>Sample 1995Q1-2019Q4</i>			
EXPORTS			
World Trade in Goods. Volume (log)	0.6560	World Trade in Goods. Volume (dlog)	0.3996
Nominal effective exchange rate vs. developed countries (log)	-0.4452	Nominal effective exchange rate vs. developed countries (dlog)	-0.4782
Relative unit labour costs (log)	-0.7000	Imports of intermediate goods (dlog)	0.1378
Imports of intermediate goods (log)	0.3023	Dummy 2009q1	-0.0387
dummy after 2017q3	0.0513	Dummy 2012q3	0.0256
Constant	5.4213	Long-term error	-0.1663
		Constant	0.0041
<i>Sample 2000Q1-2019Q4</i>			
IMPORTS			
Demand for imports. Volume (log)	1.1113	Demand for imports. Volume (dlog)	1.7451
Relative price of imports (log)	-0.6512	Relative import price (dlog)	-0.2133
Constant	2.5005	Dummy 2009q1	-0.0552
		Dummy after 2010q3	-0.0072
		Long-term error	-0.1485
<i>Sample 2000Q1-2019Q4</i>			
PRIVATE EMPLOYEES			
GDP Volume (log)	1.8952	GDP Volume (dlog)	1.6044
Working age population. Total (log)	1.9914	Working age population. Total (dlog)	1.7721
Private capital stock (log)	-1.3290	Private capital stock (dlog)	-0.7545
Nominal compensation per private employee (log)	-0.1175	Nominal compensation per private employee (dlog)	-0.4674
Dummy 2009q1 2009q2	0.0313	Dummy 2009q1	0.0239
Dummy 2000q1 2000q3	-0.0178	Dummy 2009q1 2009q2	-0.0143
		Dummy 2008q1	0.0223
		Dummy 2014q2	0.0093
		Long-term error	-0.1654
<i>Sample 2000Q1-2019Q4</i>			
COMPENSATION PER EMPLOYEE. PRIVATE			
Headline CPI (log)	0.6510	Headline CPI (dlog)	0.2607
Productivity per employee (log)	0.2601	Productivity per employee (dlog)	0.2425
Salary per employee. Public (log)	0.2100	Dummy 2007q2 2007q4	0.0079
Effective rate of social contributions * Dummy after 2008q3 (levels)	0.0021	Dummy 2008q1 2008q3	0.0174
Unemployment rate * Dummy financial crisis	-0.0004	Dummy 2015q3 2018q2	-0.0050
		Long-term error	-0.2397
		Constant	0.0039
<i>Sample 1995Q1-2019Q4</i>			
GROSS DISPOSABLE INCOME OF HOUSEHOLDS AND NPISHs			
Compensation of employees Total: Nominal (log)	0.5158	Compensation of employees Total: Nominal (dlog)	0.6082
Gross Operating Surplus Households and NPISHs Nominal (log)	0.2720	Gross Operating Surplus Households and NPISHs Nominal (dlog)	0.2763
IRPF proxy rate (levels)	-0.0059	IRPF proxy rate (differences)	-0.0078
Different Social Benefits STK. Nominal (log)	0.1728	Different Social Benefits STK. Nominal (dlog)	0.1326
Constant	1.3199	Long-term error	-0.7003
<i>Sample 1999Q1-2019Q4</i>			
CORE CPI			
GDP Volume (log)	0.2925	GDP Volume (dlog)	0.0682
IVA effective rate (levels)	0.0229	Unemployment rate (differences)	-0.0002
Unit labour costs (log)	0.6308	IVA effective rate (differences)	0.0018
Dummy 2012q1 2012q4	0.0299	Dummy 2009q1 2010q2	-0.0044
		Dummy after 2013q2	-0.0034
		Long-term error	-0.0398
		Constant	0.0087
<i>Sample 1997Q1-2019Q4</i>			
HEADLINE CPI			
		Core CPI (dlog)	1.0651
		Brent in € = Brent * exchange rate €/\$/ (dlog)	0.0195
		Dummy 1999q2	-0.0082
		Dummy 2009q2	-0.0059
<i>Sample 1997Q1-2019Q4</i>			
GDP DEFLATOR			
		Headline CPI (dlog)	0.3263
		House Price INE. Nominal (dlog, lagged one period)	0.0801
		IPRI capital goods (dlog, lagged three periods)	0.7134
		Dummy12q4.	-0.0094
		Dummy13q1.	0.0138
		Dummy15q1.	0.0087
<i>Sample 2000Q1-2019Q4</i>			