Report on the draft budget and main budgetary lines of the General Government 2023:

Autonomous Regions and Local Governments

REPORT 52/22

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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 Budget and Main Budgetary Lines of the General Government (GG). To date, AIReF published a report on October 4th in which it endorsed the macroeconomic forecasts of the draft General State Budget for 2023 (GSB) and issued a second report on October 18th on the GSB, focusing on the Central Government (CG) and the Social Security Funds (SSFs) with a preliminary approximation of the fiscal situation of the GG. This report completes the analysis of the GG as a whole, including a medium-term scenario up to 2026, and of the Autonomous Region (AR) and Local Government (LG) sub-sectors. In addition, AIReF will also publish the individual reports of the ARs and the LGs that are subject to individual monitoring.

After presenting the draft GSB for 2023 on October 6th, the Government sent the 2023 Budgetary Plan to the European Commission on October 15th, in which, with the same macroeconomic scenario as the GSB, it presented two budgetary scenarios with the same reference deficit rate - 5% of GDP for 2022 and 3.9% for 2023. In theory, Scenario 1 would be aligned with the forecasts contained in the 2023 GSB and would not contain the extension of the measures adopted since 2021 to mitigate the effects of the energy crisis and the war in Ukraine. Scenario 2 would include a more realistic revenue forecast in 2022, new measures for 2022 and the extension of part of the existing measures for 2023. However, AIReF observes significant inconsistencies in the construction of the two scenarios that could stem from the fact that both scenarios share the same deficit forecast for both years.

AIReF's fiscal forecasts do not include any extension of the measures due to a lack of information on the matters both in the Budgetary Plan and in the GSB. Neither the GSB nor Scenario 1 of the Budgetary Plan reflect the extension of the measures. In contrast, Scenario 2 includes, in quantitative terms, new measures in both 2022 and 2023, but since the measures are not specifically

identified, it is not possible to incorporate them into AIReF's forecasts. Finally, AIReF's forecasts, as a new aspect with respect to the report of October 18th, include the new measures approved by Royal Decree Law 18/2022. Consequently, the comparability between the two scenarios, the budget figures and AIReF's forecasts is limited by the lack of homogeneity in their starting assumptions.

In addition, AIReF's macroeconomic and budgetary forecasts incorporate a medium-term vision up to 2026 that helps contextualise and understand the state of public finances. This medium-term vision is also what AIReF has been recommending to the different Regional and Local Governments as a framework for the development of their budgetary procedures.

The medium-term macroeconomic scenario

The macroeconomic scenario that serves as the basis for the preparation of this report exactly matches that published by AIReF on October 18th, both for 2023 and in the medium term, and that used on October 4th to endorse the Government's macroeconomic scenario that accompanies the 2023 GSB.

AIReF considers that the nominal GDP growth that has served as the basis for the preparation of the 2023 GSB and the scenarios of the Budgetary Plan is feasible as it is in the central range of AIReF's probability intervals. However, there is an inconsistency arising from the fact that the Government's macroeconomic scenario is not modified to take into account the macroeconomic impact of the various fiscal measures that are incorporated in Scenario 1 and Scenario 2.

On the other hand, AIReF considers that there are downside risks to the real growth expected by the Government, whose 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, AIReF estimates real growth of 4.4% in 2022 and 1.5% in 2023 and nominal growth of 8.2% and 5.9%, respectively.

Compared with AIReF's scenario, the Government's macroeconomic outlook includes significant growth in investment and in imports and exports, which is unlikely in the context of uncertainty, high energy prices and the deterioration of our main export markets. This is not adequately reflected in the technical assumptions of the Government's scenario. Furthermore, the Government's scenario sets out a slightly more favourable evolution of employment than AIReF's and estimates that wage increases remain moderate, which carries risks if workers try to recover part of the purchasing power lost in 2022.

In addition, AIReF considers 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, which pose downside risks to real GDP growth and upside risks to inflation.

Budgetary scenario

AIReF estimates a deficit of 3.3% of GDP in 2023 for the GG a whole, after closing 2022 with a deficit of 4.6% of GDP. AIReF therefore raises its forecast for year-end 2022 with regard to the report of October 18th as it includes the measures approved by Royal Decree Law 18/2022.

The deficit reduction of 1.3 points would only materialise if the measures adopted to mitigate the effects of the energy crisis and the invasion of Ukraine were not extended. The evolution of the deficit would be explained by several factors with opposite effects. Firstly, the progressive withdrawal of COVID-19-related measures, which accounts for most of the deficit reduction in 2022, still contributes 0.3 points in 2023. In addition, the revenue measures included in the GSB result in an additional reduction of 0.3 points, 0.1 points more than in 2022. Finally, the evolution of revenue offset by the baseline evolution of expenditure, excluding the increase in pensions, would contribute 0.3 points to the reduction in the deficit. These factors are offset by the rise in pension expenditure due to the increase in line with the 2022 CPI, amounting to 8.9% according to AIReF's forecasts.

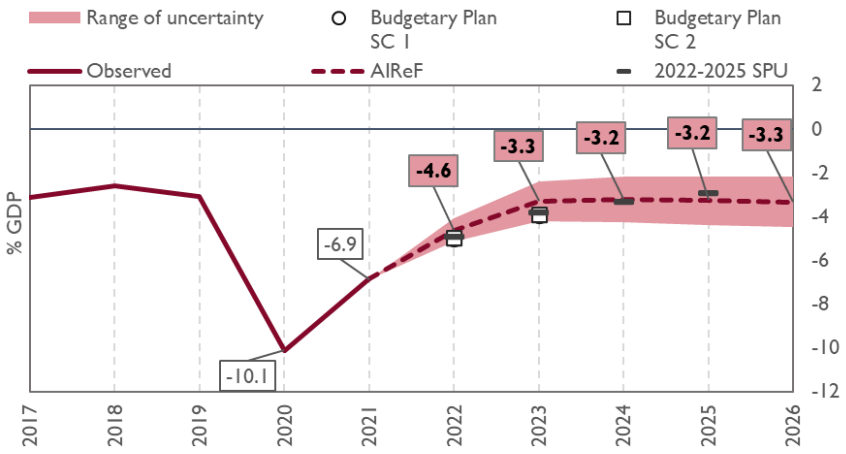
Both in 2022 and 2023, AIReF's estimates fall below the two scenarios of the Budgetary Plan, which forecast a deficit of 5% for 2022 and 3.9% for 2023. However, the two scenarios are not fully comparable as they include different assumptions about the measures, especially in 2023. For 2022, AIReF's forecasts remain below the forecasts of the two scenarios despite incorporating all the measures mentioned in the Budgetary Plan for this year. For 2023, AIReF's forecasts would be directly comparable with Scenario 1 as they do not include the extension of the measures.

In the absence of more detailed information, the comparison with Scenario 2 requires assumptions about the amount of the cost of the extension of the measures. As an approximation, it is possible to identify a rise in expenditure of 0.7 points in Scenario 2 compared with Scenario 1. With regard to revenue, it is stated that all the measures are extended, which, according to AIReF's estimate, would mean slightly less than 0.4 points of deficit. As a whole, Scenario 2 would imply a cost of the extension of the measures of 1.1 points of GDP. Therefore, AIReF's deficit forecast for 2023, in the event of the extension

included in the Government's Scenario 2, would rise to 4.4% of GDP, 0.5 points above the forecast in said scenario.

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.

EVOLUTION OF THE NET LENDING/BORROWING OF THE GG



Source: AIReF and IGAE

In the event that the measures are not extended, revenue, excluding the RTRP, will reach 43.5% of GDP in 2023, after reaching 43% in 2022. These forecasts are higher for both years than forecast in Scenario 1 of the Budgetary Plan, by 0.9 points and 1.2 points, respectively. The gaps widen in 2023, as AIReF forecasts revenue growth of 7.2% without the extension of measures compared with 6.1% in Scenario 1. In contrast, once the effect of the extension of the measures is considered, the forecasts of Scenario 2 would be in line with those of AIReF in both 2022 and 2023, albeit with a different composition. AIReF forecasts lower revenue from taxes and higher revenue from social contributions and other revenue.

AIReF estimates that expenditure will fall to 46.8% of GDP in 2023, after reaching 47.6% in 2022. Apart from the measures, AIReF estimates higher growth in expenditure than contained in the Budgetary Plan in the two years. For 2022, these forecasts are 0.5 points above Scenario 1 and 0.2 points below Scenario 2 and incorporate all the measures mentioned in Scenario 2 of the Budgetary Plan. For 2023, AIReF forecasts expenditure growth of 4.2% without the extension of measures, more than half a point above that forecast in both scenarios of the Budgetary Plan. Therefore, without extension of the measures,

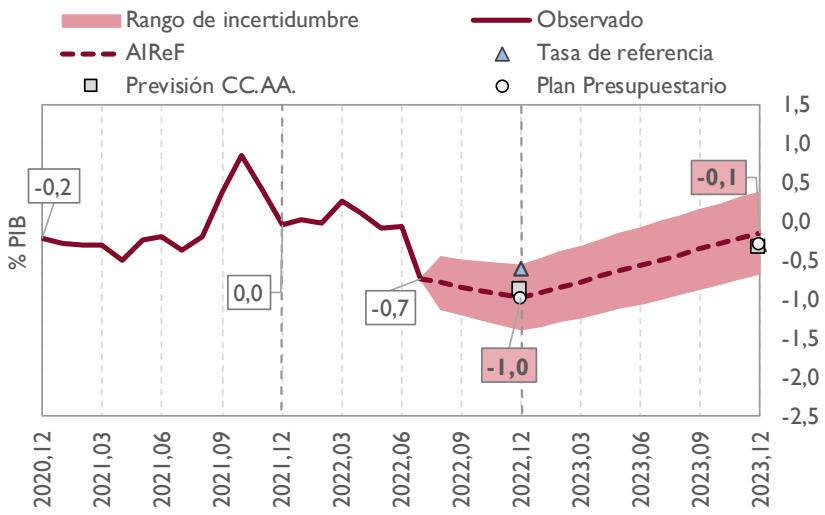
AIReF expects expenditure in 2023 to be 0.6 points higher than in Scenario 1. This difference is mainly concentrated in the components of public consumption and in other expenditure. If we add a cost of extension of measures of 0.7 points to allow comparison with Scenario 2, the expenditure forecast by AIReF would stand at 47.5% of GDP, also 0.6 points above that forecast in Scenario 2.

In the medium term, AIReF estimates a reduction in the weight of revenue over GDP, after reaching a peak in 2023, to 42.5% in 2026. This reduction is supported by the gradual withdrawal of temporary measures, which will be implemented in 2023 and which extend their effects until 2025, such as the new temporary levies on the energy and banking sectors, the tax on large fortunes and the limitation of the offsetting of losses in Corporate Income Tax. Expenditure will continue to reduce its weight over GDP until it stabilises at 45.8% in 2026. Particularly noteworthy is the increase in interest expenditure of 0.3 points of GDP from the low recorded in 2021.

Autonomous Regions

According to AIReF's forecasts, the balance of the ARs will improve substantially in 2023, reaching a deficit of 0.1% of GDP after closing 2022 with a deficit of 1% of GDP. This improvement is mainly explained by the evolution of the revenue from the financing system, which grew by 23.9%, driven by the growth in interim payments and, to a greater extent, by the settlement which is again positive after the exceptionally negative value of 2022. In the medium term, this irregular evolution of the financing system's revenue linked to the settlement of previous years will provide extraordinary revenue of a mainly short-term nature. Thus, in 2024, the ARs will record a surplus of 0.4% of GDP, which will deteriorate until reaching a balanced budget in 2026, a year with a settlement of the financing system at normal levels. With regard to expenditure, after stronger growth in 2023, AIReF projects more moderate growth once inflationary tensions have been overcome and fiscal rules have been restored.

EVOLUTION OF THE NET LENDING/BORROWING OF THE ARS

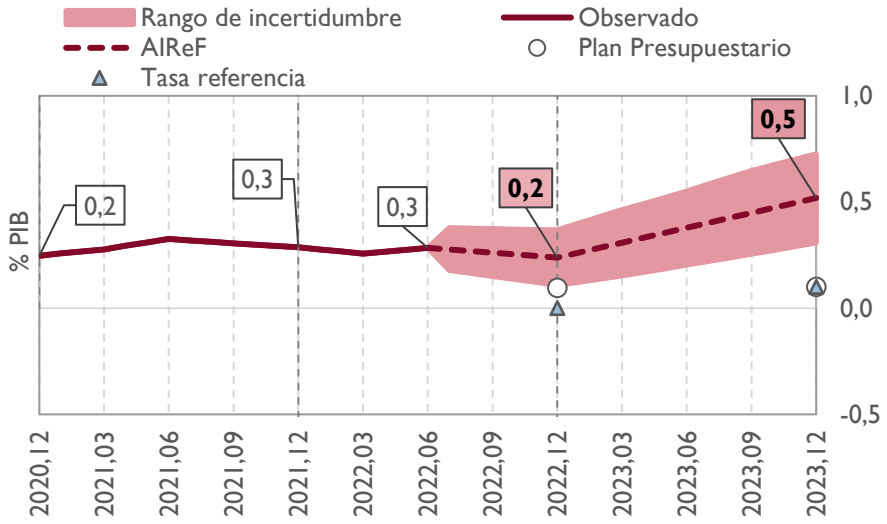


Source: AIReF and IGAE

Local Governments

AIReF estimates a surplus in 2023 of 0.5% of GDP in the LGs, after recording 0.2% in 2022. Similarly to the ARs, the evolution of the surplus is marked by the settlements of the financing system in addition to the compensations between 2022 and 2024 as a result of the negative settlement of 2020. Consequently, the surplus of the LGs will grow again in 2024 to 0.6% of GDP and will subsequently fall to 0.3% in 2026.

EVOLUTION OF THE NET LENDING/BORROWING OF THE LGS



Source: AIReF and IGAE

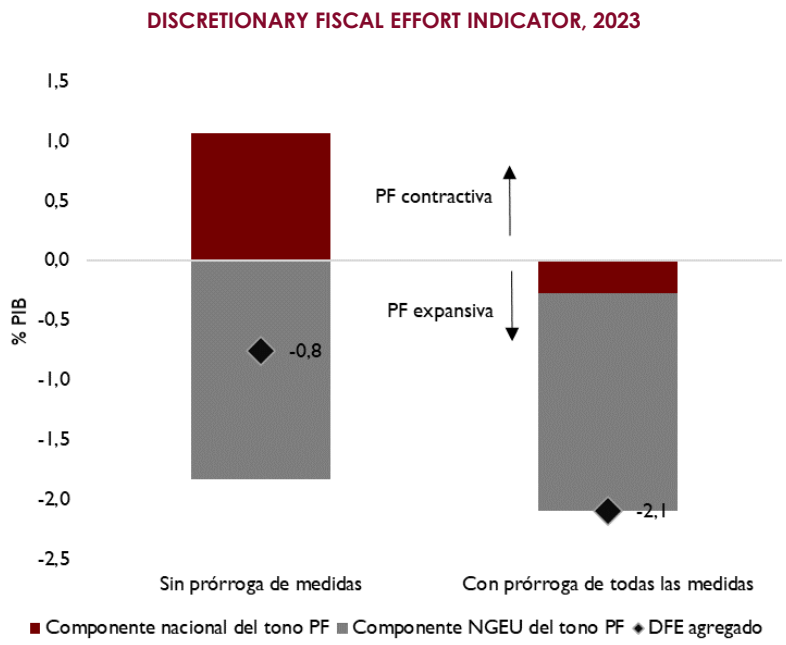
Fiscal policy stance and assessment of the Specific Recommendation of the European Council on fiscal matters

The first Country Specific Recommendation addressed to Spain this year states that the increase in nationally financed current primary expenditure should be below medium-term potential growth.

For the GG as a whole, AIReF forecasts 3.5% growth in current primary expenditure net of revenue measures in 2023 if the measures are not extended over the whole of next year. This increase would fall within the range considered by AIReF for the evaluation of the Council's Fiscal Recommendation. In this scenario, the evolution of the structural balance would show an effort to consolidate the national fiscal policy, resulting from the withdrawal of the measures.

However, if all the measures were extended in 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 would mean an increase in current primary expenditure net of revenue measures of 6.5% per year in 2023, which is well above the benchmarks compatible with compliance with the fiscal recommendation. At the same time, the extension would imply a slightly expansionary stance of national fiscal policy, taking into account the evolution of the structural balance.

From a macroeconomic point of view, the aggregate fiscal policy stance should be assessed including the boost associated with the *Next Generation EU* funds. In this case, the Discretionary Fiscal Effort (DFE) indicator points to a considerable fiscal expansion in 2023, regardless of whether the measures are extended. AIReF's current forecast incorporates an increase in expenditure in 2023 of around €25bn charged to these funds. If this boost materialises, it will determine the aggregate fiscal policy stance next year, either reinforcing a slight national expansion in the event that the measures are extended, or more than compensating for a certain containment of national expenditure in the event that they are not extended.



Source: AIReF

Debt sustainability

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. This significant cumulative reduction over recent quarters is mainly due to the denominator effect, given the strong upturn in economic activity and prices. However, it continues to represent a net increase compared with year-end 2019 of 17.9 points.

For 2023, AIReF estimates a reduction in the debt ratio of 6.9 points of GDP compared with the 2021 level, supported mainly by the growth in nominal GDP (15.3 points), where the deflator will make a very significant contribution (8.8). Accordingly, and in line with its stochastic projections, AIReF considers the reduction of 5.8 points projected by the Government for 2023 to be feasible. 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.

With regard to debt financing costs, 2022 is a turning point. The low interest rate scenario recorded in 2020 and 2021 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.

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 reach a path of fiscal rebalancing in the medium term that would allow more fiscal space to be generated in an environment of major uncertainty and demographic pressures. This is because the significant stock of public debt resulting from the health crisis, on top of a previous high level, places the medium-term sustainability of public finances in a vulnerable position.

Recommendations

In the current context of fiscal rules suspended for several years, the Government decided, in the absence of budgetary stability targets, to set reference rates for the GG and for each sub-sector. These reference rates can be considered a success to the extent that they indicate the fiscal policy orientation and act as an anchor in the design of the budgets of each administration.

For this reason, when the reference rates are lax, as is currently the case, they do not encourage the necessary reduction in the structural deficit, even if allowed, in certain cases, by the economic and fiscal situation. This is the underlying risk in 2023 with the AR sub-sector, which, according to AIReF's estimates, could reach a lower deficit, 0.1% of GDP compared with the 0.3% of GDP of the sub-sector's reference rate. However, regardless of their previous situation, all the ARs have presented budgets in line with the reference rate of -0.3% of GDP or -0.6% in the case of the Basque Country and Navarre. Moreover, setting the same reference rate for all ARs under the ordinary regime is unrealistic, as it is excessively demanding for some and lax for others. This also applies to the General Government as a whole.

For this reason, AIReF recommends that the Ministry of Finance define reference rates for each administration taking into account their starting situation, so that they are demanding, but achievable.

1. INTRODUCTION

In compliance with the legal mandate to report on the main budgetary lines and draft budgets of the General Government (GG), AIReF published the report on the draft 2023 GSB on October 18th[1]. The aim of the report was to analyse the macroeconomic and fiscal scenario of the draft 2023 GSB, which was approved on October 4th by the Council of Ministers and sent on October 6th for passage through Parliament. The evaluation focused on the CG and SSF sub-sectors, the assessment of which is now updated with the latest available information. In addition, AIReF developed the analysis it had brought forward for its endorsement of the macroeconomic forecasts underpinning the 2023 GSB, published on October 4th.

In this report, AIReF completes the previous report with an evaluation of the main lines of the 2023 budgets of the Autonomous Region (AR) and Local Government (LG) sub-sectors. AIReF continues its reporting on the main lines of the 2023 budgets with the evaluation of the AR and LG sub-sectors. This assessment will be completed with the forthcoming publication, at a regional level, of the individual reports of the ARs and, at a local level, a more extensive

[1] AIReF Report on the 2023 General State Budget

report that will include the individualised analysis of the 21 large LGs and the three Provincial Councils of the Basque Country.

In addition, in order to complete its assessment, AIReF provides an evaluation of the GG as a whole and includes a medium-term scenario up to 2026. From an overall perspective, it provides an analysis of the GG as a whole and compares its forecasts with those contained in the 2023 Budgetary Plan submitted by the Government to the European Commission on October 15th. The fiscal scenario included in the Budgetary Plan is defined for the GG as a whole and sets out the main revenue and expenditure headings in national accounting terms. This year, as a new aspect, the Budgetary Plan puts forward two alternative scenarios depending on whether or not additional energy measures are included. In addition, in order to frame the analysis of the GG as a whole for 2023 within a multi-year perspective, AIReF extends its forecast with a medium-term scenario up to 2026.

The evaluation set out in this report is performed from a macroeconomic and budgetary perspective. For this purpose, the analysis is divided into nine main blocks. Following this introduction, Section 2 sets out the content and scope of the report. Section 3 contains an analysis of the macroeconomic scenario of the 2023 Budgetary Plan, highlighting the main macroeconomic risks. Section 4 then analyses in detail the evolution of the revenue and expenditure of the GG as a whole. This section is supplemented by a section on the main measures and an analysis of the balance of the sub-sectors. Section 5 analyses the AR sub-sector, while Section 6 analyses the LG sub-sector. Section 7 then focuses on the fiscal policy stance. Section 8 provides an analysis of the evolution of public debt and assesses the challenges for the sustainability of public finances. Finally, Section 9 presents the recommendations emerging from the analysis conducted.

2. PURPOSE AND SCOPE

The purpose of this report is to assess the main budgetary lines of the territorial administrations and the GG as a whole for 2023 in relation to whether they comply with the reference rates. As a result of the fact that fiscal rules remain suspended in 2023 both at an EU and a national level, AIReF's analysis focuses on assessing compliance with the deficit reference rates set by the Government for 2023[2]. These match the forecast set out in the Budgetary Plan, with the exception of the CG deficit, which in the Plan stands at 3.3% of GDP as opposed to the 3.2% set as the reference rate. In addition, AIReF estimates the rate of change in eligible expenditure for the purposes of the expenditure rule of the regional and local sub-sectors and the debt-to-GDP ratio for the purposes of debt sustainability, in order to show the evolution of these fiscal variables.

The content of the Budgetary Plan is not sufficient to perform a proper analysis of fiscal policy. As AIReF noted in its Opinion on Fiscal Transparency in the General Government[3], the budgetary process is fragmented in practice, and it is not possible to ensure consistency between its main elements: the Stability

[2] Resolution of the Council of Ministers of July 26th, 2022: -3.9% of GDP for the GG as a whole; -3.2% of GDP for the CG; -0.3% of GDP for the ARs; -0.5% of GDP for the SSFs and 0.1% of GDP for the LGs.

[3] AIReF Opinion on Fiscal Transparency

Programme Update, the budgets of each administration and the Budgetary Plan. This characteristic, which AIReF has already highlighted in previous years, is accentuated because the 2023 Budgetary Plan:

- Presents two alternative budgetary scenarios, with the same macroeconomic scenario as the 2023 GSB and sharing the same deficit reference rate, 5% of GDP for 2022 and 3.9% for 2023. In theory, Scenario 1 would be in line with the forecasts contained in the 2023 GSB, while Scenario 2 would include a more realistic revenue forecast in 2022, new measures for 2022 and the extension of part of the existing measures for 2023. AIReF observes significant inconsistencies in the construction of these scenarios that could stem from the fact that they both share the same deficit forecast for the two years.
- Still does not fully reflect the impact of the RTRP and REACT-EU funds on the revenue and expenditure of the GG, while the draft GSB does include a granular breakdown of each of the actions financed with the two mechanisms.
- Still does not provide a breakdown of the headings of expenditure and revenue by tier of government, which makes it difficult to ensure consistency with the budgets of the different administrations.

TABLE 1. ASSUMPTIONS USED IN DRAWING UP THE BUDGETARY SCENARIOS

			BUDGETARY PLAN	
		AIReF	Scenario 1	Scenario 2
REVENUE	Updated to the latest available information	YES	NO	YES
	Including the measures approved in 2022	YES	Yes?	YES
	Including the measures included/announced in the GSB in 2023	YES	Yes, except Tax on Large Fortunes and offsetting losses in CIT	YES
	Including potential extension of measures in 2023	NO	NO	YES
EXPENDITURE	Updated to the latest available information	YES	NO	YES
	Including all measures approved in 2022	YES	Partially	YES
	Including the measures included/announced in the 2023 GSB	YES	Partially	YES
	Including potential extension of measures in 2023	NO	NO	YES

Source: Budgetary Plan and AIReF

Furthermore, the 2023 Budgetary Plan does not contain a complete 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 contingent liabilities faced by the CG. It only partially reports on the balance of the guarantees granted by the GG and its sub-sectors at year-end 2021. In addition, when reporting on the measures adopted by the different tiers of government as a result of the crisis caused first by the pandemic and then by the war in Ukraine, it indicates the maximum amount of the guarantees and the amount granted, but does not contain a forecast of defaults and their possible impact on the deficit. Finally, it only mentions the expected impact of some court rulings at a local level.

3. MACROECONOMIC SCENARIO

3.1. Macroeconomic scenario 2022-2026

AIReF's macroeconomic scenario, like that of the Government, remains unchanged compared with that published in the report on the General State Budget for 2023 (2023-GSB)[4]. AIReF endorsed the Government's macroeconomic outlook on October 4th on the basis of its own scenarios. AIReF stresses that 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 this purpose, the relevant variables are not only real growth and employment, but also the composition of growth and variables expressed at current prices.

To analyse the government's macroeconomic outlook, AIReF draws up its own scenarios and builds probability ranges around its forecasts. In its report on the 2023 GSB, AIReF presented 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. Details of the analysis and determining factors of AIReF's macroeconomic outlook can be found in that report.

[4] See Report 49/22 of October 18th.

AIReF forecasts real growth for 2023 below that of the Government. The Government's macroeconomic scenario assumes real GDP growth of 4.4% in 2022 and 2.1% in 2023. AIReF estimates the same growth for 2022, while for 2023 GDP growth in volume terms is expected to stand at around 1.5%.

The main differences between the Government's and AIReF's macroeconomic forecasts are in the expected growth of investment and exports and imports. The differences between the Government's macroeconomic outlook and that of AIReF for 2023 are mainly based on a greater strength of domestic demand in the case of the Government, linked to the expected behaviour of gross fixed capital formation, while the other aggregates of domestic demand would follow a pattern similar to that forecast by AIReF. AIReF considers that in the current environment of uncertainty about the security of energy supply and weakening demand, it is reasonable to think that companies will be cautious when expanding their production capacity. Regarding external demand, although its contribution for 2023 is similar in both scenarios, it is underpinned by very different performance of exports and imports of goods and services. While the Government assumes that the strength of foreign trade flows observed in 2022 will continue, AIReF forecasts a more intense moderation as a result of a worsening of the external environment, especially of Spain's main trading partners. In line with lower real growth, AIReF expects lower employment growth and a higher unemployment rate than the Government.

Regarding prices, AIReF estimates higher growth of the GDP deflator and compensation per employee in 2023 compared with the Government. On the price front, the Government's scenario envisages a slight reduction in the GDP deflator in 2023, from 4% to 3.8%. In contrast, AIReF estimates an acceleration in the implicit GDP deflator, from 3.6% in 2022 to 4.3% in 2023. This larger increase in domestic prices in AIReF's scenario is accompanied by higher wage growth, since it is assumed that, following the sharp fall in real wages observed in 2022, workers will try to recover part of their lost purchasing power. The increase in the percentage of collective bargaining agreements incorporating wage review clauses would support this assumption.

As a result of the above, the forecast of nominal GDP growth for 2023 is very similar in both scenarios, 6% in the case of the Government and 5.9% in the case of AIReF. The Government's forecast of real GDP for 2023 lies in the optimistic part of AIReF's confidence intervals, while that of the GDP deflator would lie at the lower limit of the central range. This results in a nominal GDP forecast that lies in the central part of AIReF's probability bands.

TABLE 2. MACROECONOMIC OUTLOOK FOR 2022-2026.

	AIREF						Government	
Year-on-Year Rates of Change	***2021***	***2022***	***2023***	***2024***	***2025***	***2026***	***2022***	***2023***
Private Domestic Final Consumption Expenditure	6.0	1.5	1.3	2.7	2.0	1.8	1.2	1.3
General Government Final Consumption Expenditure	2.9	-0.9	0.8	1.1	0.8	0.9	-1.0	0.4
GFCF	0.9	5.5	3.9	5.3	3.2	2.2	5.1	7.9
GFCF Equipment and Cultivated Assets	*6.5*	*5.1*	*2.7*	*9.9*	*5.8*	*3.6*	*6.6*	*9.5*
GFCF Construction and Intellectual Property	*-1.5*	*5.6*	*4.4*	*3.4*	*2.0*	*1.6*	*4.5*	*7.2*
Domestic Demand*	5.2	1.7	1.7	2.9	2.0	1.7	1.5	2.4
Exports of Goods and Services	14.4	16.9	2.5	2.7	1.5	1.3	17.9	7.3
Imports of Goods and Services	13.9	9.6	3.0	3.0	1.9	1.5	9.9	8.2
External Balance*	*0.3*	2.7	-0.2	-0.1	-0.2	-0.1	2.9	-0.3
Gross Domestic Product	**5.5**	**4.4**	**1.5**	**2.7**	**1.8**	**1.6**	**4.4**	**2.1**
Nominal Gross Domestic Product	**7.9**	**8.2**	**5.9**	**5.0**	**3.9**	**3.4**	**8.6**	**6.0**
Gross Domestic Product Deflator	2.3	3.6	4.3	2.2	2.0	1.8	4.0	3.8
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	2.9	0.6
Unit Labour Cost	0.3	1.3	4.6	2.4	1.6	1.1	0.5	2.3
Productivity per Full-Time Employee	-1.0	1.5	1.2	1.2	0.9	1.0	1.5	1.5
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	12.8	12.2
Household and NPISH Savings Rate (% Gross Disposable Income)	13.6	8.5	8.7	8.5	8.1	7.3	-	-

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

FIGURE 1. RATE OF CHANGE IN GDP IN TERMS OF VOLUME (%)

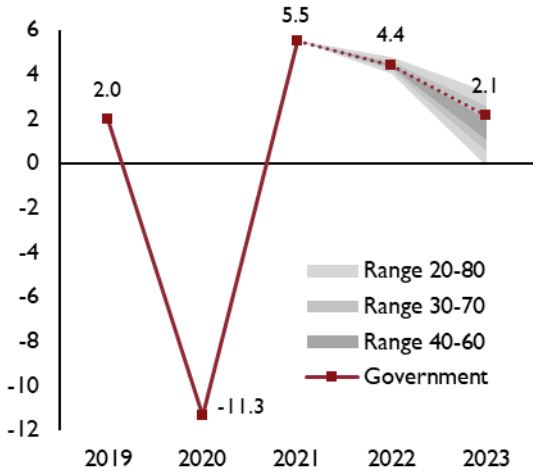
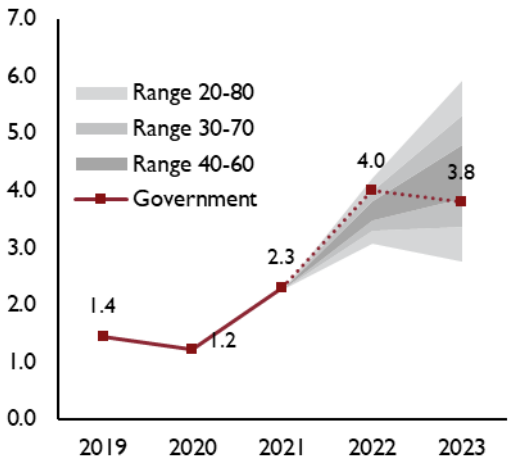


FIGURE 2. RATE OF CHANGE IN THE GDP DEFLATOR (%)



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

FIGURE 3. RATE OF CHANGE IN NOMINAL GDP (%)

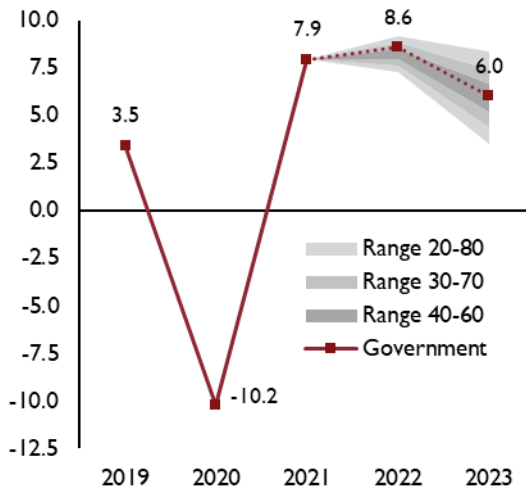
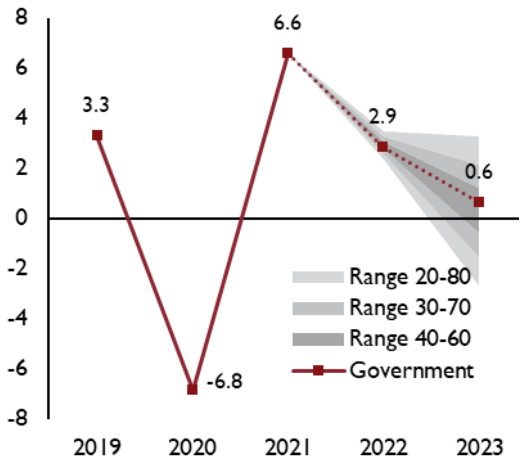


FIGURE 4. RATE OF CHANGE IN FULL-TIME EQUIVALENT EMPLOYMENT (%)

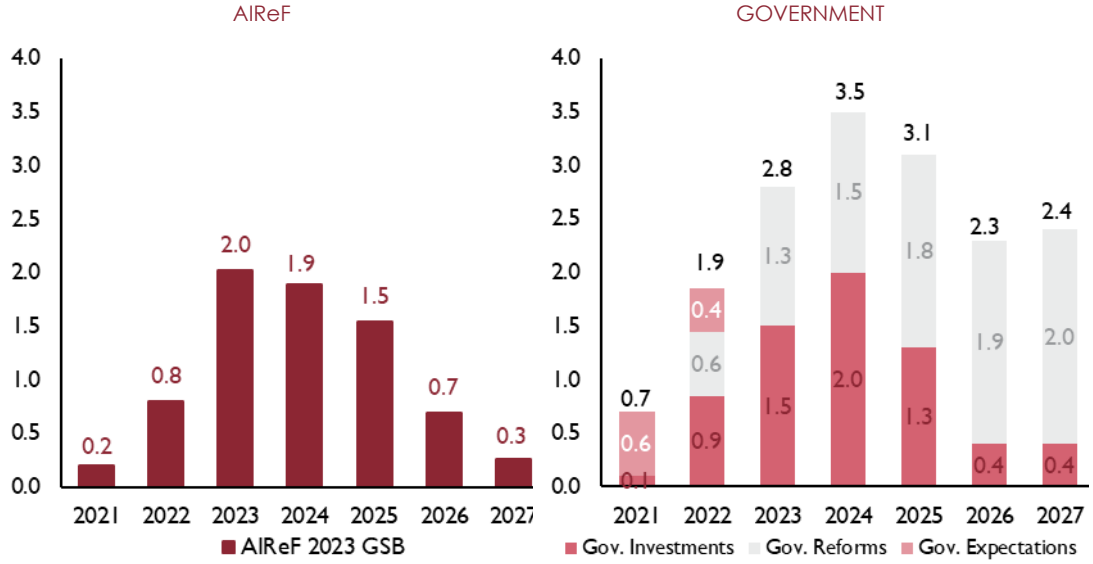


Source: INE, Ministry of Economic Affairs and Digital Transformation and AIReF

AIReF estimates an impact of the Recovery, Transformation and Resilience Plan (RTRP or Plan) of 0.2 percentage points (pp) in 2021, which would raise up the level of GDP compared with a scenario without the Plan to 0.8 pp in 2022 and 2 pp in 2023, while the Government forecasts a higher impact in the three years (0.7 pp, 1.9 pp and 2.8 pp, respectively). The estimates made by the Ministry of Economic Affairs and Digital Transformation of the impact of the RTRP suggest that the Plan would have raised economic growth since 2021 through a positive boost to the expectations of economic agents. The progressive materialisation of the calls for investment for the projects associated with the Plan would have taken over in 2022 and 2023. The above is in addition to the impact that the Government associates with the implemented reforms, which would raise 2022 GDP by 0.6 points and 2023 GDP by almost 1.3 points. Overall, according to the Government, the RTRP raises the 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 the absence of information in national accounting terms to approximate the rate at which the investments associated with the RTRP are materialising, AIReF makes estimates on the pace of execution of the RTRP funds that allow it to approximate the potential impact of the Plan. Based on these estimates, in 2021 the impact would have been 0.2 pp of GDP compared with a scenario without the RTRP, as a consequence of the delay in the materialisation of the investments, and 0.8 pp in 2022. The impact in 2023 would amount to 2 pp on the level of GDP compared with a scenario without the Plan. Unlike the Government, AIReF 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 thus far until a complete diagnosis

is available based on evidence of its effects on aspects such as total factor productivity.

FIGURE 5. IMPACT ON GDP (% DEVIATION WITH RESPECT TO A SCENARIO WITHOUT RTRP)



Source: Ministry of Economic Affairs and Digital Transformation and AIReF

Note: Government data extracted from the Report on the 2023 Budgetary Plan

AIReF believes that there are significant risks around the Government's scenarios and AIReF's own scenarios. The environment in which the global economy operates continues to change and analysts and forecasting institutions continue to revise growth projections for 2023 downwards, while inflation forecasts are revised upwards. The outlook for growth continues to be marked by geopolitical tensions, uncertainty about energy security and persistent high inflation rates, which are causing a significant fall in the purchasing power of households and a tightening of financing conditions that are faster than expected a few months ago. All of these elements carry downside risks to global growth. On the opposite side, the recent fall in gas prices and the extent of the measures being taken by governments to mitigate the effects of the energy crisis on the purchasing power of households and business costs could halt the expected deterioration in activity.

3.2. Report on the macroeconomic outlook of the ARs

In accordance with the provisions of Organic Law 6/2013 on the establishment of AIReF, the macroeconomic forecasts incorporated in the draft budgets of all public administrations must have a report from AIReF indicating whether they have been endorsed. However, Royal Decree 215/2014, of March 28th,

approving the Organic Statute of AIReF, states that in the event that any public administration incorporates or applies in the corresponding budget a set of forecasts that exactly match those incorporated by another public administration in whose territorial scope it is integrated, and which have been endorsed by AIReF, the issuance of a specific report will not be necessary. This shall be expressly stated in the draft budget itself. In addition to evaluating the degree of realism of these forecasts, this report will assess whether the scenarios meet the transparency and quality requirements established by European regulations for EU Member States, as specified in Article 4 of Directive 2011/85/EU of 8 November 2011.

AIReF's activity in the analysis of macroeconomic outlooks is currently taking place in a particularly complex context due to major economic uncertainty, but also in relation to regional accounting data. Numerous risks identified by AIReF - mainly centred around the energy crisis, persistent inflation and the tightening of financing conditions - have materialised from the end of 2021 and, especially, over 2022. These are having an impact on the economic growth expectations of the European Union and Spain for the next few years. This makes it difficult to assess them at a national level, and particularly at a territorial level. The latest available information on the Spanish Regional Accounts is that referring to 2020. Even this is not in line with the most up-to-date information for the nation as a whole as a result of the latest statistical revisions performed by the National Statistics Institute for the years 2019 to 2021, published on September 15th, 2022.

Up to and including October 24th, 2022, eight reports have been issued on the macroeconomic outlooks included in the general budgets of the various Autonomous Regions. AIReF has issued a report on the macroeconomic outlook of eight Autonomous Regions: Andalusia, Aragon, Navarre, Castile-La Mancha, Castile and Leon, Extremadura, the Basque Country and Galicia. The reports of three Autonomous Regions are also in the process of being drafted and a request for a report from four further Autonomous Regions is expected. The forecasts of GDP growth in volume terms for 2023 of the analysed Autonomous Regions are, except in the case of Extremadura, above the central range of AIReF's estimates. However, in all cases the GDP forecasts of the ARs are below the growth expected by the Government for the Spanish economy as a whole, and most of the ARs provide nominal growth estimates that are significantly closer to those of AIReF. Therefore, AIReF has endorsed the macroeconomic scenarios presented. In this regard, the provision of estimates of the GDP deflator and medium-term macroeconomic outlooks by some Autonomous Regions is considered positive. In addition to the best practice advice provided by AIReF, the reports have included a cross-cutting recommendation to all the Autonomous Regions to collect information on the

assumptions on the impact of the Recovery, Transformation and Resilience Plan (RTRP) that is assigned over the forecast horizon. The only exception is the case of Galicia, which provides an extended analysis on the potential impact associated with the RTRP in its economic and financial report.

In addition, notification has been received of the adoption of the Government's macroeconomic outlook by two Autonomous Regions. Both Cantabria and Rioja have reported the adoption of the macroeconomic framework underlying the 2023 GSB, in line with the provisions of the regulations.

TABLE 3. ACTIVITY OF ISSUING REPORTS ON THE MACROECONOMIC OUTLOOKS OF THE AUTONOMOUS REGIONS FOR THE BUDGETS FOR THE YEAR 2023

Autonomous Region	Report	Notes	Recommendations	Best Practice Advice
Cantabria		Assumes forecasts of 2023 GSB, pending preparation		
Rioja		Assumes forecasts of 2023 GSB		
Andalusia	Report 50/22 of October 24th, 2022		**Cross-cutting recommendation:** At the present time, it is particularly important to specify the assumptions about the macroeconomic impact associated with the Recovery, Transformation and Resilience Plan that is assigned over the forecast horizon.	-
Aragon	Report 46/22 of October 13th, 2022			Employment forecasts should be included in terms of people employed in Regional Accounts.
Navarre	Report 42/22 of September 20th, 2022			The documentation provided and the corresponding report should contain more detailed information on the assumptions, models and parameters used in its macroeconomic forecasts and projections beyond the current quarter, which should be made public, following the provisions of Directive 2011/85/EU on requirements for budgetary frameworks of the Member States.
Castile-La Mancha	Report 43/22 of September 30th, 2022			-
Castile and Leon	Report 51/22 of October 24th, 2022			1) Employment forecasts should be included in terms of people employed in Regional Accounts. 2) The documentation provided and the corresponding report should contain more detailed information on the assumptions, models and parameters used in its macroeconomic forecasts and projections beyond the current quarter.

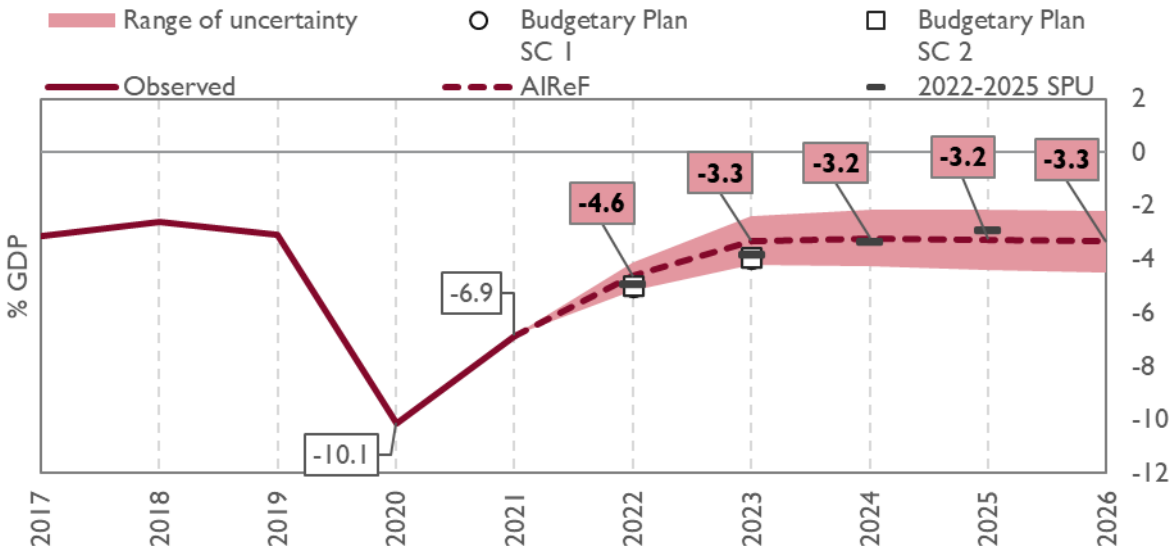
Autonomous Region	Report	Notes	Recommendations	Best Practice Advice
Extremadura	Report 44/22, of September 29th, 2022			The documentation provided and the corresponding report should contain more detailed information on the assumptions, models and parameters used in its macroeconomic forecasts and projections beyond the current quarter, which should be made public, following the provisions of Directive 2011/85/EU on requirements for budgetary frameworks of the Member States.
Basque Country	Report 47/22 of October 13th, 2022			Employment forecasts should be included in terms of people employed in Regional Accounts.
Galicia	Report 48/22 of October 13th, 2022			Employment forecasts should be included in terms of people employed in Regional Accounts.
Canary Islands	-	Report Requested, in process	-	-
Valencia	-	Report Requested, in process	-	-
Balearic Islands	-	Report Requested, in process	-	-
Madrid	-	Report Requested, in process	-	-
Asturias	-	Pending request	-	-
Catalonia	-	Pending request	-	-
Murcia	-	Pending request	-	-

4. ANALYSIS OF THE 2022-2026 BUDGETARY SCENARIO

AIReF forecasts a GG deficit in 2022 of 4.6% of GDP, 0.4 points less than the Government, with a reduction in 2023 of 1.3% to 3.3%, 0.6 points higher than the Government. AIReF's forecasts include the measures approved so far, including those contained in RDL 18/2022, but do not include the possible extension of such measures. Therefore, the 1.3-point reduction in the deficit in 2023 will depend on the measures adopted in the coming months. The Budgetary Plan describes two alternative scenarios: one that broadly follows the 2023 GSB line and a second scenario, with higher expenditure and revenue for both 2022 and 2023, which includes additional measures in 2022 and the partial extension of the measures in 2023. However, both scenarios result in the same deficit over the two years, coinciding with the Government's reference rates. In contrast, AIReF considers that any extension of the measures would have a direct impact on the deficit, virtually eliminating the improvement forecast for 2023.

In the medium term, AIReF estimates that the deficit will stabilise between 0.2 and 0.3 points above the limit of 3%. Once the measures to mitigate the effects of the war in Ukraine and the energy crisis, as well as the temporary revenue measures, are no longer in force, the deficit stabilises at around 3.2%, with a slight rise in 2026 to 3.3%. This means that, in the absence of further measures, the margin for reducing the deficit, which would remain above the 3% threshold set by the Stability and Growth Pact, is exhausted.

FIGURE 6. EVOLUTION OF THE NET LENDING/BORROWING OF THE GG



Source: IGAE, Budgetary Plan and AIReF estimate

TABLE 4. REVENUE AND EXPENDITURE AS % OF GDP (WITHOUT NGEU). AIREF MEDIUM-TERM PATH

	AIReF				
	2022	2023	2024	2025	2026
REVENUE	43.0	43.5	43.0	42.6	42.5
EXPENDITURE	47.6	46.8	46.2	45.8	45.8
DEFICIT	-4.6	-3.3	-3.2	-3.2	-3.3

Source: AIReF

TABLE 5. REVENUE AND EXPENDITURE AS % OF GDP (WITHOUT NGEU). COMPARISON WITH DBP

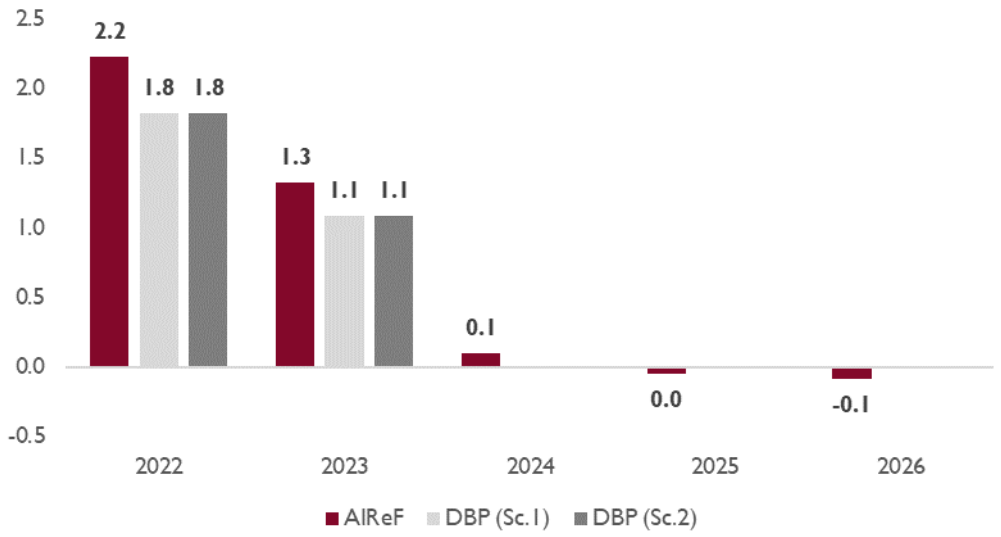
	2022			2023			Differences			
	DBP-1	DBP-2	AIReF	DBP-1	DBP-2	AIReF	2022 - 1	2022 - 2	2023 - 1	2023 - 2.
REVENUE	42.1	42.9	43.0	42.3	43.0	43.5	-0.9	-0.1	-1.2	-0.5
EXPENDITURE	47.1	47.9	47.6	46.2	46.9	46.8	-0.5	0.2	-0.6	0.1
DEFICIT	-5.0	-5.0	-4.6	-3.9	-3.9	-3.3	-0.4	-0.3	-0.6	-0.6

Source: Budgetary Plan and AIReF

AIReF expects a reduction in the deficit of 2.2 points in 2022 and a further 1.3 points in 2023 (without extension of the measures). Both figures are above the improvements forecast by the Government. For 2023, the Government considers the same improvement in the deficit in both scenarios, despite the fact that one includes measures while the other does not. In the case of AIReF, the scenario only includes the measures approved so far, including those approved in RDL 18/2022, and no assumption of an extension is made. In the event that new measures are announced, the improvement in the deficit for the year for which they are adopted would be affected to the same extent

as the approved measures. The scenario proposed by AIReF considers that once the measures disappear, the deficit will stabilise at around 3.2%.

FIGURE 7. ANNUAL DEFICIT REDUCTION FORECAST (% GDP)



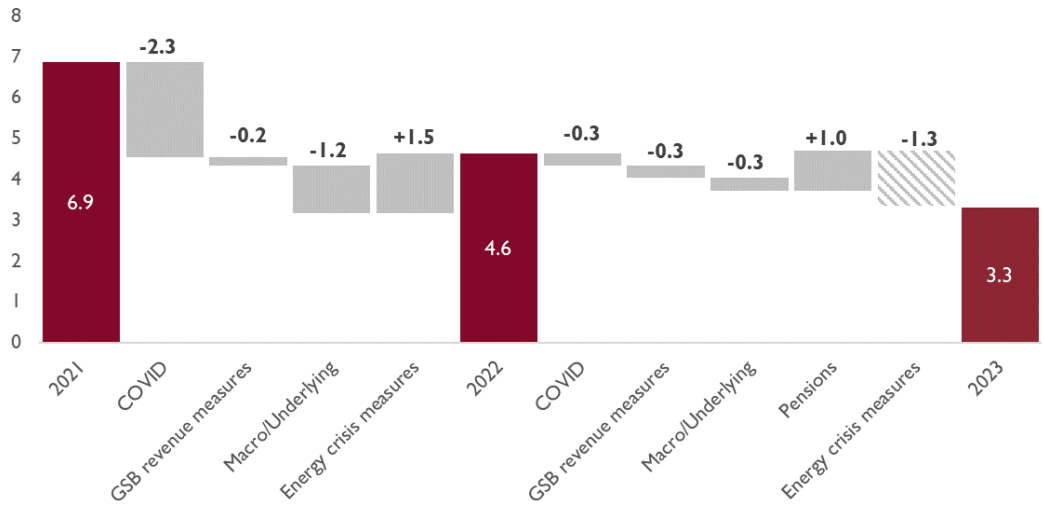
Note: positive sign means a reduction in the deficit

Source: Budgetary Plan and AIReF

The reduction in the deficit in 2022 is mainly due to the withdrawal of COVID-related measures and the evolution of the economy, while the package of energy measures slows the improvement. The withdrawal of COVID-related measures reduces the deficit by more than 2 percentage points, while the revenue measures included in the 2022 GSB lower the deficit by a further 0.2 points. In addition, the performance of the economy, partially offset by the baseline evolution of expenditure, brings an improvement of over 1 point of GDP. However, the package of measures adopted to date increases the deficit by 1.5 points to end the year at 4.6%.

The reduction in the deficit in 2023 was mainly due to the withdrawal of energy measures, partially offset by the cost of increasing pensions in line with the CPI of the previous year. The withdrawal of the measures associated with COVID-19, mainly Temporary Incapacity due to COVID-19, lowers the deficit by 0.2 points. The evolution of revenue offset by the baseline evolution of expenditure, excluding the increase in pensions, would contribute 0.5 points to the reduction. In the opposite direction, the increase in pensions in line with the CPI of the previous year pushes the deficit up by 1 point, offsetting the effect of the three previous factors. The deficit reduction would come from the withdrawal of energy measures. The reduction in the deficit will be greater or lesser depending on which measures are extended.

FIGURE 8. CONTRIBUTION TO THE EVOLUTION OF THE DEFICIT. 2021-2023

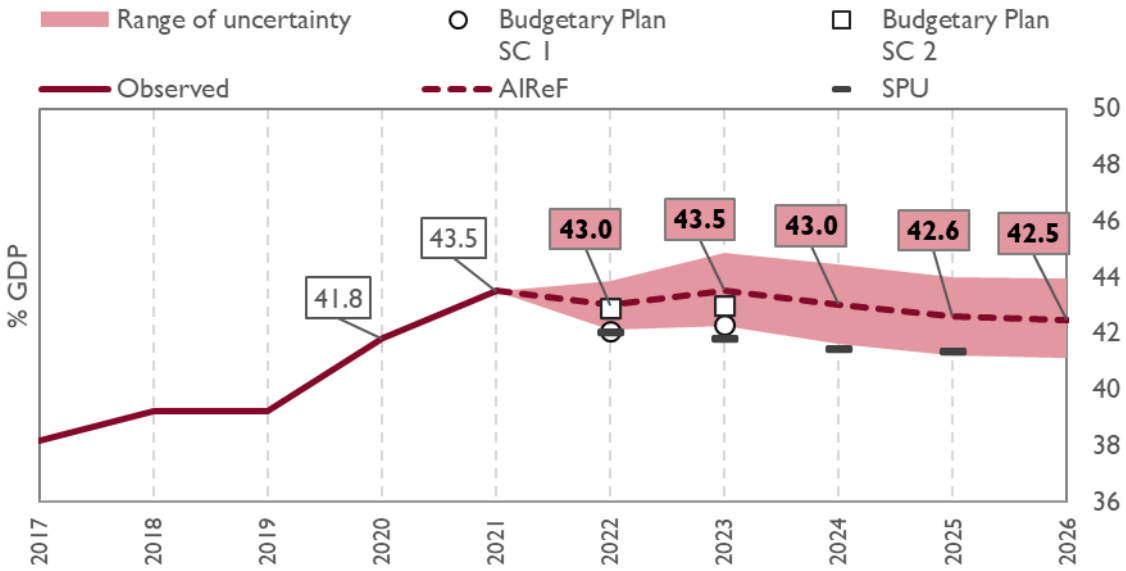


Source: AIReF

From 2023 onwards, the deficit remains stable, with the withdrawal of temporary revenue measures being offset by the baseline evolution of revenue and expenditure. While the evolution of revenue is linked to the performance of the economy, the baseline evolution of expenditure will be marked by the reduction in inflationary pressures and the return to fiscal rules. In 2025 and 2026, the rise in interest rates somewhat reduces the impact of the underlying factors and therefore the deficit rises slightly.

AIReF forecasts that the weight of revenue over GDP, excluding the RTRP, will stand at 43.5% in 2023, with the level falling over the rest of the period to stand at 42.5% in 2026. In 2023, the inflationary boost to VAT, PIT and social contributions, together with the approved measures (temporary measures such as the new temporary levies and the Tax on Large Fortunes and permanent measures, such as the Intergenerational Equity Mechanism and the increase in maximum contribution bases), push the weight of revenue upwards by almost 0.6 points. As from 2024, the reduction in nominal GDP growth, together with the progressive disappearance of temporary revenue measures, lead to 2026 closing with a weight of revenue over GDP of 42.5%. The weight of revenue in 2026 will continue to be more than 3 points higher than in 2019, thus consolidating part of the increase in revenue observed following the pandemic.

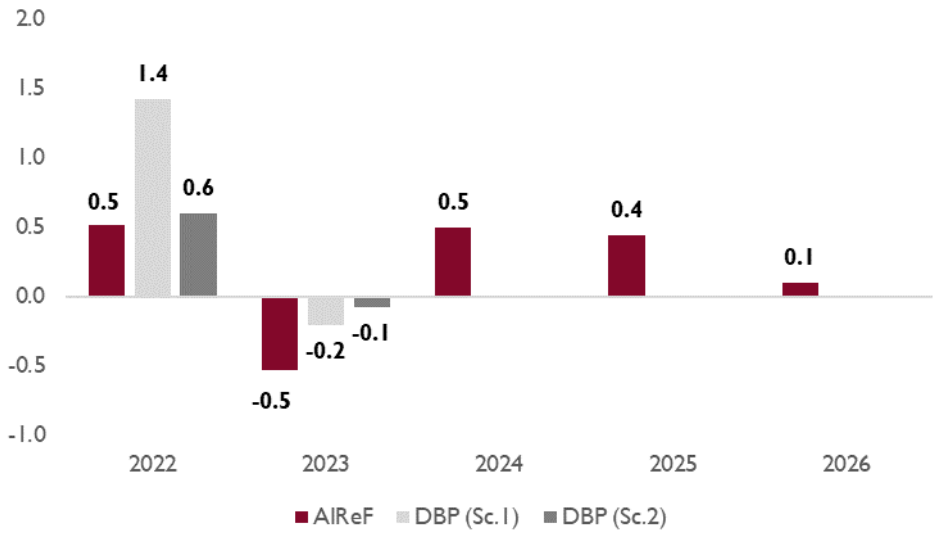
FIGURE 9. TOTAL GG REVENUE (% GDP)



Source: IGAE, Budgetary Plan and AIReF estimate

The revenue forecasts of Scenario 2 are in line with those of AIReF, while those of Scenario 1 are clearly lower, as are those set out in the GSB. The differences with Scenario 1 are due to the year-end 2022 figure, which AIReF estimates at a level of 43%, 0.9 points higher than Scenario 1 and very similar to that set out in Scenario 2. For 2023, AIReF expects higher revenue growth than in Scenario 1, which increases the differences. As for Scenario 2, under the assumption that the measures in response to the energy crisis are extended, AIReF considers a weight of revenue over GDP in line with that set out in the Budgetary Plan in both 2022 and 2023.

FIGURE 10. FORECAST ANNUAL REDUCTION IN REVENUE (WITHOUT NGEU) (% GDP)



Note: positive sign means a reduction in revenue

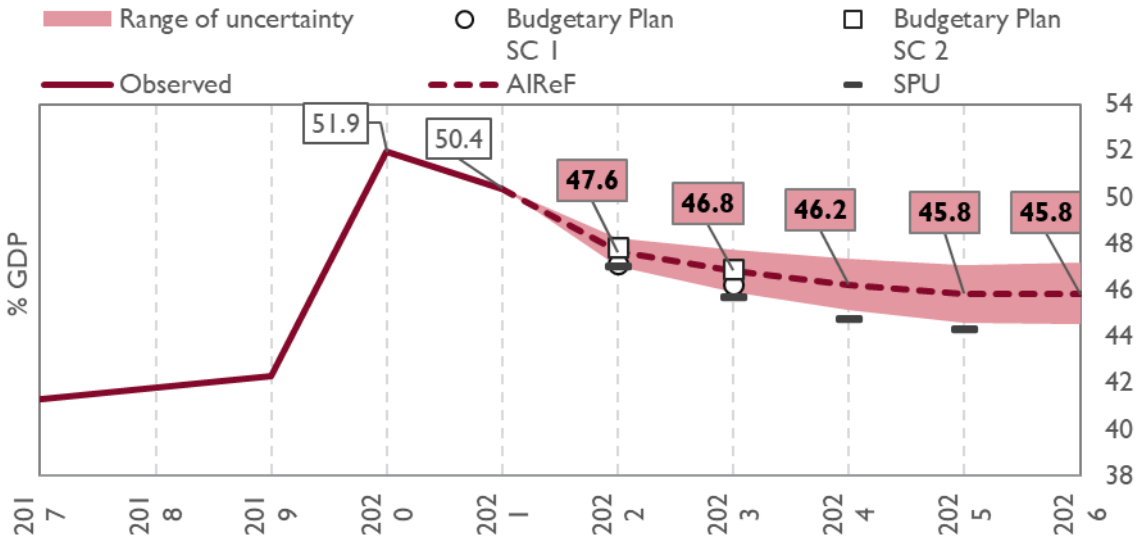
Source: Budgetary Plan and AIReF

AIReF estimates that expenditure in 2023 will reach a weight of 46.8% of GDP and its weight will continue to fall to stabilise at 45.8% in 2025 and 2026. In 2023, there is a sharp rise in expenditure due to the increase in pensions in line with the CPI of the previous year. However, if the energy measures are withdrawn, the final result would be a reduction in expenditure of 0.8 points. If, on the other hand, the measures are extended, expenditure would increase, although there would be greater reductions in the year in which the withdrawal eventually takes place. As from 2024, AIReF forecasts that the return of national and European fiscal rules will help reduce expenditure growth. In 2024, expenditure falls by a further 0.5 points due to the easing of inflationary pressures and the disappearance of measures. In 2025, expenditure grows at a level below GDP, which leads to a further reduction in its weight over GDP. In 2026, the increase in interest expenditure causes the decreasing expenditure path to stagnate. Consequently, in 2026, according to AIReF's estimates, the weight of expenditure over GDP will be more than 3 points higher than in 2019. This implies a structural increase in expenditure that is reflected in both the components of public consumption and in social transfers in cash.

AIReF's forecasts place expenditure in 2023 above the forecasts of the Budgetary Plan in Scenario 1 and aligned with Scenario 2. Apart from the measures, AIReF estimates higher growth in expenditure than the Budgetary Plan in 2022 and 2023. For 2022, these forecasts are 0.5 points above Scenario 1 and 0.2 points below Scenario 2 and incorporate all the measures

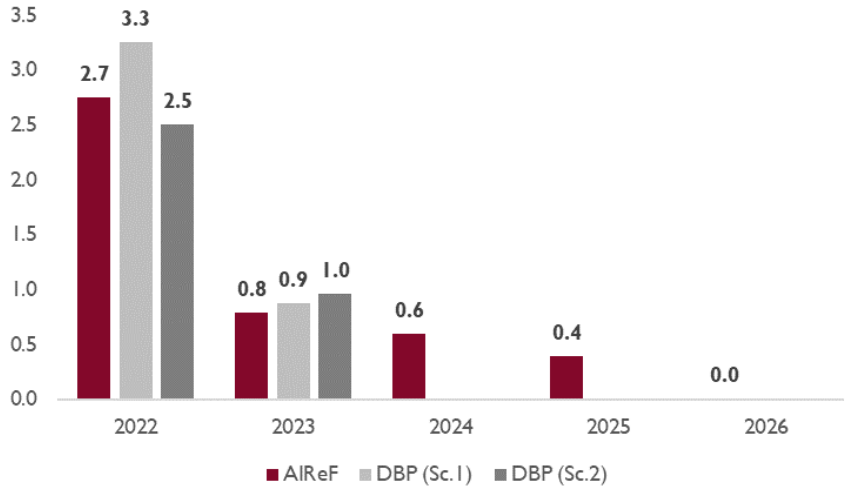
mentioned in Scenario 2 of the Budgetary Plan. For 2023, AIReF forecasts expenditure growth of 4.2% without the extension of measures, more than half a point above that forecast in both scenarios of the Budgetary Plan. Therefore, without the extension of the measures, AIReF expects expenditure in 2023 to be 0.6 points higher than Scenario 1. This difference is mainly concentrated in the components of public consumption and in other expenditure. If we add a cost of extension of measures of 0.7 points to allow a comparison with Scenario 2, the expenditure forecast by AIReF would stand at 47.5% of GDP, also 0.6 points above that forecast in Scenario 2.

FIGURE 11. EVOLUTION OF TOTAL GG EXPENDITURE (% GDP)



Source: IGAE, Budgetary Plan and AIReF estimate

FIGURE 12. ANNUAL REDUCTION IN EXPENDITURE (WITHOUT NGEU) (% GDP)



Note: positive sign means a reduction in expenditure

Source: Budgetary Plan and AIReF

4.1. Evolution of General Government revenue

Under the assumption that the measures to mitigate the energy crisis will be extended over 2023, AIReF's forecast for total revenue is aligned with Scenario 2 of the Budgetary Plan. AIReF forecasts that the weight of revenue over GDP will reach 43.5% in 2023, 1.2 points of GDP above Scenario 1 of the Budgetary plan and 0.5 points above Scenario 2. As this second scenario includes the update of the latest collection data available for 2022, it is more appropriate in comparative terms with respect to the results obtained by AIReF. Scenario 2 also considers the extension of the current revenue measures introduced to mitigate the increase in energy prices[5] over the whole of 2023. According to AIReF's estimates, this would mean a reduction in revenue of 0.6 points of GDP to 43%, in line with the weight forecast in the Budgetary Plan for this scenario. However, the revenue structure projected by AIReF is different, with a lower weight of taxes together with a higher weight of both social contributions and other revenue.

TABLE 6. REVENUE IN % OF GDP (WITHOUT RTRP) AIREF VS. BUDGETARY PLAN

	2022			2023			
	DBP-1	DBP-2	AIReF	DBP-1	DBP-2	AIReF	AIReF *
REVENUE	**42.1**	**42.9**	**43.0**	**42.3**	**43.0**	**43.5**	**43.0**
TAXES	24.4	25.3	24.9	24.8	25.5	25.5	24.9
On production	12.2	12.6	12.3	12.2	12.3	12.7	12.1
On income	11.8	12.2	12.1	12.2	12.8	12.4	12.4
Capital	0.5	0.5	0.4	0.4	0.5	0.4	0.4
CONTRIBUTIONS:	13.6	13.6	13.7	13.7	13.7	13.9	13.9
Other revenue	4.0	4.0	4.4	3.8	3.8	4.2	4.2

* Considering the extension of energy measures throughout 2023

Source: Budgetary Plan and AIReF

AIReF projects a slowdown in revenue growth over 2022-2026 to 42.5% by the end of the period. AIReF's forecasts show growth in revenue in 2023, which slows down over the following years due to the ongoing fall from 2023 in the weight of taxes and, from 2024, also of social contributions. Taxes show the highest falls, standing at 24.6% of GDP in 2026, 0.9 points less than in 2023, while contributions fall by a little over 0.1 points, to stand at 13.7% by the end of the period. Other revenue returns to its historical weight of GDP.

[5] Reduction in the rate of VAT on energy products, reduction in the rate of the Special Tax on Electricity and suspension of the Tax on the Value of Electricity Production.

TABLE 7. REVENUE AS % OF GDP (WITHOUT RTRP). AIREF MEDIUM-TERM PATH

	AIReF				
	2022	2023	2024	2025	2026
REVENUE	**43.0**	**43.5**	**43.0**	**42.6**	**42.5**
TAXES	24.9	25.5	25.3	24.8	24.6
On production	12.3	12.7	12.5	12.2	12.1
On income	12.1	12.4	12.4	12.1	12.2
Capital	0.4	0.4	0.4	0.4	0.4
CONTRIBUTIONS:	13.7	13.9	13.9	13.8	13.7
Other revenue	4.4	4.2	3.9	4.0	4.1

Source: AIReF

4.1.1. Taxes on production and imports

AIReF forecasts that the weight of taxes on production and imports in 2023 will stand at 12.1% if an extension of energy measures is incorporated, 0.2 points below Scenario 2 of the Budgetary Plan. The main components of this heading are VAT and taxes on products, including special taxes and the Tax on the Value of Electricity Production, which are taxes affected in 2022 by the energy crisis measures, currently in force until December 31st, 2022. AIReF's estimates for this heading are higher than those of Scenario 1 of the Budgetary Plan by 0.1 points in 2022 and a little over 0.4 points in 2023. However, in comparative terms with Scenario 2, when considering the extension of the measures to mitigate the rise in energy prices, which represents a negative impact on total revenue of 0.6 points (see Section 4.3.2 Measures for energy crisis and war in Ukraine), AIReF's forecasts stand at 12.1%, 0.2 points below the figure included in the Budgetary Plan.

AIReF projects an acceleration in these taxes once the current measures expire, and a subsequent slowdown in their growth, bringing them to 12.1% of GDP in 2026. The growth in these taxes at the end of the period 2022-2026 is explained by (i) the fall in the buoyancy of VAT, the projection of which is linked to domestic demand, (ii) the slowdown in the growth of special taxes in line with the evolution of real GDP, and (iii) the decrease in the Tax on the Value of Electricity Production, linked to the gradual expected fall in electricity prices.

4.1.2. Taxes on income and wealth

AIReF's forecasts for taxes on income and wealth are lower than those considered in Scenario 2 of the Budgetary Plan, standing 0.3 points lower in 2023. The main items making up this heading are Personal Income Tax (PIT),

Corporate Income Tax (CIT) and Non-Resident Income Tax (NRIT). Although AIReF's projections are higher than those set out in the Budgetary Plan for Scenario 1, it is Scenario 2 that is considered comparable as it includes the update of the latest collection data. This is particularly important in this case as it includes the settlements of the 2021 campaign, both for PIT and for Corporate Income Tax. This heading will temporarily rise in 2023 and 2024 as a result of implementation of the Solidarity Tax on Large Fortunes, excluded from Scenario 1, and as a result of the levies on the energy and financial sectors. In addition, in 2024 and 2025, and to a much lesser extent in 2023, Corporate Income Tax will include the additional impact resulting from the temporary restriction on offsetting losses (see Section 4.3.1 Central Government revenue measures included in the Budgetary Plan.), which are not specified in Scenario 1.

AIReF forecasts that the weight of taxes on income at the end of the period 2022-2026 will stand at 12.2% of GDP. At the end of the period 2022-2026, the trend of AIReF's projections for PIT wage bases slows down, following the trend in compensation of employees, although the weight of this tax will continue to be higher than the pre-crisis level. For its part, the Corporate Income Tax base is less buoyant in relation to the evolution of the gross operating surplus. Finally, the progressive withdrawal of temporary revenue-increasing measures also drives the reduction in the weight of these taxes.

4.1.3. Taxes on capital

AIReF forecasts that taxes on capital will remain at a weight of 0.4% of GDP in 2022 and 2023, standing just under 0.1 points below the scenarios of the Budgetary Plan in 2022 and in line with them in 2023. AIReF considers that taxes on capital will not change substantially over the projection period, maintaining their weight of 0.4 points of GDP throughout the period.

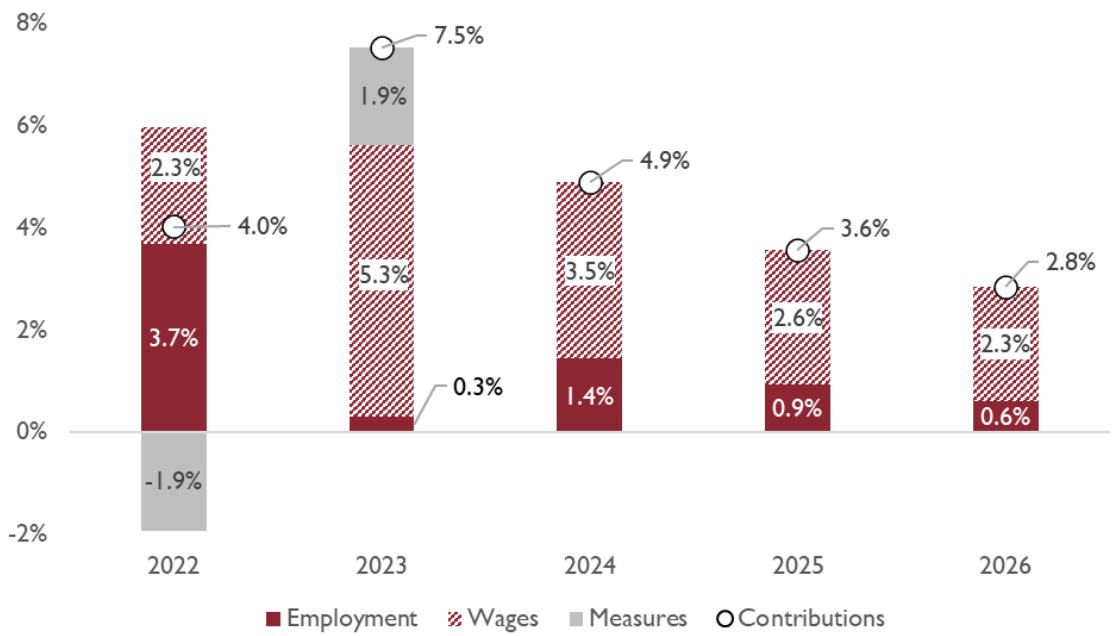
4.1.4. Social contributions

AIReF expects the weight of contributions over GDP to rise from 13.7% in 2022 to 13.9% in 2023, 0.2 points above both government scenarios, before falling to 13.7% in 2026. According to AIReF's forecasts, the weight of contributions over GDP rises by almost 0.2 points in 2023 to stand at 13.9%, compared with the 13.7% estimated in both scenarios of the Budgetary Plan. This is due to the increase in wages driven by inflation and effects of the measures, specifically the Intergenerational Equity Mechanism and the 8.6% increase in the maximum contribution bases. Over the rest of the period, the fall is caused by

the denominator effect, a result of the moderation of the weight of compensation of employees over GDP.

The positive trend in wages is the determining factor in the evolution of social contributions over the projection period and, to a lesser extent, employment and the measures implemented. In 2022, the gradual disappearance of subsidies for exemptions from contributions for job-retention schemes (ERTEs) and self-employed workers pushes the growth rate of contributions down, while wages and employment contribute positively to the growth in contributions. In 2023, the entry into force of the Intergenerational Equity Mechanism and the increase in the maximum contribution bases means that the measures will then make a positive contribution to the growth in social contributions. In contrast, the weight of employment, which AIReF's macroeconomic outlook considers to be virtually unchanged in 2023, hardly contributes to growth at all, with the increase in wages being the key factor in the growth of this heading. Employment regains momentum in 2024, but wages remain the determining factor for growth throughout the projection horizon.

FIGURE 13. BREAKDOWN OF GROWTH (% CHANGE) IN SOCIAL CONTRIBUTIONS



Source: AIReF

4.1.5. Other revenue

AIReF forecasts that the weight of other revenue will fall by over 0.2 points in 2023 to stand at 4.2% of GDP, 0.4 points higher than in both scenarios of the

Budgetary Plan. AIReF considers that the reduction in weight of this heading is due to the withdrawal of REACT funds. It is expected to return to its historical values in 2024 and remain stable for the rest of the projection period. The Budgetary Plan considers that the 2019 level is reached in 2022 and that the weight of the heading falls again by almost 0.3 points in 2023, maintaining a difference of 0.4 points with AIReF's estimate in both years.

BOX 1. IMPACT OF INFLATION ON TAX COLLECTION IN 2021, 2022 AND 2023

The evolution of prices since the end of 2021 has raised tax collection. Specifically, the impact on VAT is direct, while the impact on PIT or contributions will take place through wage increases. AIReF estimates the impact of the increase in prices on the collection of these three taxes by applying the rate of change of the deflator corresponding to each aggregate to the collection of the previous year, free of temporary measures.

DEFLATORS USED IN THE ESTIMATE

Aggregate		Deflator	Value 2021	Value 2022	Value 2023
Social contributions		Compensation per employee	-1.3	3.5	5.7
PIT	***Private wages***	Compensation per private employee 2022/ CPI 2023	-1	2.6	3.9
	Public wages	Increase in public wages	1.1	3.5	3
	Pensions	CPI	2.5	2.5	8.9
VAT		Deflator of domestic demand	2.5	7.1	3.9

The results of the increase in tax collection explained by inflation can be seen in the following table:

INCREASE IN TAX COLLECTION DUE TO INFLATION (€M)

	Social Contributions	PIT	VAT	TOTAL
2021	-1,925	97	2,194	**366**
2022	5,811	2,207	7,091	**15,109**
2023	10,086	3,917	3,324	**17,327**

Source: AIReF estimate

There is a clear difference between the aggregates most dependent on income from work (contributions and PIT), in which the impact on collection has a delay with respect to the time of the increase in prices, and those dependent on consumption (VAT), in which the impact is direct and immediate.

Disaggregating the increase in the collection of PIT into that resulting from private wages, public wages and pensions, it can be seen that in the case

of public wages, since a lower level of increase was established by law in 2023 than in 2022, the impact will be greater in that year. This impact already reflects the effect of fiscal drag, that is, the increase in the effective rate associated with the increase in wages.

INCREASE IN PIT COLLECTION DUE TO INFLATION (€M)

	PIT private wages	PIT public wages	PIT pensions	TOTAL
2021	-414	202	309	**97**
2022	1,203	685	319	**2,207**
2023	1,980	626	1,310	**3,917**

Source: AIReF estimate

Finally, the weight of this increase in collection on the total increase of each tax is analysed, always free of temporary measures.

INCREASE IN COLLECTION DUE TO INFLATION / TOTAL INCREASE IN COLLECTION

	Social Contributions	PIT	VAT	TOTAL
2021	-13.8%	2.0%	23.5%	**1.3%**
2022	55.3%	25.5%	60.5%	**48.9%**
2023	74.4%	64.7%	71.9%	**71.5%**

Source: AIReF estimate

The weight on the increase in collection grows for all tax headings, reaching a maximum in 2023.

4.2. Evolution of GG expenditure

AIReF estimates that non-RTRP expenditure will amount to 47.6% of GDP in 2022 and 46.8% of GDP in 2023, above the forecast in Scenario 1 of the Budgetary Plan and in line with Scenario 2. AIReF forecasts a fall of 0.8 points of GDP in 2023, mainly due to the increase in expenditure in 2022 resulting from the energy measures approved without equivalence in 2023. Expenditure in both 2022 and 2023 is higher than that forecast by the Government in Scenario 1, which is the most directly comparable scenario with AIReF's projections since, in theory, it is in line with the forecasts contained in the 2023 GSB. Scenario 2 of the Budgetary Plan includes new measures for 2022, which have also been incorporated into AIReF's forecasts, although with a lower cost. In addition, Scenario 2 includes the extension of part of the existing measures for 2023 for an amount of 0.7 points of GDP. In the absence of information on the amount and nature of these measures, AIReF has not been able to incorporate them

into its projections. If we add that increase to AIReF's forecast, AIReF's expenditure estimate for that year is higher than the Government's. By expenditure component, AIReF expects lower expenditure on interest, social transfers in kind and gross capital formation in 2023, and, in contrast, higher expenditure on compensation of employees, intermediate consumption and capital transfers.

In the medium term, AIReF forecasts a downward trend in expenditure to stabilise at 45.8% of GDP in 2026. The reduction is initially driven by the withdrawal of measures associated with COVID and the energy crisis. In addition, the return to fiscal rules will condition the evolution of expenditure, as well as the reduction in inflationary pressures. Inflation is transmitted directly, albeit with a one-year lag, to pension expenditure and, indirectly, to compensation of employees, which has been reflected in the agreements with trade unions. In addition, it also puts upward pressure on the cost of goods and services purchased by the public sector.

TABLE 8. EXPENDITURE AS % OF GDP (WITHOUT RTRP) AIREF VS. BUDGETARY PLAN (SCENARIOS 1 AND 2)

	2022			2023		
	DBP-1	DBP-2	AIReF	DBP-1	DBP-2	AIReF
EXPENDITURE	**47.1**	**47.9**	**47.6**	**46.2**	**46.9**	**46.8**
Compensation of employees	11.6	11.8	11.8	11.4	11.4	11.6
Intermediate consumption	5.7	5.7	5.8	5.6	5.6	5.7
Social transfers (in kind and in cash)	20.6	20.7	20.4	20.8	21.1	20.7
Interest	2.2	2.2	2.2	2.4	2.4	2.2
Subsidies	1.8	2.2	2.0	1.2	1.4	1.4
Gross capital formation	2.5	2.5	2.3	2.6	2.6	2.4
Investment support and other Cap. Tr,	0.9	0.9	1.1	0.6	0.6	0.9
Other expenditure	1.9	1.9	2.1	1.7	1.7	1.9

Source: Budgetary Plan and AIReF

TABLE 9. EXPENDITURE AS % OF GDP (WITHOUT RTRP). AIREF MEDIUM-TERM PATH

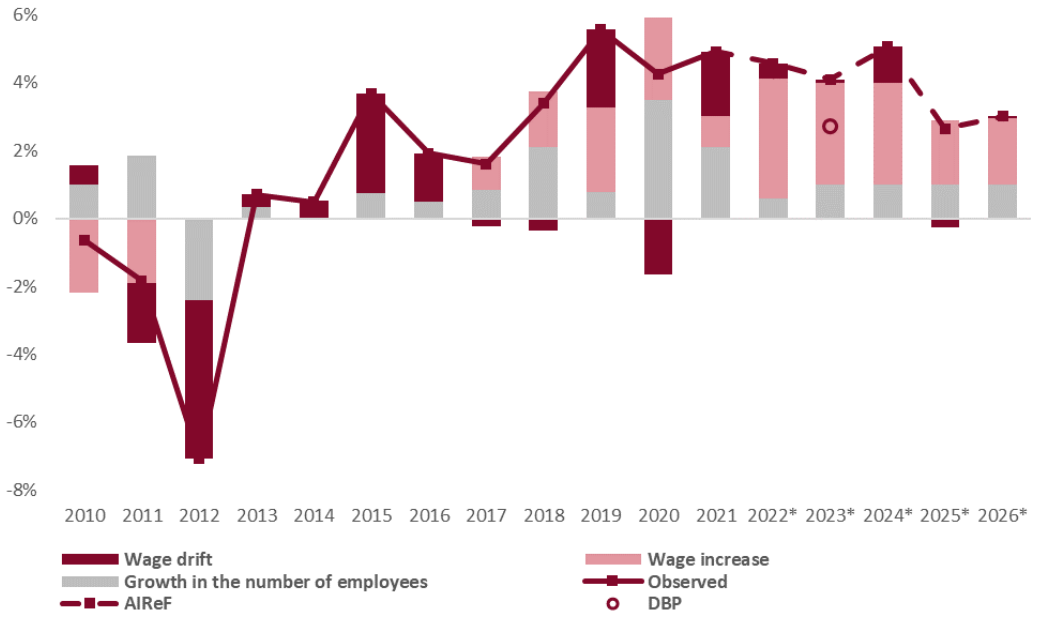
		AIReF				
	2020	2022	2023		2025	2026
EXPENDITURE	**51.9**	**47.6**	**46.8**		**45.8**	**45.8**
Compensation of employees	4.5	11.8	11.6		11.5	11.4
Intermediate consumption	7.7	5.8	5.7		5.6	5.6
Social transfers in kind via market	6.3	2.9	2.9		2.8	2.8
Social benefits in cash	0.2	17.5	17.8		17.7	17.7
Interest	9.3	2.2	2.2		2.3	2.5
Gross capital formation	-11.4	2.3	2.4		2.2	2.2
Subsidies and other expenditure		5.2	4.2		3.7	3.7
NET LENDING OR BORROWING	**0.0**	**-4.6**	**-3.3**		**-3.2**	**-3.3**

Source: AIReF

4.2.1. Compensation of employees

AIReF's forecast for compensation of employees is 11.8% of GDP in 2022 and 11.6% of GDP in 2023, 0.2 points higher in both years than forecast in Scenario 1 of the Budgetary Plan. AIReF forecasts a fall in this item of expenditure as a percentage of GDP from 11.8% in 2022 to 11.6% in 2023, as its growth is 4% lower than that of nominal GDP. AIReF has included for 2022 the increase for the entire GG of 1.5% in addition to the 2% approved in the 2022 GSB. For 2023, AIReF has considered the increase of 2.5% plus the additional 0.5% dependent on the CPI whose condition is expected to be met and paid in October 2023. However, the other additional 0.5% conditional on GDP has not been incorporated because, if the condition is met, it will not be paid until 2024. In addition, at a regional and local level, the impact of specific measures that particularly affect, in the case of the ARs, the healthcare and education sectors, such as recovery or increase in career bonuses, reduction of ratios in the education sector and the increase in the number of teachers, has been considered. Finally, the medium-term forecast is that compensation of employees will undergo higher growth due to the pay improvement agreed by the General Bargaining Committee of the Civil Service until 2024 and then moderate its growth. At any event, this growth would be below the projections of nominal GDP and therefore its weight over GDP is expected to fall gradually to 11.4% in 2026.

FIGURE 14. BREAKDOWN OF THE GROWTH IN COMPENSATION OF PUBLIC EMPLOYEES (%)



Source: INE, IGAE and AIReF

The evolution of public employees is conditioned by the consolidation of part of the spending resulting from the pandemic. From 2022 onwards, AIReF assumes that part of the expenditure associated with the COVID measures is consolidated and stabilises at the end of the period. In addition to this, an increase in the number of public employees of around 1% is assumed in accordance with the models based on the evolution of GDP and the population.

With regard to the compensation component, the improvements agreed for the period 2022-2024 and the increase in public wages with the CPI for 2025 and 2026 are assumed. The 2% wage increase provided for in the 2022 GSB and the pay improvements agreed by the General Bargaining Committee of the Civil Service for the period 2022-2024 have been taken into account in 2022. For the rest of the period, in the absence of specific compensation agreements, the rate of increase in the CPI estimated by AIReF has been used. In addition, a wage drift has been considered that includes the payment of the arrears of 2023 in 2024 as a result of compliance with the condition on nominal GDP and that, in turn, reduces growth in 2025, which explains the negative wage drift in that year.

4.2.2. Intermediate consumption

AIReF estimates intermediate consumption expenditure at 5.8% of GDP in 2022 and 5.7% in 2023, 0.1 points of GDP higher in both years than Scenario 1 of the Budgetary Plan. However, the Budgetary Plan estimates a downward trend in expenditure on intermediate consumption in 2022 and in 2023 due to the lower expenditure associated with the pandemic. For its part, AIReF agrees with this decrease but estimates that it will be lower, forecasting a higher expenditure of 0.1 points of GDP in both years compared with Scenario 1 of the Budgetary Plan. In its estimate, AIReF considers that intermediate consumption is one of the items most affected by inflation. This expenditure item includes expenditure on vaccines and antivirals for COVID-19. Furthermore, in 2022 it incorporates a large part of the increase to cover the extraordinary spending on the Armed Forces as a result of the war in Ukraine approved by the Resolution of the Council of Ministers of July 5th. In 2023, it incorporates the spending on elections. Subsequently, as inflationary tensions

ease, the growth in expenditure moderates. Up to 2026, spending in terms of GDP is expected to fall to stand at 5.6% in that year.

4.2.3. Social benefits (in kind and in cash)

AIReF forecasts that the weight of social transfers over GDP will rise by 0.3 points in 2023 to stand at 20.7%, a similar level to that indicated in Scenario 1 of the Budgetary Plan and 0.3 points below that of Scenario 2. As the Budgetary Plan provides an aggregate valuation of social transfers in kind and social benefits in cash, it is only possible to compare the Government's forecasts with those of AIReF on an aggregate basis. AIReF expects the weight of the heading to fall by 1.5 points of GDP in 2022, mainly as a result of the disappearance of COVID-19 measures. In 2023, an increase of 0.3 points is expected, leading to a weight over GDP of 20.7%. In Scenario 1 of the Budgetary Plan, the Government sets 20.6% and 20.8% for 2022 and 2023, respectively, while Scenario 2 proposes a similar level for 2022 and 0.4 points more for 2023. From 2024 onwards, AIReF considers that social transfers will gradually reduce their weight to end at 20.5% in 2026.

Social benefits in kind

AIReF estimates that social transfers in kind will amount to 2.9% of GDP in 2022 and 2023, with their weight falling slightly until 2026. In its estimate, AIReF estimates the greatest expenditure in the area of the CG to be on care for refugees. The amount allocated to this item has increased as a result of the war in Ukraine. At an AR level, social transfers in kind incorporate the increases and remuneration measures, as well as the impact of inflation on healthcare and education agreements. In addition, the increase in pharmaceutical expenditure is maintained and the increase of the thermal social voucher recently approved by RDL 18/2022 is included. For the LGs, some measures of support for families and groups in need resulting from the crisis persist (first due to COVID-19 and then due to the current price crisis). Finally, the medium-term forecast is that this expenditure will slightly decrease its weight over GDP to 2.8% in 2026.

Social benefits in cash

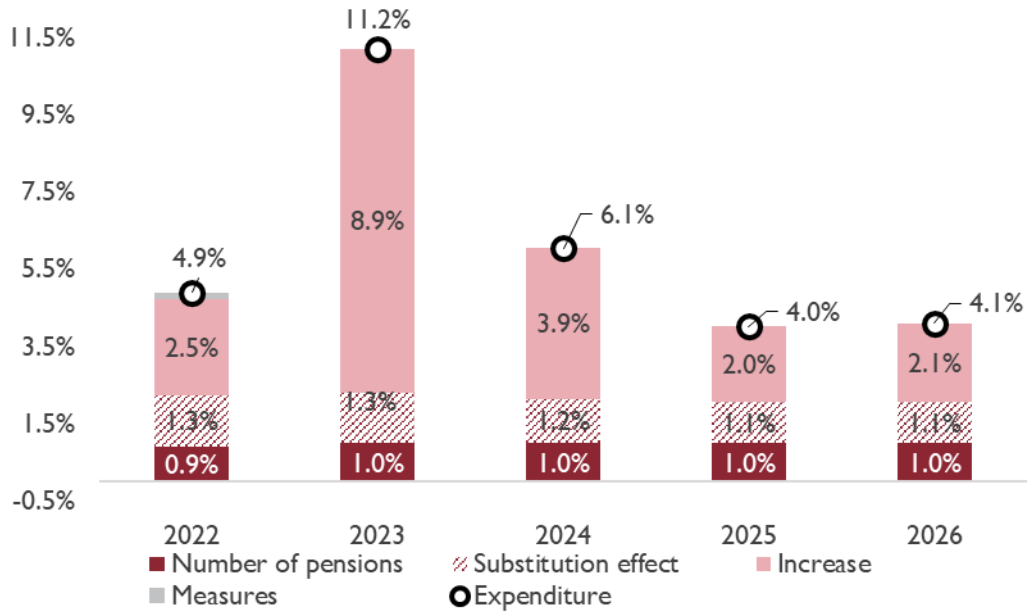
AIReF expects the weight of social transfers in cash to rise by more than 0.3 points in 2023 due to the increase in pensions in line with the CPI of the previous year. This increase comes after a reduction of 1.4 points in 2022 due to the disappearance of COVID-19 measures, to stand at a weight of 17.8% in 2023. The weight of social transfers in cash falls in 2022 due to the disappearance of COVID-19 measures, especially due to ERTEs. In 2023, the increase in pensions causes expenditure to soar, while the disappearance of temporary incapacity

due to COVID-19, the decrease in unemployment spending and the denominator effect offset that upward pressure, with the final impact on this heading being an increase of a little over 0.3 points.

AIReF forecasts that social transfers in cash during the rest of the projection period will remain around this value, standing at 17.7% of GDP in 2026. In 2024, the increase in pensions with the 2023 CPI means that the weight of the heading does not fall despite the improvement in the economy. From 2025, the denominator effect pushes the weight of this heading downwards. In 2026, the level remains 1.9 points above the pre-crisis level, mainly due to pension expenditure and, to a lesser extent, structural measures in other benefits such as the MLI.

AIReF estimates that pension expenditure will rise by 4.9% in 2022, 11.2% in 2023, 6.1% in 2024, 4% in 2025 and 4.1% in 2026. The evolution of pension expenditure is explained by the increase in the number of pensions, the annual pension increase, the substitution effect and the measures approved. AIReF estimates the increase in the number of pensions and the substitution effect with the pension expenditure projection model, and considers that the pension increase will be made in line with the CPI of the previous year, as established by Law 21/2021. The measures included in the 2022 GSB on the increase in non-contributory pensions and minimum pensions at 3%, as well as the increase in non-contributory pensions by 15% from July to December 2022 approved in RDL 11/2022, are included. In the 2023 GSB, it is estimated that pensions will rise by 11.4% compared with the 2022 Budget. The Budgetary Plan specifies that the rate of growth of pensions will be 9.7% compared with the forecast 2022 settlement, as they rise in line with the CPI of the previous year, valued at 8.5% in the Budgetary Plan.

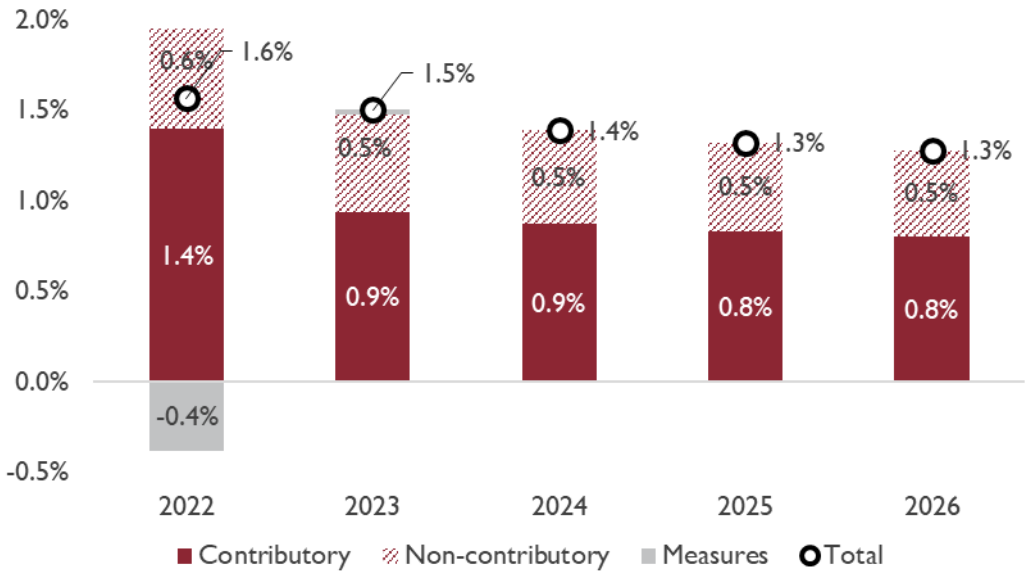
FIGURE 15. GROWTH IN PENSION EXPENDITURE (% CHANGE). AIREF PROJECTIONS



Source: AIReF

Unemployment benefits fall slightly from 1.6% of GDP in 2022 to 1.5% in 2023, to then continue the downward path to 1.3% in 2026. In 2022, the disappearance of COVID-19 measures lowers the weight of unemployment benefits, mainly due to the fact that the total spending on ERTEs goes from around €5.5bn in 2021 to around €240m in 2022. The measures include a 2.5% increase in the IPREM (Public Multiple-Effect Income Indicator) in 2022 and the cost of the subsidy for people over 52 years of age. It also includes the 3.6% increase in the IPREM in 2023 approved in the 2023 GSB. The weight of the heading moderates over the rest of the projection horizon due to the expected reduction in the unemployment rate, which, after a slight stagnation in 2023 compared with 2022, would converge from 12.8% to 11.5% in 2026. The Government's forecasts for the unemployment rate are somewhat more positive than those of AIReF for 2023, standing at 12.2%.

FIGURE 16. EVOLUTION OF UNEMPLOYMENT EXPENDITURE AS % OF GDP. AIREF'S FORECASTS



Source: AIReF

Other benefits stabilise after falling by 0.4 points in 2022 and a further 0.1 points in 2023 due to the disappearance of healthcare measures. Their weight as a proportion of GDP falls from 3.9% in 2023 to 3.8% for the remainder of the period. The reduction mainly takes place in 2022 due to the near disappearance of the spending on healthcare measures, mainly the benefit for cessation of activity. In 2023, the expenditure for temporary incapacity for work due to COVID-19 disappears, which pushes the weight down by a further 0.1 points. In addition, this heading includes the cost of financing the Minimum Living Income (MLI), the 8.5% increase in the MLI for 2023 provided for in the 2023 GSB, and the extraordinary measure included in RDL 6/2022 of an increase of 15% in the MLI for the months of April, May and June 2022.

4.2.4. Subsidies

AIReF forecasts that expenditure on subsidies will stand at 2% of GDP in 2022 and 1.4% of GDP in 2023. These figures are 0.2 points of GDP higher in both years than Scenario 1 of the Budgetary Plan. AIReF concentrates most of the energy measures approved in 2022 under this heading, including the latest ones approved by RDL 18/2022, dated October 18th (the natural gas tariff of last resort and funding of the flexibility of electricity contracts). The fall of 0.6 points of GDP in 2023 is mainly due to the fact that this year does not include the potential impact of the possible extension of these measures with the exception of the free multi-journey tickets included in the draft 2023 GSB. At any event, the evolution of this item in 2023 may change if the extension of all or part of the measures is approved, which is provided for in Scenario 2 of the

Budgetary Plan although no further information is currently available. In the medium term, this expenditure item is estimated to fall to 1.1% of GDP in 2026, in the absence of measures in the analysed time horizon.

4.2.5. Interest

AIReF's forecast for interest expenditure remains at 2.2% of GDP in 2022 and 2023. This matches the two scenarios of the Budgetary Plan in 2022, but is 0.2 points lower in 2023. In 2022, there was a turning point in the evolution of debt financing costs. The low interest rate scenario has taken a sharp turn as a result of record rate hikes in an attempt to curb inflation. 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. Therefore, 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, AIReF considers that the increase as a percentage of GDP will not be very significant in the short term as it will be cushioned by the expected growth of nominal GDP. However, in the medium term, the weight of this item is estimated to rise to stand at 2.5% of GDP in 2026.

4.2.6. Gross capital formation

AIReF estimates gross capital formation, excluding the RTRP, of 2.3% of GDP in 2022 and 2.4% in 2023. In both years, these figures are 0.2 points of GDP lower than Scenario 1 of the Budgetary Plan. The expenditure on domestic investment estimated by AIReF in 2022 includes the effect of the absence of reversals of motorway concessions that took place in 2020 and 2021. In contrast, in 2023 there was an increase in military spending associated with defence modernisation programmes, as explained in the Budgetary Plan. As a consequence of the involvement of the different tiers of government in the management of the RTRP funds, AIReF has incorporated into its scenario a level of execution lower than the historical average of investment expenditure by the General Government, given the difficulty in absorbing these investments plus those of the RTRP in the same year. In the medium term, the weight of domestic investment of GDP is forecast to fall to 2.2% in 2026 due to it taking place at the same time as execution of RTRP funds and despite the planned increase in military spending for the period.

4.2.7. Capital transfers

In contrast, AIReF's estimate of capital transfer expenditure is 1.1% of GDP in 2022 and 0.9% of GDP in 2023, exceeding the Government's estimate by 0.2

points and 0.3 points of GDP, respectively. AIReF forecasts a fall in the weight of capital transfers in 2023 compared with 2022, driven by the reduction in other capital transfers due to the absence of forecasts of possible court rulings and the lower expected impact of some of the measures (defaults on the guarantees granted due to COVID-19 and the war in Ukraine or due to the enforcement of the COVID-19 debt restructuring line). In contrast, this fall is partially offset by the expected growth of the investment support heading at an AR level as a result of the new measures provided for in the draft 2023 GSB (School 4.0, primary care, culture, and others that affect various areas). From a medium-term perspective, capital transfers are expected to fall to 0.7% of GDP in 2026. This figure may be affected by the evolution of ICO guarantee defaults or other contingencies that may materialise.

4.3. Impact of the measures on the General Government accounts

The measures to mitigate the effects of the energy crisis amount to 1.5 points of GDP in 2022, but the extent to which they will be extended in 2023 is unknown. The price spiral caused by the energy crisis has led the Government to adopt four packages of revenue and expenditure measures approved during 2022 to address estimated inflation amounting to €19.15bn, which mostly 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 excluded. In its central scenario, AIReF includes the structural revenue measures approved in the 2022 GSB, 2023 GSB and Law 7/2022, and the announced temporary revenue measures.

Scenario 2 of the Budgetary Plan includes the partial extension of the measures with a cost of 1.1 points of GDP. It does not specify which expenditure measures have been included, although it assumes the extension of all the revenue measures. It is therefore possible to quantify the impact of the extension reflected in Scenario 2. In the case of expenditure, the impact would be 0.7 points due to the difference with Scenario 1, which includes no measures. In the case of revenue, it would be necessary to take the estimate of the measures approved over 2022 for the full annual cost, which amounts to 0.6 points, of which 0.2 points would have no impact on the deficit as they correspond to the suspension of the Tax on the Value of Electricity Production.

AIReF's scenario also includes the measures approved for the Social Security Funds for 2023, especially the Intergenerational Equity Mechanism and the increase in the maximum contribution bases, both valued at 0.2 points of GDP. It also includes the measures approved in the 2023 GSB, including the increase in the MLI in line with the CPI of the previous year and the 3.6% increase in the IPREM.

The Budgetary Plan values the lower revenue expected by the ARs as a result of the measures adopted at a regional and state level at €724m. The Plan incorporates, among other elements, the higher collection expected as a result of the new Tax on Waste Deposits transferred to/agreed with the ARs, which recognises the possibility for them to exercise regulatory powers in this area. Most of the ARs already had similar taxes, which will be repealed, and which are estimated to have a lower revenue-raising capacity, in general. This element offsets part of the lower revenue resulting from other measures, particularly those adopted by the ARs in previous years in PIT (incorporated in the interim payments for 2023 and/or the 2021 settlement forecast), quantified at over €500m, the rebates in Wealth Tax, which could amount to €110m, and the transport discounts valued at over €500m.

The Budgetary Plan also includes measures of the LGs for 2023 with a negative, but very small, effect on the balance. The expenditure and revenue measures of the LGs included in the Budgetary Plan for 2023, of almost 0.01 points of GDP and with a negative result for the year essentially relate to personnel costs and modification of their organisations, capital expenditure and tax and tax management measures. The impact of these measures has been taken into account by AIReF in its forecasts for 2023.

4.3.1. Central Government revenue measures included in the Budgetary Plan.

The revenue measures of the Central Government included in the GSB will add 0.3 points to the weight of revenue over GDP in 2023. The positive impact is mainly produced by the establishment of temporary levies on the profits of the financial and energy sectors, by the Solidarity Tax on Large Fortunes and, marginally in 2023, by the limitation on offsetting losses in Corporate Income Tax. There is also the positive impact of the structural measures approved in the 2022 GSB[6], which will have an impact on the revenue for 2023 as this will be the year in which the settlements of PIT and Corporate Income Tax relating

[6] 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.

to 2022 will be filed and due to the entry into force of the new Tax on Single-Use Plastics from January 1st, 2023[7]. In the opposite direction, the new measures adopted in the draft 2023 Budget will reduce the revenue from PIT as a result of the increase in the reduction on income from work and minimum taxation and, slightly, as a result of reducing the VAT rate on feminine hygiene products to 5%. The impact of the increase in the maternity deduction included in the Budgetary Plan is also incorporated in this report.

Overall, the temporary revenue measures will reach their maximum impact in 2024 and will expire in 2026. 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 will add €3.5bn to tax collection in 2023 and 2024. For its part, the bulk of the impact of the limitation on the offsetting of losses in Corporate Income Tax is shifted to 2024 and 2025, as these are the years in which the settlements corresponding to 2023 and 2024 will be filed. However, AIReF updates its impact assessment with respect to its previous report, considering part of the impact associated with the instalment payments for the year in 2023, in accordance with the quantification announced in the Budgetary Plan. As the Solidarity Tax on Large Fortunes is not included in the Law on the 2023 GSB and on the basis of the announcement of its entry into force on January 1st, 2023, AIReF considered in its Report on the 2023 General State Budget that its collection would take place in 2024. However, this tax is included in the Budgetary Plan, with its impact in 2023 and 2024, from which it is deduced that it will be approved with effects prior to December 31st, 2022. Although the year of entry into force will depend on its passage through Parliament, AIReF estimates its impact at €1.27bn and €1.37bn in 2023 and 2024, respectively, based on the data published by the State Tax Administration Agency (AEAT) on rebates corresponding to the 2020 accrual and taking into account the ARs that have regional rebates at that date.

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

TABLE 10. REVENUE MEASURES INCLUDED IN THE BUDGETARY PLAN: AIREF ESTIMATE IN CASH TERMS

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		**-685**	**0.0**	**-1,506**	**-0.1**	**-1,506**	**-0.1**	**-1,506**	**-0.1**
PIT		**-1,363**	**-0.1**	**-1,986**	**-0.1**	**-1,986**	**-0.1**	**-1,986**	**-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
Extension of the maternity tax credit	DBP23.	-222	0.0	-274	0.0	-274	0.0	-274	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		**4,964**	**0.4**	**7,210**	**0.5**	**2,115**	**0.1**	**-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		**4,770**	**0.3**	**4,870**	**0.3**	**0**	**0.0**	**0**	**0.0**
Temporary Levy Financial Institutions	In process	1,500	0.1	1,500	0.1	0	0.0	0	0.0
Temporary Levy 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	1,270	0.1	1,370	0.1	0	0.0	0	0.0
TOTAL		**4,279**	**0.3**	**5,704**	**0.4**	**609**	**0.0**	**-1,545**	**-0.1**

Source: Government and AIReF estimates

4.3.2. Measures for energy crisis and war in Ukraine

AIReF estimates the total impact of the measures of the National Response Plan for the economic and social consequences of the Russian war, including those

approved in RDL 18/2022 of October 18th, at 1.5% of GDP for 2022. AIReF's estimate of the impact of the measures to combat the energy crisis resulting from the Russian war includes those set out in the four RDLs approved to date for this purpose, namely RDL 6/2022 of March 29th, RDL 11/2022 of June 25th, RDL 14/2022 of August 1st, and RDL 18/2022 of October 18st. The latest approved legislation results in an additional budgetary impact of almost 0.3 points of GDP.

The new measures approved on October 18th are part of the application of the "Plan+seguridad para tu energía (+SE)" energy plan and will add higher expenditure of more than €3.5bn for this year. Noteworthy among these measures are the transfer to the National Commission for Markets and Competition (CNMC) in compensation for the extension of the application of the limitation of the tariff of last resort until the end of 2023 and the possibility of homeowners' associations availing themselves of this tariff, which will amount to €3bn. In addition, an improvement in the conditions of the Thermal Social Voucher was approved, which will have a total impact for 2022 of €453, of which €228m is already included in the 2022 GSB. Finally, a new transfer will be made to the CNMC to compensate for a temporary increase in flexibility of electricity supply contracts, for an additional amount of almost €200m.

Although the Government has not specified in the Budgetary Plan for 2023 the measures considered in its Scenario 2, AIReF estimates the impact of those already approved at 0.15 points of GDP. The measures considered with an impact next year include the extension to December 31th, 2022 of the fuel price rebate, with a very low cost of around €600m for 2023. In addition, it includes free travel passes in Renfe's commuter, suburban and medium-distance transport service, with an impact of almost €700m; the measure to strengthen the protection offered by the Thermal Social Voucher, which amounts to €453m for the whole year; and a transfer to the CNMC to compensate for the increased flexibility of energy contracts for companies and the self-employed, with a cost of about €200m.

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 €2.1 billion. AIReF estimates that extending the current reductions in VAT on energy products by an additional year would have a negative impact of just over €3.1 billion 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 11. 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 (*)**
Revenue Measures (effective until 31/12/2022)	**-4,051**	**-160**
VAT: Reduction of electricity rate to 10% (RDL 12, 17 & 29 /2021 & 6/2022) & to 5% since July (RDL 11/2022)	-1,955	
Reduction in gas rate to 5% (RDL 17/2022)	-151	
STs Electricity rate reduction (RDL 2021, 6/2022 & 6/2022)	-1,944	-160
Expenditure Measures	**15,099**	**1,876**
Fuel rebate	4,531	576
Sectoral support	4,122	187
Direct support for individuals	540	
Other support for individuals	4,706	1,113
Support for refugees	1,200	
TOTAL	**-19,150**	**-2,036**
TOTAL (% GDP)	**-1.5**	**-0.1**
Other (valid until 31/12/2022)		(*)
Tax on the Value of Electricity Production: Suspension (RDL 12, 17, 29/2021 & 6/2022)	-3,780	-784

(*) Revenue corresponding to the accrual of 2022

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 income 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 for Markets and Competition (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.

4.4. Analysis by sub-sector

AIReF forecasts a different deficit level and breakdown by sub-sector for 2023 from that presented in the Budgetary Plan. However, in both cases the Central Government bears the greatest weight of the deficit. The biggest discrepancy between the two scenarios occurs at the level of the expected deficit for 2023, which is 0.6 points higher in the case of the Budgetary Plan. In 2022, the distribution of the deficit by sub-sector is similar, but in 2023 there are substantial differences. AIReF considers that the territorial administrations contribute a surplus of 0.4 points as opposed to the deficit of 0.2 points included in the Budgetary Plan. The differences in the estimate of the deficit of the CG and the SSFs are in the opposite direction, while for the CG, AIReF's estimate is 0.3 points more positive than that of the Budgetary Plan. In the case of the SSFs, AIReF forecasts a deficit that is 0.2 points higher than that estimated in the Plan.

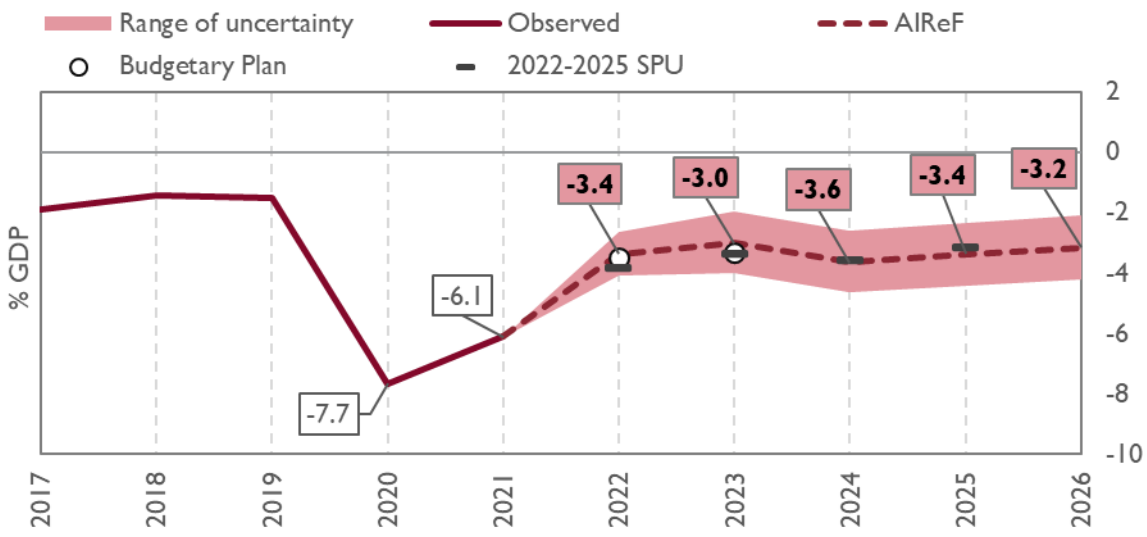
TABLE 12. EVOLUTION OF THE DEFICIT BY SUB-SECTOR, AIREF VS BUDGETARY PLAN (% GDP)

	AIReF					BUDGETARY PLAN	
	2022	2023	2024	2025	2026	2022	2023
GG	**-4.6**	**-3.3**	**-3.2**	**-3.2**	**-3.3**	**-5.0**	**-3.9**
CG	-3.4	-3.0	-3.6	-3.4	-3.2	-3.5	-3.3
SSFs	-0.5	-0.7	-0.5	-0.5	-0.5	-0.5	-0.5
ARs	-1.0	-0.1	0.4	0.2	0.0	-1.0	-0.3
LGs	0.2	0.5	0.6	0.4	0.3	0.1	0.1

Source: Budgetary Plan and AIReF

AIReF forecasts a Central Government deficit of 3.4% of GDP in 2022, which falls to 3% in 2023, compared with the 3.5% and 3.3% in the Budgetary Plan. The deficit forecast by AIReF in 2023 is 0.3 points lower than the 3.3% of GDP set out in the Budgetary Plan and is also 0.2 points lower than the 3.2% of GDP set as the reference rate by the Council of Ministers on July 26th, 2022. For the medium term, according to AIReF's estimates, the deficit of the CG rises in 2024 and moderates thereafter to 3.2% in 2026.

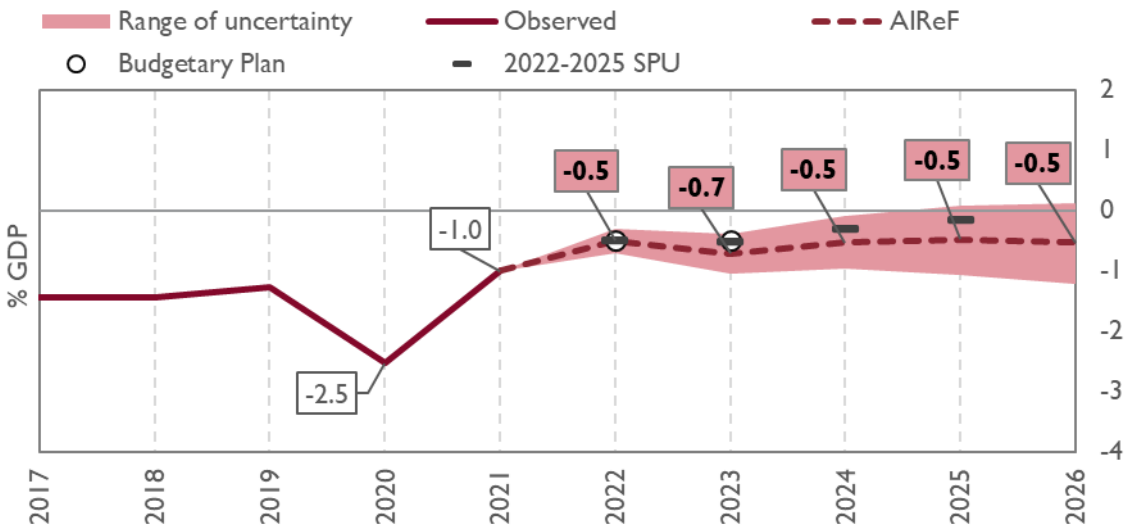
FIGURE 17. CENTRAL GOVERNMENT. NET LENDING/BORROWING (% GDP)



Source: IGAE, Budgetary Plan, Stability Programme Update (SPU) and AIReF estimate

AIReF's estimate of the SSF deficit is 0.5% in 2022, similar to that of the Government. However, in 2023 the Budgetary Plan maintains the deficit at 0.5% while AIReF increases it to 0.7%, which in 2024 drops again to 0.5%, a level that is maintained until 2026. AIReF considers that the cost of increasing pensions with the CPI of 2022 (8.9% in the last macroeconomic scenario) pushes the deficit of the SSFs upwards. The reduction in spending on unemployment, the elimination of spending on Temporary Incapacity due to COVID-19, the introduction of the Intergenerational Equity Mechanism and the increase in the maximum contribution bases partially offset this increase, with the total effect on the deficit amounting to 0.2 points.

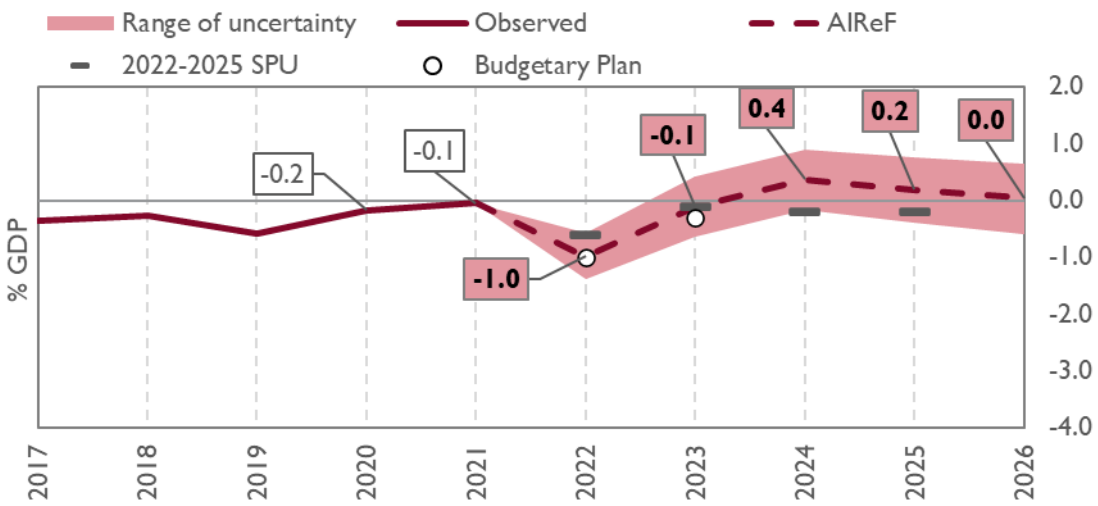
FIGURE 18. SOCIAL SECURITY FUNDS. NET LENDING/BORROWING (% GDP)



Source: IGAE, Budgetary Plan, Stability Programme Update (SPU) and AIReF estimate

AIReF forecasts a deficit of the ARs of 1% of GDP in 2022, similar to the forecast in the Budgetary Plan, which falls to 0.1% in 2023, compared with 0.3% in the Plan. The deficit estimated by AIReF in 2023 for the ARs is 0.2 points lower than that included in the Budgetary Plan. For the medium term, according to AIReF's estimates, the AR balance rises significantly in 2024 and gradually falls to reach equilibrium in 2026. This profile is largely conditioned by the settlements of the financing system, which are estimated to be exceptionally large in 2024 and then to return to normal progressively over the following years.

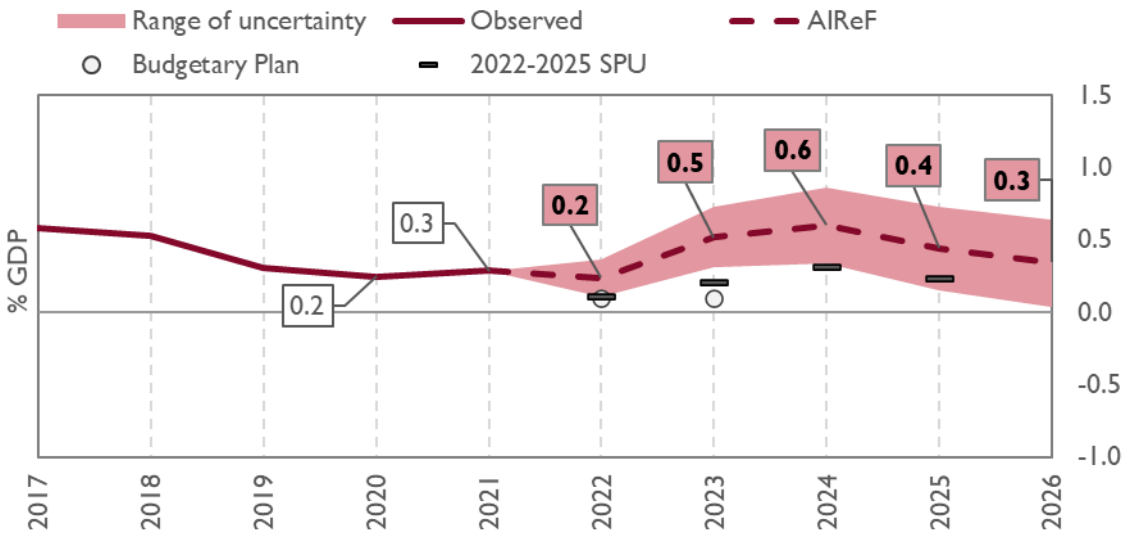
FIGURE 19. AR SUB-SECTOR NET LENDING/BORROWING (% GDP)



Source: IGAE, Budgetary Plan, Stability Programme Update (SPU) and AIReF estimate

In the case of LGs, in the medium term, AIReF estimates an increase in the surplus of 0.1 points in 2024 compared with 2023, which will progressively fall to 0.3% of GDP in 2026. As in 2023, 2024 will be influenced by the compensation for the repayment of the instalment corresponding to said year of the negative settlement of 2020, already fully allocated to 2022 (box 2. Impact of the settlement of the 2020 financing system on the net lending/borrowing of the ARs and the LGs). Moreover, there will be a large settlement of the financing system corresponding to 2022 as a result of the current increase in tax collection that has not been taken into account in determining the interim payments. The two effects will lead to an estimated surplus of 0.6% in 2024. As from that year, without the effect of these compensations and with settlements of the system less based on short-term cyclical circumstances, the surplus will fall to 0.3%.

FIGURE 20. LG SUB-SECTOR NET LENDING/BORROWING (% GDP)



Source: IGAE, Budgetary Plan, Stability Programme Update (SPU) and AIReF estimate

BOX 2. Impact of the settlement of the 2020 financing system on the net lending/borrowing of the ARs and the LGs

As a result of the fact that the interim payments of the revenue from the financing system made to the ARs and LGs in 2020 without taking into account the result of the COVID-19 tax revenue, the settlement corresponding to said year, made in July of this year, was negative (in favour of the State) in all the ARs except for Valencia, the Balearic Islands and the Canary Islands, and in the vast majority of the LGs.

Consequently, the ARs with a negative settlement have to refund the State €4.4bn and the LGs, €3.14bn.

In accordance with the provisions of the regulations governing the financing system of the Territorial Administrations, the settlements must be paid out or in at the time they are made. In addition, according to the criteria of the ESA, in national accounting they have to be applied to the year in which their amount becomes known, irrespective of whether they are deferred or made in instalments.

However, as an exception, in the case of the LGs and for the settlement corresponding to their share of State revenue, the Law on the 2022 GSB established that the LGs must repay it within a maximum period of three years by means of quarterly withholdings on the interim payments for the amount of 25% of said payment (or a higher amount if it cannot be repaid within three years).

Said law also established for both sub-sectors that, in order not to have an impact on their public accounts, the State would pay them compensation from its expenditure budget for the full amount to be repaid for the year. Along the same lines, in the case of the LGs, the draft Law on the 2023 GSB establishes the same provision applicable to the amount to be repaid for 2023.

Therefore, both in budgetary terms and in national accounting, the repercussion of the aforementioned settlement will be different in the ARs and the LGs, as shown in the following table.

In the case of LGs and, as a consequence of the fact that, in 2022, as established by the Law on the 2022 GSB, accounting operations will be carried out in the last quarter of the year, the amount to be repaid in this year will be all the negative settlement of the transferred taxes and only a part of the negative settlement of the share in revenue equivalent to the

amount of 25% of a monthly payment. In 2023, they would repay the part of the negative settlement of the share in revenue equivalent to a monthly payment of the year (25% in each quarter), with the remaining amount left for 2024.

EFFECT OF NEGATIVE SETTLEMENT OF THE FINANCING SYSTEM (€M)

BUDGETARY ACCOUNTING				
	ARs	LGs		
	2022	2022	2023	2024
Repayment Settlement	-4,404	-732	-1,682	-727
Compensation revenue	4,404	732	1,682	727
	0	0	0	0

NATIONAL ACCOUNTING				
	ARs	LGs		
	2022	2022	2023	2024
PIT	812			
Transfers to CSA	-5,216	-3,141		
Transf. from CSA (compensation)	4,404	732	1,682	727
Impact in NA	0	-2,409	1,682	727

Source: Ministry of Finance and Civil Service and AIReF estimate

As indicated, therefore, in ARs in national accounting, there is no impact from the negative settlement that is compensated as the compensation is paid in the same year in which the settlement is charged to national accounting.

However, in the LGs, according to data estimated by AIReF, there is an impact on the surplus of the sub-sector as it is reduced in 2022 by €2.41bn and increased in 2023 by €1.68bn and in 2024 by €727m. This is due to the fact that the revenue to be received as a transfer from the CSA offsets a repayment of the settlement that was already recorded in national accounting in 2022.

In the case of the LGs that are analysed individually, all of them with a negative settlement, no LG has allocated in its forecast the effects of this negative settlement, either in 2022 or 2023, except the City Councils of Alicante, Barcelona, Palma and Valladolid, as well as the Provincial Council of Valencia. AIReF estimates that the allocation to 2022 of this negative settlement to this group of governments will amount to €800m. In 2023, a

positive effect in the group of over €500m million is estimated and half that amount in 2024.

5. AUTONOMOUS REGIONS

5.1. Analysis of the sub-sector

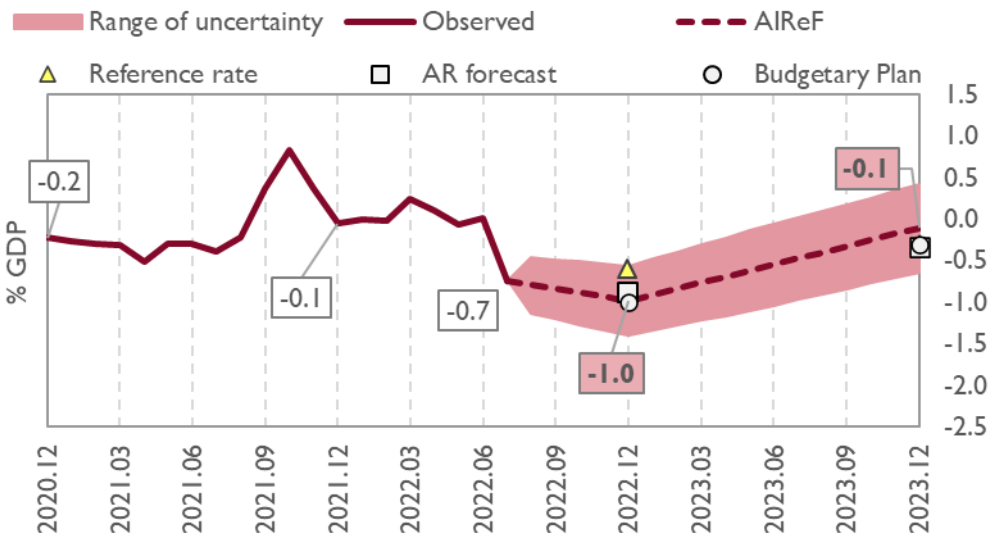
AIReF forecasts a deficit for the ARs in 2022 of 1% of GDP, similar to the forecast in the Budgetary Plan and 0.1 points higher than estimated by the regions. AIReF raises the deficit forecast for 2022 for the ARs as a whole that it previously issued on July 15th. On the basis of the execution data observed to date, the final year-end 2021 figures, the information provided by the Regions and measures resulting from Royal Decree Law 18/2022, revenue and, to a greater extent, expenditure, have been revised upwards, in both cases without considering the RTRP. AIReF forecasts higher collection from tax revenue - mainly from Transfer Tax and Stamp Duty - and from European funds. At the same time, AIReF raises its forecast for expenditure, mainly current expenditure, recording, among other items, the recently approved update of the basic compensation of public employees. The regions have generally worsened the estimates for 2022 provided for the previous report, by 0.2 points for the sub-sector as a whole, to -0.9%. However, they do not incorporate the recent wage increase.

AIReF forecasts that the AR sub-sector will record a deficit of 0.1% of GDP in 2023, which is more favourable than the set reference rate and the forecast for the ARs as a whole for that year. The sub-sector's balance will be 0.9 points better that expected by AIReF in 2022. This is mainly due to the exceptional increase in the revenue of the financing system resulting from the positive 2021 settlement, as indicated in the report of July 15th. A 10% year-on-year increase

in non-RTRP regional revenue is expected, which, under 5% growth in non-Plan expenditure, would allow the sub-sector to close with a deficit of 0.1% of GDP.

The ARs as a whole expect to reach a deficit in 2023 similar to the reference rate of -0.3% of GDP. Most of the ARs expect to reach the reference set for 2023 (-0.3% for the Regions under the ordinary regime, -0.6% for Navarre and the Basque Country). A balanced budget is only estimated to be achieved in the budgetary lines for 2023 prepared by the Canary Islands. Therefore, the aggregate regional forecasts would result in a deficit of 0.3% in 2023, with estimates of revenue slightly more moderate and expenditure higher than those considered in AIReF's scenario.

FIGURE 21. REVOLUTION OF THE AR BALANCE (% GDP)



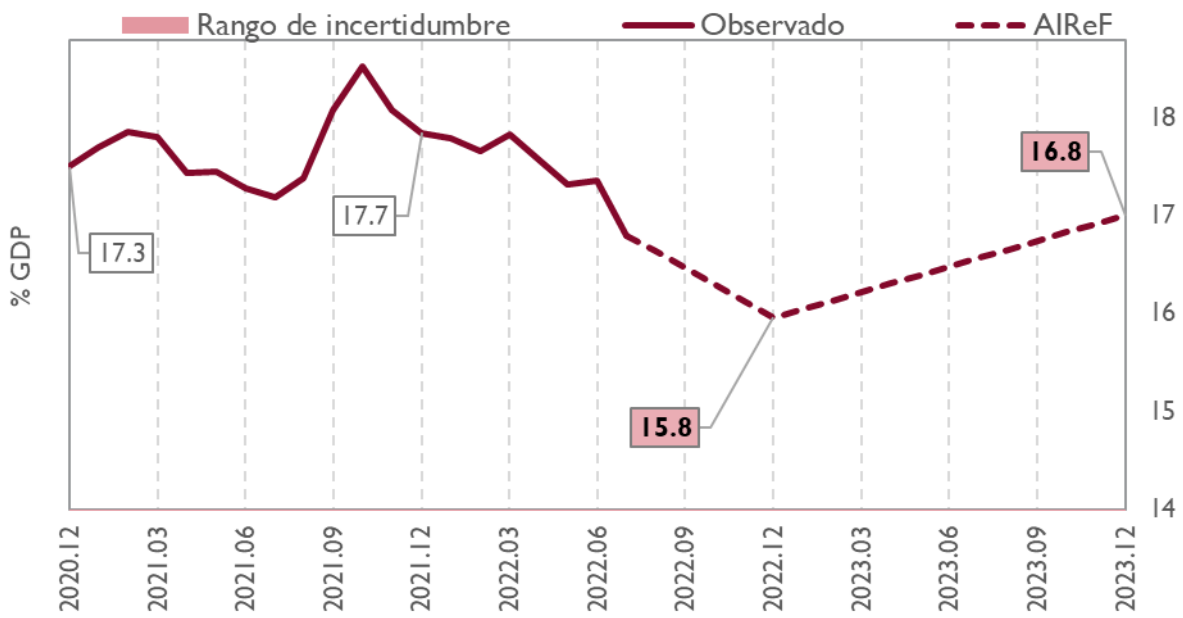
Source: AIReF and IGAE

AIReF estimates that regional revenue will rise by 10%, excluding the RTRP, gaining 1 point of weight over GDP. The 24% increase in the revenue from the financing system, conditioned by the positive settlement in 2021, compared with the negative amount of the settlement in 2020, is mitigated by a more moderate evolution in other revenue. Tax revenue will grow by 4% as a result of conflicting factors. On the negative side are the regional tax reduction measures and the slowdown in the rate of growth in the collection of taxes such as Transfer Tax and Stamp Duty and Inheritance and Gift Tax. In contrast, the expected collection of the new State Tax on Waste, the withdrawal of some temporary measures from 2022 and the impact of inflation operate in a positive direction. With regard to other revenue, the State transfers included in the draft 2023 GSB are incorporated and it is expected that European funds, both from the REACT EU and other structural funds, will fall slightly compared with those recorded in 2022. Considering the revenue associated with the RTRP

that is expected to be executed, regional revenue will grow by 13% on the previous year.

Aggregate regional forecasts envisage a lower level of revenue not associated with RTRP funds. Overall, the estimates of the ARs forecast a more moderate evolution of tax revenue, fees, State transfers unrelated to the RTRP (with the exception of Valencia, which includes in its budgetary lines a recurring transfer of €1.34bn from the State not included in the GSB) and European funds, with some significant exceptions, such as Andalusia and Extremadura.

FIGURE 22. EVOLUTION OF AR REVENUE (% GDP)



Source: AIReF and IGAE

TABLE 13. EVOLUTION OF REGIONAL REVENUE 2023. AR SUBSECTOR (€BN AND % CHANGE)

	2022	2023	% change 23/22
Total net revenue	**206**	**232**	***13***
Net revenue without RTRP	**202**	**223**	***11***
Net RFS	110	136	*24*
Net IPs	*113*	*125*	*11*
Net Settlement	*-3*	*11*	
Extraordinary funds/compensation	8	0	*-100*
Tax on Property Transfers and Stamp Duty	13	13	*2*
Inheritance and Gift Tax	3	3	*-3*
Other non-RFS taxes	11	12	*8*
Other revenue	58	60	*3*
REACT revenue	*4*	*3*	*-22*
Other	*54*	*57*	*5*
Traditional EU funds	*10*	*8*	*-13*
Contribution PC of BC	*12*	*12*	*3*
Other non-RTRP or RFS GG transfers	*32*	*31*	*-2*
Other (production and others)	*1*	*5*	*329*
RTRP revenue	*4*	*10*	*128*

Source: AIReF

Tax collection in 2023 will be €700m lower as a result of the tax measures adopted by the ARs, mostly in previous years and incorporated in the interim payments of the financing system. According to the information provided by the ARs, the net impact in 2023 of the fiscal measures adopted by the ARs under the ordinary regime in PIT in the last two years is valued at around €450m. The effect of these changes will have been incorporated by the Ministry of Finance and Civil Service in the interim payments of this year. The reduction adopted by Navarre is estimated at €78m. The collection of Inheritance and Gift Tax will be reduced by €10m. Collection of Wealth Tax is estimated to be €114m lower due to the rebates of 15% and 100% approved, respectively, in Galicia and Andalusia for 2022 (with a collection impact in 2023). Finally, various temporary reduction measures are forecast for a total amount of about €100m. These mainly affect fees and charges or, in the case of Navarre, the Tax on the Value of Electricity Production and VAT. The impact

of these measures is offset by €60M by the increase in environmental taxes and the elimination of reductions or rebates from previous years.

TABLE 14. IMPACT IN 2023 OF THE REVENUE MEASURES ADOPTED BY THE ARS. (€M)

ARs	PIT	Inheritance and Gift Tax	Wealth Tax	Tax on Property Transfers and Stamp Duty	Other	TOTAL
ANDALUSIA	-24	-13	-97		-75	-209
BALEARIC ISLANDS				3		3
CANTABRIA					2	2
CASTILE AND LEON				-2	-7	-9
CATALONIA	-24	3			25	4
EXTREMADURA					-12	-12
GALICIA	-63		-17	-1	3	-78
MADRID	-334				-1	-335
MURCIA	-20				8	-12
NAVARRE	-78				-15	-93
VALENCIA	14			15	24	53
TOTAL ARs	-529	-10	-114	15	-48	-686

Source: AIReF, based on the main 2023 lines of the ARs.

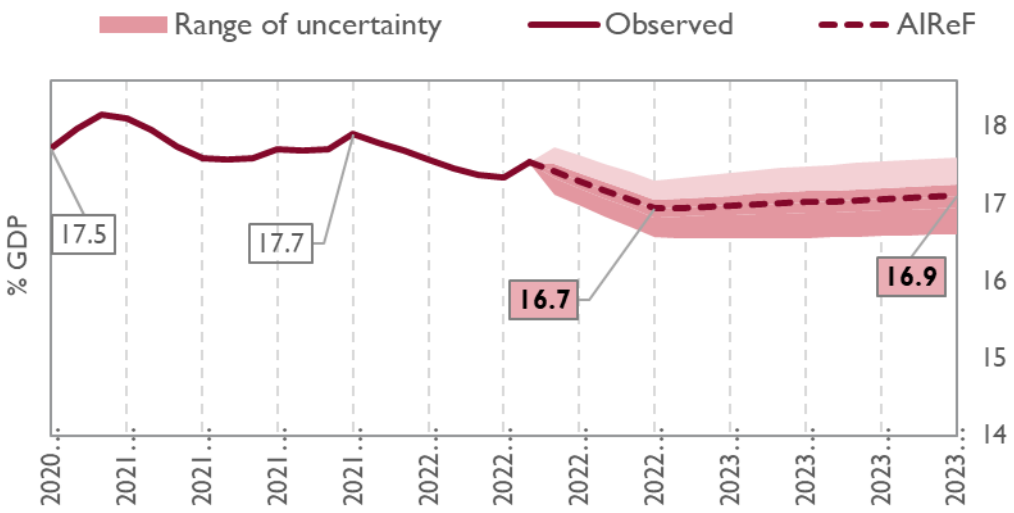
Most of the tax measures recently adopted or planned will have their impact from 2024. The main measures recently approved in PIT in Andalusia, Murcia, Madrid, Valencia and Castile and Leon, are already applied to 2022 income. Therefore, their impact will be transferred to the settlement of the system that will be carried out in 2024, in addition to the interim payments of that year. Those other measures announced in PIT that affect 2023 income will have their effect on the revenue of the ARs in 2024 as they are incorporated into the interim payments, and in the following years, due to the impact both on the interim payments and on the settlement. Based on the information provided by the ARs, the net impact of the PIT measures in 2024, 2025 and 2026, respectively, is valued at around €1.9bn, €1.5bn and €1.1bn, with the largest effect concentrated in Madrid, Andalusia, Valencia and the Canary Islands. In addition, 2024 will also be affected by the additional 25% rebate in the Wealth Tax payable adopted by Galicia, estimated at €17m, and the maintenance and withdrawal of temporary measures that, in net terms, could result in lower collection of around €40m.

AIReF forecasts that the expenditure of the ARs well grow by 5% without considering the expenditure associated with the RTRP, to stand at 0.2 points of

GDP above the 2022 level. Expenditure is expected to grow significantly over the level of the previous year due to the incorporation of the impact of inflation, the increase in civil servant remuneration provided for in the draft GSB and other measures adopted at a regional level, particularly in relation to staff. The items most affected by these factors, which have a particular impact on the areas of healthcare and education, are intermediate consumption, compensation of employees and social transfers in kind. Taking into account the expenditure estimated to be executed as a result of the RTRP, expenditure would grow by 7% over the previous year.

Regional forecasts envisage a similar level of expenditure not associated with RTRP funds. Although at an individual level the ARs present very different scenarios, the aggregate estimates include slightly lower forecasts for staff costs, which do not generally reflect the increase in remuneration provided for in the GSB, and record higher amounts in other current and capital expenditure, partly associated with higher forecasts for revenue from structural funds.

FIGURE 23. EVOLUTION OF AR EXPENDITURE (% GDP)



Source: AIReF and IGAE

TABLE 15. FORECAST EVOLUTION OF REGIONAL EXPENDITURE 2023. AR SUB-SECTOR (€BN AND % CHANGE)

	2022	2023	% change 23/22
Total net expenditure	**219**	**234**	**7**
Net expenditure without RTRP	**214**	**224**	**5**
Healthcare	88	93	6
Education	53	56	6
Other expenditure	74	75	2
Of these, REACT expenditure	*4*	*3*	*-22*
RTRP expenditure	*4*	*10*	*128*

Source: AIReF

Compensation of employees in the ARs could increase in 2023 by around €600m due to regional measures, in addition to the increase resulting from the rise in basic compensation. The main measures or effects that are expected to be recorded at a regional level in relation to staff are concentrated in: (i) the review of career bonuses and specific or productivity supplements, particularly in the field of healthcare and education, (ii) the reduction of ratios in education and the reduction in teaching hours of teachers, (iii) higher estimated cost of social contributions of education staff who move from MUFACE to the Social Security, and (iv) compensation for the elimination of temporary staff, although this last aspect is temporary in nature. In 2022, these measures especially affected the healthcare sector, while in 2023 and 2024 a greater effect is expected in the educational sector.

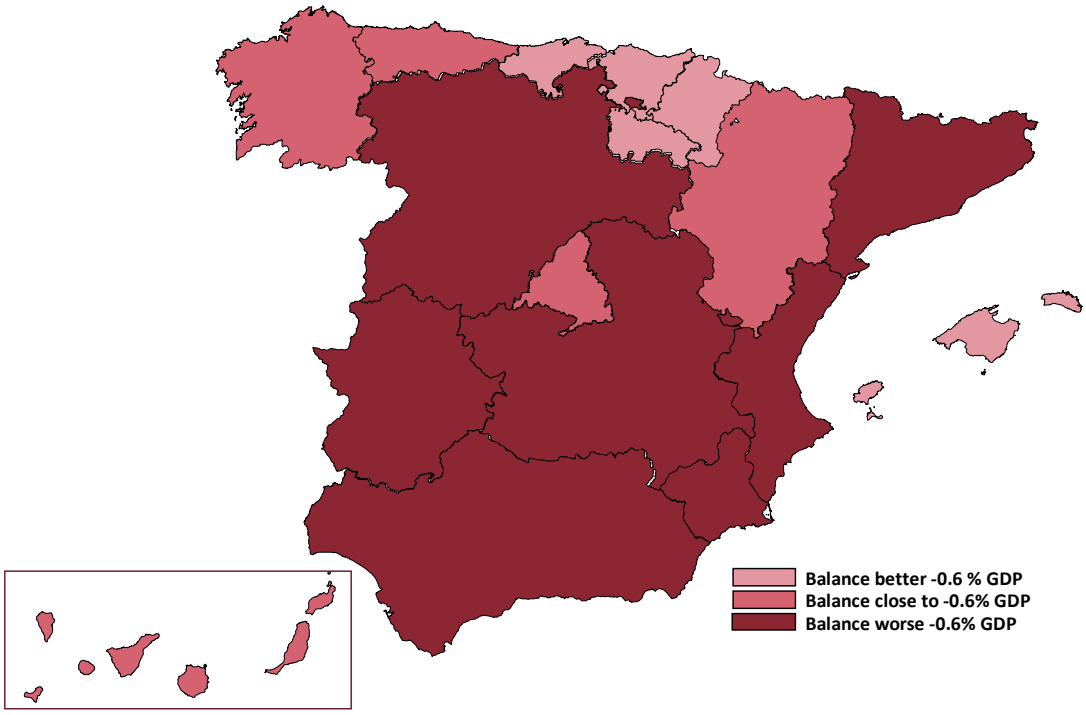
AIReF considers that the eligible expenditure for the purposes of the expenditure rule will increase by 6% in 2023. On the basis of an estimate of eligible expenditure in 2022 that could increase by 3% on that of 2021, eligible expenditure is expected to rise by around 6% in 2023 under the aforementioned estimates of expenditure, special-purpose State transfers, revenue from EU funds and tax measures adopted at a regional level.

5.2. Individual forecasts

At an individual level, seven ARs would close 2022 with a deficit higher than the reference of -0.6% of GDP set for the sub-sector. Under the new forecasts, seven ARs may close with a deficit higher than the reference of -0.6% of GDP

set for the sub-sector, while ten ARs may close with a similar or more favourable balance, which in the case of Navarre and the Basque Country is expected to be a surplus. With respect to the July report, the year-end forecasts for 13 ARs worsen. The execution data to date, the incorporation of the latest measures approved by the Central Government and the information provided by the ARs have led to the revision of expected revenue and expenditure at the end of 2022. Consequently, the forecasts for Andalusia improve, while they worsen in Aragon, Asturias, the Balearic Islands, Cantabria, Castile and Leon, Castile-La Mancha, Catalonia, Extremadura, Madrid, Murcia, Navarre, Rioja and Valencia.

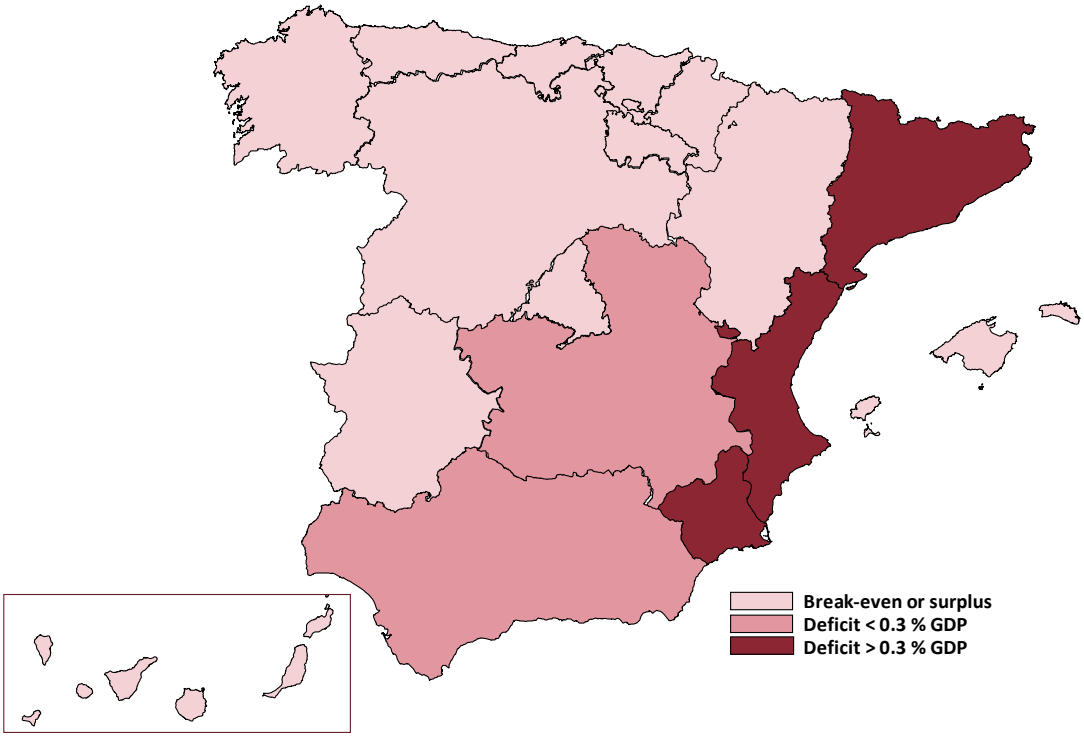
FIGURE 24. MAP OF ARS NET LENDING/BORROWING IN 2022 IN RELATION TO THE REFERENCE OF -0.6% FOR THE SUB-SECTOR.



Source: AIReF

The situation changes substantially in 2023, when AIReF forecasts that only three ARs will close with a deficit higher than the reference of -0.3% set for the sub-sector. Under the current estimates, 12 ARs (Aragon, Asturias, the Balearic Islands, the Canary Islands, Cantabria, Castile and Leon, Extremadura, Galicia, Madrid, Navarre, the Basque Country and Rioja) could close the year with a surplus or balance, or with a 0.1% deficit, in the case of Andalusia. Castile–La Mancha could reach a balance close to the reference indicated for the sub-sector and Catalonia a slightly higher deficit. For Murcia and Valencia alone, AIReF continues to estimate deficits of more than 1% of regional GDP.

FIGURE 25. MAP OF ARS NET LENDING/BORROWING IN 2023 IN RELATION TO THE REFERENCE OF -0.3% OF THE SUB-SECTOR.



Source: AIReF

A detailed analysis is included in the corresponding reports to be published shortly. The individual reports that will be published shortly will contain detailed information on the forecast for 2023 of each of the ARs.

5.3. Medium-term outlook

In the medium term, AIReF estimates a short-term surplus in 2024 of 0.4% of GDP, which will progressively fall until a balanced budget is recorded in 2026. The improvement in the estimated balance for 2023 will continue in 2024 to reach a surplus situation that would be cyclical as it is based on the exceptionally positive settlement of the financing system. Subsequently, the balance will deteriorate, recording a surplus of 0.2% in 2025 and equilibrium in 2026.

In this period, the revenue of the ARs will show an irregular profile as a result of the settlements of the financing system. The settlements of the financing system will imply that in 2023 and 2024 they will receive short-term revenue resulting from the growth in tax collection in 2021 and 2022 above the amounts forecast in the GSB. The revenue from the financing system for 2023 is 23.9% higher than the previous year, while for 2024 AIReF forecasts that this revenue

will grow by over 13%, once the effect of the tax reduction measures approved by some ARs is incorporated. While there will be a more moderate increase in interim payments in 2025 and 2026, the net settlement will fall to a more normalised level in 2026. As a result, the system's revenue will grow at rates of 1.3% and 2% in 2025 and 2026, respectively.

TABLE 16. AR REVENUE FORECASTS (% GDP)

% GDP	2021	2022	2023	2024	2025	2026
Total net revenue	**17.7**	**15.8**	**16.8**	**16.8**	**16.2**	**15.8**
Net revenue without RTRP	**17.6**	**15.4**	**16.1**	**16.3**	**16.0**	**15.7**
Net RFS	9.5	8.4	9.8	10.6	10.3	10.2
Net IPs	*8.8*	*8.6*	*9.0*	*9.1*	*9.2*	*9.3*
Net Settlement	*0.7*	*-0.2*	*0.8*	*1.5*	*1.1*	*0.8*
Extraordinary fund/compensation	1.1	0.6	0.0	0.0	0.0	0.0
Tax on Property Transfers and Stamp Duty	0.9	1.0	0.9	0.9	0.9	0.8
Inheritance and Gift Tax	0.3	0.2	0.2	0.2	0.2	0.2
Other non-RFS taxes	0.8	0.8	0.8	0.8	0.8	0.8
Other revenue	5.1	4.4	4.3	3.8	3.7	3.7

Source: IGAE and AIReF forecasts.

The medium-term evolution of expenditure will be conditioned by the easing of inflationary pressures and the return of fiscal rules. Following the expected growth for 2023, AIReF forecasts a more moderate baseline evolution of expenditure not associated with European funds or personnel expenditure in the following years. The evolution of compensation of employees is marked by the agreement reached with unions at a national level, once the measures announced by the Region are applied in 2023. Other public consumption, mainly associated with healthcare and education, will resume an evolution in line with the pre-pandemic evolution, since over 40% of the increase in COVID-related spending is considered to be structural in nature. Lastly, the evolution of capital expenditure not related to European funds, both structural and that associated with the RTRP, is expected to be contained as a result of the need to execute the expenditure of projects linked to said funds. In addition, the return to fiscal rules, although the final result of the reform at a European and national level remains unknown, will also contribute to the moderation of spending growth.

TABLE 17. AR EXPENDITURE FORECASTS (% GDP)

% GDP	2021	2022	2023	2024	2025	2026
Total net expenditure	**17.7**	**16.7**	**16.9**	**16.4**	**16.1**	**15.7**
Net expenditure without RTRP	**17.7**	**16.4**	**16.2**	**16.0**	**15.8**	**15.7**
Healthcare	6.9	6.7	6.7	6.7	6.6	6.6
Education	4.2	4.0	4.0	4.0	4.0	4.0
Other expenditure	6.6	5.7	5.5	5.3	5.2	5.2

Source: IGAE and AIReF forecasts.

Under the level of expenditure and revenue forecast by some ARs in 2023, the aforementioned medium-term situation could deteriorate. To the extent that the estimates of revenue and expenditure not related to European funds in the regional budgetary lines for 2023 assume the consolidation of a lower level of revenue or higher level of expenditure than that estimated by AIReF, the medium-term profile indicated in the above paragraphs would worsen over the entire period.

6. LOCAL GOVERNMENTS

AIReF estimates that the LG sub-sector will reach a surplus of around 0.2% of GDP in 2022, higher than the 0.1% forecast by the Government in the Budgetary Plan. AIReF has updated the year-end 2022 forecast for the LGs as a whole in light of the latest published data. Having analysed these new data, AIReF maintains for the end of this year its forecasts for the local sub-sector of a surplus of around 0.2% of GDP, although with a slight improvement compared with its July forecasts. This is due to the improved performance of local revenue, mainly that resulting from economic activity, despite the negative impact of the allocation to the year of the full amount of the negative settlement of the State financing system for 2020, of over 0.2 points of GDP (see box 2. Impact of the settlement of the 2020 financing system on the net lending/borrowing of the ARs and the LGs). Stripping out the effect of this settlement, the LGs could have closed the year with a surplus of almost 0.4% of GDP.

The data sent by the LGs to the Ministry of Finance and Civil Service about the year-end 2022 forecast in accordance with the quarterly execution show a deficit as a result of the underestimation of revenue and the overestimation of expenditure. AIReF has requested from the Information Centre of the Ministry of Finance and Civil Service the information sent by the LGs on the year-end 2022 forecast according to the latest execution data from the first half of the year. According to this information, which is highly representative, almost 98% of all the LGs expect to obtain a combined deficit of around 0.2 points of GDP at year-end. This is the result of estimating their revenue, particularly tax

revenue, following prudent criteria, and, in contrast, their expenditure with excess optimism in view of the verified percentage of execution in the previous year in a similar context of suspended fiscal rules. In most LGs, predictably, these estimates also do not include the negative impact on net lending/borrowing for the year of the allocation of all of the 2020 negative settlement of the financial system.

In 2022, AIReF estimates that local revenue could grow by 6%, excluding the RTRP. According to AIReF's estimates, the injection of revenue from the EU's economic recovery facilities, of over 0.1 points of GDP, the growth in the tax revenue most linked to economic activity, such as that of the Provincial Councils of the Basque Country and the main local taxes, along with the increase in revenue from the interim payments of the financing system of 13% could result in a year-on-year increase in local revenue of close to 8%. With the revenue from the RTRP estimated by AIReF, the growth would be almost 8%.

Local expenditure will rise by 3% in 2022 if the effect of the negative 2020 settlement of the financing system and of the revenue from the RTRP is eliminated. AIReF estimates that the year-on-year growth in expenditure in 2022 could exceed 8% as a result of the allocation to the year of the entire amount of the negative settlement of 2020 to be paid to the State for the financing system for an amount close to €3bn, as well as due to AIReF's estimate of the expenditure to be made with the RTRP. The increase in spending is mainly expected in the compensation of employees and intermediate consumption, which are together expected to grow by 4%. The prioritisation of the performance of investment projects financed with RTRP funds seems likely to delay the execution of other new projects financed with their own revenue. Therefore, AIReF estimates that capital expenditure may decrease in 2022.

For 2023, AIReF forecasts that the LGs will achieve a surplus of 0.5% of GDP, 0.4 points higher than the forecasts in the Budgetary Plan and the reference rate set for the year. AIReF forecasts a local balance of around 0.5% of GDP for 2023, resulting from expected year-on-year growth in expenditure of slightly more than 2%, well below the expected growth in revenue of almost 7%. This estimated result for 2023 improves on that expected for 2022 by almost 0.3 points of GDP. However, net of the effect of the 2020 settlement of the financing system, the estimated surplus of 2023 would be very similar (around 0.3% of GDP).

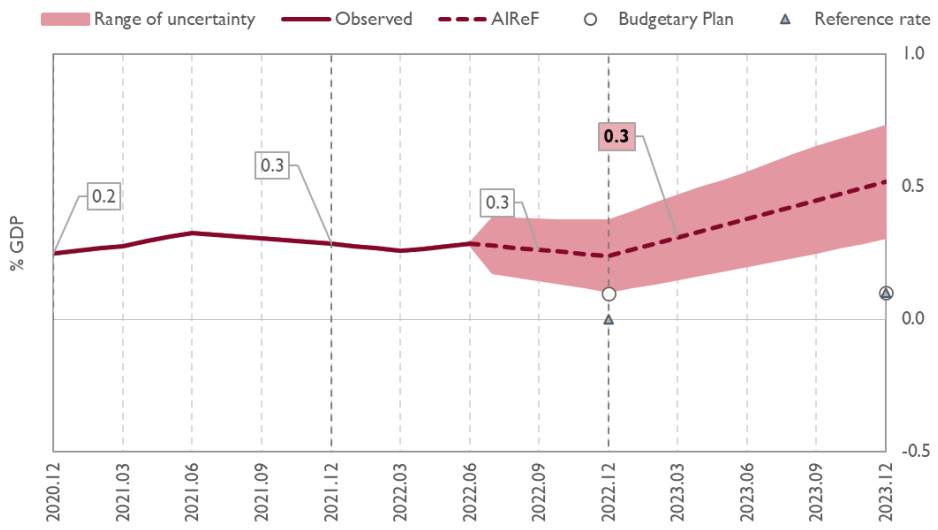
The data sent by the LGs to the Ministry of Finance and Civil Service on the main budgetary lines of 2023 show a surplus of around 0.2% of GDP, 0.3 points below AIReF's forecast. According to this information, the LGs expect to obtain

a combined surplus of around 0.2 points of GDP in 2023, although as usual, revenue is estimated with excessive caution and expenditure at an execution level close to 100%, which is difficult to achieve. In addition, it seems that the LGs' forecasts, in line with 2022, have not taken into consideration the reversal effect in 2023 of part of the adjustment due to the 2020 negative settlement which should have been performed in 2022.

For 2023, AIReF forecasts that local revenue, excluding the RTRP, will grow by 5% as a result of the improvement in the revenue most directly linked to economic activity. According to AIReF's estimates, the injection of revenue from the EU's economic recovery facilities, of more than 0.3 points of GDP, and expected growth in the tax revenue most linked to economic activity, as well as that of the Provincial Councils of the Basque Country and the main local taxes, make it possible to forecast a year-on-year increase in local revenue of almost 7%. If the effect of the revenue from the RTRP is eliminated, the growth would be 5%.

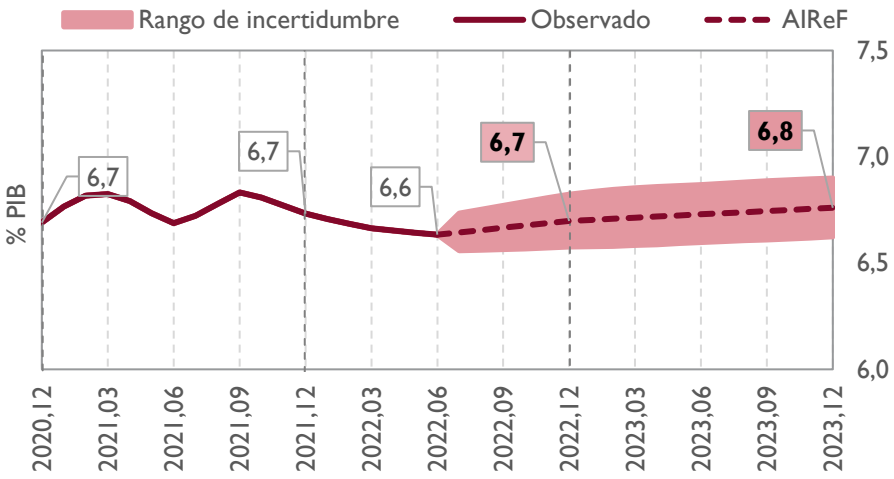
AIReF forecasts that local expenditure in 2023 will be almost 4% higher than 2022, without including the RTRP or the negative settlements. AIReF estimates that the real growth in expenditure in 2023 could reach 4%, after homogenising both years - 2022 and 2023 - due to the RTRP and the effect of the negative settlement of 2022. This increase is mainly reflected in compensation of employees, intermediate consumption and the contribution of the Provincial Councils of the Basque Country to the Autonomous Region of the Basque Country in relation to its share of transferred taxes.

FIGURE 26. EVOLUTION OF NET LENDING/BORROWING OF LGS (% GDP)



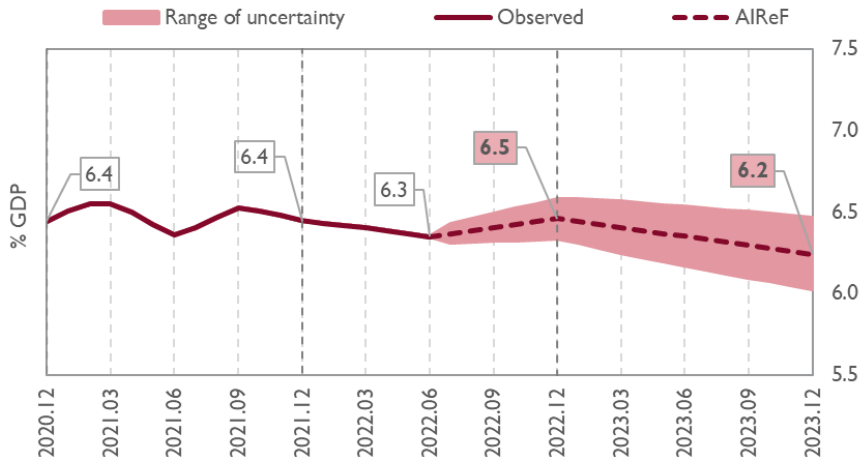
Source: IGAE, Budgetary Plan and AIReF estimate

FIGURE 27. EVOLUTION OF LG REVENUE (% GDP)



Source: IGAE, Budgetary Plan and AIReF estimate

FIGURE 28. EVOLUTION OF LG EXPENDITURE (% GDP)



Source: IGAE, Budgetary Plan and AIReF estimate

The available information on the evolution of local debt and deposits corroborates AIReF's forecasts on the results to be achieved by the LGs in 2022 and 2023. According to the latest data published by the Bank of Spain on local debt and deposits as of June 2022, the debt of the LGs rose in the second quarter of the year by almost €400m, while local deposits have increased by a similar amount. Consequently, the sub-sector's net asset position has been maintained, with a slight improvement on the position at the end of last year, which allows it to be consolidated at the end of this year. For 2023, revenue linked to economic activity is expected to rise well above the most optimistic expenditure possibilities allowed by the current suspension framework. AIReF therefore estimates that the net active position of LGs will improve as the surplus to be obtained in both years rises.

AIReF considers that eligible expenditure for the purposes of the expenditure rule will rise by 4% in 2023. On the basis of an estimate of eligible expenditure in 2022, which could rise by 2% on the level of 2021, eligible expenditure is expected to rise by more than 4% in 2023 on the basis of the estimates made on expenditure, as well as on the basis of the special-purpose State transfers and revenue from EU funds.

6.1. Local Governments analysed individually

The group of the 24 large LGs that are subject to individual analysis have worsened their 2022 forecasts with respect to the data submitted in June. Except for the Provincial Councils of the Basque Country, most of the Local Governments analysed under the ordinary regime worsen their forecasts. Thus, the group of the 24 large LGs reduces the projected surplus to half of the amount forecast in June, while the three Provincial Councils of the Basque Country have improved from a slight deficit forecast in June to a surplus of €200m. According to AIReF's estimates, this group of large LGs will maintain a position close to equilibrium, although the surplus forecast for the Provincial Councils of the Basque Country will offset the lower result of city councils and provincial councils under the ordinary regime and similar bodies.

The 2022 result of the group of large city councils, provincial councils under the ordinary regime and similar bodies is affected by an amount of close to €800m as a result of the allocation of the negative settlement of the financing system. According to AIReF's estimates, this group would have a position close to equilibrium in 2022 as a result of the impact of the negative settlement of 2020, for an amount of almost €800m. It should be noted that, with the exception of the City Councils of Alicante, Barcelona, Palma and Valladolid, as well as the Provincial Council of Valencia, all the entities have made their forecasts without allocating to 2022 the amount of the part of the settlement that is deferred to the following two years, without prejudice to it being compensated by the State. Neither do they reflect in 2023 the adjustment in the opposite direction due to the amount repaid in said year.

The forecasts for 2023 of the large LGs are a surplus of close to €400m, which AIReF places at more than three times that amount. Only the City Councils of Las Palmas, Bilbao and Córdoba, as well as the Provincial Council of Seville and the three Provincial Councils of the Basque Country forecast a deficit for 2023, albeit for small amounts. Taking into account that, as indicated above, the repayment of the instalment corresponding to 2023 of the 2020 system settlement of governments under the ordinary regime is not calculated in the result of the following year (as it was already carried out in the previous year),

AIReF estimates a surplus of over €1.5bn, of which €500m corresponds to that settlement.

7. PUBLIC DEBT

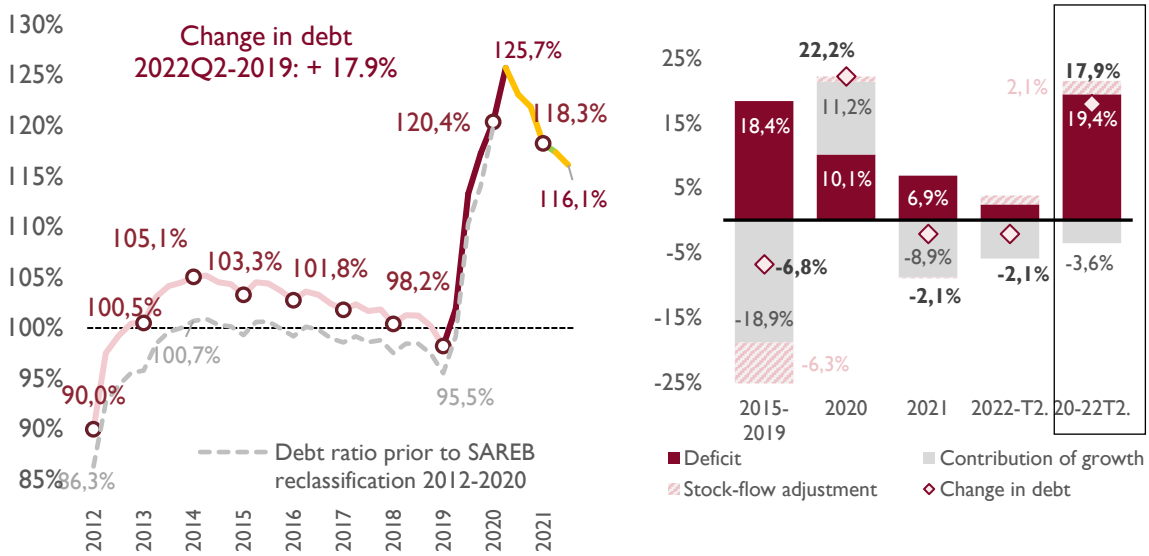
7.1. Recent evolution

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 growing, adding €64.21bn in the first eight months of 2022 to reach a new all-time high of €1.49tn. 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.

FIGURE 29. EVOLUTION OF DEBT AND CONTRIBUTIONS TO THE CHANGE

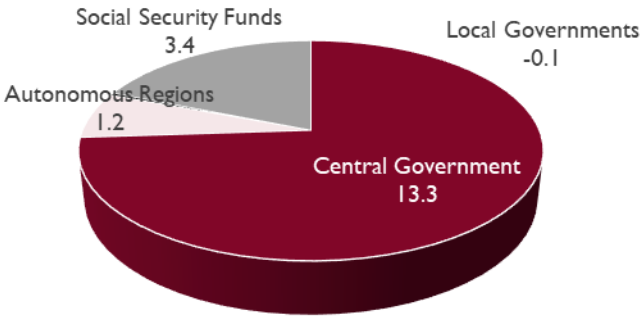
DEBT (% GDP), QUARTER-ON-QUARTER EVOLUTION **CONTRIBUTION TO THE CHANGE IN DEBT (% GDP)**



Source: Bank of Spain, INE, and AIReF.

At a sub-sector level, the largest increase in the debt ratio was recorded in the Central Government and the Social Security Funds, which have borne 93.5% of the increase in debt in the last two and a half years by financing most of the expenditure associated with the pandemic. The extraordinary transfers and the non-impact of the fall in tax revenues on the interim payments made to the Autonomous Regions under the ordinary regime have mitigated the increase in the debt ratio of the ARs. This ratio has only grown by 1.2 points – to 24.9% of GDP – while the Local Governments have slightly reduced their debt.

FIGURE 30. DEBT INCREASE (GDP POINTS) BY SUB-SECTOR (JUNE 2022-DECEMBER 2019)

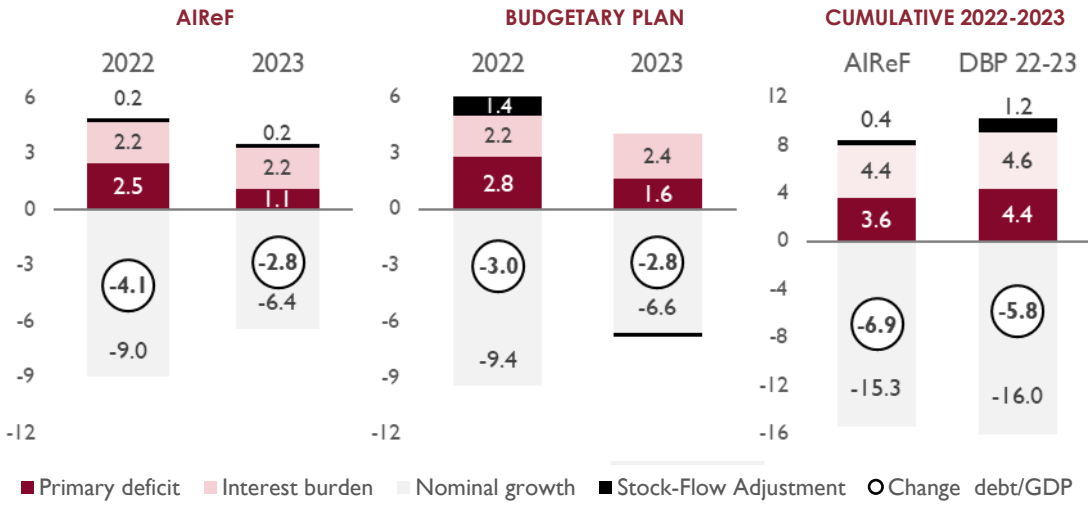


Source: Bank of Spain, INE, and AIReF.

7.2. Short- and medium-term projections

For 2023, AIReF estimates a reduction in the debt ratio of 6.9 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 (8.8). 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.

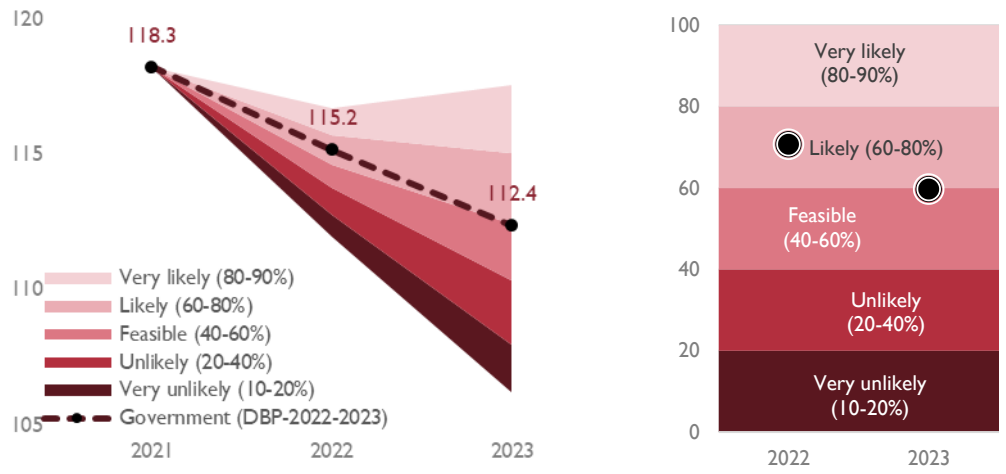
FIGURE 31. CONTRIBUTIONS TO THE CHANGE IN THE DEBT-TO-GDP RATIO



Source: Government and AIReF

AIReF considers the debt projection included in the Budgetary Plan for 2023 to be feasible. According to AIReF's stochastic projections, achieving a debt-to-GDP ratio equal to or lower than that projected by the Government for 2023 is considered feasible. In fact, AIReF estimates a somewhat higher reduction in the ratio. This cumulative divergence until 2023 of 1.1 points of GDP mainly occurs in 2022 and is the result of the greater fiscal deficit (1.0) and stock flow adjustment (0.8) presented in the Plan, which is partly offset by a greater contribution from nominal growth (-0.7).

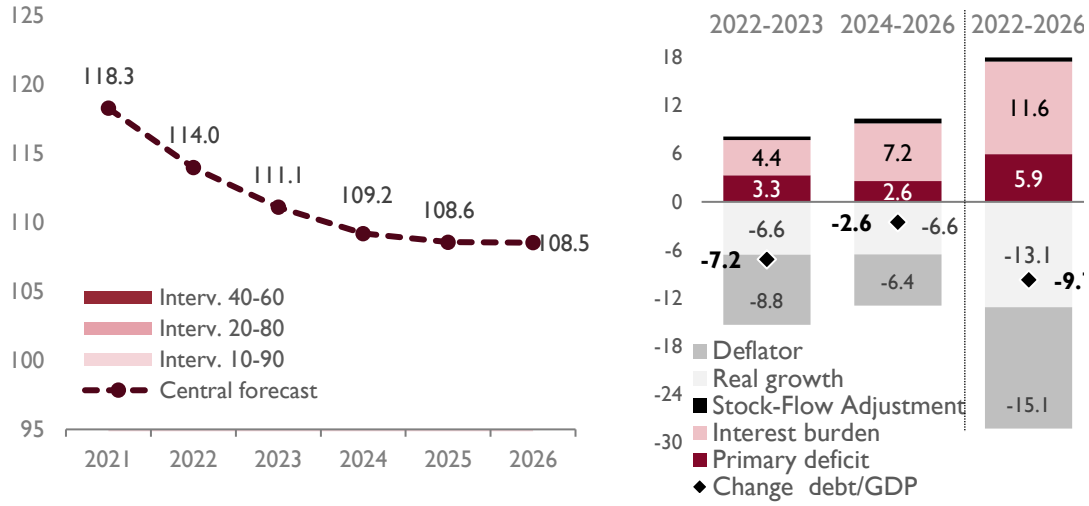
FIGURE 32. DEBT FORECASTS (% GDP) AND LIKELIHOOD OF REACHING A RATIO EQUAL TO OR LOWER THAN THAT PROJECTED BY THE GOVERNMENT IN THE 2022-2023 BUDGETARY PLAN



Source: Government and AIReF

The pace of reduction in the debt ratio is projected to slow down in the medium term for it to stabilise at 108.8% of GDP. AIReF's 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 zero with a stabilised ratio of 108.8% of GDP.

FIGURE 33. DEBT FORECAST (% GDP) AND CONTRIBUTION TO CHANGE



Source: AIReF

Compared with AIReF's estimates presented in the Stability Programme at the end of the forecast horizon (2025), the projected debt ratio rises by 0.2 points. A higher financial burden accumulated in the period (0.9 points) is offset by a greater negative contribution from nominal growth (-0.9 points), with the

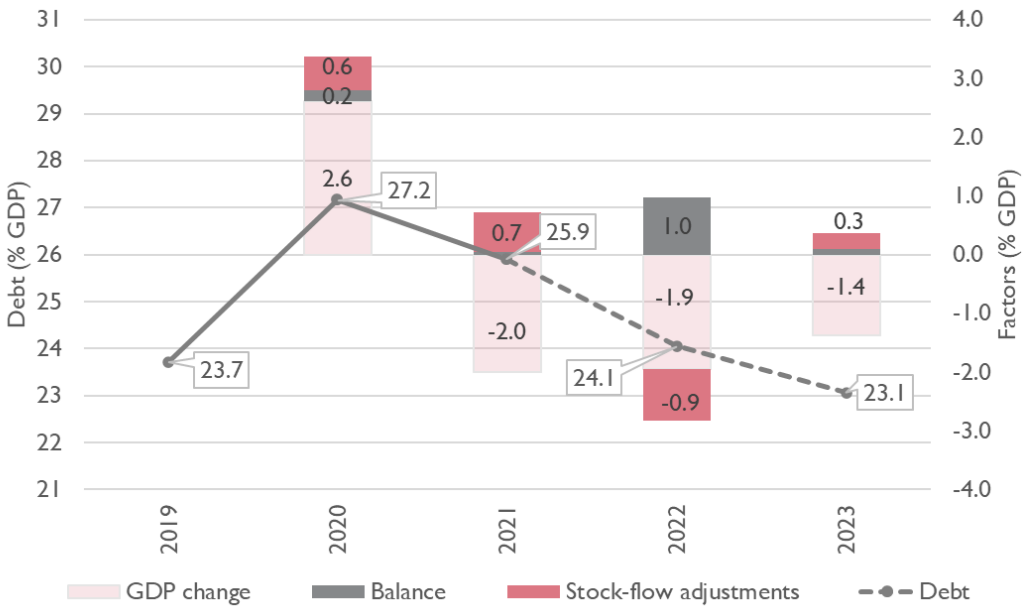
estimate of the ratio worsening by 0.2 points as a result of a slight deterioration in the evolution of the primary balance.

7.3. Autonomous Regions and Local Governments

AIReF forecasts that the ARs will reduce their level of indebtedness by almost 3 points from 2021, to stand at 23.1% of GDP in 2023. Starting from 25.9% in 2021, the ratio would improve in 2022 due to the effect of projected GDP growth and the application of excess financing from previous years. This would be partially offset by the expected deficit for the sub-sector. In 2023, projected GDP growth would result in a further reduction in the ratio.

The ARs as a whole expect to reach a higher level of debt in 2023. The ARs estimate that over the period they will reach a higher level of debt mainly due to less favourable balance forecasts and to the fact that part of the accumulated excess financing is not expected to be compensated.

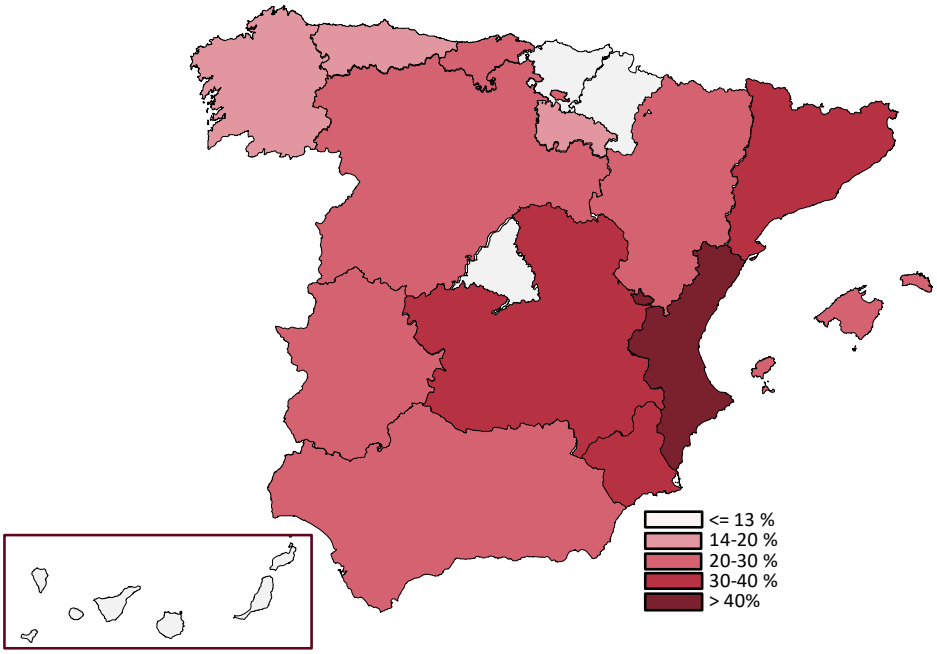
FIGURE 34. FORECAST EVOLUTION OF AR DEBT (% GDP)



Source: Bank of Spain and AIReF

Under the above estimates, four ARs could have a debt ratio above 30%, while another four could stand at 13%. Valencia, Murcia, Castile-La Mancha and Catalonia could be above 30% of debt/GDP in 2023. The Balearic Islands, which started from a level higher than that reference in 2021, would see its ratio reduced to substantially lower levels. Navarre, the Canary Islands, the Basque Country and Madrid could have a debt ratio of around 13% of GDP at year-end 2023.

FIGURE 35. REGIONAL DEBT-TO-GDP RATIO FORECASTS 2023 (% GDP)



Source: AIReF

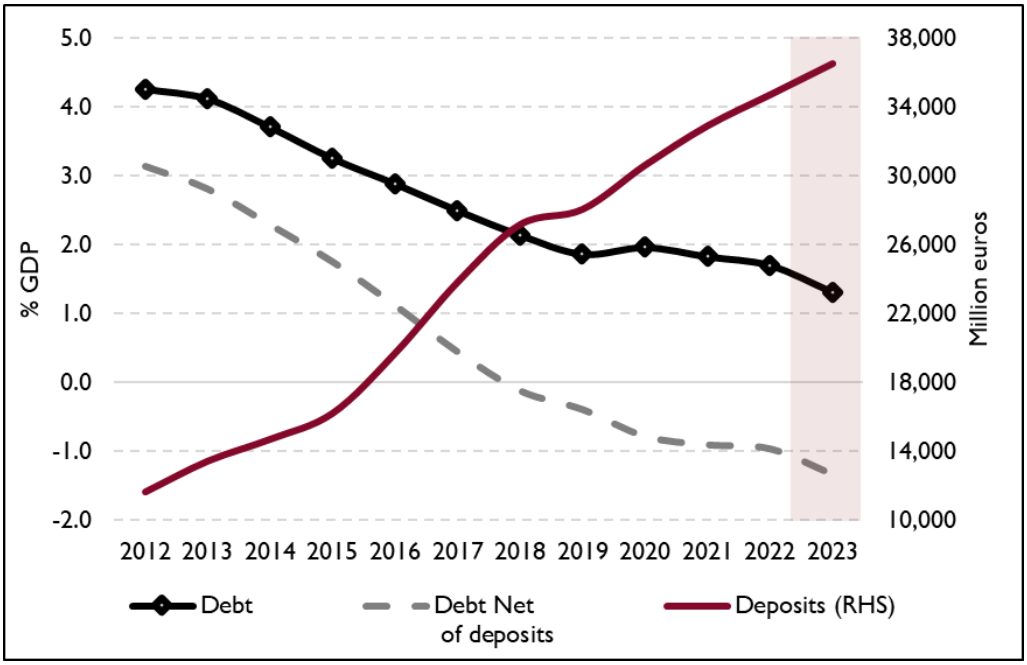
The draft budgets and budgetary lines presented by the ARs expect to reach the deficit reference set and adjust their debt to said reference. There is therefore a clear risk that excess borrowing will be generated again. All the budget documents analysed, except the Canary Islands, expect the reference rate to be achieved: in the case of the Basque Country and Navarre, -0.6% of GDP agreed in the respective Mixed Commission on the Economic Arrangement and the Coordinating Commission of the Economic Agreement with Navarre and, in the others, -0.3% of the GDP established for the sub-sector. This means that although at an aggregate level there are no major discrepancies between AIReF's forecasts and those of the ARs as a whole, in some cases such differences are very significant at an individual level. If the regional forecasts for 2023 are met, the medium-term situation overall and at an individual level would be compromised. As noted in the previous report of July 15th, setting lax reference rates that are not in line with reality raises the risk that unsustainable decisions in the medium term or, in the short term, may lead to excess borrowing similar to that accumulated at the end of 2021.

Regarding the LGs, the information available on the net asset position at the end of the first half of 2022 makes it possible to forecast expected positive results in 2022 and 2023. The latest information published by the Bank of Spain on local debt and deposits, corresponding to the second quarter of 2022, shows an increase in both figures of around €400m. This means that the sub-sector's net asset position has stabilised, improving slightly on that recorded at

the end of 2021, which makes it possible to forecast, at least, its consolidation at the end of the year. For 2023, the expected increase in revenue more directly linked to economic activity beyond the potential increase in expenditure means that AIReF estimates an improvement in the net asset position of the LGs as their expected surplus increases in both years.

The following figure shows the evolution of the observed data on debt, deposits and the net liability position of the LGs (as a percentage of GDP), from 2012 to 2021. It also shows AIReF's year-end forecast for 2022 and 2023.

FIGURE 36. EVOLUTION OF DEBT AND DEPOSITS OF LOCAL GOVERNMENTS



Source: Bank of Spain and AIReF estimates

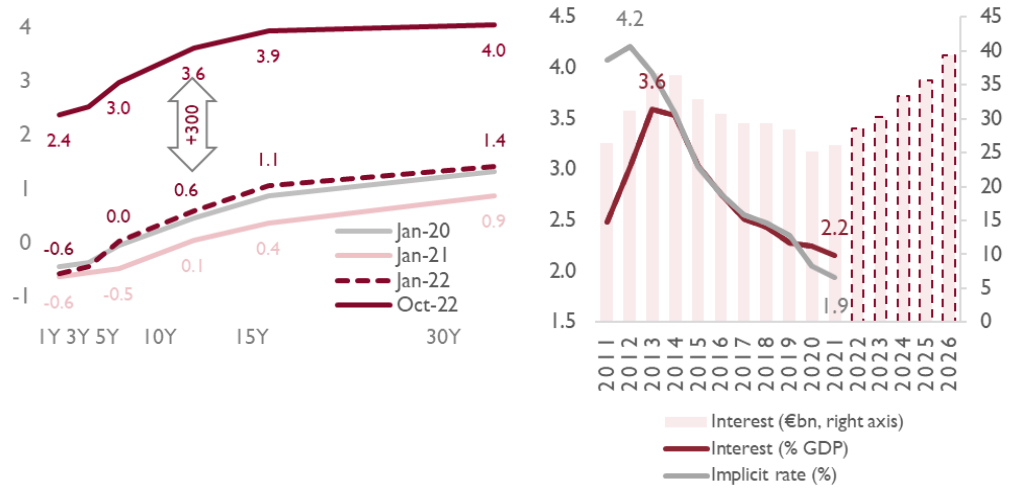
7.4. Financing conditions

2022 is marking 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, with central banks around the world having 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 37. DEBT INTEREST RATES AND FINANCIAL BURDEN

SPANISH DEBT YIELD CURVE (%) **FIN. BURD. & IMPLICIT RATE OF THE DEBT**



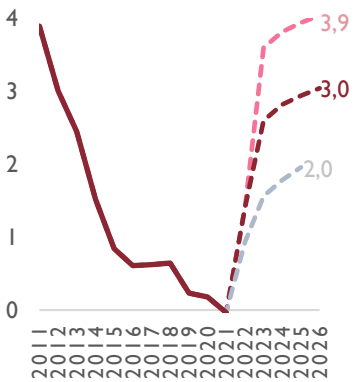
Source: Refinitiv, IGAE and AIReF

In the short term, an additional rise in sovereign debt interest rates would have a limited impact on the evolution of the debt ratio. However, in the medium and long term, higher interest rates would require a more intense and prolonged fiscal effort. According to AIReF's simulations, a 100-bp rise in rates from 2023 in issuance expectations in all sections of the curve would not result in a substantive change in the evolution of the short-term debt ratio (specifically, it would generate an increase of 1.1 points in 2026). However, it would result in a certain increase in the financial burden as a percentage of GDP (by 0.5 points) and an additional cumulative interest expense in 2026 of over €17bn, of which €1.4bn would correspond to 2023.

Although in the short term the deterioration in financing conditions has a limited impact, it begins to be significant when compared with past scenarios where low interest rates generated a fiscal space that has gradually disappeared. In the medium and long term, the current worsening of financing conditions will end up having a significant impact on the evolution

of the financial burden and, if not offset by adjustments in other expenditure or revenue items, on the debt path.

FIGURE 38. INTEREST RATES ON NEW ISSUES



Source: AIReF

FIGURE 39. AVERAGE INTEREST RATE OF THE DEBT

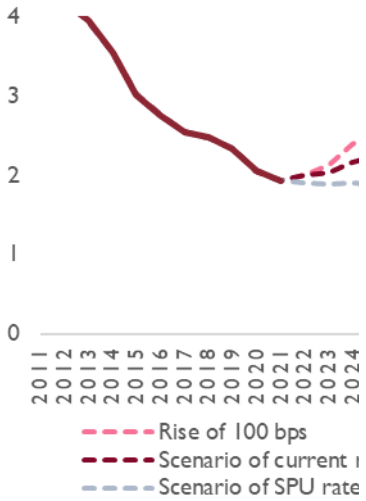
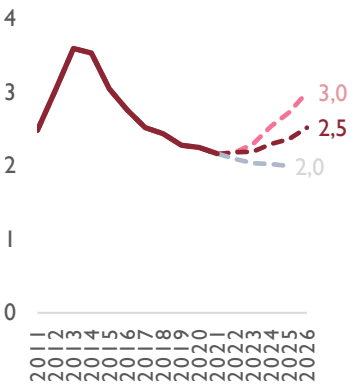


FIGURE 40. INTEREST EXPENDITURE (% GDP)



7.5. Risks for sustainability

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.

AIReF's projections paint an unfavourable trend in the medium and long-term debt ratio under a no-policy-change scenario. Beyond the reduction in the debt ratio expected in the short term, once the boost in growth as a result of the rebound in activity following the shutdown during the pandemic ends and prices return to their historical average, the debt-to-GDP ratio will return to an upward path under the assumption of a no-policy-change scenario. In this case, a high level of debt, together with higher borrowing rates, will require a sustained structural adjustment to maintain the stabilisation of the debt ratio and containment of the financial burden.

In this regard, the increase in structural expenditure that is not linked to the need to adopt temporary measures to mitigate the effects of the successive crises, means a loss of the opportunity to advance in 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 taken place 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.

8. FISCAL POLICY STANCE

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 fiscal adjustment – gradual and high-quality – and preserve 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 Spain[8]. 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 support in favour of the households and companies most

[8] 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

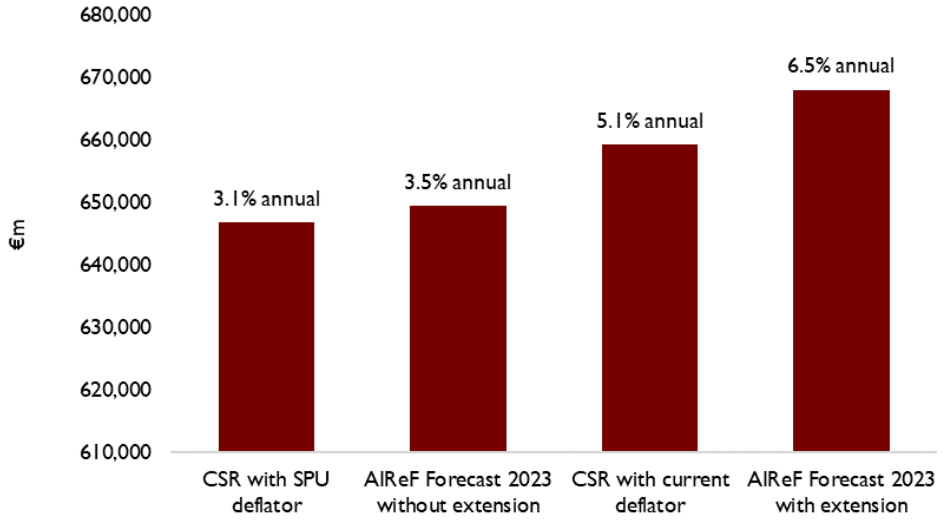
vulnerable to the rises in energy prices and the refugees caused by the war in Ukraine.

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 scenarios[9].

For the GG as a whole, AIReF forecasts 3.5% growth in current primary expenditure net of revenue measures in 2023 if the measures adopted this year are not extended. This rate of change would fall within the range defined above for the evaluation of the fiscal CSR.

[9] 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%).

TABLE 18. CURRENT PRIMARY EXPENDITURE NET OF REVENUE MEASURES. COMPARISON WITH THE FISCAL CSR, GG AS A WHOLE



Source: AIReF and Budgetary Plan

In the event that 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 6.5% per annum in 2023 according to AIReF's current estimates. This rate would be above the two benchmarks compatible with compliance with the fiscal recommendation. In this scenario, bringing the change in current primary expenditure back to CSR-compatible rates would entail additional deficit reduction measures of €8.6bn or 0.6% of GDP.

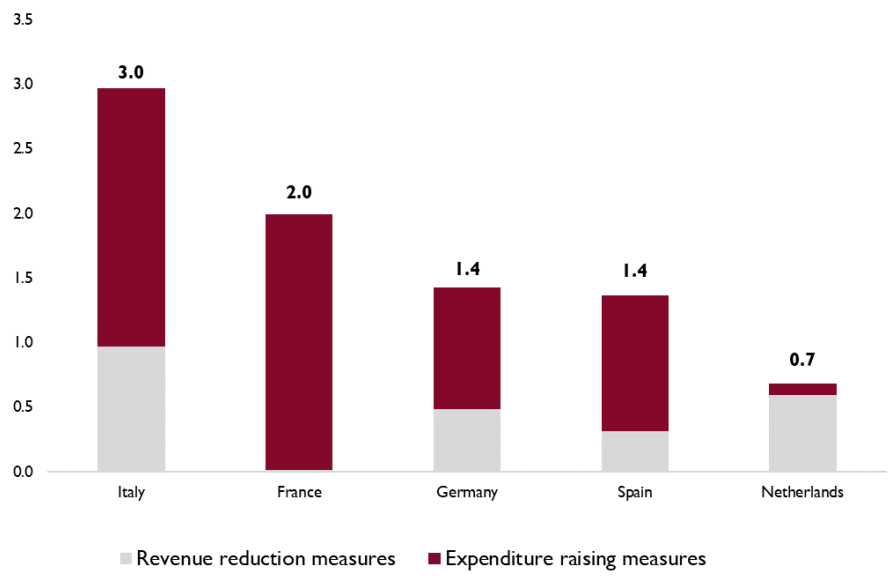
In this context and in order to assess compliance with the recommendation, the targeted nature of the measures adopted must be analysed in order to determine that they are temporary and targeted towards the households and companies most vulnerable to energy price rises. box 3 shows that the measures adopted by the Government have a different degree of targeting, although there is no joint and coordinated strategy to act on the households that are most vulnerable to energy shocks. On an aggregate basis and weighted by the relative importance of each of the measures, there is a moderate level of targeting towards the most vulnerable households. The degree of targeting is accentuated when analysed in relative terms, that is, expressed as the inflation points that they manage to decrease for each income group.

BOX 3. Measures implemented to mitigate the impact of inflation and the energy crisis. International comparison and degree of targeting towards the most vulnerable households in Spain.

The increase in energy and other raw material prices observed since mid-2021 has caused inflation in EU countries to rise to levels not seen in decades. In Spain, from June 2021 to July 2022, when it peaked, inflation rose by more than 8.1 pp, to stand at 10.8%. Much of this increase in inflation resulted from the rise in energy prices (50%) and food prices (30%). In the case of the euro area, inflation rose by 6.7 pp in the same period.

Spain, like most EU Member States, has taken various measures to alleviate the impact of high prices on the purchasing power of households and the costs of industries most affected by rising energy prices (Sgaravatti *et al.*, 2022). Analysing the five largest euro area economies, the budgetary impact of these aid packages in 2022 has ranged from 0.7% of GDP for the Netherlands to 3% of GDP for Italy.

BUDGETARY IMPACT OF THE MEASURES ADOPTED IN 2022 IN RESPONSE TO THE ENERGY CRISIS (% GDP)



Source: Prepared by AIReF based on Bruegel, Budgetary Plans 2023 and various national sources

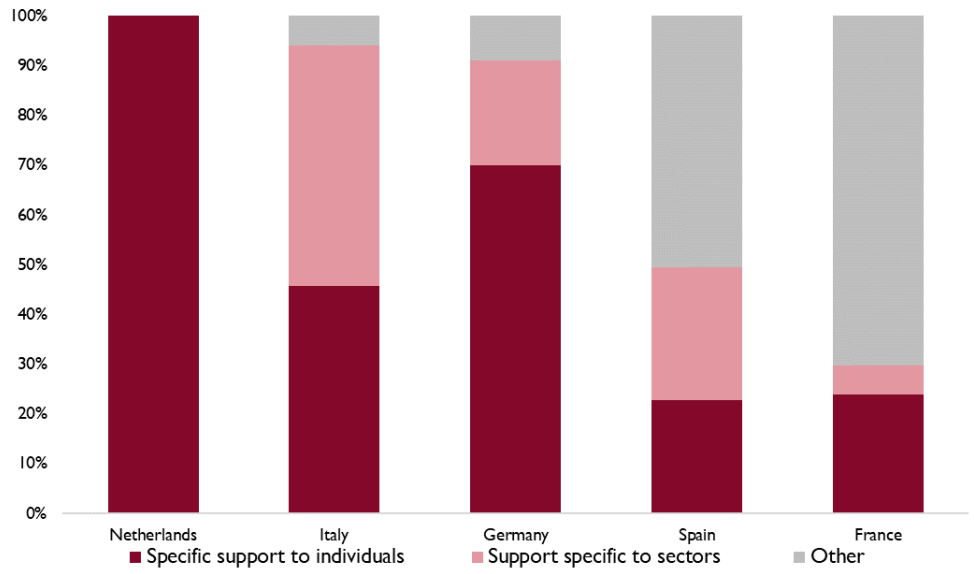
In relation to the composition of these aid packages, at a first level of breakdown it can be seen that Italy, France, Germany and Spain have prioritised measures to increase expenditure over those to reduce revenue. In these four countries, expenditure measures have accounted for between 70% and almost 100% of all aid packages. At the opposite end is the

Netherlands where 87% of the measures have consisted of tax reductions and surcharges to moderate energy prices.

Looking a little further into the breakdown of the composition of aid, on the revenue side, VAT reductions on electricity and gas are measures adopted by several of the countries analysed. The Netherlands has reduced the rate of VAT on gas, electricity and district heating to 9%. In Italy, the rate on gas has been reduced to 5% and in Spain the rates on gas and electricity have been reduced to the same level. These measures have been combined with the cancellation of electricity and gas charges (in Italy) and the reduction of energy-related special taxes (electricity in Spain, petrol and diesel in the Netherlands). Germany has recently approved the reduction of gas VAT to 7% for 2023. France, in contrast, announced the establishment of a direct limit on the increase in electricity prices of 4% in September 2021 while gas prices were frozen at the level of October 2021.

On the expenditure side, a possible breakdown would be to distinguish between the measures that have been specifically aimed at supporting individuals and specific sectors compared with more cross-cutting measures aimed, for example, at fuel rebates (Spain, France, Italy and Germany) or compensation to electricity and gas suppliers for the limit set on regulated retail prices (France). According to this classification, the Netherlands would have allocated its expenditure increase (of a limited amount compared with the revenue measures) entirely to support for individuals, while, in the case of Spain, support specifically targeted towards individuals and specific sectors would account for around half of the cost of the expenditure measures.

BREAKDOWN OF THE EXPENDITURE MEASURES ADOPTED IN 2022 IN RESPONSE TO THE ENERGY CRISIS (% OF THE TOTAL EXPENDITURE MEASURES)



Source: Prepared by AIReF based on Bruegel, Budgetary Plans 2023 and various national sources

In this context, the Country Specific Recommendations (CSRs) adopted this year set a quantitative benchmark for high-debt countries, such as Spain, which limits the increase in nationally-financed current primary expenditure. The recommendations note that when assessing compliance with this recommendation, the nature of the measures implemented to mitigate the effects of the energy crisis and inflation will be taken into account and, in particular, whether the measures are temporary and targeted towards those households and companies most vulnerable to the energy shock.

There are several reasons that could justify these measures targeting the most vulnerable households and companies. On the one hand, the high levels of debt maintained by countries and the need for fiscal policy not to conflict with the monetary tightening measures being applied by central banks in a context of high inflation call for a targeted response. On the other hand, inflation has heterogeneous effects on individuals through numerous channels (Jaravel, 2021)[10]. Notable among them are the differences in consumption patterns between individuals of different income levels and a

[10] Jaravel (2021), Inflation Inequality: Measurement, Causes, and Policy Implications, Annual Review of Economics. Vol. 13:599-629, https://doi.org/10.1146/annurev-economics-091520-082042

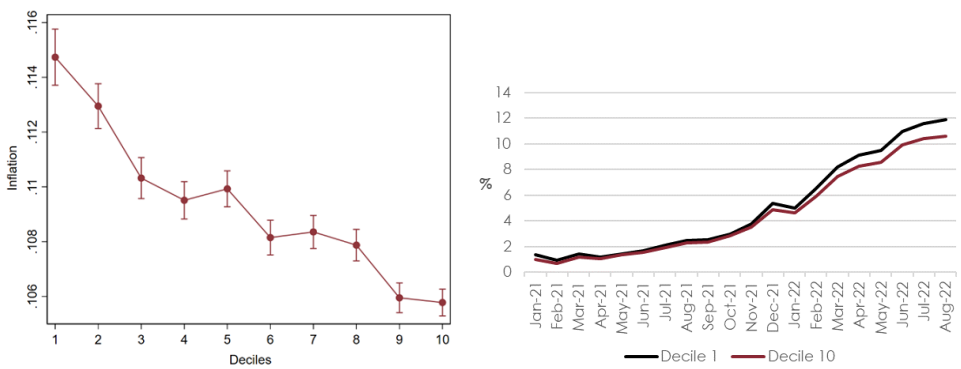
reduced ability to protect themselves against price increases by changing their consumption patterns.

In this episode, lower-income households are more vulnerable to higher inflation since they spend a larger share of their income on energy and food consumption, which are the main drivers of high inflation rates (Claeys and Guetta-Jeanrenaud, 2022). Furthermore, it is precisely these households that have the least capacity to reduce their consumption or replace it with other goods (generation with solar panels or greater use of public transport).

The figure below shows the differences in the increase in inflation recorded between August 2022 and June 2021, distinguishing by income level (once controlled for age, employment situation and household composition of individuals). The results have been calculated from the Household Budget Survey, combining the consumption patterns of households at each income level (decile 1 lower income vs. decile 10 higher income) in 2021 with the data from the Consumer Price Index disaggregated at the product level of the ECOICOP consumption classification. As can be seen, the differences in inflation rates amount to almost 1 percentage point between the lowest and highest income individuals. In addition, the gap between the inflation that households in the upper decile bear compared with those in the lower decile has widened as the crisis has progressed due to the greater weight that food and energy have in the consumption baskets of the most vulnerable households, which have seen the largest price increases.

INFLATION RATE BETWEEN JUNE 2021 AND AUGUST 2022 BY HOUSEHOLD INCOME LEVEL (PANEL A) AND EVOLUTION OF INFLATION OF DECILES 1 AND 10 OF HOUSEHOLD INCOME (PANEL B),

PANEL A **PANEL B**



Source: Prepared by AIReF based on microdata from the Family Budget Survey (INE) and the Consumer Price Index (INE)

Note: In panel A, age, employment situation and household composition are controlled

In this context, it is worth looking into the degree of targeting of the measures implemented by the Government aimed at mitigating the impact of inflation on households (in theory, support for companies is mostly targeted at a sector level, as it is aimed at electro-intensive industries). The analysis includes the measures applied or announced up to October 2022, as set out in the attached table.

MEASURES WITH LARGEST BUDGETARY IMPACT APPLIED OR ANNOUNCED UP TO OCTOBER 2022 TO MITIGATE THE EFFECTS OF INFLATION
Reduction of VAT on electricity from 21% to 5%
Reduction to 0.5% of the Special Tax on Electricity
Reduction of gas VAT from 21% to 5%
Tariff of Last Resort for gas
Strengthening of thermal social voucher
Discount from 20 cents to 15 cents per litre of fuel
15% increase in the amount of the Minimum Living Income
15% increase in non-contributory pensions
€200 support to vulnerable households
Supplement of €100 per month to the amount of scholarships
Free suburban and medium-distance transport and 30% subsidy for metropolitan transport
Extension of the reduction in income from work for personal income tax

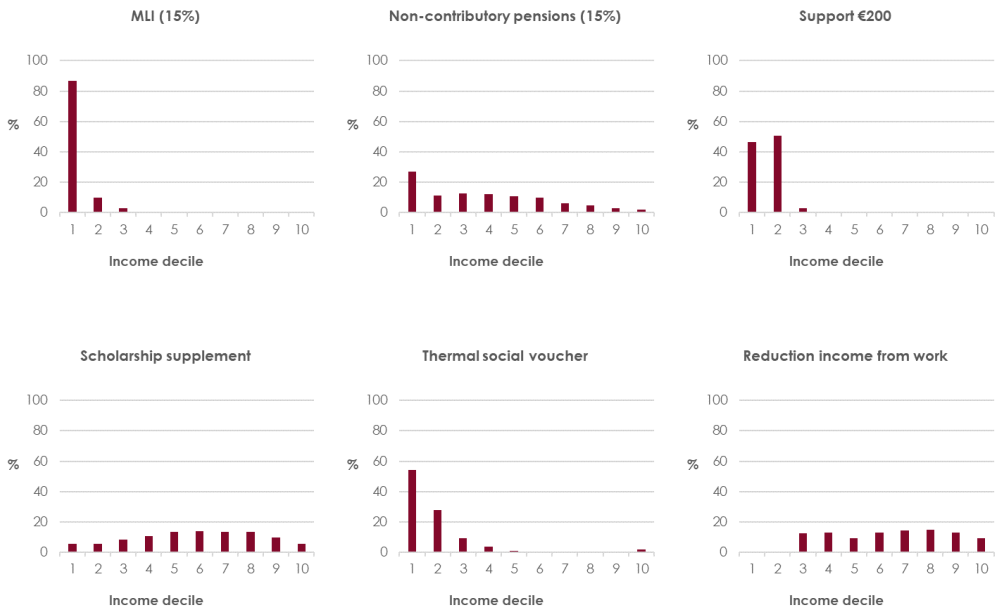
In general, it can be seen that the measures adopted have a different degree of targeting. Accordingly, measures acting on energy and transport prices are not particularly targeted at lower income individuals. For example, the reduction of VAT and of taxes on electricity has a homogeneous impact by income level, while the reduction of VAT on gas or the fuel consumption rebate is more concentrated among higher incomes. The results obtained for discounts for metropolitan, suburban and medium-distance transport are not targeted either, as these infrastructures are concentrated in cities with a generally higher level of income.

DISTRIBUTION OF THE COST OF THE MEASURES THAT ACT ON THE PRICE OF ENERGY AND TRANSPORT (BY DECILE OF HOUSEHOLD INCOME)

Source: Prepared by AIReF based on microdata from the Household Budget Survey (INE)

In contrast, measures aimed at offsetting the loss of real income caused by inflation such as the 15% increase in the Minimum Living Income and non-contributory pensions, the €200 aid to vulnerable households or the social thermal voucher are, by definition, targeted. Other measures such as supplementing scholarships or extending the reduction in income from work mainly affect middle-income households.

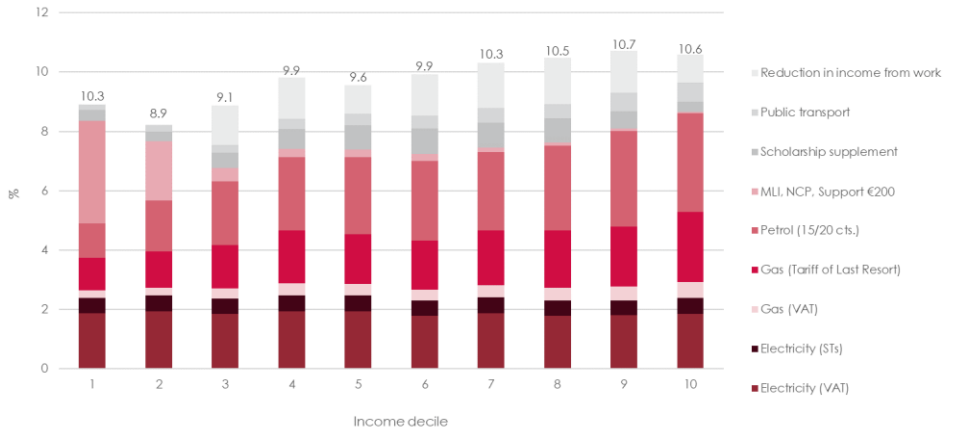
DISTRIBUTION OF THE COST OF MEASURES TO OFFSET THE LOSS OF REAL INCOME CAUSED BY INFLATION (BY DECILES OF HOUSEHOLD INCOME)



Source: Prepared by AIReF based on microdata from the Household Budget Survey (INE) and the Panel on Households, Income and Wealth (IEF- INE)

On the whole, weighted by the size of each of the measures, the package of measures is somewhat targeted towards the most vulnerable, although the higher deciles absorb a significant part of the cost of the measures.

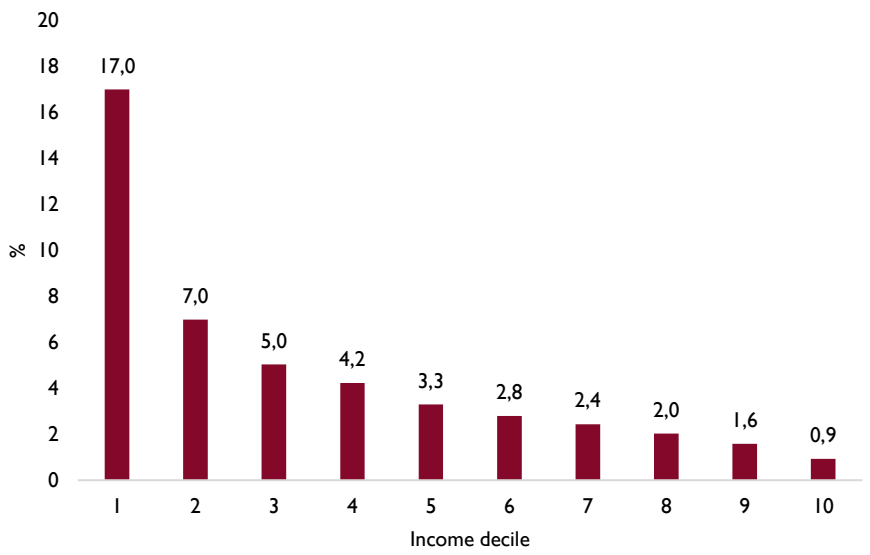
DISTRIBUTION OF THE TOTAL COST OF MEASURES TO OFFSET THE LOSS OF INCOME CAUSED BY INFLATION (BY DECILES OF HOUSEHOLD INCOME)



Source: Prepared by AIReF based on microdata from the Household Budget Survey (INE) and the Panel on Households, Income and Wealth (IEF- INE)

Finally, in terms of their gross income, the amount allocated to households in the first decile accounts for 17%, while for higher income households this percentage does not reach 1%.

AMOUNT OF TOTAL MEASURES IN RELATION TO GROSS INCOME (BY HOUSEHOLD INCOME LEVEL)



Source: Prepared by AIReF based on microdata from the Household Budget Survey (INE) and the Panel on Households, Income and Wealth (IEF- INE)

For 2023, a fundamental difference between the budgetary plans of the five largest economies in the euro area is the degree of specificity that they have provided to date in relation to the measures that will be extended or adopted next year. France, Germany and the Netherlands set out several of these measures in their DBP and their budgetary impact. In the case of France, for example, the DBP explicitly extends the compensation to electricity and gas suppliers due to the limit set on regulated retail prices, both of which entail an estimated fiscal cost higher than that of 2022. Measures such as the reduction in the tax on electricity consumption for final consumers are also maintained, again with a greater budgetary impact than in 2022. Other measures adopted this year would not be extended in 2023 according to the French DBP. These include the fuel rebate and certain sectoral aid, although the subsidy for energy-intensive companies is maintained.

For its part, the German Government includes measures in the DBP such as the reduction in the VAT rate on gas and the adoption of new measures such as a tax allowance for special payments of up to €3,000 that German companies can give their employees to offset the effects of inflation. It also includes the adjustment of the income tax brackets and the increase in tax

relief for children. In contrast, some of the measures adopted in March 2022 such as the single payment for the beneficiaries of certain social transfers, the reduction in the fuel tax and the reduction in public transport prices are not extended. At the same time, the German DBP makes it explicit that some budgetary impacts are estimated on the basis of technical assumptions since the final design of some measures is still being negotiated in their passage through Parliament.

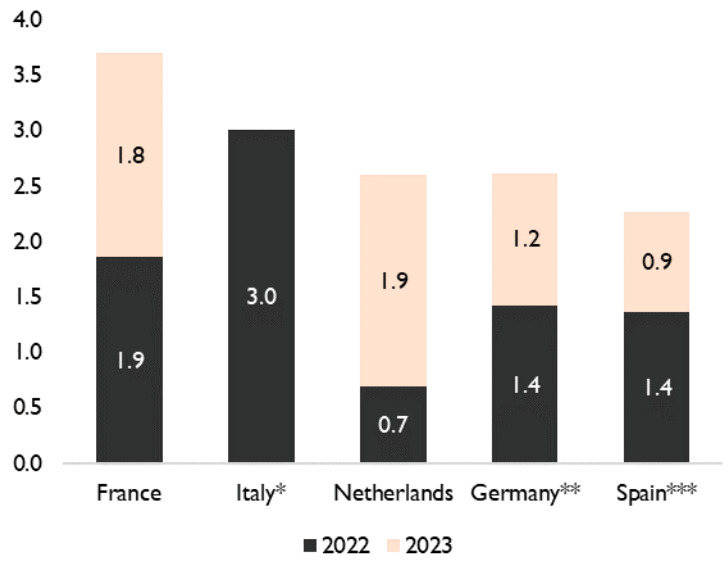
The Dutch Government's DBP specifies the extension of measures such as the reduction in energy taxes and special taxes on fuel. In addition, new spending measures are announced to support individuals, such as support for students who live outside the family home to offset rising living costs, an increase in rent support for vulnerable households, and an increase in the minimum wage, and, therefore, in the social benefits linked to its level.

In the opposite case, Italy, following the elections of September 25th, presents a trend scenario in its DBP with no measures for 2023. It specifies that an update of the DBP will be sent when the new Government defines the public finance targets for the three-year period between 2023 and 2025.

Spain lies at an intermediate position as to the degree of fiscal policy implementation in 2023. The DBP presents a first scenario compatible with the draft 2023 GSB that does not provide for the extension of this year's measures in 2023. At the same time, it proposes a second scenario in which the adoption of new measures or the extension of existing ones would result in an additional cost of 0.9 points of GDP. However, it is not specified which measures would be adopted or extended in this second scenario.

Considering the measures announced so far for next year, the total support in 2022 and 2023 in the five largest economies of the euro area would be between 3.7% and 2.3% of GDP. It should be highlighted that the countries that do specify the measures for next year (France, Germany and the Netherlands) in their DBPs forecast that the budgetary impact of these measures in 2023 will be higher than in 2022 (in the case of Germany, if we take into account the aid package of €200bn that the Coalition Government announced in September).

BUDGETARY IMPACT OF THE MEASURES ADOPTED IN 2022 AND ANNOUNCED FOR 2023 IN RESPONSE TO THE ENERGY CRISIS (% GDP)



Source: Prepared by AIReF based on Bruegel, Budgetary Plans 2023 and various national sources

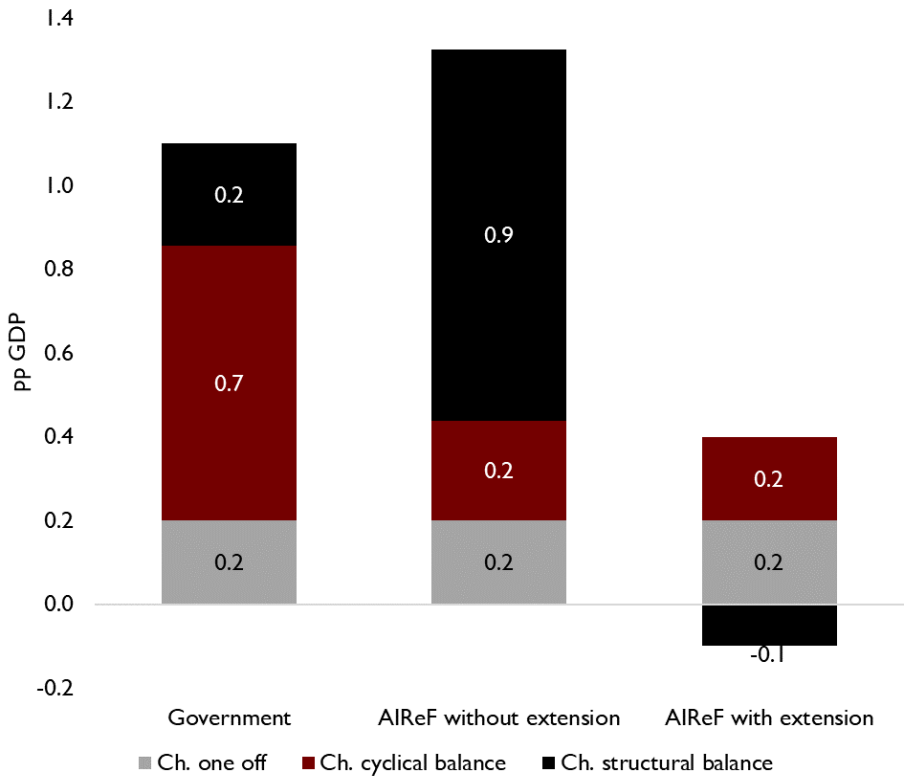
(*) The Italian DBP contains a trend scenario for 2023 because it was presented before the Government resulting from the elections of September 25th was formed

(**) The estimate of the impact of the measures in 2023 contained in the German DBP does not include the package of €200bn announced by the Coalition Government in September. If this aid package is included, the cost of the measures in 2023 rises to almost 6 points of GDP

(***) The impact for Spain of the possible extension of measures in 2023 is taken from Scenario 2 of the DBP

Breaking down the forecast change in the government deficit in 2023 into its cyclical and structural components, differences can be seen between the Government's estimate and AIReF's estimate. The reduction in the government deficit for 2023, compatible with Scenarios 1 and 2 of the Budgetary Plan, is the result of a notable cyclical contribution according to its estimates. This is the result of an output gap that improves by more than 1 point next year, according to the Budgetary Plan. In contrast, AIReF's output gap estimates show a more modest contribution of the cycle to the improvement in the deficit in 2023. In a scenario without an extension of the measures, the improvement in the structural balance would mainly explain the reduction in the deficit in 2023 according to AIReF. However, in a scenario with an extension of measures, the structural improvement would disappear and the reduction in the deficit in 2023 would be much lower.

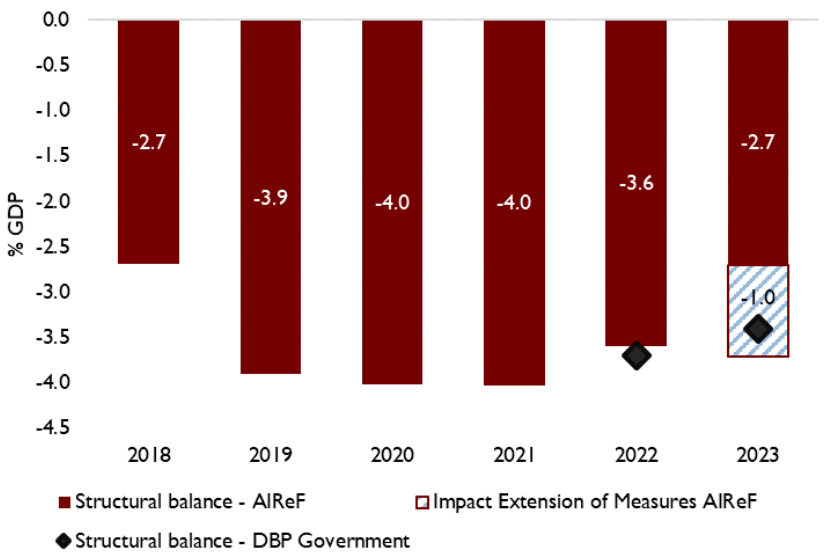
FIGURE 41. CONTRIBUTIONS TO THE CHANGE IN THE GG DEFICIT IN 2023



Source: AIReF and Budgetary Plan

In relation to the structural effort, AIReF's current estimates for 2023 show differences with the figures that the Government has presented in the Budgetary Plan. In a scenario without an extension of the measures in 2023, the mere phasing out of the measures would lead to an improvement in the structural balance of almost 1 percentage point of GDP. For this reason, AIReF estimates show a considerable structural adjustment in that scenario. In contrast, if the package were extended for the whole of 2023, there would be little structural effort next year and national fiscal policy would adopt a neutral stance with respect to 2022. Therefore, according to AIReF's estimates, the national fiscal policy will have a neutral or contractionary stance depending on whether the measures adopted this year are extended or not. The Government, in contrast, presents a single estimate for the structural balance – since it believes that the scenario with and without an extension of measures is compatible with the same overall figure for the public deficit in 2023 – which results in a slightly contractionary stance next year. In both cases, the distance to the MTO of -0.4% of GDP would be more than two points of GDP.

FIGURE 42. STRUCTURAL BALANCE



Source: AIReF and Budgetary Plan

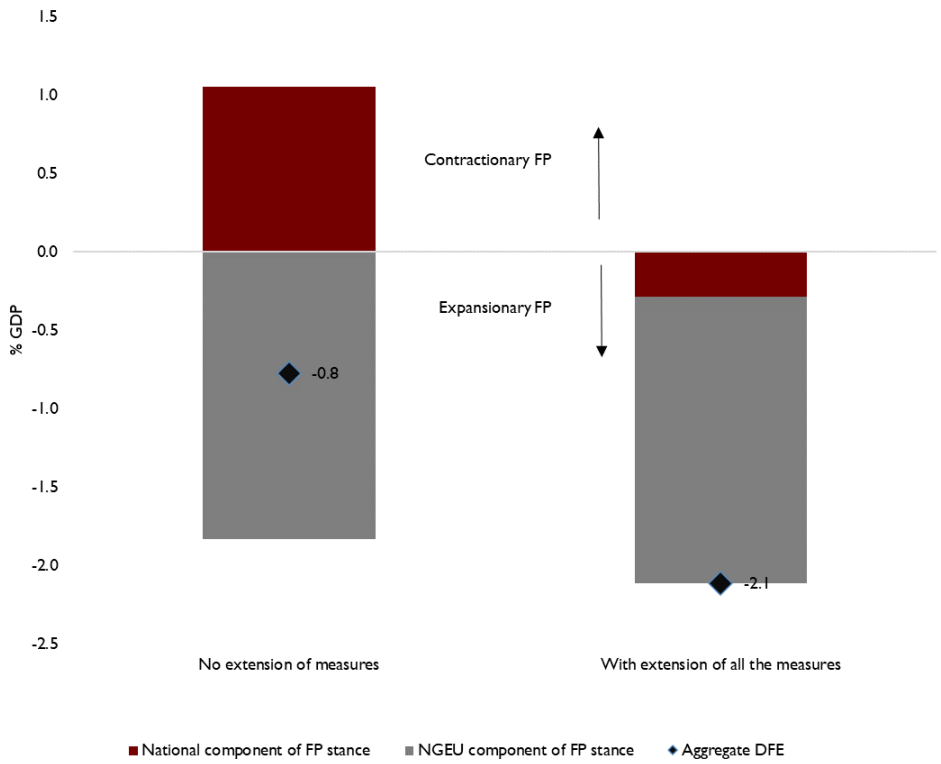
The aggregate fiscal policy boost should be analysed including the Next Generation EU funds. Although the current volatility intensifies the uncertainty surrounding the estimate of the output gap, the structural balance remains a relevant tool for approximating the underlying situation of the national component of public finances. In the same way, changes in said figure make it possible to approximate the stance of the part of the fiscal policy that is financed nationally. However, from a macroeconomic point of view it is relevant to analyse the aggregate fiscal policy stance including the considerable boost provided by Next Generation (NGEU) funds. Given that these funds have, in theory, a deficit-neutral impact, the evolution of the structural balance does not capture the size of the boost associated with these funds. Measuring the evolution of expenditure, including NGEU funds, in relation to the potential performance of the economy in the medium term makes it possible to estimate the aggregate fiscal policy stance. This supplementary discretionary fiscal effort (DFE) measure[11] is relevant in current circumstances.

The discretionary fiscal effort (DFE) indicator signals that the aggregate fiscal policy stance - including expenditure from NGEU and nationally-financed funds - will be expansionary in 2023 whether or not the measures are extended. The DFE points to a considerable fiscal expansion in 2023 once the

[11] For further details on the methodology for calculating discretionary fiscal effort, see Carnot, N. & F. de Castro (2015). "The Discretionary Fiscal Effort: an Assessment of Fiscal Policy and its Output Effect." European Commission. *Economic Papers 543* (February 2015).

boost associated with the NGEU funds is taken into account. AIReF's current forecast incorporates an increase in expenditure in 2023 of around €25bn charged to these funds. If this boost materialises, it will determine the aggregate fiscal policy stance next year, either reinforcing a slight national expansion in the event that the measures are extended, or more than compensating for a certain containment of national expenditure in the event that they are not extended.

FIGURE 43. DISCRETIONARY FISCAL EFFORT (DFE) INDICATOR, 2023*



* **Note**: a negative sign represents an expansive fiscal policy and *vice versa*
Source: AIReF

9. RECOMMENDATIONS

9.1. New Recommendations

AIReF has been recommending the implementation of a realistic and credible medium-term fiscal strategy aimed at guaranteeing the sustainability of public finances. One of the fundamental elements of this strategy is the setting of realistic reference rates or targets that reflect the reality of each one of the administrations.

In the current context of fiscal rules suspended for several years, the Government decided, in the absence of budgetary stability targets, to set reference rates for the GG and for each sub-sector. These reference rates can be considered a positive option to the extent that they indicate the orientation of fiscal policy even though failure to comply with them does not trigger activation of the mechanisms provided for in a context where fiscal rules are applied.

Therefore, the reference rates act as an anchor in the design of the budgets of each administration. This is demonstrated by the fact that this year, as in previous years, all administrations have brought their budgets up to that reference rate, irrespective of whether AIReF's forecasts estimate a more positive or negative year-end figure, depending on the case.

In general terms, AIReF has warned that the reference rates are lax, both at the sub-sector level and at the level of the General Government, which does not encourage the necessary reduction in the structural deficit.

Although it is also present for the GG as a whole, this is the underlying risk in 2023 in the AR sub-sector, which, according to AIReF's estimates, could reach a lower deficit - 0.1% of GDP compared with the 0.3% of GDP of the sub-sector's reference rate. However, regardless of their previous situation, all the ARs have presented budgets in line with the reference rate of -0.3% of GDP or -0.6% in the case of the Basque Country and Navarre. Moreover, setting the same reference rate for all ARs under the ordinary regime is unrealistic, as it is excessively demanding for some and lax for others.

For this reason, AIReF makes the following **recommendations to the Ministry of Finance and Civil Service:**

1. ***To define reference rates for each administration taking into account their starting situation, so that they are demanding, but feasible to achieve.***

9.2. Live recommendations[12]

The Budgetary Plan is an essential document within the budget cycle for the analysis of the fiscal and economic policy of the countries of the European Union. Its relevance stems from the fact that it collects information on the main lines of the budgets of all tiers of government in an integrated manner in national accounting terms. However, as AIReF has pointed out on numerous occasions, its content is insufficient to carry out this analysis and verify consistency with the budgets of the different GG sub-sectors.

This characteristic, which AIReF has already pointed out in previous years, is accentuated because the 2023 Budgetary Plan presents two alternative budgetary scenarios, with the same macroeconomic scenario as the 2023 GSB and sharing the same deficit reference rate - 5% of GDP for 2022 and 3.9% for 2023. In theory, Scenario 1 would be in line with the forecasts contained in the 2023 GSB and Scenario 2 would include a more realistic revenue forecast in 2022, new measures for 2022 and the extension of part of the existing measures for 2023. AIReF observes significant inconsistencies in the

[12] This section sets out recommendations made in previous reports which, even though the Ministry of Finance 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 it not do so, it is not necessary to once again explain the reasons for deviating from them, unless they are no longer the same.

construction of these scenarios that could stem from the fact that they both share the same deficit forecast for the two years.

In addition, it still does not fully reflect the impact of the RTRP and REACT-EU funds on the revenue and expenditure of the GG, while the draft GSB does include a granular breakdown of each of the actions financed under the two mechanisms.

Finally, it still does not provide a breakdown of the headings of expenditure and revenue by tier of government, which makes it difficult to ensure consistency with the budgets of the different administrations.

For these reasons, AIReF **recommends that:**

2. ***The Budgetary Plan should incorporate all the measures planned by the Government and the impact of the REACT-EU and RTRP funds on the GG's revenue and expenditure, as well as the breakdown by sub-sector in national accounting terms.***

The President of AIReF

Cristina Herrero Sánchez