Report on the Initial Budgets of the General Government 2023

AIReF
April 5th, 2023

1 Introduction

AIReF has the legal mandate to issue a report on the initial budgets of the General Government

The Organic Law on Budgetary Stability and Financial Sustainability establishes the obligation to prepare a report on the level of compliance with the budgetary stability and public debt targets of the initial budgets of the General Government

This report assesses changes since the previous report (October 25th, 2022) and analyses all new available information

Both the Central Government and most of the Territorial Administrations have approved their budgets for 2023

2 Macroeconomic scenario

External environment. Growth

The most recent information suggests that global activity continues to perform more favourably than expected by the consensus of analysts in the autumn of 2022 (easing of bottlenecks, reopening of China)
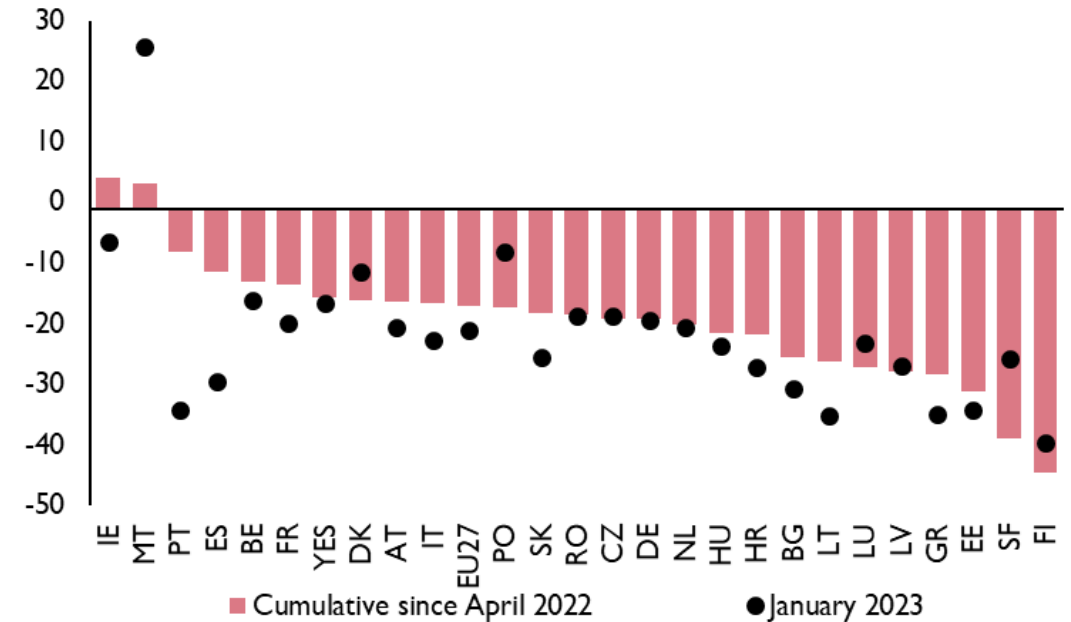
In Europe, energy saving measures, favourable weather conditions and the use of alternative energy sources to Russian gas have made it possible to avoid the most adverse scenarios

EVOLUTION OF REAL GDP GROWTH FORECASTS FOR 2023 (YEAR-ON-YEAR RATE OF CHANGE, %)

Legend: Spain, Germany, France, Italy, USA
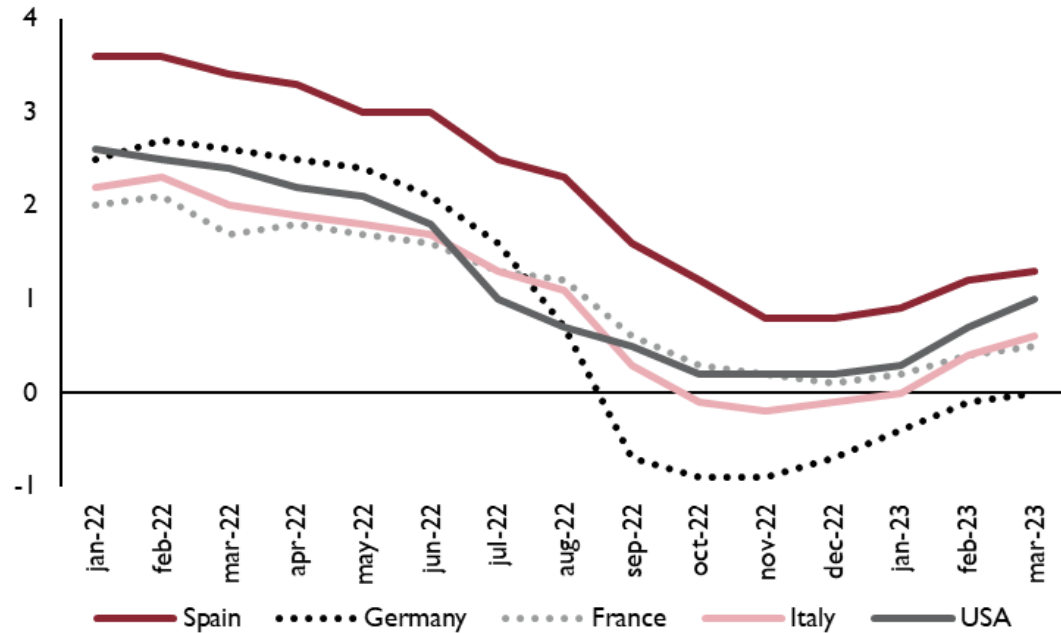
Source: Consensus Forecasts

YEAR-ON-YEAR RATE OF CHANGE OF GAS CONSUMPTION (%)

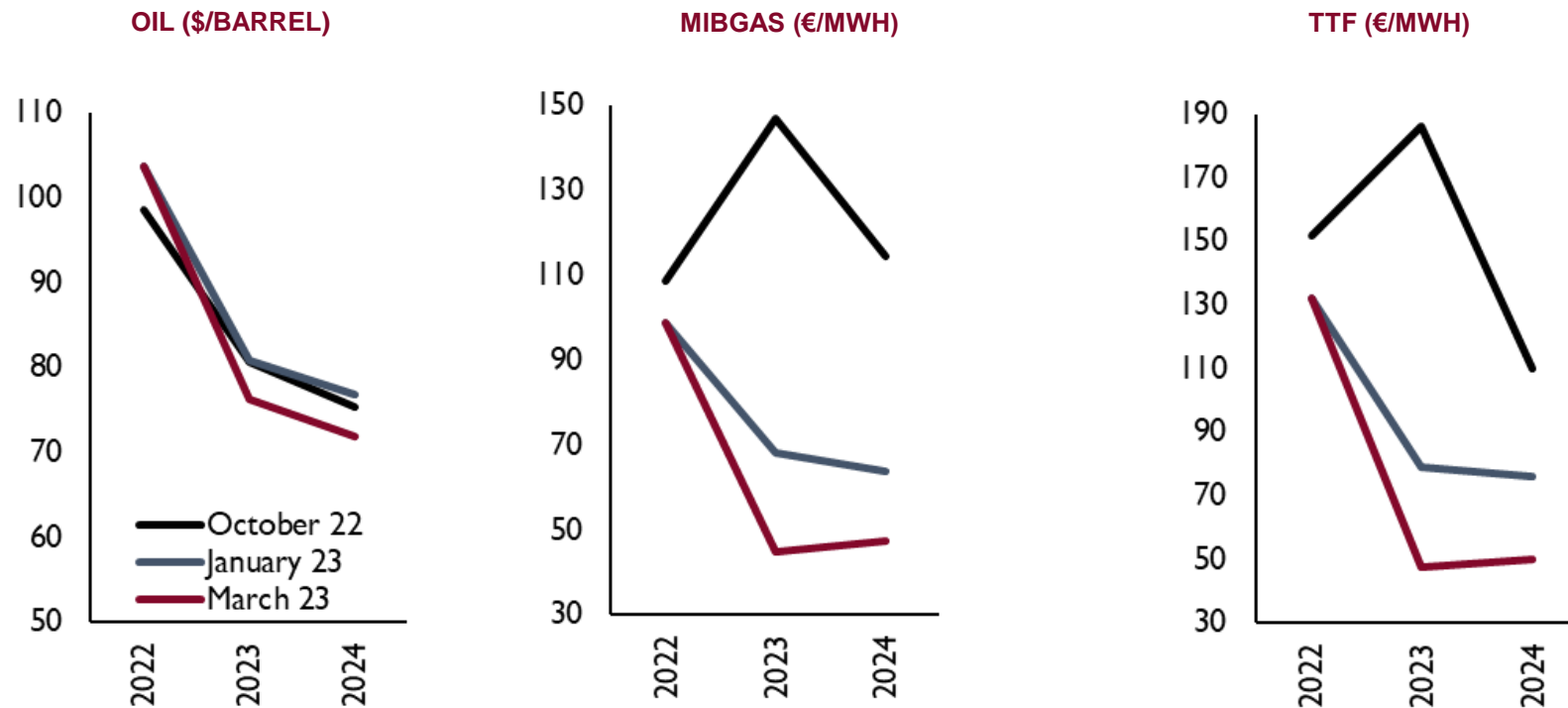Legend: Cumulative since April 2022, January 2023

Source: Eurostat

External environment. Commodity prices

Energy and non-energy commodity prices have fallen since the autumn

EVOLUTION OF ENERGY COMMODITY PRICES

OIL ($/BARREL) — MIBGAS (€/MWH) — TTF (€/MWH)

Legend: October 22, January 23, March 23

Source: Refinitiv
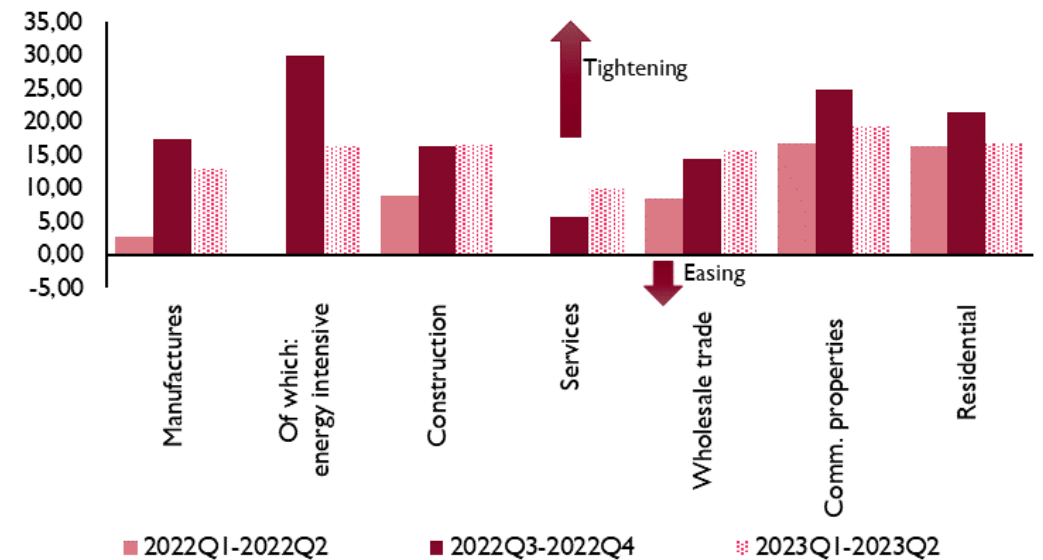
External environment. Financing conditions

The intense, rapid and simultaneous rise in benchmark interest rates since the start of 2022 has come together with a tightening of credit standards for loans to businesses and households, which may condition their consumption and investment decisions in the remainder of the year.

BENCHMARK RATES OF VARIOUS CENTRAL BANKS

Japan	-0,10
Switzerland	1,50
Denmark	2,75
Norway	3,00
Sweden	3,00
Euro area	3,50
Australia	3,60
United Kingdom	4,25
Canada	4,50
New Zealand	4,75
USA	5,00

Source: Refinitiv

CHANGE IN CREDIT STANDARDS IN LOANS TO COMPANIES IN THE EURO AREA

■ 2022Q1-2022Q2   ■ 2022Q3-2022Q4   ⋮ 2023Q1-2023Q2

Source: ECB

Spanish economy. Labour market

At the beginning of 2023, there was an upturn in job creation concentrated in permanent contracts, while temporary employment continued to fall due to the labour reform. In the month of March, Social Security affiliation rose by 206,410 people, the largest increase in a month of March on record.

SOCIAL SECURITY AFFILIATIONS

THOUSAND PEOPLE

YEAR-ON-YEAR RATE OF CHANGE (%)
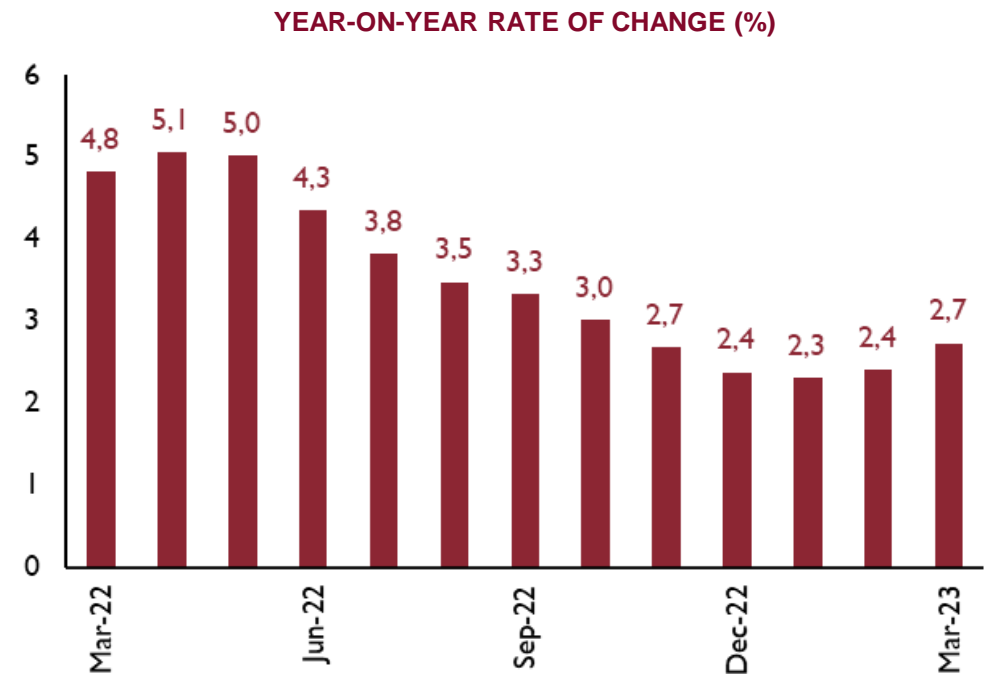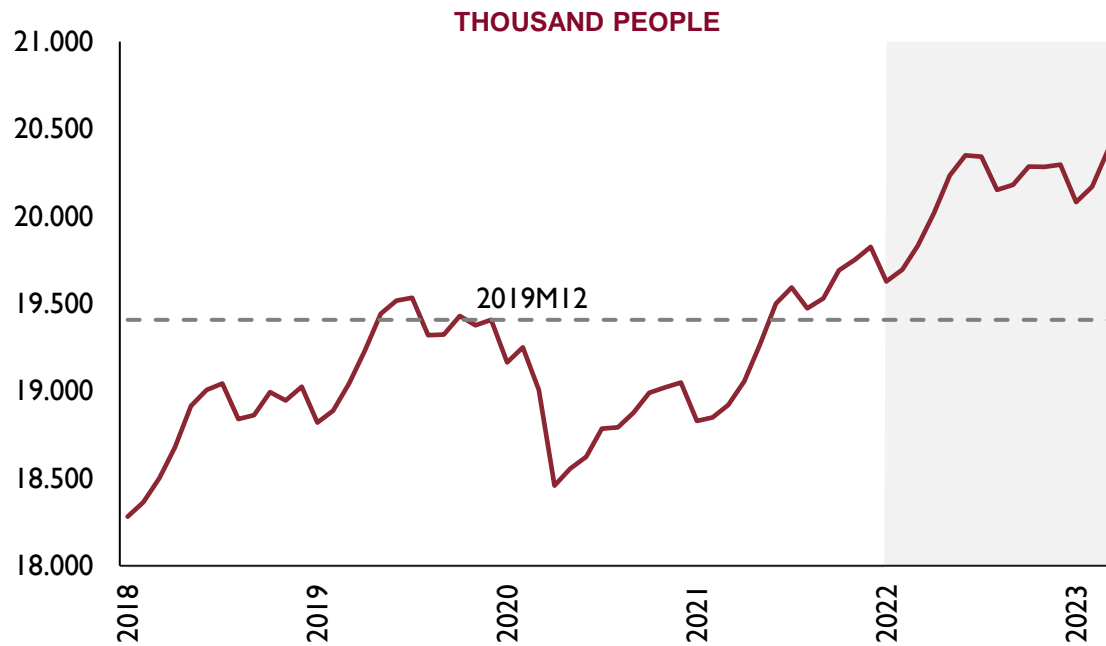
Source: Social Security

Spanish economy. External sector

Exports of goods and services are expanding faster than export markets, which suggests a possible gain in external market share

YEAR-ON-YEAR CHANGE IN EXPORTS OF GOODS AND SERVICES AND GROWTH IN SPANISH EXPORT MARKETS. VOLUME (%)

Spanish Export Markets — Exports of goods and services.
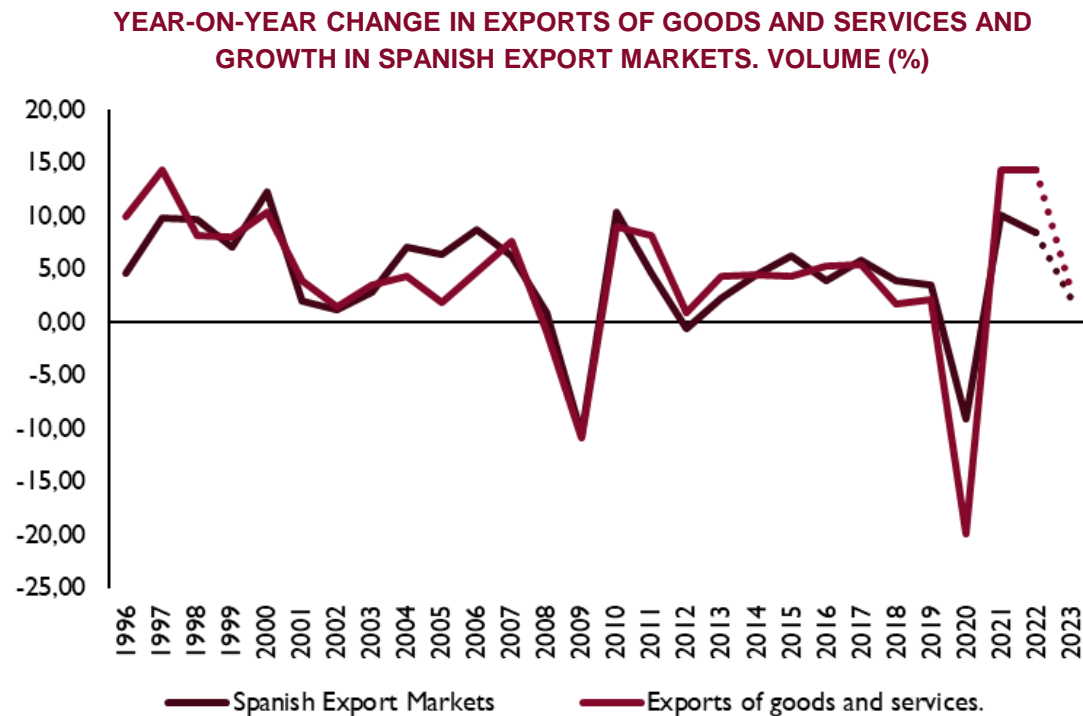
Source: INE and IMF
The dotted line represents AIReF forecasts

Recent short-term information

During the first quarter of 2023, the overall indicators suggest greater buoyancy in economic activity
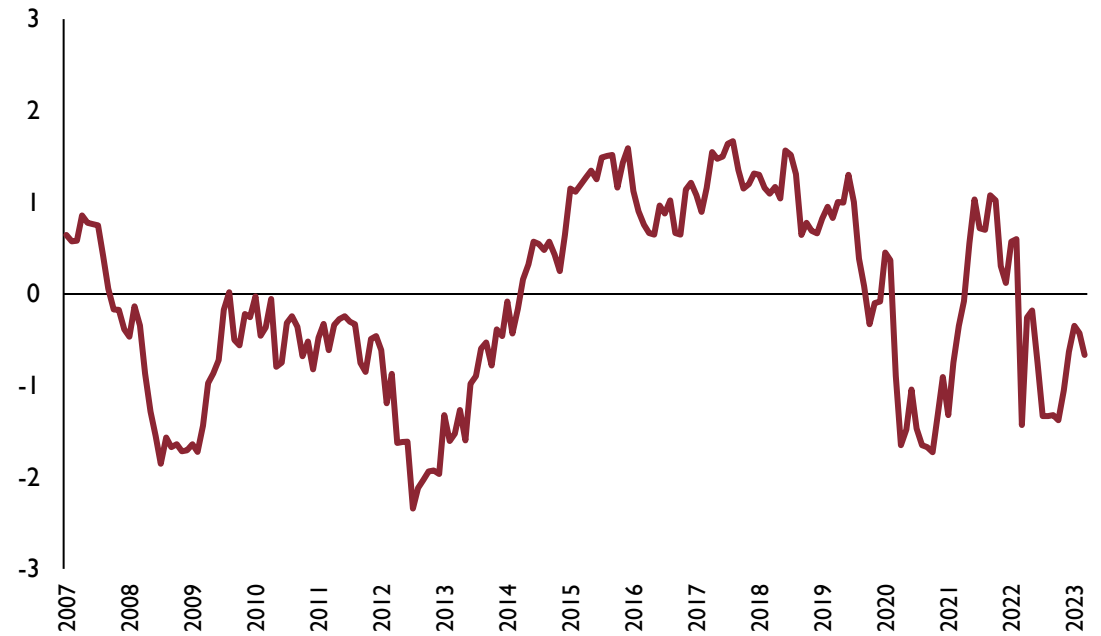
Consumer confidence is up from October 2022 lows

EVOLUTION OF THE ESTIMATE OF THE QUARTER-ON-QUARTER CHANGE IN REAL GDP. FIRST QUARTER 2023. MIPRED MODEL
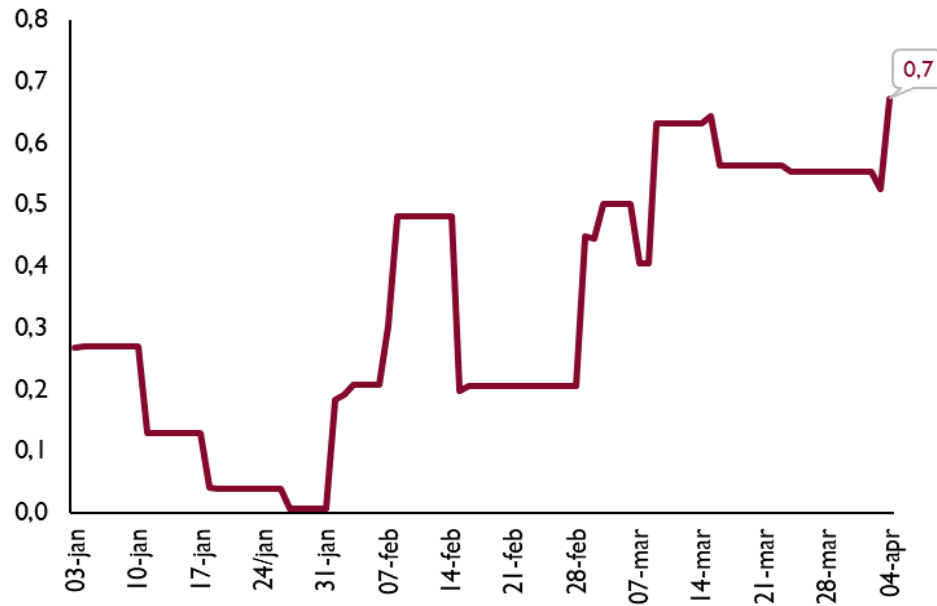
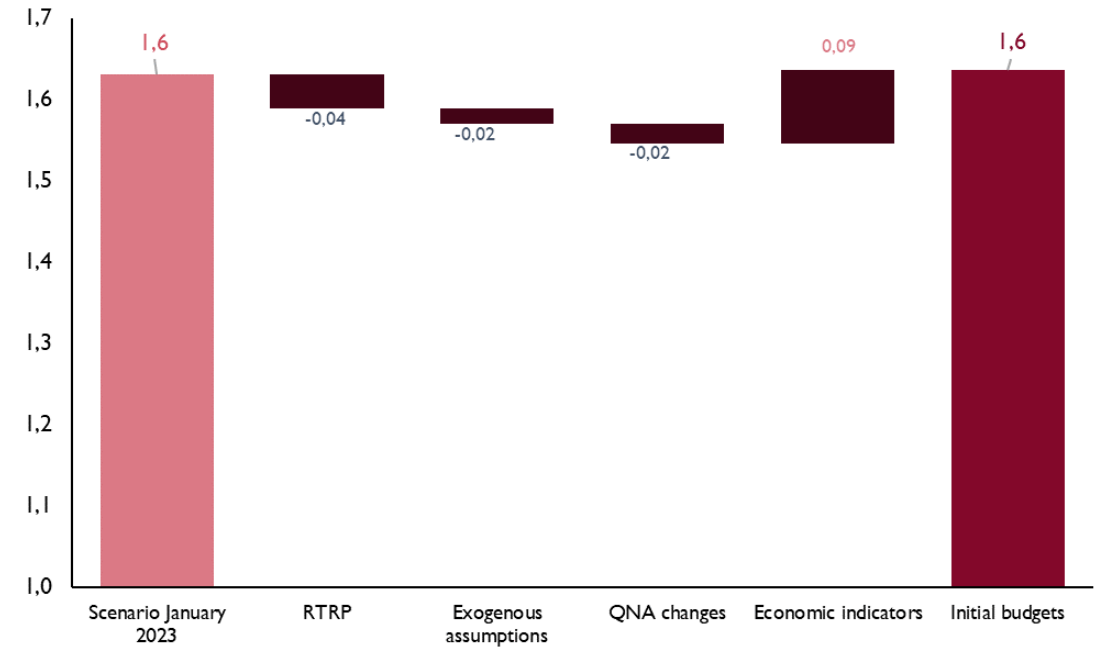**Source:** AIReF

STANDARDISED CONSUMER CONFIDENCE INDEX

Source: Ministry of Economic Affairs and Digital Transformation

AIReF maintains its estimate of real GDP growth for 2023 at 1.6%

Year-on-Year Rates of Change	APRIL-2023		JAN-2023	Difference
	2022	2023	2023	2023
Private Domestic Final Consumption Expenditure	4,4	1,2	1,2	-0,02
General Government Final Consumption Expenditure	-0,7	1,0	0,8	0,22
GFCF	4,6	3,0	3,7	-0,78
GFCF Equipment and Cultivated Assets	4,1	2,1	2,3	-0,21
GFCF Construction and Intellectual Property	4,9	3,4	4,4	-1,04
Domestic Demand*	3,1	1,4	1,6	-0,21
Exports of Goods and Services	14,4	3,1	2,9	0,2
Imports of Goods and Services	7,9	2,7	3,0	-0,3
External Balance*	2,4	0,2	0,0	0,2
Gross Domestic Product	**5,5**	**1,6**	**1,6**	**0,0**
Nominal Gross Domestic Product	**10,0**	**6,5**	**6,1**	**0,4**
Gross Domestic Product Deflator	4,3	4,8	4,4	0,4
CPI	8,4	4,0	4,2	-0,2
Full-Time Equivalent Employment	3,8	1,2	0,8	0,4
Unit Labour Cost	0,4	4,3	5,1	-0,9
Productivity per Full-Time Employee	1,6	0,4	0,8	-0,4
Compensation per Employee	2,0	4,7	5,8	-1,1
Unemployment Rate	12,9	12,7	12,6	0,1
Household and NPISH Savings Rate (% Gross Disposable Income)	7,2	7,0	7,8	-0,8

BREAKDOWN OF THE SOURCES OF REVISION OF THE GDP GROWTH RATE IN TERMS OF VOLUME WITH RESPECT TO THE MACROECONOMIC SCENARIO OF JANUARY 2023

Scenario January 2023: 1,6 | RTRP: -0,04 | Exogenous assumptions: -0,02 | QNA changes: -0,02 | Economic indicators: 0,09 | Initial budgets: 1,6
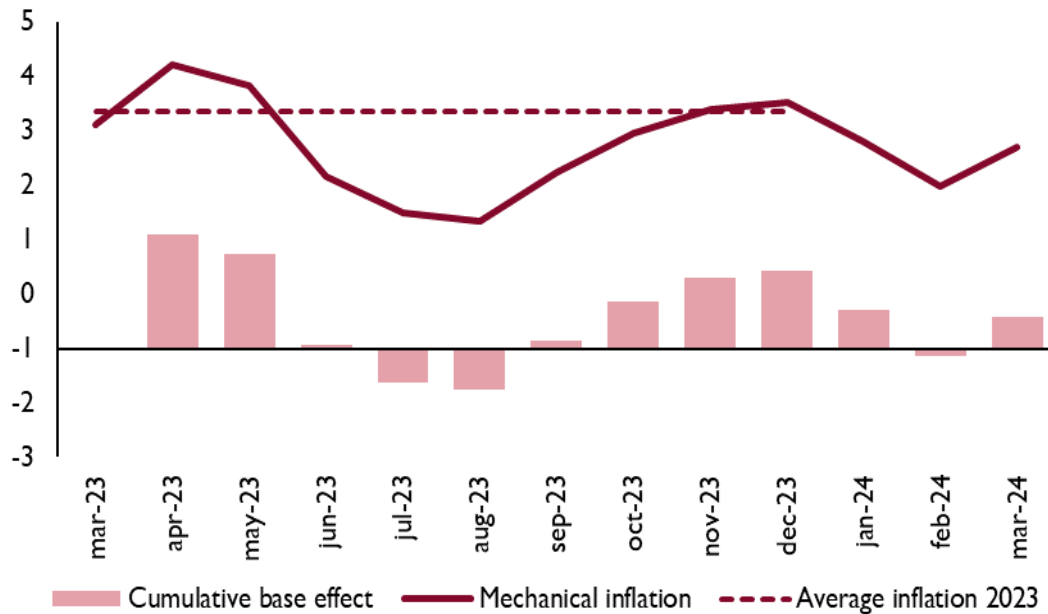
Source: AIReF

2023 forecasts. Inflation

Expected inflation stands at 4% in 2023 - mainly due to the base effects associated with energy - while core inflation would stand at around 5.4%

Wages would grow somewhat above inflation on average in 2023, recovering only partially the purchasing power lost the previous year

ACCUMULATED BASE EFFECTS AND MECHANICAL INFLATION (%, PP)

Cumulative base effect — Mechanical inflation ----- Average inflation 2023

Source: INE and AIReF

CHANGES IN PRICES AND WAGES. YEAR-ON-YEAR RATE (%)

CPI ---- Core CPI —— Coll. Barg. Agreem. wages —— Av. compensation of large companies
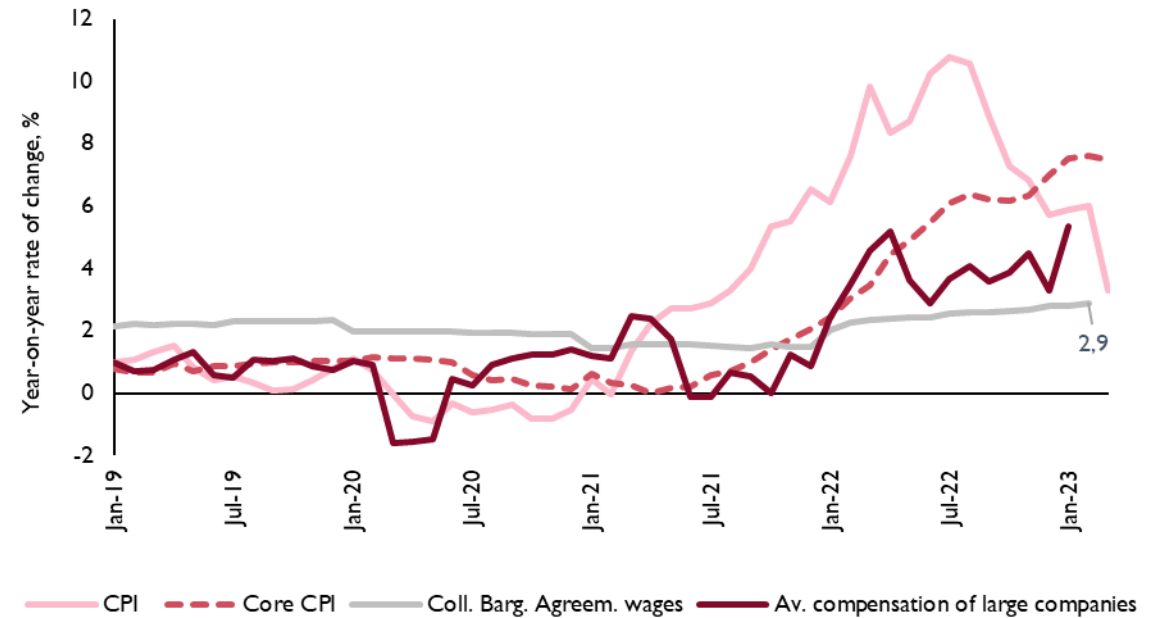
Source: INE, Ministry of Economic Affairs and Digital Transformation and AIReF.

Risks: geopolitical tensions and inflation

The geopolitical uncertainty associated with the war in Ukraine persists

Also noteworthy are the protectionist measures being implemented by many governments, which might undermine global growth capacity

Persistent inflation could lead to further tightening of monetary and financial conditions

NUMBER OF RESTRICTIONS HARMFUL TO INTERNATIONAL TRADE IMPLEMENTED

■ Goods   ■ Investment   ■ Services
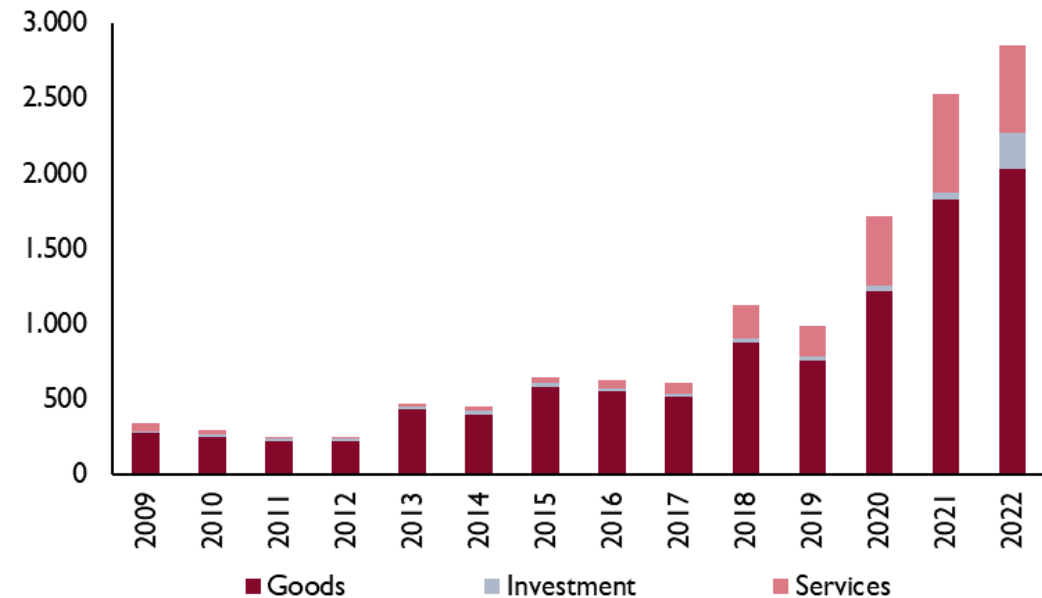
Source: Global Trade Alert

* 2023: includes figures up to March 31st, 2023

3 Fiscal scenario

AIReF estimates a GG deficit of 4.2 % of GDP in 2023

EVOLUTION OF GG BALANCE (% GDP)

Legend: Range of uncertainty — Observed — O 2023 Budgetary Plan — - - - AIReF

Data labels: -10,1 | -6,9 | -4,8 | -4,7 | -4,2 | -3,9
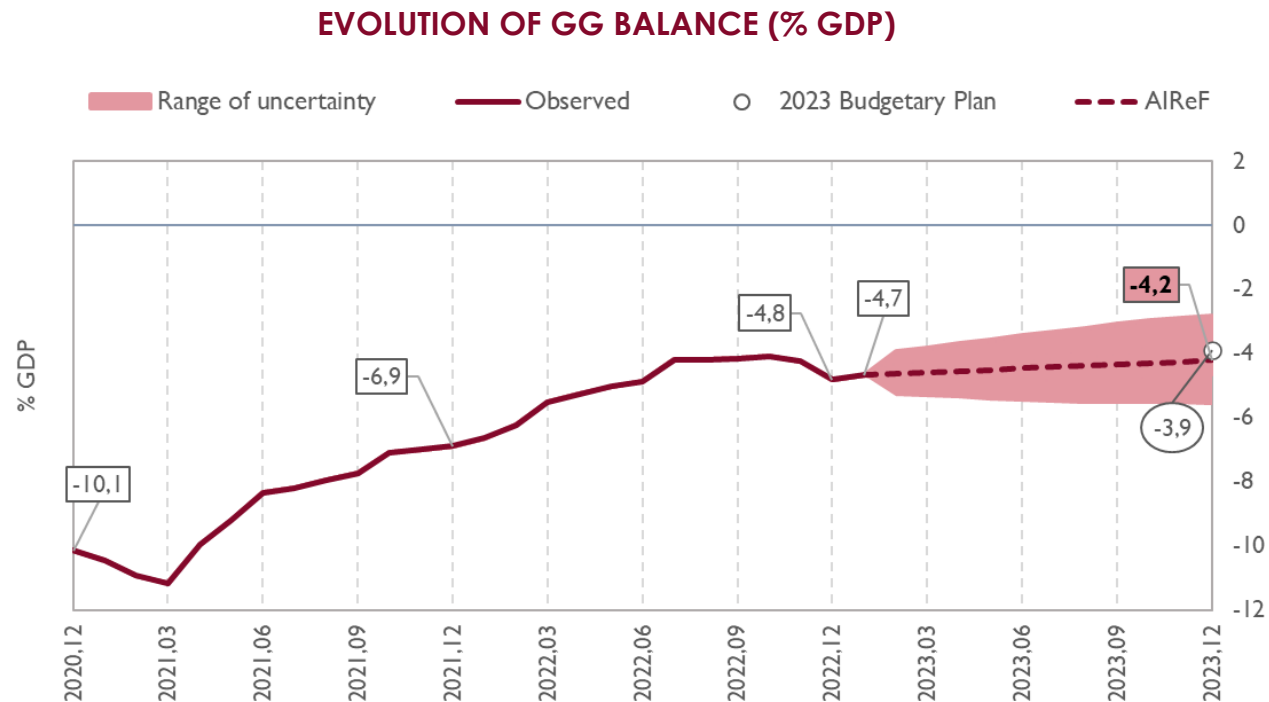
Source: AIReF and IGAE

The year-end 2022 figure was 0.2 points lower than expected in the October report and 0.2 points higher than the Government's reference rate

AIReF estimates a deficit for 2023 of 4.2%, 0.3 points higher than the Government's reference rate

AIReF raises its deficit estimate by 0.9 points of GDP for 2023

Report on Main Lines (October 25th, 2022)

GG deficit 2023
3.3% of GDP

GG	**-3,3**
CG	-3,0
SSFs	-0,7
ARs	-0,1
LGs	0,5

**Measures:
-1% of GDP**

- Measures in response to the energy crisis RDL 20/2022

**New information:
-0.1% of GDP**

- Increase in tax collection
- Increase in expenditure

**Macro effect:
+0.2% of GDP**

- Denominator effect
- Increased tax collection

Report on Initial Budgets (April 5th, 2023)

GG deficit 2023
4.2% of GDP

GG	**-4,2**
CG	-3,5
SSFs	-0,6
ARs	-0,3
LGs	0,2

The improvement in the macroeconomic scenario and the increase in tax collection at the end of the year do not offset the cost of the measures approved and the increase in expenditure

The cost of the measures to mitigate the energy and price crisis in 2023 is 1% of GDP

Impact in National Accounting terms (€m)	AIReF Bud. Plan 2023	AIReF Current 2023	Difference
Revenue Measures	**-160**	**-6.083**	**-5.923**
VAT:			
VAT Electricity			
Reduction of electricity rate to **10%** (RDL 12, 17 & 29/2021 & 6/2022)		-2.342	-2.342
Reduction to **5%** since July 2022 (RDL 11/2022)			
Extension until 31-12-2023 (RDL 20/2022)			
VAT on gas, briquettes and pellets			
Reduction to **5%** gas rate (RDL 17/2022)		-806	-806
Extension until 31-12-2023 (RDL 20/2022)			
VAT on foodstuffs			
Reduction from **4% to 0%** on basic foodstuffs (RDL 20/2022) (Until 30-6-2023)		-643	-643
Reduction from **10% to 5%** on oils and pasta (RDL 20/2022) (Until 30-6-2023)		-139	-139
STs			
Electricity ST			
Electricity rate reduction (RDL 17, 29/2021 & 6, 11/2022)	-160	-2.153	-1.993
Extension until 31-12-2023 (RDL 20/2022)			
Expenditure Measures	**1.876**	**7.931**	**6.055**
Fuel allowance	576	1.347	771
Sectoral support	187	2.688	2.501
Direct support for individuals		1.200	1.200
Other support for individuals	1.113	2.396	1.283
Support for refugees		300	300
TOTAL	**-2.036**	**-14.014**	**-11.978**
TOTAL (% GDP)	**-0,1**	**-1,0**	**-0,8**

- RDL 20/2022 of December 27th extends and enhances the scope of existing measures and approves new measures worth almost €12bn

- The cost of the tax reduction measures is valued at approximately €6bn, a cost similar to that associated with the measures that raise expenditure

- AIReF has also revised the valuation of the **revenue measures included in the Budgetary Plan** based on the legislation finally approved and the collection data now known **(-0.1% GDP)**

The new information leads to an upward revision of both revenue and expenditure

**New information
-0.1% of GDP**

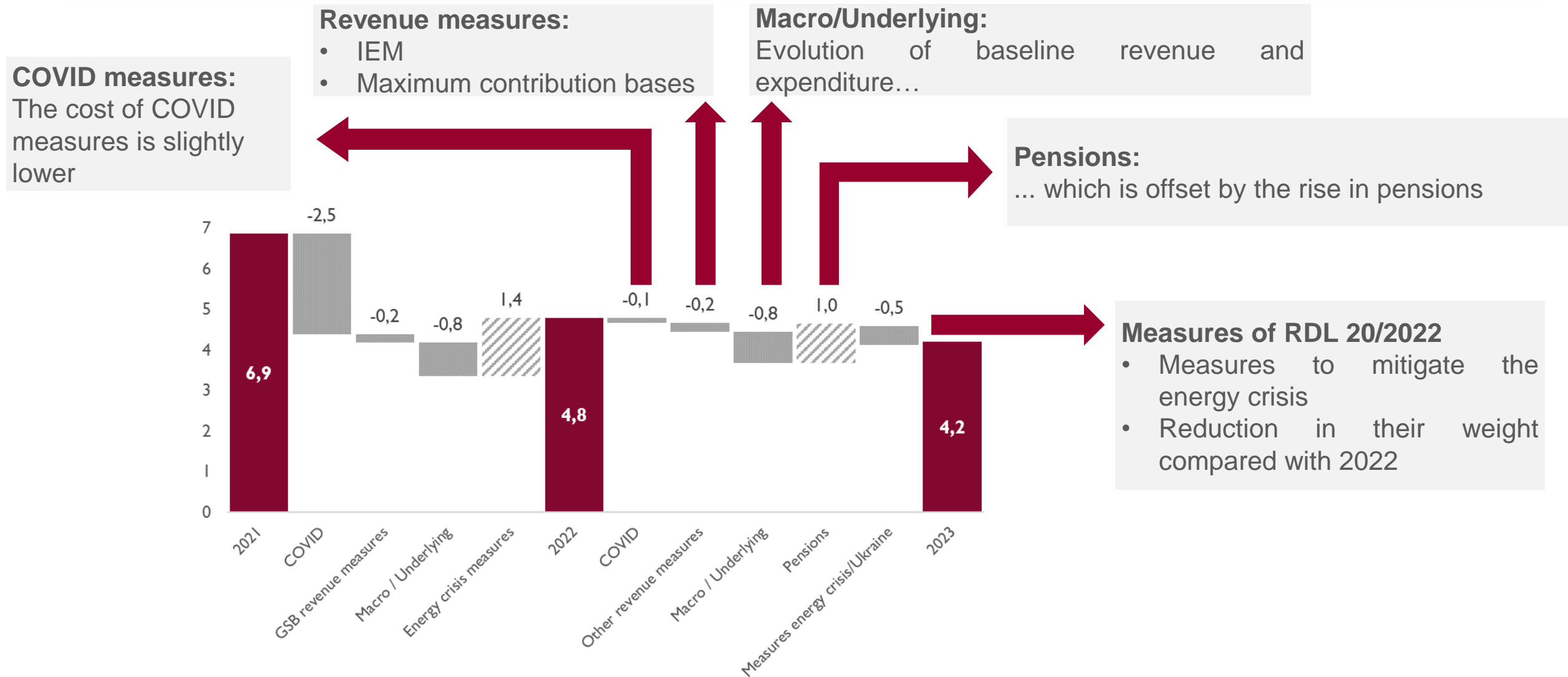|	
Increase in revenue (+0.5% GDP)	Evolution of tax collection in last few months of 2022 and early months of 2023: • Taxes on products (+0.1 points) • Taxes on income (+0.3 points) • Contributions (+0.1 points)
Increase in expenditure (+0.6% GDP)	Year-end 2022 with higher level of expenditure: • Intermediate consumption (+0.1 points) • Interest (+0.3 points) • Investment (+0.2 points)

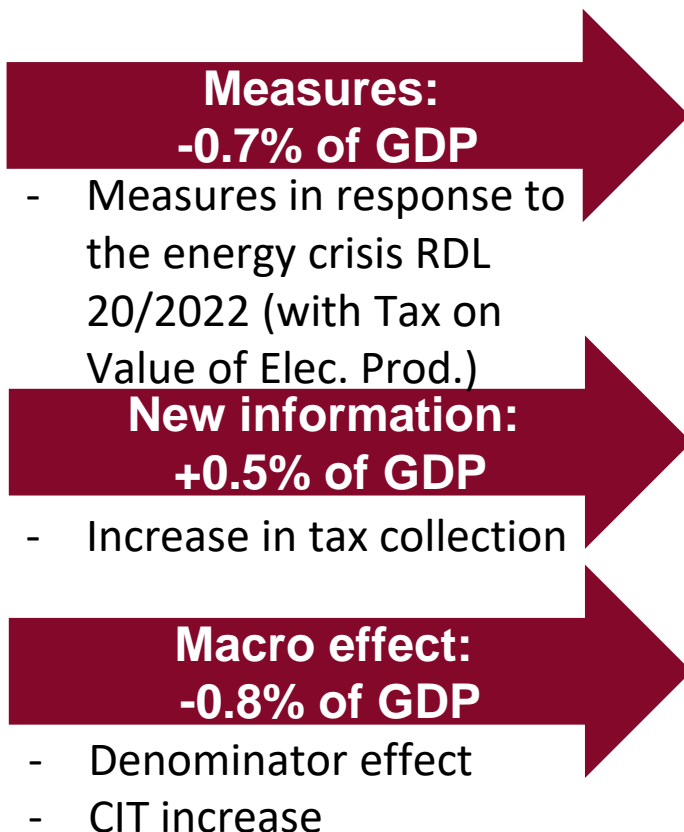**Macroeconomic effect
+0.2% of GDP**

Denominator effect (0.1% GDP): Higher level of nominal GDP forecast for 2023
Increase in tax collection: Especially in CIT as a result of the increase in GOS

The reduction in the deficit of 0.6 points of GDP is based on several factors

COVID measures:
The cost of COVID measures is slightly lower

Revenue measures:
- IEM
- Maximum contribution bases

Macro/Underlying:
Evolution of baseline revenue and expenditure…

Pensions:
... which is offset by the rise in pensions

Measures of RDL 20/2022
- Measures to mitigate the energy crisis
- Reduction in their weight compared with 2022

Waterfall chart values:
- 2021: 6,9
- COVID: -2,5
- GSB revenue measures: -0,2
- Macro / Underlying: -0,8
- Energy crisis measures: 1,4
- 2022: 4,8
- COVID: -0,1
- Other revenue measures: -0,2
- Macro / Underlying: -0,8
- Pensions: 1,0
- Measures energy crisis/Ukraine: -0,5
- 2023: 4,2

AIReF reduces its estimate of the level of revenue to 42.5%, one point less than in the previous report

	2023 DBP
REVENUE	**43,5**
TAXES	25,5
On production	12,7
On income	12,4
Capital	0,4
CONTRIBUTIONS:	13,9
Other Revenue	4,2

**Measures:
-0.7% of GDP**

- Measures in response to the energy crisis RDL 20/2022 (with Tax on Value of Elec. Prod.)

**New information:
+0.5% of GDP**

- Increase in tax collection

**Macro effect:
-0.8% of GDP**

- Denominator effect
- CIT increase

	2023 Current
REVENUE	**42,5**
TAXES	24,8
On production	11,9
On income	12,5
Capital	0,5
CONTRIBUTIONS:	13,7
Other Revenue	4,0

The more dynamic evolution of revenue in 2022 and the early months of 2023 does not offset the weight of the measures, mainly in taxes on production, and a denominator effect due to higher nominal GDP on all aggregates

AIReF lowers its estimate of the weight of expenditure to 46.7% of GDP, 0.1 points lower than in the previous report

	2023 DBP
EXPENDITURE	**46,8**
Compensation of employees	11,6
IC + STK purch. mark.	8,6
Social benefits in cash	17,8
Interest	2,2
GCF	2,4
Subsidies and other expenditure	4,2

**Measures:
+0.2% of GDP**

- Measures in response to the energy crisis RDL 20/2022 (with Tax on Value of Elec. Prod.)

**New information:
+0.6% of GDP**

- Increase in expenditure in 2022

**Macro effect:
-1% of GDP**

- Denominator effect

	2023 Current
EXPENDITURE	**46,7**
Compensation of employees	11,4
IC + STK purch. mark.	8,7
Social benefits in cash	17,6
Interest	2,4
GCF	2,6
Subsidies and other expenditure	4,1

The denominator effect of higher GDP offsets the increase in expenditure resulting from the approval of new measures and the higher than expected expenditure execution in 2022 in intermediate consumption, interest and investment

The increase in the deficit is spread across the Central Government, the ARs and the LGs, with the SSFs improving their balance

DIFFERENCE IN THE BALANCE BY SUB-SECTOR IN AIREF'S SCENARIOS (% GDP)

	2022		2023	
	AIReF Report on 2022 Budgetary Plan	Year-end	AIReF Report on 2023 Budgetary Plan	Rep. Initial budgets 2023
GG	**-4,6**	**-4,8**	**-3,3**	**-4,2**
CG	-3,4	-3,1	-3,0	-3,5
SSFs	-0,5	-0,5	-0,7	-0,6
ARs	-1,0	-1,1	-0,1	-0,3
LGs	0,2	-0,1	0,5	0,2

Source: AIReF and IGAE

- The worsening of the CG balance is mainly due to the approval of new measures and the increase in interest expenditure
- The SSFs improved their balance due to pensions eventually rising by 8.5% instead of by the 8.9% estimated in the previous report and the higher than expected collection of social contributions
- The worsening of the balance of the ARs and the LGs is mainly due to higher growth and expenditure in 2022, which consolidates the starting level for 2023
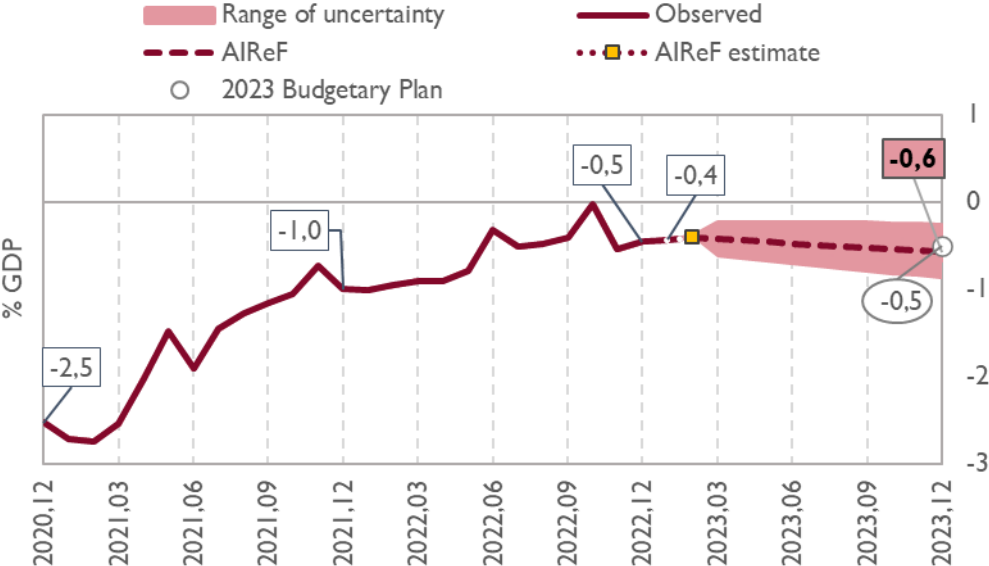
Central Government: AIReF estimates a deficit of 3.5% of GDP in 2023, 0.5 points higher than the previous forecast

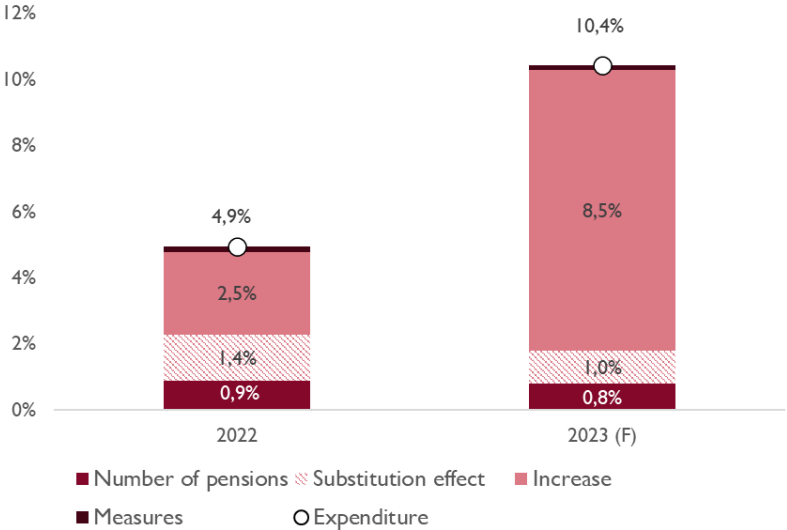**AIREF FORECASTS CG BALANCE (% GDP)**
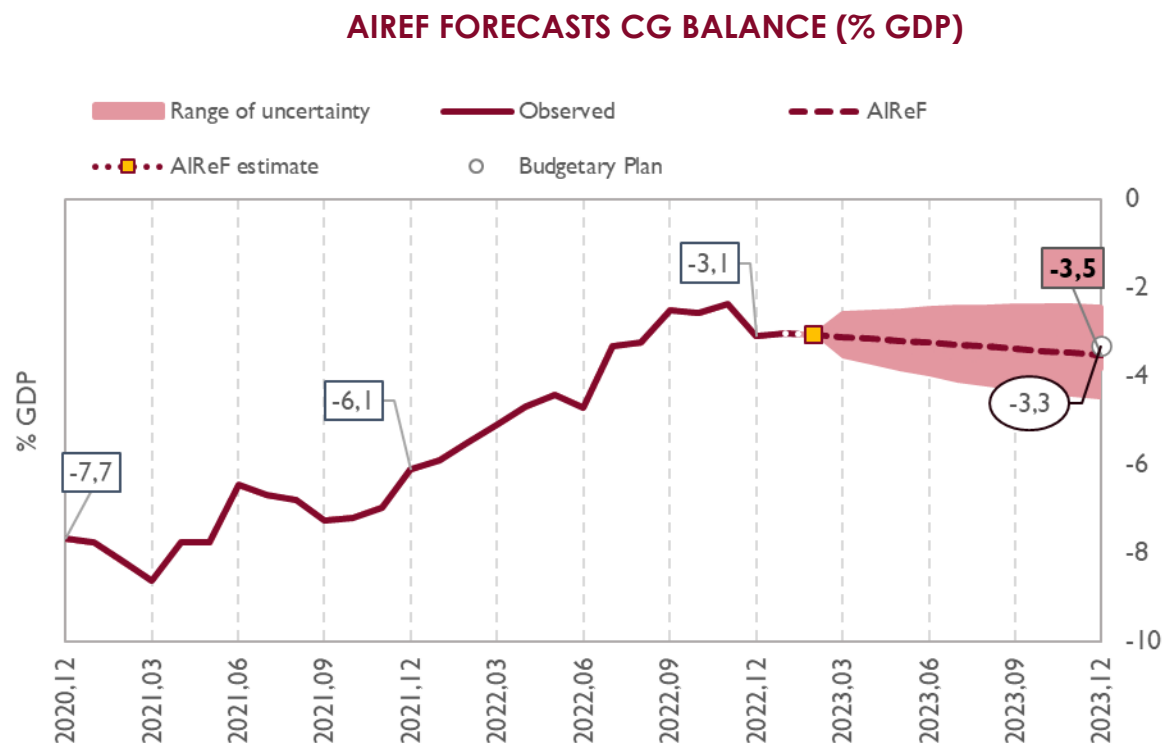
- The cost of the new measures is fully borne by the CG, leading to a downward revision of the deficit

- Both the new information and the new macroeconomic scenario raise the collection forecasts compared with the previous report, partially offsetting the cost of the measures

Social Security Funds: AIReF reduces the deficit by 0.1 points compared with the previous report


AIREF FORECASTS SSF BALANCE (% GDP)

Legend:
- Range of uncertainty
- AIReF
- 2023 Budgetary Plan
- Observed
- AIReF estimate

Values labelled: -2,5 ; -1,0 ; -0,5 ; -0,4 ; -0,6 ; -0,5

GROWTH IN PENSION EXPENDITURE (% CHANGE)

2022: 4,9% (Increase 2,5%, Substitution effect 1,4%, Number of pensions/Measures 0,9%)
2023 (F): 10,4% (Increase 8,5%, Substitution effect 1,0%, Measures 0,8%)

Legend:
- Number of pensions
- Substitution effect
- Increase
- Measures
- Expenditure

- The 2023 deficit is revised downwards by 0.1 points compared with the previous report due to a lower forecast of expenditure and higher revenue
- The expected growth in pension expenditure is corrected due to the lower increase linked to CPI, which was lower than expected in 2022, and as a result of the latest data on the number of pensions and the substitution effect
- Social contributions recorded higher than expected growth in the last few months of 2022, raising the starting level for 2023

ARs: AIReF increases the deficit of the ARs by 0.1 points compared with the previous report

**AIREF FORECASTS AR BALANCE (% GDP)**
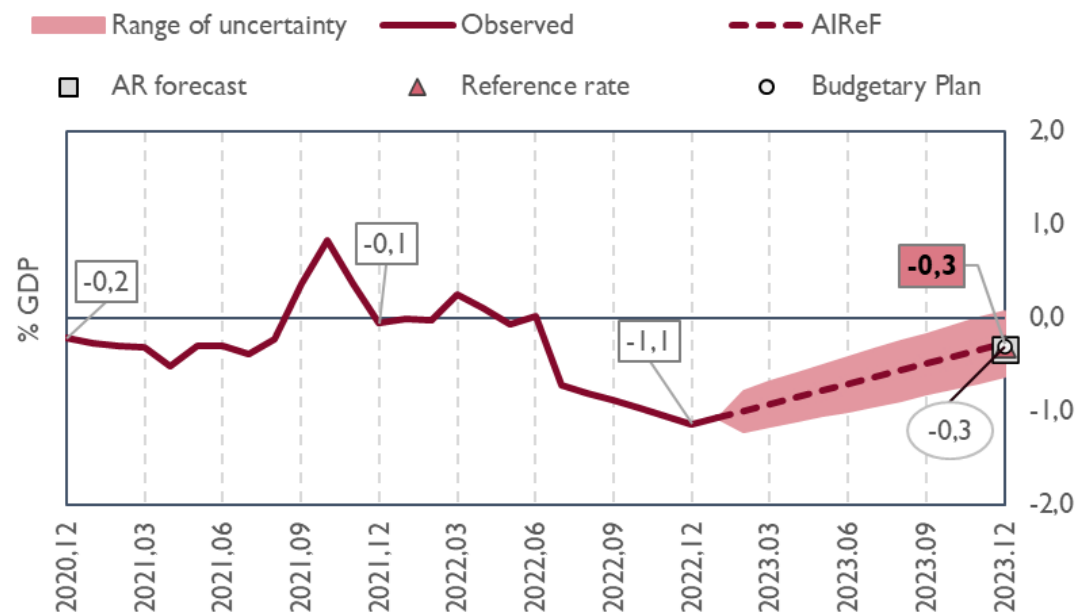
- The new information received leads to a downward revision of the deficit by 0.2 points due to a downward revision of revenue and an upward revision of expenditure in line with the year-end 2022 information
- The improvement in the balance in 2023 compared with 2022 is linked to the regional financing system:
  - ✓ Settlement: moves from negative in 2022 to positive in 2023
 - ✓ Interim payments rise by 10.7%

Only four ARs will close 2023 with a deficit higher than the 0.3% set for the sub-sector

Break-even or surplus
Deficit < 0.3 % GDP
Deficit > 0.3 % GDP
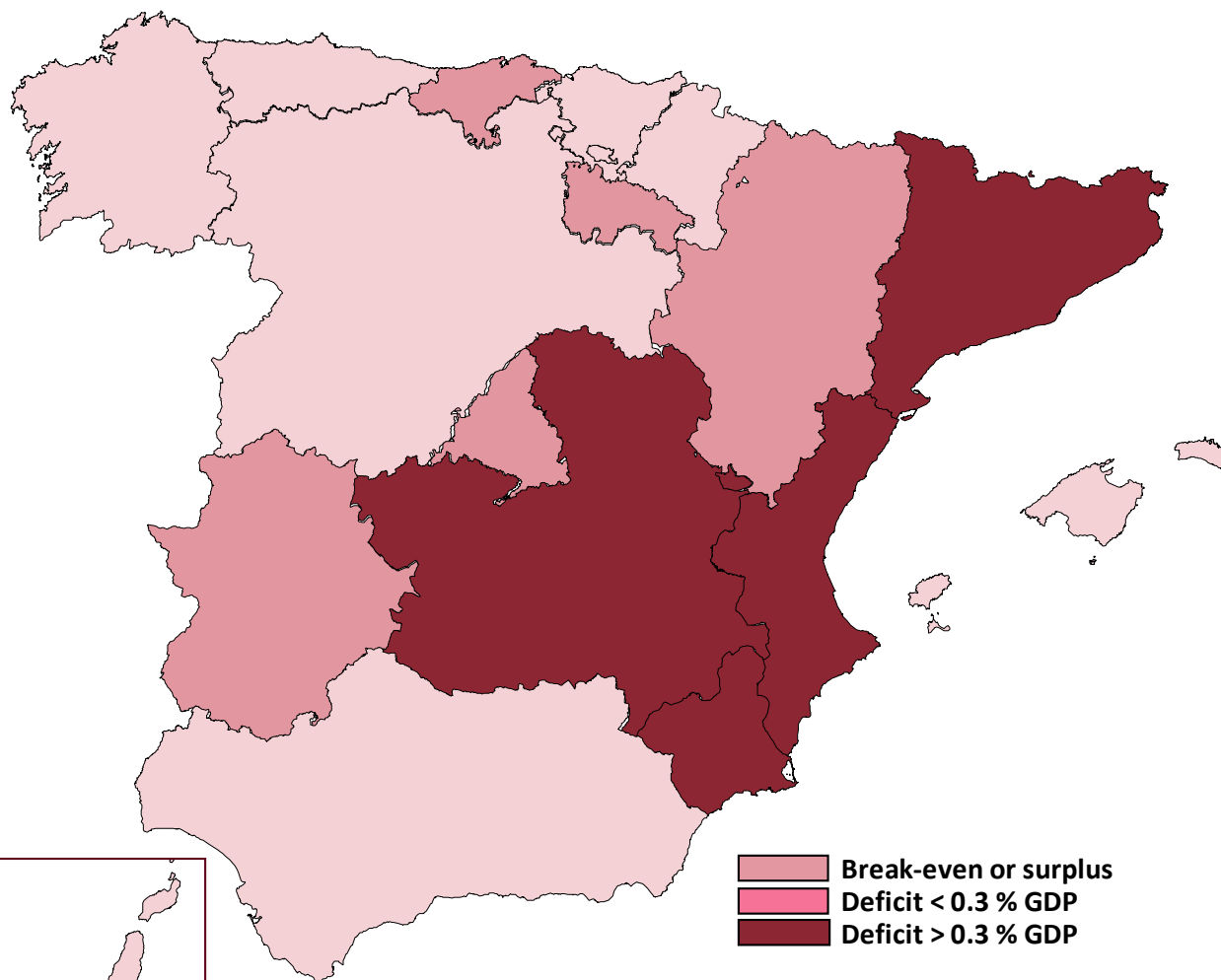
- Five ARs will close the year with a deficit close to the reference rate and four with a higher deficit

- The other ARs will close the year with a balanced budget or surplus

- On Thursday, April 13th, the individual reports by AR will be published.
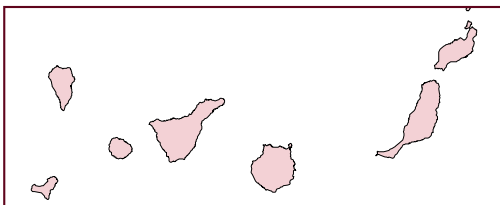
LGs: AIReF revises the surplus downwards by 0.3 points

**AIREF FORECASTS LG BALANCE (% GDP)**
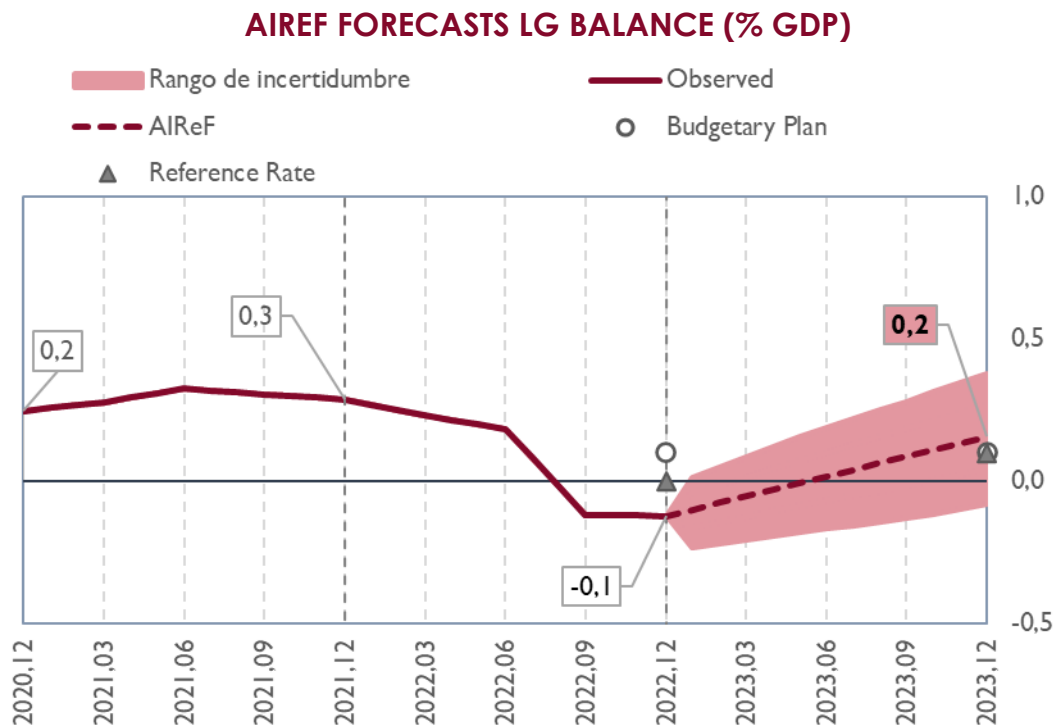
- The change in forecasts is mainly due to the year-end 2022 figure, with a deficit of 0.1% compared with the surplus forecast in the previous report.
- Expenditure grew in 2022 by 14.6%, above the forecast in the previous report, raising the level for 2023

AIReF's macro-fiscal forecasts project a reduction in the debt ratio of 2.6 points of GDP, placing it at 110.6% at the end of 2023

The Spanish debt-to-GDP ratio stood at 113.2% at the end of 2022, a reduction of 5 points over the year and an increase of 15 points on the pre-pandemic level

The reduction in the ratio will be mainly supported by the nominal growth of GDP, where the deflator will play a very significant contribution The deficit will continue to contribute significantly to the increase in debt

DEBT (% GDP). QUARTER-ON-QUARTER EVOLUTION, 2023 FORECAST AND CONTRIBUTIONS TO CHANGE
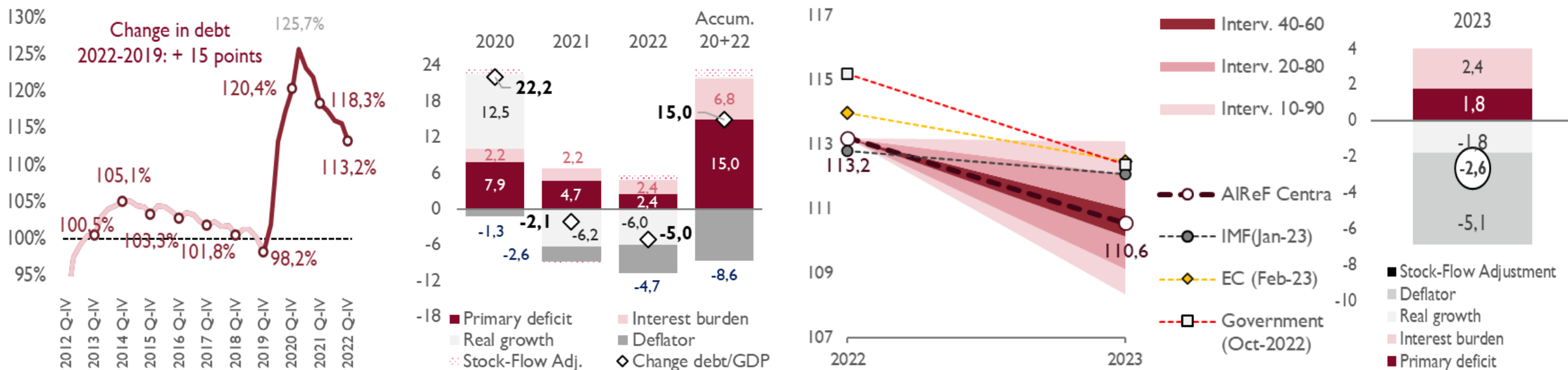
Source: Bank of Spain, INE, and AIReF.

Recommendations

Provide the Stability Programme Update with sufficient content and scope to effectively set out a medium-term fiscal strategy in line with the principles of the reform of the European fiscal framework.

- The Stability Programme is Spain's medium-term budget planning document
- The European Commission, in its Communication on the fiscal policy guidance for 2023, calls for the incorporation of some elements of the reform of the fiscal framework in the updates of the Stability Programmes
- Need to ensure prudent fiscal policy and to place debt on a sustainable path
- Integrate the macroeconomic and fiscal implications of the investments set out in the RTRP
- The Stability Programme should include information broken down by sub-sector in national accounting terms

AIReF reiterates the recommendation to publish all the information disaggregated by headings and sub-sectors on the RTRP in national accounting terms

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