REPORT ON THE INITIAL BUDGETS OF THE GENERAL GOVERNMENT FOR 2023

REPORT 1/23

April 5th, 2023

AIReF
Independent Authority for Fiscal Responsibility

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 the legal mandate to evaluate the initial budgets of the General Government (GG) from the perspective of their compliance with fiscal targets, focusing its assessment, as provided for in its organic law, on the main changes with respect to the report on the main budgetary lines and draft budget dated October 25th, 2022. As the fiscal rules for 2023 are suspended, AIReF's fiscal supervision takes on greater importance as a guarantor of the sustainability of the General Government.

In this report, AIReF updates its macroeconomic and fiscal forecasts incorporating the impact of the measures approved or extended since the last report. In this context, AIReF presents a new macroeconomic scenario that maintains the forecasts for real growth in gross domestic product (GDP) for 2023 at 1.6%, while nominal GDP growth, which is particularly relevant for fiscal forecasts, stands at 6.5%.

AIReF revises the General Government deficit forecast in its central scenario to 4.2% of GDP from the 3.3% forecast in the previous report. This increase is mainly explained by the measures taken or extended since the previous report. The revision of the macroeconomic scenario has a slightly positive effect on tax collection, which is offset by the most recent budget execution information.

Revision of the macroeconomic scenario for 2023

AIReF maintains its forecast of real GDP growth for 2023 at 1.6%, compared with the 5.5% observed in 2022, while the expected nominal growth stands at 6.5%, compared with 10% the previous year.

Global growth expectations are being revised upwards, while energy raw material prices in international markets are moderating. This is the result of energy-saving measures and the high reserve levels of the European economies, the relatively high temperatures recorded last winter and the replacement of Russian gas with alternative energies that have allowed industrial activity to be sustained and energy prices to be contained in relation to the expectations last autumn. Added to this is the reopening of the Chinese economy, which is providing a significant boost to global demand. In contrast, financing conditions continue to tighten and past increases in interest rates are expected to be further passed on to the real economy in the second half of 2022. Therefore, the forecast for 2023 remains unchanged at 1.6%.

Regarding prices, energy products show negative rates of change. In contrast, high inflation rates persist in food, industrial goods and services, reflecting a gradual pass-through of past cost increases, while wage increases remain moderate. In 2023, the expected change in the consumer price index stands at 4% (4.8% in the case of the GDP deflator).

Budgetary scenario of the General Government.

For its central scenario, AIReF estimates a GG deficit of 4.2% of GDP in 2023, 0.3 points higher than the reference rate set for 2023. This revision raises the deficit forecast by 0.9 points of GDP compared with the October report, which did not assume the extension of the measures approved since 2021 to mitigate the effects of the energy and inflation crisis in line with the provisions of the General State Budget (GSB) for 2023. Before the end of the year, by means of Royal Decree-Law 20/2022, the Government partially extended the existing measures and approved additional measures for 2023.

The deficit increase due to the additional measures is 1% of GDP for 2023. On the revenue side, the energy tax reduction measures have been extended for the full year. In addition, a reduction in VAT on certain foodstuffs has been introduced and will initially apply in the first half of the year. It also incorporates the rise in expenditure resulting from the fuel subsidy for the transport sector and a series of other measures of a sectoral nature and support to individuals.

In addition, the changes in the macroeconomic scenario reduce the deficit by 0.2 points due to improved tax collection and the denominator effect due to a higher level of GDP in nominal terms for 2023. With regard to revenue, there is a noteworthy increase in the forecast for gross operating surplus, which raises the forecast for Corporate Income Tax collection by slightly less than 0.1 points. For its part, the higher expected level of nominal GDP in 2023, mainly due to higher growth in 2022, reduces the weight of the deficit of GDP by a further 0.1 points.

Finally, the incorporation of the latest available information leads to an increase in the forecast of the deficit of 0.1 points of GDP compared with October due to contrasting factors. At the end of 2022, the evolution of revenue was significantly more positive than previously expected in Corporate Income Tax and, to a lesser extent, in Personal Income Tax (PIT) and social contributions. In the opposite direction, the latest higher-than-expected budget execution data lead to an increase in the forecast of interest expenditure, intermediate consumption and investment.

As a consequence of the above, the deficit in 2023 will fall by 0.6 points of GDP compared with 2022. The progressive withdrawal of the measures implemented to mitigate the effects of the COVID–19 crisis reduces the deficit by 0.1 points in 2023. In addition, the cost of the measures approved to date to mitigate the effect of the energy and price crisis in 2023 is lower than in 2022, which results in a further reduction in the deficit of 0.5 points. In contrast, the increase in pensions in line with the 2022 CPI, of 8.5%, results in an increase in the deficit of 1 point. Finally, the underlying trend in other expenditure and revenue results in a reduction in the deficit of 0.8 points of GDP, plus an additional 0.2 points due to the impact of the revenue measures included in the GSB.

TABLE 1. EVOLUTION OF GENERAL GOVERNMENT BALANCE

	2022		2023	
	AIReF Report on 2022 Budgetary Plan	Year-end	AIReF Report on 2023 Budgetary Plan	AIReF 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

AIReF forecasts that revenue will grow by 6.4% in 2023 to stand at 42.5% of GDP, 44% if RTRP revenue is included. This level would be 1 point of GDP lower than that forecast in the previous report. Most of this reduction, 0.9 points, is due to the higher expected level of nominal GDP for 2023, as a result of the higher nominal growth recorded in 2022. The extension of all the temporary tax measures in force in 2022 relating to the taxation of energy, as well as the new measures adopted, reduce the collection forecast by 0.7 points compared with the figure included in the previous report. This amount also includes the extension of the suspension of the Tax on the Value of Electricity

Production, which is partially offset by lower transfers to the electricity sector. In addition, the new macroeconomic scenario results in higher overall tax collection, which is particularly concentrated in Corporate Income Tax due to the higher forecast of gross operating surplus. Finally, the collection data for the final months of 2022 and the early months of 2023 have been higher than those forecast in the previous report in Corporate Income Tax, Personal Income Tax and social contributions, which raises the forecast for these taxes for 2023. As a whole, the new information on collection raises the forecast of total revenue by 0.5 points.

Expenditure, excluding the RTRP, will stand at 46.7% in 2023, according to AIReF's estimates, compared with 46.8% in the previous report. As with revenue, the reduction in expenditure as a proportion of GDP is explained by the effect of higher nominal GDP. In contrast, the approval of new measures and the extension of some of the existing ones result in an increase in expenditure of 0.2 points of GDP compared with the October forecast. Finally, including the RTRP, expenditure would stand at 48.3% of GDP.

Central Government

AIReF estimates a deficit of 3.5% of GDP for the Central Government (CG) in 2023, an increase of 0.5 points on the previous forecast. In this case, the most important factor is the approval of the new measures and the partial extension of the existing ones, whose impact falls fully on the CG. In contrast, the changes in the macroeconomic scenario and the new information, especially regarding tax collection, reduce the deficit by 0.5 points.

Social Security Funds

AIReF reduces the deficit estimate of the Social Security Funds (SSFs) by 0.1 points to 0.6% of GDP. On the expenditure side, inflation in 2022 (from December 2021 to November 2022) has been somewhat lower than estimated in the October report, eventually standing at 8.5%, which reduces pension expenditure. Along the same lines, the forecasts for the collection of social contributions worsen in terms of points of GDP due to the denominator effect. However, they rise in level having recorded a better-than-expected evolution over the last few months of 2022 and the early months of 2023.

Autonomous Regions

The deficit of the Autonomous Regions (ARs) will rise in 2023 to 0.3%, 0.2 points more than in the previous report. This increase in the deficit forecast is due to the latest budget execution data. The reduction in the deficit of the ARs in 2023 compared with 2022 is mainly due to the increase in revenue from the regional financing system. Specifically, after the negative settlement of 2022, the ARs will receive a positive settlement in 2023 relating to 2021. In addition, interim payments also grew by 10.7%.

Local Governments

Local Governments (LGs) will improve their balance in 2023 to return to a surplus of 0.2% of GDP, 0.3 points lower than in the previous report. 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. As with the ARs, the increase in the surplus is mainly due to the settlement of the financing system, which goes from having a negative impact in 2022 to being positive in 2023. In addition, the compensation for the negative settlement of 2022 that the LGs will receive in 2023 also has a positive impact.

Challenges foreseen from a perspective of sustainability of public finances

AIReF's macro-fiscal forecasts for this year project a reduction in the debt-to-GDP ratio of 2.6 points on the level recorded in 2022, which would place the ratio at 110.6% at the end of 2023. In the first quarter of 2021, the debt ratio reached an all-time high (125.7%). According to AIReF's forecasts, this will be the ceiling after which a downward path has begun that has put the ratio at 113.2% of GDP at the end of 2022. It is forecast to stand at around 110.6% at the end of 2023.

This forecast improves the one presented by the Government in the Draft Budgetary Plan for 2023 of 112.4%, which is in line with the latest forecasts of the IMF and the European Commission. The public deficit will continue to contribute to the increase in debt in a similar way to 2022 and the reduction in the ratio will be mainly supported by the nominal growth in GDP, where the deflator will make a very significant contribution.

Beyond some correction of the sharp increase in the debt ratio in the first year of the pandemic, AIReF projects an unfavourable evolution following an initial period of some stabilisation.

The expected increase in spending on pensions, healthcare and long-term care as a result of the ageing of the population, together with the new monetary cycle - with a rapid and intense tightening of financing conditions - and the high level of existing debt, places the sustainability of public finances in a vulnerable situation.

Recommendations

The Stability Programme Update is Spain's medium-term budget planning document, which is why AIReF considers that the time is right for setting out a realistic and credible medium-term fiscal strategy that guarantees the sustainability of public finances. In this regard, the European Commission has underlined in its Communication on fiscal policy guidance that the escape clause will be deactivated at the end of 2023 and has called for Member States to present a path that will ensure that debt is on a downward path.

Accordingly, AIReF recommends that the Government 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. For this purpose, it should include disaggregated forecasts in national accounting terms for each sub-sector, as well as sufficient detail of the measures necessary to comply with the proposed deficit and debt path.

In addition, in order to have complete information on the implementation of the RTRP, AIReF recommends that the Ministry of Finance and Civil Service publish separately the amounts corresponding to the revenue and expenditure of the RTRP in national accounting headings. It should also publish a breakdown in national accounting terms of the amount transferred and the recipient sub-sector of the current and capital transfers between GG sub-sectors corresponding to the RTRP.

1. INTRODUCTION

AIReF has the legal mandate to report on the initial budgets of the General Government (GG). Organic Law 2/2012 on Budgetary Stability and Financial Sustainability establishes that this report must be prepared by April 1st, from the perspective of their compliance with the expenditure rule and the budgetary stability and public debt targets. However, AIReF has had to delay the issuance of this report by a few days because the year-end 2022 public accounts, which are essential information for the analysis, were not published until March 30th. Moreover, given that the fiscal rules continue to be suspended for 2023, the assessment is instead made with respect to the Government deficit forecasts contained in the 2023 Budgetary Plan[1].

The preparation of this report focuses on the changes with respect to the Reports on the Main Budgetary Lines issued in the fourth quarter of 2022. AIReF gave its opinion on the main budgetary lines of the GG for 2023 in the last quarter of 2022. Firstly, AIReF, after publishing its endorsement of the macroeconomic forecasts of the draft General State Budget (GSB) for 2023, issued its report on October 18th on the draft General State Budget for 2023[2]. It

[1] These slightly modify the reference rates approved by the Government by increasing the projected deficit for the CG by 0.1 points of GDP to 3.3%.

[2] Report on the main budgetary lines and draft budget of the GG: 2023 GSB

then completed its opinion with the issuance, on October 25th, of the Report on the Main Budgetary Lines and draft budget of the General Government (GG) and regional and local governments[3]. Days later, AIReF concluded its analysis with the issuance, on October 28th, of the individual reports on the Autonomous Regions (ARs)[4] and Local Government (LGs) [5].

Since then, the Central Government and most of the Territorial Administrations have approved their budgets for 2023. The GSB for 2023 was approved by Parliament on December 20th and entered into force on January 1st, 2023. At a territorial level, all ARs have an approved budget for 2023 with the exception of the Region of Madrid, which is currently in budgetary extension. For their part, most of the LGs analysed individually by AIReF have also approved their budgets for 2023.

This report updates AIReF's macroeconomic and fiscal forecasts for 2023 in order to assess the initial budgets of the General Government. With regard to the previous report, AIReF presents a new macroeconomic scenario that slightly modifies GDP growth forecasts, in real and nominal terms. In addition, the new estimates incorporate the most recent figures from the quarterly accounts published on March 24th, the accounts of the institutional sectors published on March 31st, as well as the economic policy measures implemented up to the time of publication of the report, including the package of anti-crisis measures approved by Royal Decree-Law 20/2022 of December 27th, 2022 on measures to respond to the economic and social consequences of the war in Ukraine[6].

AIReF gives its opinion on the situation of the GG as a whole and on each one of the sub-sectors. This report analyses the GG forecasts for 2023 as a whole and broken down for each sub-sector. In addition, the assessment included in this report for the territorial administrations will soon be supplemented, at a regional level, with the publication of the individual reports on the initial budgets for 2023 and, at a local level, with a more extensive report with the individualised analysis of the 21 large LGs and the three Provincial Councils of the Basque Country.

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[3] Report on the main budgetary lines and draft budget GG: ARs and LGs 2023

[4] Individual reports on the main budgetary lines and draft budgets of the ARs 2023

[5] Report on the main budgetary lines and draft budgets of the LGs 2023, analysed individually

[6] Royal Decree-Law 20/2022 of December 27th

Finally, as regards the organisation of the report, it is divided into six sections. Following this introduction, Section Two sets out the content and scope of the report. Section Three analyses the evolution of the macroeconomic scenario. It then offers an in-depth look at the reasons for revising the scenario to end with an overview of macroeconomic risks. Section Four refers to the development of the budgetary scenario, indicating the impact of fiscal policy measures, to then analyse in detail the evolution of revenue and expenditure for the GG as a whole and for each of the sub-sectors. This section ends with an analysis of the contingent liabilities and fiscal risks for 2023. Section Five assesses the challenges for the sustainability of public finances resulting from the updated macroeconomic and budgetary scenarios. Finally, Section Six presents the recommendations emerging from the analysis conducted.

2. PURPOSE AND SCOPE

The aim of this report is to assess the initial budgets in relation to the changes noted with regard to the previously reported main budgetary lines. AIReF prepares this report with the GSB approved for 2023, the measures that were subsequently approved by the Government, further additional information received and the latest published data, particularly that relating to year-end 2022. With this information, AIReF updates the forecast for 2023 for the Central Government (CG) and Social Security Fund (SSFs) sub-sectors. In the case of the AR and LG sub-sectors, the analysis has been carried out by comparing the information of the initial budgets for 2023 and updated regional forecast for 2023 with that analysed in the Report on their Main Budgetary Lines and draft budgets.

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

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

2017. This lack of information, contrary to EU legislation and the principle of transparency provided for in the Organic Law on Budgetary Stability and Financial Sustainability (Articles 6 and 27) significantly conditions AIReF's analysis. In addition to failing to publish the adjustments, an initial budget expressed in national accounting terms has not been published either. This makes it extremely difficult to ensure consistency and coherence between the various budget planning documents such as the GSB, the Budgetary Plan and the Stability Programme Update, as noted by AIReF in its Opinion on Fiscal Transparency in the General Government[7]. In this regard, it should be noted that, as a new development, many ARs have provided in the Medium-Term Budgetary Plans, in addition to the usual budgetary scenarios and aggregated national accounting adjustments, detailed forecasts of revenue and expenditure in national accounting terms.

2. **Lack of transparency on the degree of execution of the Recovery, Transformation and Resilience Plan (RTRP) in national accounting terms.** No information has been published on the execution of the RTRP in national accounting terms for 2022. From a macroeconomic point of view, this lack of transparency is a limitation in terms of knowing which funds are reaching the final recipient and, therefore, which are having an effect on the economy. In addition, from a fiscal point of view, it limits the analysis of the evolution in 2022 of revenue and expenditure that are not related to the RTRP and that constitute the ordinary activity of the GG. This affects the national accounting projections of revenue and expenditure for 2023.

3. **The uncertainty caused by the energy and price crisis and the war in Ukraine.** The duration of the war in Ukraine, one year after its outbreak, continues to generate major geopolitical uncertainty. At the same time, the persistence of inflation has led to a progressive rise in interest rates to cool the economy. In this context of major uncertainty, we should add the lack of information on the conditions for continuation or reversal in 2023 of the measures approved by the Government for this year by means of Royal Decree-Law 20/2022. Therefore, AIReF's opinion remains conditioned by the major uncertainty resulting from the current economic and geopolitical context. Consequently, the estimates made should continue to be treated with greater caution than usual.

[7] AIReF's Opinion on Fiscal Transparency

Furthermore, the approved 2023 GSB, like the draft budget, 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 liabilities faced by the CG resulting from contingent liabilities, such as court rulings and information on public-private partnerships or non-performing loans. AIReF currently considers that there are greater fiscal risks than before the pandemic as, in addition to those arising from the Government's ordinary activity, there are also those generated by COVID and, currently, by the energy crisis and the war in Ukraine.

3. 2023 MACROECONOMIC SCENARIO

3.1. Introduction

The economic data reflect that activity weakened in the second half of 2022, although to a lesser extent than expected in the autumn of 2022. Real GDP growth in 2022 was 5.5%, according to the most recent estimates of the National Statistics Institute (INE), above the forecasts that AIReF and the Government itself made at the time of drawing up the budgets for 2023. AIReF maintains expected real growth for 2023 at 1.6%.

Expectations for global growth, and in particular for the European economies, are being revised upwards. The energy saving measures implemented, a favourable climate and the replacement of Russian gas with alternative energy sources allowed the recovery of European industry as a whole to continue in 2022, while there was a significant containment of energy raw material prices towards the end of the year. Added to this is the gradual easing of bottlenecks in global production chains, the slowdown in the prices of industrial and agricultural raw materials and the reopening of China, following the "zero-COVID" policy, which has driven global demand.

In the case of the Spanish economy, job creation continues to perform favourably and, although exports have slowed, as a result of the stabilisation of tourism services, they maintain rates of change that exceed the growth of

export markets. Although INE Quarterly National Accounts (QNA) figures show a fall in household consumption expenditure, investment and exports in the fourth quarter of 2022, the most recent economic data point to relatively dynamic growth in the early months of the year.

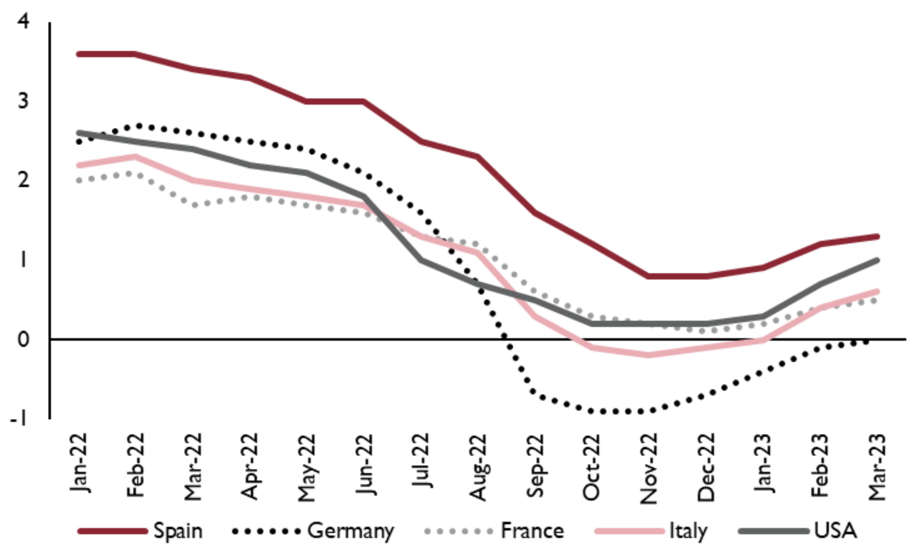
On the price side, energy prices now show negative rates compared with the previous year, although food and core inflation are still growing strongly. In 2022, the rate of change in the CPI was lower than expected (8.4% compared with a forecast of 8.9%), although the change in the implicit GDP deflator was higher than expected (4.3%, compared with the 3.6% forecast by AIReF and the 4% forecast by the Government). For 2023, the expected change in the consumer price index stood at 4% (4.8% in the case of the GDP deflator). Continued inflationary pressures are leading to a tightening of financing conditions across all European economies, while volatility in international financial markets, particularly in the United States, is rising.

This section presents AIReF's macroeconomic forecasts for 2023 and the corresponding main risk elements identified.

3.2. Evolution of international economic outlook

In the first few months of 2023, there has been an upward revision of the short-term growth outlook for most developed countries. In recent months, some of the factors hampering global growth have dissipated. On the one hand, the easing of bottlenecks in global value chains has led to a fall in freight and raw material prices. On the other hand, the reopening of China following its "zero-COVID" policy has boosted global demand.

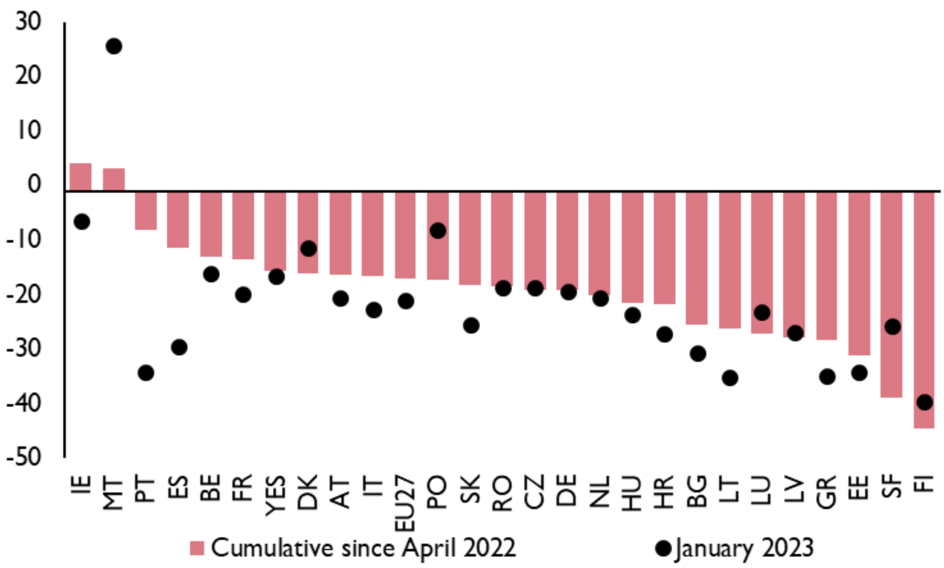
FIGURE 1. EVOLUTION OF REAL GDP GROWTH FORECASTS FOR 2023



Source: Consensus Forecasts

There has been a significant improvement in the outlook for growth in the European economies most affected by the energy crisis triggered by Russia's invasion of Ukraine. 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. At the same time, the measures that have been deployed by governments to mitigate the effects of the energy crisis have made it possible to sustain household and business demand. As a result, the GDP growth outlook for euro area countries for 2023 has been revised upwards.

FIGURE 2. YEAR-ON-YEAR RATE OF CHANGE OF GAS CONSUMPTION (%)



Source: Eurostat

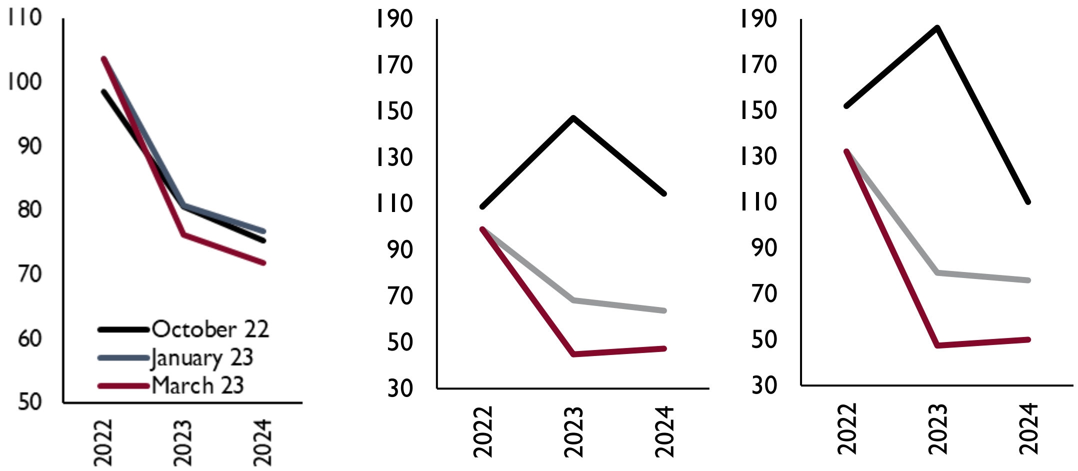
Energy raw material prices have been on a downward trend since autumn 2022. Like energy raw materials, the prices of other primary inputs, both agricultural and industrial, are moderating from the peaks reached in mid-2022. However, OPEC+ announced a voluntary reduction in its oil production on April 2nd - of 1.66 million barrels per day from May 1st to the end of the year - which could place a strain on energy product markets again. It was not possible to incorporate these changes as they occurred after the cut-off date for the preparation of the macroeconomic outlook.

FIGURE 3. EVOLUTION OF THE ASSUMPTIONS OF THE MACROECONOMIC OUTLOOK ON THE PRICE OF OIL AND NATURAL GAS

FIGURE 3.A OIL PRICE (US$/BARREL)

FIGURE 3.B GAS PRICE. MIBGAS. (€/MWH)

FIGURE 3.C GAS PRICE. TTF. (€/MWH)

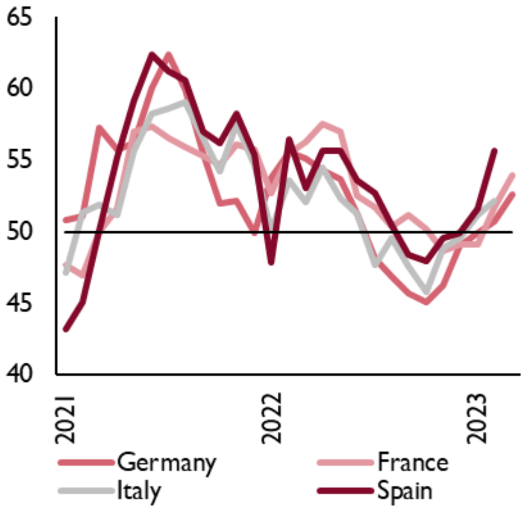


Source: Refinitiv

The most recent economic information suggests that European activity continues to perform more favourably than expected by the consensus of analysts in the autumn of 2022. Activity indicators in the euro area are improving, albeit with differing performances in services and some industrial sectors. After falling into recessionary territory in the final months of 2022, euro area countries' purchasing indices for services and industry have improved significantly in the early months of 2023 due to the easing of energy raw material price pressures. However, countries with greater dependence on Russian gas, such as Germany, and the most energy-intensive sectors show more moderate performance.

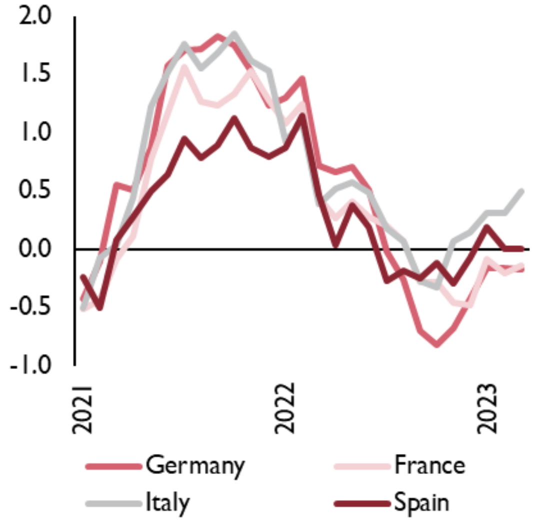
FIGURE 4. OPINION INDICATORS ON THE ECONOMIC SITUATION

FIGURE 4.A COMPOSITE MANUFACTURING AND SERVICES PMI



Source: S&P Global

FIGURE 4.B ECONOMIC SENTIMENT INDEX. STANDARDISED

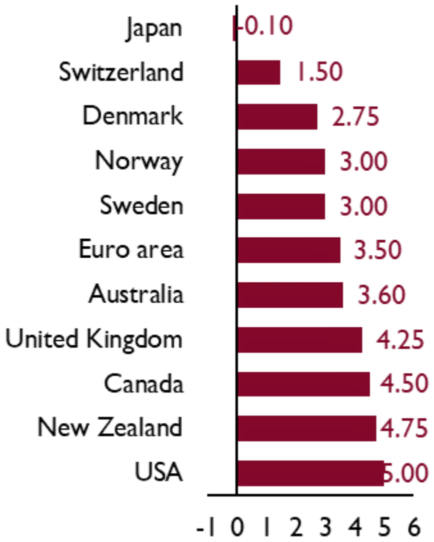


Source: European Commission.

A relevant element in the international context has been the tightening of monetary and financial conditions. Despite the recent containment of headline inflation, linked to lower pressures on raw material prices and freight rates, the persistence of core inflation has led central banks to tighten monetary policy further. The intense, rapid and simultaneous rise in benchmark interest rates since the start of 2022 has coincided 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.

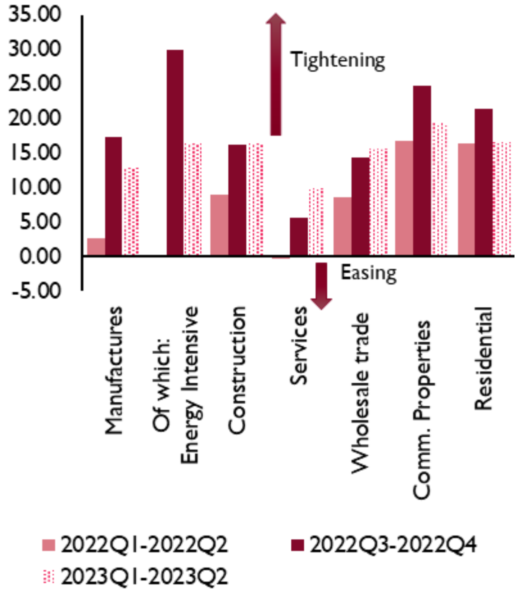
FIGURE 5. INTEREST RATES AND CREDIT STANDARDS

FIGURE 5.A BENCHMARK RATES OF VARIOUS CENTRAL BANKS



Source: Refinitiv

FIGURE 5.B CHANGE IN CREDIT STANDARDS IN LOANS TO COMPANIES



Source: ECB

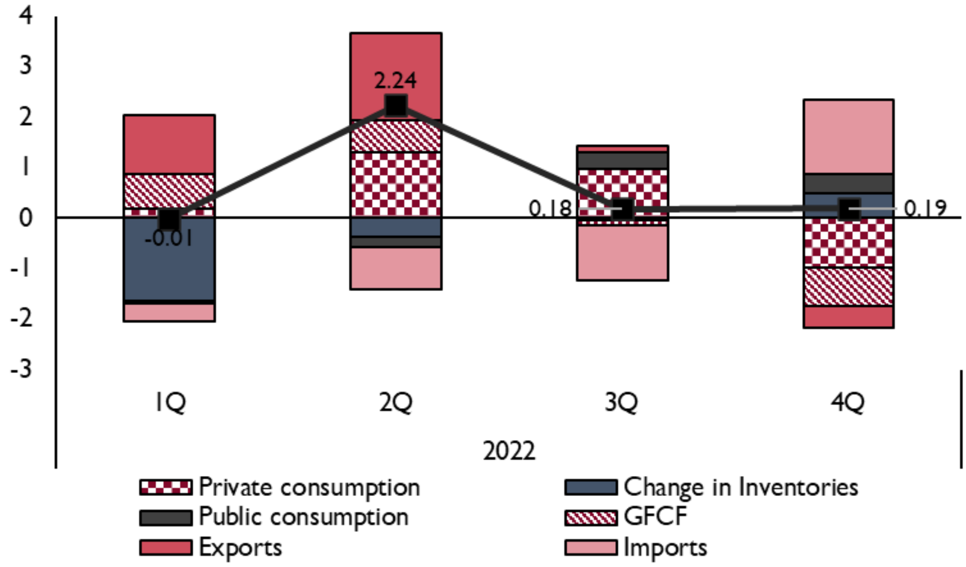
More recently, episodes of focused instability have emerged in some financial institutions in the US and Switzerland. The monetary authorities of these countries have acted quickly in the wake of the bankruptcy of Silicon Valley Bank, Signature Bank and the acquisition of Credit Suisse by UBS, in an attempt to forcefully stem the possibility of financial contagion.

3.3. Recent evolution of the Spanish economy

Real GDP growth of the Spanish economy surprised on the upside, reaching 5.5% in 2022, the same rate as in 2021. Real GDP growth far exceeded the average forecast of the panel of analysts, which in January was half a point below the figure finally reported in the Quarterly National Accounts (QNA). However, GDP growth in the second half of the year was moderate (0.2%).

The evolution of the last quarter of the year showed that growth stabilised, albeit with a contraction in all macroeconomic aggregates except for public consumption. While growth in the first two quarters of 2022 was supported by an expansion in private consumption, investment and exports, these three aggregates contracted in the fourth quarter. Therefore, only increases in public consumption and changes in inventories, together with the sharp contraction in imports, contributed towards GDP growth in the last quarter of the year (see figure 6).

FIGURE 6. CONTRIBUTION TO THE QUARTER-ON-QUARTER RATE OF GDP ON THE DEMAND SIDE (%)

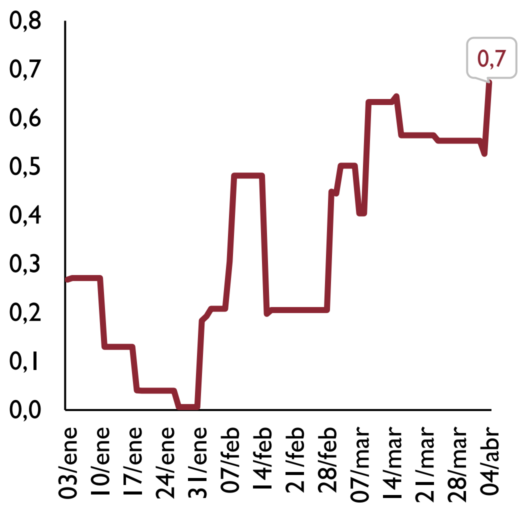


Source: INE

During the first quarter of 2023, the indicators together suggest greater buoyancy in economic activity. The MIPred model developed by AIReF, which summarises the evolution of indicators that are closely related to economic activity, points to GDP growth of 0.7% in the first quarter of 2023. Business sentiment indicators (PMIs) have risen to levels prior to the invasion of Ukraine, although the economic sentiment indicator is more contained. Similarly, consumer confidence is up from October 2022 lows. The information relating to the evolution of the foreign sector is still very scant.

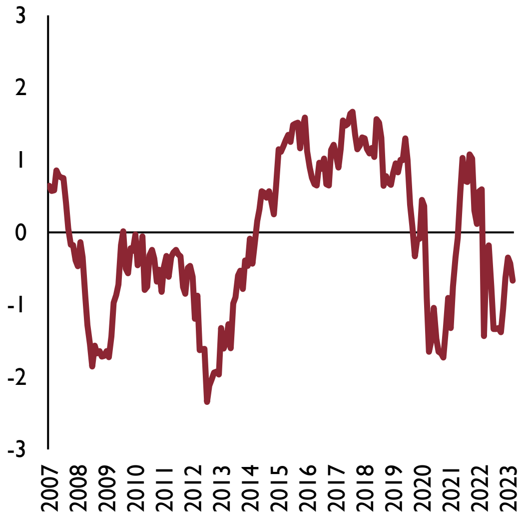
FIGURE 7. EVOLUTION OF THE ESTIMATE OF THE CHANGE IN REAL GDP IN REAL TIME AND CONSUMER CONFIDENCE

FIGURE 7.A REAL-TIME GDP ESTIMATE



Source: AIReF (as of April 4th, 2023)

FIGURE 7.B STANDARDISED CONSUMER CONFIDENCE INDICATOR



Source: Ministry of Economic Affairs and Digital Transformation

At the beginning of 2023, job creation recovered a dynamism 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. In the first quarter as a whole, Social Security affiliation rose by 2.5% in annual terms.

FIGURE 8. EVOLUTION SOCIAL SECURITY AFFILIATION

FIGURE 8.A THOUSANDS OF PEOPLE

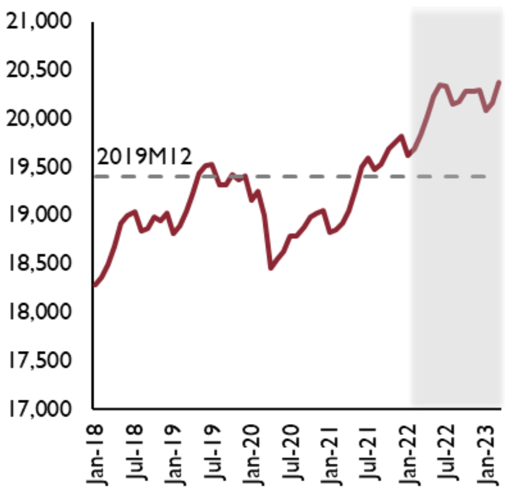
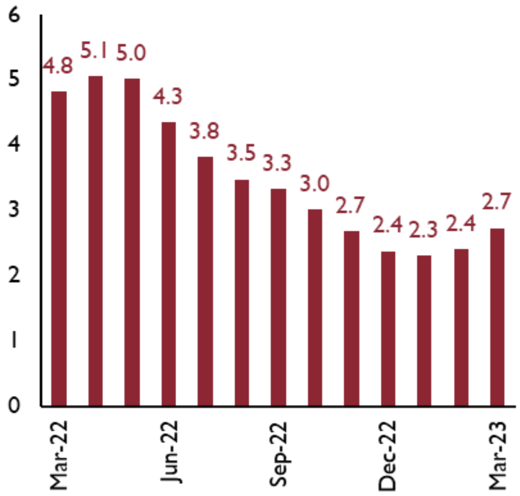


FIGURE 8.B YEAR-ON-YEAR RATE (%)



Source: INE and Social Security

Since the entry into force of the labour reform, the part-time employment rate has remained stable. Since 2022, there has been an increase in the part-time employment rate in permanent Social Security affiliation as a result of the higher importance of both permanent seasonal contracts and of ordinary part-time contracts. However, the part-time employment rate in total affiliation and in the LFS has remained practically stable due to the decrease in the part-time employment rate in temporary contract affiliation.

FIGURE 9. PART-TIME EMPLOYMENT RATE IN AFFILIATIONS

FIGURE 9.A PART-TIME EMPLOYMENT RATE IN TOTAL AFFILIATIONS

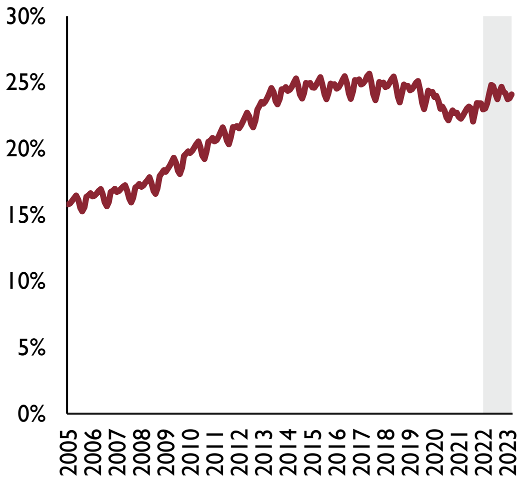
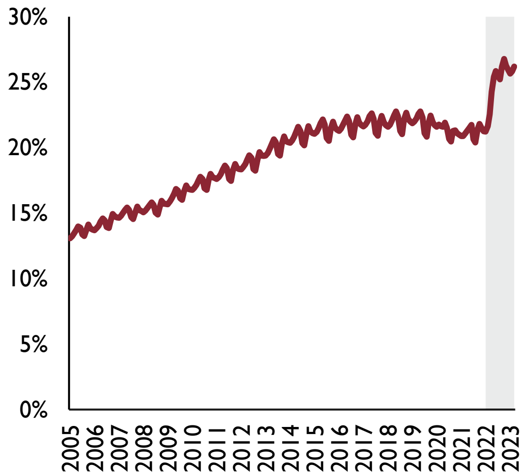


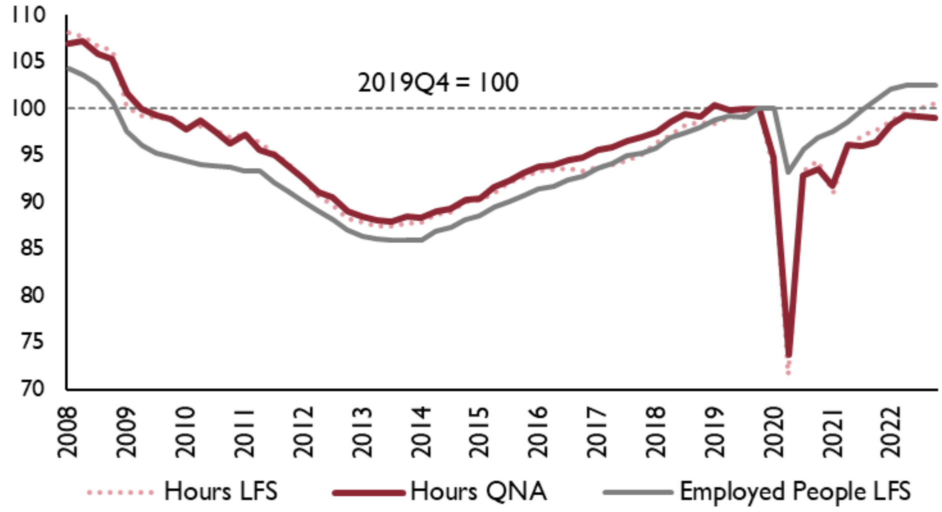
FIGURE 9.B PART-TIME EMPLOYMENT RATE IN PERMANENT AFFILIATIONS



Source: Social Security

Despite the stability of the part-time employment rate, hours worked have recovered less since the pandemic than either the number of new affiliations or the number of people employed in the LFS. The information available on hours worked shows that their recovery is slower than that of employed people. The hours worked according to the LFS would be at the pre-pandemic level, while the number of hours in the QNA figures remain slightly lower. In contrast, as previously noted, LFS employment is above pre-pandemic levels.

FIGURE 10. EVOLUTION OF HOURS WORKED



Source: INE

The fall in hours worked per employee is part of the path already observed over recent decades. In particular, the growing specialisation of service activities, the progressive incorporation of women into the labour market and the growing weight of older workers who generally have a shorter average working day[8] has resulted in recent decades in a fall in the number of hours worked per employee. This trend would have continued after the pandemic when there was an increase in employed people working between 1 and 19 hours in the reference week of the survey in relation to employed people with a longer working day. Among employed people who did not work in the reference week, certain reasons for not working have gained importance, such as holidays, maternity/paternity leave and sick leave.

[8] An analysis of hours worked per worker in Spain: trends and recent developments. Economic Bulletin 1/2023. (bde.es)

FIGURE 11. EMPLOYEES BY HOURS WORKED AND EMPLOYEES THAT DID NOT WORK IN REFERENCE WEEK

FIGURE 11.A EMPLOYEES BY HOURS WORKED (2019Q4 = 100)

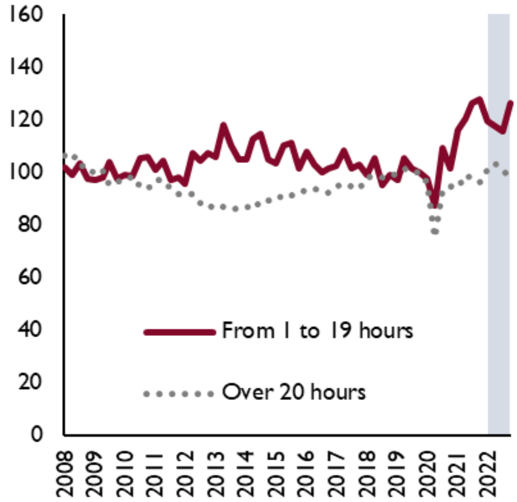
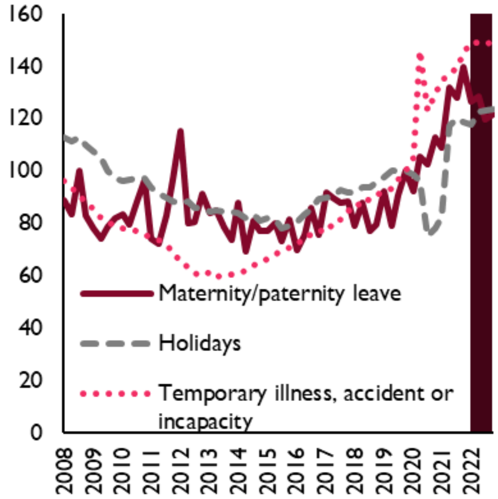


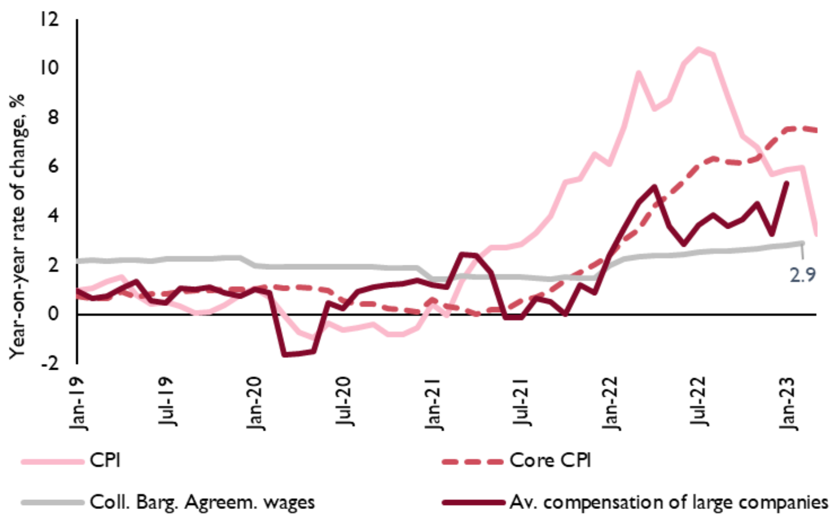
FIGURE 11.B EMPLOYEES BY REASON FOR NOT WORKING (2019Q4 = 100)



Source: INE and AIReF seasonal adjustment.

Wages negotiated under bargaining agreements remained contained in 2022, growing by around 2.5%. In the first few months of 2023, they maintained lower growth rates than those recorded by the CPI. In February 2023, the increase in wages under bargaining agreement with economic effects in that year (largely signed in previous years) stood at 2.89%. However, the wage increase in newly signed agreements was high - 5.21% in February - although the percentage of workers affected is still low (fewer than 250,000). Similarly, wages in large companies have also grown more sharply, by 5.4% in January 2023 (see figure 12).

FIGURE 12. EVOLUTION OF PRICES AND WAGES



Source: Ministry of Economic Affairs and Digital Transformation

Inflationary tensions are easing, although containment is concentrated in energy prices. Energy prices have continued to fall as a result of the moderation in gas and electricity prices. The fall in energy prices is due to the lower demand for energy raw materials at an international level, which has mitigated the fear of shortages that existed in the autumn. The mild temperatures recorded this winter have also helped this saving. Current gas prices mean that the Iberian mechanism - extended until December 2023 - to limit the price of gas is *de facto* inactive.

FIGURE 13. INFLATION IN SPAIN (%)

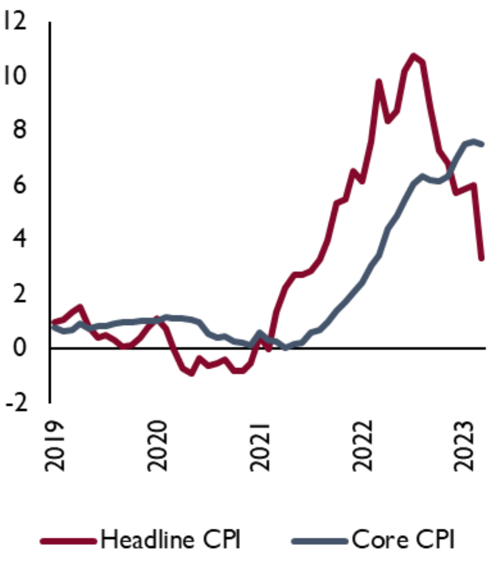
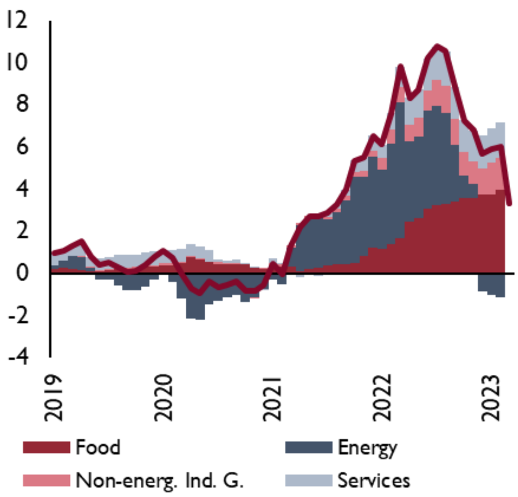


FIGURE 14. CONTRIBUTIONS TO CPI GROWTH (%, PP)



Source: INE

Inflation remains high in the rest of the consumption basket, with a special impact on food. Despite the reduction in VAT on some products, food price growth continues at historically high levels, reaching 15.7% growth year-on-year in February. Although the tensions in the prices of intermediate consumption are easing[9], the pass-through of past increases on the price of production of industrial goods and services continues. Thus, in February, 62% of products and services had inflation rates above 4%. In an international comparison (in terms of the harmonised CPI), following the flash estimates for March, Spain is the country with the lowest inflationary pressures among the large economies with which it has the highest trade links, with the average

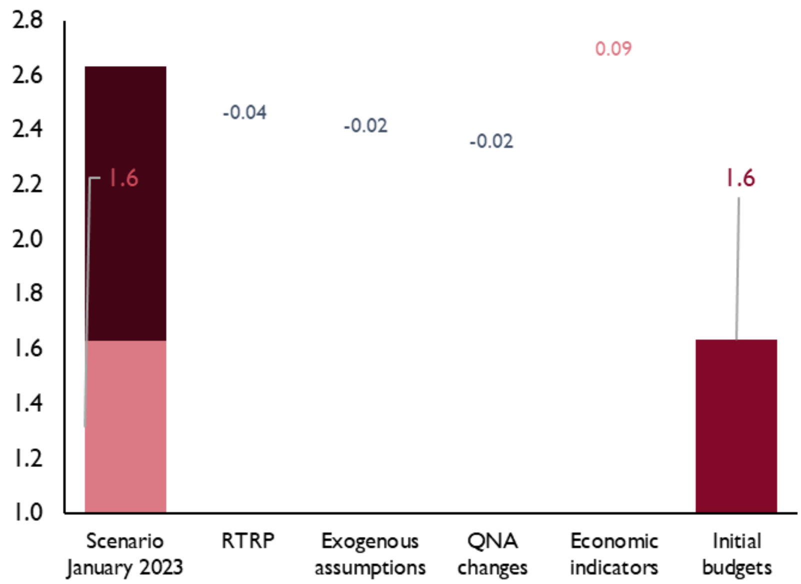
[9] Survey of Spanish companies on the evolution of their activity: first quarter of 2023. Economic Bulletin 1/2023. (bde.es)

annual change in CPI and the euro area improving by 3.8 percentage points. The year-on-year change in the CPI stood at 3.1% in Spain in March compared with 6.9% in the euro area. Regarding core inflation, there are no significant differences in growth recorded in Spain and the euro area (7.5% in both cases)

3.4. Macroeconomic outlook for 2023

AIReF maintains its estimate of real GDP growth for 2023 at 1.6%, after the 5.5% increase in 2022. The update of the external assumptions with respect to the forecasts made in January 2023 includes lower raw material prices and an increase in interest rates which, together with the incorporation of the QNA, result in a very slight revision of the forecast for the year. In this context, the estimated impact of RTRP investments on growth in 2023 remains virtually unchanged. All these effects are offset by the current information known to date for the first quarter of 2023, which suggests a better start to the year than expected in January.

FIGURE 15. BREAKDOWN OF THE SOURCES OF REVISION OF THE GDP GROWTH RATE IN TERMS OF VOLUME WITH RESPECT TO THE MACROECONOMIC SCENARIO OF JANUARY 2023 (%)



Source: INE and AIReF

TABLE 2. MACROECONOMIC OUTLOOK FOR 2023

	APRIL-2023		JAN-2023	Difference
Year-on-Year Rates of Change	***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

Source: INE and AIReF

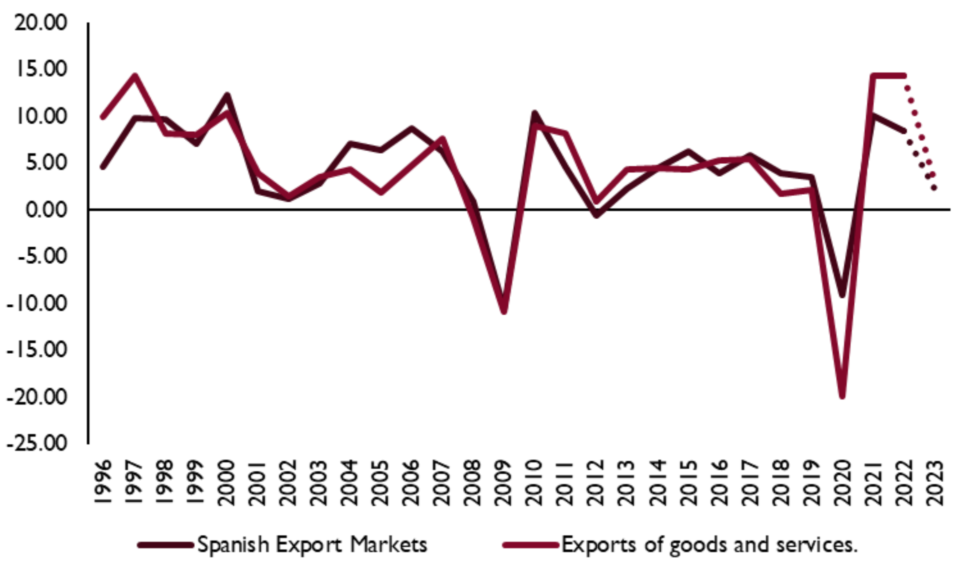
The moderation in economic activity in 2023 largely reflects the carryover effects of the slowdown in growth recorded in the second half of last year. The expected slowdown in the pace of growth would be driven by both the domestic and foreign demand components. Uncertainty, high inflation and tightening financial conditions will continue to influence spending decisions by private agents, while export growth may slow, in line with external market growth expectations.

Private consumption is expected to slow in 2023. The increase in employment is offset by the cumulative loss of purchasing power suffered by households since the start of the inflationary tensions and the tightening of financing conditions in a context in which household confidence remains negative, although more positive than in autumn 2022. The excess savings accumulated during the pandemic could have run out as the savings rate stands at relatively low levels.

The expected growth of investment in equipment and construction is revised downwards after the contraction of the final months of 2022. The Bank of Spain's survey of Spanish companies shows a worsening of the investment activity of companies in the first quarter of the year, a period in which 13.2% of companies increased their investment, compared with 17.7% in the previous quarter. Continued high input costs, despite their recent moderation, uncertainty and the tightening of financing conditions could have put a brake on companies' decisions to increase their capital. In the case of construction, all indicators suggest a slowdown of this aggregate, conditioned by the tightening of financing conditions. In particular, home buying and selling is on a downward path and new lending for home buying has fallen.

After exports of goods and services recorded growth well above that of export markets in 2021 and 2022, they are expected to return to a similar path in 2023. Following the expansion observed in 2022, supported by the favourable performance of services in the first half of the year - especially tourism - and by the significant expansion of exports of goods throughout the year, exports of goods and services are expected to record growth more in line with export markets in 2023.

FIGURE 16. RATE OF CHANGE IN EXPORTS OF GOODS AND SERVICES AND SPANISH EXPORT MARKETS (%)

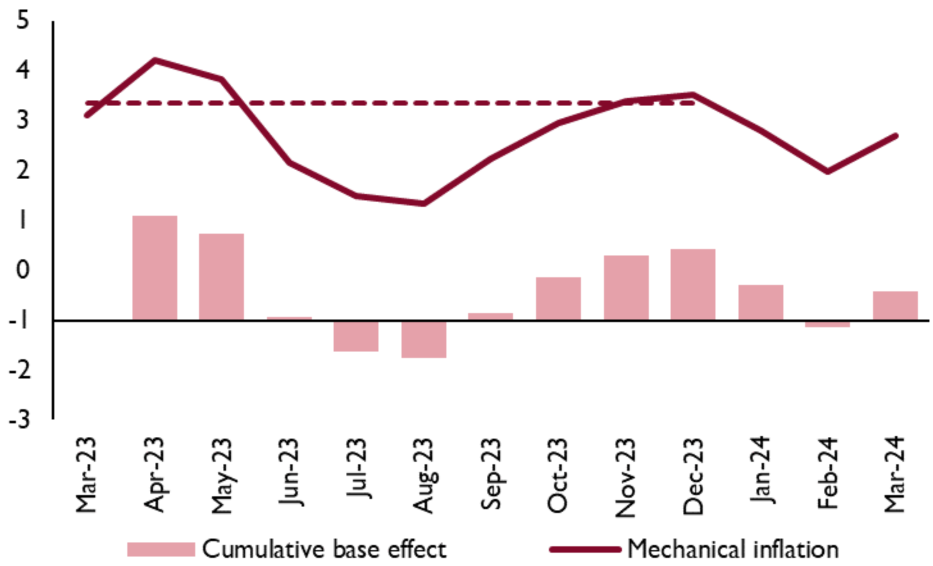


Source: INE and IMF

For its part, employment growth is expected to slow in 2023, in line with the moderation in GDP growth. This would result in very slight growth in apparent labour productivity.

In this context, expected inflation for 2023 as a whole currently stands at 4%, compared with the 4.2% projected in the January report. The containment of the year-on-year rate of the CPI mainly reflects two factors: (i) the mechanical effects or base effects associated with the high prices observed since March 2022 as a result of the war in Ukraine - which would place inflation at 3.3% on average in 2023 - and (ii) the recent moderation in energy prices compared with the levels observed over the previous year. In contrast, food prices maintain very high rates of inflation - despite the reduction in VAT on some products - as do some services such as holiday packages (10%) and restaurants and hotels (8.5%). Overall, the expected CPI rate would stand at 4%, while core inflation would stand at around 5.4%.

FIGURE 17. BASE EFFECTS AND MECHANICAL INFLATION (PP AND %)



Source: INE and AIReF

From the perspective of its determining factors, price growth will be supported by wage growth and the contribution of gross operating surplus. The forecasts incorporate the assumptions that wages will grow somewhat above inflation on average in 2023, only partially recovering the purchasing power lost the previous year. For its part, the contribution of the gross operating surplus to GDP deflator growth will remain positive in 2023, although lower than that recorded in 2022.

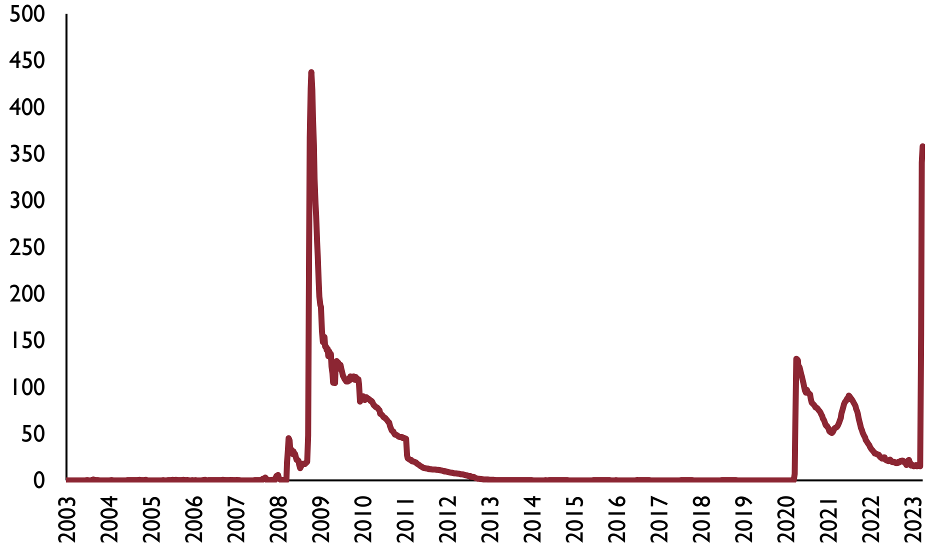
3.5. Risks surrounding the macroeconomic scenario

The balance of risks surrounding these projections continues to be orientated downwards in the case of GDP growth. Geopolitical tensions continue to cast shadows over the growth scenario. Uncertainty about the possible developments of the war in Ukraine, which might lead to higher energy prices, along with the protectionist measures currently being implemented by many governments, could undermine global growth capacity.

The biggest focal point of risks remains the evolution of inflation and the tightening of financing conditions. Firstly, the persistence of inflation continues to reduce households' purchasing power against a backdrop of the tightening of financing conditions in the economy and dissipation of savings accumulated during the pandemic. Secondly, price growth raises the risk of wage-margin and price spirals. Inflationary tensions could lead to further tightening of the economy's financing conditions and increase financial market volatility.

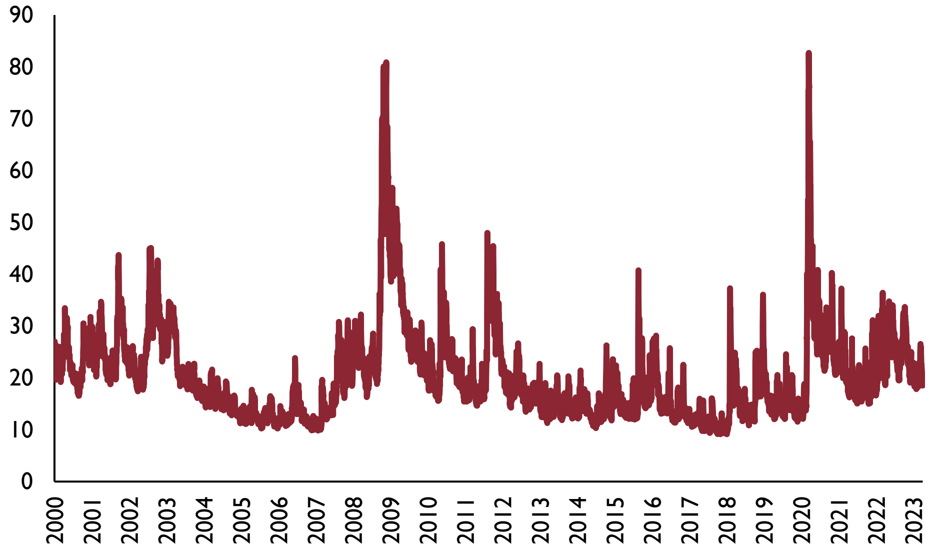
As the various central banks have been increasing their benchmark rates and abandoning unconventional monetary policy measures, problems have been observed in some financial institutions, especially in the US and Switzerland. Over the last decade, there has been considerable progress in the regulation and supervision of financial institutions in the European Union, which currently have healthy liquidity and capital positions. This would have prevented events such as those in the US relating to Silicon Valley Bank and Signature Bank or Credit Suisse in Switzerland from spreading to this area. The FED's decision to stem liquidity problems in the US has turned out to be essential for avoiding contagion from the US financial sector (see FIGURE 18). This situation has also revealed that EU banks are better prepared to deal with "sudden" interest rate rises. In fact, the financial market volatility index (VIX) remains at relatively moderate levels (see FIGURE 19).

FIGURE 18. CREDIT AND LIQUIDITY FACILITIES (US$ BN)



Source: US Federal Reserve

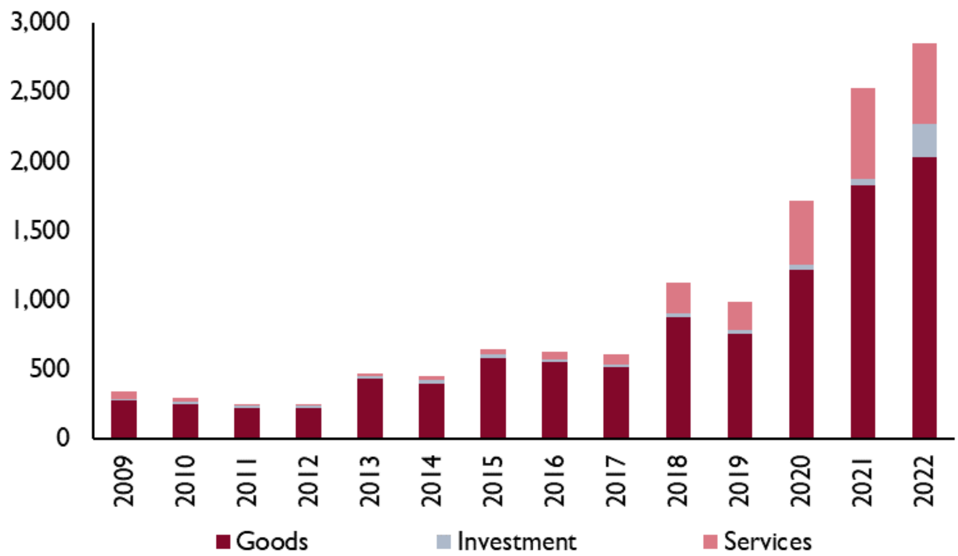
FIGURE 19. VIX INDEX



Source: Refinitiv

The drift towards implementing restrictions on international trade in goods and services and regionalisation of trade flows following the COVID-19 epidemic continued over 2022. The trend towards the regionalisation of international trade flows continued over 2022, in which the largest number of harmful restrictions to world trade in the last decade were implemented, particularly relating to cross-border investments.

FIGURE 20. NUMBER OF HARMFUL RESTRICTIONS ON INTERNATIONAL TRADE IMPLEMENTED



Source: Global Trade Alert

4. ANALYSIS OF 2023 BUDGETARY SCENARIO

AIReF estimates a GG deficit of 4.2% of GDP in 2023, 0.9 points higher than that forecast in the previous report. This update of the deficit forecasts places AIReF’s central scenario at 0.3 points below the reference rate set by the Government in the Budgetary Plan. This change is due to several factors with opposing effects on AIReF's central scenario. Firstly, since the last report in October, the Government has approved a package of measures in Royal Decree-Law 20/2022 to mitigate the economic consequences of the war in Ukraine, in addition to those previously taken. Furthermore, the evolution of macroeconomic variables and the new information received have altered the macroeconomic scenario, which is transferred to the revenue and expenditure forecasts. Finally, AIReF's analysis incorporates all the new information published and provided by the different General Government sub-sectors since the previous report. Particularly noteworthy among this new information are the year-end 2022 figures, with a GG deficit of 4.8% of GDP. This year-end figure is 0.2 points of GDP below the forecasts published in the Budgetary Plan and 0.2 points above the forecasts in AIReF's last report. Finally, AIReF assumes that the Recovery, Transformation and Resilience Plan (RTRP) and the REACT-EU funds will have a neutral effect on the 2023 deficit.

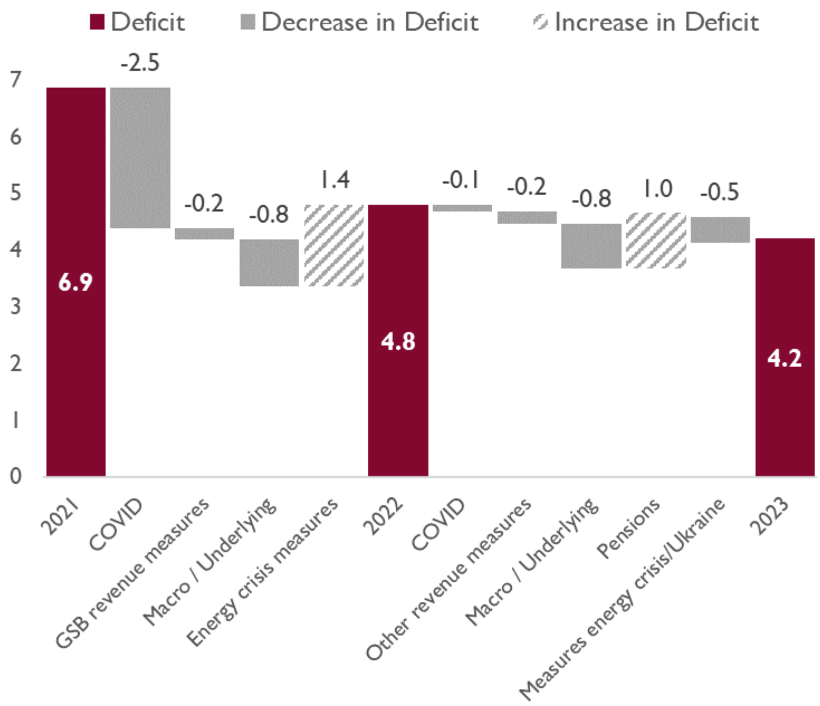
The new measures approved, and the update of the valuation of some already in force, raise the 2023 deficit by 1 point of GDP. By means of Royal Decree-

Law 20/2022, the Central Government has approved a package of measures to mitigate the effects on the Spanish economy of the war in Ukraine and the energy and price crisis. These measures, which are based on both revenue and expenditure, add to or extend other measures already in force to offset the rise in prices. On the one hand, the measures approved since the last report result in a fall in collection of 0.7 points of GDP, while they result in an increase in expenditure, mainly through subsidies and social transfers and cash, of 0.2 points of GDP.

The revision of the macroeconomic scenario results in an improvement in the deficit of 0.2 points of GDP. AIReF's central macroeconomic scenario suggests higher real GDP growth in 2023, which would stand at 1.6% compared with the 1.5% forecast in the previous report. The GDP deflator is revised upwards by almost 0.5 points, leading to a revision of GDP in nominal terms of 0.6 points, from 5.9% to 6.5% in the current scenario. On the one hand, the increased buoyancy of the economic variables raises the revenue projection, mainly as a result of Corporate Income Tax, thus reducing the deficit by 0.1 points. On the other hand, the higher nominal GDP reduces the deficit by 0.1 points through the denominator effect.

The new data incorporated, mainly the year-end 2022 figures, result in higher revenue and expenditure than forecast by AIReF in its last report with a total impact of a higher deficit of 0.1 points. The GG deficit in 2022 was 0.2 points higher than that forecast by AIReF in its October report last year. The main reason for this is higher-than-expected growth in both budgetary revenue and expenditure. On the revenue side, tax collection and contributions, isolating other effects, ended the year at 0.5 points higher than expected. This leads to a higher starting point for collection in the remainder of 2023, which has led to an upward revision in forecast receipts from contributions and taxes on income (PIT and Corporate Income Tax). On the expenditure side, the new information raises the estimates by 0.6 points, mainly due to expenditure on interest, investment and intermediate consumption.

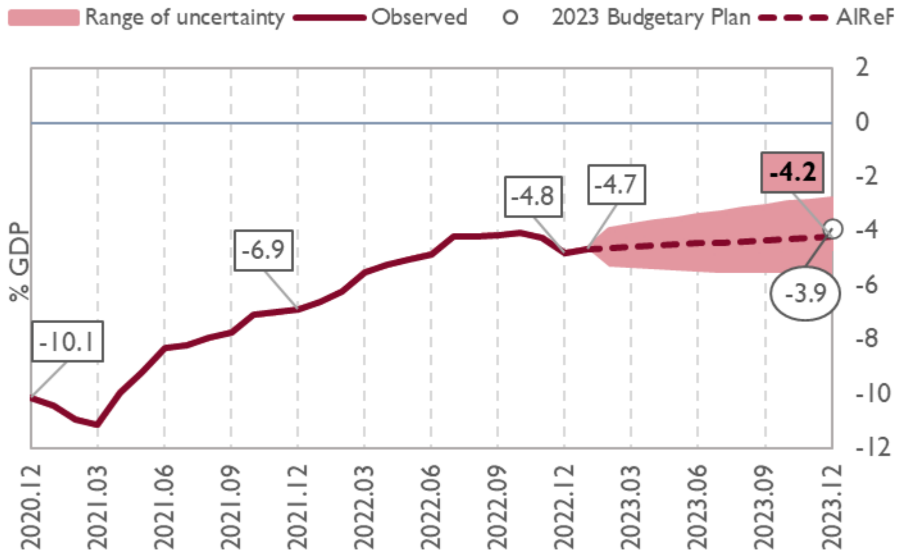
FIGURE 21. EVOLUTION OF DEFICIT BY COMPONENT, AIREF (% GDP)



Source: AIReF and IGAE

The lower cost of measures due to the energy and price crisis in 2023 compared with 2022 is the main factor reducing the deficit in 2023, with an impact of 0.5 points of GDP. In 2021, the weight of the deficit over GDP reached 6.9% of GDP. In 2022, the deficit narrowed by 2.1 points, of which 2.5 points are explained by the withdrawal of COVID measures, while the structural revenue measures and underlying evolution of revenue and expenditure due to the economic recovery reduced it by 0.2 points and 0.8 points, respectively. This is partially offset by the adoption of measures to combat the energy crisis valued at 1.4 points of GDP over the year. In 2023, the deficit is expected to fall by 0.6 points. This year, the withdrawal of COVID measures still contributes 0.1 points and the revenue measures included in the GSB, including the Intergenerational Equity Mechanism (IEM) and the increase in the contribution bases, contribute an additional 0.2 points. In addition, the lower weight of the measures to combat the energy crisis reduces the deficit by a further 0.5 points. However, the increase in pension expenditure exceeds the deficit reduction linked to the underlying evolution of revenue and other expenditure.

FIGURE 22. NET LENDING/BORROWING OF THE ENTIRE GG (% GDP)



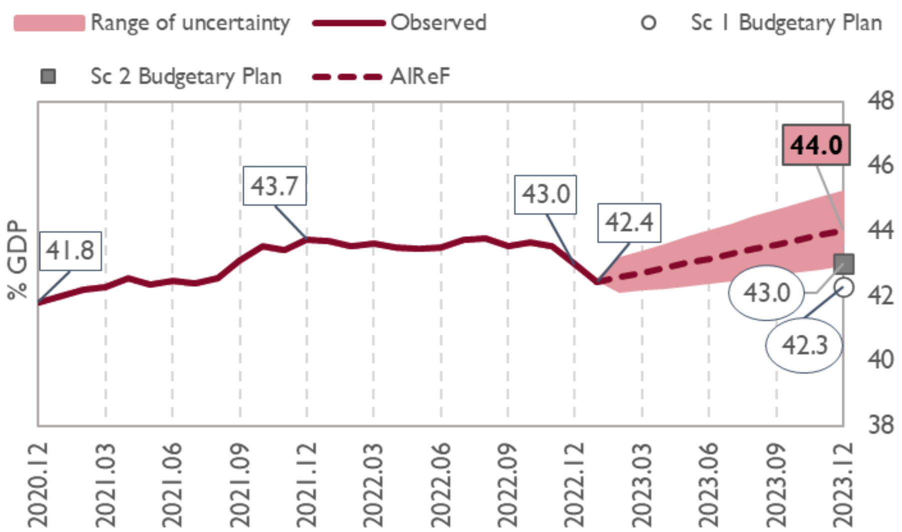
Source: AIReF and IGAE

TABLE 3. NET LENDING/BORROWING OF THE GENERAL GOVERNMENT (% 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

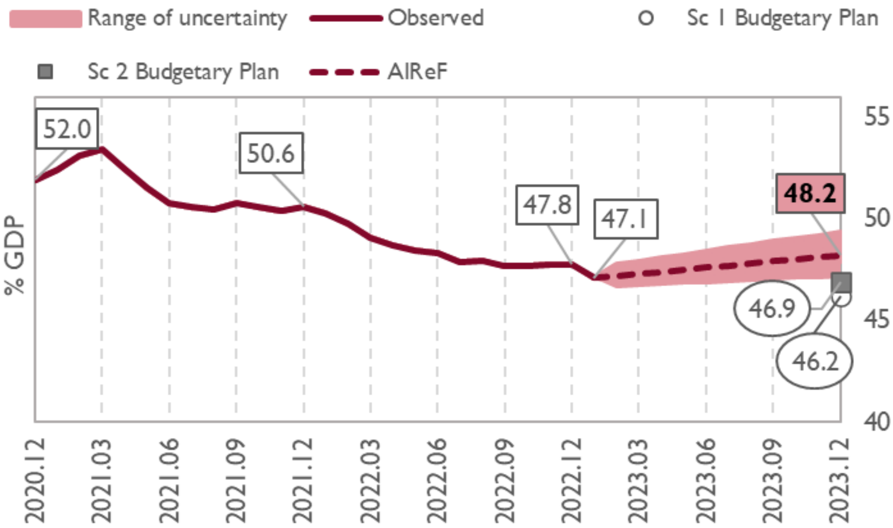
Source: AIReF and IGAE

FIGURE 23. REVENUE OF THE ENTIRE GG WITH RTRP (% GDP)



Source: AIReF and IGAE

FIGURE 24. EXPENDITURE OF THE ENTIRE GG WITH RTRP (% GDP)



Source: AIReF and IGAE

4.1. Measures

The tax and spending measures approved since the Report on the Main Budgetary Lines raise the deficit by 1 point of GDP in 2023. The changes are the result of updated information, the modification during the passage through Parliament of certain measures and, above all, the approval of Royal Decree-Law 20/2022, of December 27th, on measures to respond to the economic and social consequences of the war in Ukraine and to support the reconstruction of the island of La Palma and other situations of vulnerability.

4.1.1. Revenue measures included in the 2023 Budgetary Plan

The valuation of the revenue measures included in the Budgetary Plan for 2023 is reduced by almost 0.1 points of GDP compared with the previous report, mainly due to the Temporary Solidarity Tax on Large Fortunes. On December 27th, the Spanish Congress (Lower House of Parliament) approved Law 38/2022 for the Establishment of Temporary Levies on Energy and Credit Institutions and creating the Temporary Solidarity Tax on Large Fortunes. After the amendments approved during its passage through Parliament, it was established that the joint tax payable on PIT, the Wealth Tax and the Temporary Solidarity Tax on Large Fortunes may not exceed 60% of the tax bases for PIT. If this percentage is exceeded, the tax payable for the Temporary Solidarity Tax on Large Fortunes is reduced by up to 80%. This reduction in the tax payable for the Tax on Large Fortunes in the event that the combined limit of PIT and Wealth Tax is exceeded results in a reduction in the impact that the Government estimates of 50%. Therefore, the valuation estimated by AIReF is set at €635m for 2023.

The forecast for the collection of the new levies on financial institutions and energy companies is reduced by about €590m compared with the previous report due to the availability of the first results. The expected impact is updated after incorporating the results announced by the Ministry of Finance on February 21st, 2023 on the first advance payment of these levies, which have been slightly below the initial forecast made by AIReF. It should be noted that after its passage through Parliament, amendments were approved that modified the scope of these levies, incorporating in the case of financial institutions those foreign entities that operate in Spanish territory and which are subject to the same threshold as resident entities. In the case of energy companies, the main operators in the oil sector are incorporated and revenue from the regulated market is exempted.

AIReF increases its estimate for the new Tax on Single-Use Plastics with the first collection data received. The estimate of the impact of this new tax is revised after receiving its first results in the collection data last February.

TABLE 4. REVENUE MEASURES OF THE CENTRAL GOVERNMENT INCLUDED IN THE BUDGETARY PLAN: AIREF ESTIMATE IN CASH TERMS

REVENUE measures (Total annual impact)	Legislation	AIReF Budgetary Plan 2023	AIReF Current 2023	Difference
Structural revenue measures		**-685**	**-480**	**205**
PIT		**-1,363**	**-1,363**	**0**
Reduction of the contribution limit to pension plans from 2,000 to 1,500.	22GSB	149	149	0
Increase in reduction of work income and minimum taxation.	23GSB	-1,290	-1,290	0
Extension of the maternity tax credit	23GSB	-222	-222	0
Corporate Income Tax		**421**	**421**	**0**
Establishment of a minimum rate of 15% of the taxable income.	22GSB	400	400	0
Reduction to 40% of allowance under housing rental regime	22GSB	21	21	0
VAT		**-24**	**-24**	**0**
Reduction rate to 5% on female hygiene products	23GSB	-24	-24	0
OTHER		**282**	**487**	**205**
Tax on Single-Use Plastics:	Law 7/2022	282	487	205
Temporary revenue measures		**4,964**	**3,782**	**-1,182**
PIT		**-50**	**-5**	**45**
Deductions for housing rehabilitation.	RDL 19/2021	-50	-5	45
CIT		**244**	**244**	**0**
Limitation on offsetting losses in consolidated groups.	23GSB	244	244	0
OTHER		**4,770**	**3,543**	**-1,227**
Temporary Levy Financial Institutions	Law 38/2022	1,500	1,274	-226
Temporary Levy Energy Companies	Law 38/2022	2,000	1,634	-366
Solidarity Tax on Large Fortunes	Law 38/2022	1,270	635	-635
TOTAL		**4,279**	**3,302**	**-977**
TOTAL (% GDP)		**0.3**	**0.2**	**-0.1**

Source: Government and AIReF estimates

The forecasts of the contributions of the SSFs in 2023 include the measures approved to date without changes in their valuation. In particular, they include the IEM and the increase in the maximum contribution bases valued at almost 0.3 points, the same weight as estimated in the Report on the Budgetary Plan.

4.1.2. Measures in response to the energy crisis

AIReF estimates that the total cost of the measures in response to the economic and social consequences of the Russian war will be 1% of GDP in 2023. This results in a deficit that is 0.8 points higher than in the previous report. AIReF's assessment of the impact of the measures to combat the energy crisis resulting from the Russian war includes those set out in the five Royal Decree-Laws approved to date for this purpose, namely Royal Decree-Law 6/2022 of March 29th, Royal Decree-Law 11/2022 of June 25th, Royal Decree-Law 14/2022 of August 1st, Royal Decree-Law 18/2022 of October 18th and Royal Decree-Law 20/2022 of December 27th, on measures to respond to the economic and social consequences of the war in Ukraine and to support the reconstruction of the island of La Palma and other situations of vulnerability. The latest approved legislation results in an additional budgetary impact of almost 0.2 points of GDP for 2022 and 0.8 points for 2023, bringing the cost of the measures in 2022 to 1.4% of GDP. This is expected to fall to 1% of GDP in 2023.

The measures approved after the publication of the October report result in an increase in expenditure of €6.01bn, which adds to the impact of those already approved previously for 2023, giving a total of almost €8bn for this year. AIReF incorporates the expenditure measures approved in Royal Decree-Law 20/2022 into its estimates. A significant amount of this new support is allocated to a new line of direct support to individuals with a low level of income and wealth, who may request a €200 subsidy subject to income and wealth criteria, with an estimated impact of €1.2bn. It also approves the continuation of the allowance implemented last year per litre of fuel, aimed exclusively at the transport, agricultural and fishing sectors, whose total impact up to June 30th, 2023 will exceed €1.3bn. It also includes sectoral support (mainly to the transport sector and to gas-intensive companies), much of which is an extension of the support already approved over 2022. This new sectoral support, together with other new support, will have a total impact of €2.7bn. Finally, Royal Decree-Law 20/2022 approves new support for individuals, particularly the reduction in the price of transport for recurring users up to June 30th, channelled through the regional and local governments, and the possibility that part of the extraordinary appropriation approved last year for the care of Ukrainian refugees may be transferred to 2023.

In addition, the measures reduce the collection forecast for 2023 by around €6bn compared with the previous report due to the extension of the tax reductions on energy products and the new VAT reductions to mitigate the rise in prices. Royal Decree-Law 20/2022 extends the tax measures in the field of energy, continuing up to December 31st, 2023 the reduction to 5% of the VAT rate on electricity, natural gas, firewood and pellets and the reduction to 0.5%

of the Special Tax on Electricity. In addition, it introduces new fiscal measures aimed at alleviating the rise in agri-food products, reducing the VAT rate for all basic foodstuffs from 4% to 0% and the VAT rate for olive and seed oils and pasta from 10% to 5%, with effect from January 1st, 2023 and effective until June 30th, 2023.

AIReF quantifies the extension of the tax reductions on energy products at about €5.9bn in 2023. In national accounting terms, the extension of the VAT on energy products in 2023 will mean a reduction in revenue of about €3.9bn compared with the valuation made by AIReF in its previous report, while that of the Special Tax on Electricity will mean a reduction of about €2bn. AIReF updates its valuation by introducing the new periods of validity set and incorporating the latest updates on the impacts observed included in the Collection Reports published by the Tax Agency and, in the case of the Special Tax on Electricity, also incorporating future electricity prices.

AIReF estimates that the reduction in the VAT rate on food established until the middle of 2023 will mean a reduction in collection of around €780m. In national accounting terms, AIReF quantifies the reduction in the VAT rate on basic foodstuffs at about €640m and the reduction in the rate on olive and seed oil and on pasta at about €140m, according to a microsimulation carried out with the individual inflation of each good as of November 2022. In the event that the year-on-year rate of core inflation for March, published in April, is under 5.5%, the usual VAT rate on these products would be resumed as early as May. Nevertheless, the provisional figure is higher, at 7.5%. If confirmed, the measure would therefore be maintained until June 30th, 2023.

The extension of the suspension of the Tax on the Value of Electricity Production will reduce collection by around €2.3bn compared with the valuation of the previous report. The period of suspension of this tax is extended, having been applied during the four quarters of 2022, of which the last quarter, which would be paid in the first quarter of 2023, was already included in the quantification of the impact in the previous report. The extension means that the impact on collection will continue for a further four quarters, of which the first three quarters will reduce the collection of 2023 and the last will affect the collection of the first quarter of 2024. In 2023, the collection loss for this tax would be about €3.01bn. AIReF's estimate is made through the observed impacts included in the 2022 Collection Reports published by the Tax Agency and future electricity prices. In terms of deficit, the impact is limited to the amount of the planned transfer to the electricity system in the GSB, of €1.15bn[10], and the rest of the loss of collection results in a reduction in said transfer.

TABLE 5. IMPACT OF THE CG MEASURES ADOPTED IN RESPONSE TO THE ECONOMIC AND SOCIAL CONSEQUENCES OF THE WAR IN UKRAINE

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) Reduction to **5%** since July 2022 (RDL 11/2022) Extension until 31-12-2023 (RDL 20/2022)		-2,342	-2,342
VAT on gas, briquettes and pellets Reduction to **5%** gas rate (RDL 17/2022) Extension until 31-12-2023 (RDL 20/2022)		-806	-806
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%** of 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) Extension until 31-12-2023 (RDL 20/2022)	-160	-2,153	-1,993
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**
Other			
Tax on the Value of Electricity Production: Suspension (RDL 12, 17, 29/2021 & 6/2022) Extension to 31-12-2023 (RDL 20/2022)	-784	-3,099	-2,316

Source: AIReF

[10] This impact is reflected in the expenditure measures within the sectoral support.

4.2. Evolution of General Government revenue

AIReF forecasts that revenue, excluding the RTRP, will stand at 42.5% of GDP in 2023, 1 point lower than the forecast in the previous report. This revision in the revenue forecast is explained by different conflicting factors. On the negative side, the denominator effect subtracts 0.9 points from growth due to the increase in the nominal GDP forecast, while legislative measures subtract a further 0.7 points as a result of the extension of the tax reductions on energy products and the new VAT reductions to mitigate the rise in prices. On the positive side, the update of the macroeconomic scenario results in an increase in the revenue forecasts of 0.1 points, which is in addition to the 0.5 points added due to the incorporation of new information in AIReF's forecasts.

TABLE 6. BREAKDOWN OF THE CHANGE IN REVENUE BETWEEN AIREF ESTIMATES IN THE REPORT ON THE MAIN LINES OF THE 2023 BUDGET AND THE CURRENT FIGURE

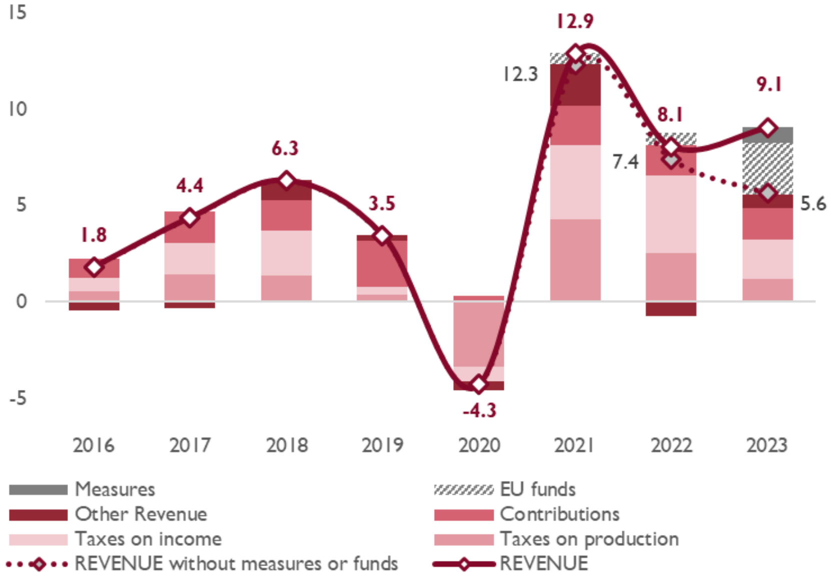
	2023 DBP	Breakdown of change in % GDP				2023 Current	Difference (Current - DBP)
		Denominator effect (a)	Effect of measures (b)	Macro effect (c)	New information effect (d)		
REVENUE	**43.5**	**-0.9**	**-0.7**	**0.1**	**0.5**	**42.5**	**-1.0**
TAXES	25.5	-0.5	-0.7	0.1	0.5	24.8	-0.7
On production	12.7	-0.3	-0.7	0.0	0.1	11.9	-0.8
On income	12.4	-0.3	0.0	0.1	0.3	12.5	0.1
Capital	0.4	0.0	0.0	0.0	0.0	0.5	0.0
CONTRIBUTIONS:	13.9	-0.3	0.0	0.0	0.1	13.7	-0.2
Other Revenue	4.2	-0.1	0.0	0.0	-0.1	4.0	-0.1

Source: AIReF

By headings, the reduction in the forecast of the weight of revenue over GDP is generalised across all the main taxes and social contributions, with the exception of taxes on income. Taxes on production are the aggregates with the largest decrease, mainly as a result of the extension of energy measures and the new reductions in VAT on food. In contrast, forecasts of taxes on income improve after collection in 2022 exceeded expectations and add an additional 0.1 points as a result of the effect of the new macroeconomic scenario. The weight of social contributions over GDP falls due to the denominator effect, despite rising by 0.1 points as a result of the incorporation of the latest information available.

AIReF estimates growth in revenue of 9.1% in 2023, or 5.7% without taking into account the effect of the RTRP or the measures. Excluding the RTRP, revenue will grow by 6.4% in 2023. The total calculation of legislative measures adopted will have a positive contribution on 2023 revenue as a result of the approval of new taxes and levies, while measures to increase social contributions[11] offset the tax reductions to control price rises. Isolating the effect of the measures and the RTRP, a lower contribution to growth from taxes and a higher contribution from social contributions and other revenue is expected in 2023 than in the previous year.

FIGURE 25. CONTRIBUTIONS TO THE CHANGE IN REVENUE (%) AIREF



Source: IGAE and AIReF

TABLE 7. RATE OF CHANGE (%) OF MAIN TAXES AND SOCIAL CONTRIBUTIONS IN NATIONAL ACCOUNTING TERMS

	AIReF 2023 Budgetary Plan	AIReF Current 2023	Difference Current - Budgetary Plan
	%Change	%Change	%Change
Taxes on prod. & import.	8.6	4.9	-3.8
Household income tax	5.9	6.9	0.9
Corporate income tax	3.0	6.8	3.8
Social contributions	7.5	7.3	-0.3

Source: AIReF

AIREF estimates that tax revenue will stand at 24.8 points of GDP, 0.7 points less than in its previous forecast. The denominator effect and the measures subtract 1.3 points from this change, while the new macroeconomic outlook increases revenue by 0.1 points. The update of the data with the latest

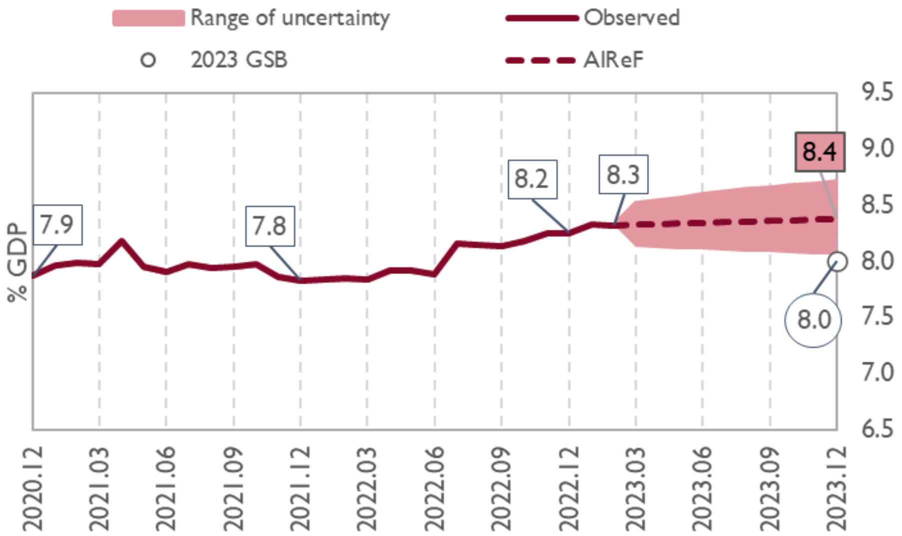
[11] See Section 4.1.1 Revenue measures included in

available information from 2022 and the start of 2023 generates a positive effect amounting to 0.5 points of GDP, mainly explained by more buoyant performance of direct taxes in 2023.

4.2.1. PIT

AIReF maintains the weight of PIT collection in 2023 with respect to the previous report at 8.4% of GDP. Following the update of the latest available information and the revision of the macroeconomic variables, which revises employment growth upwards, the forecast collection for 2023 is raised. Since the revision of the macroeconomic scenario also increases the denominator, the same weight over GDP is maintained as that forecast in the GSB.

FIGURE 26. EVOLUTION OF CASH REVENUE FROM PIT[12] (% GDP)



Source: AIReF and AEAT

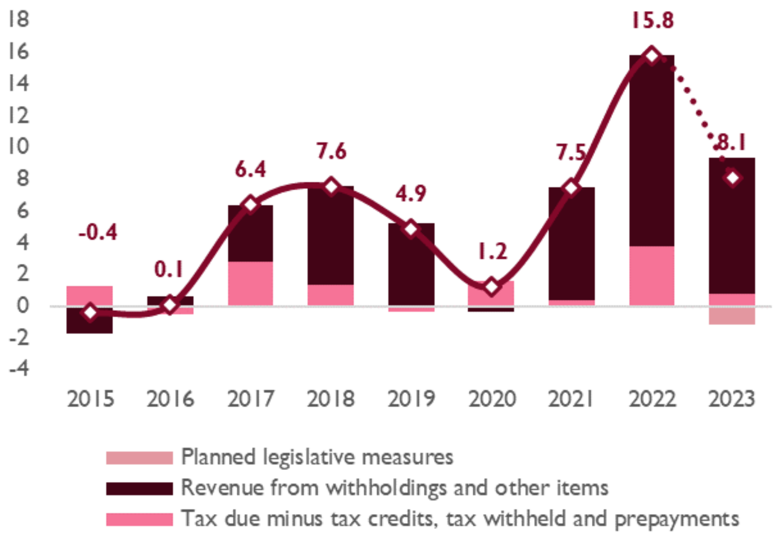
For 2023, year-on-year growth in PIT revenue is expected to be 8.1%, 1.7 points above the previous report. The components of PIT increase their contribution to 9.3 points of its growth, while the legislative measures, with hardly any valuation changes from the previous report[13], subtract 1.2 points. These measures incorporate, *inter alia*, the impact of the increase in the reduction

[12] AIReF's range of uncertainty is estimated using a VAR model with two lags that include the seasonally-adjusted series of the variable to be explained and its corresponding explanatory variables. Monte Carlo simulations are performed based on this model. The result of these simulations is sorted in percentiles, from which the range of uncertainty is obtained.

[13] See section 4.1.1 Revenue measures included in

in income from work introduced in the 2023 GSB. The increase in the estimate mainly affects withholdings from labour and economic activities, which account for 7.9 points of the growth. In addition, a positive contribution of an additional 0.8 points is expected for tax due minus tax credits, tax withheld and prepayments resulting from the 2022 settlement, which will be paid in 2023 and reflects the growth in the previous year of income not subject to withholding linked to investment income, leased properties and capital gains (27.2%, 14.9% and 4.2%, respectively). Instalment payments and withholdings on capital add another 0.2 and 0.3 points, respectively, of additional growth.

FIGURE 27. CONTRIBUTION BY COMPONENT TO THE GROWTH OF PIT COLLECTION (% CHANGE)



Source: AIReF and AEAT

Withholdings on work income, the main component of which is wages, will grow by 8.7% in 2023. The incorporation of the latest available information places them at year-end 2022 at 1.2 points above the forecast, thus raising the starting level for the 2023 projections. Regarding the composition, all components are projected to contribute less to growth than in 2022. The highest growth will correspond to pensions, which are estimated to grow by 15.4%. However, it will be private wages that will contribute most to growth, with a more dynamic increase of 8.2% compared with the 5.7% for the public sector. In 2022, the boost in private employment has been the main contribution to the growth in private wage withholdings, with an increase also recorded in pensions, in average public wages and in their associated effective rates. For 2023, it is the increases across the board in public wages, private wages and pensions, together with the consequent increase in their corresponding effective rates, that largely explain the estimated growth.

FIGURE 28. EVOLUTION OF ACCRUED WITHHOLDINGS FROM WORK (% CHANGE)

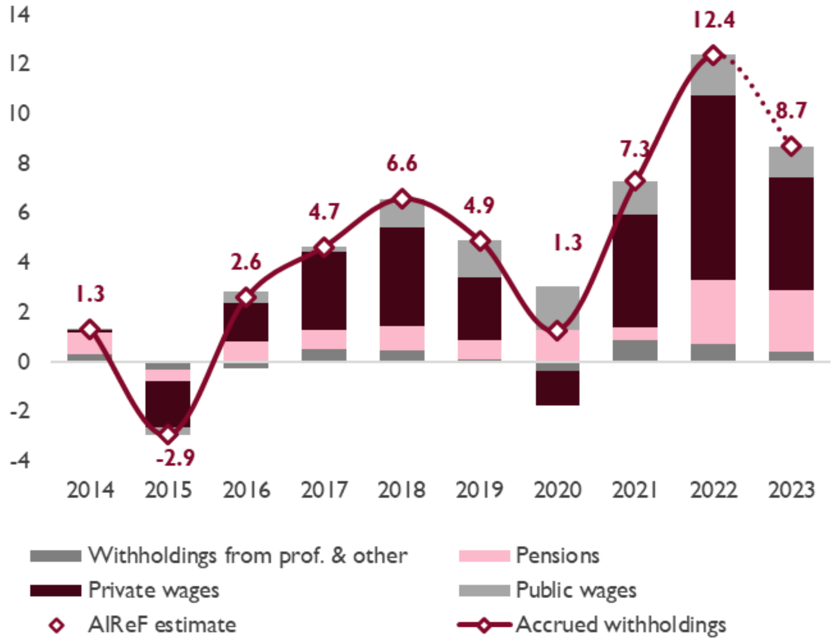
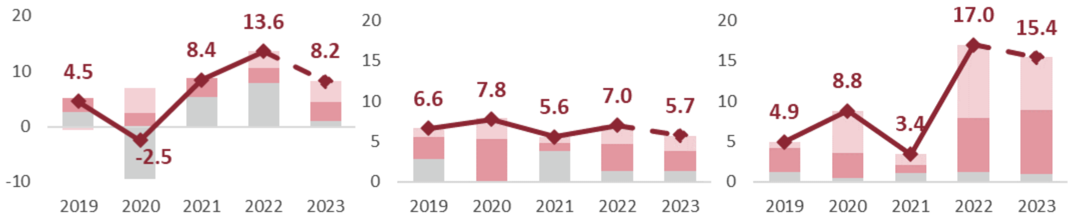


FIGURE 29. WITHHOLDINGS ACCRUED FROM WAGES AND PENSIONS (% CHANGE)

FIGURE 29.A PRIVATE WAGES **FIGURE 29.B PUBLIC WAGES** **FIGURE 29.C PENSIONS**



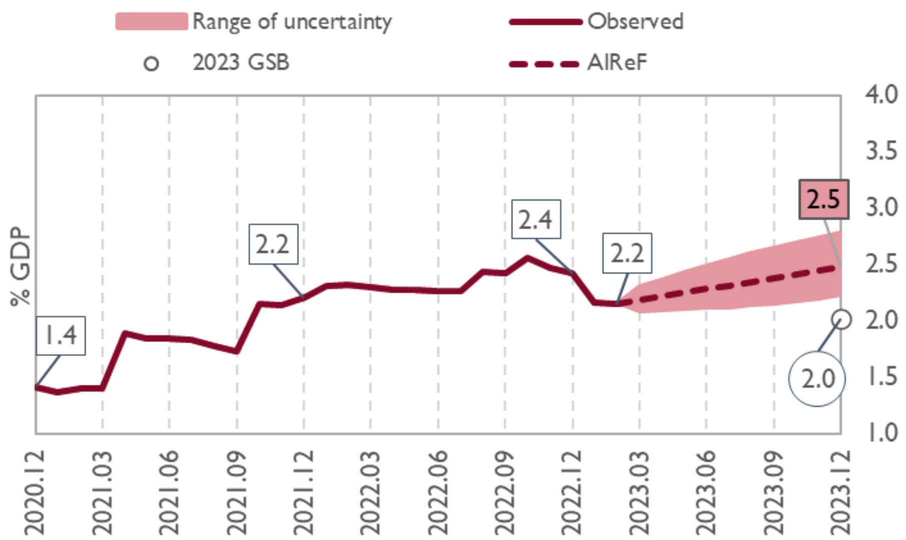
Source: AIReF and AEAT

PIT will grow in 2023 in national accounting terms by 7.1%, somewhat lower than the expected increase in cash terms. The national accounting adjustment was higher for 2022 than that forecast for 2023. This is due to the fact that the growth in 2022 was higher than that expected for 2023. Therefore, the transfer from cash to accrual of the first few months of 2023 to 2022 has been greater than estimated for the first few months of 2024 to 2023.

4.2.2. Corporate Income Tax

AIReF's forecasts place the weight of Corporate Income Tax for 2023 at 2.5 points of GDP, 0.5 points higher than in the October report. The new forecast incorporates the year-end 2022 figure, which is 0.2 points better than expected, and the update of the macroeconomic scenario, which forecasts greater dynamism of the gross operating surplus, a variable linked to the evolution of the base for this tax. The previous estimate had a high component of uncertainty as it was made without having information on the revenue from the last two instalments, which usually constitute more than 70% of the tax and whose result is 0.3 points of GDP higher than expected in the GSB.

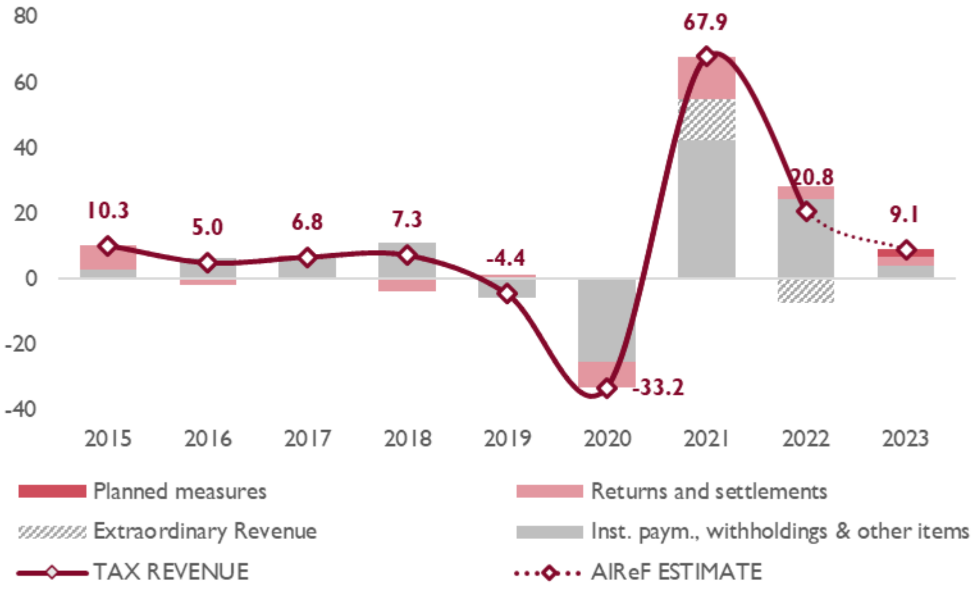
FIGURE 30. EVOLUTION OF CASH REVENUE FROM CORPORATE INCOME TAX (% GDP)



Source: AIReF and AEAT

AIReF forecasts growth in Corporate Income Tax collection in 2023 of 9.1% after recording increases of over 20% over the last two years. Instalment payments and withholdings will contribute 4.3 points of growth, compared with 24.4 points in 2022. The returns and settlements add a positive contribution of 2.7 points of growth as revenue is expected to grow to a greater extent than refunds. Refunds evolve at a different pace than revenue since while revenue refers to the previous year's settlement, refunds refer to the last two years' settlements. Thus, there were fewer refunds in 2022 because they were still affected by the lower settlement of 2020, although they were increased due to the recording of exceptional refunds because of one court ruling and due tax credits that were requested in 2021. Lastly, the remaining 2.1 points of growth will come from the incorporation of legislative changes. This is mainly due to the impact of the establishment of the minimum rate at 15% introduced in the draft 22GSB, which will be reflected for the first time in July when the settlement corresponding to 2022 is submitted, and the impact on the instalment payments for 2023 due to the limitation on offsetting losses approved in the draft 23GSB.

FIGURE 31. CONTRIBUTION BY COMPONENT TO THE GROWTH OF CORPORATE INCOME TAX COLLECTION (% CHANGE)



Source: AIReF and AEAT

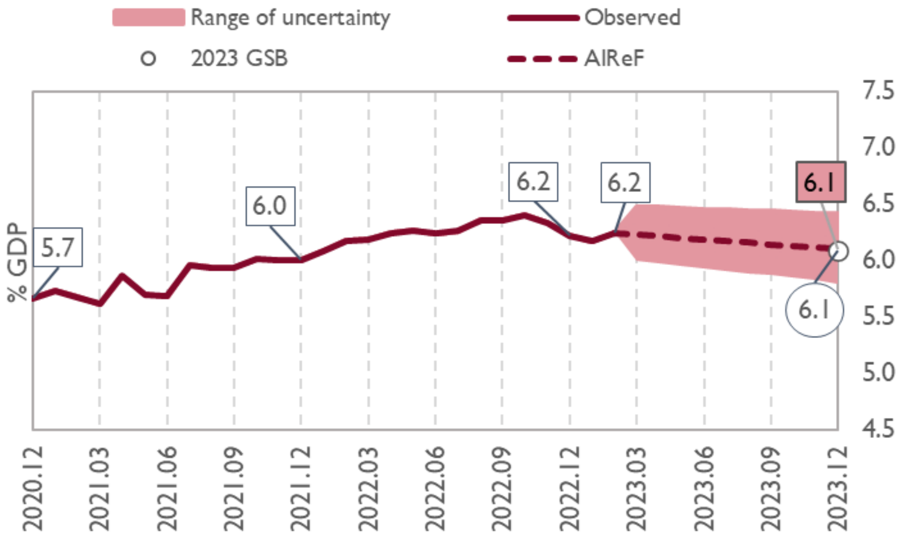
The evolution of the tax is reduced to 7.7% in national accounting terms by the effect of the settlement and by discounting the effect of extraordinary refunds. In national accounting terms, the refunds are recorded in the year they are requested. This therefore smooths out the increase in revenue recorded in 2022 cash as a result of the lower 2020 settlement. In addition, in national accounting terms, the negative effect of the court ruling and the due tax credits are not recorded as lower revenue but as higher expenditure associated with their year of accrual, which corresponds to 2022 for the court ruling and 2021 for the credits. As a consequence, in national accounting terms, the effects of the refunds made in 2022 are smoothed out, with growth of 7.7% expected for 2023 compared with the 9.1% estimated in cash terms.

4.2.3. VAT

AIReF forecasts that VAT will reduce its weight to 6.1 points of GDP in 2023, 0.3 points below its previous forecast. The change is mainly the result of the extension of the tax reductions on energy products and the new reductions in the VAT rate on certain foods[14], in addition to the incorporation of the latest available data and the revision of the macroeconomic scenario.

[14] See section 4.1.2 TablE 1. Evolution of General Government balance

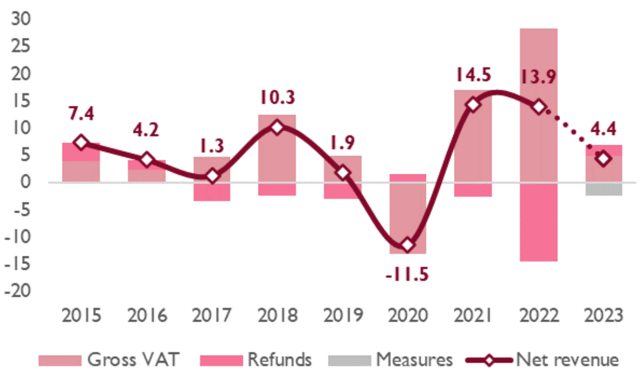
FIGURE 32. EVOLUTION OF VAT REVENUE (% GDP)



Source: AIReF and AEAT

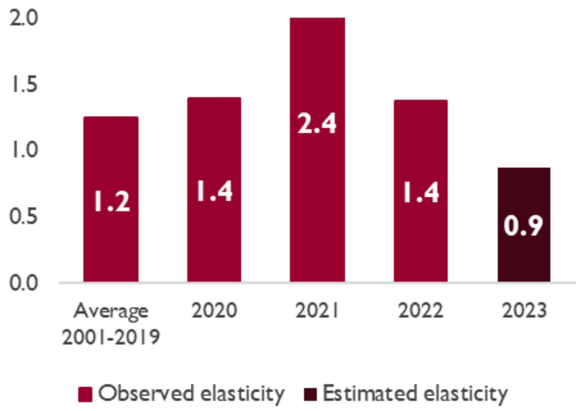
VAT collection will grow by 4.4% in 2023, 2.9 points less than in the October report. The revision is mainly a consequence of the tax reductions approved since the last report, which lower collection growth by 2.4 points. Without the measures, growth of 6.9% would be expected in 2023. The update of the 2022 tax bases has revealed a more dynamic evolution of final expenditure subject to VAT during the first quarters of 2022 that slows down in the last quarter. This, together with the downward revision of national demand, also reduces the growth of gross revenue in 2023 compared with the previous estimate. In addition, during the final few months of 2022, the pace of execution of VAT refunds accelerated. Therefore, the year-end figure was lower than forecast by AIReF, despite obtaining higher-than-estimated gross revenue. This advance in the execution of refunds requested in 2022 raises the negative weight of the contribution to growth of refunds in 2022, which reverts to a positive contribution during 2023 in cash terms.

FIGURE 33. CONTRIBUTION BY COMPONENT TO THE GROWTH OF VAT COLLECTION (% CHANGE)



In 2023, discounting the effect of rate reductions, it is estimated that VAT evolution in national accounting terms is below that expected for national demand. From the start of the pandemic, the evolution of VAT expenditure has been separated from the evolution of domestic demand, with a greater fall in VAT in 2020 and, in contrast, greater growth in 2021. The observed divergences are maintained in 2022, with the observed elasticity with respect to national demand reaching 1.4, which is above the historical average. In this context, AIReF's forecasting models produce a lower annual elasticity than the historical one for 2023.

FIGURE 34. ESTIMATE OF THE ELASTICITY OF VAT (NATIONAL ACCOUNTING, ADJUSTED FOR REDUCTIONS IN ENERGY PRODUCTS AND FOOD) IN RELATION TO NATIONAL DEMAND



Source: AEAT, INE and AIReF

The change to national accounting reduces the expected growth for 2023, which is estimated at 2.1%. Recording in national accounting terms shifts revenue to its accrual month and refunds to the month they are requested. This fact softens the greater dynamism recorded in revenue due to the changes in the pace of execution of the refunds.

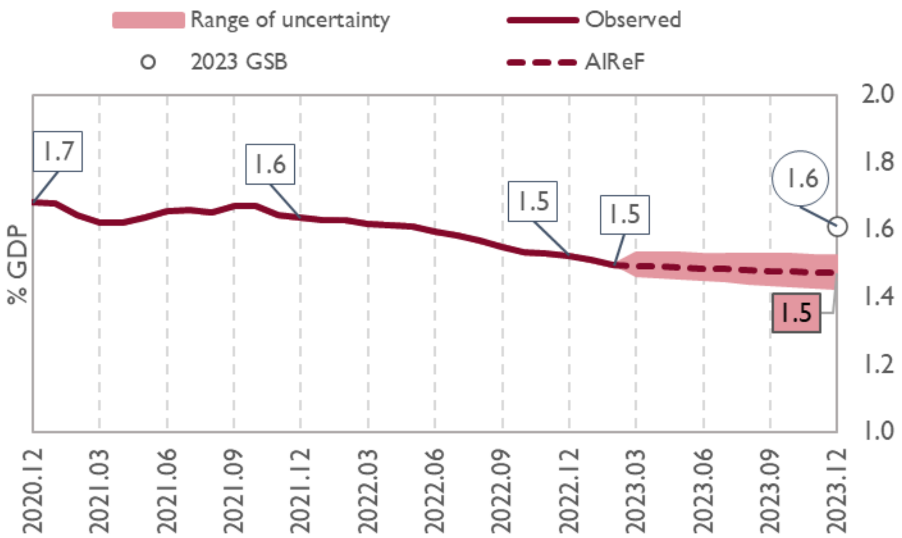
4.2.4. Special Taxes

Special Taxes reduce their weight by 0.2 points of GDP compared with the previous report to 1.5% of GDP as a result of the extension of the measures to mitigate the rise in energy prices. Following the update of the latest available information, growth in 2023 is expected to be 2.8%, 7.9 points below the previous forecast. The main change is the extension of the rate reduction in the Tax on Electricity detailed in the section on measures[15], with its total

[15] See section 4.1.2 Measures in response to the energy crisis

recovery having been forecast in the previous report. Regarding the other Special Taxes, the Tax on Hydrocarbons and the revenue from the new Tax on Single-Use Plastics contribute 0.9 and 2.4 points of growth, respectively. The Tax on Tobacco Products is expected to fall, which subtracts 0.3 points of growth, while the other Special Taxes remain at levels similar to those recorded in 2022.

FIGURE 35. EVOLUTION OF REVENUE FROM SPECIAL TAXES (% GDP)



Source: AIReF and AEAT

4.2.5. Other tax revenue

According to AIReF's forecasts, other tax revenue will remain at 0.8 points of GDP during 2023, 0.2 points less than its previous forecast. The main changes are due to the update of the new information available and the macroeconomic forecasts, as well as the lengthening of the extension of the suspension of the Tax on the Value of Electricity Production, whose effect on the estimate is detailed in the section on measures[16]. In 2023, an increase of 10% is expected mainly due to the upward revision of Non-Resident Income Tax, for which lower revenue was estimated in 2022 due to refunds related to Supreme Court ruling 1581/2019[17], which did not take place in the end.

[16] See section 4.1.2 Measures in response to the energy crisis

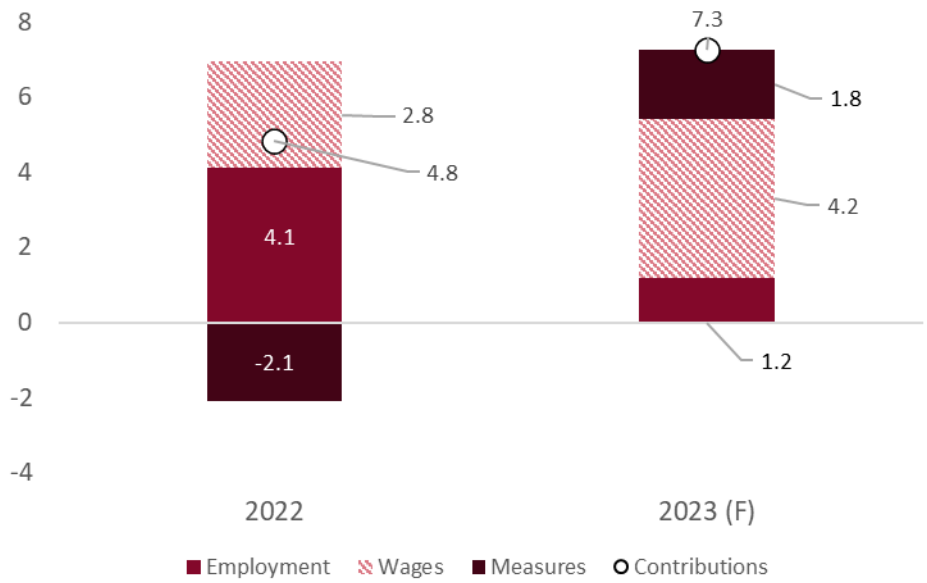
[17] STS 1581/2019 of November 13th

4.2.6. Social contributions

AIReF estimates that social contributions will increase their weight to 13.7% of GDP in 2023, 0.2 points below the percentage of GDP forecast in the previous report. The downward revision is explained by the denominator effect of the upward revision of GDP, partially offset by the information effect resulting from revenue from social contributions at the end of 2022 being higher than estimated in the last report.

The positive trend in wages and, to a lesser extent, employment are driving growth in contributions in 2023. In 2023, the contribution of wages and employment to the growth in social contributions is expected to be 4.2% and 1.2%, respectively. The measures, which include the increase in the social contributions of the Intergenerational Equity Mechanism and increase in the maximum contribution bases in the 2023 GSB, add 1.8 points to that growth. This forecast represents a downward revision of the contribution of wages and an upward revision of the contribution of employment compared with that estimated in the previous report.

FIGURE 36. BREAKDOWN OF GROWTH IN SOCIAL CONTRIBUTIONS



Source: AIReF, IGAE and Ministry of Inclusion, Social Security and Migration.

4.2.7. Other revenue

The weight of other revenue in relation to GDP falls compared with AIReF's previous estimate by 0.1 points, to stand at 4% of GDP, excluding the RTRP. The cause of the reduction in the weight of this type of revenue is due to the denominator effect. This section includes all revenue from the European Union.

Including the RTRP, while other revenue would stand at 5.6% of GDP. However, there is a great deal of uncertainty with respect to this heading, as no disaggregated information is provided by type of fund (traditional structural, REACT or RTRP). This uncertainty affects the pace of execution of both the RTRP and of other European funds.

4.3. Evolution of General Government expenditure

According to AIReF's estimates, expenditure in 2023, excluding the RTRP, will be 46.7% of GDP, 0.1 points lower than the 46.8% contained in the previous report. The impact of the measures to combat the energy crisis increases spending by 0.2 points and the new information raises it by an additional 0.6 points. However, the upward revision of nominal GDP reduces the weight of expenditure through the denominator effect by 1 point. The effect of the measures is concentrated in subsidies and other expenditure, while the impact of the new information is divided between intermediate consumption, interest and gross capital formation.

TABLE 8. FACTORS EXPLAINING THE DIFFERENCES BETWEEN THE ESTIMATE OF EXPENDITURE IN THE REPORT ON BUDGETARY LINES AND INITIAL BUDGETS (WITHOUT RTRP AS % GDP)

	2023 DBP	Breakdown of change in % GDP				2023 Current	Difference (Current - DBP)
		Denominator effect (a)	Effect of measures (b)	Macro effect (c)	New information effect (d)		
EXPENDITURE	**46.8**	**-1.0**	**0.2**	**0.0**	**0.6**	**46.7**	**-0.1**
Compensation of employees	11.6	-0.2	0.0	0.0	0.0	11.4	-0.2
IC + STK purch. mark.	8.6	-0.2	0.0	0.0	0.2	8.7	0.0
Social benefits in cash	17.8	-0.4	0.1	0.0	0.0	17.6	-0.3
Interest	2.2	-0.1	0.0	0.0	0.3	2.4	0.2
GCF	2.4	-0.1	0.0	0.0	0.3	2.6	0.3
Subsidies and other expenditure	4.2	-0.1	0.1	0.0	-0.2	4.1	-0.2

Source: AIReF

4.3.1. Main components of public consumption expenditure

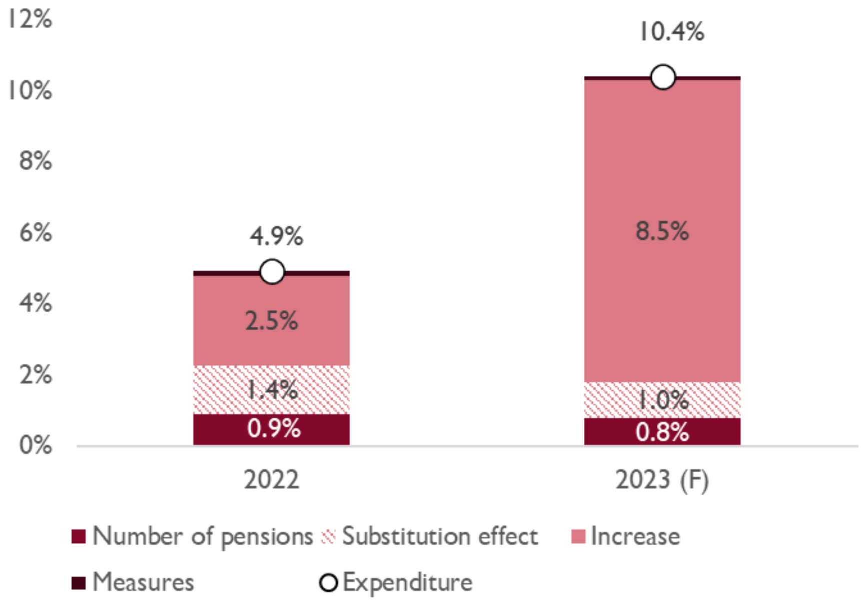
AIReF lowers the forecast for public consumption for 2023 by 0.2 points GDP to 20% of GDP. The forecast for compensation of employees is lowered by 0.2 points to 11.4% of GDP. This is mainly the result of the upward revision of GDP, which reduces its weight over GDP through the denominator effect. In the opposite direction, AIReF raises its estimate of the other two main components of public consumption, intermediate consumption and social transfers in kind, which rise from jointly accounting for 8.6% of GDP to 8.7%, a rise of only 0.1 points. In this case, while AIReF maintains the expenditure estimate of social transfers in kind at 2.9% of GDP, the forecast for intermediate consumption rises from 5.7% to 5.8% of GDP. This increase of 0.1 points of GDP is due to the increase in intermediate consumption in the CG and LG sub-sectors as a result of the higher expenditure executed in 2022. In contrast, it is estimated that there is lower expenditure on intermediate consumption in the ARs, where, on the one hand, the expenditure executed in 2022 was lower than expected by AIReF and, on the other hand, a portion of the expenditure on intermediate consumption for vaccines is reclassified to expenditure on the change in State inventories. This is due to the fact that it is estimated that more vaccines will be stored by the State and, therefore, fewer vaccines will be transferred to the ARs, in line with unused vaccine data in 2022.

4.3.2. Social Benefits in Cash

AIReF forecasts that social benefits in cash will increase their weight over GDP to 17.6% in 2023, almost 0.3 points below the forecast contained in the previous report. The revision is mainly due to a denominator effect resulting from the upward revision of nominal GDP in 2023. Furthermore, the measure included in Royal Decree-Law 20/2022 on direct support to individuals of €200 is included under this heading, which AIReF values at 0.1 points. In addition, the cost of State civil servant pensions has increased compared with the previous estimate. This offsets the reduction in expenditure on pensions from the Social Security system resulting from the new information received.

AIReF revises downwards its estimate of an increase in Social Security pension expenditure for 2023, from a rate of 11.2% in the previous report to a rate of 10.4% today. This revision is the combined result of the estimate of a lower increase in the number of pensions, lower substitution effect and lower pension increase than in the October forecasts. AIReF estimates that the number of pensions will rise by 0.8% in 2023, compared with 1% forecast in the previous report, according to the latest data published. In addition, the substitution effect is revised from 1.3% to 1% due to the new data received. Finally, the increase in pensions in 2023 has been 8.5%, compared with the 8.9% forecast in the October report, at which time the final inflation figure from November 2021 to November 2022 was unknown.

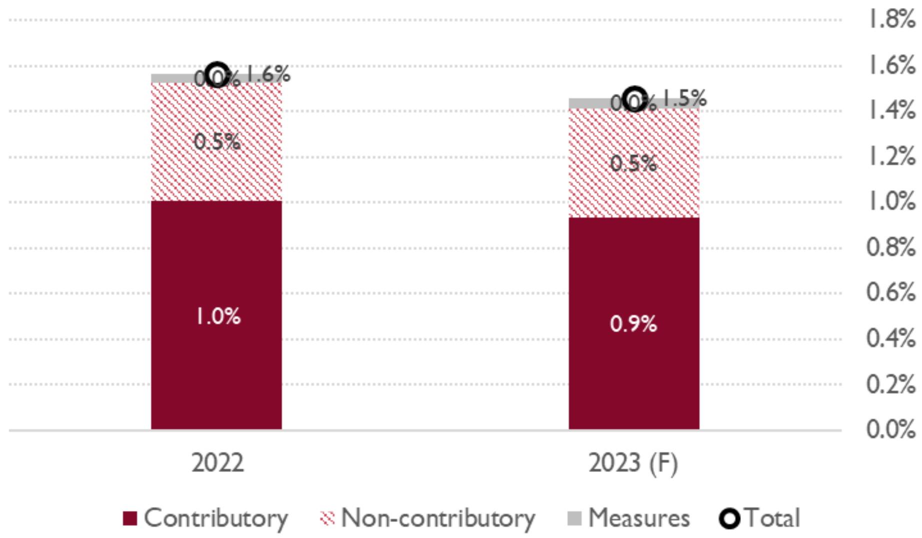
FIGURE 37. GROWTH IN PENSION EXPENDITURE. AIREF PROJECTIONS



Source: AIReF and Ministry of Inclusion, Social Security and Migration.

AIReF estimates that unemployment benefits will reduce their weight over GDP by 0.1 points in 2023, to 1.5%, similar to the forecast in the last report. The moderation of this item between 2022 and 2023 is explained by a denominator effect, while spending levels remain stable. Expenditure on unemployment benefits is assumed to be in line with the unemployment rate, which moderates between 2022 and 2023. This is in addition to the cost of the budgetary measures to increase the IPREM (Public Multiple-Effect Income Indicator) for non-contributory benefits and the minimum and maximum contributory benefit. In addition, between 2022 and 2023 the rate of reduction in the cost of job-retention schemes (ERTEs) is reduced.

FIGURE 38. EVOLUTION OF UNEMPLOYMENT EXPENDITURE (% OF GDP). AIREF'S FORECASTS



Source: AIReF and SEPE

4.3.3. Other expenditure

Interest

AIReF revises interest expenditure upwards for 2023, by just under 0.3 points of GDP to 2.4%. The new estimate is explained by the progressive rise in interest rates in recent months and taking into account the latest information published by the Bank of Spain. At the same time, persistent inflation continues to have an impact on interest expenditure through two different channels. On the one hand, recorded inflation has a direct impact on the entire debt portfolio linked to inflation. On the other hand, expectations of inflation and the normalisation of monetary policy are shifted to sovereign bond yields, with the consequent impact on new issues. The sensitivity is very high, given a portfolio of debt that stands at 113.2% of GDP at the end of 2022. However, the average maturity of the debt is also very long, which will soften the impact, deferring the pass-through of rate increases to the average debt rate by eight years. As a percentage of GDP, the increase in the volume of interest expenditure of 0.3 points has been reduced by almost 0.1 points due to the denominator effect, changing from the 2.2% forecast in the previous report to the 2.4% of GDP estimated for this year.

Gross capital formation

The estimate of expenditure on gross capital formation increases to 2.6% of GDP excluding the RTRP, almost 0.3 points more than in the previous report. This heading has been revised, mainly taking into account the execution data at the end of 2022. On the one hand, the execution of investment has been significantly higher in 2022 than forecast by AIReF in the field of the CG and the LG sub-sectors, leading to the upward revision of this expenditure item for 2023 in these sub-sectors. On the other hand, the expenditure on stock changes in the CG has been raised as a result of higher expected expenditure for stored vaccines in view of the volume of unused vaccines in 2022. As a percentage of GDP, the increase in the volume of expenditure on gross capital formation of 0.3 points has been reduced by almost 0.1 points due to the denominator effect, from the 2.4% forecast in the previous report to the 2.6% of GDP estimated for 2023.

Subsidies and other expenditure

The other expenditure headings collectively fall by 0.1 points of GDP to stand a 4.1%, with the largest changes being recorded in spending on subsidies and other capital transfers. In relation to this expenditure, the new information on the year-end 2022 data has resulted in a downward revision in the CG of other capital transfers and of non-produced non-financial assets as a result of lower estimated expenditure for 2023 in line with the year-end 2022 figures. There is an increase in other current expenditure items, mainly in subsidies as a result of the measures to fight the energy crisis, such as the extension of the fuel allowance for transporters and farmers, several types of sectoral support and the transfer of part of the expenditure of the Tariff of Last Resort (TUR) for gas to 2023, as the allocation for this measure was not used up in 2022. In addition, the subsidy of the tariff deficit has been reduced to the amount provided for in the GSB as a result of the suspension of the Tax on the Value of Electricity Production. Finally, the revision of GDP causes the ratio as a percentage of GDP to rise by 0.1 points less, to stand at 4.1% of GDP.

4.4. Analysis by sub-sector

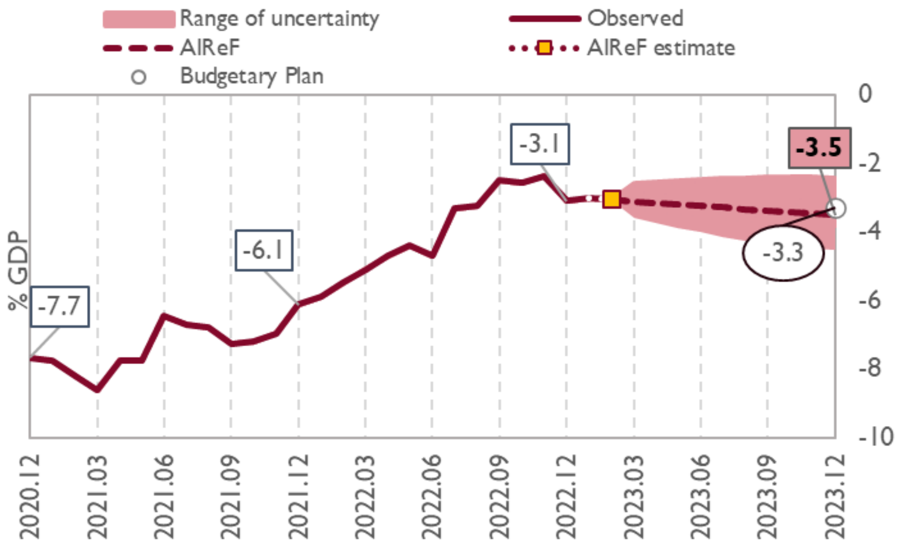
4.4.1. Central Government

AIReF estimates a deficit of 3.5% of GDP for 2023, 0.5 points higher than that forecast in the previous report (3%). The main factor behind this increase in the deficit is the adoption of new measures totalling 0.9 points of GDP. In the opposite direction, the new information reduces the deficit by 0.3 points, while the macroeconomic scenario reduces it by a further 0.1 points.

The increase in the deficit compared with the end of 2022 is 0.4 points of GDP. This change is mainly due to the financing systems of the regional and local governments. In 2023, the Regional Financing System (RFS) reduces the level of tax revenue that corresponds to the CG, while reducing the transfers received from the ARs. As already indicated in the previous report, the change in the transfers of revenue and expenditure compared with the previous year is conditioned by the RFS and the extraordinary transfers paid to the ARs. The growth in expenditure transfers stems from the increase in interim payments and the 2021 settlement in favour of the ARs (the 2020 settlement was in favour of the State). However, this is offset by the non-repetition of last year's extraordinary transfers to the ARs (negative settlement compensation and VAT management system – SII). At the same time, revenue transfers fall because in 2022 the significant 2020 RFS settlement was received in favour of the State, while in 2021 the settlement is in favour of the ARs. Similarly, there is also an increase in the transfers to the LGs through the financing system. In addition, there is the transfer to offset part of the negative settlement of 2022, which is paid in 2023.

Within the CG, the estimate for the State worsens by 0.6 points, from the -3.2% forecast in the previous report to -3.8% of GDP, while the bodies' balance improves from a surplus of 0.2% of GDP to 0.3%. The increase in the cost of the measures is borne by the State, as well as the reduction in tax collection and the increase in the interest burden. For their part, the CG bodies increase their surplus by 0.1 points of GDP to 0.3% after incorporation of the latest available information and execution data at year-end 2022.

FIGURE 39. NET LENDING/BORROWING OF THE CENTRAL GOVERNMENT (% GDP)



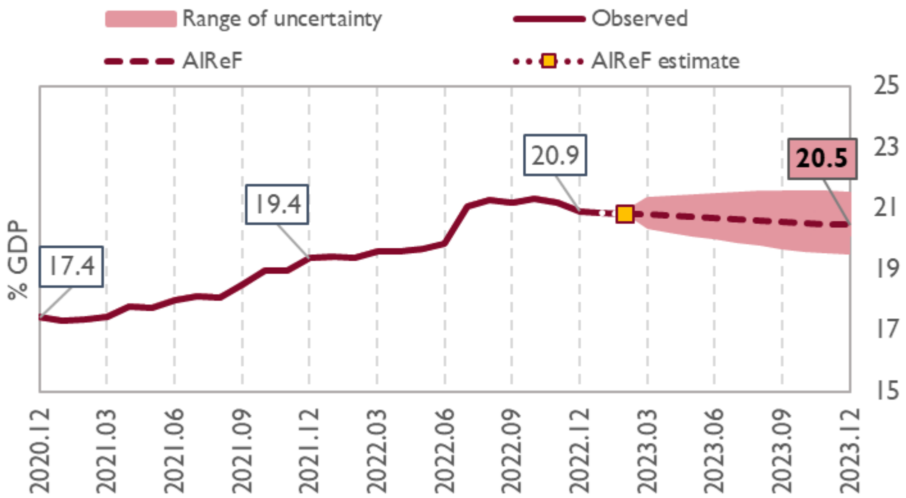
Source: AIReF and IGAE

Central Government Revenue

AIReF forecasts that CG revenue, excluding RTRP funds, will reach 18.9% of GDP in 2023, 0.5 points below the last report. After 2022 ended at the level forecast by AIReF, the total revenue of the CG has been revised downwards.

The update is concentrated in taxes, which fall by 0.5 points compared with the previous report, mainly as a result of the impact of the measures taken to mitigate the crisis. Revenue with the RTRP will fall by 0.4 points of GDP, from 20.9% at the end of 2022 to 20.5% at the end of the year.

FIGURE 40. CENTRAL GOVERNMENT REVENUE WITH RTRP (% GDP)



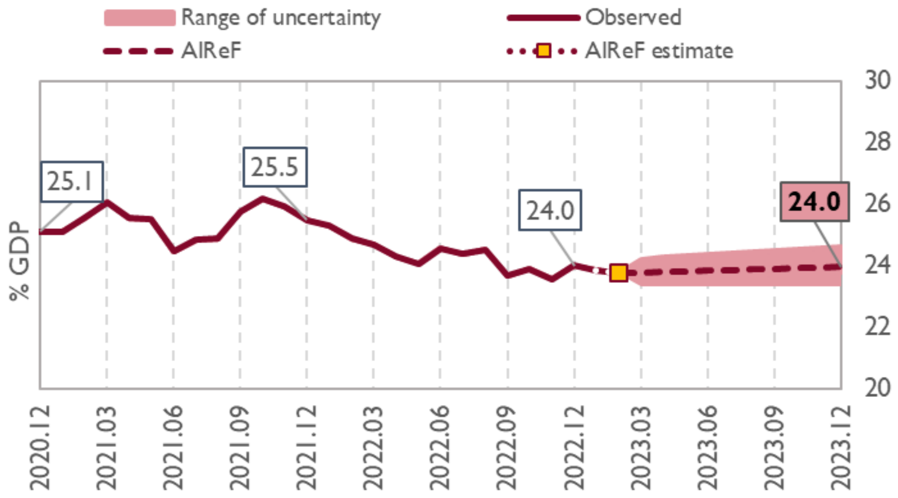
Source: AIReF and IGAE

Taxes on production and imports now stand at 8.4% of GDP, while taxes on income stand at 7.2%. This is 0.6 points less than in the previous report in the case of the former and more than 0.1 points higher in the case of the latter. In taxes on production, the change is due to the adoption of measures to combat the energy crisis. In taxes on income, it is the incorporation of new information and the macroeconomic effect that raises their weight.

Central Government Expenditure

AIReF maintains non-RTRP expenditure at 22.4% of GDP for 2023. The expenditure estimate for 2023 remains unchanged despite the revision of both the fiscal and the macroeconomic scenario. From a fiscal perspective, expenditure is estimated to rise mainly as a result of the Government's latest package of measures to fight the crisis and the update of interest expenditure in line with the latest information available. This increase has been offset by the upward revision of nominal GDP for 2023 in AIReF's update of the macroeconomic scenario. Finally, if we consider expenditure linked to the RTRP, CG expenditure would stand at 24% of GDP.

FIGURE 41. CENTRAL GOVERNMENT EXPENDITURE WITH RTRP (% GDP)



Source: AIReF and IGAE

The year-end 2022 information barely changes the amount of expenditure forecast for 2023, but it does slightly affect its composition. The analysis of the year-end 2022 information has led to an increase in the estimated expenditure of some items for 2023, including intermediate consumption and gross fixed capital formation. This is due to expenditure execution in 2022 that was higher than expected by AIReF. This increase is almost completely offset by the decrease in other items, including capital transfers and non-produced non-financial assets. In addition, the year-end 2022 data have led to some expenditure reallocations for 2023. In this regard, it is estimated that there will be an increase in the item of changes in inventories to the detriment of current transfers to the ARs for vaccines in 2023. This is due to the storage of vaccines that were not used in 2022.

In addition, the approved amendments to the numerical statements do not change the total amount of expenditure forecast for 2023. In the passage through Parliament of the 2023 GSB, amendments were approved to the expenditure appropriations that have not resulted in an increase in initial expenditure, as the new appropriations or their increases are financed by reductions of the same amount in other appropriations. These amendments affect the composition of State expenditure and the distribution of expenditure between sub-sectors, albeit at a very low level given their small amount. By way of example, part of the benefit in kind for the discount on air transport with the Canary Islands has become a current transfer to that Autonomous Region to reduce the price of the ticket for public land transport.

As a result of the above changes, AIReF raises its current expenditure forecast for 2023 by 0.4 points of GDP. The expenditure heading with the largest increase is interest, up by 0.3% of GDP, driven by the rise in interest rates over recent months. Social transfers in cash rise by 0.1% of GDP, mainly due to the direct support of €200 for low incomes provided for in Royal Decree-Law 20/2022. To a lesser extent, current transfers between GG sub-sectors are increased as a result of the measures of Royal Decree-Law 20/2022 on transport and non-contributory pensions to territorial administrations and to the Social Security system, respectively. However, the increase in expenditure on subsidies for sectoral support and the continuation of the fuel allowance for transporters and farmers is expected to be largely offset by the lower expenditure on the transfer to the electricity system due to the suspension of the Tax on the Value of Electricity Production[18].

In contrast, the estimate of capital expenditure remains virtually unchanged from the previous report. Taking into account the 2022 execution data, AIReF increases the expenditure forecast on gross capital formation due to the increase in the investment of the CG bodies and the storage of vaccines compared with the forecast in the previous report. In the opposite direction, expenditure on capital transfers and the net acquisition of non-produced non-financial assets falls in line with the year-end 2022 data.

According to the new estimate, expenditure, excluding the RTRP, is expected to grow by 1.5% in 2023 compared with the figure recorded in 2022 and with the 0.1% reduction forecast in the previous report. After updating the data, higher expenditure growth is expected in 2023 compared with 2022, driven by the new Government measures and the upward revision of interest expenditure. However, if RTRP expenditure were included, expenditure would rise by 6.3% compared with last year.

AIReF estimates that the eligible expenditure in 2023 would fall by 0.1% on 2022, compared with the 1.6% decrease forecast in the previous report. This new estimate is due to the fact that the eligible expenditure of 2023 mainly rises as a result of incorporation of the expenditure of Royal Decree-Law 20/2022, together with higher eligible expenditure executed in 2022 than estimated by AIReF in the previous report. As a result, the expected reduction in eligible expenditure in 2023 compared with 2022 falls. In addition, the extension of revenue measures of the aforementioned Royal Decree-Law

[18] As a result of the suspension of the Tax on the Value of Electricity Production, AIReF changes its estimate of the expenditure on the transfer to the electricity system for 2023, replacing the amount equivalent to the initial forecast for collection for the tax in 2023 (at around €3bn) with the initially budgeted amount of €1.15bn, estimating that the latter figure will be the amount transferred as compensation for suspension of the tax.

20/2022 has reduced the negative net impact of the revenue measures for 2023. Compared with the 0.1% of GDP in the previous report, its impact is no longer significant, and it thus has hardly any effect on the change in eligible expenditure.

The lack of information on the execution of the RTRP and REACT-EU funds in national accounting terms in 2022 is a specific constraint on the calculation of the expenditure rule. The calculation of eligible expenditure requires the elimination of expenditure from the RTRP and REACT-EU funds, since expenditure financed by the European Union falls outside the expenditure rule. The lack of information on the expenditure financed with these funds, which has been executed in 2022 in national accounting terms, prevents it from being excluded in the calculation of 2022 eligible expenditure. This affects the base for calculating the change in 2023. Due to this lack of information, AIReF's estimates have had to be used. However, the sensitivity of the change in eligible expenditure to small differences in the amount of expenditure highlights the significant constraint imposed by the absence of this information in AIReF's analysis. Therefore, the estimate should be taken with greater caution than usual.

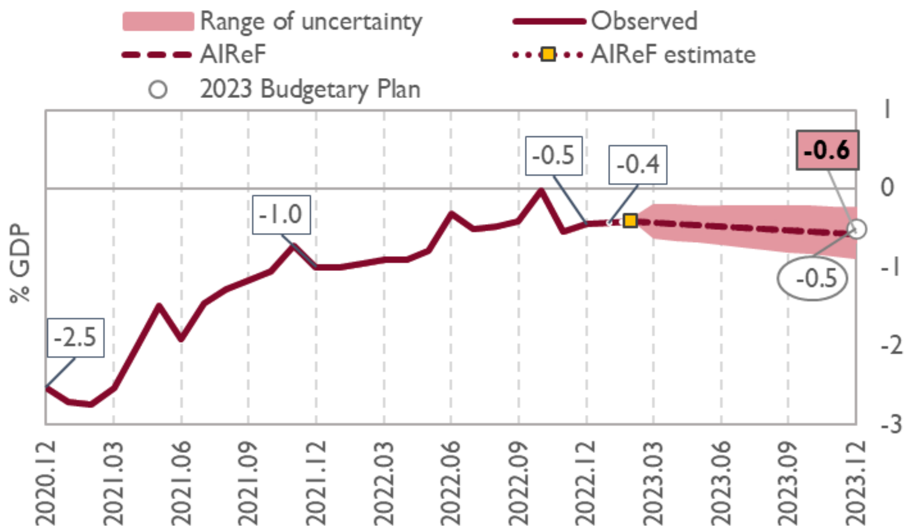
4.4.2. Social Security Funds

The Social Security Funds (SSFs) will increase their deficit from 0.5% of GDP in 2022 to 0.6% in 2023, compared with the 0.7% estimated in the previous report for 2023. The weight of revenue over GDP falls by more than 0.2 points compared with the previous estimate, while expenditure falls by 0.4 points. The moderation in the weight of revenue is mainly due to the reduction in the weight of social contributions, while the fall in expenditure is due to the downward revision of pension expenditure.

The weight of revenue over GDP moderates by over 0.2 points compared with the estimate in the previous report, to stand at 15.8 points in 2023. This moderation is explained by the reduction in the weight of social contributions over GDP due to the denominator effect caused by higher growth than expected in the previous report. The effects of the new information operate in the opposite direction, with higher social contributions recorded at year-end 2022 than previously forecast.

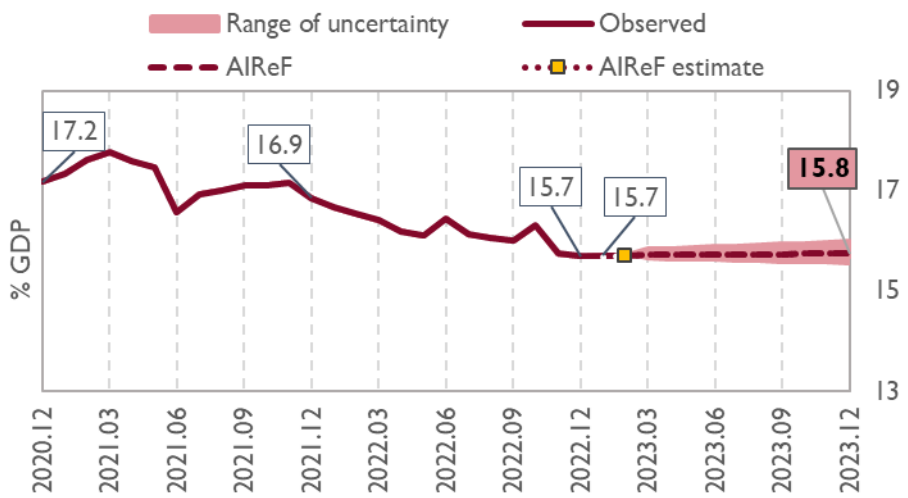
Expenditure is revised downwards by 0.4 points compared with the previous report to end 2023 with a weight of 16.3 points of GDP. The reduction in expenditure as a proportion of GDP is mainly explained by the denominator effect of higher nominal GDP and by the evolution of pension expenditure. The latter in turn stems both from a lower starting point in 2022 and from a lower increase between 2022 and 2023 than expected in the previous report. Pension expenditure observed at year-end 2022 was lower than previously estimated. The forecast increase in pension expenditure in 2023 is moderated due to a more subdued increase in the CPI (8.5%) than the figure estimated in October 2022 (8.9%) and to a more moderate substitution effect and increase in the number of pensions.

FIGURE 42. NET LENDING/BORROWING OF THE SOCIAL SECURITY FUNDS (% GDP)



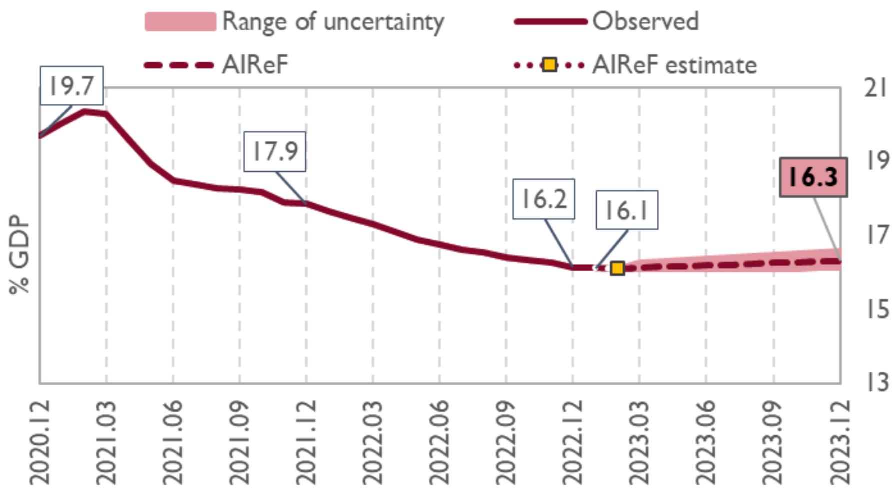
Source: AIReF and IGAE

FIGURE 43. REVENUE OF THE SOCIAL SECURITY FUNDS WITH RTRP (% GDP)



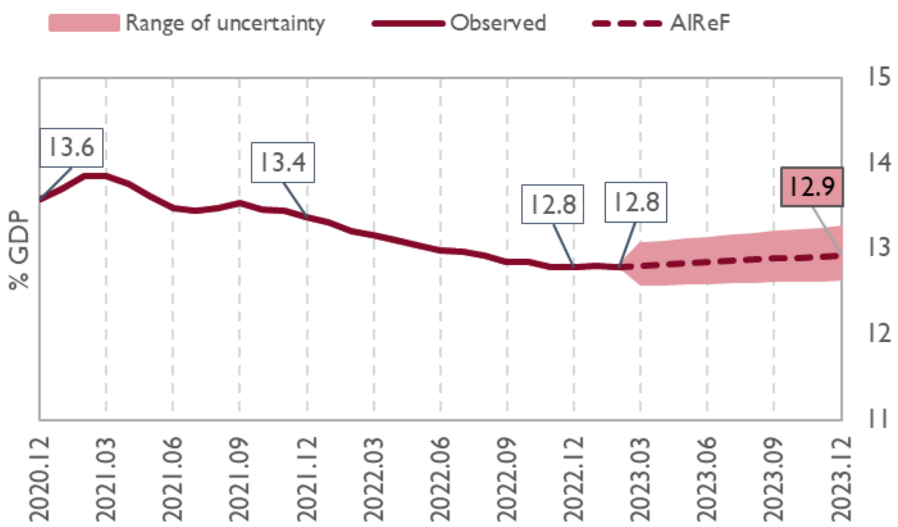
Source: AIReF and IGAE

FIGURE 44. EXPENDITURE OF THE SOCIAL SECURITY FUNDS WITH RTRP (% GDP)



Source: AIReF and IGAE

FIGURE 45. EVOLUTION OF THE CONTRIBUTIONS OF THE SOCIAL SECURITY FUNDS

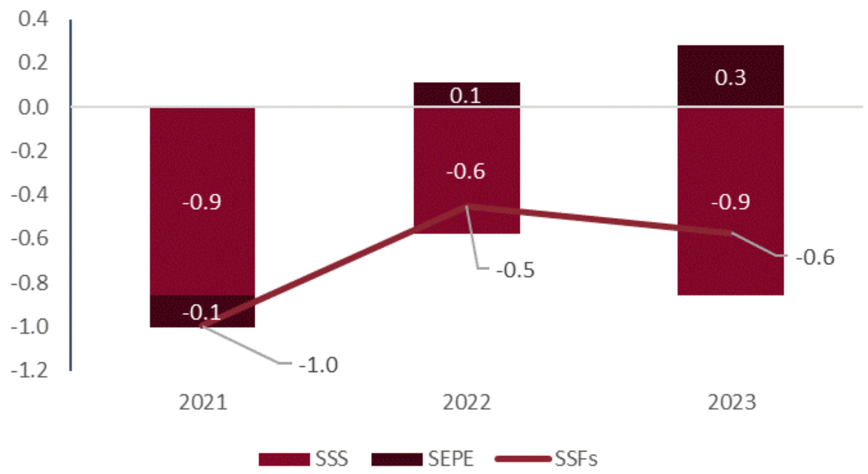


Source: AIReF and IGAE

This evolution does not affect the various agents of the Social Security Funds equally. The deficit of the Social Security Funds fell by 0.5 points of GDP in 2022, of which 0.3 points corresponded to the Social Security system and 0.2 to the SEPE. SEPE expenditure falls as a result of the reduction in the cost of job-retention scheme (ERTE) benefits to mitigate the impact of COVID-19 on the job market and the improvement in the unemployment rate. In the case of the Social Security system, the fall is due to a denominator effect. In 2023, the deficit rises by 0.1 points as a result of the deficit of the Social Security System widening by 0.3 points, partially offset by the increase in the balance of the

SEPE of 0.2 points of GDP. The balance of the SEPE mainly improves due to the denominator effect of the improvement in GDP, while expenditure on unemployment benefits remains stable. The worsening of the balance of the Social Security system is mainly due to the increase in pension expenditure following the annual increase in line with the CPI of the previous year.

FIGURE 46. BALANCE OF THE SOCIAL SECURITY FUNDS BY AGENT (% GDP)



NB: FOGASA presents a balanced budget in this period

Source: AIReF, Social Security, SEPE and IGAE

4.4.3. Autonomous Regions

AIReF forecasts a deficit for the sub-sector of 0.3% of GDP, 0.2 points higher than the estimate in the previous report. With respect to its previous statement on October 25th[19], AIReF has worsened its year-end 2023 forecast for the regional sub-sector by 0.2 points as a result of the year-end 2022 figures. It is thus considered that the ARs could have a balance similar to the reference of -0.3% set for the sub-sector.

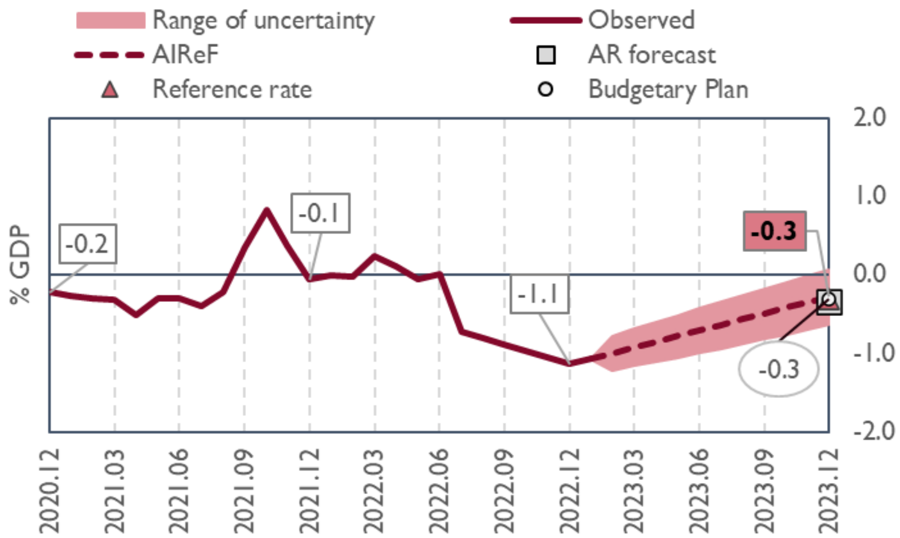
The deficit in 2022 was more than 0.1 points higher than the forecast in the report on the main budgetary lines. The sub-sector closed 2022 with a deficit of 1.1% of GDP, 0.1 points higher than that forecast in the previous report. This change was already anticipated in the latest monthly monitoring sheets published by AIReF. After adjusting for the effect of the NGEU funds, with a

[19] Report on the Main Lines of the 2023 Budget of the General Government, including the ARs and LGs

neutral effect on the deficit, the year-end 2022 figures mainly show, with regard to expectations in October, a sharper evolution in expenditure not related to European funds and a worse result for revenue from traditional European funds. This explains the change with regard to the estimates of the previous report. The worse outcome in 2022 is carried over to the projections for 2023.

The scenarios provided by the ARs for 2023 do not show significant changes with respect to those reported in October. For the sub-sector as a whole, they show a deficit of 0.3% of GDP in 2023, in line with the reference rate set for the sub-sector. In general, there have been no substantive changes between the approved budgets and budgetary lines or draft budgets reported in October. Only the budget of the Region of Madrid for 2023 has not been approved and therefore the budget of the previous year will be extended in accordance with its extension decree. However, the medium-term budgetary plans drawn up by the region include an updated forecast scenario for 2023 similar to that considered in the main budgetary lines of October. In the other ARs, both the budgets and the updated forecasts contained in the medium-term budgetary plans estimate that the reference rate set or agreed will be reached (-0.3% for the subsector; -0.6% for the Basque Country and Navarre), with some exceptions: the Canary Islands, the Balearic Islands and Rioja expect to reach more favourable balances (balanced budget for the Canary Islands and a deficit of 0.1% for the other two regions). In contrast, Andalusia and Navarre, which approved their budgets in accordance with the established reference rate, have provided more pessimistic forecasts (year-end figure for 2023 of -0.6% and -1.1%, respectively). The available aggregate data shows a balance for the Autonomous Regions as a whole of -0.3% of GDP.

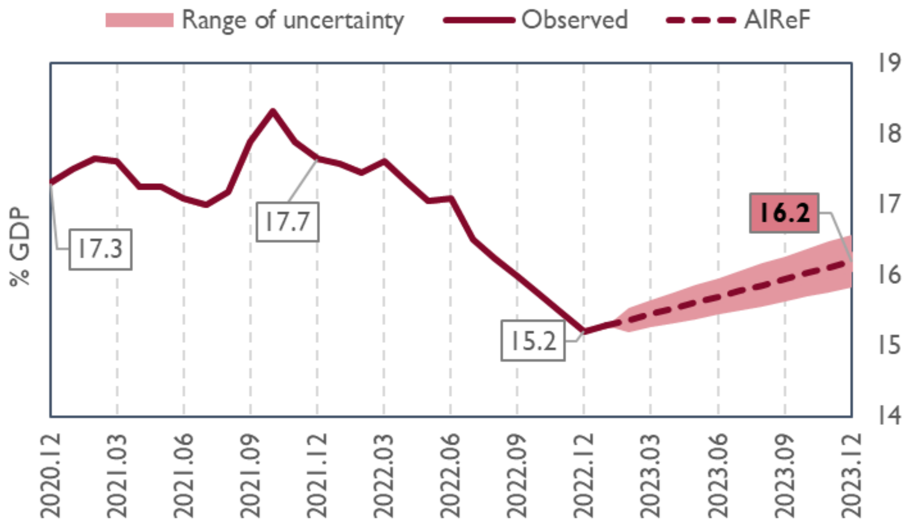
FIGURE 47. NET LENDING/BORROWING (% GDP) OF THE ARS (% GDP)



Source: IGAE, AIReF and Medium-Term Budgetary Frameworks of the ARs.

AIReF continues to forecast that the net revenue of the ARs in 2023, without taking into account RTRP revenue, will rise by 11% on the previous year, to reach 15.6% of GDP. As already indicated in the previous report, the increase of 24% in the revenue of the financing system over the 2022 figure determines the evolution of overall revenue. Compared with the aforementioned growth in revenue of the financing system, resulting from the positive 2021 settlement compared with the negative settlement of the preceding year, the extraordinary compensation received in the previous year (as a result of the negative 2020 settlement and the VAT management system – SII) disappear. Other revenue is still estimated to rise by around 3% on 2022. Adding the revenue that is expected to be recorded as a result of the Recovery Plan, regional revenue would rise by 13% on the previous year, to stand at 16.2% of GDP.

FIGURE 48. REVENUE OF THE ARS WITH RTRP (% GDP)



Source: AIReF and IGAE

However, due to the lower level of non-NGEU revenue in 2022 compared with the October estimates, the expected level in 2023 also decreases. With regard to the Report on the Main Budgetary Lines, AIReF has slightly corrected downwards the collection expected from Transfer Tax and Stamp Duty, the new Tax on Waste[20] and other revenue such as traditional European funds. However, it increases the estimated amount of contributions from the Provincial Councils, transfers from the State for the measures under Royal Decree-Law 20/2022 (transport support) and the revenue associated with production. It should be noted that, although REACT-EU revenue was executed in 2022 below the October estimates, the current data published for 2020 shows over €900m in revenue associated with these funds. Therefore, the remaining part to be executed in the sub-sector for 2023 is similar to that estimated in the Report on the Main Budgetary Lines.

[20] Tax on the deposit of waste in landfills, incineration and co-incineration of waste, regulated in Title VII, Chapter II, of Law 7/2022, of April 8th, on contaminated waste and soil for a circular economy.

TABLE 9. EVOLUTION OF REVENUE 2023/2022. AR SUB-SECTOR COMPARISON WITH REPORT ON BUDGETARY LINES (€BN AND % CHANGE)

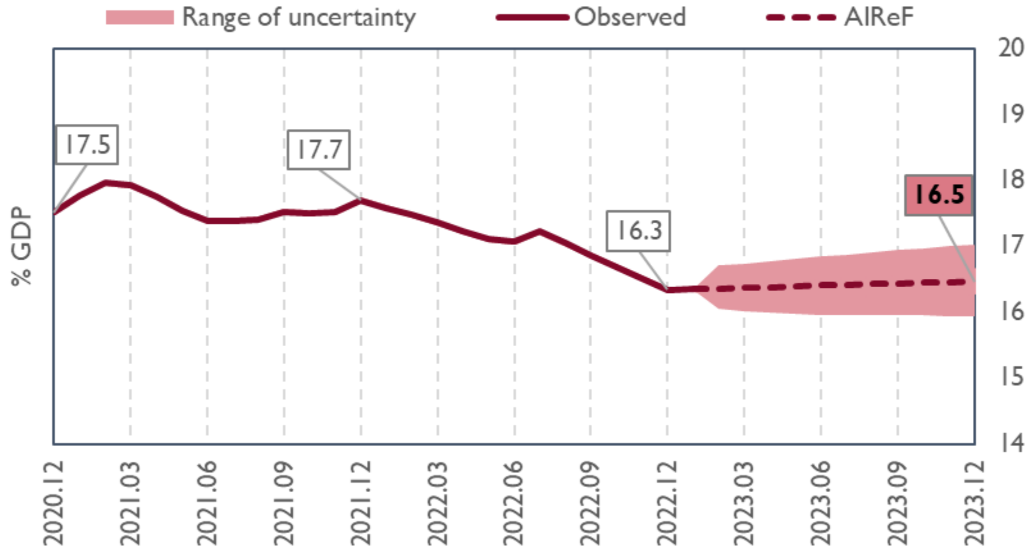
	Forecast 2022 Lines	Forecast 2023 Lines	% change 23/22 Lines	Year-End 2022	Forecast current 2023	% change 23/22 current
Total net revenue	**206**	**232**	***13***	**202**	**229**	***13***
Net revenue without RTRP	**202**	**223**	***11***	**200**	**221**	***11***
Net RFS	110	136	*24*	110	136	*24*
Net IPs	*113*	*125*	*11*	*113*	*125*	*11*
Net Settlement	*-3*	*11*		*-3*	*11*	
Extraordinary fund/compensation	8	0		8	0	
Tax on Property Transf. & Stamp Duty	13	13	*2*	12	12	*2*
Inheritance and Gift Tax	3	3	*-3*	3	3	*-3*
Other non-RFS taxes	11	12	*8*	11	12	*6*
Other revenue	58	60	*3*	56	58	*3*
REACT revenue	*4*	*3*	*-22*	*3*	*3*	*5*
Support for companies Covid line	*0*	*0*		*0*	*0*	
Other	*54*	*57*	*5*	*53*	*55*	*3*
RTRP revenue	*4*	*10*	*128*	*2*	*8*	*300*

Source: AIReF and IGAE

The regional budgets and forecasts as a whole maintain revenue estimates similar to those of the budgetary lines and draft budgets. The current regional estimates set out an overall level similar to the previous forecasts, but with a higher amount of tax revenue and more moderate figures for European funds and State transfers not associated with the financing system or the RTRP (the year-end forecasts for the Region of Valencia, as usual, do not include the transfer from the State of €1.34bn which is systematically included in its budget but not set out in the State budget). The decrease in AIReF's estimates over those considered in the previous report brings its revenue scenario closer to the aggregated data of the ARs.

AIReF estimates that the net expenditure of the ARs not associated with the RTRP will grow by 5%, to stand at 0.2 points of GDP below the 2022 level. Compared with the previous report, the estimates of expenditure growth in 2023 over 2022 are maintained, which, as noted, are largely conditioned by the impact of inflation and the updating of the remuneration of public employees due to basic State legislation and regional measures. Adding the expenditure estimated to be executed as a result of the RTRP, expenditure would grow by 7% over the 2022 level.

FIGURE 49. AR EXPENDITURE WITH RTRP (% GDP)



Source: AIReF and IGAE

The level of expenditure not linked to NGEU funds expected in 2023 increases above the estimate included in the budgetary lines as a result of incorporating the year-end 2022 figures. The level of expenditure is corrected upwards as the amount of expenditure not associated with funds or non-recurring operations was higher in 2022 and as a result of incorporating the expenditure resulting from the transport subsidies under Royal Decree Law 20/2022. In 2023, this raises the expected expenditure on social transfers in kind (pharmacy and agreements), subsidies, interest and gross capital formation, and decreases that of intermediate consumption - also affected by the reduction in expected expenditure on vaccines - and, to a lesser extent, that of personnel.

TABLE 10. EVOLUTION OF EXPENDITURE 2023/2022 AR SUB-SECTOR COMPARISON WITH REPORT AND BUDGETARY LINES (€BN AND % CHANGE)

	Forecast 2022 Lines	Forecast 2023 Lines	% change 23/22 Lines	Year-End 2022	Forecast current 2023	% change 23/22 current
Total net expenditure	**219**	**234**	**7**	**217**	**233**	**7**
Net expenditure without RTRP	**214**	**224**	**5**	**215**	**225**	**5**
Healthcare*	88	93	6	86	92	6
Education*	53	56	6	52	56	6
Other expenditure*	74	75	2	76	78	2
Of this, REACT expenditure	*4*	*3*	*-22*	*3*	*3*	*5*
RTRP	*4*	*10*	*128*	*2*	*8*	*300*

* Functional distribution estimated by AIReF

Source: AIReF and IGAE

The current estimates of the regions slightly raise the forecasts of expenditure set out in the budgetary lines and draft budgets reported in October. The scenarios updated by the ARs for 2023 show slightly higher expenditure forecasts, for the sub-sector as a whole, than those provided in October. They include upward corrections of current budgetary expenditure and downward corrections, albeit to a lesser extent, of capital expenditure. At an aggregate level, without taking into account the expenditure associated with the RTRP, they show a level similar to that estimated by AIReF.

AIReF considers that the eligible expenditure for the purposes of the expenditure rule will increase by 5% in 2023. With the published year-end figures, eligible expenditure in 2022 could rise by more than forecast in the previous report, by around 5%. In 2023, under the current estimates of expenditure, special-purpose State Transfers and receipts of EU funds, eligible expenditure in the sub-sector would grow by 5% on 2022.

REACT-EU Funds and Recovery, Transformation and Resilience Plan.

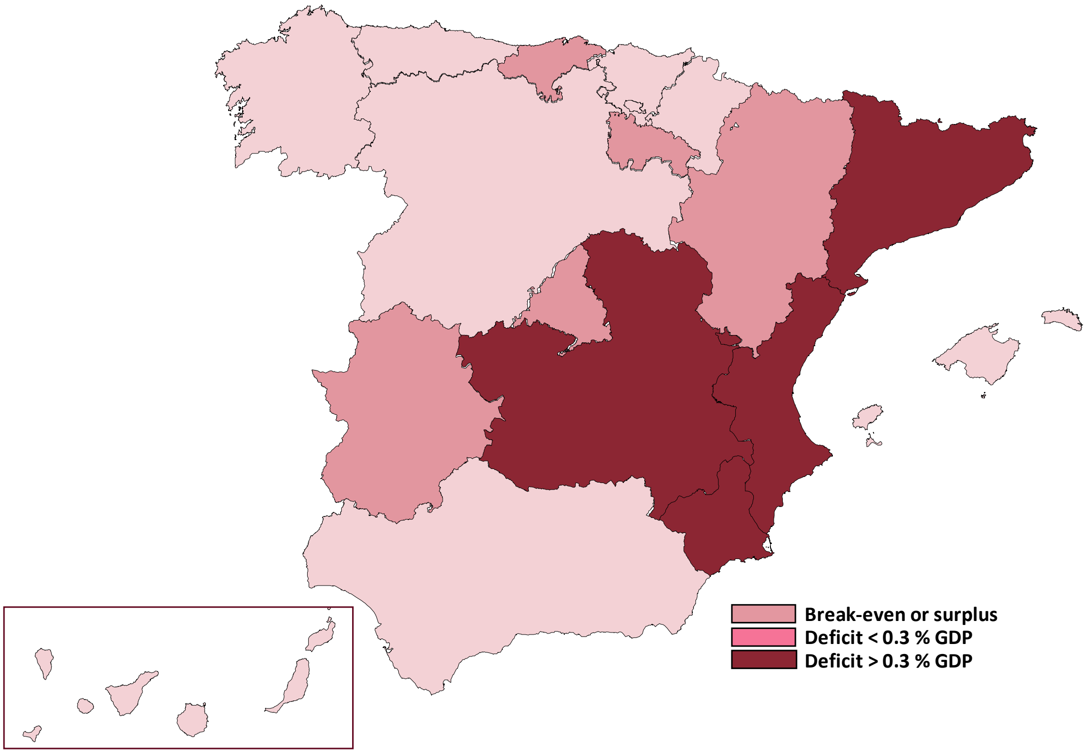
According to the updated information on expenditure recorded by the ARs, up to 2022, 28% of the allocated REACT-EU funds would remain to be executed in the sub-sector in 2023. The current information of the Accounting Information Centre of the Ministry of Finance and Civil Service on fiscal years 2020 and 2021, and the year-end data published for 2022, shows that to date 72% of the funds assigned to the regions by REACT-EU (€9.96bn allocated) has been executed. The remainder to be executed in 2023 is similar to that estimated in October.

AIReF forecasts that execution of the RTRP in 2023 in the ARs will stand at around 0.5% of GDP. Although AIReF has revised downwards the amount expected to be executed in 2023 by the ARs, it still considers that the largest application of these funds in the period may be concentrated in 2023. Accordingly, it estimates, in line with the forecast contained in the medium-term budgetary plans of the ARs, that in 2023 projects amounting to 0.5% of GDP might be implemented at a regional level.

Individual analysis

At the individual level, the forecasts for year-end 2023 worsen for 12 ARs compared with the previous report. Almost all the individual variations mainly result from the year-end 2022 figures. Consequently, the forecast for most ARs worsen, particularly in the Canary Islands, Valencia, Aragon, Rioja and Castile-La Mancha. In contrast, they improve in Andalusia and Navarre.

FIGURE 50. AR MAP NET LENDING/BORROWING 2023 WITH RESPECT TO -0.3% REFERENCE FOR EL SUB-SECTOR.



Source: AIReF

However, AIReF continues to estimate that only four ARs will close 2023 with a deficit higher than the 0.3% set for the sub-sector. Although the individual estimates have generally worsened compared with those prepared in October, AIReF forecasts that only the ARs of Castile-La Mancha, Catalonia, Murcia and Valencia will close 2023 with a worse balance than the reference set for the sub-sector. In Aragon, Rioja, Cantabria, Extremadura and Madrid, moderate deficits could be recorded, below or around the -0.3% reference, while the other ARs could close the year with a balanced budget or surplus.

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

4.4.4. Local Governments

AIReF estimates that the LG sub-sector will reach a surplus of around 0.2% of GDP in 2023, 0.3 points lower than in the previous report. AIReF's forecasts for the local sub-sector update the data considered for the Report on the 2023 Budgetary Lines based on the latest information published on the year-end

2022 figures and the correction of the quarterly execution data up to September of last year, the financial data at year-end 2022 on local debt and deposits published by the Bank of Spain, as well as information provided by the Information Centre of the Ministry of Finance and Civil Service on the approved/carried over budgets of the Local Governments and that provided by the 24 large LGs subject to individual evaluation. Based on all these data, AIReF reduces its forecast on the result to be achieved by the local sub-sector by 0.3 points in 2023, placing it at a surplus of around 0.2% of GDP.

The worsening of AIReF's forecasts for 2023 is a consequence of the impact in this year of sharp growth in expenditure in 2022 (14.6%). The year-end 2022 information published incorporates the update of the data for the first three quarters published by the Ministry of Finance and Civil Service in December of last year. This includes a downward revision of the deficit up to September of over €1.3bn, or 0.15 points of GDP, as a result of the increase in expenditure of almost €1bn and the reduction in revenue of around €400m. It should be noted that the worsening of the data for those quarters of 2022 is not explained by allocation of the full amount of the negative settlement for 2020, of over 0.3 points of GDP, as this was already known in July. On the contrary, the worsening was mainly the result of the recognition of higher current expenditure on goods and services, and subsidies.

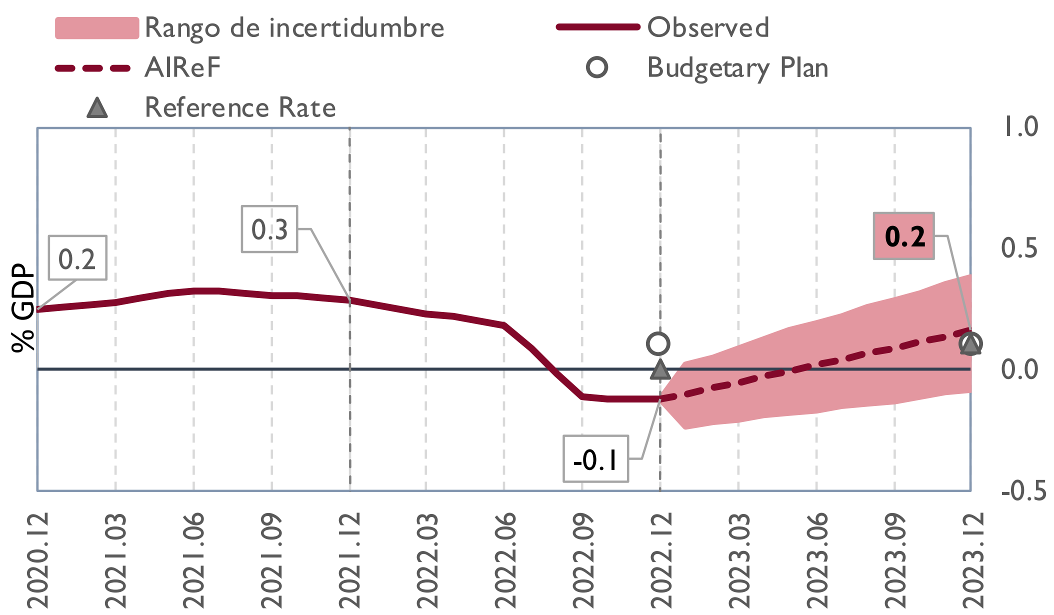
The sharp growth in recurring current expenditure in 2022 conditions AIReF's forecasts for 2023. The year-end 2022 figures involved an increase in expenditure on the 2021 level, in homogeneous terms, of over 10%, mainly affecting current expenditure, which therefore mostly recurs in future years. This higher recognised expenditure in 2022, which is likely to be repeated in the following years, has made it necessary to revise the surplus estimates for 2023 by 0.3 points of GDP.

In 2023, local revenue, homogenised from settlements and compensation from previous years and NGEU funds, will grow by over 3%, mainly as a result of the improvement in revenue linked to economic activities. In homogeneous terms, deducting the effect in 2022 and in 2023 of the positive settlements from the State and the compensation in both years as a result of the negative 2020 settlement, as well as the compensation of the VAT management system (SIII) in 2020 and NGEU funds, the year-on-year growth of local revenue in 2023 would reach more than 3%. This increase is mainly the result of growth in tax revenue linked to improved economic activity, such as that resulting from State financing, that from the Provincial Councils and other local taxes, such as public fees and prices.

Homogenised local expenditure will increase by around 4% in 2023 compared with 2022. AIReF estimates that expenditure in 2023, homogenised from payments from previous years to the State and NGEU funds, could grow by almost 4%. A major factor in this growth is the expected increase in current expenditure, particularly compensation of employees and intermediate consumption, of around 5%.

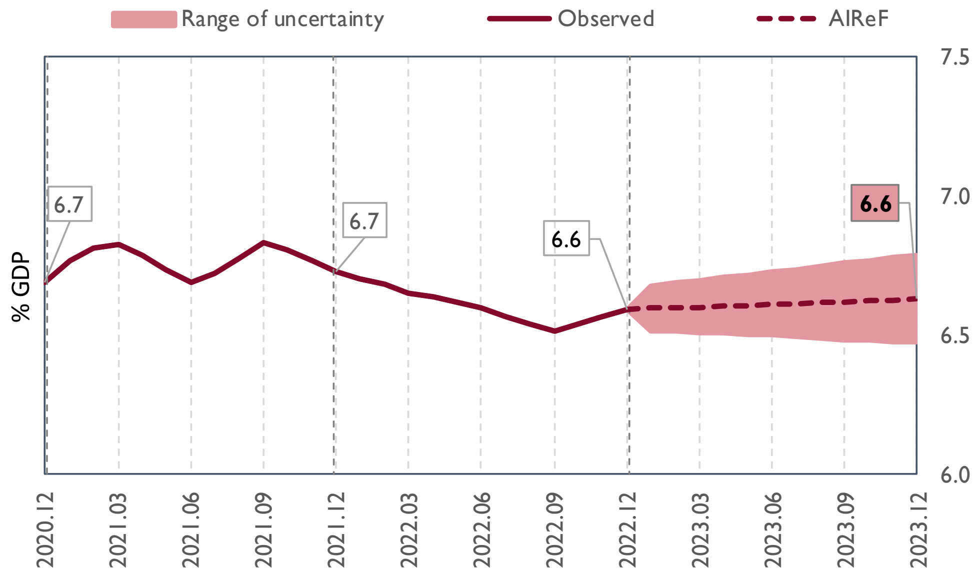
There are significant uncertainties that could compromise the local result for 2023 resulting from the possible consolidation of the expansion in expenditure in 2022. AIReF's central scenario for 2023 may be altered to the downside by the significant uncertainties resulting from the quantification of the spending that LGs may carry out this year, mainly current expenditure, as a result of a repeat of the levels recorded in 2022 and their expansion at the same rate. This, in turn, may compromise the balance forecast for 2023.

FIGURE 51. NET LENDING/BORROWING OF THE LGS (% GDP)



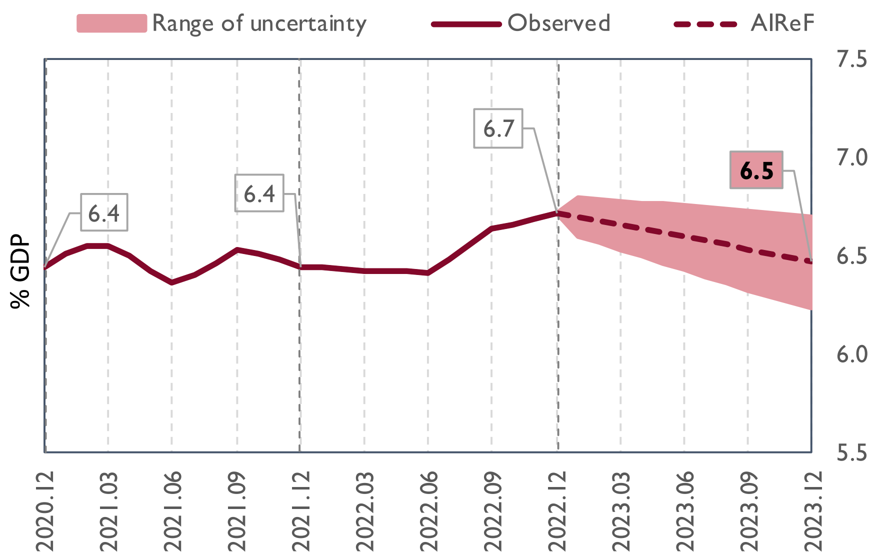
Source: AIReF and IGAE

FIGURE 52. LG REVENUE WITH RTRP (% GDP)



Source: AIReF and IGAE

FIGURE 53. LG EXPENDITURE WITH RTRP (% GDP)



Source: AIReF and IGAE

The information available on the evolution of local debt and deposits at the end of 2022 corroborates AIReF's forecasts of the results to be achieved by LGs in 2023. According to the latest data published by the Bank of Spain on local debt and deposits at year-end 2022, LG debt fell by 0.1 points of GDP in 2022, while local deposits rose by 0.3 points of GDP. Therefore, the sub-sector's net asset position has improved, despite the higher expenditure recorded last year, mainly due to the increase in revenue for the year. Expenditure growth in 2023 is expected to be lower than in 2022 given the high level of growth recorded in that year. Therefore, AIReF forecasts that the surplus to be reached in 2023 will stand at around 0.2% of GDP.

The forecasts for 2023 of the group of large LGs show a substantial improvement compared with those sent with the budgetary lines for the year and with respect to the results recorded at year-end 2022. The group of large LGs under the ordinary regime analysed have worsened their 2022 estimates given in October. This is due to the fact that they mostly (including Madrid with almost €200m) do not include the effect in that year of the negative 2020 settlement of the financing system. For 2023, current data from these LGs show results there are significantly better than those previously submitted. This improvement is also due to the fact that the positive effect of the 2020 settlement was not attributed to this year either. AIReF estimates a surplus for this sub-group very similar to their estimates. They are worse than the October forecasts mainly because the expenditure data on which they are based, mainly submitted by the LGs, did not include all expenditure expected to be carried out at year-end, but only that taken from the budgetary lines. The subgroup of the Provincial Councils also worsens the estimates for 2023, with all of them forecasting deficits, particularly the Provincial Council of Bizkaia. AIReF also revises its forecasts for this year downwards, albeit projecting a slight surplus in each of them.

AIReF estimates that the eligible expenditure of the local sub-sector will grow in 2023 by around 4% over 2022, a year in which AIReF estimates growth of almost 12%. AIReF's forecasts on the growth of eligible expenditure for the expenditure over 2023 are around 4% higher than the 2022 levels. They are thus lower than the expected growth for last year of almost 12%, which was unprecedented in previous years and essentially due to the increase in current expenditure. AIReF estimates that, given the high levels of expenditure seen in 2022 and the expected slowdown in expenditure at present until the new Local Governments emerging from the municipal elections in May start to operate, the increase in eligible expenditure to be carried out in 2023 will stand at around 4%.

4.5. Contingent liabilities and fiscal risks

Persistent inflation, in a context of uncertainty due to the continuation of the war in Ukraine, could lead to the adoption of new anti-crisis measures or the

extension of those in force over the year. After the approval of the 2023 GSB, the Government approved a package of anti-crisis measures which will mostly be in force until June 30th, 2023 (see Section 4.1 on measures). Currently, the risk of inflationary tensions persists in an uncertain geopolitical context due to the continuation of the war in Ukraine, which could lead the Government to adopt new measures or extend some of those in force beyond the first half of the year. In this case, revenue and/or expenditure measures would increase the State deficit in 2023.

There is a risk of default on ICO guarantees, although AIReF does not estimate higher expenditure for the State in 2023 as a result of the recent recording of standardised guarantees in 2021 and 2022. Early materialisation in the State deficit of the forecast potential losses over the life of the ICO guarantees (standardised guarantees) has resulted in higher expenditure in the last two years for the State of around €4.9bn (€4.3bn in 2021 due to the COVID guarantees and €600m in 2022 due to guarantees granted as a result of the war in Ukraine). In 2023, the risk of defaults has increased due to high inflation and the expiry of the grace period of the loans on June 30th, 2022. Therefore, the risk of further allocations to the deficit remains in place to the extent that the actual amount of defaults exceeds the potential amount.

In addition, there remains a risk that a worse macroeconomic scenario than that considered in the fiscal projections will materialise and affect the 2023 deficit. The macroeconomic scenario underpinning the 2023 deficit forecasts remains subject to a great deal of uncertainty. Particularly noteworthy is the increase in raw material prices, inflation, the rise in interest rates and the deterioration of households' purchasing power, together with the reduction in savings generated during the pandemic. In addition, geopolitical uncertainty stemming from the war in Ukraine continues unabated. This high level of uncertainty regarding the macroeconomic scenario is compounded by the risk of a slower-than-planned annual pace of RTRP execution. All these elements remain key in the evolution of certain variables such as employment, wages, private consumption and gross operating surplus, which will affect the final path of tax revenue and contributions, as well as unemployment and interest expenditure, with an impact on the deficit for the year.

In addition, there are other fiscal risks without a macroeconomic origin, mainly related to the enforcement of court rulings. According to the latest information published in the CSA account for 2021, it is worth highlighting the case of ACESA, which could amount to €3.09bn in addition to the compensation paid by the State in 2021, given the discrepancies about the final amount claimed. In addition, the dispute over renewable energies remains open. In this regard, although the Government considers it unlikely that it will have to compensate the plaintiff companies, the amount of the unfavourable awards totals

€1.18bn, and therefore it is a risk that remains alive and that may affect the accounts for the coming years.

Risks whose amount is repeatedly unknown and for which no information is provided may also have an impact on the 2023 accounts. As indicated for the 2023 Budgetary Plan and for the draft 2023 GSB, neither do the approved budgets contain full and detailed information on the main risks that may have an impact on the year. In this regard, there is no information on the possible impact in 2023 of the risks assumed as a result of public-private partnership agreements, loans granted by the GG that may become bad debts and on outstanding judicial cases that are significant due to their amount. In addition, although the amount of defence spending is now more significant because of the Government's commitment to NATO to raise military spending to 2% of GDP by 2029, no information has been published on the planning of these military deliveries and their impact on the public deficit.

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

5. EVOLUTION AND SUSTAINABILITY OF THE PUBLIC DEBT

5.1. Recent evolution and short-term projections

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. In monetary terms, public debt has continued to grow in 2022 to reach €1.5tn. However, the rate of debt growth has been lower than that of nominal GDP, which has led to a reduction in the public debt ratio. The quarterly profile shows seven consecutive quarters of reduction in the ratio after five quarters of rises, with the ratio falling by 12.5 points from the peak reached in the first quarter of 2021 (125.7%).

The reduction in the ratio has surprised on the upside, reflecting, among other factors, a higher contribution from growth. Nominal GDP grew by 10% in 2022. The contribution of growth to the fall in the ratio was 10.7 points, of which 6 points came from the real part, and 4.7 points from the deflator. For their part, fiscal factors (mainly deficits) resulted in an increase of 5.7 points, a reduction of 1 point on the previous year.

Following the sharp initial increase caused by the pandemic, the debt ratio is on a clear downward path. The significant contraction of the high public deficit resulting from the health crisis together with the upturn in activity and much higher than expected inflation have managed to correct approximately one third of the increase caused in the first year of the pandemic, placing the ratio on a clear downward path. Of the 15 points of increase in the ratio over the last three years, the public deficit has contributed with a positive contribution of 21.8 points, which has been partially offset by the GDP deflator by 8.6 points, while the contribution of real growth has been practically zero in that period.

FIGURE 54. DEBT (% GDP), QUARTER-ON-QUARTER EVOLUTION

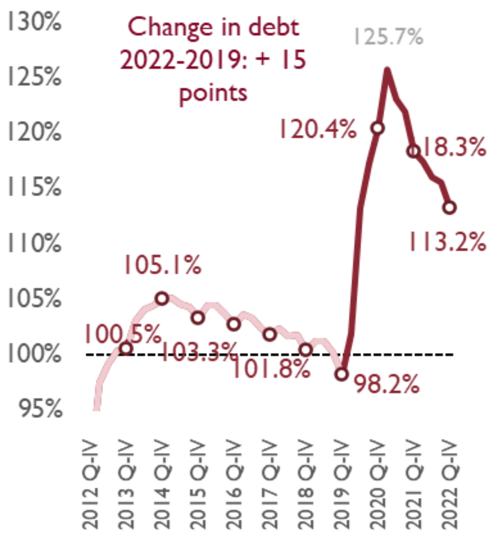
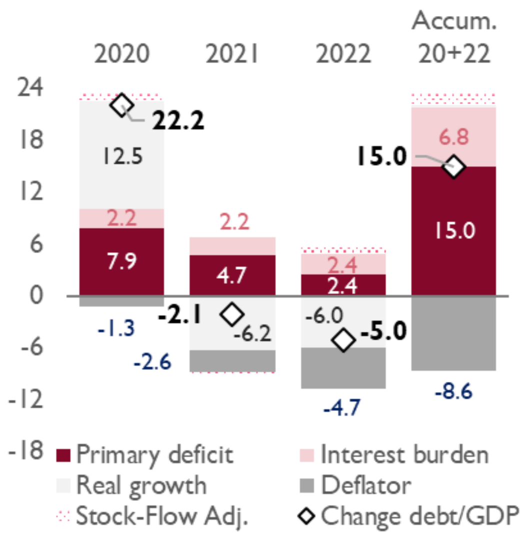


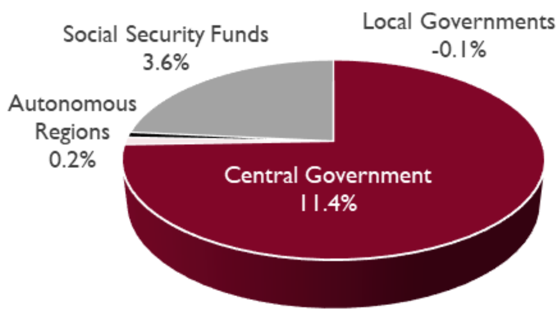
FIGURE 55. CONTRIBUTION TO THE CHANGE IN DEBT (% GDP)



Source: Bank of Spain, INE, and AIReF.

The Central Government and the Social Security Funds have borne practically all of the increase in debt over the last three 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 ARs under the ordinary regime have mitigated the increase in the debt ratio of the ARs. This ratio has only grown by 0.2 points – to 23.9% of GDP. For their part, Local Governments saw their debt fall slightly by 0.1 points.

FIGURE 56. INCREASE IN DEBT (% GDP) BETWEEN 2022 AND 2019 BY SUB-SECTOR



Source: Bank of Spain, INE, and AIReF

AIReF's macro-fiscal forecasts project for this year a reduction in the debt-to-GDP ratio of 2.6 points on the level recorded in 2022, which would place the ratio at 110.6% at the end of 2023. This forecast improves the forecast presented by the Government in the draft Budgetary Plan for 2023 of 112.4%, which is in line with the latest forecasts of the IMF and the European Commission. The public deficit will continue to contribute to the increase in debt in a similar way to 2022 and the reduction in the ratio will be mainly supported by nominal growth in GDP, where the deflator will make a very significant contribution**.**

FIGURE 57. DEBT FORECASTS BY AIREF AND THE DRAFT GSB

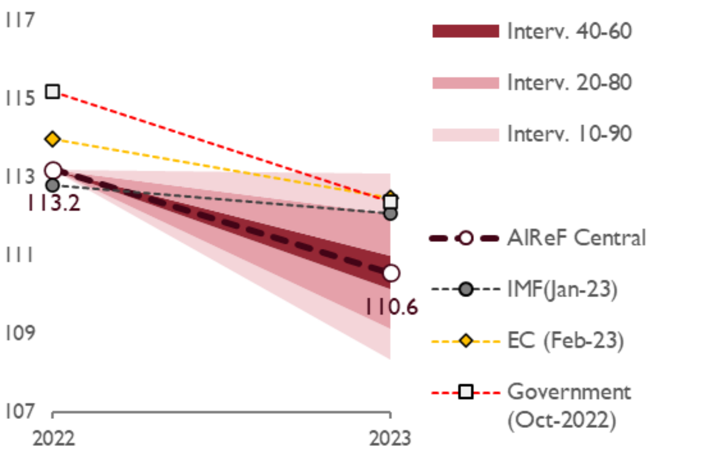
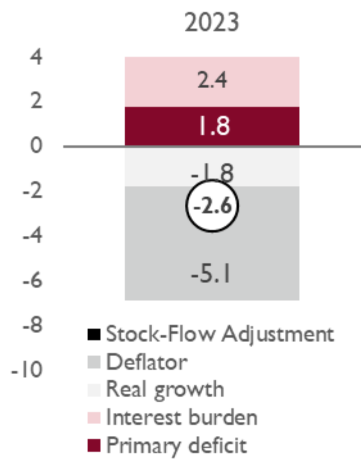


FIGURE 58. CONTRIBUTION TO THE CHANGE IN DEBT (% GDP)



Source: Ministry of Economy and Digital Transformation, IMF, EC and AIReF

2022 has marked a turning point in the evolution of debt financing costs. The low interest environment of recent years turned sharply in 2022, when central banks around the world 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.

FIGURE 59. OFFICIAL INTEREST RATES

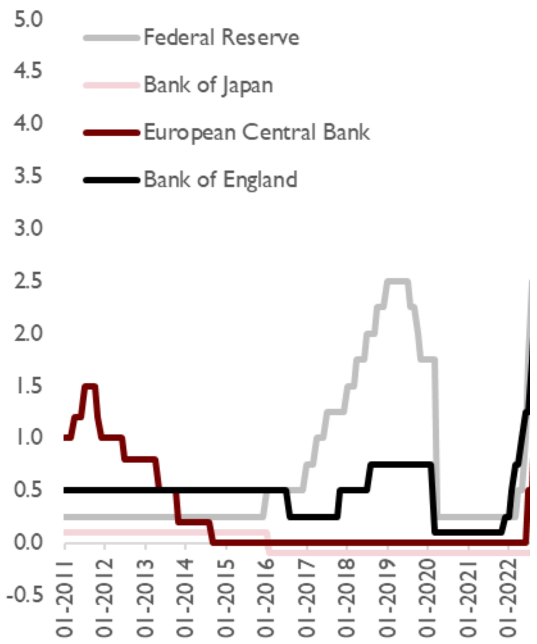
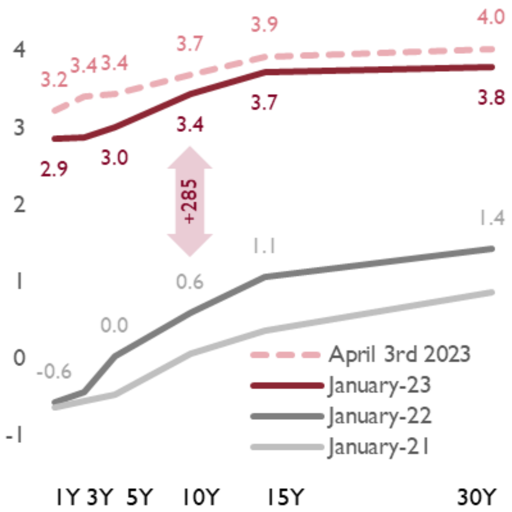


FIGURE 60. SPANISH INTEREST RATE CURVE (%)



Source: ECB and Refinitiv

After reaching its minimum in 2021, the average cost of new Treasury issues rose in 2022 from -0.04% to 1.35%, a value not recorded since 2014. This higher issuance cost has also generated a turning point in the average cost of the State debt portfolio, which has increased from its historical low of 1.64% to 1.73%.

The total interest expenditure of the GG rose by €5.6bn in 2022 to a total of €31.6bn, representing 2.4% of GDP. In 2022, interest expenditure in nominal terms has consolidated and accelerated the change in trend that began in 2021 after seven continuous years of reduction. Although the high average maturity of the debt portfolio means that higher interest rates are passed through gradually, it should be noted that the financial burden rose sharply in 2022 as a result of the increase in the debt portfolio linked to inflation, which amounted to over €8bn. However, the strong growth of the economy has made it possible for the financial burden measured as a percentage of GDP to have grown more moderately in 2022, recording a turning point after a continuous reduction for eight years.

FIGURE 61. AVERAGE COST OF STATE DEBT (%)

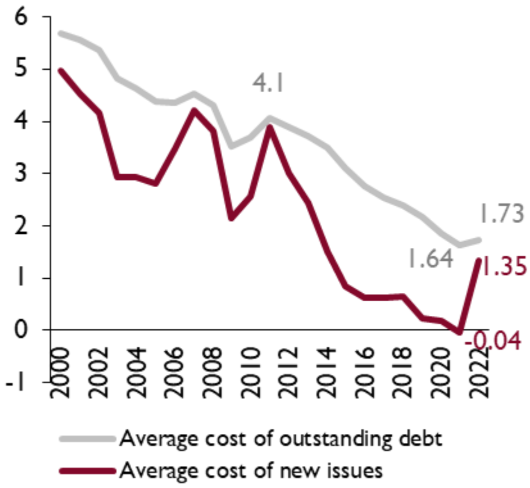
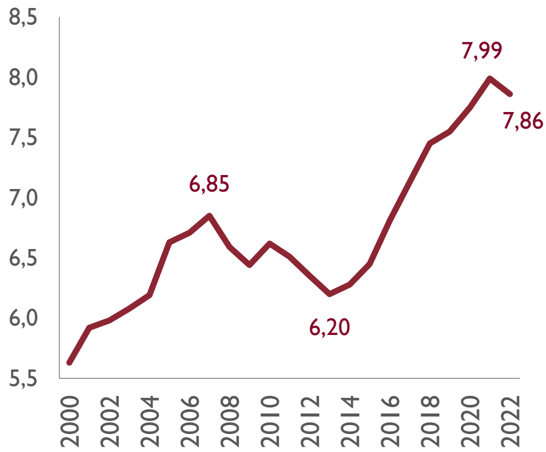


FIGURE 62. AVERAGE LIFE OF STATE DEBT (YEARS)



Source: Public Treasury

FIGURE 63. INFLATION-LINKED DEBT AND ANNUAL INCREASE

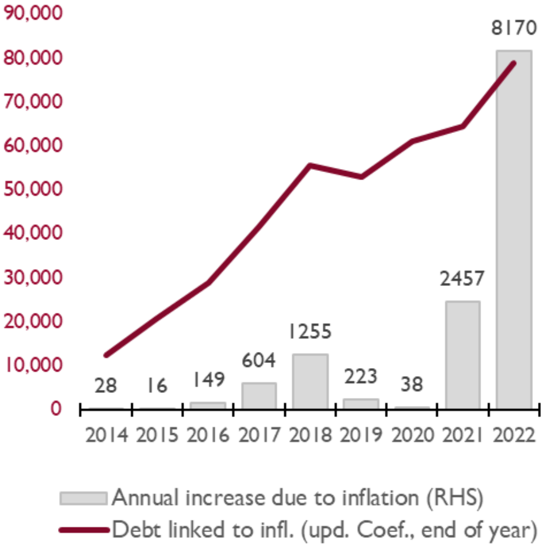
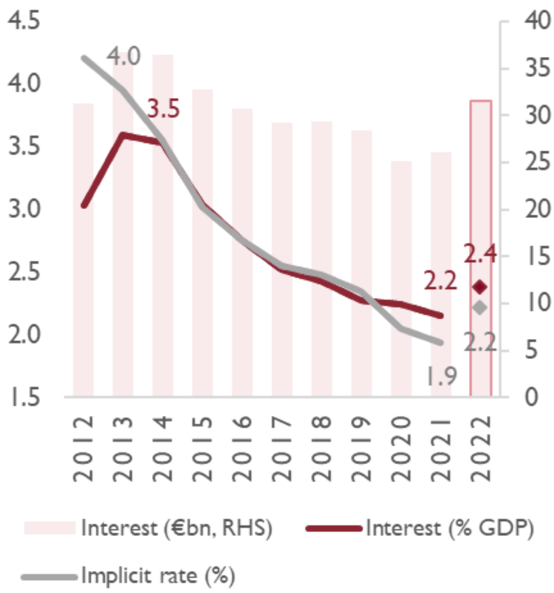


FIGURE 64. FINANCIAL BURDEN AND IMPLICIT RATE OF THE DEBT



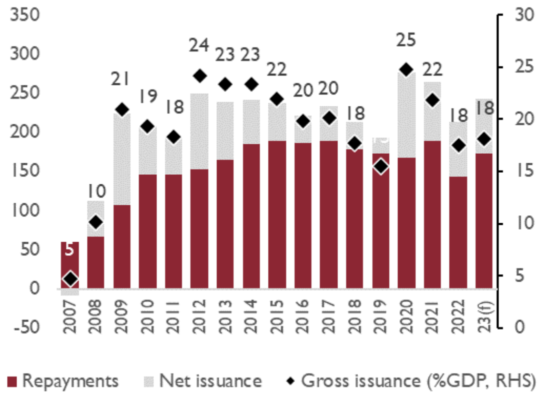
Source: Public Treasury, IGAE, AIReF

For 2023, the Public Treasury proposes a borrowing schedule similar to that of last year, maintaining the goal of net issues at the €70 billion recorded at the end of 2022. The higher volume of repayments will imply a 10% increase in gross issuance in 2023, although as a percentage of GDP they are estimated to remain at 18%, a relatively low ratio by historical standards, representing a low refinancing risk. The Treasury's financing strategy is that all net financing will be obtained through the issuance of medium and long-term instruments, with a negative net issuance of short-term instruments.

FIGURE 65. TREASURY BORROWING IN 2022 AND 2023 (€BN)

(billions of euros)	Initial forecast 2022	Executed 2022	Forecast 2023
Net borrowing	**75.0**	**70.1**	**70.0**
Gross borrowing	**237.5**	**232.6**	**256.8**
Medium and long-term			
Gross borrowing	148.1	143.2	172.5
Repayment	68.1	68.1	97.5
Net borrowing	80.0	75.1	75.0
Letras del Tesoro			
Gross borrowing	89.4	89.3	84.3
Repayment	94.4	94.4	89.3
Net borrowing	-5.0	-5.1	-5.0

FIGURE 66. TREASURY BORROWING NEEDS (€BN AND % GDP)



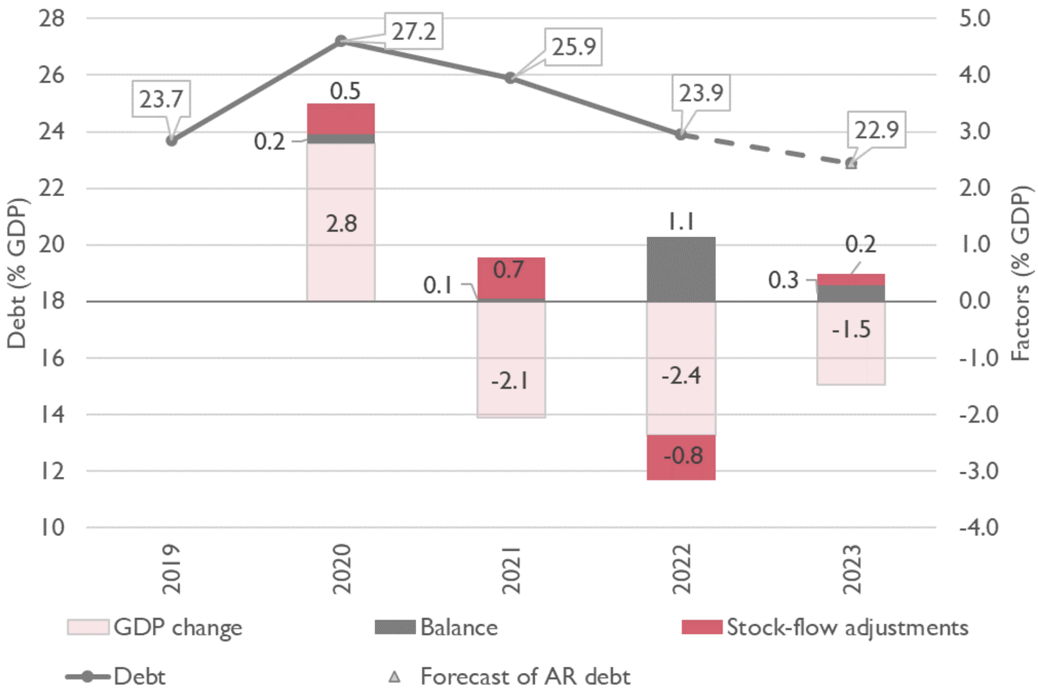
Source: Treasury and AIReF

5.2. Autonomous Regions and Local Governments

AIReF forecasts that the ARs will reduce their level of debt by 1 point in 2023, to stand at 22.9% of GDP. With the year-end 2022 figures and the new balance forecast for 2023, the volume of debt in the sub-sector rises with respect to the estimate included in the previous report. However, the increase in nominal GDP causes the debt-to-GDP ratio to fall with regard to the estimate in October. Starting from 23.9% in 2022, the ratio would improve in 2023 by 1 point to 22.9%, thanks to expected GDP growth. This growth is a positive factor only offset to a small extent by the forecast deficit for 2023 (0.3% of GDP) and the stock-flow adjustments, which would once again imply an increase in debt after 2022, a year in which they contributed to a reduction in debt or lower growth as result of application of the excess financing from previous years.

The ARs expect to reach a level of debt in line with AIReF's forecast in 2023. The ARs as a whole estimate a level of aggregate debt in 2023 in line with AIReF's forecast, on the basis of a similar overall balance forecast.

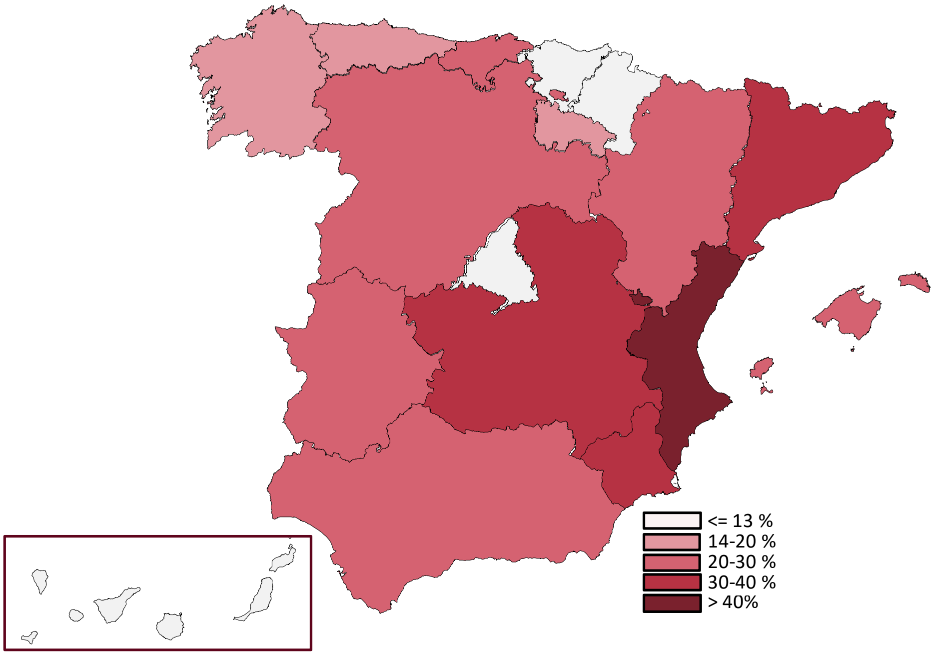
FIGURE 67. FORECAST EVOLUTION OF AR DEBT (% GDP)



Source: Bank of Spain and AIReF

The situation indicated in the Report on the Budgetary Lines would remain in place: four ARs could have a debt ratio above 30%, while another four could stand at 13%. In general, the trends recorded in the October report in relation to the level of debt to be recorded by the ARs are maintained: Valencia, Murcia, Castile-La Mancha and Catalonia could be above 30% of GDP in 2023; while in Navarre, the Canary Islands, the Basque Country and Madrid, debt may come close to 13% of GDP or even below that level.

FIGURE 68. REGIONAL DEBT-TO-GDP RATIO FORECASTS 2023 (% GDP)



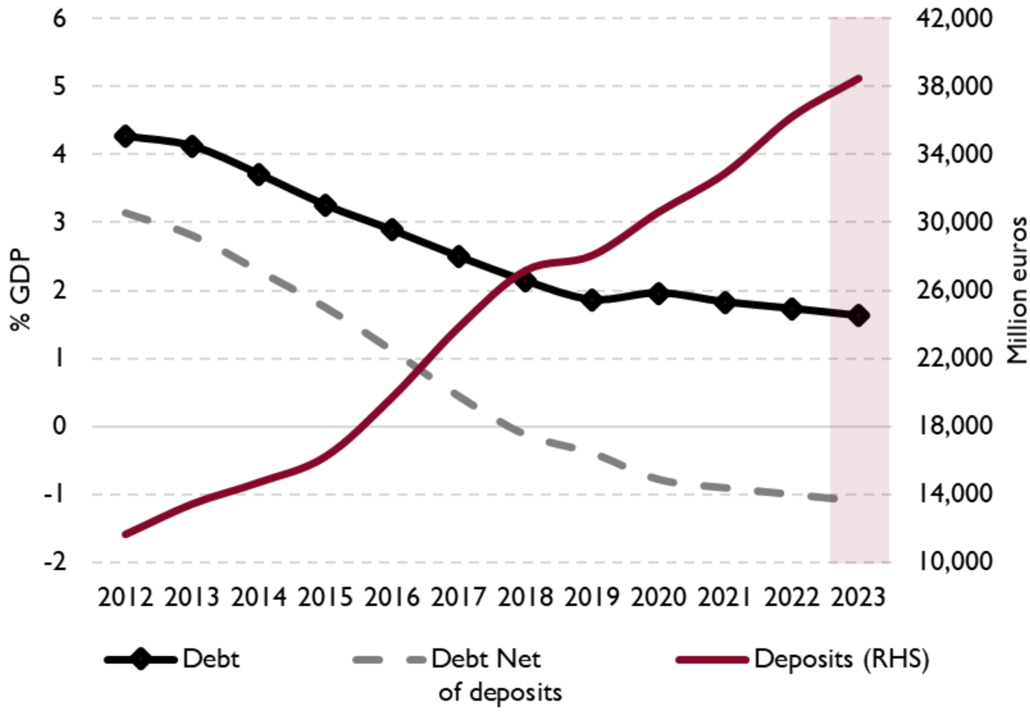
Source: AIReF

The risks of excess financing being generated in 2023 remain, although more moderate and less widespread than in previous years. As already indicated in the Report on the Main Budgetary Lines, although at the aggregate level there are no major discrepancies between AIReF's forecasts and those of the ARs as a whole, at an individual level there are some significant deviations. If the regions adjust their borrowing to their current forecasts, generally in line with the reference rate set, new debt excesses could be generated in those cases where AIReF forecasts a more positive year-end figure.

Regarding the LGs, the information available on the net asset position at the end of 2022 makes it possible to forecast the expected positive results for 2023. The latest information published by the Bank of Spain on local debt and deposits, corresponding to year-end 2022, shows an increase in both figures of around €2.4bn. This means that the sub-sector's net asset position continues to improve, which makes it possible to forecast, at least, its consolidation at the end of the year.

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 2022. It also shows AIReF's year-end forecast for 2023.

FIGURE 69. EVOLUTION OF DEBT AND DEPOSITS OF LOCAL GOVERNMENTS



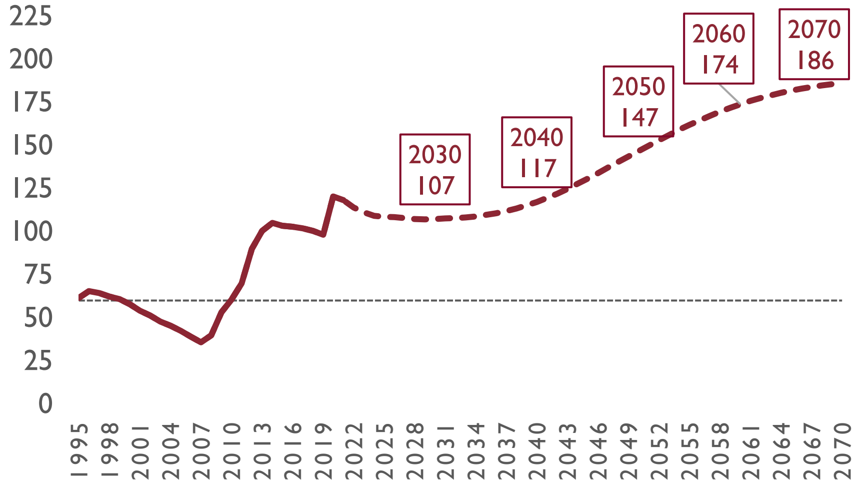
Source: Bank of Spain and AIReF estimates

5.3. Medium- and long-term risks

The new monetary cycle, together with rapid and intense tightening of financing conditions and the high level of existing debt, places the sustainability of public finances in a highly vulnerable starting position. The evolution of inflation, which is higher and more persistent than initially anticipated by the central banks, has made it necessary to intensify the restrictive monetary policy stance. This has led to sharp upturns in global sovereign debt yields and in financing expectations for the coming years. This new interest rate environment implies a major vulnerability in the sustainability of public finances, given the high debt that will have to be refinanced at significantly higher rates. In the coming years, a relatively rapid return is expected from the low of 0% recorded in 2021 to average rates for new issues of 3%. This evolution in interest rates is generating a turning point in the average total cost of debt, which will begin an upward path from the low of 1.9% to approximately 3% in the medium term.

AIReF projects an unfavourable evolution of the debt-to-GDP ratio in the medium and long term. Based on the growth projections, fiscal variables and interest rates recently published in the "*Opinion on the long-term sustainability of the General Government: the impact of demographics*", AIReF projects an increasing debt ratio following an initial period of some stabilisation. The expected increase in expenditure on pensions, healthcare and long-term care as a result of the ageing of the population is one of the main challenges for the sustainability of public finances in the medium and long term. Higher structural expenditure that is not covered by additional revenue will lead to a very significant rise in debt from levels that are already historically very high. The high stock of debt will generate a financial burden that will accelerate, even considering low financing rates.

FIGURE 70. DEBT (% GDP)



Source: AIReF, Opinion on the long-term sustainability of the General Government

The projected deterioration of the primary balance from 2030 onwards due to the ageing of the population will mark a turning point in the evolution of the debt, which will resume an accelerating upward path.

6. RECOMMENDATIONS

6.1. New Recommendations

The Stability Programme Update (SPU) is, in theory, the medium-term national fiscal plan required by European regulations. However, the SPU sent to the European institutions needs to be completed in order to be considered as a medium-term fiscal strategy that will act as fiscal guidance and to realistically and credibly ensure the financial sustainability of the GG.

For its part, the European Commission, in its Communication on the Fiscal Policy Guidance for 2023[21], has given a series of indications to the Member States to incorporate some elements of the reform of the fiscal framework in the updates of the Stability or Convergence Programmes that they present on April 30th. These elements are in line with the requirements that AIReF considers that the SPU should comply with in order to be a national fiscal strategy.

In the current context of transition towards restoring fiscal rules in 2024, there is a need to ensure prudent fiscal policy and to place debt on a sustainable path. Therefore, on the basis of realistic macroeconomic and fiscal forecasts, the SPU should establish a downward debt path and reduce the deficit below

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[21] Communication

3% of GDP, thus complying with the requirements of the European Commission.

Moreover, the SPU should integrate the macroeconomic and fiscal implications of the investments provided for in the Recovery, Transformation and Resilience Plan (RTRP). Despite the importance of the RTRP, both due to the volume of funds and because of its transformative nature for the economy, it is still not integrated into the SPU. On the one hand, no realistic path of execution of the investments in national accounting terms or their potential impact on structural spending is presented. On the other hand, it does not integrate the reforms that are part of the RTRP into its budget scenario or quantify their potential impact, nor does it include an assessment of how the planned reforms and investments will contribute to fiscal sustainability and inclusive and sustainable growth.

The uncertainty characterising the current situation requires the capacity to adapt economic policy to the possible materialisation of risks, mainly those stemming from the persistence of inflation and the energy crisis. For this reason, the SPU should incorporate a complete section on fiscal risks that, should they occur, may affect the deficit or debt and where potential measures are included in the event of contingent scenarios, explaining their impact, the assumptions under which their implementation would occur and the duration of the measures.

Finally, in a decentralised state such as Spain, the SPU should set out the information broken down by sub-sector, consistent with the aggregate information for the GG as a whole. In the SPU, the medium-term forecasts are made at an aggregated level for the GG as a whole and in national accounting terms, without developing their link with the annual budgets of the different GG authorities. For this reason, it would be necessary to add detailed information at a sub-sector level that would avoid the current fragmentation in how the budgetary process is carried out and which would make it possible to ensure consistency between its main elements: the SPU, the budgets of each authority and the budgetary plan.

Therefore, having a medium-term fiscal strategy is particularly important in the current context of uncertainty and on the eve of the reactivation of fiscal rules in 2024. In this regard, the Stability Programme Update is Spain's medium-term budget planning document, which is why AIReF considers that the time is right to set out a realistic and credible medium-term fiscal strategy that guarantees the sustainability of public finances.

AIReF therefore recommends that the Government should:

Provide the 2023-2026 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. This requires:

a) Establishing a downward debt and deficit path, complying with the requirements of the European Commission, on the basis of realistic macroeconomic and fiscal forecasts.

b) Integrating the macroeconomic and fiscal implications of the implementation of the investments and reforms set out in the Recovery, Transformation and Resilience Plan (RTRP), including an assessment of how the reforms and investments will contribute to fiscal sustainability.

c) Incorporating measures in the event of contingent scenarios, with particular detail of the measures to combat the energy crisis, explaining their impact, the assumptions under which their implementation would occur and the duration of the measures.

d) Including more complete and detailed information on fiscal risks which, should they occur, may affect the deficit or debt.

e) Adding disaggregated forecasts in national accounting terms for each sub-sector which incorporate sufficient detail of the necessary measures and the contribution to compliance with the proposed deficit and debt path.

6.2. Repeated recommendations

The Ministry of Finance and Civil Service did not publish information on the execution of the Recovery, Transformation and Resilience Plan (RTRP) in national accounting terms for 2022.

Irrespective of the fact that RTRP revenue and expenditure have a neutral effect on the deficit in national accounting terms, it is essential to identify the part of the GG revenue and expenditure that corresponds to the RTRP in accordance with national accounting. From a macroeconomic point of view, this would make it possible to know which funds are reaching the final recipient and, therefore, those that are producing effects on the economy. From a fiscal point of view, it allows an analysis of the evolution of the revenue and expenditure that are not related to the RTRP and that constitute the ordinary activity of the General Government.

Therefore, AIReF considers it essential for the analysis and monitoring of the accounts of the General Government that information on the revenue and expenditure of the RTRP that are executed in national accounting be published regularly separately from the other revenue and expenditure. This publication should coincide in time and in the detail provided with the information published by IGAE in the monthly and quarterly execution reports in national accounting terms.

In addition, in order to have complete information on the flows that occur between the sub-sectors in order to carry out the decentralised execution of the RTRP, it would be desirable to publish the amounts transferred in national accounting terms and the recipient sub-sectors of such transfers.

Therefore, **AIReF makes the following recommendations to the Ministry of Finance and Civil Service**:

1. ***Publish separately the amounts corresponding to the revenue and expenditure of the RTRP in the national accounting headings of the monthly and quarterly execution reports published by the IGAE and in the data at year-end.***
2. ***Publish the breakdown in national accounting of the amount transferred and the recipient sub-sector of the current and capital transfers between the GG corresponding to the RTRP of the different sub-sectors.***

The President of AIReF

Cristina Herrero Sánchez