Report on Budgetary Execution, Public Debt and Expenditure Rule of the General Government 2023

AIReF

July 6th, 2023

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1 Introduction

Legal mandate to report on budgetary execution, public debt and expenditure rule by July 15th (Article 17 of Law 6/2013)

Takes place once again in a context of suspended fiscal rules

- ✓ The economic and fiscal forecasts for 2023 are updated with the new information available
- ✓ Analysis of the General Government (GG) as a whole and all sub-sectors: Central Government (CG), Social Security Funds (SSFs), Autonomous Regions (ARs) and Local Governments (LGs)
- ✓ Individual analysis of the 17 ARs. Regional elections lead to postponement of AIReF's medium-term scenarios
- ✓ Individual analysis of 24 large LGs and Local Governments with sustainability risks are not included, which will be published in the last week of July

High level of uncertainty with regard to the application of the fiscal framework with a view to the process for the preparation of the budgets for 2024 that will take place in the second half of the year

- ✓ The budgetary cycle and the process to set the targets have been affected by the calling of general elections and the dissolution of Parliament
- ✓ There is also uncertainty regarding the reform of the European and national fiscal frameworks
- ✓ Certainties:
  - Deactivation of the European and national escape clause. ➡ Fiscal rules will be introduced in 2024
  - CSR 2024: limitation on growth in spending
- ✓ AIReF formulates recommendations to limit uncertainty in 2024 and promote the consistency of the National Budget with European guidelines

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Macroeconomic scenario

AIReF updates its macroeconomic outlook for 2023 and improves its GDP growth forecast to 2.3%

Most recent evolution of indicators of economic situation

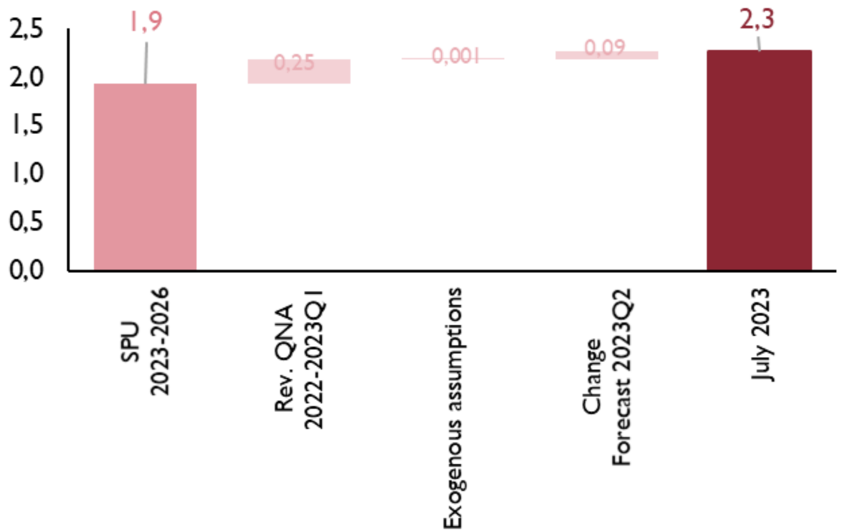
Update of exogenous assumptions (raw material prices, euro area growth, interest rates, etc.)

Latest National Accounts data

Year-on-Year Rates of Change	2022	2023	Revision Compared With 2023
Private Domestic Final Consumption Expenditure	4,4	0,8	-0,2
General government Final Consumption Expenditure	-0,7	1,3	0,0
GFCF	3,5	2,0	0,3
GFCF Equipment and Cultivated Assets	*4,1*	*1,0*	-0,2
GFCF Construction and Intellectual Property	4,9	2,6	0,0
Domestic Demand*	**3,1**	**1,1**	**-0,03**
Exports of Goods and Services	14,4	6,1	0,1
Imports of Goods and Services	7,9	3,5	-0,8
External Balance*	**2,4**	**1,1**	**0,37**
Gross Domestic Product	**5,5**	**2,3**	**0,34**
Nominal Gross Domestic Product	**10,0**	**7,2**	**0,36**
Gross Domestic Product Deflator	**4,3**	**4,8**	**0,00**
CPI	**8,4**	**3,7**	**-0,31**
Full-Time Equivalent Employment	3,8	1,5	0,1
Unit Labour Cost	0,4	4,0	0,1
Productivity per Full-Time Employee	1,6	0,8	0,3
Remuneration per Salaried Worker	2,0	4,8	0,4
Unemployment rate (% of Active Population)	12,9	12,4	-0,1
Household and NPISH Savings Rate (% Gross Disposable Income)	7,2	8,3	1,1

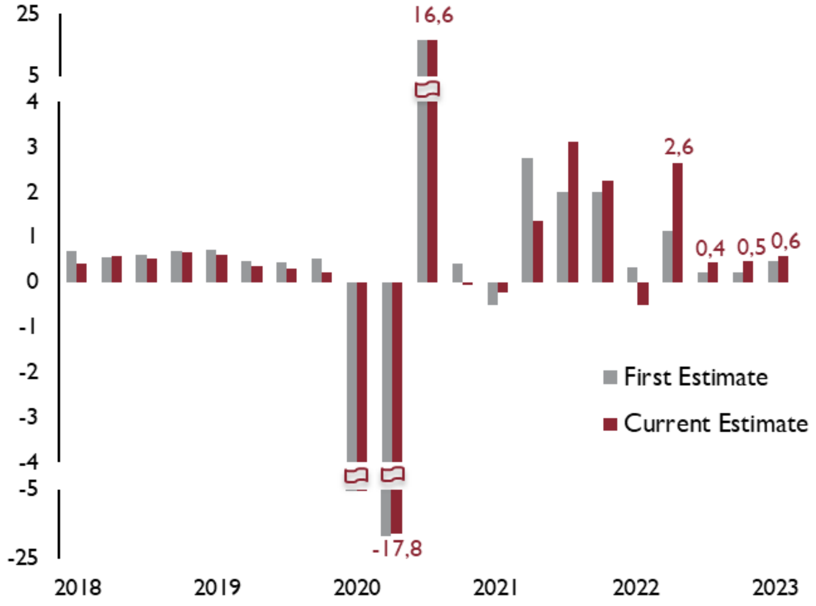
The revision mainly follows the incorporation of National Accounts figures published in June

DECOMPOSITION OF THE SOURCES OF THE REVISION OF THE GDP GROWTH RATE IN VOLUME TERMS FOR 2023 COMPARED WITH THE MACROECONOMIC SCENARIO OF THE SPU



Source: AIReF

QUARTER-ON-QUARTER RATE OF CHANGE OF REAL GDP. FIRST ESTIMATE COMPARED WITH CURRENT ESTIMATE (%)



Source: INE

The upward revision in the GDP growth figures for the first quarter of 2023 compared with those published in the advance figures of the QNA in April, together with the change in quarterly growth profile for 2022 amount to a mechanical revision of the estimate for 2023 of 0.25 percentage points

The revision of exogenous assumptions barely affects growth expectations for 2023

EXOGENOUS ASSUMPTIONS OF AIREF'S MACROECONOMIC OUTLOOK FOR 2023

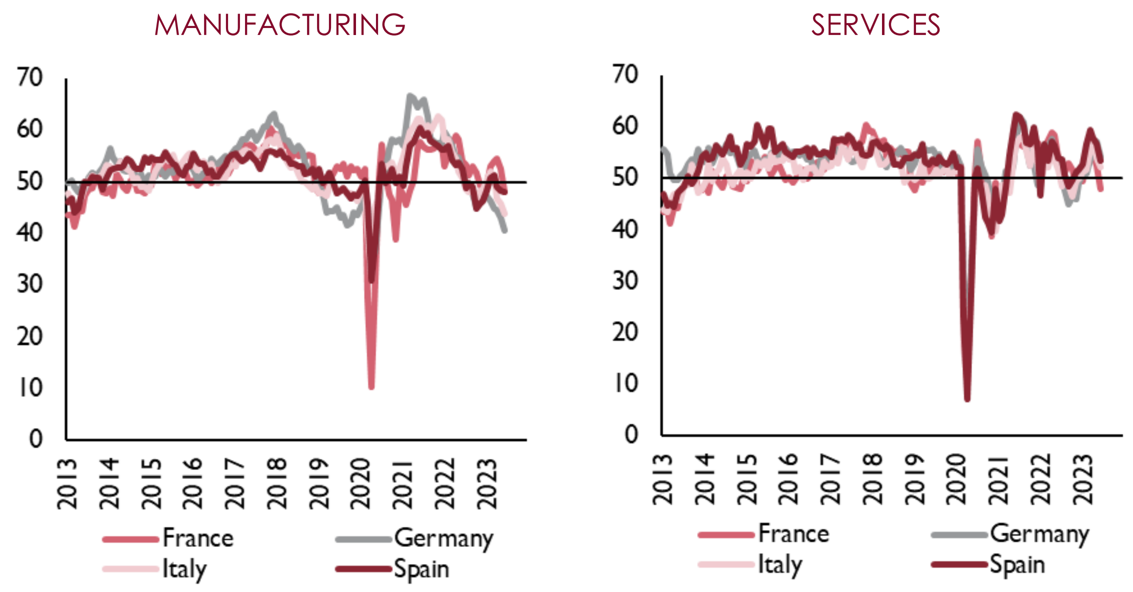
	2022	2023	Revision 2023
3-month Euribor (%)	0,3	3,4	▲ 0,1
10-year Government debt Interest Rate (%)	2,2	3,3	▼ -0,2
Extended NEIR	116,8	121,9	▲ 0,5
Exchange rate $/€	1,05	1,08	▼ 0,0
Oil ($/Barrel)	103,7	77,7	▼ -5,3
Gas TTF (€/Mwh)	132,2	43,6	▼ -6,5
MIBGAS (€/Mwh)	99,0	41,8	▼ -4,5
Export measures (% annual)	7,9	1,9	▬ 0,0

Source: IMF, Refinitiv and MIBGAS

The impact on expected economic growth of containment in advance perspectives of energy raw material prices and long-term interest rates is modest and counteracted by the worse than expected evolution of short-term rates

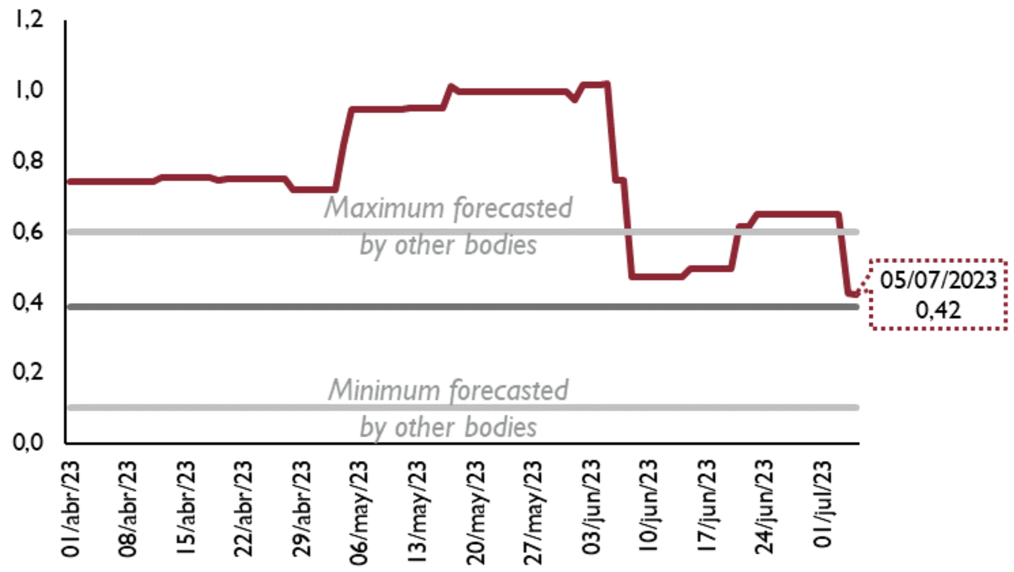
The positive trend of the economic situation indicators would also lead to an upward revision of growth expectations for 2023

SERVICES AND MANUFACTURING INDUSTRY PMIS IN DIFFERENT EURO AREA COUNTRIES (>50 INDICATES EXPANSION/<50 INDICATES CONTRACTION)



Source: S&P Global

COMPARISON OF REAL-TIME EXPECTATIONS FOR QUARTER-ON-QUARTER RATE OF GDP IN VOLUME TERMS. SECOND QUARTER OF 2023 (%)



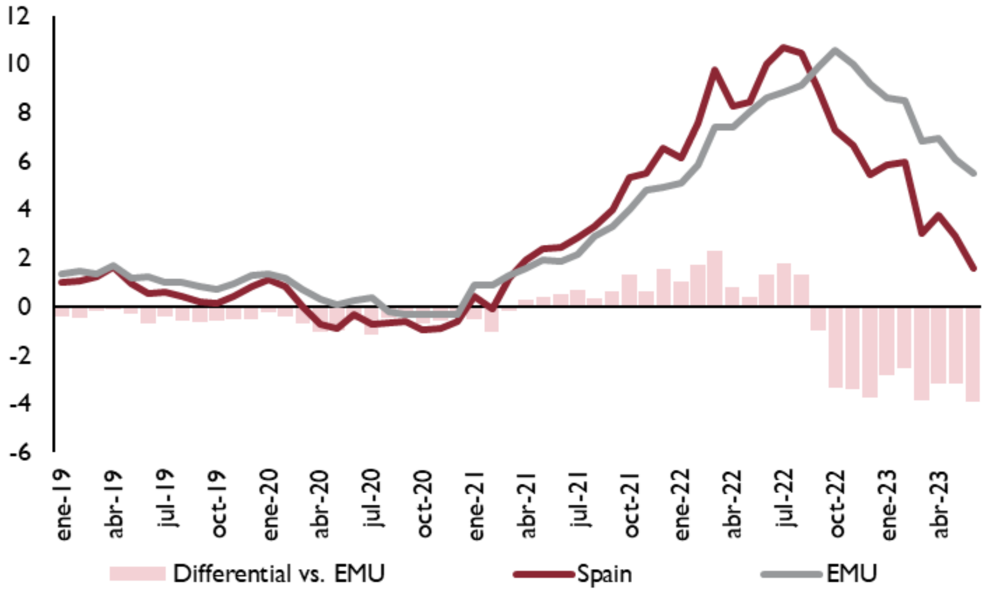
Source: AIReF, FUNCAS Panel, Consensus Forecasts, EsadeEcPol and Oxford Economics

The indicators on industrial activity point to the stagnation or decline in production of this sector, while services remain in expansion, although with a less favourable outlook compared with the early months of the year given the worsening of the global context

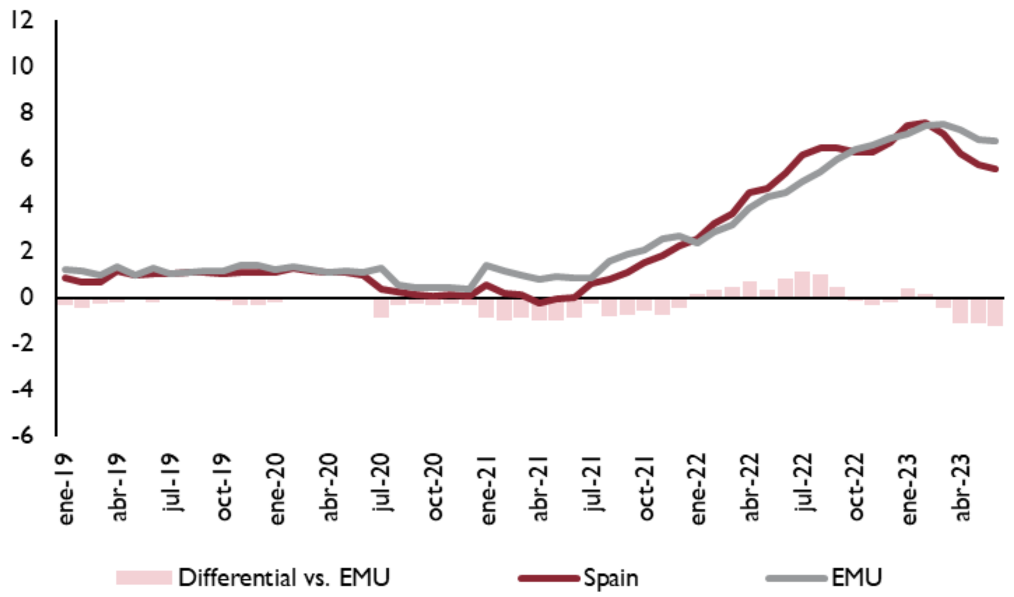
General inflation has moderated significantly, although strong persistence of core inflation is observed

HARMONISED INDEX OF CONSUMER PRICES (HICP). COMPARISON SPAIN-EMU.
YEAR-ON-YEAR CHANGE

IPCA



HICP EXCLUDING ENERGY AND UNPROCESSED FOODS



Source: Eurostat

Once the base effects observed in the third quarter of 2022 disappear, the containment of inflation may be halted by the drought, the acceleration of negotiated wages following the moderation in the previous year and the expansion of business margins

Risk factors: persistence of inflation, weakness of global economic activity and worsening of geopolitical tensions

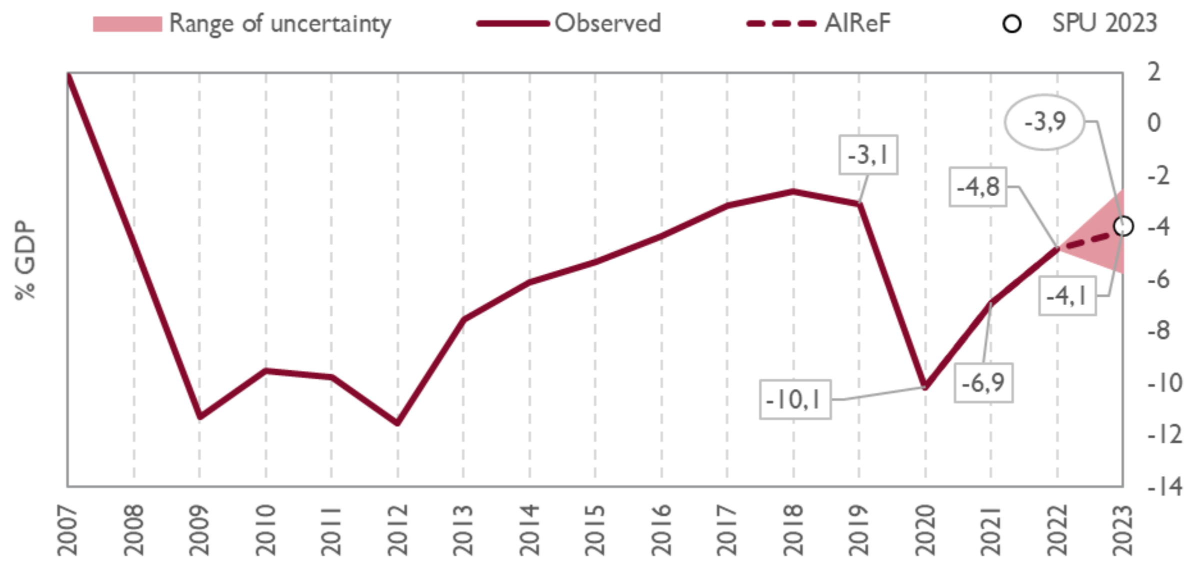
MAIN RISK FACTORS TO MACROECONOMIC OUTLOOK

Persistence of high core inflation in euro area as a whole	Continuation or worsening of geopolitical tensions and global trade
Worsening of growth perspectives of global economy	Rate of implementation of Recovery, Transformation and Resilience Plan (RTRP)

3 Fiscal scenario

AIReF estimates GG deficit of 4.1% of GDP for 2023

EVOLUTION OF GG BALANCE (% GDP)



Source: IGAE and AIReF

AIReF maintains the same deficit forecast for 2023 as in the previous report and revises both revenue and expenditure upwards

The improvement in the macroeconomic scenario and new information offset the cost of the new measures

Report on SPU (May 12th, 2023)

GG deficit 2023

- 4.1% GDP

GG	**-4,1**
CG	-3,4
SSFs	-0,6
Ars	-0,3
LGs	0,2

Measures: -0.2% GDP

- Measures to tackle energy crisis and drought under RDL 4/2023 and RDL 5/2023

New information: +0.1% GDP

Change in valuation of measures
Execution and collection data

Macro effect: +0.1% GDP

- Denominator effect
- Rise in social contributions

Report on Budgetary Execution (July 6th, 2023)

GG deficit 2023

- 4.1% GDP

GG	**-4,1**
CG	-3,4
SSFs	-0,5
Ars	-0,4
LGs	0,2

The deficit of the SSFs improve by 0.1 points, while the balance of the ARs worsens (0.1 points) as does the balance of the CG (less than 0.1 points)

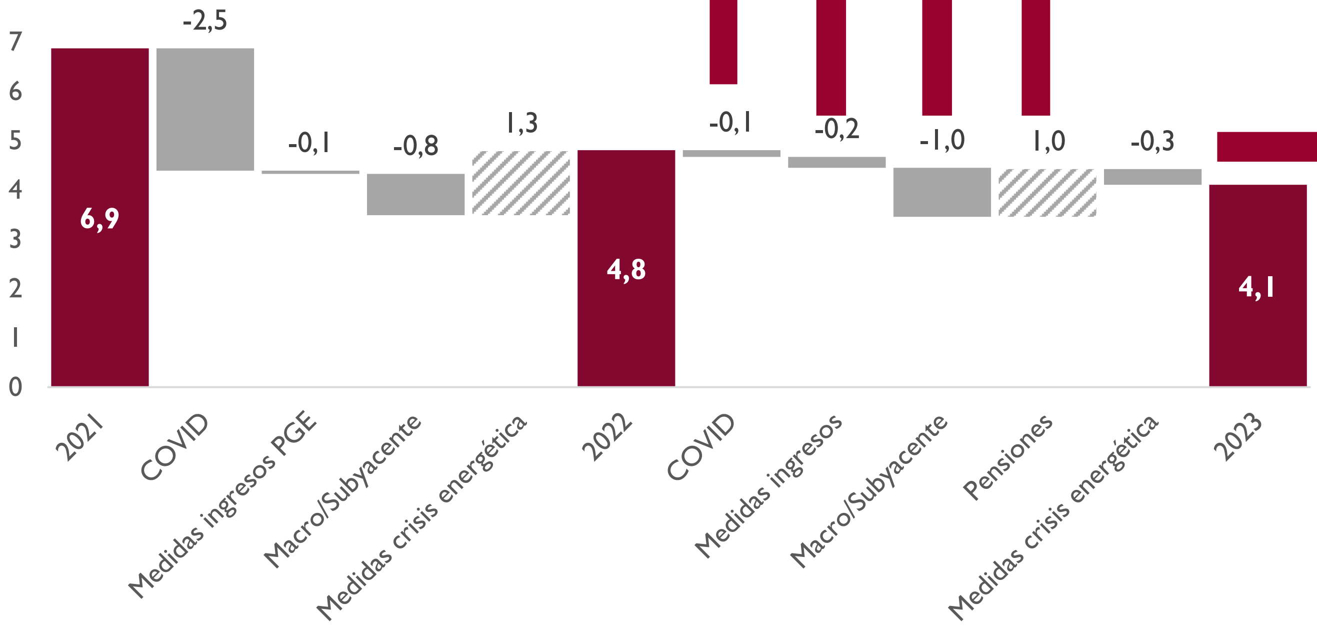
The deficit reduction of 0.7 points of GDP compared with 2022 is driven by several factors

COVID measures:
The cost of the COVID measures still contribute 0.1 points to the reduction

Revenue measures:
- IEM
- Maximum contribution rates

Macro/core:
Rise in revenue and inertial expenditure…

Pensions:
… offset by the rise in pensions



Measures under RDL 20/2022, RDL 4/2023 and 5/2023
- Measures to alleviate the energy crisis, price rises and drought
- Reduction in their cost compared with 2022

The cost of the measures to alleviate the energy crisis, price rises and drought amount to 1.1% of GDP in 2023

Impact 2022 in National Accounting terms (€m)	Measures approved before start of 2023	Measures approved in 2023 (RDL 4/2023 and RDL 5/2023)	Total impact in 2023
Revenue Measures	**-5.907**	**-521**	**-6.428**
VAT	**-3.869**	**-521**	**-4.390**
VAT on Electricity Reduction to 10% of electricity rate RDL 12, 17 and 29/2021 and 6/2022 up to June 30th, 2022) Reduction to 5% from July 1st, 2022 (RDL 11/2022 and 20/2022 up to December 31st, 2023)	-2.383		-2.383
VAT on gas, briquettes and pellets Reduction in gas rate to 5% (RDL 17/2022 and 20/2022 up to December 31st, 2023)	-704		-704
VAT on food			
Reduction from 4% to 0% on basic necessity food	-643	-429	-1.072
Reduction from 10% to 5% on oils and food pastas	-139	-92	-231
(RDL 20/2022 up to June 30th, 2023, RDL 5/2023 up to			
ST	**-2.038**		**-2.038**
ST on Electricity Reduction in rate on electricity (RDL 17, 29/2021 and 6, 11/2022 up to December 31st, 2022) (RDL 20/2022 up to December 31st, 2023)(RDL 20/2022 hasta 31-12-2023)	-2.038		-2.038
Expenditure Measures	**7.198**	**1.706**	**8.904**
Fuel discount	1.355	312	1.666
Sector support	2.680	849	3.529
Direct support for individuals	600		600
Rest of support for individuals	2.396	546	2.942
Support for refugees	167		167
TOTAL	**-13.105**	**-2.227**	**-15.332**
TOTAL (% GDP)	**-0,9**	**-0,2**	**-1,1**

AIReF includes the cost of the measures approved under RDL 4/2023 and RDL 5/2032 in its estimate, which amounts to a cost increase of 0.2 points of GDP

AIReF has also revised the valuation of the measures according to the new information available and the new macroeconomic outlook

The rest of the revenue measures approved will raise revenue in 2023 by more than 0.2 points of GDP

Central Government revenue measures	Regulation	Total impact in 2023	
		M€	% GDP
Structural revenue measures		**-565**	**0,0**
PIT		**-1.334**	**-0,1**
Reduction in contribution limit to pension plans from 2,000 to 1,500	GSB22	149	0,0
Increase in reduction of income from work and minimum taxation	GSB23	-1.247	-0,1
Increase in maternity deduction	Budgetary Plan 2023	-222	0,0
PIT – Increase in exemption to provide guarantee for deferment up to €50,000	Order HFP/311/2023	-14	0,0
Corporate Income Tax		**421**	**0,0**
Establishment of 15% minimum rate on taxable income.	GSB22	400	0,0
40% reduction on discount under property lease regime.	GSB22	21	0,0
VAT		**-258**	**0,0**
5% rate reduction on feminine hygiene products	GSB23	-24	0,0
Increase in exemption to provide guarantee for deferment up to €50,000	Order HFP/311/2023	-234	0,0
OTHERS		**606**	**0,0**
Tax on Single-Use Plastics.	Law 7/2022	606	0,0
Temporary income measures		**4.047**	**0,3**
PIT		**-346**	**0,0**
Deductions for home refurbishments.	RDL 19/2021	-30	0,0
Reduction estimated target crop and livestock farming yield	Order HFP/405/	-123	0,0
Increase in hard-to-justify expenses (direct estimate)	GSB 2023	-51	0,0
Additional reduction on net yield (objective estimate)	GSB 2023 and HFP/1172/2022	-142	0,0
CIT		**851**	**0,1**
Limitation on offsetting losses in consolidated groups.	GSB23	851	0,1
OTHERS		**3.543**	**0,2**
Equity Provision Financial Institutions	Law 38/2022	1.274	0,1
Equity Provision Energy Companies	Law 38/2022	1.634	0,1
Solidarity Tax on Large Fortunes	Law 38/2022	635	0,0
TOTAL		**3.482**	**0,2**

- AIReF considers that the rest of the revenue measures will contribute an additional €3.5bn in 2023
- Structural measures account for a reduction in revenue of more than €500m
- Temporary measures increase tax collection by €4bn

- This estimate is updated with the latest information available

AIReF raises its estimate of the level of revenue slightly to 42.7%

	2023 (Rep. SPU)
REVENUE	**42,6**
TAXES	24,9
On production	11,8
On income	12,6
Capital	0,5
CONTRIBUTIONS:	13,6
Other revenue	4,1

Measures: -0.1% GDP

- Extension of VAT rates on food

New information: +0.2% GDP

- Change in valuation of measures

Neutral macro effect

- Denominator effect
- Increase in contributions

	2023 (Current)
REVENUE	**42,7**
TAXES	24,8
On production	11,7
On income	12,6
Capital	0,5
CONTRIBUTIONS:	13,7
Other revenue	4,2

- The new measures approved are offset by the new information to update the cost of the measures and the latest tax collection data
- The increase in contributions is due to the higher forecast remuneration of salaried workers

AIReF raises its estimate of the weight of expenditure slightly to 46.8% of GDP

	2023 (Rep. SPU)
EXPENDITURE	**46,7**
Compensation of employees	11,3
Intermediate Consumption	5,8
Social transfers in kind via market	2,9
Social benefits in cash	17,5
Interest	2,4
Gross capital formation	2,8
Subsidies and other expenditure	4,1

Measures: +0.1% GDP

- RDL 4/2023
- RDL 5/2023

New information: +0.1% GDP

- Higher execution than forecast

Macro effect: -0.2% GDP

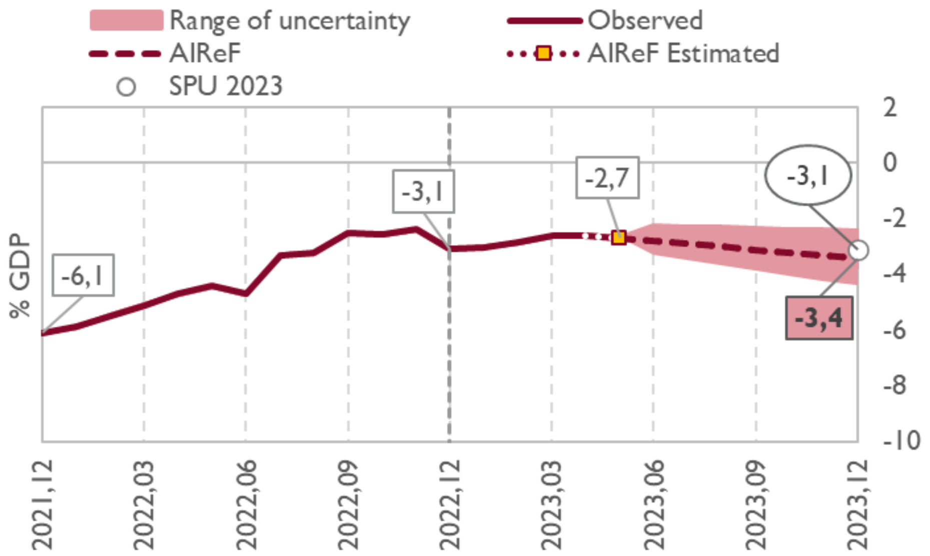
- Denominator effect

	2023 (Current)
EXPENDITURE	**46,8**
Compensation of employees	11,3
Intermediate Consumption	5,8
Social transfers in kind via market	2,8
Social benefits in cash	17,5
Interest	2,4
Gross capital formation	2,8
Subsidies and other expenditure	4,1

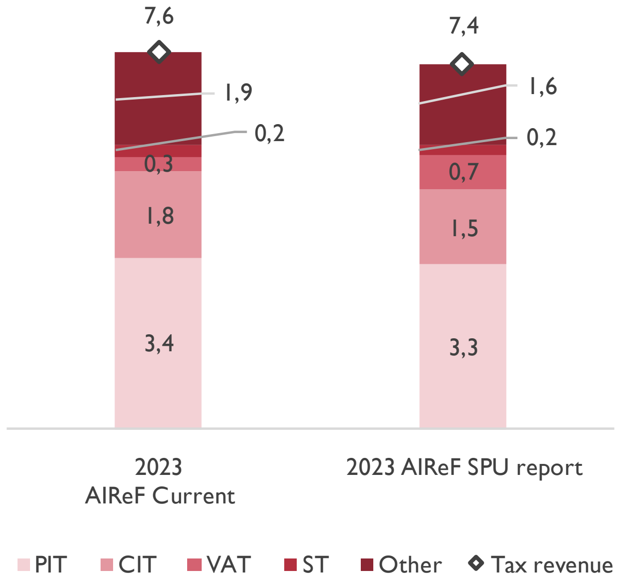
The denominator effect from higher GDP offsets the rise in spending as a result of the approval of new measures and new information

Central Government: AIReF estimates a deficit of 3.4% of GDP in 2023, in line with its previous forecast

AIREF FORECASTS CG BALANCE (% GDP)



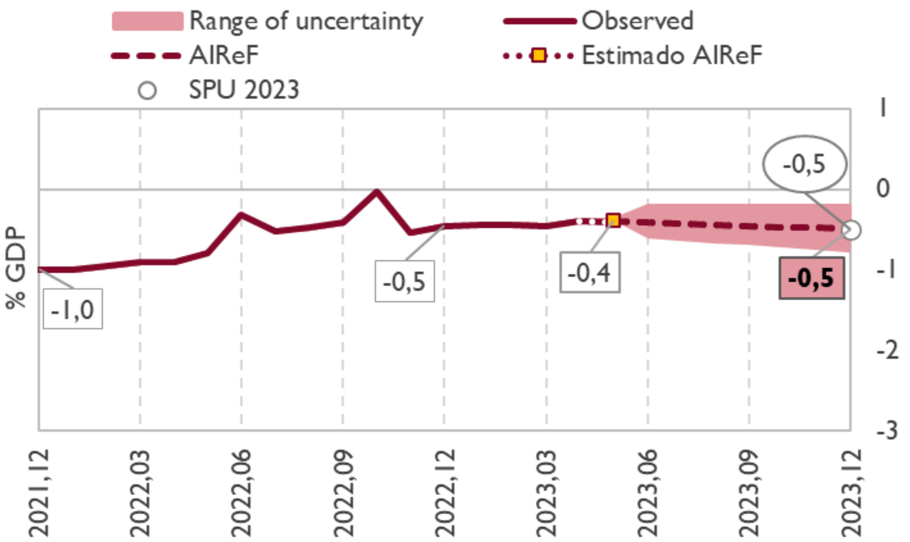
TAX REVENUE UNDER COMMON TAX REGIME. NATIONAL ACCOUNTS (% CHANGE)



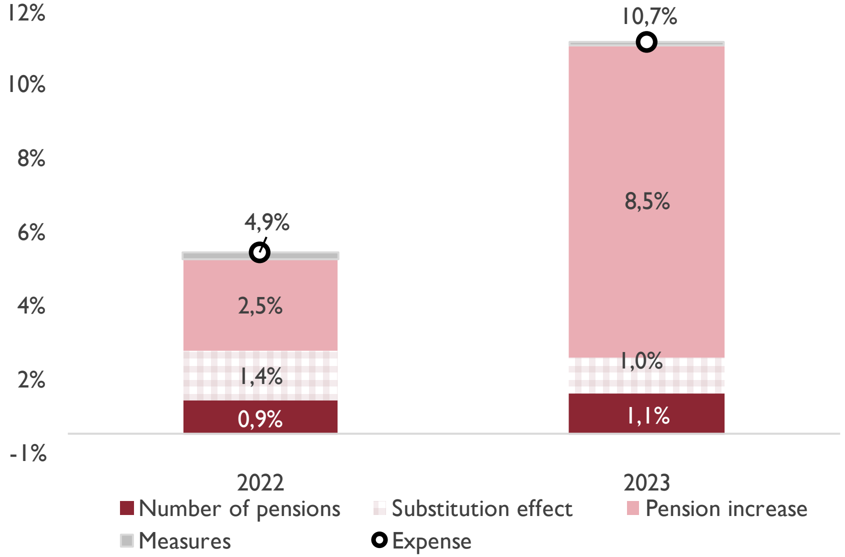
- The deficit forecast is raised slightly, by less than 0.1 points, and hence remains at 3.4% of GDP
- The cost of the new measures, assumed by the CG, is largely offset by the better tax collection forecast due to the latest information available

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

AIREF FORECASTS SSF BALANCE (% GDP)



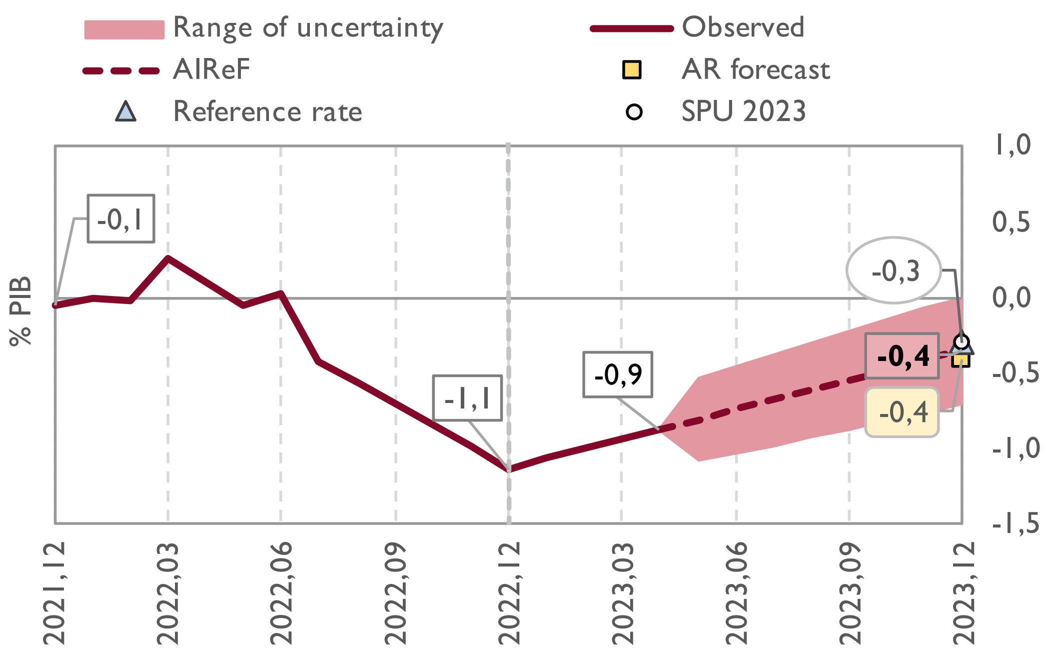
GROWTH IN PENSION EXPENDITURE (% CHANGE)



- AIReF raises its estimate of pension expenditure for 2023 to 10.7% due to the new information published
- However, the dynamism of contributions more than offsets the increase in expenditure and leads the downward revision of the deficit of the SSFs by 0.1 points

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

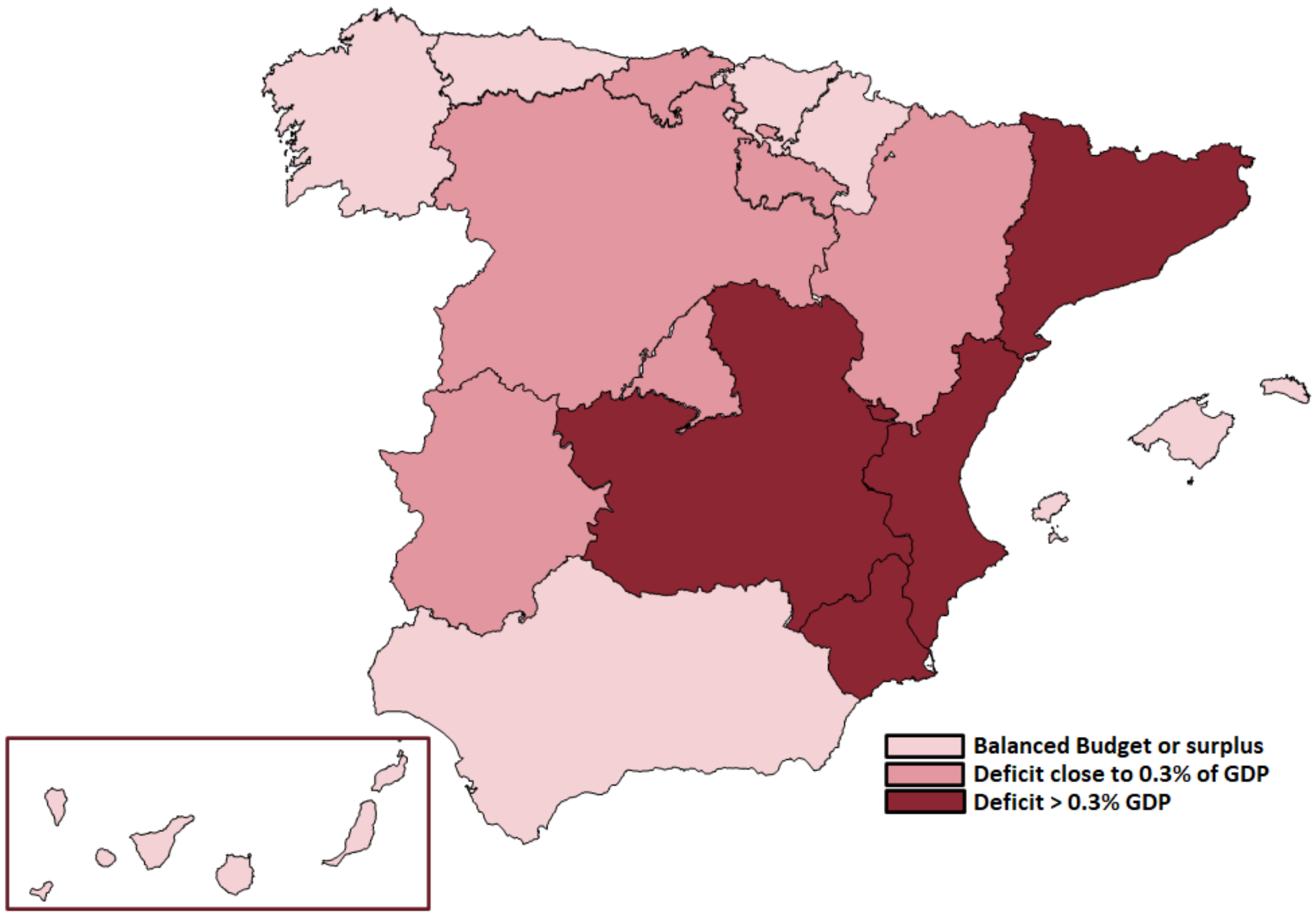
AIREF FORECASTS AR BALANCE (% GDP)



	Year-end 2022	AIReF forecast 2023	"% change 23/22"
Net revenue without RTRP	**200**	**221**	*10*
SFA neto	110	136	*24*
Compensation	8		
TATDLA	12	11	*-6*
ISD	3	3	*-2*
Other non-RFS taxes	11	12	*7*
Other revenue	56	58	*4*
REACT revenue	*3*	*3*	*5*
Other	*54*	*56*	*4*
Net expenditure without RTRP	**215**	**226**	***5***
Health*	86	91	*6*
Education*	52	55	*6*
Other expenses*	77	80	*3*
Of these, REACT expenses	*3*	*3*	*5*
COVID Line aid for companies	*1*		*-100*
Cap./nec. financing	**-15**	**-5**	
Cap./nec. financing % GDP	**-1,1**	**-0,4**	

- The revision of the deficit of the sub-sector to 0.4% of GDP can be explained by the increase in the expenditure forecast
- The aggregate forecasts of the ARs also worsen by 0.1 points, to stand in line with AIReF's estimates
- The improvement in the balance in 2023 compared with 2022 can be explained by the Regional Financing System (RFS):
  - ✓ Settlement: changes from negative in 2022 to positive in 2023
  - ✓ Payments on account grow by 10.7%

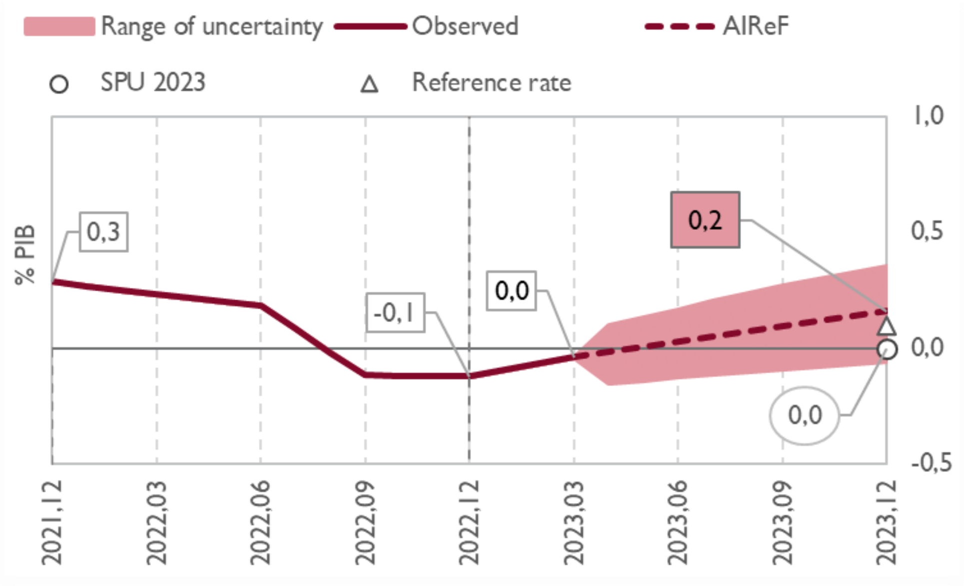
At an individual level, only four ARs will close 2023 with a higher deficit than the 0.3% set for the sub-sector



- The forecasts worsen for eight ARs and improve for three:
  - Six ARs will close the year with a deficit close to the reference rate and four with a higher deficit
  - The rest will close with a balanced budget or a surplus
- The individual reports are published for each AR
- The detailed information on the forecasts and data observed can also be found in the MONITOR OF ARs

LGs: AIReF maintains its surplus forecasts

AIREF FORECASTS LG BALANCE (% GDP)

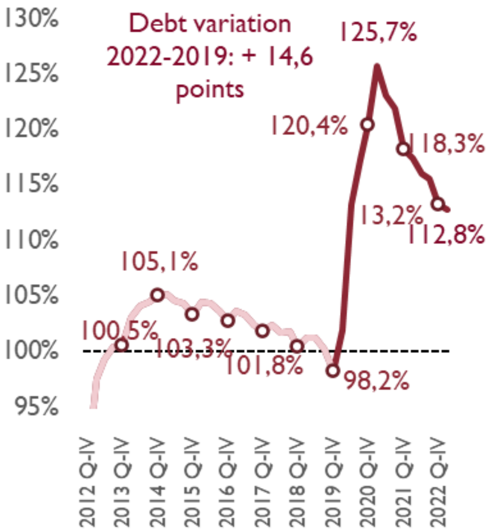


- AIReF forecasts growth in expenditure calculated for 2023 at 4%, following growth of 11% in 2022

- The effect of the compensation received from the State under the settlement of the financing system for 2020, along with the positive settlement of 2021, drive the surplus forecast for 2023
- Excluding the extraordinary compensation in 2022 and 2023 and the previous years' settlements, the balance in both years will be close to a balanced budget

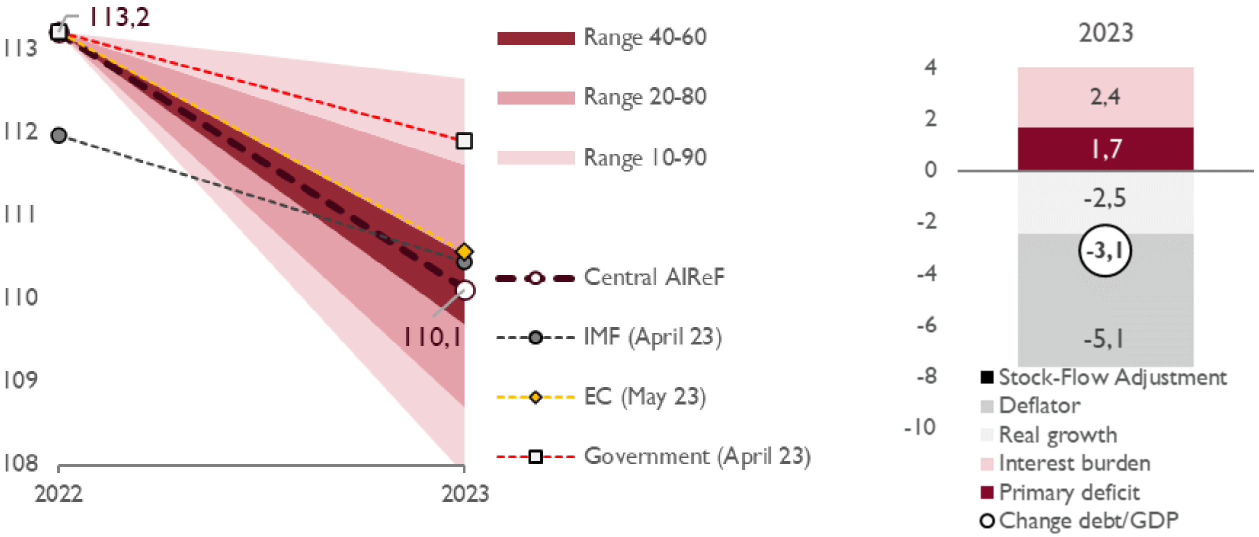
Evolution of debt and forecast for 2023

EVOLUTION OF DEBT (% GDP)



Source: Bank of Spain, INE and AIReF

DEBT FORECAST (% GDP) AND CONTRIBUTIONS TO CHANGE (GDP POINTS)



Source: AIReF

- The Spanish debt-to-GDP ratio stood at 112.8% in the first quarter of 2023, which amounts to a reduction of 0.4 points on year-end 2022, and a rise of 14.6 points on the pre-pandemic level
- AIReF's macro-fiscal forecasts point to a reduction in the debt-to-GDP ratio of 3.1 points this year compared with the level recorded in 2022, which would place the ratio at 110.1% at year-end 2023
- The new monetary cycle, together with the high level of existing debt, place the sustainability of the public finances in a situation of vulnerability

4 Recommendations

Recommendation to the Ministry of Finance

With a view to the preparation of the budgets of all of the GG sub-sectors, AIReF proposes reference rates of growth in primary expenditure net of revenue measures for the different sub-sectors that take into account the temporary or structural nature of revenue and expenditure for each sub-sector for 2024 in such a way that is coherent with compliance with the Country Specific Recommendation issued by the Council of the European Union

- Institutional uncertainty: reform of the European fiscal framework is still in the preliminary phase, the reform of the national framework is not yet underway, and the calling of general elections has taken place before the approval of the stability targets and the expenditure rule

- Country Specific Recommendation for 2024: limitation on growth of primary expenditure net of revenue measures financed nationally to 2.6% in 2024

- Risk of non-compliance with the recommendation: if the balance of the AR and LG sub-sectors stand in line with the forecast under the Stability Programme in 2024, the growth in primary expenditure net of revenue measures of the GG could amount to 4%

Recommendations to ARs and LGs

ARs and LGs under common regime

Avoid increased spending and revenue reductions of a structural nature financed by the increase in temporary revenue that will take place in 2024 and take into account the application of the expenditure rule in 2024, even though this means temporarily obtaining a surplus

- Processes to begin the preparation of the 2024 budgets begin in a situation of institutional uncertainty
- The ARs under the common regime and LGs will receive temporary revenue in 2024 stemming from the settlement of the financing systems relating to 2022
- Risk of financing increased expenditure and reductions in structural revenue stemming from temporary revenue
- According to prevailing legislation, the reference rate for the national expenditure rule would stand at around 3%

Foral ARs and LGs

Avoid increased spending and revenue reductions that do not have permanent financing and take into account the application of the expenditure rule in 2024

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