

# REPORT ON THE MAIN LINES OF THE BUDGETS OF THE GENERAL GOVERNMENT 2024

REPORT 49/23

EXECUTIVE SUMMARY

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Independent Authority  
*for* Fiscal Responsibility



## EXECUTIVE SUMMARY

The Independent Authority for Fiscal Responsibility, AAI (AIReF), must report on the projects and main lines of the budgets of the General Government (GG). Given the fact that the General State Budget (GSB) for 2024 has not been presented, the Budgetary Plan is shaped as the main milestone in Spain's fiscal strategy for this year. Accordingly, AIReF reports on the macroeconomic forecasts that underpin it, along with its budgetary scenario and the main lines of the budgets of the Autonomous Regions (ARs). This report also updates the macroeconomic and fiscal forecasts at constant policies until 2028 to strengthen the medium-term approach of the fiscal situation of the GG. AIReF has been recommending this medium-term vision to the different GG sub-sectors as the framework for the development of their budgetary procedures.

Previously, AIReF endorsed the macroeconomic forecasts contained in the Budgetary Plan on October 16<sup>th</sup>, indicating significant downside risks. This report is also complemented with the individual reports of the ARs which also include a fiscal scenario at constant policies until 2028 for the first time, along with the Report on Local Governments (LGs), subject to individual monitoring.

The preparation of this report, along with the budgetary procedures of the different GG sub-sectors, is strongly conditioned by institutional uncertainty, in addition to the existing economic uncertainty. First, the situation of an acting Central Government has prevented the presentation of the GSB for 2024, which also affects the rest of the GG sub-sectors. Furthermore, the Government has not published or communicated the calculation of the instalment payments and settlement of the regional and local financing systems.

Another source of institutional uncertainty is the application of the fiscal rules as from 2024, which have been suspended for four years. On the one hand, the European fiscal framework is undergoing a reform process. The European institutions have stated their aim of concluding the negotiations before the end of the year so they can be applied next year, although delays should not be ruled out. Furthermore, the results of this reform must be transposed to the national fiscal framework, although work has not yet commenced on its reform. In addition, the budgetary stability targets have not yet been approved due to the situation of an acting government. Lastly, the Government has not published the Report on the Situation of the Spanish Economy, which contains the reference rate for the expenditure rule, although this will stand at around 3% in 2024, according to AIReF's estimations pursuant to prevailing regulations.

In light of this lack of definition of the fiscal framework, the risk exists that the GG sub-sectors will prepare budgets that are not adapted to compliance with the European and national fiscal frameworks, as indicated in previous reports. In this regard, AIReF considers that coordination mechanisms exist that could reduce institutional uncertainty.

In its macroeconomic scenario, AIReF forecasts real GDP growth of 1.7% in 2024, which will converge over the medium term with its potential to stand at 1.4% in 2028. At a fiscal level, AIReF considers that the withdrawal of the measures will allow the GG deficit to be reduced to 3% in 2024, to subsequently stabilise at around 3.2% of GDP until 2028. The sustainability analysis indicates that debt would begin an upward path after reaching 106% of GDP in 2028. This once again underlines the need for a realistic and credible medium-term fiscal strategy that places debt on a downward path in the long term.

### **The medium-term macroeconomic scenario**

The Spanish economy has shown greater resilience than other European economies in 2022 and in the months of 2023 to date, given that it has been less exposed to most disruptions since the pandemic. The disruptions in the value chains, the energy crisis and, more recently, the weakening of China, have together affected other European economies with greater industrial specialisation. However, the tightening of the financing conditions of the economy, the deterioration of household and business confidence and weak economic growth in the euro area point to a deceleration of growth in Spain, which has already been detected in the information available for the third quarter of the year. In this context, AIReF forecasts that GDP growth for 2023 will remain at 2.3%, however, has revised expected growth for 2024 down to

1.7%, a rate that remains higher than the 1% projected by the European Central Bank (ECB) for the euro area as a whole.

Furthermore, inflation – measured by the private consumption deflator – is expected to remain at 3.9% in 2023 and 2024, while growth in the GDP deflator will fall from an estimated 5.8% in 2023 to 3.2%. The containment of prices, which is expected as the transfer of the recent increased production costs is completed along with the base effects associated with food prices in 2024, will be offset by the acceleration of nominal wages, the withdrawal of the measures introduced to mitigate the effects of inflation on household income in December 2023 and the recent rise in oil prices.

Based on these forecasts, AIReF endorsed the Government's macroeconomic scenario that accompanies the Budgetary Plan for 2024 on October 16<sup>th</sup>. The Government's scenario forecasts real GDP growth of 2.4% in 2023 and 2% in 2024, which places it in the central range of the probability bands prepared by AIReF based on its own forecast scenarios. In nominal terms, the Government's forecasts are higher than AIReF's, albeit within the probability range that is considered feasible. In light of this, AIReF considers that downside risks on the economic growth estimated by the Government predominate in 2024. In particular, the Government's scenario includes a significant acceleration of domestic demand, which may be optimistic in the current content of deteriorating consumer and business confidence and the tightening of financing conditions.

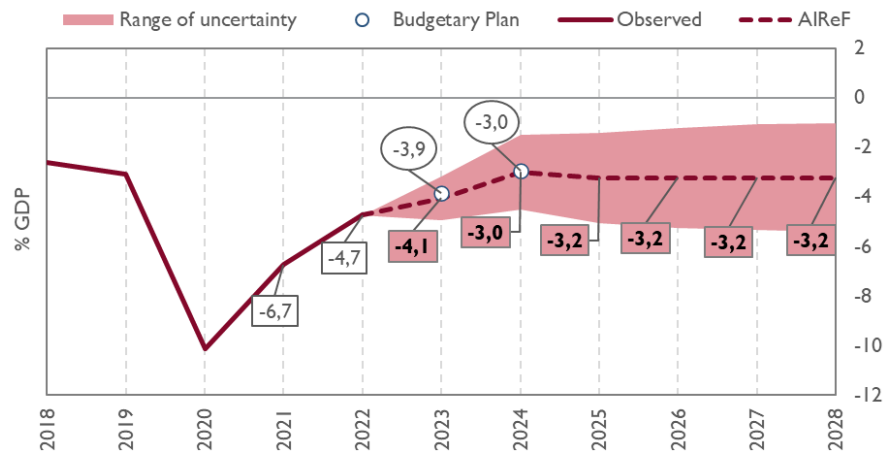
According to the forecasts made by AIReF, following the slowdown in growth in 2023 and 2024, the Spanish economy would gradually converge towards its potential growth, which AIReF estimates at around 1.3%. Economic growth would mainly be driven by the contribution from domestic demand. The contribution from the foreign sector to growth would be positive, but to a lesser extent (0.2 percentage points on average).

### **Budgetary scenario**

AIReF estimates a deficit of 3% of GDP for the General Government Sector in 2024, in line with the Budgetary Plan, after closing 2023 with a deficit close to 4.1%, 0.2 points higher than the forecast contained in the Budgetary Plan and unchanged as regards the July report. The 1.1-point reduction in the deficit would only materialise in the event that the measures adopted to alleviate the effects of the energy crisis and price rises are not extended, and if the Autonomous Regions and Local Governments do not exhaust the margin for increased spending and reduced revenue granted to them under the temporary revenue received under the extraordinary settlement of the financing systems.

In the medium term, AIReF estimates that the GG deficit will stabilise at around 3.2% of GDP between 2025 and 2028. Once the measures are withdrawn, the margin for reducing the deficit without adopting additional measures will be exhausted, resulting in a higher level than the 3% limit set in the Stability and Growth Pact. In 2025, the deficit will rise again to 3.2%, mainly due to the withdrawal of the temporary measures to increase revenue.

**FIGURE 1. EVOLUTION OF BORROWING CAPACITY/NEEDS OF GG.**



Source: AIReF and IGAE estimates

Revenue, without including the Recovery, Transformation and Resilience Plan (RTRP) will amount to 42.7% of GDP in 2024, after closing 2023 at 42%. These forecasts are higher than those included in the Budgetary Plan, by 0.1 points of GDP in 2023 and 0.7% points in 2024. The difference in 2024 stems from AIReF estimating a higher nominal level of revenue of 0.2 points and a lower nominal level of GDP, which increases the weight of this higher level of revenue over GDP by almost 0.5 points.

In 2024, AIReF forecasts revenue growth of 6.5%, driven by the withdrawal of the measures and the nominal growth in economic activity. In the opposite direction, the end of the execution of the REACT-EU funds in 2023 will reduce the rest of the revenue. As regards the Budgetary Plan, AIReF forecasts higher revenue from the tax on production and from other sources and lower income from tax revenue in 2024. Including the revenue associated with the RTRP, with a neutral impact on the deficit, revenue will amount to 42.9% of GDP in 2023 and 44.2% in 2024.

In the medium term, AIReF forecasts a small reduction in the weight of revenue in 2025, due to the withdrawal of the temporary measures to increase revenue, such as the taxes on the energy and banking sectors and the tax on large fortunes. Revenue will then recover its upward path to reach 43.1% in 2028, mainly driven by the progressive nature of income tax.

AIReF estimates that expenditure, without including the RTRP, will fall to 45.7% of GDP in 2024, after reaching 46.1% in 2023. In both years, the Budgetary Plan presents a lower level of expenditure. In a similar way to revenue, the difference between the two forecasts of 0.7 points in 2024 can be explained by the higher GDP forecast by the Government, of 0.5 points, and the higher level of expenditure forecast by AIReF, of 0.2 points.

According to AIReF's estimates, expenditure will grow by 4% in 2024, moderating its growth compared with the estimate for 2023, with heterogenous performance by its components. The withdrawal of the measures will also entail less expenditure, on top of the moderation of growth from the components of public consumption. Although growth in pensions will drop due to an increase of 4% compared with 8.5% in 2023, the weight of social transfers in cash will grow by 0.1 points. Furthermore, interest will continue to grow at high rates in 2024. As regards the Budgetary Plan, AIReF estimates higher spending on the compensation of employees, interest payments and social transfers in cash in 2024.

Medium-term expenditure will increase its weight over GDP to reach 46.3% in 2028. This increase will be driven by the growth in spending on pensions and interest payments that will gradually increase their weight. In contrast, the components of public consumption and investment will maintain their approximate weight over GDP over the course of the period, while other expenditure will fall slightly.

**TABLE 1. EVOLUTION OF BORROWING CAPACITY/NEEDS OF GG BY SUB-SECTOR**

	AIReF					
	2023	2024	2025	2026	2027	2028
<b>GG</b>	<b>-4,1</b>	<b>-3,0</b>	<b>-3,2</b>	<b>-3,2</b>	<b>-3,2</b>	<b>-3,2</b>
<b>CG</b>	-3,2	-3,1	-2,8	-2,8	-2,9	-2,9
<b>SSFs</b>	-0,4	-0,4	-0,4	-0,4	-0,4	-0,4
<b>ARs</b>	-0,6	0,2	0,0	-0,1	-0,1	-0,1
<b>LGs</b>	0,1	0,2	0,1	0,1	0,1	0,1

Source: AIReF estimates

### Central Government

Despite the withdrawal of the measures, the Central Government will only reduce its deficit in 2024 to 3.1%, due to the extraordinary increase in the settlement of the regional and local financing systems. Subsequently, the deficit will stabilise at around 2.9% of GDP until 2028, offsetting the increase in the burden to service debt with the growth in tax collection and the moderation in the growth of other expenditure.

## **Social Security Funds**

The deficit of the Social Security Funds will stabilise at 0.4% of GDP during the complete projection horizon. The growth in spending on pensions will moderate once inflationary tensions are overcome, which will transfer directly to the pension increase. For its part, following the strong growth observed in 2023 in spending on unemployment benefits, AIReF estimates it will evolve in line with the unemployment rate and reduce its weight of GDP. On the revenue side, contributions will moderate their growth in the following years, in line with the evolution of employment and wages, also incorporating the impact of the introduction of the Intergenerational Equity Mechanism and the solidarity tax.

## **Autonomous Regions**

According to AIReF's forecasts, the balance of the ARs will improve significantly in 2024, recording a surplus of 0.2% of GDP, after closing 2023 with a deficit of 0.6% of GDP. This improvement is mainly due to the evolution of the revenue under the financing system, which will grow by more than 16%, driven by the growth in instalment payments and, to a lesser extent, by the exceptionally high settlement corresponding to 2022. Subsequently, following weak growth in 2025 due to the return of the settlement system to normal levels, the flow of revenue under the system will normalise. As regards expenditure, a moderation of its growth is expected once the inflationary tensions abate and the return to fiscal rules materialises. Consequently, the balance will stand at zero in 2025 and subsequently decline slightly to reach a deficit of 0.1% of GDP in the rest of the period.

## **Local Governments**

AIReF estimates a surplus of 0.2% of GDP for the LGs in 2024, after reaching 0.1% in 2023. In a similar way to the ARs, the evolution of the surplus is marked by the settlements of the financing system, to which must be added the offsetting implemented between 2022 and 2024 due to the negative settlement in 2020. Accordingly, the LG surplus will stabilise in 2025 at 0.1% of GDP, with this level consolidating until 2028, once the increased growth in expenditure observed in the years in which the fiscal rules were suspended moderates.

## **Direction of fiscal policy and evaluation of the Country Specific Recommendation of the European Council on fiscal matters**

The Country Specific Recommendations (CSRs) adopted this year establish a quantitative reference for fiscal policy in 2024 for countries with high levels of debt like Spain.



Specifically, Spain is recommended not to increase primary spending financed at a national level and net of revenue measures above 2.6% next year. For the GG Sector, AIReF forecasted growth in primary expenditure net of revenue measures for 2024 at the limit of the recommendation issued, such that the scenario at constant policies set out in the Budgetary Plan would exhaust the margin for increased expenditure. By sub-sector, the fall in primary expenditure net of revenue measures of the Central Government allows the growth above this limit for the rest of the sub-sectors to be offset.

Complying with this recommendation will entail a restrictive tone of the nationally-financed fiscal policy which, however, due to the effect of the boost from the RTRP funds, will end up with a practically neutral tone overall.

### **Sustainability of the debt**

The reduction in the public deficit, together with the rebound in activity and much higher inflation than expected, have managed to correct more than half of the increase in the debt ratio generated in the first year of the pandemic, placing it on a downward path. The updated macro-fiscal forecasts drawn up by AIReF project a fall in the debt-to GDP ratio of 5.3 points over the next two years to stand at 106.3% of GDP in 2024. This reduction will mainly be driven by the growth in nominal GDP, where the deflator will play a very significant contribution. Accordingly, AIReF considers the Government's debt projection included in the Budgetary Plan for 2024 to be feasible, since, in the period as a whole, both the reduction in the ratio and the composition of the factors that determine its evolution are similar to AIReF's estimates.

The new monetary cycle, along with the high level of existing debt, place the sustainability of the public finances in a vulnerable starting position. AIReF projects a rising debt ratio in its long-term inertial scenario following an initial period of certain stabilisation, whereby a foreseeable increase in spending associated with the ageing population is one of the main challenges to the sustainability of the public finances in the medium and long term. The moderation of the contribution from nominal growth, which will fall slightly, together with the upward curve of interest payments that exceed the reduction in the primary deficit, will end up translating into an unfavourable dynamic of the debt ratio. The high level of initial indebtedness, along with unbalanced public accounts, will generate a higher financial burden, even in a scenario of contained debt servicing costs.

The generation of a fiscal space that allows such shocks as have occurred in recent years to be addressed in the future would require the design of a medium-term plan that guides the public accounts towards a balanced situation. In this regard, the European Commission's recommendation, along

with its proposed reform of the fiscal framework, represent an opportunity and a guide to the preparation of a fiscal-structural plan. According to AIReF's calculations, the fiscal path that would comply with the guidelines to calculate the technical path contained in the proposed reform would require measures to be taken over the period 2025-2028 with a value of 0.64 points a year. This adjustment (a cumulative 2.56 points over four years) would generate a reduction in the debt ratio of 34 points of GDP over the next 16 years as regards its inertial projection, placing it on a clearly downward dynamic.

### **Recommendations**

The medium-term direction of the analysis of the macroeconomic and fiscal scenario made by AIReF, together with the sustainability analysis, once again show the vulnerability of the Spanish economy, due to the structural persistence of the deficit and the high level of debt. Against this backdrop, the institutional uncertainty at both a European and a national level following four years of suspension of the fiscal rules poses an additional risk to the sustainability of the public accounts to the extent that this could shield increased expenditure and reduced revenue of a structural nature.

In fact, the risk of non-compliance with the CSR for 2024 will increase if the ARs only employ the 0.1% deficit reference provided for in the Budgetary Plan for the sub-sector when preparing their budgets. According to AIReF's forecasts, the 0.1% deficit would be compatible with growth in expenditure of close to 9%, which would be incompatible with compliance with the CSR.

However, AIReF considers that formal and informal mechanisms exist that would allow this institutional uncertainty to be reduced to a certain extent, which have been included in the report's recommendations. In this regard, AIReF already recommended in its endorsement report that the Ministry of Economic Affairs and Digital Transformation should publish the Report on the Situation of the Spanish Economy provided for in Article 15.5 of Organic Law 2/2012, of April 27<sup>th</sup>, on Budgetary Stability and Financial Sustainability, which contains the reference rate of the expenditure rule for 2024.

Along the same line, AIReF recommends that the Government should publish its forecasts for instalment payments and the settlement of the regional and local financing systems.

AIReF also recommends the Ministry of Finance to convene the coordination mechanisms under existing fiscal policy – the Fiscal and Financial Policy Council and the National Commission of Local Administrations to:

- agree on reference rates for financing capacity/needs and the growth in primary expenditure net of revenue measures for the different sub-sectors, considering the temporary or structural nature of revenue and expenditure for each sub-sector for 2024 in a way that is coherent with compliance with the Country Specific Recommendation issued by the Council of the European Union.
- commence, as soon as possible, the work on drawing up a realistic and credible medium-term fiscal strategy that complies with the sustainability requirements that will foreseeably be included in the reform of the European fiscal framework
- to commence, as soon as possible, the work on the reform of the national fiscal framework.