

## **AIReF FORECASTS THAT THE ECONOMY WILL GROW BY 2% IN 2024 AND THE DEFICIT WILL FALL TO 3% OF GDP**

- The Independent Authority for Fiscal Responsibility (AIReF) updates its macroeconomic and fiscal forecasts and medium-term scenarios with the new information available and the latest measures approved
- It raises the forecast for GDP growth in 2024 to 2% and estimates that the rate will gradually converge in the medium term to potential growth
- It maintains the General Government deficit forecast at 3% of GDP and estimates that it will stabilise above 3% in the medium term. The margin for reducing the deficit without further measures is therefore exhausted
- It revises the distribution of the deficit by sub-sector: the balance expected for the Central Government in 2024 and that of the Social Security improves, while that of the Autonomous Regions (ARs) and that of the Local Governments (LGs) worsens
- AIReF estimates growth in primary expenditure net of revenue measures of 4%. This means that the specific recommendation for Spain limiting the growth of this expenditure to 2.6% will not be met
- AIReF considers that there is a risk of non-compliance with the national expenditure rule in 2024 by the Central Government, all the ARs and ten of the LGs that are subject to individual monitoring
- AIReF maintains that debt will stabilise at above 100% of GDP. An adjustment will therefore be necessary in order to comply with the new fiscal framework, which the institution estimates at 0.63 points of GDP per annum if undertaken in four years and 0.43 points if undertaken in seven years
- AIReF recommends that those General Government authorities at risk of breaching the national expenditure rule adopt measures to correct the growth of eligible expenditure for the purposes of the expenditure rule and thus avoid the structural deterioration of their accounts over the medium and long term
- It recommends that the Ministry of Finance initiate dialogue and work with all the General Government authorities in order to draw up the medium-term Structural Plan required under the new fiscal rules

The Independent Authority for Fiscal Responsibility (AIReF) published the Report on the Initial Budgets of the General Government (GG) for 2024 on its website today, in which it updates its macroeconomic and fiscal forecasts and its medium-term scenarios, after incorporating the latest available information and the impact of the latest measures approved or extended. AIReF forecasts that the economy

will grow by 2% in 2024 and that the public deficit will fall to 3% of GDP. In the medium term, AIReF estimates that growth will gradually converge to the potential figure, that the deficit will stabilise at above 3% and that debt will remain above 100% of GDP. Adjustments will therefore be necessary in order to comply with the new European fiscal framework. With regard to the application of fiscal rules, which are reactivated this year, AIReF estimates that in 2024 the European specific recommendation will not be met, with a total increase in primary expenditure net of revenue measures for the General Government of 4%, higher than the 2.6% required by Brussels. In addition, there is a risk of non-compliance with the national expenditure rule by the CG, all the ARs and ten LGs subject to individual monitoring by AIReF. Beyond the legal consequences that might arise from the formal breach of the current national fiscal framework or the specific recommendation, a high growth in eligible expenditure in 2024 will result in a deterioration of the public finances in the medium term in a context of high public debt. This would also increase the adjustment required by the new European fiscal framework.

In this Report, AIReF evaluates the budgets from the perspective of their compliance with fiscal targets, with the changes with respect to the draft budgets and main budgetary lines of the month of October. The evaluation this year takes place in a unique context, characterised by the reactivation of fiscal rules and the uncertainty surrounding their implementation. At the national level and until the new European fiscal rules are transposed, national fiscal rules are once again in force in their current configuration. The budgetary stability and public debt targets proposed by the Government were rejected by the Senate, but the expenditure rule, set at 2.6% in the report on the situation of the Spanish economy, would apply all General Government (GG) authorities. At the European level, Spain must comply with the recommendation from Brussels limiting the increase in eligible expenditure net of revenue measures to 2.6%, and it will have to submit the 2025-2028 Fiscal Plan in September.

In this context, AIReF analyses the available budgetary documents: the extension of the General State Budget for 2024, the budgets and forecasts of the Autonomous Regions (ARs) and the budgets and forecasts of the Local Governments (LGs). It incorporates the latest published information and the impact of the latest measures approved and extended and it updates its macroeconomic and fiscal forecasts and its medium-term scenarios for the GG as a whole.

### **Macroeconomic scenario**

AIReF raises the GDP growth forecast for 2024 to 2%. From that year on, in its medium-term scenario, the institution considers that real GDP growth will gradually converge to the long-term potential, which AIReF still estimates at around 1.3%. Specifically, AIReF estimates that GDP will grow by 1.5% in 2028.

AIReF estimates that, in 2023, employment growth favoured an expansion of consumption above the figure previously estimated. Public consumption also rose by more than expected by AIReF and by the Government itself. For its part, revenue from tourism has surpassed pre-pandemic levels and exports of some business services remained remarkably dynamic. In the opposite direction, gross capital formation remained very moderate and grew by well below the levels expected by AIReF and the Government. In fact, according to AIReF, the weakness that investment is showing is one of the most remarkable features of the recent growth pattern of the economy, particularly in a context in which some projects linked to the Recovery, Transformation

and Resilience Plan (RTRP) are materialising. In addition, this has been accompanied by a stagnation in productivity, which, following the ups and downs of the pandemic, maintains a level somewhat lower than that recorded in 2015.

In this context, AIReF estimates that the economy will maintain significant growth of 2% in 2024, supported by the dynamism of private consumption and by an expansion of investment conditional on the rollout of investments associated with the RTRP. This GDP growth far exceeds that expected by the ECB for the euro area as a whole (0.6%). As from 2024, AIReF considers a scenario of gradual convergence towards long-term potential growth, which is still estimated at around 1.3%. Specifically, it estimates that the economy will grow by 1.5% in 2028.

As regard prices, AIReF notes that energy inflation is falling faster than expected in a context of a correction of the prices of these raw materials in international markets and, in particular, of gas prices. In contrast, some tourism-related services maintain high rates. In this regard, AIReF revises the expected growth of the CPI for 2024 downwards to 3.1%. In contrast, it maintains the expected growth of the GDP deflator at 3.2% as this indicator reflects domestic price pressures to a greater extent. For the following years, a gradual convergence to 2% - the monetary policy benchmark rate - is expected.

As a consequence of the foregoing, nominal GDP growth is revised slightly upwards, to 5.2% in 2024. In turn, the unemployment rate is expected to fall to 11.6% in 2024, from the 12.1% recorded in 2023, with progressive containment projected to stand at 10.3% in 2028.

### **Budgetary scenario**

In its central scenario, AIReF estimates a GG deficit of 3% of GDP in 2024, in line with the Government's forecasts. In the medium term, AIReF maintains that the deficit will stabilise, in the absence of additional measures, at around 3.2% of GDP in line with the previous report.

AIReF has taken into account the latest measures approved, the budget extension, the changes in the macroeconomic scenario and the latest available information. While the new and extended measures represent an estimated cost of around 0.3 points of GDP, 0.1 points had already been incorporated into AIReF's fiscal scenario since the previous report. The budget extension does not result in significant changes on the previous forecast, since the Government has expressed its intention to incorporate elements such as the wage increase of public employees through different legislative instruments. The changes in the macroeconomic scenario reduce the deficit by 0.3 points in 2024, due to improved tax collection and lower expected spending on unemployment benefits. And the latest available information, mainly the year-end 2023 data, results in significant changes at the level of GG authorities and headings, which in aggregate amount to an increase in the deficit of the GG as a whole of 0.1 points of GDP.

In particular, the higher expenditure by regional and local governments in 2023 is carried over to 2024 and the following years, resulting in a worsening of their fiscal position in the medium term. Furthermore, part of the lower Central Government expenditure in 2023 has no impact on the 2024 forecast. This is the case of capital transfers associated with court rulings, whose amount in 2023 was lower than in previous years, but which in 2024 will rise again due to the recording of court rulings that are now known. Along the same lines, the fall in military investment in 2023 is deemed to be of a one-off nature. It is expected to rise again in 2024, bearing in mind the budgetary execution recorded in 2023 and the political commitment to raise military spending.

As a consequence of the foregoing, the deficit in 2024 will fall by 0.6 points of GDP compared with 2023. The gradual phasing out of the measures implemented to mitigate the effects of the energy and price crisis in 2024 will result in a reduction in the deficit of around 0.7 points. Furthermore, the underlying trend of other expenditure and revenue results in a reduction in the deficit of over 0.1 points of GDP, which is cancelled out by the increase in non-recurring expenditure linked to court rulings. In contrast, the rest of the revenue measures have a practically neutral impact on the deficit of 0.1 points, since the negative impact of the measures approved by the Central Government and the ARs offset the positive impact of those approved in regard to Social Security.

AIReF forecasts that revenue will grow by 6.2% in 2024, to stand at 42.5% of GDP, 43.9% if RTRP revenue is included. This level would be 0.2 points of GDP lower than that forecast in the previous report. In the medium term, it estimates a gradual increase in revenue to reach 43% of GDP in 2028, 0.1 points lower than the figure estimated in the previous report. For its part, expenditure will stand at 45.4% in 2024, excluding the RTRP, also 0.2 points below the forecast in the previous report. In the medium term, expenditure will increase its weight over GDP to reach 46.2% in 2028, slightly more than 0.1 points lower than in the previous report.

In the report, AIReF notes that, in the new European fiscal framework, the main supervisory variable becomes primary expenditure net of revenue measures. Accordingly, it has already begun to forecast its evolution in the medium term both at the GG level and at the level of the sub-sectors. According to AIReF's estimates, this net expenditure for the GG as a whole will grow at an average rate between 2024 and 2028 of 3.8% per annum in its central scenario.

### **Sub-sectors**

AIReF estimates a deficit of 2.7% of GDP for the Central Government in 2024, a reduction of 0.4 points on the previous forecast. As regard the expenditure rule, AIReF estimates that the growth of eligible expenditure of this sub-sector will stand at 6.8%, more than 0.4 points of GDP above the level that would be reached if the 2.6% limit were met. This growth is conditioned by the allocation in 2024 of certain non-recurring operations not recorded in 2023 and the recovery of military investment after the one-off drop in 2023. In the medium term, AIReF estimates that the Central Government deficit will stabilise at around 2.5% of GDP and primary expenditure net of revenue measures will grow on average by 3.7% per annum.

In the case of the Social Security Funds, AIReF reduces the deficit estimate by 0.1 points to 0.3% of GDP in 2024, but maintains it at 0.4% of GDP in the medium term. Between 2024 and 2028, it estimates that primary expenditure net of revenue measures will grow by 3.9% per annum for this sub-sector, including the impact of revenue measures linked to the pension reform.

For the ARs, AIReF worsens the deficit forecast for 2024 by 0.3 points to 0.1% of GDP. However, the figure will be an improvement on year-end 2023, mainly as a result of the extraordinary revenue from the settlement of the financing system. In addition, instalment payments also grew by 8.3%. For its part, the sub-sector's eligible expenditure for the purposes of the expenditure rule increases by 5.7% in 2024, 0.4 points of GDP above the reference rate of 2.6%. At the individual level, all the ARs are at risk of non-compliance. In the medium term, AIReF estimates that from 2025 on, the balance of the ARs will deteriorate to stabilise at around -0.2% of GDP and primary expenditure net of revenue measures of the sub-sector will grow on average by 3.7% per annum.

In the case of the LGs, AIReF worsens the surplus forecast for 2024 by 0.1 points to place it at 0.1% of GDP. This figure, however, is an improvement compared with year-end 2023 as a result of the settlement of the financing system, which will be extraordinarily high in 2024. In addition, the compensation for the negative settlement of 2022 that the LGs will receive in 2024 also has a positive impact. According to AIReF's estimates, the eligible expenditure of this sub-sector for the purposes of the expenditure rule would grow by around 3.7%, which highlights the risk of non-compliance with this rule for numerous entities at the individual level. In the medium term, AIReF estimates that the balance of the LGs will stabilise at around equilibrium, and expenditure net of revenue measures will grow at an average annual rate of 3.7%.

### **Recommendations of the European Council**

In 2023, the European Council recommended to Spain that the increase in nationally-financed current primary expenditure net of revenue measures should not exceed the nominal medium-term potential growth of the economy, which is currently estimated at 7.3%. Spain would have comfortably fulfilled this recommendation, as this variable grew by 4.7% in 2023. This containment would have set a clearly contractionary tone to the domestic component of the fiscal policy stance in 2023, only partially offset by the boost related to the NGEU funds. For its part, nationally-funded public investment would have contributed neutrally to the aggregate tone last year.

For 2024, it has been recommended to Spain that the increase in nationally-financed primary expenditure net of revenue measures should not exceed 2.6%. However, AIReF forecasts 4% growth in this variable in 2024 for the GG as a whole. AIReF estimates that complying with the recommendation would require reaching a deficit figure of 2.4% in 2024, compared with the 3% currently expected. In turn, this would result in a neutral overall fiscal policy stance: the contraction associated with the domestic component would be offset by the boost provided by RTRP funds. In addition, and in terms of the composition of public finances, it has been recommended that Spain maintain nationally-financed public investment in 2024. According to AIReF, this aspect of the recommendation would be fulfilled this year since, although there is some containment of the investment dynamism of the General Government, in terms of GDP its weight would remain stable.

### **Sustainability of public finances**

The update of AIReF's macro-fiscal forecasts projects a fall in the debt-to-GDP ratio of 1.8 points this year, placing it at 105.8%. This reduction in the ratio will be mainly supported by the growth in nominal GDP, where the deflator will make a very significant contribution. This forecast slightly improves the forecast presented by the Government in the draft Budgetary Plan for 2024 (106.3%), and is in the range of the latest forecasts by the IMF (104.7%) and the European Commission (106.5%).

In its long-term baseline scenario, AIReF projects an increasing debt ratio following an initial period of a certain level of stabilisation. According to the institution, the generation of fiscal space that will make it possible to deal with shocks in the future, such as those of recent years, requires the design of a medium-term plan that will guide the public accounts towards a situation of balance. In this regard, AIReF considers that the agreement to reform the fiscal framework represents an opportunity and a guide for drafting a fiscal-structural plan. According to AIReF's calculations, the fiscal path that would comply with the guidance for calculating the benchmark trajectory contained in the reform proposal would require taking measures during the period 2025-2028 worth 0.63 points per annum. This adjustment (2.52 points accumulated over four years) would

generate a reduction in the debt ratio of 25 points of GDP in the next 15 years, placing it on a clearly downward path. Extending the adjustment plan to seven years would reduce the annual adjustment by 0.2 points to 0.43 points of GDP, but would entail a greater adjustment in cumulative terms (3.01 points).

### **Recommendations**

Beyond the legal consequences that might arise from the formal breach of the current national fiscal framework or the specific recommendation from Brussels, AIReF points out that a high level of growth in eligible expenditure in 2024 will result in a deterioration of the public finances in the medium term in a context of high public debt, which would also increase the adjustment required by the new European fiscal framework. Consequently, AIReF recommends that these GG authorities monitor the execution of their budget and adopt the measures they deem appropriate to correct the growth of eligible expenditure for the purposes of the expenditure rule and thus avoid the structural deterioration of their accounts over the medium and long term.

In addition, it stresses that this year is critical as a starting point for determining the path of primary expenditure net of revenue measures that Spanish GG authorities will be required to follow after the approval of the medium-term Fiscal-Structural Plan. This plan should be drawn up over the summer on the basis of the reference trajectory that the European Commission will provide in June and will now mark the process of drawing up the budgets for 2025, taking as a starting point the year-end 2024 forecast. In this regard and in line with previous recommendations, AIReF recommends that the Ministry of Finance initiate dialogue and work with all GG authorities in order to draw up this medium-term Fiscal-Structural plan. In addition, this process should clarify the practical application of fiscal rules in 2024 and lay the foundations for a new national fiscal framework for the implementation of the medium-term Fiscal-Structural Plan.