

# REPORT ON THE INITIAL BUDGET OF THE GENERAL GOVERNMENT FOR 2025

EXECUTIVE SUMMARY

April 10<sup>th</sup>, 2025





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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Publication date: April 10<sup>th</sup>, 2025

## EXECUTIVE SUMMARY

The Independent Authority for Fiscal Responsibility (AIReF) has a legal mandate to evaluate the initial budget of the General Government (GG) from the perspective of compliance with fiscal targets, focusing its evaluation on the main changes with respect to the projects and main lines of the budget previously reported on November 5<sup>th</sup>, 2024. To date, the Government has not presented the draft General State Budget for 2025. At the regional level, ten Autonomous Regions (ARs) have approved their budgets and seven have extended them, although one has just presented its draft budget. Furthermore, the budgetary stability and debt targets for 2025 have not been approved either, although the reference rate of the national expenditure rule has been set at 3.2%. In this report, AIReF updates its macroeconomic and fiscal forecasts for 2025, incorporating the impact of the measures approved since the last report, including those aimed at mitigating the effects of the Isolated High Altitude Depression (DANA), as well as recently published information on year-end 2024.

In this context, AIReF presents a new macroeconomic scenario that maintains the real gross domestic product (GDP) growth forecast for 2025 at 2.5%, while nominal GDP growth, which is particularly relevant for fiscal forecasts, stands at 4.8%.

According to AIReF's estimates, primary expenditure net of revenue measures will grow by 4.6% in 2025, 0.9 points above the expenditure commitment of the Medium-Term Structural-Fiscal Plan (MTP). Furthermore, AIReF maintains the forecast for the GG's deficit at 2.7%, as predicted in the previous report, which did not yet incorporate the impact of the DANA. If the fiscal impact of the DANA is excluded, the deficit for 2025 would be 2.4% of GDP, 0.3 points below the forecast in the previous report. In addition to the increase due to the measures adopted to mitigate the effects of the DANA, estimated at 0.3 points of GDP, the deficit forecast also incorporates the impact of the measures adopted by the GG sub-sectors since the previous report, with a slightly positive net impact of deficit reduction. In addition, the incorporation of new information, such as year-end 2024 figure of 2.8% of GDP excluding the impact of the DANA, explains a reduction in the deficit by 0.1 points of GDP. Lastly, the revision of the macroeconomic scenario also implies a reduction in the deficit forecast by an additional 0.1 points.

#### Revision of the macroeconomic scenario for 2025

AIReF maintains its forecast for real GDP growth for 2025 at 2.5%, in contrast to other institutions that have recently revised their estimates upwards. The absence of revisions is based on the strength of domestic demand and, in particular, private consumption projected for 2025, underpinned by growth in job creation, the high rates of savings achieved - not seen since the outbreak of the global financial crisis - and the improvement in financing conditions. The scenario also incorporates a recovery in business investment which, in the current context of uncertainty, is subject to downside risks. Furthermore, this scenario does not yet incorporate the impact of the trade war unleashed by the United States, the outcome of which is difficult to predict at present. Nor does it incorporate the negative effects associated with the extraordinary increase in uncertainty about trade policy, which AIReF estimates could subtract up to 0.5 percentage points (pp) from the growth of the Spanish economy as early as 2025 if not corrected quickly.

The downside risks surrounding this growth scenario are high. The uncertainty is reflected in a fall in the stock markets that could slow the recovery of investment. The increase in tariffs fuels expectations of a recession in the United States. Tariff escalation, the end result of which is unknown at the time of writing this report, may lead to a fragmentation of trade relations with the consequent loss of efficiency at a global level and a redesign of global value

chains. Increased defence spending or a shift in German fiscal policy could offset this scenario, but its effects are not expected until 2026.

In terms of prices, the GDP deflator is expected to slow to 2.2%, reflecting the moderation of energy prices and the absence of wage pressures in a context of increased labour supply associated with immigration. The imposition of tariffs by the United States may pose an upside risk to inflation if China diverts its production to European markets. Nominal GDP would grow by 4.8% in 2025, compared with 6.2% the previous year.

### Budgetary scenario for the General Government

AIReF estimates that by 2025 the growth in GG primary expenditure net of revenue measures will be 4.6%, 0.9 points above the commitment contained in the MTP. This deviation would be 0.3 points of GDP and thus stand at the limit of the annual deviation allowed by European regulations. After closing 2024 with growth of 3.5% in net expenditure, 1.8 points below the MTP forecast, the cumulative growth of net expenditure from 2025 would stand at 8.3%, 0.9 points below the MTP. Unlike in the case of the fiscal balance, the figure for net expenditure in 2024 has not yet been published, so in both cases this is an AIReF forecast subject to a certain degree of uncertainty as no official methodology has been published at either the national or European level.

AIReF's forecast for the GG deficit for 2025 stands at 2.7% of GDP, although excluding the impact of the DANA it would be 2.4% of GDP. This represents a reduction in the deficit forecast excluding the impact of the DANA of almost 0.3 points of GDP compared with the November report.

Taking into account AIReF's revenue forecast, meeting the MTP commitment regarding the growth of primary expenditure net of revenue measures - 3.7% in 2025 - would imply an additional reduction in the deficit of 0.3 points of GDP to 2.4% of GDP in 2025, 2.1% excluding the impact of the DANA. Furthermore, compliance with the national expenditure rule of 3.2% by the Central Government (CG), the Autonomous Regions (ARs) and the Local Governments (LGs) would lead to a deficit of 2.3% of GDP and growth in primary expenditure net of revenue measures of 3.5%, in line with the commitment contained in the MTP.

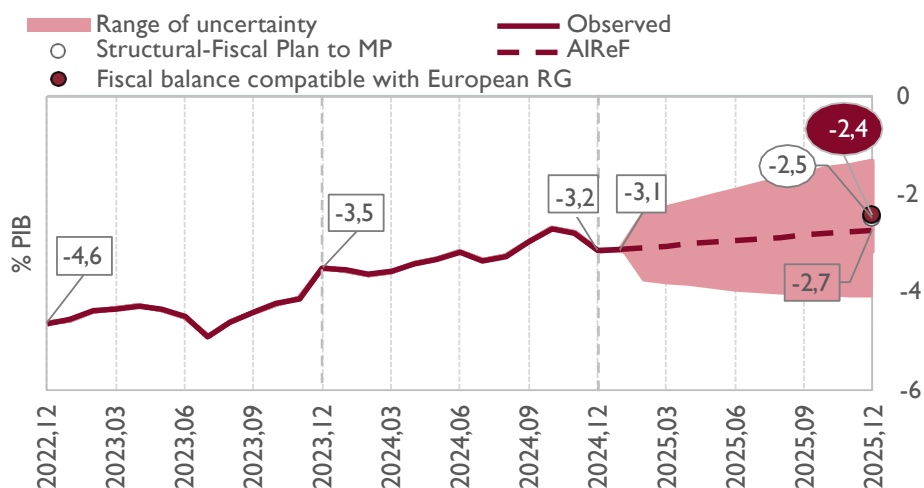
The estimated cost of the measures to mitigate the effects of the DANA in 2025 is 0.3 points of GDP. Together with the 0.4-point impact in 2024, this amounts to a total cost of almost 0.7 points of GDP for the GG Sector. In addition to these

measures, the Government has adopted others, including the tax measures approved at the end of 2024, which incorporate changes to Corporate Income Tax (CIT), the approval of the Complementary Tax to guarantee a minimum global level of taxation, the Tax on the Margin of Interest and Commissions that replaces the Tax on Credit Institutions and the repeal of the Energy Tax. Measures to increase spending have also been adopted, such as a pay rise for military personnel and the extension of public transport subsidies. In net terms, the new measures not associated with the DANA imply a reduction in the deficit of just under 0.1 points in 2025.

In addition, changes in the macroeconomic scenario reduce the deficit by 0.1 points due to improved tax collection. The improvement in the growth forecast for compensation of employees for 2025 raises collection from Personal Income Tax (PIT) and social contributions, which is partially offset by the reduction in the gross operating surplus (GOS) which implies a lower forecast for CIT collection.

Finally, the incorporation of the latest information available leads to a reduction in the deficit of 0.1 points of GDP compared with November. In 2024, the GG closed with a deficit, excluding the impact of the DANA, of 2.8% of GDP, 0.2 points better than estimated by AIRcF in November. Although part of the improvement is explained by higher than expected income from European funds that does not carry over to 2025, another part is due to factors that do carry over to 2025, such as higher income tax collection and lower expenditure, for example, the unexpected fall in gross capital formation of the LGs.

As a consequence of the above, AIRcF estimates that the deficit in 2025 will fall by 0.5 points of GDP compared with 2024. On the one hand, the gradual withdrawal of measures to alleviate the effects of the price and energy crisis contributes to a reduction of 0.3 points of GDP in the deficit in 2025, while other revenue measures adopted represent an additional reduction of 0.1 points of GDP. The expected reduction in non-recurring operations associated with court rulings will also reduce the deficit by another 0.2 points of GDP. In contrast, the evolution of other revenue and expenditure will imply an increase in the deficit of 0.2 points.

**FIGURE 1. EVOLUTION OF GG BALANCE**


Source: AIReF and IGAE

AIReF forecasts that revenue without the RTRP will grow by 5.1% in 2025, reaching 41.6% of GDP, or 42.4% including RTRP revenue. The level of revenue without the RTRP would be 0.1 points higher than forecast in the previous report, mainly due to the impact of the new measures adopted. In this case, the improvement in tax collection due to changes in the macroeconomic scenario is offset by the denominator effect due to the higher forecast of the nominal GDP level. In 2025, both taxes and social contributions are expected to grow by around 6%, with income taxes, PIT and CIT growing by around 8%. In contrast, AIReF expects a 2.9% reduction in other revenue.

Expenditure in 2025, excluding the RTRP, will stand at 44.3% of GDP, with growth of 4.1% according to AIReF's estimates. This level would be 0.1 points higher than forecast in the previous report due to the impact of the measures adopted to mitigate the impact of the DANA, which are partially offset by the incorporation of new information and the denominator effect of the new estimate of nominal GDP. The components of public consumption (compensation of employees, intermediate consumption and transfers in kind) will grow by more than 4%, while social transfers in cash and interest will grow by more than 5.5%. AIReF also expects a recovery in gross capital formation. Conversely, other expenditure will fall due to the gradual withdrawal of measures to alleviate the effects of the price crisis and the lower expected impact of non-recurring operations, especially court rulings.

## Central Government

The CG's eligible expenditure for the purposes of the national expenditure rule will grow by 5.2% in 2025 excluding expenditure to mitigate the effects of the DANA, 2 points above the reference rate of 3.2%. AIRcF also estimates that the contribution of the CG to the European expenditure rule would result in an increase in primary expenditure net of revenue measures of 3.5% with respect to 2024, slightly below the MTP reference rate.

AIRcF estimates a CG deficit of 2.2% of GDP in 2025, which represents an increase of 0.2 points compared with the previous forecast. This deterioration in the balance is explained by the measures to mitigate the effects of the DANA, mainly the transfers to LGs, as well as other measures such as the extension of support for public transport and pay rises for military personnel. The changes in the macroeconomic scenario are offset by the increase in PIT collection vs. the decrease in CIT. Excluding the impact of the DANA, the CG deficit would stand at 2% of GDP. Under AIRcF's current revenue scenario, compliance with the expenditure rule in 2025 would improve the deficit by 0.2 points to 2% of GDP.

## Social Security Funds

AIRcF increases the deficit estimate of the SSFs by 0.1 points to 0.3% of GDP. The increase in the expenditure forecast due to the incorporation of the most recent information is partially offset by the improvement in the forecast for tax collection from social contributions due to the increase in the forecast for the growth of compensation of employees. For its part, primary expenditure net of revenue measures for the purposes of the European expenditure rule would grow by 4.8% in 2025.

## Autonomous Regions

According to AIRcF's estimates, the eligible expenditure of the ARs for the purposes of the national expenditure rule will grow by 5.3% in 2025, 2.1 pp above the 3.2% limit. Primary expenditure net of revenue measures, calculated in accordance with the European fiscal framework methodology, will also grow by 5.4%.

The deficit of the ARs will increase in 2025 to 0.5% of GDP, 0.4% excluding the impact of the DANA. This represents an improvement of 0.1 points on the previous report, mainly due to the better-than-expected year-end 2024 figures, partially carried over to 2025. The worsening of the deficit in 2025 is

mainly explained by the fall in revenue from the settlement of the regional financing system which, after the extraordinary increase in 2024, returns to its usual levels. This means that, although instalment payments grow by 9.5%, revenue from the regional financing system grow by only 2.5%. Excluding the RTRP, expenditure will grow by 4.8%. Under AIRcF's current revenue scenario, compliance with the expenditure rule in 2025 would improve the deficit by 0.3 points, to 0.2% of GDP, or 0.1% without the DANA measures.

### Local Governments

For the LGs, AIRcF forecasts growth in eligible expenditure for the purposes of the national expenditure rule of 2.6%, excluding the effects of the DANA, below the reference rate set at 3.2%. For the purposes of the European expenditure rule, primary expenditure net of revenue measures for the LGs will grow by 3.8%, slightly above the MTP reference rate.

The LGs will close 2025 with a surplus of 0.3% of GDP, an improvement on the forecast of the previous report by 0.3 points. The LG sub-sector registered a surplus of 0.4% of GDP in 2024, 0.3 points higher than forecast by AIRcF in its previous report. This improvement in the surplus is mainly explained by lower expenditure, principally gross capital formation, which reduces the starting level for 2024 and transfers the improvement in the surplus to the forecasts.

### Challenges that can be appreciated from the point of view of the sustainability of public finances

The updated macro-fiscal forecasts produced by AIRcF project a 1% decrease in the debt-to-GDP ratio this year, bringing it to 100.8%. Although the public deficit will continue to contribute to the increase in debt, its impact will be more moderate than in previous years. At the same time, the contribution of economic growth to the reduction of the debt ratio will be lower this year, in addition to a foreseeable increase in the stock-flow adjustment stemming from European loans. All this will result in a slowdown in the pace of debt reduction, from a fall of 3.3 points to just 1 point.

This reduction is consistent with the projections presented by the Government in the MTP, as well as by the European Commission and the IMF, which estimate decreases of 1.1 points, 1 point and 1.6 points respectively.

AIRcF predicts, under the assumptions of a regulatory scenario, that the ARs will reduce their level of indebtedness by 1.3 points in 2025, reaching 19.8% of GDP. This forecast is conditioned by the estimate of the excess financing from previous years pending application and by the assumption of strict

compliance with the regulations, which would imply that in 2025 the unspent surpluses, regardless of the real cash flows, and the excess financing pending from previous years should be used to reduce net borrowing. These positive factors are only partially offset by the deficit forecast for 2025 (0.5% of GDP), of which more than 0.1 points corresponds to spending resulting from the DANA. The regulatory scenario considered does not consider the effect of the announced write-off of regional debt, on the understanding that, in any case, it would have no impact in 2025. As far as the LGs are concerned, AIRcF forecasts an improvement in their net position in 2025 due to an increase in deposits and a decrease in debt.

### Recommendations

According to AIRcF's current forecasts, the growth in primary expenditure net of revenue measures for 2025 for the purposes of the European expenditure rule is above the commitment made in the MTP but within the limit of the annual deviation permitted by European regulations. However, it should be acknowledged that, in addition to the usual uncertainty of a fiscal year forecast is the fact that the net expenditure figures for 2024 have not yet been published and that doubts persist about the calculation of this net expenditure.

Furthermore, the European Commission has recently announced the possibility for Member States to request the activation of the national escape clause, so that the increase in defence spending of up to 1.5% of GDP compared with the level registered in 2021 is not considered for the purposes of the European expenditure rule.

Furthermore, AIRcF also identifies a risk of non-compliance with the national expenditure rule for 2025 for the CG, the ARs and four LGs. In addition, according to AIRcF's current forecasts, compliance with the national expenditure rule in 2025 would lead to compliance with the European expenditure rule.

Consequently, AIRcF recommends that the Ministry of Finance monitor budgetary execution and establish the coordination mechanisms necessary to guarantee compliance with the national and European expenditure rules by the GG Sector. It also recommends that the Ministry of Finance publish monthly figures for primary expenditure net of revenue measures for the purposes of the European expenditure rule and resume the monthly

publication of eligible expenditure for the national expenditure rule. Along the same lines, it recommends that the ARs and five LGs monitor budgetary execution and periodically update the growth estimates for eligible expenditure. Finally, AIRcF recommends signing an agreement with the Ministry of Finance for the provision of the information necessary for the preparation of its reports.