REPORT ON BUDGETARY EXECUTION, PUBLIC DEBT AND EXPENDITURE RULE 2024

REPORT 22/24

EXECUTIVE SUMMARY

Independent Authority for Fiscal Responsibility

EXECUTIVE SUMMARY

The Independent Authority for Fiscal Responsibility (AIReF) has the legal mandate to report on budgetary execution, public debt and the expenditure rule of the different General Government (GG) authorities in 2024. In this report, AIReF updates its macroeconomic and fiscal forecasts in accordance with the latest budgetary execution data available and the new measures adopted by the GG authorities. This report is published together with the individual reports for each Autonomous Region and the supplementary report on Local Governments (LGs).

AIReF projects real GDP growth for 2024 as a whole of 2.4%, compared with the 2% estimated in May. The dynamic nature of the export of services and the influx of immigrants, which is underpinning consumer spending while boosting the favourable performance of the labour market, are the main factors behind this revision.

As for the fiscal scenario, AIReF maintains its deficit forecast for the General Government sector as a whole at 3% of GDP in 2024. The decline in the deficit forecast for the Autonomous Regions (ARs) due to the incorporation of the budgetary execution data is offset by the improvement in the forecasts for the Central Government (CG). However, compliance with these forecasts would be affected by the materialisation of certain risks. On the one hand, the impact of certain tax rulings could be greater in 2024 than contained in AIReF's forecasts. On the other hand, the uncertainty over the application of the fiscal rules in 2024 and the implementation of the new European fiscal framework in 2025 could be encouraging strategic behaviour in terms of spending increases and revenue reductions at present.

In this respect, AIReF continues to see a risk of non-compliance with the expenditure rule in 2024 for the CG, all the ARs and thirteen large LGs subject to individual analysis. Furthermore, according to AIReF's estimates, the growth in primary expenditure net of revenue measures will stand at 4.3% in 2024, compared with the 2.6% limit established by the Council's specific recommendation for Spain. Aside from the legal consequences, the forecast increase in eligible expenditure leads to a decline in the medium-term fiscal position of the GG sector. Moreover, in view of the preparation of the medium-term fiscal-structural plan, it also raises the necessary adjustment to be made by the Spanish General Government to meet the medium-term fiscal targets set by the Council. Moreover, with a view to drawing up the medium-term fiscal-structural plan, it also increases the necessary adjustment that Spanish GG authorities will have to make in order to comply with the sustainability requirements of the new European fiscal governance framework.

In view of the above, AIReF recommends that the Ministry of Finance (MINHAC) activate the preventive measures contained in Article 19 of the Organic Law on Budgetary Stability and Financial Sustainability (LOEPSF) for all the ARs and 13 of the LGs under individual analysis. Furthermore, insofar as Article 19 is not applicable to the CG, AIReF recommends that the Ministry of Finance should appear before Congress[1] to explain the growth in expenditure net of discretionary revenue measures and the possible deviations, on the one hand, for the purposes of the national expenditure rule of the CG and, on the other hand, in relation to the country-specific recommendation (CSR) for 2024.

How has the macroeconomic scenario evolved?

AIReF has revised upwards the GDP growth forecast for 2024 to 2.4%, compared with the previous estimate of 2%. For its part, the forecast increase in the GDP deflator remains unchanged with respect to the previous estimate, at 3.2%, such that the increase in nominal GDP is revised up to 5.7%, compared with the 5.4% previously estimated.

In recent months, the Spanish economy has continued to show high GDP growth rates, higher than those projected just a few months ago and higher than those recorded by the euro area economies. The factors underlying this buoyant performance are revenue from tourism and exports of other services, together with the influx of foreigners, which has underpinned job creation and household spending. In turn, inflation has halted its downward trajectory due to the downward resilience of price increases in service activities which, in general, face strong demand pressures.

Looking ahead, the expected easing of financing conditions in the economy, high household savings rates and the buoyant performance of the labour market will underpin high growth rates in the short term, albeit lower than those recorded in the first quarter of 2024 (0.8%).

[1] Although no reference to the CG is included in the section on preventive measures in the LOEPSF, the application of corrective measures is provided. Accordingly, Article 23.2 of the LOEPSF states *that "The Economic-Financial Plan and the Rebalancing Plan of the Central Government shall be drawn up by the Government, at the proposal of the Minister of Finance and General Government, and shall be submitted to Parliament for approval, following the procedure provided for in Article 15.6 of this Law* ".

Nonetheless, the decline in productivity and the economy's reduced investment intensity pose downside risks to the medium-term projection scenario that the Government published on July 16th in its Report on the Economic Situation. Specifically, in the short term, the Government's macroeconomic scenario projects real GDP growth of 2.4% in 2024, identical to AIReF's estimate, and 2.2% in 2025, which, although it is above the consensus forecast, could be achievable given the economy's good cyclical momentum. However, from that year onwards the GDP growth forecasts by the Government are systematically higher than those estimated by AIReF and other institutions. Moreover, compared with its previous estimates, the Government now includes in this scenario a fiscal adjustment of 0.6 percentage points in 2025 and 0.5 percentage points in 2026 and 2027. In this respect, the Government should be more explicit about the content and impact of the reforms that lead it to project an increase in the medium-term growth of the economy to 2%, and more than offset the negative impact on growth of the planned fiscal consolidation.

How has AIReF modified its budgetary forecasts?

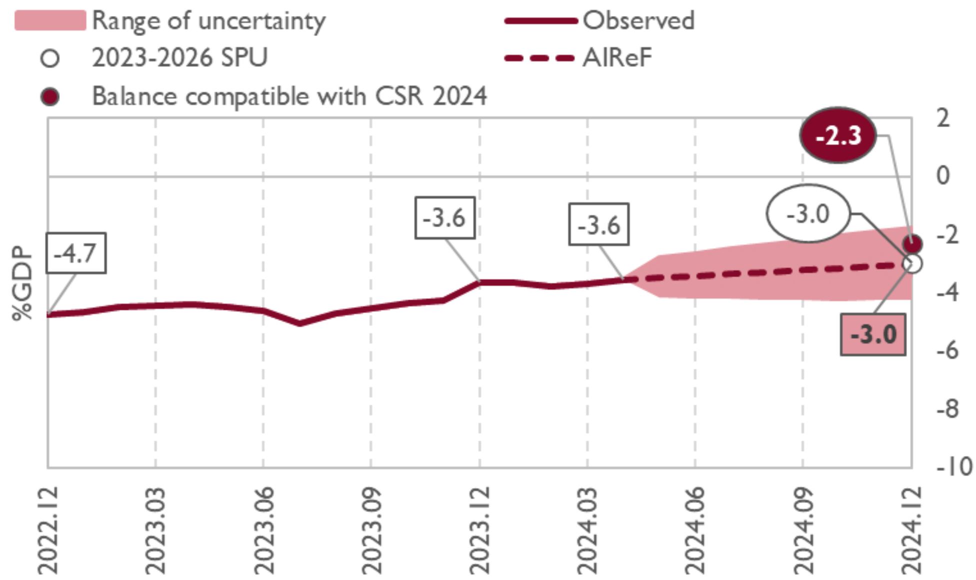
AIReF maintains its forecast for the General Government deficit at 3% of GDP in 2024, in line with the Government's forecast for this year. The update of the macroeconomic forecasts implies an increase in tax collection forecasts of 0.2 points. In contrast, the new extension of the measures to address the rise in energy prices and the effects of the war in Ukraine, together with other measures, imply an increase in the deficit of 0.1 points of GDP. In addition, the latest budgetary execution and tax collection data imply contrasting revenue and expenditure revisions by sub-sector which, on an aggregate basis, imply an increase in the deficit by 0.1 points of GDP.

As a result, the deficit reduction in 2024 would be 0.6 points of GDP from 3.6% in 2023. Following the approval of Royal Decree-laws 3/2024 and 4/2024, the measures adopted to mitigate the effects of the war in Ukraine and the energy crisis amount to 0.3% of GDP in 2024, 0.5 points less than in 2023. Furthermore, the increase in expenditure associated with court rulings and the increase in pension spending almost offset the evolution of other expenditure and the increase in tax collection. Lastly, the rest of the revenue measures will have a neutral effect on the deficit in 2024 as they offset those adopted in the different sub-sectors.

Revenue will reach 42.5% of GDP in 2024, excluding the Recovery, Transformation and Resilience Plan (RTRP), the same level projected in the previous report. This represents growth of 6.8% compared with 2023. The increase in the GDP forecast for 2024 results in a reduction in the ratio of revenue to GDP of almost 0.2 points. This denominator effect is offset by the positive impact on tax collection of the new macroeconomic scenario, mainly in social contributions and, to a lesser extent, in Personal Income Tax and VAT. Furthermore, the new data available imply an increase in the forecast of 0.1 points of GDP. In contrast, the new extension of the reduction in VAT rates means a reduction in tax collection of just over €800 m.

Expenditure, also without the RTRP, will stand at 45.5% of GDP, less than 0.1 points above the level projected in the previous report. Expenditure growth in 2024 is projected at 5.2%. The budgetary execution data lead to a higher forecast for expenditure by the Social Security Funds and the ARs, including the new measures adopted by some Regions on staff. The RTRP execution forecast has also been revised downwards to almost one point of GDP, which will bring the level of expenditure to 46.4% of GDP including the RTRP.

FIGURE 1. GENERAL GOVERNMENT NET BORROWING/NET LENDING



Source: AIReF, IGAE and SPU

What changes have taken place at the sub-sector level?

Compared with the previous report, AIReF raises the forecast deficit for the ARs to 0.3% of GDP, while the forecast deficit for the CG improves to 2.5% of GDP. Furthermore, the deficit forecast of the Social Security Funds is maintained at 0.3% of GDP, since the increase in revenue from social contributions due to the improvement in the macroeconomic scenario is offset by the increase in the expenditure forecast deduced from the analysis of the budgetary execution data. Finally, the LGs sustain the surplus forecast of 0.1% of GDP.

Compared with a reference rate of 2.6% in the national expenditure rule, AIReF forecasts that the CG will achieve growth in eligible expenditure of 4.8%. Furthermore, the forecast for growth in eligible expenditure in the AR and LG sub-sectors is 6.7% and 7.3%, respectively. Consequently, in line with the previous report, AIReF observes a risk of non-compliance with the national expenditure rule of the CG, all the ARs and ten of the large LGs subject to individual analysis. Specifically, these are the City Councils of Valencia, Palma, Las Palmas de Gran Canaria, Gijón/Xixón, Vitoria-Gasteiz, the Provincial Councils of Barcelona and Seville, the Island Council of Tenerife, the Island Council of Majorca and the Chartered Council of Gipuzkoa.

TABLE 1. EVOLUTION OF NET LENDING/BORROWING BY SUB-SECTOR

	Government estimate 2024	AIReF estimate 2024		Difference Current - Initial Budgets
	2023-2026 SPU	Rep. Initial Budgets	Current	
GG	**-3.0**	**-3.0**	**-3.0**	**0.0**
CG	-3.0	-2.7	-2.5	0.2
SSFs	-0.2	-0.3	-0.3	0.0
ARs	0.1	-0.1	-0.3	-0.1
LGs	0.2	0.1	0.1	0.0

Source: AIReF, IGAE and SPU

What are the implications from the point of view of compliance with the Country-Specific Recommendation for Spain and from the point of view of sustainability?

The forecast year-end data will represent the basis for the medium-term fiscal strategy, shored up in the fiscal-structural plan that Spain will have to present in the autumn. In this respect, the European institutions issued a specific quantitative recommendation to Spain aimed at limiting growth in primary expenditure net of revenue measures to 2.6% in 2024. According to AIReF's estimates, growth in this variable will stand at 4.3%, i.e. above the established reference. Given the current forecasts, complying with the recommendation would require additional measures to restrain expenditure and/or increase revenue with a total impact of €10.7 bn (0.7 points of GDP). Under AIReF's current scenario, complying with the recommendation would mean reaching a deficit figure in 2024 of 2.3% instead of the 3% currently forecast by AIReF, i.e. a reduction in the deficit of 1.4 points of GDP with respect to the figure recorded in 2023.

AIReF's macro-fiscal forecasts project that the debt-to-GDP ratio this year will fall by 2.3 percentage points from the level recorded in 2023, which would place the ratio at 105.3% at the end of 2024. The update of the debt ratio projection represents an improvement of 0.5 points on AIReF's projection in the "Report on the Initial Budgets of the General Government for 2024". Furthermore, the reduction in the ratio continues to be underpinned by nominal GDP growth, where the deflator continues to make a significant contribution.

What recommendations does AIReF make in this context?

In addition to the aforementioned recommendations regarding compliance with the national expenditure rule, AIReF makes two recommendations to the Ministry of Finance to enhance the transparency of the fiscal framework:

- Publication of a guide for the calculation of expenditure net of discretionary revenue measures in accordance with the new European framework, both for the whole General Government sector and for each of the sub-sectors, including the Social Security Funds. This guide should break down the specifics of the calculation for each sub-sector.
- Resume publication of the evolution of the eligible expenditure for the purposes of calculating the national expenditure rule for the sub-sectors of the CG, the ARs, including an individual breakdown by Region, and the LGs, in the same terms as before the pandemic.