REPORT ON BUDGETARY EXECUTION, PUBLIC DEBT AND EXPENDITURE RULE 2024

REPORT 22/24

Independent Authority for Fiscal Responsibility

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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.

Contact AIReF:

C/José Abascal, 2, 2nd floor. 28003 Madrid, Tel. +34 910 100 599

Email: Info@airef.es.

Web: www.airef.es

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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

[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* ".

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%).

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?

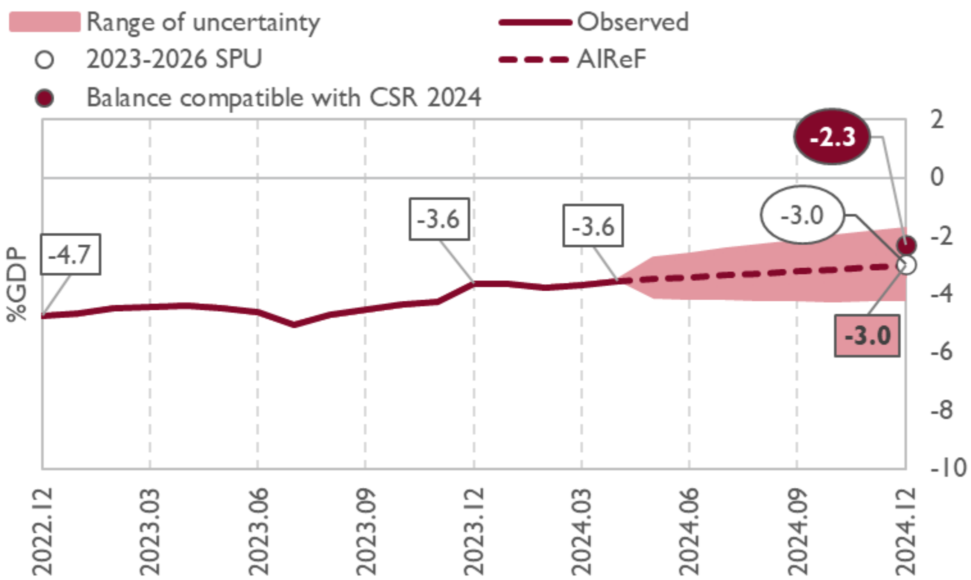
AIReF maintains its forecast for the General Government deficit at 3% of GDP in 2024, in line with the Government's forecast for this year. The update of the macroeconomic forecasts implies an increase in tax collection forecasts of 0.2 points. In contrast, the new extension of the measures to address 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 LENDING/BORROWING



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.

1. INTRODUCTION

By issuing this report, AIReF fulfils its legal mandate to report on the budgetary execution, public debt and the expenditure rule for 2024. In accordance with Article 17 of Law 6/2013 of November 14th, creating AIReF and Article 19 of Royal Decree 215/2014, approving its Organic Statute, AIReF is required to express a view on compliance with the budgetary stability and public debt targets and the expenditure rule for the current fiscal year by July 15th each year.

2024 marks the return to the recently reformed European fiscal rules. This year marks the start of the implementation of the new European fiscal rule framework after its final approval last April. As a result, in the autumn, the Government will submit a fiscal-structural plan to the European institutions that will guide fiscal policy over the next four years. In addition, Spain is obliged to comply with the Country-Specific Recommendation (CSR) for 2024, which consists of limiting the growth of primary expenditure net of discretionary revenue measures to 2.6% during this fiscal year.

At a domestic level, national fiscal rules have been reactivated in their current configuration until they are adapted to the new European fiscal framework. After four years of suspension, the Government has re-set the stability and public debt targets for 2024, as well as the expenditure rule established in the current Organic Law on Budgetary Stability and Financial Sustainability (LOEPSF). However, the targets approved by the Government have not been ratified by the Spanish Parliament, as required by Article 15.6 of the LOEPSF, as they did not overcome the Senate's veto. In these circumstances, the

Government has considered the forecasts contained in the 2023-2026 Stability Programme as stability targets for 2024. Specifically, a headline deficit of 3% of GDP is considered for the General Government sector as a whole, with the following breakdown by sub-sector: a deficit of 3% for the CG, 0.2% for the SSFs, equilibrium for the ARs and a surplus of 0.2% for the LGs. Furthermore, the reference rate of the expenditure rule, which does not require parliamentary approval, limits the increase in expenditure to 2.6% for 2024.

AIReF has already expressed its views on the macroeconomic forecasts for 2024 on two previous occasions. The first time was on October 26th, 2023, when it reported on the draft budgets and main budgetary lines of the GG[2] for 2024, supplemented by the individual reports on the ARs[3] and the report on the LGs[4] evaluated individually. The second occasion was on April 11th, 2024, when it expressed its view on the initial budgets of the GG[5] for 2024, together with the individual reports on the ARs[6] and the LGs.[7]

The macroeconomic and budgetary evaluation for 2024, contained in this report, is divided into eight sections. Following this introduction, Section Two describes the aim and scope of the report. Section Three updates the macroeconomic scenario underpinning the fiscal projections, indicating the reasons for the changes. Section Four then discusses the evaluation of the budgetary scenario, analysing in detail the changes that have occurred in the 2024 estimates of revenue and expenditure for the General Government sector as a whole and for each of the sub-sectors in relation to AIReF's latest view in its report on the initial budgets last April. It also updates the impact of fiscal policy measures and analyses the main contingent liabilities and fiscal risks for this year. Section Five evaluates the fiscal policy stance, while section Six analyses the challenges to the sustainability of public finances arising from the updated macroeconomic and budgetary scenarios. Subsequently, Section Seven reports on the advisability of activating the corrective mechanisms provided for in the LOEPSF. Finally, Section Eight presents the recommendations derived from the analysis.

[2] Report on draft budgets and main budgetary lines of the GG for 2024

[3] Reports on individual draft budgets and main budgetary lines of the ARs for 2024

[4] Report on draft budgets and main budgetary lines of the LGs analysed individually for 2024

[5] Report on initial budgets of the GG for 2024

[6] Reports on individual initial budgets of the ARs for 2024

[7] Supplementary report on individual evaluation of initial budgets of LGs for 2024

2. AIM AND SCOPE

The purpose of this report is to assess compliance with the budgetary stability and public debt targets, as well as with the expenditure rule for the General Government in 2024. In accordance with Article 17 of Organic Law 6/2013 creating AIReF, it will consider budgetary execution and the measures planned in the current year and in the previous year. It will also identify the potential risks of non-compliance for each of the agents that make up the General Government sector.

For this evaluation, AIReF updates the macroeconomic forecasts and fiscal forecasts for the General Government sector for 2024, contained in the Report on the Initial Budgets issued on April 11th. AIReF's evaluation incorporates the latest data published on budgetary execution, the new measures approved, the latest information available on the macroeconomic and fiscal environment and the additional information received. In particular, this report includes the measures approved by the Central Government by means of Royal Decree-Laws 3/2024 and 4/2024, the latest data published by the IGAE (General State Comptroller) in national accounting terms (May for the State, April for the CG, CG bodies, the SSFs and the ARs as well as the first quarter for the LGs), the budgetary execution of the different sub-sectors (May for the Central State Administration, Social Security System, SEPE and FOGASA and April for the ARs), monthly information on tax collection from the AEAT (State Tax Administration Agency), also for the month of May, the pension payroll (eSTADISS database) and statistics on unemployment benefits. It also includes information on the annual Personal Income Tax campaign, as published in the State Tax Administration Agency's press release.

This analysis is performed for all the sub-sectors, including the individual analysis by Autonomous Region and is completed with an overview of the whole GG sector. In particular, the scope of the report covers:

- The Central Government sub-sector.
- The Social Security Funds sub-sector.
- The Autonomous Regions sub-sector and each of them individually.
- The Local Governments sub-sector. In particular, the 25 large Local Governments will be analysed, i.e. 17 City Councils with more than 250,000 inhabitants, the Provincial Councils of Barcelona, Valencia and Seville, the Island Council of Tenerife and the Island Council of Majorca and the Chartered Councils of Gipuzkoa, Bizkaia and Araba/Álava. In addition, Local Governments with significant sustainability risks will be evaluated according to AIReF's selection and rating methodology.

The analysis by sub-sector is completed with an overview of the situation for the whole GG sector.

The scope of the report has been constrained by the absence of the following information common to previous reports:

- ✓ Complete and updated information on the impact of the main contingent liabilities that could have an impact on the year's deficit. Currently, this information is very important due to the numerous legal proceedings under way, whose unfavourable resolution for the interests of the State could have a significant impact on the 2024 deficit.
- ✓ Information on investments in defence modernisation programmes, the volume of which should have an increasingly significant impact on the deficit due to the Government's commitment to NATO to increase defence spending to 2% of GDP by 2029.

3. MACROECONOMIC SCENARIO

The Spanish economy continues to show remarkable strength. Short-term growth is being driven by the buoyant performance of revenue from tourism and exports of other services. Moreover, the influx of the immigrant population is sustaining employment growth and household creation, while the recovery in wages and the increase in social benefits has boosted household income growth. Against this backdrop, AIReF has revised the expected GDP growth for 2024 upwards to 2.4% compared with the previous 2%. Nonetheless, the weakness of the investment process and the scant progress made in productivity project downside risks around the medium-term scenario.

As regards prices, AIReF maintains its forecasts unchanged. Despite the fall in energy prices, services and some foodstuffs are showing strong downward resistance and therefore the downward trajectory of inflation seems to have reached a floor in Spain, at levels above those of euro area countries. The expected growth in the GDP deflator for 2024 is 3.2%, which places GDP growth at current prices at 5.7%.

AIReF considers that the medium-term scenario that the Government published in its Report on the Economic Situation is optimistic. In the short term, the Government's macroeconomic scenario projects real GDP growth of 2.4% in 2024, identical to AIReF's estimate. However, from that year onwards the GDP growth forecasts by the Government are systematically higher than those estimated by AIReF and other institutions such as the European Commission or the Bank of Spain (see box 1). The scant physical, technological and human capitalisation effort and the persistent weakness in the productive efficiency of the economy lead AIReF to be more cautious in relation to the Government's scenario. It should also be noted that, compared with its previous estimates, the Government now includes a fiscal adjustment of 0.6 percentage points in 2025 and 0.5 percentage points in 2026 and 2027 in this scenario. 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 medium-term growth of the economy to 2%, and more than offset the negative impact on growth of the expected fiscal consolidation.

3.1. Recent evolution of the Spanish economy

The growth of economic activity in Spain maintains significant dynamism, higher than anticipated a few months ago and higher than that of the euro area economies. The revised Quarterly Spanish National Accounts figures for the first quarter of 2024 raise quarter-on-quarter GDP growth to 0.8% in the first quarter of the year, higher than the 0.3% average for the euro area. The information available for the second quarter of 2024, summarised in AIReF's MIPred model, suggests that GDP would have maintained high growth rates in that period, close to 0.4%, with a certain profile of deceleration throughout the quarter.

FIGURE 2. EVOLUTION OF GDP IN SPAIN AND THE EMU

FIGURE 2. A. QUARTER-ON-QUARTER GDP GROWTH FOR SPAIN AND THE REST OF EMU*.

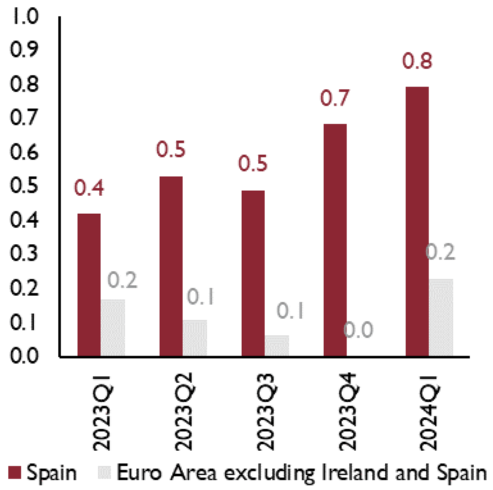
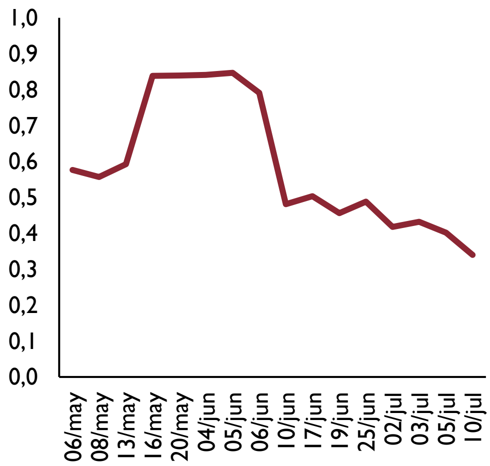


FIGURE 2. B. REAL TIME ESTIMATE OF GDP. REAL GDP QUARTER-ON-QUARTER RATE FOR THE SECOND QUARTER OF 2024 (MIPRED)



Source: Eurostat and AIReF

The composition of growth continues to be largely based on the contribution of the foreign trade sector, where the upward surprises are concentrated. In particular, revenue from tourism continues to show significant dynamism (with growth rates of 21.6% in the first four months of the year, according to Balance of Payments figures) and there is a greater influx of foreign tourists outside the summer season, greater diversification of the countries of origin and an increase in average spending per tourist. GDP from tourism, which measures the economic contribution of this activity to the GDP of the Spanish economy, amounted to almost 13% of total GDP in 2023, exceeding pre-pandemic records.

At the same time, exports of other non-tourism services maintain a marked dynamism. Since 2019, exports of non-tourism services have grown by 34.4%, with significant gains in telecommunications, IT and information and trade-related technical and other business services. All this offsets the sluggishness shown by the export of goods in a context of relative weakness in euro area economies, despite their recent improvement, and a gradual increase in protectionism and geographical fragmentation of world trade.

FIGURE 3. EVOLUTION OF EXPORTS OF GOODS AND SERVICES

FIGURE 3. A. EXPORTS OF GOODS AND SERVICES. VOLUME TERMS (2015=100)

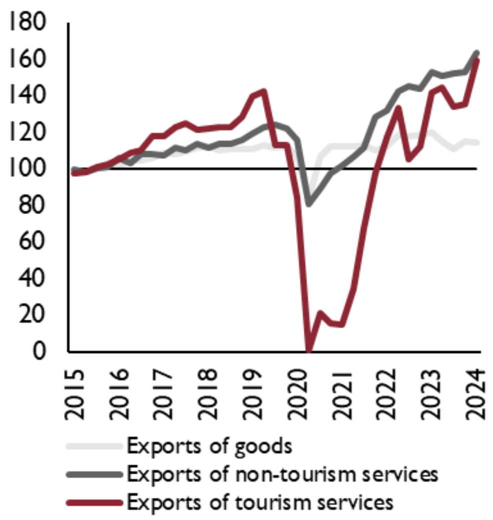
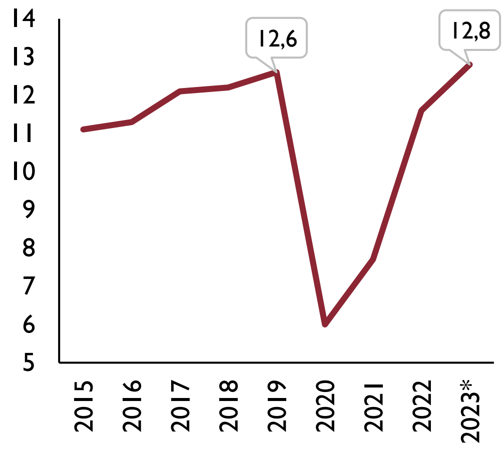


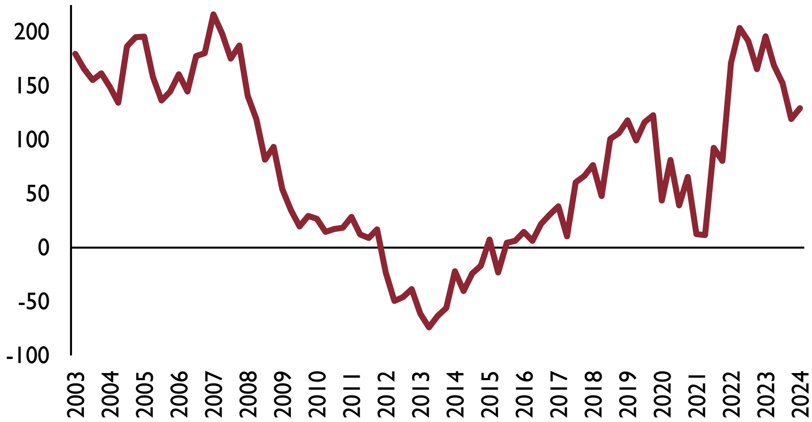
FIGURE 3. B. TOURISM GDP (% GDP)



Source: INE and *Exceltur

In addition to the favourable performance of the foreign trade sector, the second pillar underpinning the growth of the Spanish economy is the inflow of the foreign population, the implications of which are manifested on several fronts. In particular, after a slowdown in net foreign immigration towards the end of 2020 and the beginning of 2021, due to the restrictions on international mobility related to COVID-19, very high flows were observed in 2022 and 2023, comparable to those of the early 2000s. In the first few months of 2024, net immigration has lost momentum, although it remains above the values observed after the financial crisis.

FIGURE 4. NET FOREIGN MIGRATION (THOUSANDS OF PEOPLE)



Source: INE, Eurostat and AIReF

The population increase, together with rising wages, helps underpin the dynamism of employment and wage incomes. Household disposable income rose in current terms by 11% in 2023 and by 9.1% year-on-year in the first quarter of the year, allowing a remarkable recovery of the purchasing power lost due to the inflationary shock in 2022. This growth in disposable income is being driven by the buoyant performance of employment and the creation of new households together with growth in wages and pensions. In addition, net dividend and interest income made a positive contribution to disposable income growth.

FIGURE 5. GROSS DISPOSABLE INCOME AND HOUSEHOLD AND NPISH SAVINGS RATE

FIGURE 5. A. CONTRIBUTIONS TO THE CHANGE IN GDI OF HOUSEHOLDS AND NPISHS (% AND P.P.)

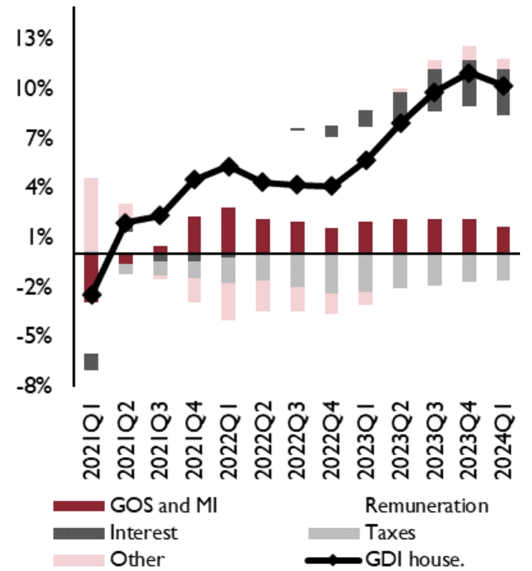
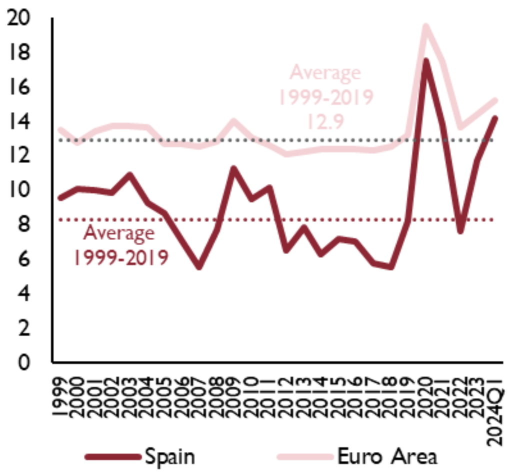


FIGURE 5. B. HOUSEHOLD SAVINGS RATE (% OF GDI)



Source: INE and Eurostat

In a context of buoyant household income and moderate growth in consumer spending, the household savings rate has reached historically high levels. Despite the increase in population and disposable income, private consumption has maintained moderate growth, with growth rates of 0.3%-0.4% in the last few quarters, due to interest rates remaining high. In this context, the savings rate rose to 11.7% of gross disposable income (GDI) in 2023 and 14.2% in the first quarter of 2024, well above the average of 8.3% observed between 1999 and 2019 (see box 2).

Households continued to deleverage in 2023 and in the first quarter of 2024, maintaining a very favourable financial position. The household debt ratio fell to 72% of GDI in the first quarter of 2024, a level not seen since the end of 2001 and 14 percentage points below the euro area average. However, it should be borne in mind that the deleveraging process of Spanish households partly reflects the lower access to home ownership of young households compared with previous cohorts[8].

Investment, on the other hand, maintains a very moderate increase. Despite the upturn in the first quarter of 2024, investment remains weak overall. By component, only intangible assets show an increase in recent years, while the rest of the components remain below pre-pandemic levels. The tightening of

[8] See Bank of Spain

financial conditions could be encouraging companies to use their surpluses to reduce their debt levels, rather than to increase investment. According to Bank of Spain figures, the unconsolidated debt of non-financial corporations stood at 81% of GDP in the first quarter of 2024 (compared with 88.5% a year earlier and below the average for the euro area). Moreover, AIReF estimates that in 2024 the execution of investments related to the Recovery, Transformation and Resilience Plan (RTRP) will increase slightly compared with 2023 (seebox 4).

FIGURE 6. PRIVATE SECTOR INVESTMENT AND DEBT

FIGURE 6. A. EVOLUTION OF GROSS FIXED CAPITAL FORMATION BY PRODUCT TYPE (CHANGE COMPARED WITH 2019 LEVELS, %)

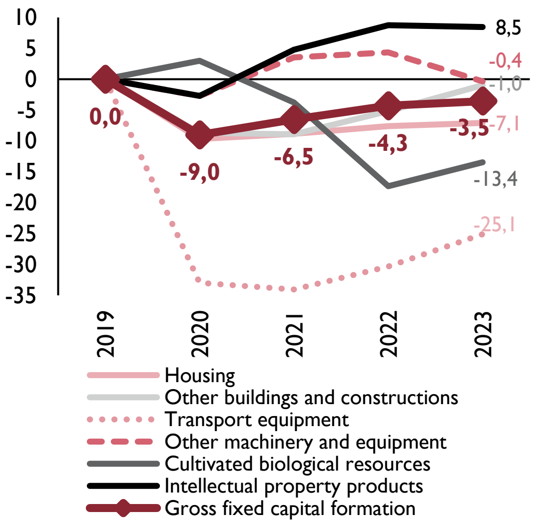
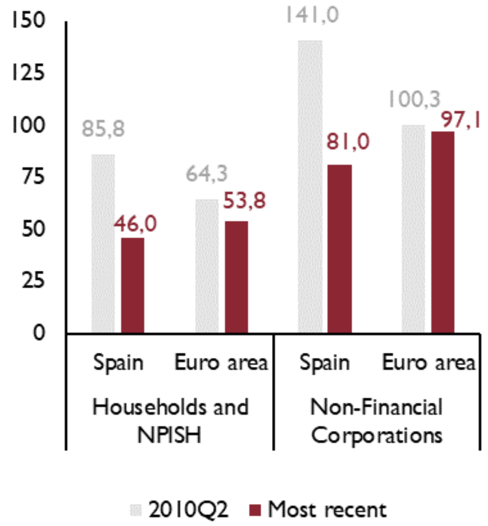


FIGURE 6. B. COMPARATIVE EVOLUTION OF THE DEBT RATIO OF HOUSEHOLDS AND NPISHS AND NON-FINANCIAL CORPORATIONS (% GDP)



Source: INE, Bank of Spain and Eurostat.

Immigration is supporting very dynamic labour market performance and lower wage pressures compared with other European economies. In the second quarter of 2024, average affiliation increased by 533,693 people compared with the first quarter. This is the second largest increase in a second quarter on record, behind only the increase in affiliation recorded in the second quarter of 2023. In year-on-year terms, Social Security affiliation grew by 2.43% in the second quarter, slightly lower than in recent quarters. Since the entry into force of the labour market reform, affiliation growth has been concentrated in permanent contracts. As a result, there has been a sharp fall in temporary employment, despite the slight seasonal upturn in June.

FIGURE 7. EVOLUTION OF SOCIAL SECURITY AFFILIATION

FIGURE 7. A. QUARTERLY AFFILIATION. YEAR-ON-YEAR RATE (%)

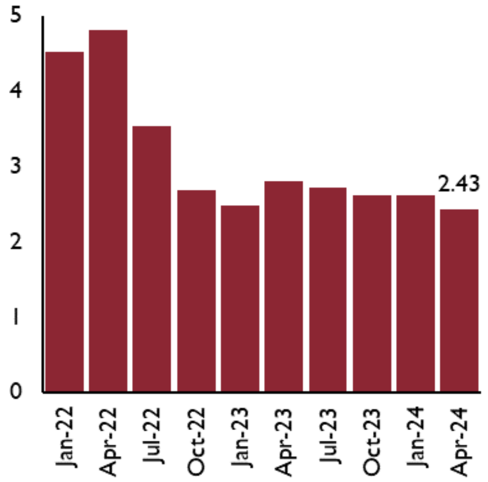
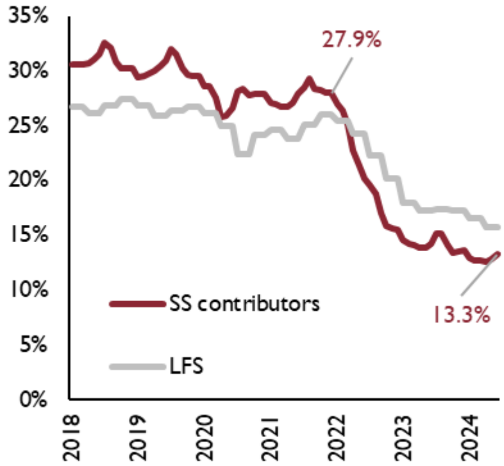


FIGURE 7. B. SEASONALITY RATE (%)



Source: Haver

Despite the reduction in temporary employment, there is still high turnover in the labour market. As AIReF has been pointing out in previous reports, affiliation rates show a high turnover with sharp fluctuations at the start and end of each month and at the start and end of each week. In addition, since January 2022 there has also been an increase in the number of permanent contracts per person. Since the entry into force of the labour reform, the number of deregistrations of permanent workers for various reasons, such as dismissal, end of the probationary period, voluntary grounds or seasonal workers becoming inactive, has increased sharply. While some of these causes of deregistration are inherent to the labour reform, such as the inactivity of seasonal workers, others, such as the end of the probationary period or dismissals, point to a higher turnover of permanent workers.

FIGURE 8. DEREGISTRATIONS OF PERMANENT WORKERS

FIGURE 8. A. DISMISSALS (% DEREGISTRATIONS OVER PERMANENT SS CONTRIBUTORS)

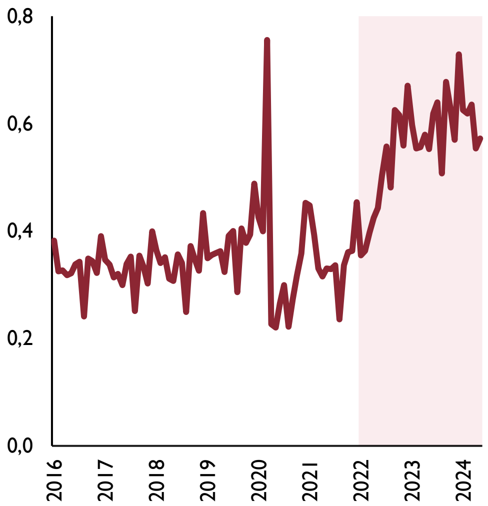


FIGURE 8. B. VOLUNTARY CAUSES (% DEREGISTRATIONS OVER PERMANENT SS CONTRIBUTORS)

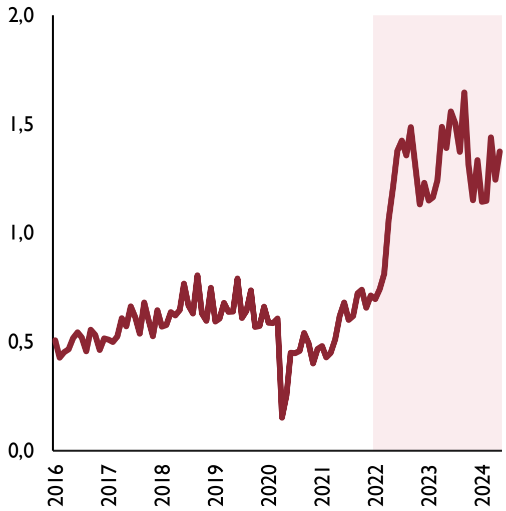


FIGURE 8. C. END OF PROBATIONARY PERIOD (% DEREGISTRATIONS OVER PERMANENT SS CONTRIBUTORS)

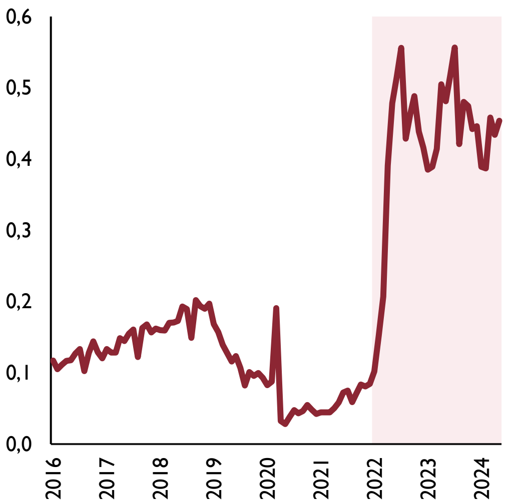
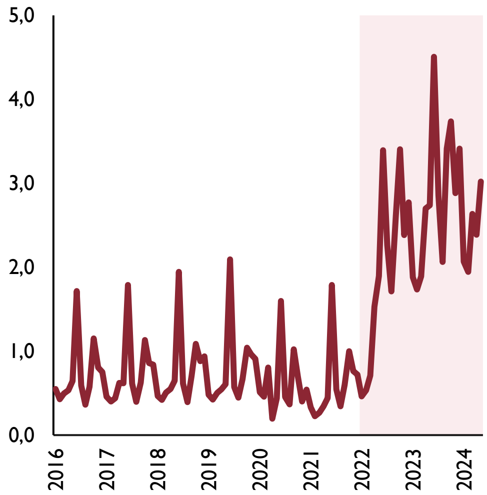


FIGURE 8. D. INACTIVITY PERMANENT SEASONAL WORKERS (% DEREGISTRATIONS OVER PERMANENT SS CONTRIBUTORS) (%)



Source: Social Security

The evolution of employment has been conditioned by the intensity of recent demographic phenomena. Data from the Labour Force Survey (Spanish acronym: EPA) show that the total population in Spain has been growing in recent quarters at a year-on-year rate of around 1%. This growth can be explained by the increase in the foreign and dual nationality population, while the Spanish population is falling. This demographic evolution has been reflected in the labour market. In recent quarters, growth in activity has mainly been due to the increase in the number of active workers with foreign or dual nationality. Similarly, two thirds of the growth in EPA employment is concentrated in foreign and dual nationality workers. These increases in labour supply could have implications for real wage and productivity developments. In particular, in sectoral terms, foreign and dual nationals have made a larger contribution to employment growth in sectors such as hotels and catering, transport and trade, construction, household services and manufacturing. These sectors are characterised, with the exception of manufacturing, by a lower level of productivity.

FIGURE 9. LABOUR MARKET EVOLUTION BY NATIONALITY

FIGURE 9. A. CONTRIBUTIONS TO POPULATION GROWTH IN FAMILY HOUSES BY NATIONALITY (YEAR-ON-YEAR RATE, %)

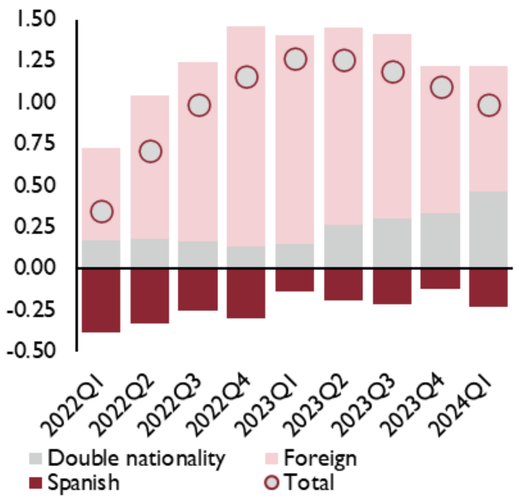


FIGURE 9. B. CONTRIBUTIONS TO EMPLOYMENT GROWTH BY NATIONALITY (YEAR-ON-YEAR RATE, %)

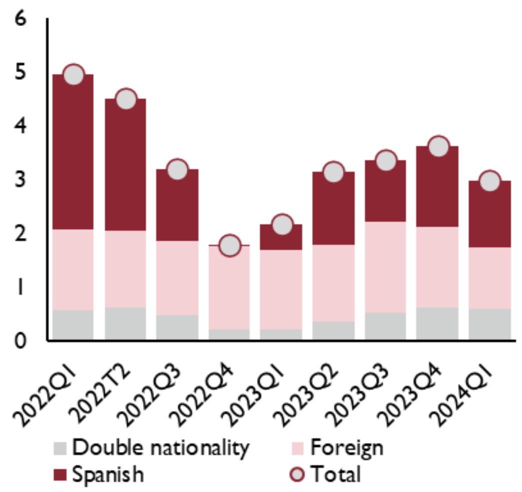


FIGURE 9. C. CHANGE IN EMPLOYEES BETWEEN 2022 AND 2023 (THOUSANDS)

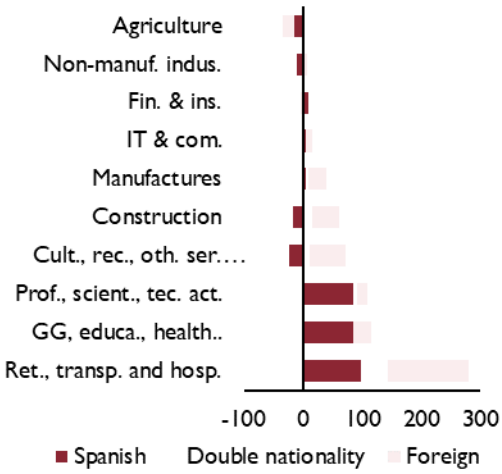
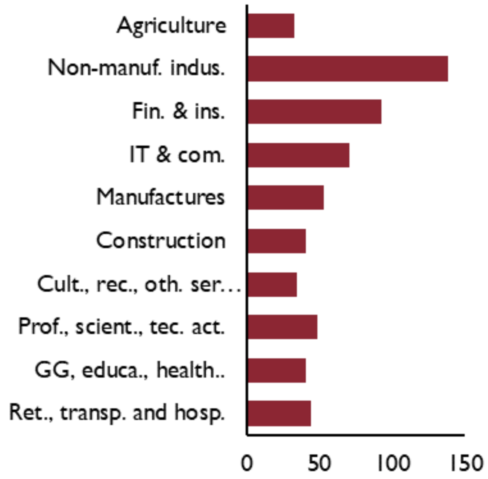


FIGURE 9. D. PRODUCTIVITY IN 2023 (€ THOUSAND 2015)



Source: INE

Despite these demographic changes, structural relationships in the labour market remain relatively stable. In the first quarter of 2024, the year-on-year growth of affiliation and GDP was in line with the historical relationship between the two variables, following the trend of recent quarters. Accordingly, there does not appear to be a structural change in the long-term relationship between employment and GDP growth for the time being. For its part, the relationship between the vacancy rate and the unemployment rate (Beveridge curve) reflects the fact that the stability of the unemployment rate has been accompanied by high values in the vacancy rate. This evolution could indicate that there are certain misalignments between the characteristics of unemployed workers and the vacancy profiles of companies, while the unemployment rate is close to its structural value.

FIGURE 10. STRUCTURAL RELATIONS IN THE LABOUR MARKET

FIGURE 10. A. OKUN'S LAW (%)

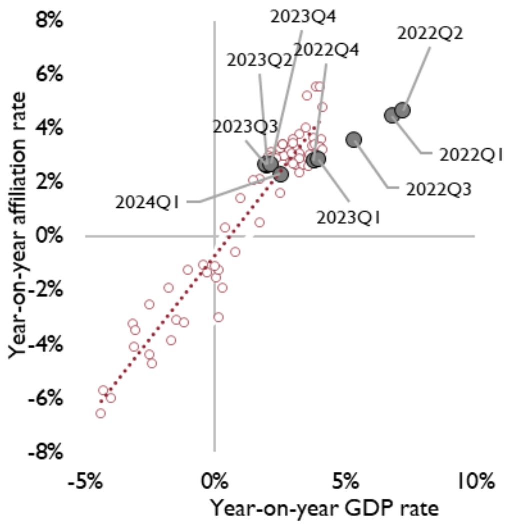
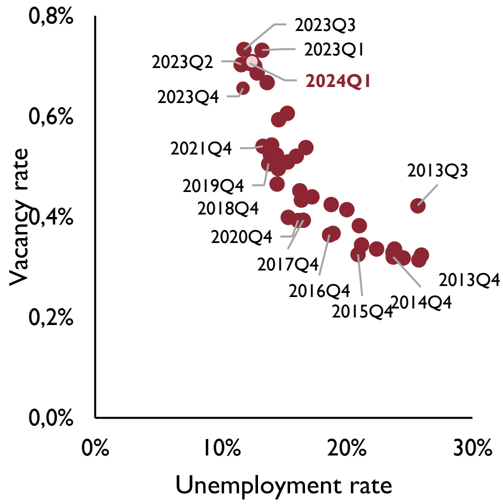


FIGURE 10. B. BEVERIDGE CURVE (%)

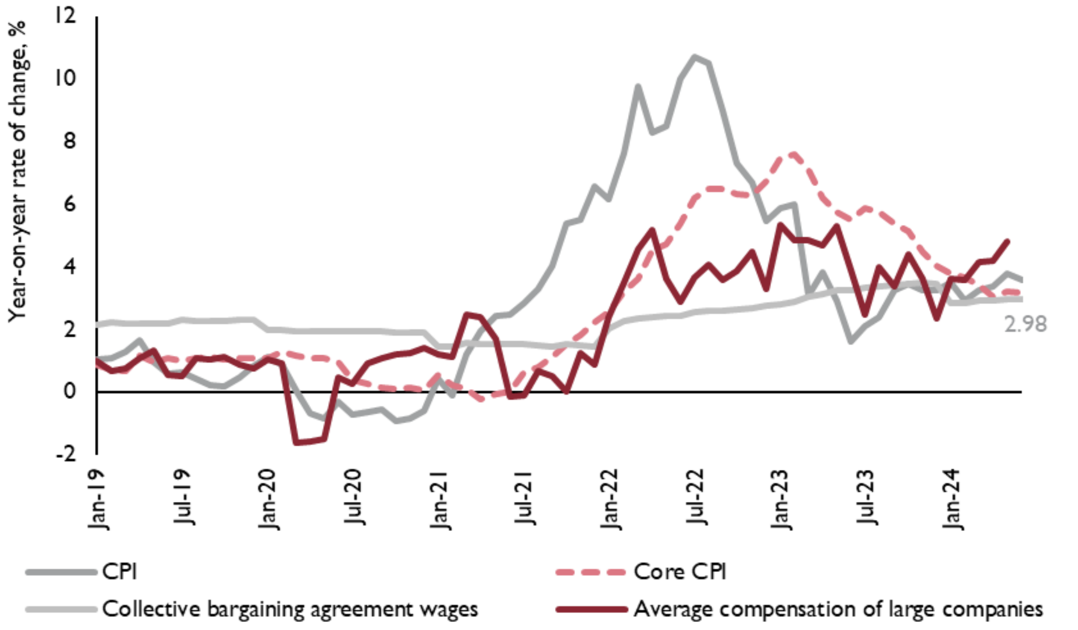


Source: Haver

In terms of wage evolution, collective bargaining wages are growing in line with core inflation. At the end of 2023, the growth agreed for the year stood at 3.6%, but as wage revisions are being applied throughout 2024, this rise is increasing slightly, now standing at 3.71%. In June 2024, the agreed wage increase for all agreements was 2.98%, similar to that of recent months. In contrast, the wage increase in newly-signed agreements in 2024 was higher than that of all agreements, reaching 3.97% in June 2024. Wage growth in large companies, on the other hand, was maintained at 4.18% in May 2024. The increase in newly-signed agreements, still with a low level of coverage, is well above the 3% for 2024 set in the 5th Agreement for Employment and Collective Bargaining (AENC), signed in May 2023 by trade unions and employers' organisations.

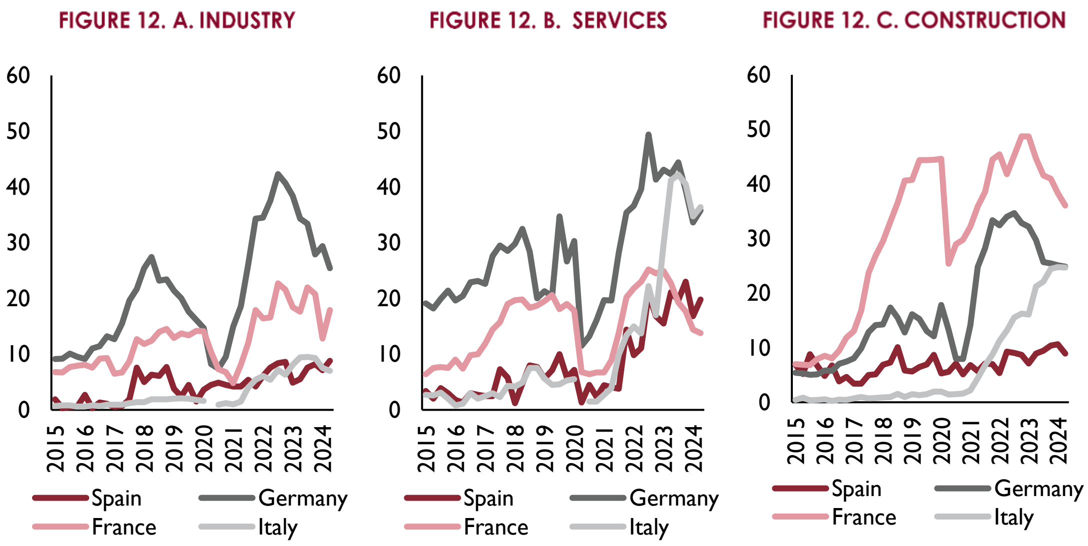
Nevertheless, wage pressures in the Spanish economy are lower than in other European countries. Real wages per hour worked were still 2.5% lower in the first quarter of 2024 than in the fourth quarter of 2019, while they are 2.3% higher - on average - in euro area economies, albeit with high variability across Member States. Strong immigration inflows may be allowing labour shortages to be lower than those generally seen in euro area economies.

FIGURE 11. EVOLUTION OF WAGES AND PRICES (%)



Source: Haver, Ministry of Economy, Trade and Enterprise and Ministry of Labour and Social Economy.

FIGURE 12. LABOUR AS A LIMITING FACTOR IN PRODUCTION

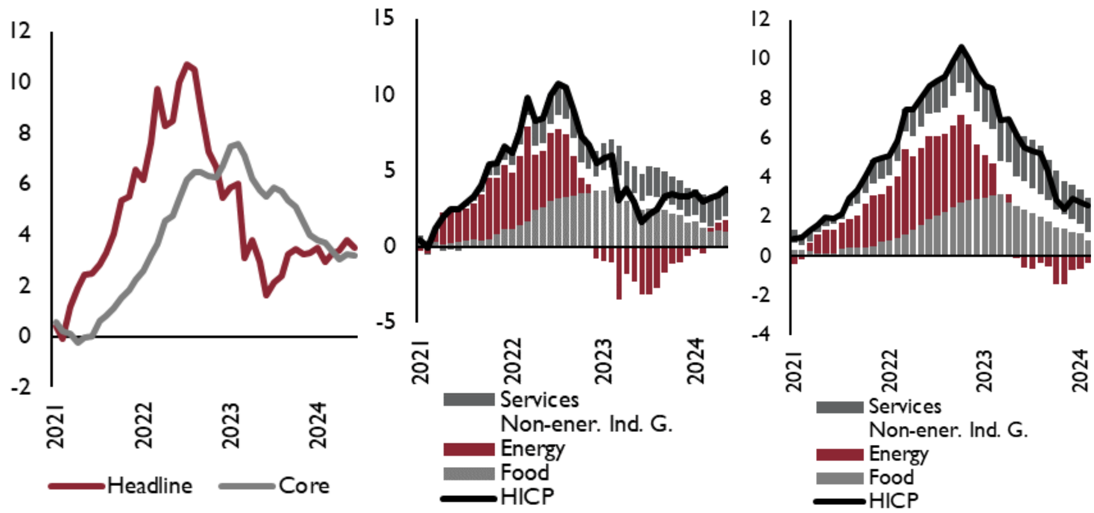


Source: European Commission

The containment of inflation appears to have reached a plateau in a context of high price increases in the services and some food sectors. According to Eurostat's harmonised inflation indicator, inflation in Spain has remained above 3% in recent months (3.5% in June), while in the euro area it fell by 0.1 points to 2.5% (1 percentage point lower than in Spain). With these data, Spain is the country with the second highest inflation in the EMU, behind only Belgium. Core inflation remained at 3.2% in Spain, while in the EMU it fell by 0.1% to 2.8%.

FIGURE 13. HARMONISED INFLATION IN SPAIN AND THE EURO AREA

FIGURE 13. A. SPAIN (%) | **FIGURE 13. B. SPAIN. CONTRIBUTIONS (%, P.P)** | **FIGURE 13. C. EURO AREA. CONTRIBUTIONS (%, P.P.)**



Sources: INE and Eurostat.

3.2. AIReF's economic forecasts for the Spanish economy in 2024

AIReF updates its macroeconomic outlook for 2024 and raises its GDP growth forecast from 2% to 2.4%. According to these estimates, growth in 2024 will mainly be underpinned by the contribution from domestic demand, while the foreign trade sector provides a positive contribution of 0.2 percentage points, but less than the 0.8 percentage points observed in 2023. As regards prices, there are hardly any revisions: the growth of the GDP deflator and the CPI are maintained at 3.2% in 2024 in both cases. AIReF estimates that the unemployment rate will fall to 11.6% in that year.

TABLE 2. AIREF'S MACROECONOMIC OUTLOOK FOR 2024

Year-on-Year Rates of Change	*2023*	*2024*	*Revision Year 2024*
Private Domestic Final Consumption Expenditure	1.8	2.4	-0.1
General Government Final Consumption Expenditure	3.8	1.2	0.0
Gross Fixed Capital Formation	0.8	3.6	0.9
GFCF Equipment and Cultivated Assets	*-1.3*	3.5	-0.4
GFCF Construction and Intellectual Property	*1.7*	3.6	1.4
Domestic Demand*	***1.7***	**2.3**	**0.1**
Exports of Goods and Services	2.3	3.3	1.3
Imports of Goods and Services	0.3	3.2	0.6
External Balance*	***0.8***	**0.2**	**0.3**
Gross Domestic Product	**2.5**	**2.4**	**0.4**
Nominal Gross Domestic Product	**8.6**	**5.7**	**0.4**
Gross Domestic Product Deflator	**5.9**	**3.2**	**0.0**
CPI	**3.5**	**3.2**	**0.1**
Full-Time Equivalent Employment	3.2	2.5	0.0
Unit Labour Cost	6.0	3.6	-0.3
Productivity per Full-Time Employee	-0.7	-0.1	0.4
Compensation per Employee	5.2	3.5	0.2
Unemployment Rate (% of Active Population)	12.2	11.6	0.1
Household and NPISH Savings Rate (% Gross Disposable Income)	11.7	12.4	2.7

* Contribution to GDP growth
Source: INE and AIReF forecasts

The revision of the growth estimate for the Spanish economy for 2024 is mainly due to the incorporation of the Spanish National Accounts figures published in June. This update incorporates the most recent Quarterly National Accounts (QNA) figures, the most recent evolution of the economic indicators and the new exogenous assumptions on commodities prices, the growth of the euro area, interest rates, etc. As can be seen in Figure 13figure 14 from this perspective, the upward revision in 2024 growth mainly reflects the upward revision in QNA figures for the final months of 2023 and the first quarter of 2024 with respect to what was previously published. Furthermore, the most recent contextual information supports an increase in GDP of 2.4%, higher than AIReF's estimate in the Report on the Initial Budgets.

FIGURE 14. BREAKDOWN OF THE SOURCES OF REVISION OF THE GROWTH RATE OF GDP IN VOLUME TERMS FOR 2024 WITH RESPECT TO THE APRIL MACROECONOMIC SCENARIO

Source: INE and AIReF

The revision of the exogenous assumptions has little impact on the growth outlook for 2024. The favourable impact on growth related to the improvement in economic growth in the euro area and in Spain's export markets is offset by a rise in energy commodity prices on international markets compared with what was expected in April. In the case of interest rates, in line with financial market expectations, external assumptions hardly change from what was projected a few months ago.

TABLE 3. EXOGENOUS ASSUMPTIONS OF AIREF'S MACROECONOMIC OUTLOOK 2024

	2023	2024	Revision 2024
3-month Euribor (%)	3,4	3,7	0,1
Interest Rate 10-year State Debt (%)	3,5	3,2	0,0
Broad NEER	121,8	123,8	0,1
Exchange rates $/€	1,08	1,08	0,0
Oil (US $/barrel)	83,8	84,0	2,8
TTF gas (€/Mwh)	41,5	33,3	6,6
MIBGAS (€/Mwh)	39,7	33,2	7,1
Export merc. (annual %)	-0,2	2,2	0,4

Source: IMF, Refinitiv and MIBGAS

By component, the upward revision in 2024 growth is underpinned by a stronger contribution from the foreign trade sector. Positive surprises in exports of tourism and other services, together with the improvement in the economic situation in the euro area, justify this upward revision in the expected growth of sales abroad. Expected growth in investment in construction and intellectual property is also revised upwards, while expected growth in private consumption is reduced, to reflect the latest information in both cases.

Nevertheless, it is expected that in the coming months the high rates of savings achieved and the easing of the economy's financing conditions will allow domestic demand to take over from the foreign trade sector as the driver of growth. These factors should boost private consumption, underpinning higher growth rates. For its part, the expected growth in investment continues to be conditional on attaining the estimates of the execution of the RTRP made by AIReF. In this regard, AIReF's current estimates forecast an impact of 0.8 percentage points in 2023 and 1.1 percentage points in 2024 on the level of GDP compared with a scenario without the RTRP, similar figures to those estimated in the Report on the Initial Budgets.

With regard to the labour market, job creation is expected to continue at a good pace in the second half of 2024. In particular, employment is expected to maintain similar rates of increase to GDP growth, resulting in a smaller fall in productivity than in recent months.

3.3. Forecast risks

Geopolitical uncertainty remains the main source of risks to the growth and inflation outlook. The complexity of the political landscape in the United States and Europe and active military conflicts may ultimately exacerbate economic fragmentation and trade tensions with China, also affecting commodity prices in international markets.

Domestically, deteriorating productivity and subdued investment are holding back the economy's growth potential. In the short term, immigration, the favourable financial situation of households, the easing of financing conditions and the buoyant performance of the labour market continue to underpin growth. However, the growth pattern of the Spanish economy continues to be based on the contribution of the labour factor, underpinned by the influx of foreigners, while progress in productive efficiency is still lacking. Added to this is the limited effort to capitalise the economy. As pointed out in the European Commission's report on the Spanish economy in the framework of the European Semester, Spain continues to have a deficit in investment in physical, technological and human capital that hampers productivity growth, medium-term growth prospects and the sustainability of public accounts in a context of an ageing population.

Furthermore, uncertainty is growing about the pace of easing financial conditions in the euro area given the recent upward surprises in inflation. Euro area inflation declined to 2.5% in June and continues to move closer to the 2% monetary policy reference rate. However, core inflation remains at 2.9% and services inflation has shown greater downward resilience than expected, amid strong demand. In addition, high wage pressures persist in the euro area, while inflationary pressures in oil and gas prices in international markets are discernible. Against this backdrop, the most recent projections of the European Central Bank (ECB) in June revise the inflation forecast for 2024 upwards by 0.2 points to 2.5% and for 2025 by 0.2 points to 2.2%. If these inflationary risks persist, the easing of monetary conditions could be slower than assumed in the forecast year.

BOX 1. THE MACROECONOMIC SCENARIO OF THE GOVERNMENT'S REPORT ON THE ECONOMIC SITUATION

Pursuant to Article 15.5 of Organic Law 2/2012, of April 27th, on Budgetary Stability and Financial Sustainability, the proposal to set budgetary stability and public debt targets will be accompanied by a report evaluating the economic situation for each of the years evaluated in the horizon in which the targets are set. In compliance with this law, on July 15th, the Government presented its Report on the Economic Situation, which includes a macroeconomic scenario for the years 2024-2027.

Given that this scenario is the one that many authorities take as a starting point for drawing up their own macroeconomic and budgetary scenarios, AIReF considered it advisable to express a view and, in that regard, it made a recommendation in October 2023 to the current Ministry of Economy, Trade and Enterprise to consult AIReF beforehand on the Report on the Situation of the Spanish Economy. This multi-year scenario takes on special importance following the entry into force of the new European fiscal framework as it will foreseeably serve as the basis for drawing up the Fiscal-Structural Plan that the Government will have to submit to the European institutions next autumn and which will determine, along with other elements, the expected debt forecast and the fiscal adjustment needs that could place it on a downward path. In these circumstances, AIReF considers it necessary to present its evaluation on the basis of its own medium-term macroeconomic forecasts.

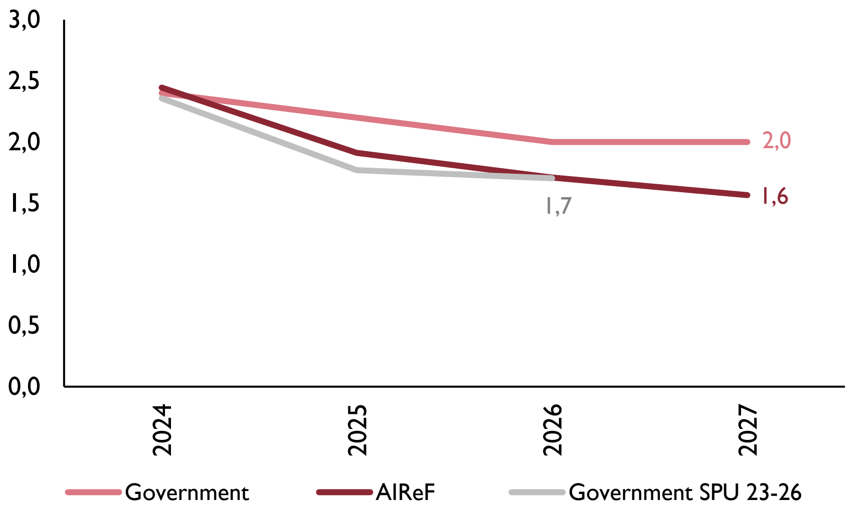
The Government's macroeconomic scenario projects real GDP growth of 2.4% in 2024, identical to that estimated by AIReF (see table 2) and other institutions.

However, from that year onwards the GDP growth forecasts by the Government are systematically higher than those estimated by AIReF and also those estimated by other institutions such as the European Commission and the Bank of Spain.

Specifically, for 2025 the Government projects growth of 2.2%, while AIReF projects growth of 1.9%, in line with the most recent FUNCAS Panel of July and with the Bank of Spain in its June projections report. Nevertheless, AIReF considers that the influx of foreigners, the improvement in the financial situation of households and the dynamism of exports could make that result attainable.

More in the medium term, a comparison with AIReF's projections and with other estimates available suggests that the Government's scenario is optimistic. Specifically, the Government expects real GDP growth of 2% in 2026 and 2027, while AIReF forecasts rates of 1.8% and 1.6%, respectively, in those same years. AIReF's expected forecast is in line with the forecast made by the Bank of Spain in its June 2024 forecasts, with expected growth of 1.9% and 1.7% in 2025 and 2026.

FIGURE B_1.1. GDP GROWTH PROJECTIONS 2024-2027



Source: AIReF, Ministry of Economy, Trade and Enterprise.

Along the same lines, the potential growth that can be deduced from the Government's scenario is above 2% over the projection horizon and around 2.3% at the end of it, in 2027. This potential growth is above that estimated by AIReF and the Bank of Spain, which stands at around 1.6% at the end of their respective forecasting horizons.

The factors that lead AIReF to consider this scenario to be optimistic, especially in the medium term, are as follows:

- By component, the biggest discrepancies are to be found in the higher growth in investment forecast by the Government in relation to AIReF and other institutions, which it justifies by the recovery in business confidence and the boost provided by the Recovery, Transformation and Resilience Plan. In this regard, it should be recalled that growth in this variable has systematically surprised on the downside since the pandemic, in a context of high interest rates and uncertainty in which companies have devoted their surpluses to reducing their debt levels instead of expanding their productive capital. The persistence of uncertainty and higher interest rates than in the past pose risks to the dynamic nature of this variable included in the Government's scenario.

- Furthermore, the Government's scenario incorporates expansionary behaviour in household spending driven, according to the Government, by the increase in the labour force and employment and by productivity gains that will lead to an improvement in the purchasing power of wages. Once again, AIReF considers that there are also risks surrounding this scenario because, although it is true that the financial situation of households is favourable, with low debt levels and high savings rates, according to our estimates a large part of that saving is concentrated in older individuals and at higher income levels, with a lower propensity to consume. The demand for housing, which has a lower weight in the purchase pattern of these individuals, could also be affected.

- Externally, trade fragmentation and geopolitical uncertainty are leading to successive downward revisions of medium-term global growth forecasts.

- On the supply side, the Government is basing its growth on an increase in the labour force and in productivity per hour worked. In this respect, the scant physical, technological and human capitalisation effort and the persistent weakness in the productive efficiency of the economy lead AIReF to be more cautious about the Government's scenario.

- Lastly, a key element is that, compared with its previous estimates, the Government incorporates for the first time in this scenario a fiscal adjustment of around 0.6 percentage points in 2025 and 0.5 percentage points in 2026 and 2027 (under the assumption that the one-off measures are zero over the projection horizon). If an average fiscal multiplier of 0.6 percentage points were applied, this adjustment would detract between 0.3 and 0.4 points from growth in each of these years.

- In this regard, the Government should be more explicit about the content and impact of the "planned labour reforms" or other measures or assumptions that lead it to revise the expected medium-term GDP growth upwards to 2%, more than offsetting the impact of the planned fiscal consolidation, and to project potential growth in excess of 2% at the end of the period.

Furthermore, the Report on the Economic Situation also establishes the reference rate that determines a limit on the variation in the eligible expenditure of the Central Government, the Autonomous Regions and Local Governments of 3.2%, 3.3% and 3.4% for the years 2025, 2026 and 2027. This rate is established taking as a reference the potential growth estimated by the Government, in accordance with the methodology established in Ministerial Order ECC/2741/2012. On this occasion, the reference rates may not be entirely consistent with the potential growth in GDP that would emerge from the Report on the Economic Situation itself. Furthermore, and given that no information is available on the expected Government revenue, it is not possible to analyse the degree of consistency between the reference rates for expenditure and the deficit targets set.

TABLE B_1.1 MACROECONOMIC OUTLOOK 2024-2028

		AIReF Apr 24					*Government*			
Year-on-Year Rates of Change	***2023***	***2024***	***2025***	***2026***	***2027***	***2028***	***2024***	***2025***	***2026***	***2027***
Private Domestic Final Consumption Expenditure	1.8	2.4	1.9	1.9	1.7	1.6	2.2	2.2	2.1	2.1
General Government Final Consumption Expenditure	3.8	1.2	1.3	1.2	1.2	1.2	1.7	1.1	1.2	1.2
Gross Fixed Capital Formation	0.8	3.6	3.6	2.7	2.2	1.6	3.4	4.8	4.0	4.0
GFCF Equipment and Cultivated Assets	*-1.3*	3.5	4.2	2.0	2.0	1.4	--	--	--	--
GFCF Construction and Intellectual Property	*1.7*	3.6	3.4	2.9	2.3	1.7	--	--	--	--
Domestic Demand*	***1.7***	**2.3**	**2.0**	**1.8**	**1.6**	**1.5**	**2.2**	**2.4**	**2.2**	**2.2**
Exports of Goods and Services	2.3	3.3	3.1	2.9	3.0	2.9	3.7	2.4	2.2	1.9
Imports of Goods and Services	0.3	3.2	3.8	3.6	3.5	3.2	3.5	3.4	3.0	2.9
External Balance*	***0.8***	**0.2**	**-0.1**	**-0.1**	**0.0**	**0.0**	**0.2**	**-0.2**	**-0.2**	**-0.3**
Gross Domestic Product	**2.5**	**2.4**	**1.9**	**1.7**	**1.6**	**1.5**	**2.4**	**2.2**	**2.0**	**2.0**
Nominal Gross Domestic Product	**8.6**	**5.7**	**4.1**	**3.7**	**3.6**	**3.4**	**6.0**	**4.9**	**4.5**	**4.3**
Gross Domestic Product Deflator	**5.9**	**3.2**	**2.2**	**2.0**	**2.0**	**2.0**	**3.5**	**2.7**	**2.5**	**2.3**
CPI	**3.5**	**3.2**	**2.0**	**2.0**	**2.0**	**2.0**	--	--	--	--
Full-Time Equivalent Employment**	3.2	**2.5**	**2.0**	**1.8**	**1.6**	**1.5**	**3.0**	**2.4**	**2.1**	**1.9**
Unit Labour Cost	6.0	**3.6**	**1.7**	**1.8**	**1.9**	**1.9**	**3.9**	**3.1**	**2.7**	**2.2**
Productivity per Full-Time Employee **	-0.7	**-0.1**	**-0.1**	**0.0**	**-0.1**	**-0.1**	**-0.6**	**-0.3**	**0.0**	**0.0**
Compensation per Employee**	5.2	**3.5**	**1.7**	**1.8**	**1.9**	**1.8**	**4.0**	**2.8**	**2.7**	**2.3**
Unemployment Rate (% of Active Population)	12.2	**11.6**	**11.1**	**10.8**	**10.6**	**10.4**	**11.1**	**10.2**	**9.6**	**8.9**
Household and NPISH Savings Rate (% GDI)	11.7	**12.4**	**12.1**	**12.0**	**11.8**	**11.6**	--	--	--	--

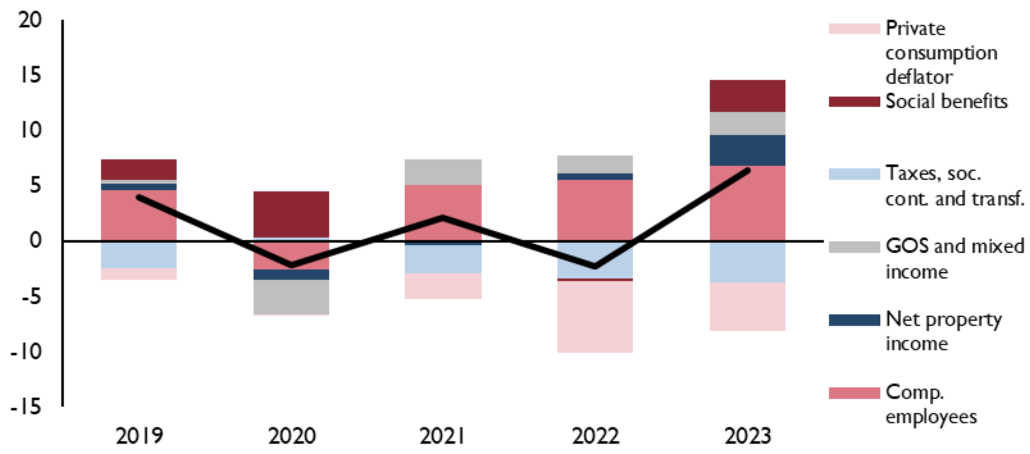
* Contribution to GDP growth

** Persons or calculated with persons in the Government's forecasts vs. Full-time equivalents employed by AIReF

BOX 2. THE INCREASE IN HOUSEHOLD SAVINGS

The household savings rate has risen sharply in 2023 and early 2024, reaching levels not seen since the pandemic and above the historical average. The significant increase in real gross disposable income, by 6.5% in 2023, driven by the rise in compensation of employees and social benefits and the increase in interest rates, are the main factors behind this savings performance.

TABLE B_2.1. GROWTH IN REAL HOUSEHOLD DISPOSABLE INCOME (% AND PP)



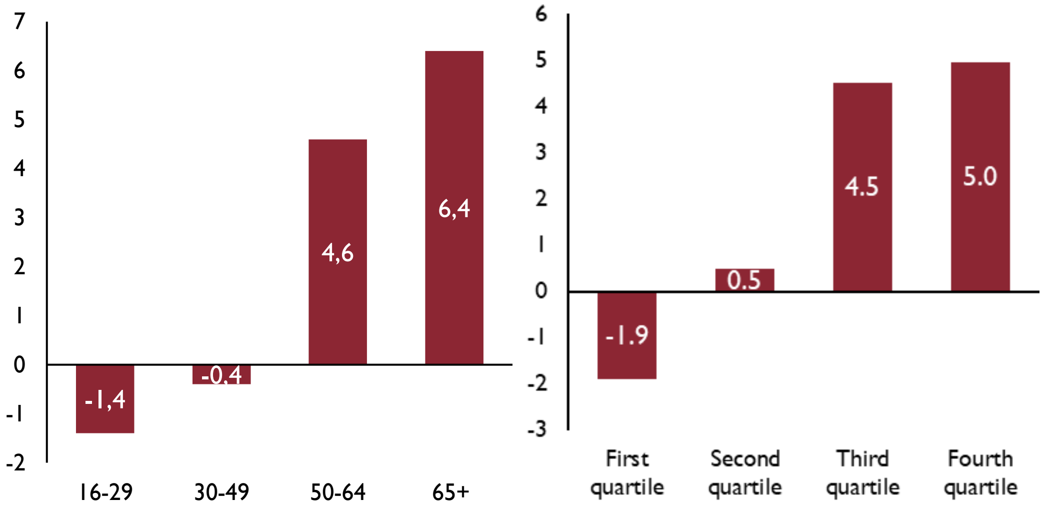
Source: INE

However, there is a high degree of heterogeneity in the behaviour of the savings rate by age and income level. In particular, according to information from European Commission surveys, it is older households and those at the top end of the income distribution that have experienced a greater increase in savings compared with the pre-pandemic period.

The life-cycle hypothesis is commonly used to explain individual consumption and saving patterns. This hypothesis indicates that from retirement age onwards, individuals' income decreases while their consumption pattern remains constant. Therefore, according to this hypothesis, we would expect a certain amount of dissaving in cohorts aged 65 and over. However, age-specific household savings data from various advanced economies* show that since the pandemic the savings rates of older households have increased. This would also be the case in Spain, where the increase in savings may be concentrated in older households with higher incomes.

TABLE B_2.2. CURRENT CONSUMER FINANCIAL SITUATION COMPARING 2019 Q4 AND 2024 Q2

FIGURE B_2.2_A SAVINGS BY AGE (PP). **FIGURE B_2.2_B SAVINGS BY INCOME (PP)**



Source: European Commission

This composition of savings may have implications for projecting the expected growth of private consumption and also its composition. With regard to intensity, to the extent that savings are concentrated among older and higher-income individuals, who generally have a lower propensity to consume, high savings rates might be compatible with maintaining a moderate path of private consumption in the coming quarters. In terms of composition, the consumption profile of older or higher income households differs from that of the median household. For example, older households spend a larger share of their income on food consumption and a smaller share on restaurants and the use and purchase of vehicles. By income level, the higher their position in the income distribution, the higher the percentage of income they spend on transport services.

TABLE B_2.3. HOUSEHOLD SPENDING STRUCTURE

FIGURE B_2.3.A BY AGE (%)

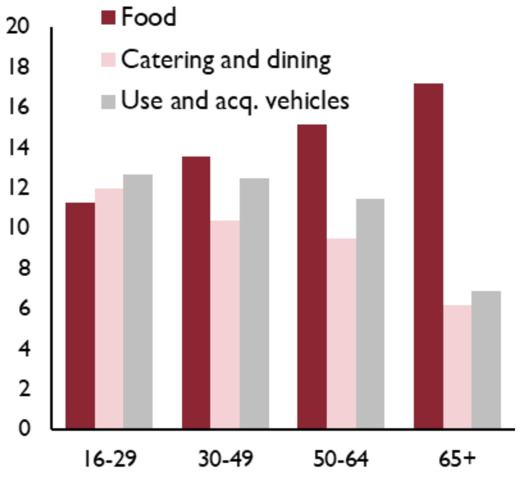
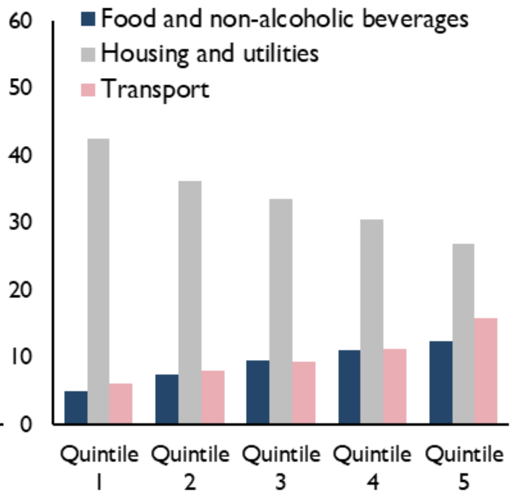


FIGURE B_2.3.B BY INCOME (%)



Source: INE

(*) Japan, United Kingdom, Australia, Germany and South Korea.

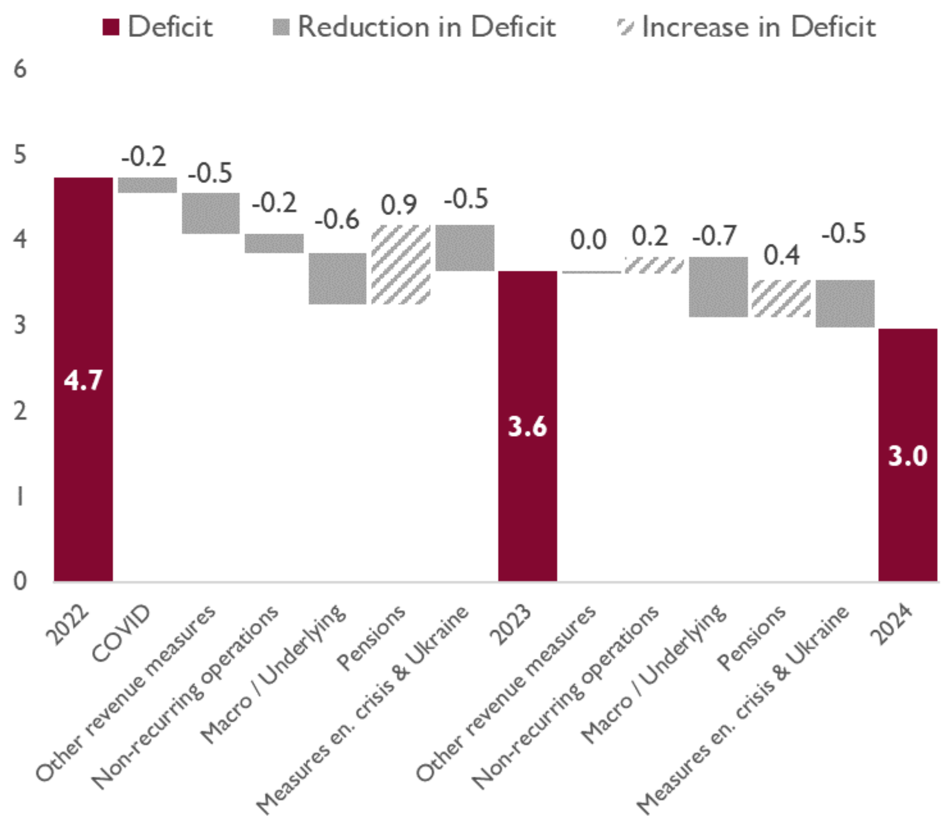
4. ANALYSIS OF BUDGETARY STABILITY AND EXPENDITURE RULE

4.1. General Government

AIReF estimates that the General Government deficit in 2024 will stand at 3% of GDP, the same level as estimated in the previous report. AIReF's forecast is in line with what the Government published in the SPU 2023-2026. Although the deficit estimate is maintained, since the publication of the Report on the Initial Budgets for 2024, changes have been detected with respect to the fiscal scenario outlined in April, which is the subject of an update in this report. First, the estimate of the cost of the measures approved in Royal Decree-Laws 3/2024 and 4/2024 raises it by 0.1 points. Second, the incorporation of the latest data published has an impact on the various headings, with the total effect being an additional increase of 0.1% points. In the opposite direction, the update of the macroeconomic scenario is included, with an impact of a deficit reduction of 0.2 points, mainly due to the effect of the increase in the estimate of compensation of employees on contributions and Personal Income Tax.

The deficit will fall by 0.6 points of GDP compared with 2023, mainly due to the lower cost of measures to mitigate the effects of the energy and price crisis. The reduction between 2022 and 2023 of 1.1 percentage points was explained by several factors. The buoyant performance of the economy was offset by the impact of increasing pensions by the previous year's CPI, the adoption of a number of revenue measures and the lower cost of the measures adopted to alleviate the energy crisis in that year. In addition, the reduction in non-recurrent operations contributed an additional 0.2 points, the same amount as the reduction in COVID spending. Between 2023 and 2024, a reduction of 0.6 points is expected. This reduction is based on the improved macroeconomic scenario, partially offset by the increase in pensions by the CPI and growth in other expenditure, and on the reduction in the cost of energy measures compared with the previous year. In contrast, the deficit is expected to increase due to the materialisation of a number of non-recurrent operations. Finally, the revenue measures approved offset each other, with their total impact being neutral.

FIGURE 15. EVOLUTION OF THE DEFICIT BY COMPONENT. AIREF (% GDP)



Source: AIReF and IGAE

AIReF estimates that revenue will stand at 42.5% of GDP in 2024, without including the RTRP, in line with the previous report, and at 43.5% if it is included. Both the macroeconomic scenario and the new information received contribute to growth in revenue. In contrast, the new measures approved imply a reduction in revenue in nominal terms, and the upward revision of growth for 2024 further reduces its weight of GDP due to the denominator effect.

Expenditure, excluding the RTRP, will stand at 45.5% of GDP, 0.1 points higher than forecast in the previous report, reaching 46.4% when including the RTRP. New information received, in particular on the evolution of social benefits in cash, temporary disability and the budgetary execution of the ARs, pushes up expenditure.

TABLE 4. AIREF FISCAL SCENARIO WITHOUT RTRP AS % GDP

	2024 Rep. Initial Budgets	2024 Current
REVENUE	42.5	42.5
EXPENDITURE	45.4	45.5
NET LENDING/BORROWING	-3.0	-3.0

Source: AIReF estimate

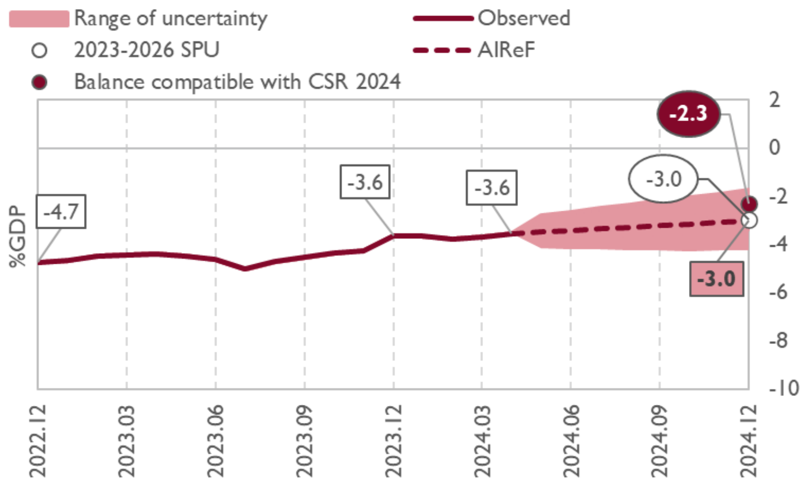
TABLE 5. AIREF FISCAL SCENARIO WITH RTRP AS % OF GDP

	2024 Rep. Initial Budgets	2024 Current
REVENUE	43.9	43.5
EXPENDITURE	46.9	46.4
NET LENDING/BORROWING	-3.0	-3.0

Source: AIReF estimate

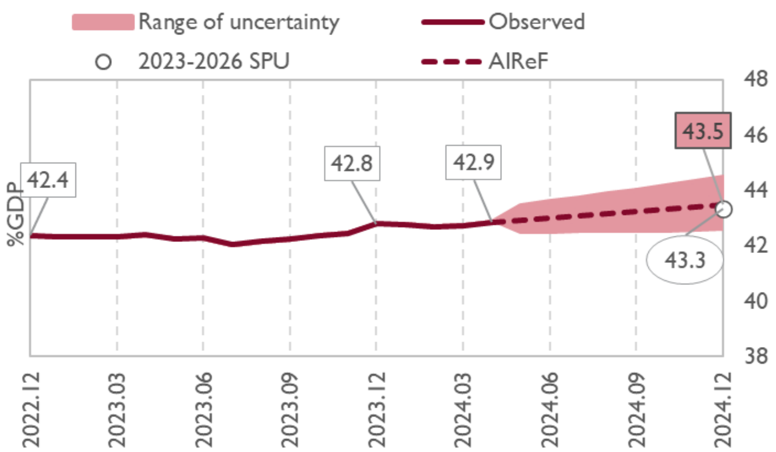
FIGURE 16. TOTAL GENERAL GOVERNMENT

FIGURE 16. A. NET LENDING/BORROWING (% GDP)



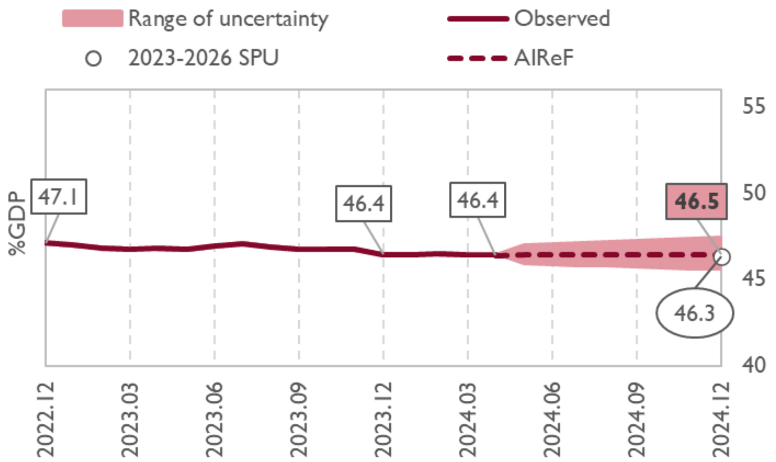
Source: AIReF and IGAE

FIGURE 16. B. REVENUE WITH RTRP (% GDP)



Source: AIReF and IGAE

FIGURE 16. C. EXPENDITURE WITH RTRP (% GDP)



Source: AIReF and IGAE

4.2. Evolution of General Government revenue

AIReF estimates revenue growth of 6.8% in 2024 compared with the 6.2% estimated in the previous report. By heading, contributions are revised upwards by around 0.1 points of GDP, while the weight of taxes on production is lowered by just over 0.1 points. The revision in contributions is due to the more dynamic macroeconomic scenario, in particular to the effect of the increase in the estimate of compensation per employee. In contrast, the extension of VAT rate cuts on certain foodstuffs reduces the forecast for taxes on production. Income taxes maintain their weight of GDP, as the increase in the estimate of Corporate Income Tax is offset by the reduction in Personal Income Tax, mainly due to lower tax payable than expected. The rest of the revenue headings increase their weight of GDP by 0.1% points due to the increase in interest income.

TABLE 6. AIREF SCENARIO COMPARISON: REVENUE WITHOUT RTRP % GDP

	2024 Rep. Initial Budgets	2024 Current	Difference Current - Initial Budgets
REVENUE	**42.5**	**42.5**	**0.1**
TAXES	24.9	24.8	-0.1
On production	11.6	11.5	-0.1
On income	12.9	12.9	0.0
Capital	0.4	0.4	0.0
CONTRIBUTIONS:	13.6	13.7	0.1
Other revenue	4.0	4.1	0.1

Source: AIReF estimate

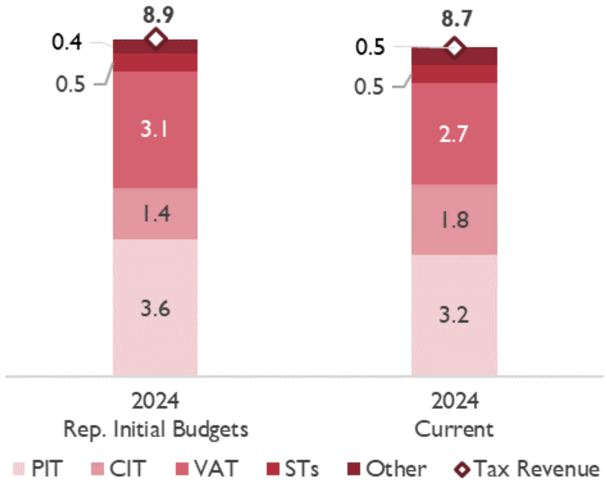
TABLE 7. AIREF SCENARIO COMPARISON: REVENUE WITH RTRP % GDP

	2024 Rep. Initial Budgets	2024 Current	Difference Current-Initial Budgets
REVENUE	**43.9**	**43.5**	**-0.4**
TAXES	24.9	24.8	-0.1
On production	11.6	11.5	-0.1
On income	12.9	12.9	0.0
Capital	0.4	0.4	0.0
CONTRIBUTIONS:	13.6	13.7	0.1
Other revenue	5.4	5.0	-0.4

Source: AIReF estimate

AIReF slightly reduces the forecast for growth in tax revenue in national accounting terms to 8.7% compared with 8.9% in the previous report. The estimate of revenue for common tax regime taxes, before their allocation to the ARs and LGs, is 8.7% compared with 8.9% in the previous report. This is due to changes in the contributions to growth as a result of the revision of the macroeconomic scenario, the latest information available and the approval of new measures. Specifically, there is an increase in the contribution of Corporate Income Tax due to new information and the macroeconomic scenario. Although the macroeconomic scenario has a positive effect on Personal Income Tax, the new data published, specifically the refunds at the end of the 2023 tax year, mean that its contribution to growth is reduced. Lastly, the VAT forecast is reduced, mainly due to the extension of the rate reductions for certain foods until year-end (see the section on measures).

FIGURE 17. EVOLUTION OF TAX REVENUE UNDER THE COMMON FISCAL REGIME IN NATIONAL ACCOUNTING. CONTRIBUTION OF MAIN TAXES TO CHANGE (% YEAR-ON-YEAR CHANGE)

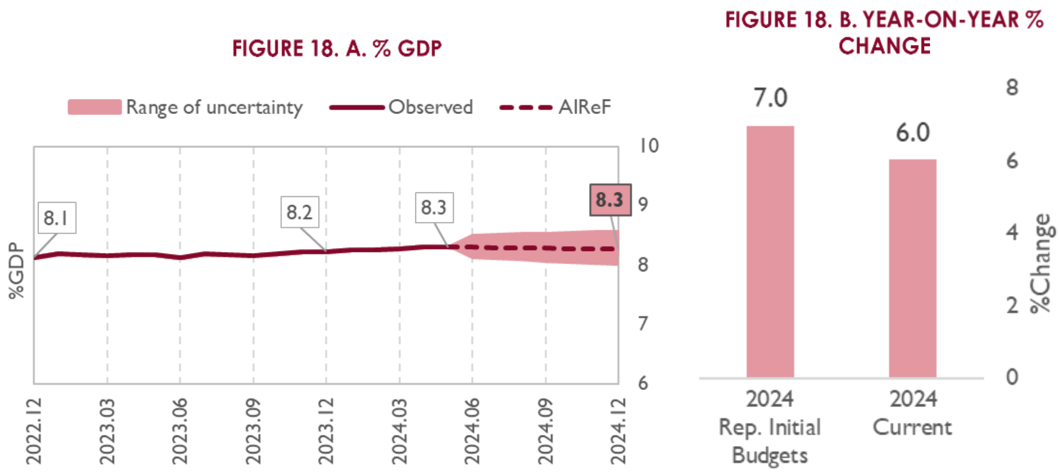


Source: AIReF estimate

1.1.1. Personal Income Tax

AIReF estimates that revenue in cash terms from Personal Income Tax will reach 8.3% of GDP, 0.1 points lower than in the previous report. The Personal Income Tax forecasts have been revised downwards following the incorporation of the information provided on the close of the 2023 income tax campaign, specifically due to a higher figure for refunds than expected, which offsets the positive data on taxable income in the first quarter, the growth in tax collection up to May and the update of the macroeconomic scenario.

FIGURE 18. EVOLUTION OF PIT IN CASH

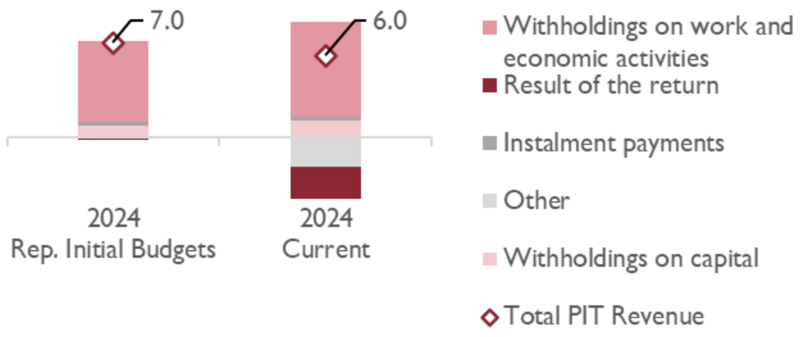


Source: AIReF and IGAE

Growth in Personal Income Tax revenue will stand at 6%, almost one percentage point lower than in the previous report. This decrease is mainly due to the data from the income tax campaign, which reduces the contribution of the tax return by 2.2 points. This figure offsets the upward revision of withholdings from work (1 point) related to a higher forecast of compensation per employee and withholdings from capital (0.4 points).

FIGURE 19. CONTRIBUTION BY COMPONENT TO THE GROWTH OF PIT IN CASH

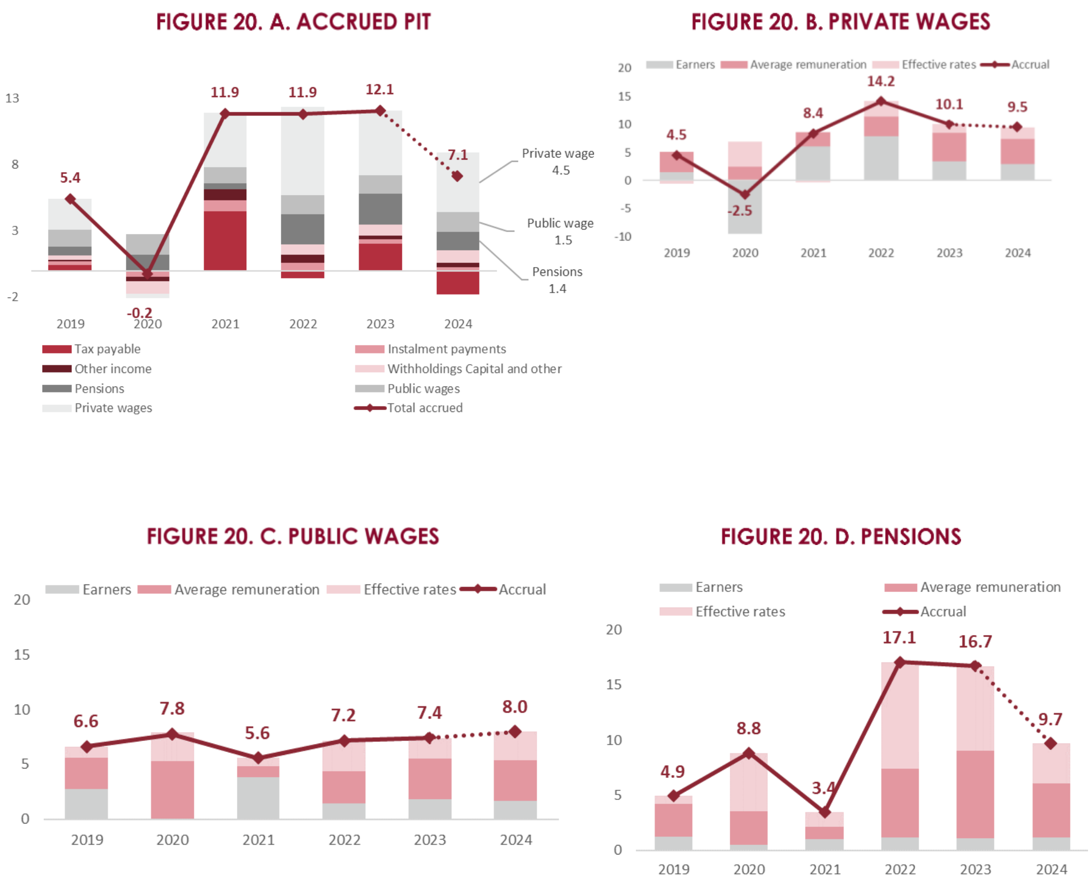
(% YEAR-ON-YEAR CHANGE)



Source: AEAT, AIReF estimate

The general increase in average pay and the pension increase, together with increases in the associated tax rates, are the main drivers of the increase in withholdings from work. The increase in withholdings and instalment payments together contribute around nine points to growth, from which 1.8 points must be subtracted for the tax liability resulting from the 2023 tax return. This estimate includes the impact of the increase in the reduction of earnings from work, which has reduced the rate by just over 1 point. In 2024, withholdings from work will grow by more than 8% as a result of the increase in its three components: recipients, average pay and their associated tax rates, both in the public and private sectors. Withholding taxes on pensions will increase by 9.7% on the previous year, mainly due to the pension increase and the resulting increase in tax rates.

FIGURE 20. CONTRIBUTION BY COMPONENT TO THE GROWTH OF ACCRUED PIT (% YEAR-ON-YEAR CHANGE)



Source: AEAT, AIReF estimate

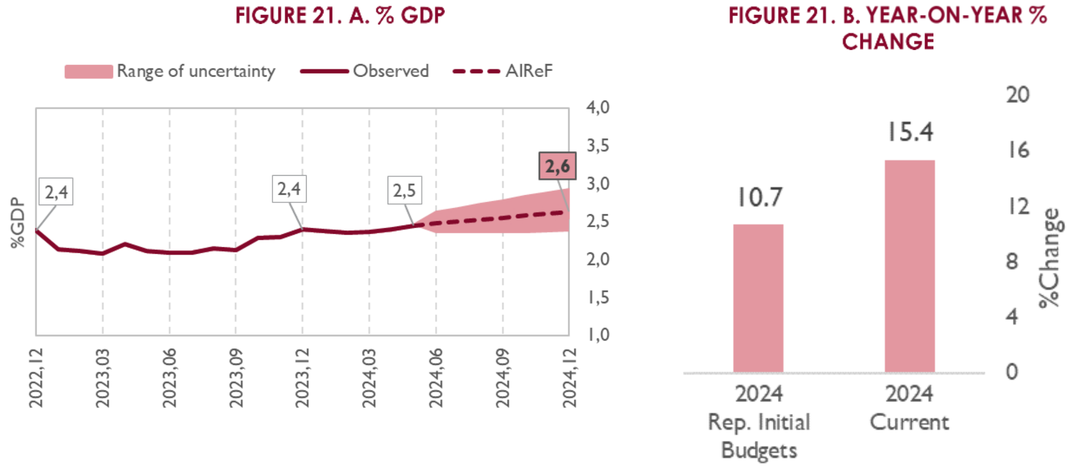
The weight of GDP from Personal Income Tax in national accounting terms is reduced by 0.1 points to 8.7% with respect to the last report. The revision of the estimates in cash terms is transferred to national accounting without any significant changes in national accounting adjustments.

1.1.2. Corporate Income Tax

AIReF revises its revenue forecast in cash terms for Corporate Income Tax, raising its weight of GDP to 2.6 points, 0.1 points more than in the previous report. The latest data available include the taxable income for the first quarter of the year, which includes the first instalment payment of the year. The estimates are updated with respect to the previous report, forecasting an increase in the annual tax liability due to the update of the projection of consolidated taxable income. The estimates are made under the assumption of the extension of the measure on the limitation to 50% for offsetting intra-group tax losses, introduced as an amendment to the Draft Law from Royal

Decree-Law 8/2023. As a result, revenue is revised to 0.1 points of GDP more than in the April report and the year-on-year rate of change rises to 15.4%. The relevant information on the evolution of the full year is still subject to uncertainty as two of the largest instalment payments and the 2023 tax year settlement will take place in the second half of the year.

FIGURE 21. EVOLUTION OF CIT IN CASH



Source: AIReF and IGAE

The forecast for Corporate Income Tax in national accounting terms increases its weight of GDP by almost 0.1% compared with the previous report. The 0.1% upward revision in cash terms, which mainly affects the annual settlement, is passed on to the forecasts in national accounting terms. It should be noted that, although the extraordinary refunds recorded as a result of the Constitutional Court ruling declaring several provisions of Royal Decree-Law 3/2016 unconstitutional will reduce revenue in cash terms, in national accounting terms they do not affect revenue as they are considered higher spending on other capital transfers and not lower revenue.

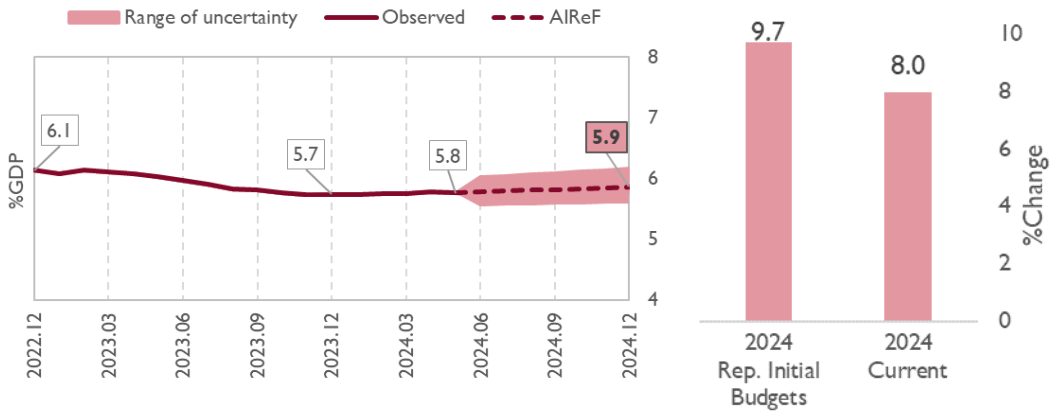
1.1.3. VAT

AIReF reduces its forecast for VAT tax collection by 0.1 points with respect to the previous report, to 5.9% of GDP, due to the new extension of the measures. The changes are a result of the incorporation of the data observed in recent months, which slightly reduce the dynamism of VAT compared with forecasts and, primarily, the continuation of the extension until the end of the year of the reduction in the food rate, approved in Royal Decree-Law 4/2024, which subtracts almost €1 bn from the forecasts in the April report. In contrast, domestic demand, a macroeconomic variable related to the evolution of final expenditure subject to VAT, is revised upwards slightly, which increases the growth forecast. As a result, AIReF forecasts that VAT will grow by 8% at the end of 2024, 1.7 points below the April report. The evolution of VAT in 2024 is also driven by the gradual withdrawal of the rate reductions established for energy products: the 10% VAT rebate on electricity is extended during 2024, conditional on the daily market price exceeding 45 euros/MWH, a threshold that was not exceeded from February to May, but which is expected to be exceeded until the year-end. Therefore, AIReF considers in its estimates the usual VAT rate from March to June and applies 10% over the rest of the year.

FIGURE 22. EVOLUTION OF VAT IN CASH

FIGURE 22. A. % GDP

FIGURE 22. B. YEAR-ON-YEAR % CHANGE



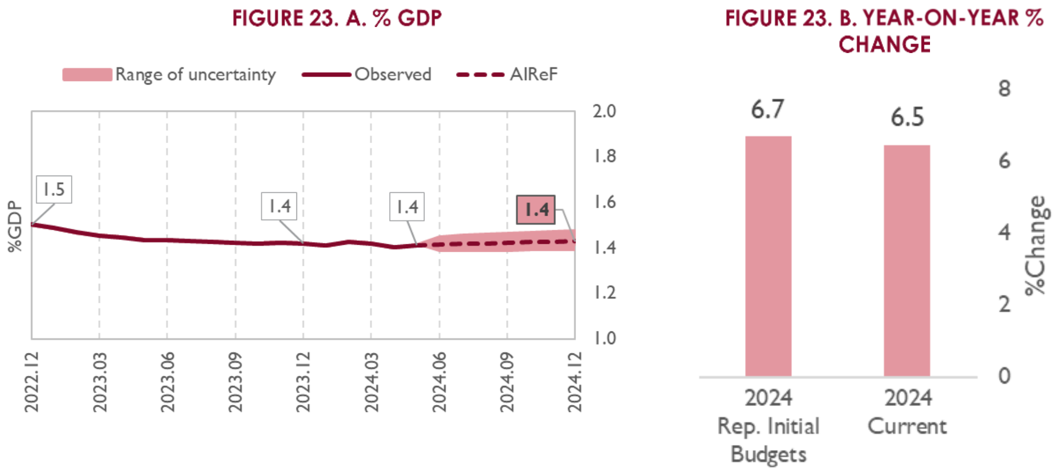
Source: AIReF and IGAE

The evolution of VAT in national accounting terms also decreases its weight of GDP by 0.1 points with respect to the previous report, to stand at 6%. The rate of change is revised down 1.4 points with respect to the previous estimate, to stand at 9%.

1.1.4. Special Taxes

AIReF maintains its forecast for Special Tax collection at 1.4% of GDP, the same as in the April report. The forecast is revised downwards slightly following the incorporation of the latest information available, placing the year-on-year rate of change at 6.5%, 0.2 points below the previous forecast. The growth of Special Taxes as a whole during 2024 will be driven by the growth of the Special Tax on Electricity, which will contribute more than two thirds of the growth, as a result of the gradual recovery of its usual rate. The rest of the expected growth is almost entirely due to the Special Tax on Hydrocarbons, with a contribution of 1.2 points and the Special Tax on Tobacco, which contributes 0.7 points. In national accounting terms, the total of Special Taxes will grow by 6.3% in 2024, a similar change to that estimated in cash terms as there are no differences between the two accounting concepts for these taxes.

FIGURE 23. EVOLUTION OF STS IN CASH



Source: AIReF and IGAE

1.1.5. Other tax revenue

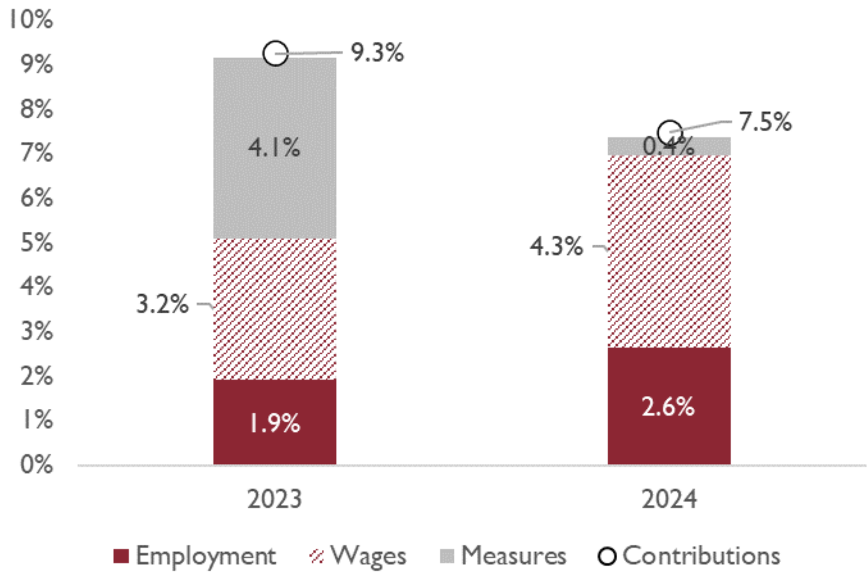
Other tax revenue in national accounting terms will maintain its weight of GDP at 1.2%, the same as in the previous report. Although its weight of GDP is maintained, the year-on-year rate of change increases by 1.8 points, mainly due to the upward revision of Non-Resident Income Tax following the incorporation of the latest tax collection data published.

1.1.6. Social contributions

AIReF estimates that social contributions will increase their weight of GDP compared with the previous report by 0.1 points to 13.7% in 2024. This upward revision is explained by the fact that the denominator effect of the upward revision of GDP is offset by the positive effect of the new macroeconomic scenario, mainly of compensation of employees, on tax collection through social contributions.

The positive evolution of wages and, to a lesser extent, employment drive the growth of contributions in 2024. The contribution of employment is maintained at 2.6 points, similar to the previous report, while the contribution of wages is revised upwards from 3.1 to 4.3 points due to the effect of the new macroeconomic scenario. The measures, which include the increase in the social contributions of the Intergenerational Equity Mechanism and the increase in the maximum contribution bases, maintain their contribution to growth of 0.4 points.

FIGURE 24. BREAKDOWN OF GROWTH IN SOCIAL CONTRIBUTIONS (% CHANGE)



Source: IGAE and AIReF estimates

1.1.7. Other revenue

Other revenue, excluding the RTRP, will reach a weight of 4.1% of GDP, 0.1 points above the estimate made in the previous report. The information on budgetary execution so far has led to interest income being revised upwards.

4.3. Evolution of General Government expenditure

According to AIReF's estimates, expenditure in 2024, excluding the RTRP, will stand at 45.5%, almost 0.1 points above the level forecast in April's Report on the Initial Budgets. The budgetary execution data lead to an increase in forecast expenditure of the Social Security Funds and the Autonomous Regions, including the new measures adopted by some ARs for staff. This increase is partially offset by the downward expenditure revision for the CG sub-sector. The increase in General Government expenditure is almost offset by the dynamism of the macroeconomic scenario through the denominator effect. According to the current estimate, expenditure growth in 2024 will be 5.2% compared with 2023. The RTRP execution forecast has also been revised downwards to almost 1% of GDP, bringing the level of expenditure to 46.4% of GDP, including the RTRP.

TABLE 8. AIREF SCENARIO COMPARISON: EXPENDITURE WITHOUT RTRP % GDP

	2024 Rep. Initial Budgets	2024 Current	Difference Current - Initial Budgets
EXPENDITURE	**45.4**	**45.5**	**0.1**
Compensation of employees	11.1	11.1	0.0
Intermediate consumption	5.7	5.7	0.0
Social transfers in kind via market	2.7	2.7	0.0
Social benefits in cash	17.3	17.3	0.0
Interest	2.5	2.5	0.0
Gross capital formation	2.7	2.7	0.0
Subsidies and other expenditure	3.4	3.5	0.1

Source: AIReF and IGAE

4.3.1. Main components of public consumption expenditure

AIReF maintains its forecast for public consumption at 19.5% of GDP for 2024, in line with the previous report. AIReF maintains the same weight of GDP for consumption as a whole and for each of its main components (compensation of employees, intermediate consumption and social transfers in kind) as in the Report on the Initial Budgets. Although it estimates slight increases in all three components by level, these are offset by the upward revision of GDP. According to the current forecast, the sum of the main components of public consumption without the RTRP is projected to grow by 4.7% in 2023, 0.3 points more than in the previous report's estimate.

The compensation of employees maintains its weight of GDP at 11.1%. AIReF has slightly increased this expenditure for the ARs due to the incorporation of new staff measures reported by the Autonomous Regions, although this increase has been partially offset by the less dynamic nature of the budgetary execution data published. In any case, the upward revision of the GDP estimate for 2024 offsets this increase in nominal spending, with its weight of GDP remaining constant. Furthermore, the 2% increase in public employees' salaries, agreed by the Civil Service General Bargaining Committee and recently approved by Royal Decree-Law 4/2024 in June, does not entail a change in the estimate. This is because it was already included in AIReF's forecasts in the previous report.

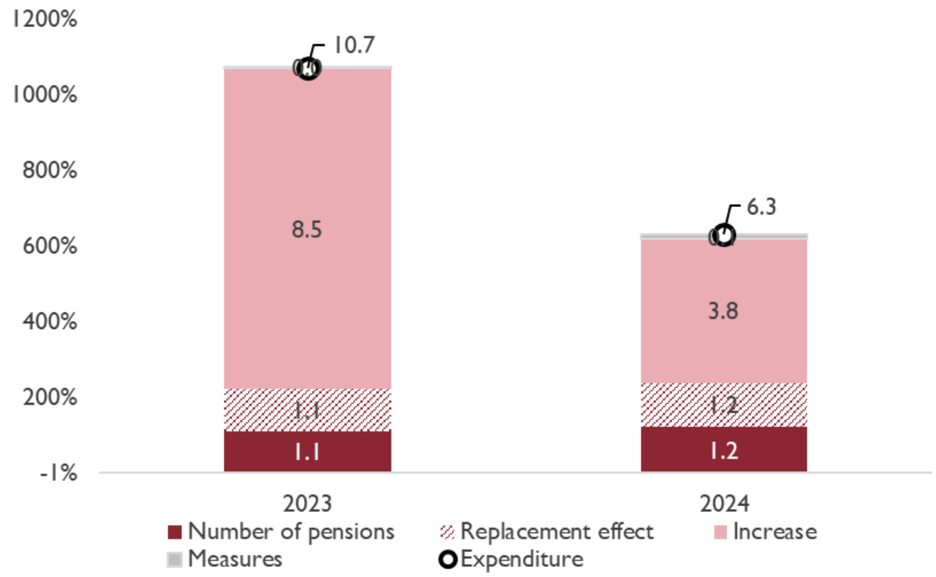
AIReF also maintains intermediate consumption at 5.7% of GDP and social transfers in kind at 2.7% of GDP, the same as in the previous report. The slight increases forecast in these expenditure headings are mainly due to the CG On the one hand, expenditure on intermediate consumption has been revised to update election spending, which was higher than AIReF forecast, and, on the other, social transfers in kind have been adjusted to include spending on transport discounts for young people over the summer. In any case, the upward revision of the GDP estimate for 2024 offsets this increase in nominal expenditure, with its weight of GDP remaining constant.

4.3.2. Social benefits in cash

AIReF estimates that social benefits in cash will maintain their weight of GDP at 17.3% in 2024, similar to the estimate in the last report. The denominator effect of the upward revision to GDP growth in AIReF's latest macroeconomic outlook is offset by the increase in expenditure as a result of the incorporation of new information on budgetary execution.

AIReF estimates that expenditure on Social Security pensions will increase by 6.3% in 2024, 0.2 points above the rate estimated in the previous report. The evolution of expenditure on pensions is explained by the sum of the increase in the number of pensions, the annual increase of these pensions, the replacement effect and the measures approved. The main factor explaining the increase in expenditure on pensions between 2023 and 2024 is the annual increase effect. According to the current regulation approved in 2021, which came into force in January 2022, pensions will be increased at the start of each year in accordance with the average annual inflation recorded between December two years earlier and November of the previous year, which amounted to 3.8% in 2023. To this factor can be added the growth in the number of pensions, which is estimated at 1.2%, a replacement effect of 1.2%, and the measure to increase non-contributory pensions and pensions with supplementation benefits to reach the poverty thresholds provided for in Royal Decree-Law 2/2023. The upward revision of the growth in expenditure on pensions estimated in the previous report is due to the upward correction by 0.1% points each of the growth in the number of pensions and the replacement effect estimated for 2024 in response to the evolution observed in the most recent data.

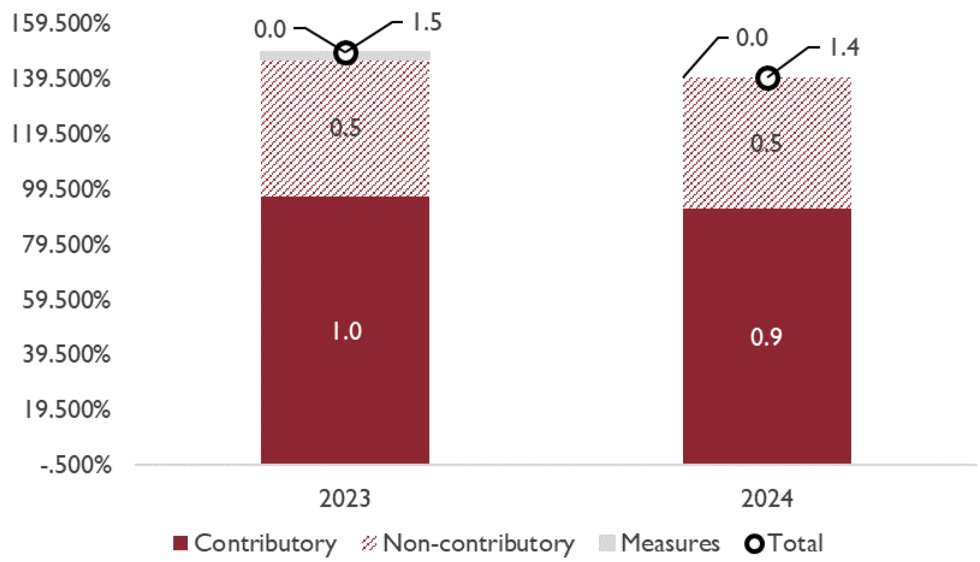
FIGURE 25. GROWTH IN PENSION EXPENDITURE. AIREF PROJECTIONS (% YEAR-ON-YEAR CHANGE).



Source: AIReF and Social Security

Unemployment benefits reduce their weight of GDP from 1.5% in 2023 to 1.4% in 2024, an estimate similar to that in the April report. The decline in expenditure on unemployment benefits between 2023 and 2024 is mainly due to the moderation of the unemployment rate and the dynamism of the labour market.

FIGURE 26. SPENDING ON UNEMPLOYMENT. AIREF PROJECTIONS (% GDP)



Source: AIReF and SEPE

The rest of the benefits included under social transfers in cash maintain their weight of GDP at 4% in 2024, a similar estimate to that included in the previous

report. Despite the upward revision of the estimate of certain spending due to budgetary execution data, mainly temporary disability, the weight of the other benefits as a percentage of GDP remains unchanged.

4.3.3. Interest

AIReF maintains its interest expenditure forecast at 2.5% of GDP for 2024. This estimate reflects inflation expectations and financing conditions throughout the year. In 2024, inflation has moderated its decline, showing signs of stabilising at levels slightly above the central banks' reference levels and, although the Treasury has had to issue debt at higher interest rates, more contained inflation has allowed expenditure to grow at a more moderate rate. In addition, the long average maturity of the debt portfolio means that the impact of higher issuance rates is being passed on gradually. Lastly, the upward revision of estimated GDP in 2024 has helped reduce the weight of expenditure relative to GDP. The combined effect of these factors has resulted in a slight reduction in interest expenditure, but without changing its weight of GDP, which remains at 2.5%, in line with the estimate in the previous report.

4.3.4. Gross capital formation

The weight of gross capital formation is maintained at 2.7% of GDP for 2024, not including the RTRP. For the ARs, expenditure is expected to increase in line with the pace of execution observed in the latest budgetary execution data published. In contrast, for the CG it is revised downwards slightly due to the estimate of lower military payments compared with those previously considered.

4.3.5. Subsidies and other expenditure

Other expenditure, excluding the RTRP, increases to 3.5% of GDP in 2024, 0.1% higher than in the previous report. This increase is mainly due to the CG sub-sector, where some spending items have been revised upwards due to the latest budgetary execution data, especially in capital transfers, where the amount expected from court rulings at the year-end has increased. These increases are partially offset by the effect of the upward revision of GDP. As for the rest of the items, there are no significant changes with respect to the estimate in the previous report.

BOX 3. QUANTIFICATION OF DEFENCE SPENDING

There are three different ways of quantifying defence spending: from a budgetary accounting perspective, in national accounting terms and from a NATO perspective. Each of these approaches has its own criteria for recording military spending. Because of differences in the recording criteria and components considered, the quantification of defence spending varies according to the perspective used to calculate it.

Budgetary accounting

From a budgetary point of view, defence spending is recorded in accordance with the budgetary allocations and execution established in the General State Budget (GSB) under the Defence Expenditure policy. This policy is made up of several spending programmes, including: Modernisation of the Armed Forces, Special Modernisation Programmes, Operating Expenses of the Armed Forces and Logistical Support. In addition, some programmes funded under the RTRP have been added since 2021.

The appropriations initially allocated under the GSB to cover the spending under these programmes are systematically insufficient compared with the spending actually executed at year-end, as can be seen in the evolution of the data for the period 2019 to 2023 (latest data closed). This difference is due to the fact that spending on peacekeeping operations is usually budgeted at a very low level and then increased during the year from the contingency fund.

TABLE B_3.1. INITIAL AND EXECUTED EXPENDITURE APPROPRIATIONS, BROKEN DOWN BY MAIN BUDGETARY SPENDING PROGRAMMES. PERIOD 2019-2023.

GSB DEFENCE POLICY		2019		2020		2021		2022		2023	
HEADING	EXPENDITURE PROGRAMME	IA	NRO	IA	NRO	IA	NRO	IA	NRO	IA	NRO
121M, 121N, 121O, 12KB and 12SC	***GENERAL DEFENCE ADMINISTRATION** (€m)*	2,127	2,296	2,127	2,466	2,547	3,193	3,282	3,473	3,622	3,776
122A	*Modernisation of the Armed Forces*	78	114	78	222	264	393	327	1,526	341	1,120
122B	*Special modernisation programmes*	2,164	2,164	2,164	1,869	2,342	2,352	2,848	2,421	4,902	3,589
122M	*AFs Operating Expenditure*	2,629	3,240	2,629	3,226	2,697	3,101	2,255	3,495	2,306	3,783
122N	*Logistical support*	1,190	1,118	1,190	1,095	994	1,123	865	1,626	892	1,362
	***ARMED FORCES** (€ m)*	6,062	6,635	6,062	6,412	6,296	6,970	6,295	9,069	8,440	9,854
	***TOTAL** (in % GDP)*	**8,189** *0.7*	**8,932** *0.7*	**8,189** *0.7*	**8,879** *0.8*	**8,843** *0.7*	**10,162** *0.8*	**9,577** *0.7*	**12,542** *0.9*	**12,062** *0.8*	**13,630** *0.9*

Source: IGAE

According to the data executed under the defence policy of the GSB, the amount has increased from 0.7% of GDP in 2019 to 0.9% in 2023, which is the last year published.

National accounting

From a national accounting perspective, this spending is recorded under the Defence function according to the Classification of the Functions of Government (COFOG) expenditure items. This function is broken down into several sub-functions, primarily Military Defence, Foreign Military Aid and Defence-related R&D.

Expenditure is recorded on the basis of national accounting criteria which differ from budgetary accounting, whereby certain adjustments are necessary for its calculation. The most important adjustment from a quantitative point of view affects military deliveries. According to Spanish national accounting rules, annual spending on military weapons and support systems should be recorded at the time the goods and services are made available to the Ministry of Defence, regardless of their budgetary allocation and the financing system used.

TABLE B_3.2. DEFENCE SPENDING BY COFOG, BROKEN DOWN BY MAIN SUB-FUNCTIONS. 2019-2022

COFOG DEFENCE FUNCTION			2019	2020	2021	2022
DIGIT	SUB-FUNCTION					
02.1	*Military defence*		9,248	9,234	10,103	13,377
02.3	*Foreign military aid*		1,051	1,059	1,374	1,541
02.4	*Defence-related R&D*		238	255	239	426
TOTAL		*In € m*	**10,537**	**10,548**	**11,716**	**15,344**
		As % GDP	*0.8*	*0.9*	*1.0*	*1.1*

Source: IGAE

According to COFOG Defence data, the amount has increased from 0.8% of GDP in 2019 to 1.1% in 2022, the latest year published. COFOG data for 2023 will be published at the end of 2024. However, information is already available showing that the year-end data have shown a fall in investment due to military deliveries related to defence modernisation programmes in national accounting terms compared with 2022. Accordingly, defence spending in 2023 is estimated to be around 1 point of GDP in national accounting terms.

According to NATO

NATO calculates defence spending according to its own methodology. To this end, the Ministry of Defence of each allied country reports to NATO on actual and estimated future defence spending according to an agreed definition. The amounts represent payments by a national government that have been or will be made during the course of the year to meet the needs of its armed forces, those of NATO Allies or NATO itself.

A major component of NATO's definition of defence spending is payments to the armed forces within the Ministry of Defence's budget. However, this methodology differs from the other two. Among these differences is the inclusion, within personnel spending, of pensions paid to military retirees and civilians employed in military departments. Spending of a military nature on mixed civil-military activities is also included when the military component can be specifically accounted for or estimated. In addition, the cost of Interior Ministry troops, national police forces, gendarmerie, carabinieri, coast guards, etc., may be included, but only to the extent that these forces are trained in military tactics, are equipped as a military force, can operate under direct military authority in deployed operations and can realistically be deployed outside the national territory in support of a military force.

TABLE B_3.3. DEFENCE DATA PUBLISHED BY NATO. PERIOD 2019-2024.

DEFENCE EXPENDITURE ACCORDING TO NATO	2019	2020	2021	2022	2023	2024
In € m	**11,281**	**11,240**	**12,546**	**15,610**	**17,451**	**19,723**
As % GDP	*0.9*	*1.0*	*1.0*	*1.2*	*1.3*	*1.3*

Source: NATO

According to NATO data, Spain's defence spending has risen from 0.9% of GDP in 2019 to 1.3% in 2023. It also estimates that it will remain at 1.3% of GDP in 2024.

BOX 4. THE EXECUTION PROFILE IN NATIONAL ACCOUNTING TERMS OF INVESTMENTS RELATED TO THE RECOVERY, TRANSFORMATION AND RESILIENCE PLAN (RTRP)

AIReF has recently published a tool to track the pace of public tenders formalised and subsidies awarded, the RTRP Monitor. The results of this tool have enabled AIReF to improve its RTRP execution forecasts in national accounting terms, under the assumption that RTRP investments are executed in full.

The main differences between the profile offered by the RTRP Monitor and its recording in national accounting terms derive from the different times at which public tenders are recorded. In our Monitor, they are recognised from the time the works or service contract is formalised. In national accounting terms and in general terms, the accounting entry will be made as the works or services are delivered[9], with the possibility of instalment payments[10]. Subsidies are included in the RTRP Monitor when they are awarded. In national accounting terms, they are mostly considered investment aid[11] and are recorded at the same time. However, there are some exceptions, since there are multi-year subsidies that would be included in the platform at the outset, but in national accounting terms, each one would be included in its corresponding year.

Forecast of public tenders formalised and subsidies awarded

First, AIReF makes a forecast on the formalisation and awarding of each of the lines of investment over the Plan's execution horizon. Using the results provided by the tool and the text of each of the 31 components, AIReF has approximated the share of each sub-sector in each line of investment. Our Monitor also provides us with the amount formalised and awarded by each sub-sector in each line of investment.

With both sets of data, the progress by line of investment and sub-sector is classified into six potential main profiles[12]. Once the deadline for the

[9] ESA 2010: 1,101 and 3,134

[10] ESA 2010: 3.55

[11] Among others, subsidies for the installation of solar panels, the purchase of electric vehicles and recharge stations, as well as the improvement of houses and buildings are considered investment aid. ESA 2010: D.92, 4,158.

[12] The names of these profiles are: *Very Fast, Fast, Linear, Slow, Very Slow and Stagnant.*

milestones and targets[13] is known, these profiles distribute the amount pending formalisation and awarded on a quarterly basis. In addition, the life of the profile is extended by one or two quarters from the date determined by its milestone or target if the profile is determined to be *Very Slow* or *Stagnant*.

Once the main profile has been determined according to its percentage of formalisation and award, it is modified according to the progress of each line and sub-sector in the current year with respect to that period in the previous year. In this way, six other secondary profiles are established[14] that modify the previous ones by increasing or decreasing the allocation difference between the first and last forecast quarter by certain percentage points.

In this way, we achieve a high degree of individualisation in the investment profile for each line of investment and sub-sector, addressing both early stage developments and recent developments.

Execution forecast in national accounting terms

Once the aggregate profile has been constructed by year and sub-sector in terms of the forecast for the formalisation of tenders and the award of subsidies, this result is approximated in national accounting terms.

With the figures in national accounting terms for the years 2021, 2022 and 2023 provided by the European Commission and the aggregate data for these years in terms of formalisations and awards, we assume that each annual figure in national accounting terms is composed of a percentage of the formalisations and awards of that same year (α) plus another percentage of the formalisations and awards of past years that have not yet been accounted for in national accounting terms (β)[15]. To ascertain these

[13] The end date of the investment profile coincides in most cases with the date of the final milestone or target for each line of investment. However, we differentiate between completion milestones and targets and award milestones and targets. If the milestone or target is classified as an award, it is because the completion milestone does not include an agreed completion date for the investment. For example, Milestone 455 requires that by the second quarter of 2026 we have disbursed at least €487m for R&D+I projects in the field of microelectronics and semiconductors. Other award milestones are, among others: 457, 460 and 462.

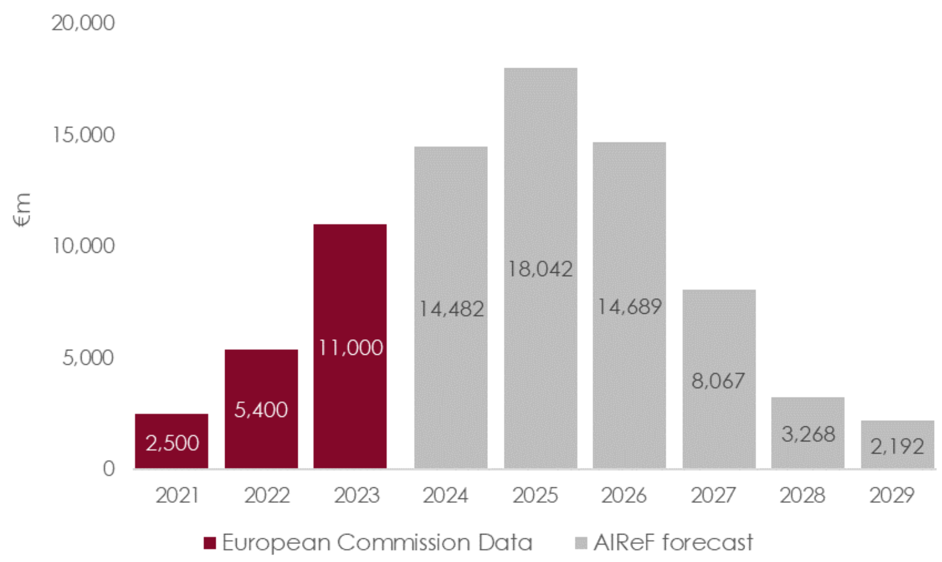
[14] The secondary profiles are: *Very Accelerated, Accelerated, Steady, Decelerated, Very Decelerated* and *No Progress*.

[15] This year is not established by separating public tenders and subsidies as there are no disaggregated forecasts for them. In general, a line of investment for a sub-sector

factors, we perform a quadratic error minimisation exercise for each sub-sector.

Having attained these results, the aggregation of all the sub-sectors is performed and the results are obtained. As can be seen, in national accounting terms, execution is extended to 2029. This is largely due to the award milestones[5] agreed with the European Commission for the end of 2025 and 2026, which will mean that the underlying projects and their reflection in the Monitor may extend beyond these years. Due to the dynamics explained above, part of their recording in national accounting terms will occur in later years without this being an obstacle to the attainment of the agreed milestones or the receipt of disbursements.

FIGURE B_4.1. RTRP, PROFILE IN NATIONAL ACCOUNTING. DATA FROM THE EUROPEAN COMMISSION AND AIREF FORECAST



4.4. Sub-sector analysis

AIReF maintains its estimate of the fiscal balance of the General Government sector at 3%, but changes the distribution by sector. AIReF considers that the fiscal balance of Central Government will improve by 0.2 points, although this improvement will be offset by a worsening of the balance of the ARs. AIReF maintains its estimate of the headline deficit of the SSFs at 0.3 points and the surplus of 0.1 points for the LGs.

can be implemented through both public tenders and subsidies, and the separation of these amounts in terms of allocation is often not possible.

TABLE 9. FISCAL BALANCE BY SUB-SECTOR (% GDP)

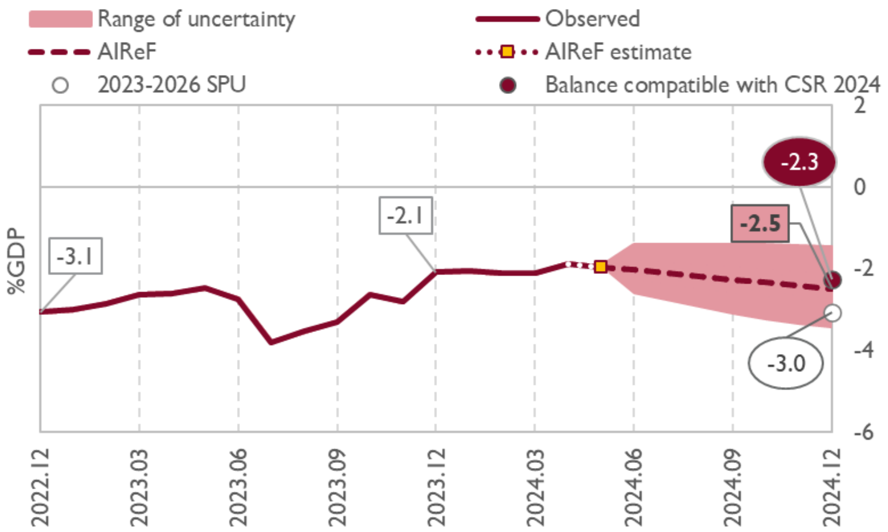
	Government estimate 2024 SPU 2023-2026	AIReF ESTIMATE 2024		Difference Current - Initial Budgets
		Rep. Initial Budgets	Current	
GG	**-3.0**	**-3.0**	**-3.0**	**0.0**
CG	-3.0	-2.7	-2.5	0.2
SSFs	-0.2	-0.3	-0.3	0.0
ARs	0.1	-0.1	-0.3	-0.1
LGs	0.2	0.1	0.1	0.0

Source: AIReF and IGAE

4.4.1. Central Government

AIReF estimates the headline deficit of the CG at 2.5%, just over 0.2 points below the estimate made in the last report. This improvement is mainly due to a reduction in expenditure. On the one hand, tax revenue reduces its weight in GDP terms because the cost of the tax measures and the new information is greater than the improvement from the new macroeconomic scenario. On the other hand, AIReF expects an increase in revenue due to interest income. On the expenditure side, a reduction is expected, mainly due to transfers to other GG sub-sectors.

FIGURE 27. NET LENDING/BORROWING OF CG (% GDP)

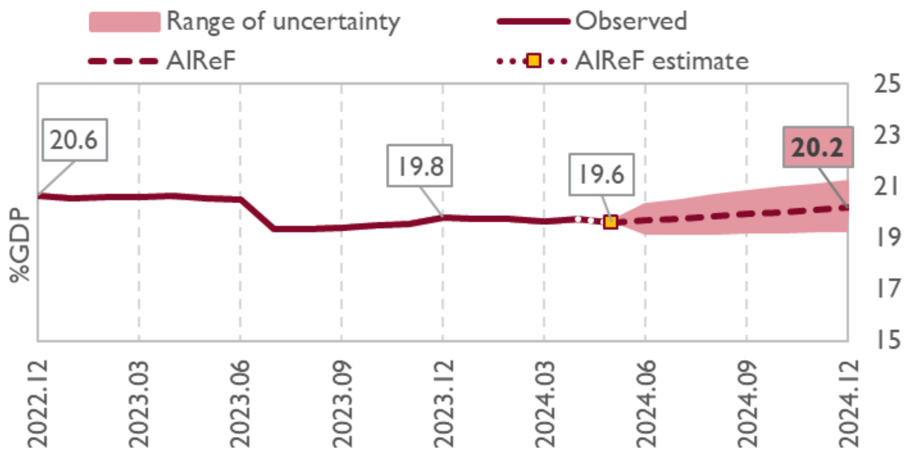


Source: AIReF and IGAE

4.4.1.1 Central Government revenue

AIReF forecasts that CG revenue will reach 19.2% of GDP in 2024, without the RTRP, and 20.2% if it is included, a level almost 0.1 points lower than in the previous report. Total CG revenue has been revised downwards in terms of weight of GDP, due to the increase from the measures and the denominator effect, which is not offset by the increase in the estimate of interest income following the new information received. Tax revenue reduces its weight of GDP by 0.1 points with respect to the previous report. This reduction is mainly due to the reduction in taxes on production as a result of the approval of measures, while in income taxes the upward revision of Corporate Income Tax is offset by the fall in Personal Income Tax, as set out in the section on General Government revenue.

FIGURE 28. CG REVENUE WITH RTRP (% GDP)



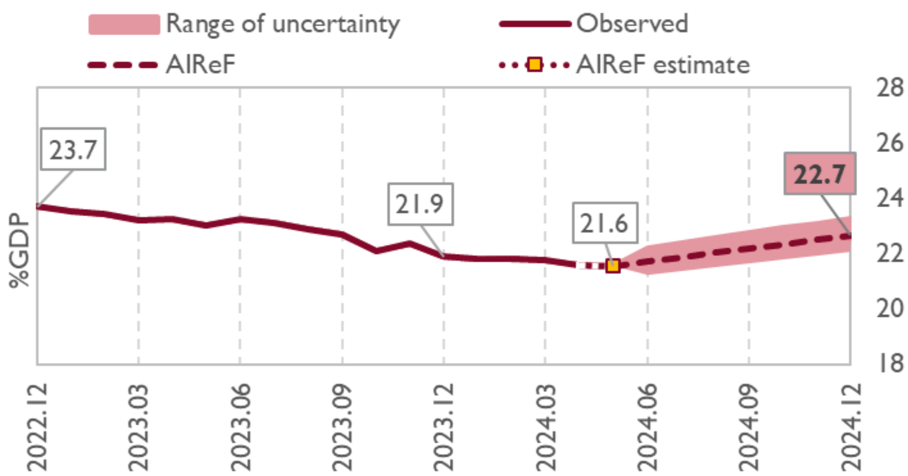
Source: AIReF and IGAE

4.4.1.2 Central Government expenditure

AIReF reduces its estimate of spending by the CG without the RTRP to 21.7% of GDP in 2024, 22.7% with the RTRP, compared with the 22% forecast in the Report on the Initial Budgets. This decrease of 0.3 points of GDP is due to the revision of both the fiscal and the macroeconomic scenario. On the fiscal side, the publication of the latest budgetary execution data and the new information received have led to a reduction in spending of about 0. 2 points of GDP. For their part, the measures approved since the last report by the Central Government by means of Royal Decree-Laws 3/2024 and 4/2024 have had hardly any impact on CG expenditure (see section on measures). From a macroeconomic point of view, the upward revision of nominal GDP forecast for 2024 explains the additional reduction in spending by 0.1 points of GDP due to the denominator effect. Finally, if we consider expenditure related to the RTRP, the total expenditure of the CG would stand at 22.7% of GDP.

By spending component, the downward revision is mainly in current expenditure and, to a lesser extent, in capital expenditure. The current expenditure items that have fallen the most due to the rate of execution observed and other information received are current transfers between GG sub-sectors, interest expenditure, other current transfers and current international cooperation. In contrast, intermediate consumption has been adjusted upwards, updating the spending on elections made in 2024 and other transfers in kind, where transport discounts for young people during the summer have been recorded. With regard to capital expenditure, AIReF estimates a decrease with respect to the previous report in gross capital formation, mainly due to the forecast of fewer military deliveries than initially considered, although this is partially offset by an increase in the estimated spending on court rulings.

FIGURE 29. CG EXPENDITURE WITH RTRP (% GDP)

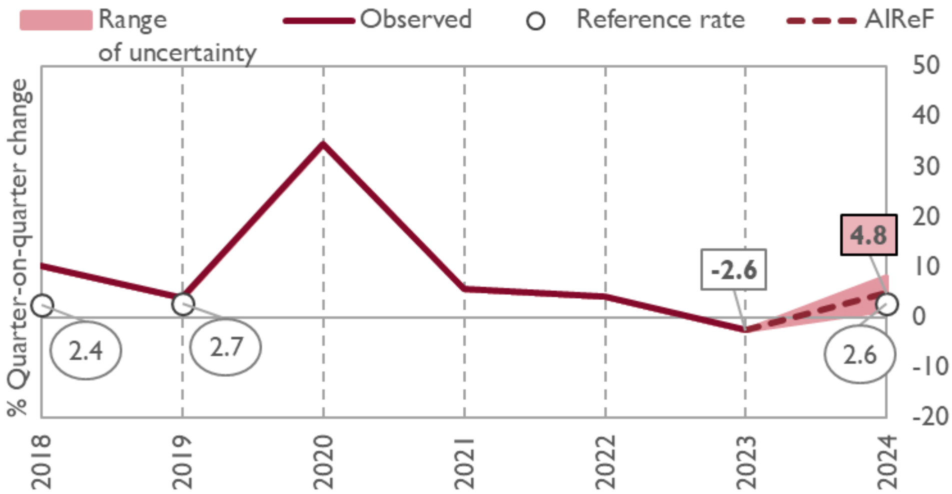


Source: AIReF and IGAE

AIReF estimates an increase in eligible expenditure under the national expenditure rule of around 4.8% for 2024; hence the forecast for non-compliance with this fiscal rule is maintained. Compared with the 6.8% increase forecast in the previous report, this new estimate is due to the downward revision of the estimated CG expenditure for 2024 in line with the updated expenditure forecasts for this fiscal year. This reduction in expenditure, with the exception of interest, results in lower eligible expenditure for 2024, which reduces the variation in spending compared with the previous year. In addition, the Ministry of Finance published the eligible expenditure for 2023 which was higher than AIReF's estimate, contributing to the variation in expenditure being lower in 2024 as the starting point for its calculation has been raised. Nevertheless, the estimated growth in eligible expenditure of 4.8% is still higher than the reference rate of 2.6% for 2024, by an estimated 0.2 points of GDP.

Compliance with the expenditure rule would result in a deficit of 2.3% of GDP in 2024 under AIReF's revenue forecasts. Furthermore, this situation compromises compliance with the specific European recommendation (CSR 2024) to limit the growth in primary expenditure net of revenue measures for the General Government sector as a whole to less than 2.6%.

FIGURE 30. CG ELIGIBLE EXPENDITURE FOR THE PURPOSES OF THE EXPENDITURE RULE (% YEAR-ON-YEAR CHANGE)



Source: AIReF and IGAE

TABLE 10.AIRF FORECASTS OF THE CHANGE IN EXPENDITURE AND ELIGIBLE EXPENDITURE FOR NATIONAL AND EUROPEAN EXPENDITURE RULE[16]. TOTAL CG (% VAR. YEAR-ON-YEAR)

Total Central Government	AIReF forecast change 2024/2023
Expenditure (without RTRP)	8.5%
Eligible expenditure national expenditure rule	4.8%
Eligible expenditure CSR 2024	-1.7%

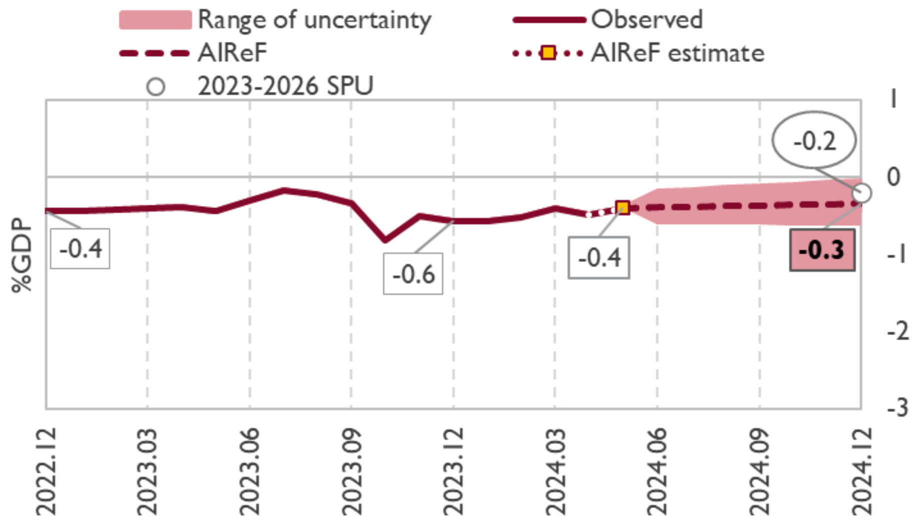
Source: AIReF and IGAE

[16] Expenditure subject to the European expenditure rule differs from expenditure subject to the national rule. Unlike the latter, the European rule excludes national

4.4.2. Social Security Funds

AIReF forecasts that the Social Security Funds (SSFs) will reduce their deficit from 0.6% of GDP in 2023 to 0.3% in 2024, a similar estimate to the previous report. Both revenue and expenditure have been revised upwards in nominal terms since the last report.

FIGURE 31. NET LENDING/BORROWING OF SSFS (% GDP)

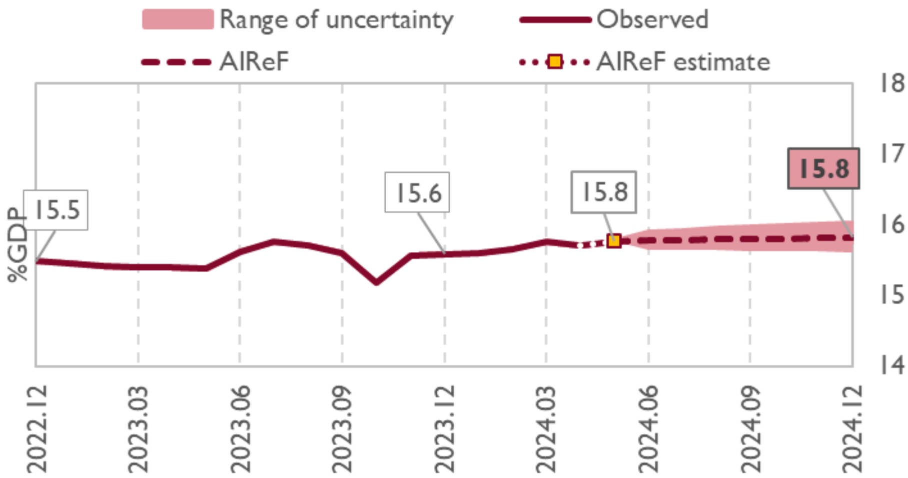


Source: AIReF and IGAE

Revenue maintains its weight of GDP at 15.8% in 2024 compared with the last report. This stability is the result of an upward revision of social contributions that is offset by a downward revision of transfers from the CG. The upward revision of the weight of social contributions in GDP can be explained by the fact that, although the increase in the GDP forecast for 2024 has a denominator effect, this is offset by the positive impact of the new macroeconomic scenario, in particular the compensation of employees, on the collection from social contributions.

expenditure on projects co-financed by EU funds, as well as expenditure on one-off and other temporary measures. In addition, it adjusts expenditure by taking into account temporary discretionary revenue measures and not just permanent measures.

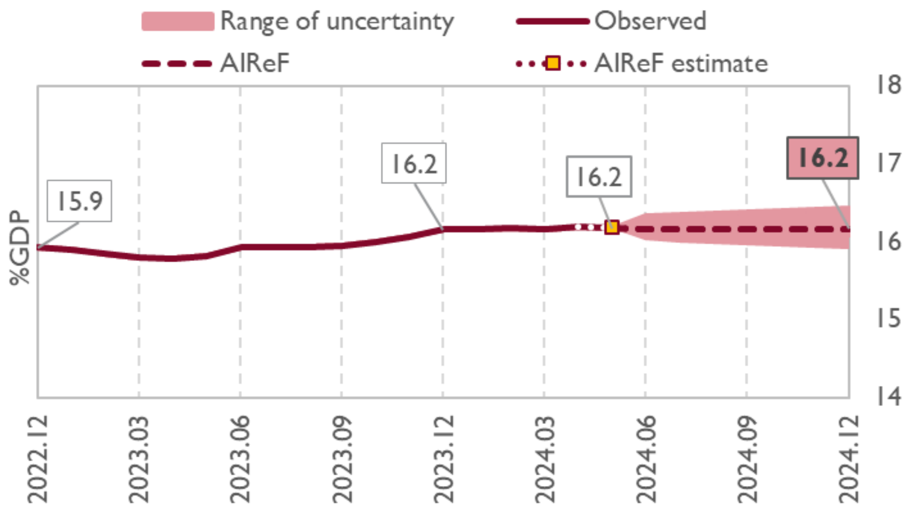
FIGURE 32. SSF REVENUE WITH RTRP (% GDP)



Source: AIReF and IGAE

Expenditure increases its weight of GDP by almost 0.1 points from the estimate in the previous report, to 16.2% of GDP in 2024. The increase is justified by the effect of new budgetary execution data, mainly on temporary disability benefits and, to a lesser extent, on spending on pensions.

FIGURE 33. SSF EXPENDITURE WITH RTRP (% GDP)

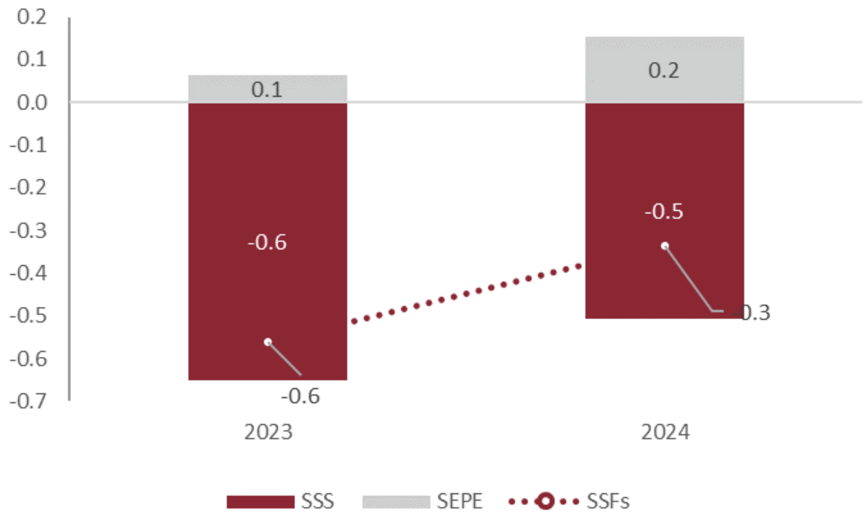


Source: AIReF and IGAE

AIReF estimates an increase in eligible expenditure under the European expenditure rule of 5.8% by 2024, above the reference rate of 2.6% set in the CSR for Spain. The European expenditure rule, unlike the national rule, includes the Social Security Funds. Compliance with the European expenditure rule would mean a surplus of 0.1% of GDP in 2024 under AIReF's revenue forecast.

This evolution does not affect the different agents of the Social Security Funds in the same way. The fiscal balance of the Social Security Funds improves by more than 0.2 points in 2024, of which 0.1 points corresponds to the Social Security System and the 0.1 points to the SEPE. The improvement in the fiscal balance of the Social Security System can be explained by the fact that revenue grows at a faster rate than expenditure thanks to the buoyant performance of the labour market and the increase in transfers from the CG. Similarly, the increase in the SEPE surplus is due to the reduction in the weight of GDP of spending on unemployment benefits derived from the dynamism of the labour market and the improvement in the unemployment rate between 2023 and 2024. FOGASA, for its part, shows budget balance in this period.

FIGURE 34. FISCAL BALANCE BY SSF AGENT (% GDP)



Source: AIReF, Social Security, SEPE and IGAE.

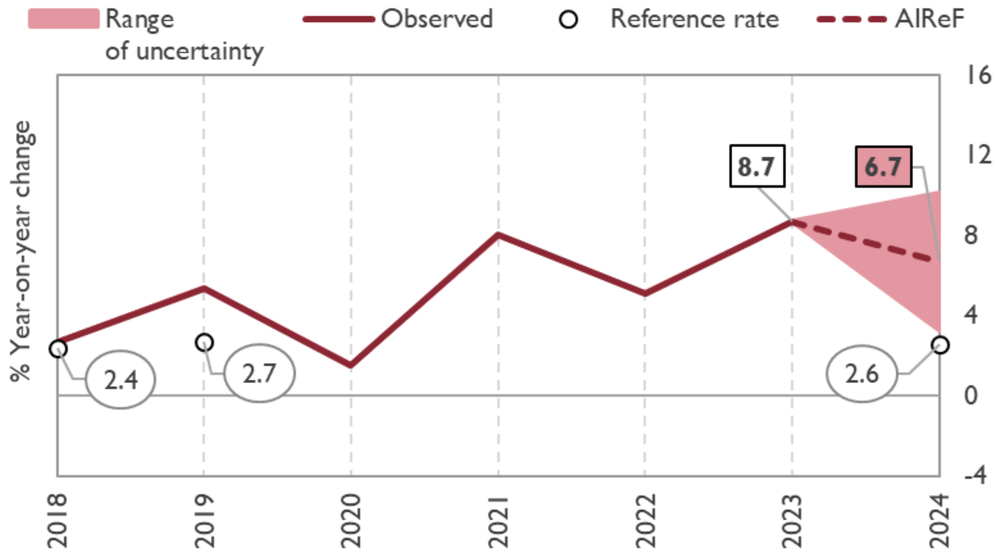
4.4.3. Autonomous Regions

4.4.3.1 Sub-sector analysis

AIReF continues to observe a risk of non-compliance with the expenditure rule for 2024 and worsens the deficit forecast for the AR sub-sector to 0.3% of GDP. AIReF raises the expenditure expected at year-end 2024 by the Autonomous Regions, increasing the deficit forecast in the previous report by 0.2 points to 0.3% of GDP. This deficit is far from the balance contained in the SPU for the sub-sector. The revision of the forecasts places the growth of eligible expenditure at 6.7%, moving further away, with respect to previous estimates, from the reference rate of the current expenditure rule of 2.6%. The risk of non-compliance with the national expenditure rule and the country-specific recommendation issued by the European Council in 2024 is therefore accentuated.

FIGURE 35. AR ELIGIBLE EXPENDITURE FOR THE PURPOSES OF THE EXPENDITURE RULE 2024.

(% YEAR-ON-YEAR CHANGE)



Source: IGAE, AIReF and forecasts of Autonomous Regions

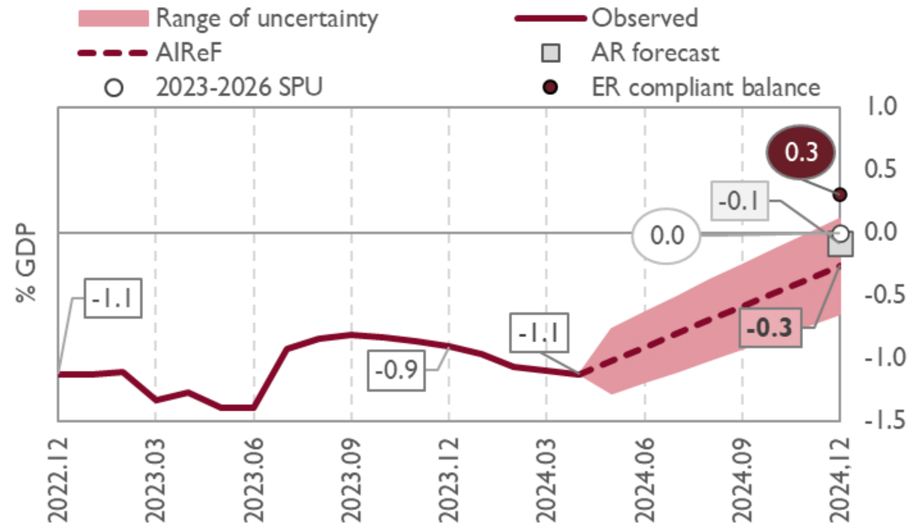
TABLE 11. AIREF FORECASTS OF THE CHANGE IN EXPENDITURE AND ELIGIBLE EXPENDITURE FOR THE NATIONAL AND EUROPEAN EXPENDITURE RULE. TOTAL ARS (% Y-O-Y CHANGE).

Total ARs	AIReF forecast % change 2024/2023
Expenditure (without RTRP)	4.4%
Eligible expenditure national expenditure rule	6.7%
Eligible expenditure CSR 2024	6.5%

Source: AIReF

Compliance with the expenditure rule in 2024 would take the sub-sector to a surplus of 0.3 points of GDP under AIReF's revenue scenario. Growth in eligible expenditure of 2.6% would mean, under AIReF's forecasts, maintaining the level of expenditure not related to the RTRP. Consequently, a surplus in the sub-sector of 0.3% of GDP would be achieved considering AIReF's estimates of revenue not related to the RTRP - more than 65% of which is the revenue reported from the financing system of the Autonomous Regions under the common regime.

FIGURE 36. NET BORROWING/NET LENDING OF THE ARS (% GDP)



Source: IGAE, AIReF, SPU and forecasts of Autonomous Regions

The ARs worsen their fiscal balance forecasts as a whole, although with different positions at an individual level. Half of the ARs maintain the fiscal balance forecasts in 2024 contained in the medium-term budgetary plans, four worsen and another four improve their estimates. The aggregate figures of the individual forecasts would take the sub-sector to a deficit of 0.1% of GDP, considering a lower level of expenditure at year-end than AIReF's estimate and with more optimistic revenue forecasts.

Not all the ARs have provided forecasts on the evolution of eligible expenditure for the purposes of the expenditure rule and only three plan to comply with it. AIReF has not been able to analyse in aggregate terms the forecasts on the evolution of eligible expenditure in the sub-sector in 2024 as that information is not available for several ARs (Aragon, Balearic Islands, Castile and Leon, Navarre and the Basque Country). However, with respect to the individual estimates provided, only Andalusia, Galicia and Madrid forecast that the growth of their eligible expenditure in 2024 will not exceed 2.6% over the figure published for 2023.

AIReF forecasts that the revenue of the Autonomous Regions in 2024, excluding the RTRP, will grow by 9%, reaching 15.5% of GDP. Overall, the revenue forecasts have not changed significantly with respect to those considered in the Report on the Initial Budgets, although they are slightly lower. Expected tax collection from the Tax on Asset Transfers and Documented Legal Acts (TATDLA) and revenue related to production (sales) have been revised downwards and, in the opposite direction, albeit with less impact, revenue from European funds has improved. Considering the potential revenue from the RTRP, revenue would reach 15.8% of GDP.

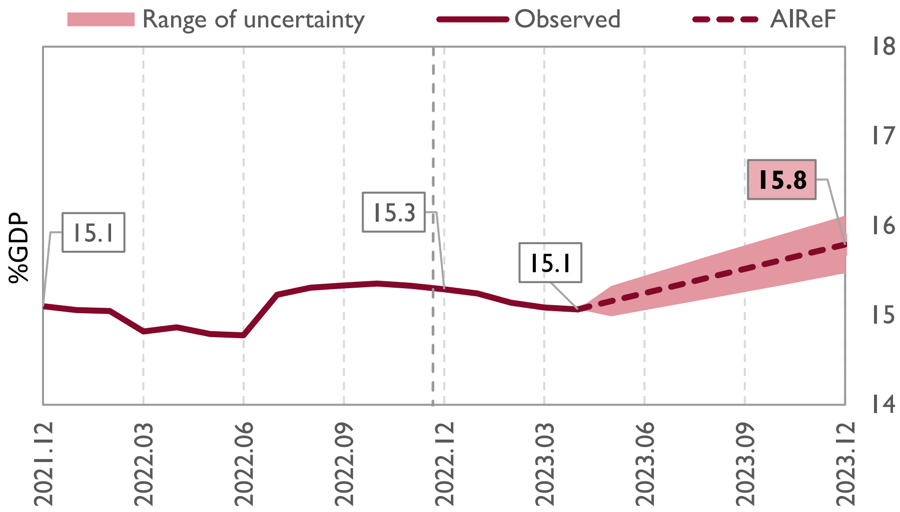
TABLE 12. EVOLUTION OF AR REVENUE.
(% GDP AND % YEAR-ON-YEAR CHANGE)

Total ARs	Year-end 2023 %GDP	AIReF forecast 2024 %GDP	24/23 % change
Total net revenue	**15.3**	**15.8**	***9***
Net revenue without RTRP	**15.0**	**15.5**	***9***
Net RFS	9.3	10.1	*15*
Net IPs	*8.5*	*8.7*	*8*
Net Settlement	*0.8*	*1.3*	*87*
CSA compensation	0.0		*0*
Tax on Asset Transfers & Doc. Legal Acts	0.7	0.7	*2*
Inheritance and Gift Tax	0.2	0.2	*-10*
Other non-RFS tax	0.9	0.9	*11*
Other revenue	3.9	3.6	*-3*
REACT-EU revenue	*0.1*		
Other	*3.8*	*3.6*	*0*

Source: IGAE and AIReF

The revenue forecasts for the ARs increase overall and are above AIReF's scenario. There are no significant changes in the revenue measures adopted by the ARs with effects on the expenditure rule and the regional headline deficit for 2024 and subsequent years, although some ARs have announced new tax reduction measures that could have an additional impact in future years. The current estimates of revenue for the ARs consider an aggregate level higher than that contained in the medium-term budgetary plans, especially as the expected revenue from European funds other than the RTRP improves.

FIGURE 37. AR REVENUE WITH RTRP (% GDP)



Source: IGAE and AIReF.

Expenditure by the ARs not related to the RTRP will grow by 4.4%, according to AIReF's estimates, to stand at 15.8% of GDP. AIReF has revised the overall expenditure forecast at year-end 2024 upwards compared with the estimates considered in the previous report, basically due to the execution observed to date and the new staffing measures reported by the ARs. The expenditure forecast at year-end 2024 mainly increases in compensation of employees, intermediate consumption and capital expenditure related to the RTRP, partly due to the recording of court rulings and other non-recurring operations. Considering the expenditure financed by the RTRP, expenditure could reach 16% of GDP.

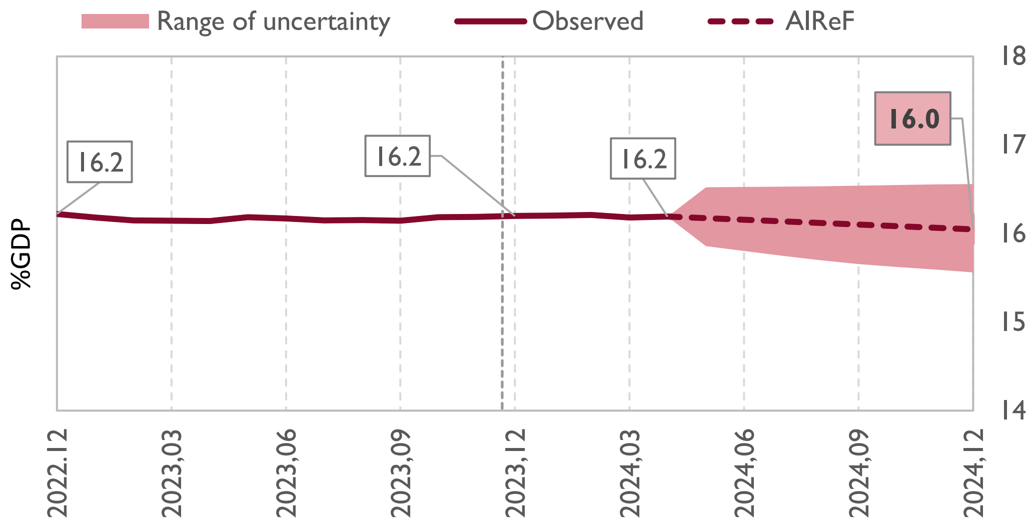
TABLE 13. EVOLUTION OF AR EXPENDITURE. (% GDP AND % YEAR-ON-YEAR CHANGE)

Total ARs	Year-end 2023 %GDP	AIReF Forecast 2024 Rep. Budgets %GDP	Rep. Budgets 24/23 % change
Total net expenditure	**16.2**	**16.0**	***5***
Net expenditure without RTRP	**15.9**	**15.8**	***4***
Intermediate consumption	2.6	2.6	*5*
Compensation of employees	6.9	6.9	*6*
Social transfers in kind	2.5	2.4	*4*
Interest	0.4	0.5	*13*
Other current expenditure	1.9	1.8	*2*
Capital expenditure	1.6	1.5	*-1*
Of this, REACT-EU expenditure	*0.1*		

Source: AIReF and IGAE

The updated forecasts of the ARs raise the expected level of expenditure not related to the RTRP above that considered in their budgetary frameworks, drawing closer to AIReF's estimates. Several ARs have reported new staffing measures with a significant impact from 2024 onwards. Aside from this, most of the ARs maintain or raise their forecasts for expenditure not related to the RTRP at year-end 2024, which increases the level of expenditure estimated for the sub-sector aggregate by 0.2 points over that considered in previous scenarios. The increase is concentrated in current expenditure. This expenditure scenario is close to that currently estimated by AIReF, although it is still slightly lower.

FIGURE 38. AR EXPENDITURE WITH RTRP (% GDP)



Source: IGAE and AIReF.

4.4.3.2 Individual analysis

AIReF continues to see a risk of non-compliance with the 2024 expenditure rule in all the ARs. Based on AIReF's forecasts on revenue and expenditure and the evolution of the main elements considered in the calculation of the expenditure rule, it warns that eligible expenditure would grow in all the ARs above the reference rate of 2.6% set for 2024. The variations calculated range between 4% and 11% for the different ARs, conditioned by the expected growth in expenditure, the variation in expenditure financed with European funds and the effect of the tax reduction measures adopted in each of the ARs.

TABLE 14.AIREF FORECASTS BY AR. CHANGE IN ELIGIBLE EXPENDITURE 2024 (% YEAR-ON-YEAR CHANGE)

ARs	Forecasts AIReF ER 2024	
	Current	Rep. Initial Budgets
ANDALUSIA	4.7%	5.1%
ARAGON	5.2%	5.3%
ASTURIAS	8.9%	7.9%
BALEARIC ISLANDS	11.2%	8.2%
CANARY ISLANDS	8.5%	8.5%
CANTABRIA	10.7%	7.9%
CASTILE AND LEON	6.0%	5.5%
CASTILE-LA MANCHA	6.5%	5.9%
CATALONIA	6.4%	4.8%
EXTREMADURA	7.8%	9.0%
GALICIA	9.0%	8.1%
MADRID	5.2%	4.5%
MURCIA	7.8%	8.0%
NAVARRE	10.4%	8.5%
BASQUE COUNTRY	4.2%	4.4%
RIOJA	6.3%	7.3%
VALENCIA	7.5%	5.9%
TOTAL AUTONOMOUS REGIONS	**6.7%**	**5.7%**

Source: AIReF

AIReF considers that 11 Autonomous Regions could close 2024 with a balanced budget or surplus. Compared with the Report on the Initial Budgets, AIReF's fiscal balance forecasts have worsened for nine ARs: Andalusia, the Balearic Islands, the Canary Islands, Cantabria, Castile & Leon, Castile-La Mancha, Catalonia, Galicia and Madrid. Estimates only improve in Extremadura, Murcia and Navarre, while they remain unchanged in the other ARs. Despite this, it is still considered that most of them may reach a surplus or close to budget balance in 2024. Only the ARs of Murcia and Valencia will close 2024 with a deficit of more than 1%, while deficits of around half a point are expected in Catalonia and Castile-La Mancha and more moderate ones in Andalusia and Madrid.

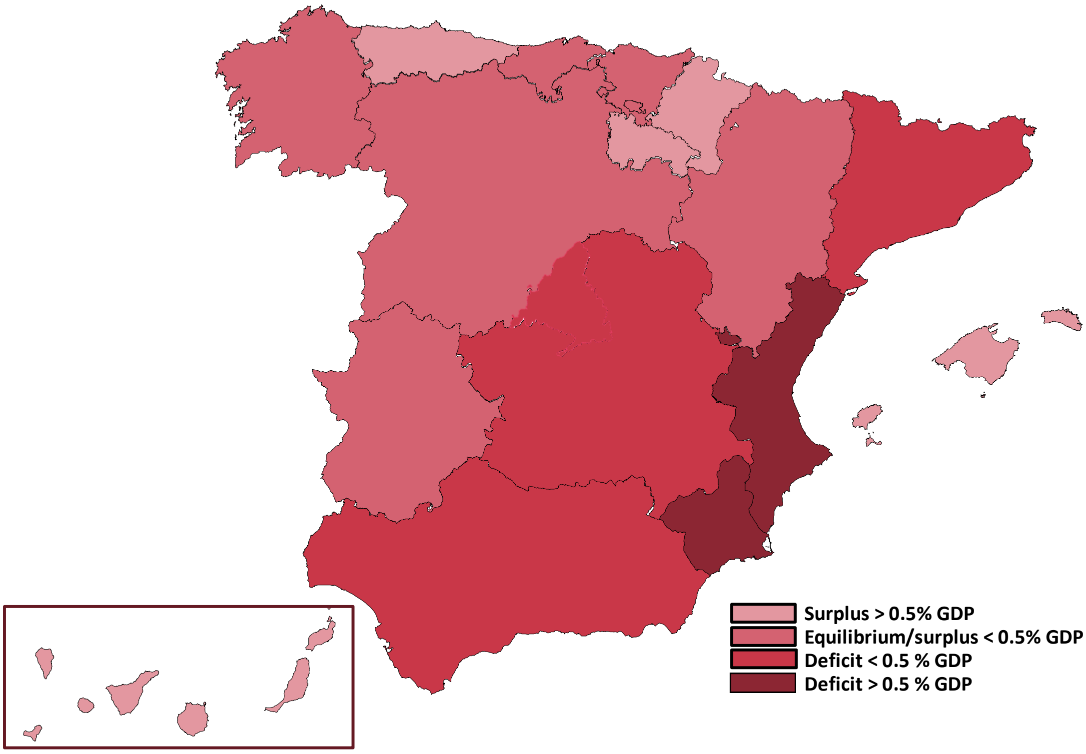
TABLE 15.CHANGES IN THE FISCAL BALANCE FORECASTS FOR 2024 BY AR (% GDP)

ARs	AIReF Forecasts Fiscal Balance 2024		AR forecasts Fiscal Balance 2024	
	Current	Rep. Initial Budgets	Current	Medium Term Bud. Plans
ANDALUSIA	-0.2%	0.0%	0.0%	0.0%
ARAGON	0.3%	0.3%	-0.1%	-0.1%
ASTURIAS	1.1%	1.1%	0.1%	0.1%
BALEARIC ISLANDS	0.8%	1.1%	-0.1%	0.5%
CANARY ISLANDS	0.5%	0.8%	0.2%	0.4%
CANTABRIA	0.4%	0.6%	0.2%	0.3%
CASTILE AND LEON	0.2%	0.3%	0.1%	-0.1%
CASTILE-LA MANCHA	-0.4%	-0.3%	0.0%	0.0%
CATALONIA	-0.4%	-0.2%	-0.3%	0.3%
EXTREMADURA	0.2%	0.0%	0.2%	0.2%
GALICIA	0.2%	0.4%	0.0%	0.0%
MADRID	-0.2%	-0.1%	0.0%	0.0%
MURCIA	-1.6%	-1.7%	-0.6%	-0.6%
NAVARRE	0.8%	0.6%	0.2%	-0.3%
BASQUE COUNTRY	0.2%	0.2%	0.0%	-0.3%
RIOJA	1.1%	1.1%	0.4%	0.3%
VALENCIA	-1.9%	-1.9%	-0.1%	-0.1%
TOTAL AUTONOMOUS REGIONS	**-0.3%**	**-0.1%**	**-0.1%**	**0.0%**

Source: AIReF and Forecasts of Autonomous Regions

Half of the ARs maintain the fiscal balance forecasts contained in their medium-term budgetary plans for 2024, and only five estimate closing with a deficit. Eight ARs have changed their year-end forecasts for 2024 with respect to those submitted in April: Cantabria, the Balearic Islands, the Canary Islands and Catalonia have worsened their forecasts, while Castile & Leon, Navarre, the Basque Country and La Rioja have improved them, although the latter only by updating its GDP estimates. Accordingly, five regions - Andalusia, Castile-La Mancha, Galicia, Madrid and the Basque Country - expect to reach a budget balance; six forecast a surplus at year-end - Asturias, the Canary Islands, Castile & Leon, Extremadura, Navarre and La Rioja - and the other six consider that they will close with a deficit, ranging from 0.1% of GDP - Aragon, the Balearic Islands and Valencia - to 0.6% of GDP – Murcia.

FIGURE 39. MAP OF AR NET LENDING/BORROWING 2024 (% GDP)



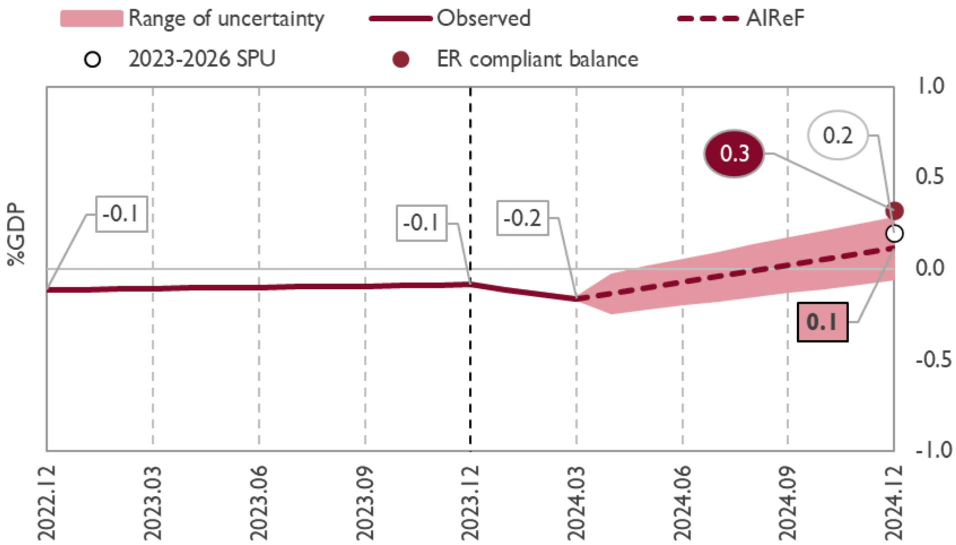
Source: AIReF

The breakdown of each AR is set out in the individual reports published with this report. The individual reports contain the breakdown of the updated projections for each AR for 2024.

4.4.4. Local Governments

AIReF maintains its April forecasts of a surplus of 0.1% of GDP in the LG sub-sector in 2024, 0.1 points lower than that forecast by the Government in the SPU. On the basis of the new information analysed, AIReF maintains its forecast for 2024 for the LG sub-sector to achieve a surplus of slightly more than 0.1% of GDP, 0.2 points above the fiscal balance in 2023, mainly due to the effect of the higher revenue to be received through the financing system in the current year. Although the annual balance obtained in the first quarter of 2024, resulting from the accumulation of that observed in the previous 12 months, is a deficit of 0.2% of GDP, the fiscal balance forecast for the end of this year (a surplus of 0.1% of GDP) is reached as a result of the fact that in the remaining months the revenue from the financing system expected to be received is around 0.3 points of GDP higher than that obtained so far.

FIGURE 40. NET BORROWING/NET LENDING OF THE LGS (% GDP)



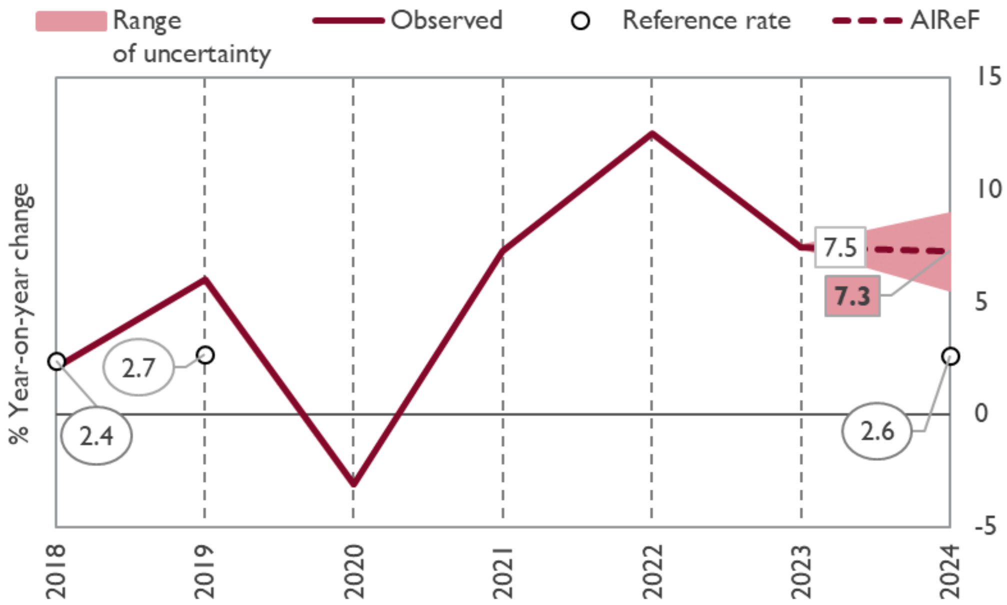
Source: AIReF and IGAE

In 2024, the LG sub-sector would obtain a very similar deficit to that of 2023, once extraordinary revenue from the financing system has been discounted from both years. As already noted in the April report, the surplus expected by AIReF for the LG sub-sector in 2024 is significantly influenced by the extraordinary revenue to be received from the financing system, estimated for 2024 at 0.2 points of GDP above that obtained in a standard year. If this extraordinary financing is subtracted from the expected fiscal balance, the LGs would obtain a deficit in 2024 of close to 0.2% of GDP, very similar to that obtained in 2023 if this year's extraordinary revenue obtained were also standardised.

AIReF continues to see a risk of non-compliance with the expenditure rule in 2024. As AIReF already anticipated in April this year, the current forecasts of a slight surplus would not allow the reference rate of the expenditure rule set at 2.6% for this year to be met, given that eligible expenditure is estimated to grow by 7.3%, close to the 2023 figure published by the IGAE (7.5%). This projected growth is mainly the result of the expected expansion of current expenditure due to wage increases, contract updates and the consolidation of current subsidies. However, it should be remembered that compliance with the expenditure rule is evaluated at the individual level of each LG.

Under AIReF's revenue scenario, in order to comply with the expenditure rule in 2024, the LG sub-sector would have to obtain a surplus of more than 0.3% of GDP. Under the hypothesis of achieving AIReF's expected scenario for the revenue of the LGs, growth in eligible expenditure of 2.6%, consistent with compliance with the expenditure rule, would require the sub-sector as a whole to achieve a surplus of more than 0.3% of GDP, 0.2 points above the fiscal balance forecast by AIReF.

FIGURE 41. ELIGIBLE EXPENDITURE FOR THE PURPOSES OF THE EXPENDITURE RULE 2024. LGS (% YEAR-ON-YEAR CHANGE)

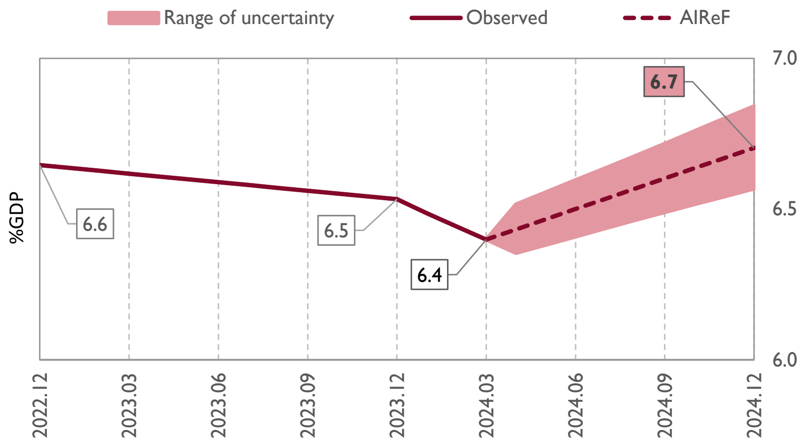


Source: AIReF and IGAE

For 2024, AIReF places its estimates for growth in LG revenue, net of the extraordinary items from the financing system and NGEU funds, at around 5%. AIReF's forecast revenue at the end of 2024, adjusted for the extraordinary items arising from the financing system and NGEU funds, would show growth of almost 5% over 2023. For 2024, and without standardisation, the expected growth in revenue would be more than 8%, reaching 6.7% of GDP. AIReF's estimated increase in LG revenue in 2024 is mainly due to the increase in revenue from the financing system, 0.2 points of GDP above that received in a standard year, those related to economic activity (especially those of the Chartered Councils of the Basque Country) and some local taxes, as well as the injection of EU revenue related to the NGEU Funds.

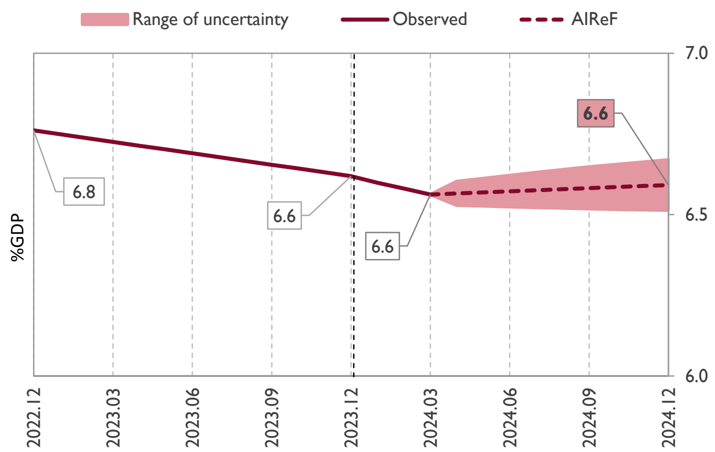
In terms of expenditure, AIReF maintains its April forecasts for 2024, estimating a year-on-year increase of close to 5% on a like-for-like basis. AIReF estimates that the growth in expenditure in 2024, standardised from NGEU Funds, could be around 5%, with the forecast increase in compensation of employees and investment being particularly significant, where it would reach 5%. An increase is also estimated in transfers from the Chartered Councils to the Autonomous Region of the Basque Country in order to make it share in the growth of agreed tax revenue. Without standardising the spending of the LG sub-sector, it would grow by more than 5%, reaching 6.6% of GDP.

FIGURE 42. LG REVENUE WITH RTRP (% GDP)



Source: AIReF and IGAE

FIGURE 43. LG EXPENDITURE WITH RTRP (% GDP)



Source: AIReF and IGAE

4.4.4.1 Analysis of the group of 25 large LGs

AIReF's forecasts raise the estimates for the group of large LGs to a combined surplus of almost 5% of revenue. This result is essentially due to adjusting their expenditure forecasts to more realistic scenarios. AIReF only worsens the 2024 year-end forecasts submitted by the LGs in the cases of the City Councils of Madrid, Malaga, Las Palmas de Gran Canaria and Cordoba and, very significantly, in the case of the Island Council of Majorca, mainly as a result of the fact that the LG unduly neutralises expenditure made with savings from previous years in the calculation of the surplus/deficit for the year. The breakdown of these is contained in the Supplementary Individual Evaluation Report published together with this report.

The forecasts for 2024 for the group of large LGs are worse than those sent with the initial budgets for the year, although the performance is very uneven. This group of large LGs has worsened its estimates for year-end 2024 from a combined surplus of more than 4% of its non-financial revenue, according to the information submitted in April, to around 3% according to current data. Within this group, both the subgroup made up of the large LGs in the common territory and that made up of the Chartered Councils in the Basque Country have worsened their 2024 year-end estimates by more than 1 percentage point on revenue, mainly as a result of less prudent expenditure estimates.

AIReF estimates a high risk of non-compliance with the expenditure rule in ten large LGs, with the growth in eligible expenditure in 2024 exceeding 7% in the cases of the City Council of Vitoria-Gasteiz, the Provincial Councils of Barcelona and Seville, the Island Councils of Tenerife and Majorca. In ten of the large LGs analysed, AIReF forecasts that, given the cumulative execution and assuming that the impact of the exclusions and regulatory revenue measures reported is not affected, there is a high risk of non-compliance with the expenditure rule. 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 Councils of Tenerife and Majorca and the Chartered Council of Gipuzkoa. Particularly significant are the increases of the City Council of Vitoria-Gasteiz, the Provincial Councils of Barcelona and Seville (all with reported growth of almost 19%) and the Islands Councils of Tenerife and Majorca (with reported growth of almost 8%).

To ensure compliance with the expenditure rule, the ten LGs where there is a risk would have to increase their net lending by between 1 and more than 14 percentage points of revenue. In the ten LGs analysed where there is a risk of non-compliance with the expenditure rule, to ensure compliance, the fiscal balance estimated by AIREF, assuming that the other elements remain constant, would have to be increased by significant amounts in the cases of the Provincial Councils of Barcelona (more than 14 points) and Seville (more than 8 points); and the City Council of Vitoria-Gasteiz, the Island Councils of Tenerife and Majorca, by around 4 points.

TABLE 16.LARGE LGS. AIREF ESTIMATE OF NET LENDING REQUIRED TO COMPLY WITH THE EXPENDITURE RULE

Entity	NL 2024	Eligible Expenditure 2024	NL compatible with 2024 expenditure rule compliance	Increase in NL compatible with expenditure rule compliance
	% / REV	Change 2024 (%)	% / REV	% / REV
City Council Valencia	6.7	4.4	8.1	1.4
City Council Palma	10.0	5.8	12.6	2.6
City Council Las Palmas GC	17.4	5.3	19.4	2.0
City Council Gijón/Xixón	8.8	4.9	10.7	1.9
City Council Vitoria-Gasteiz	0.0	7.4	4.1	4.2
Prov. Council Barcelona	-2.9	18.5	11.5	14.4
Prov. Council Seville	16.9	18.7	25.2	8.4
Island Council Tenerife	0.3	7.4	3.8	3.5
Island Council Mallorca	-12.0	7.7	-7.8	4.2
Chartered Council of Gipuzkoa	2.0	5.3	3.6	1.6

Source: Local Governments and AIReF.

4.5. Impact of the measures on General Government accounts

AIReF updates the economic impact of the measures in accordance with the latest information available and incorporates the new measures approved since the previous report. The impact of Royal Decree-Laws 3/2024 and 4/2024 adopting new measures and extending certain measures aimed at tackling the consequences of the conflicts in Ukraine and the Middle East for 2024 are included, with the estimated impact remaining unchanged at 0.3 points of GDP in 2024. It should be noted that AIReF had already included in previous reports the measures included in the Budgetary Plan 2024 relating to transport[17]; Royal Decree-Law 8/2023 of December 27th, which extended some of the measures in response to the effects of inflation and to protect the most vulnerable groups; Royal Decree 142/2024 of February 6th, amending the Personal Income Tax Regulation in relation to withholdings and payments on account on earnings from work; and the revenue measures derived from the pension reform.

AIReF includes the modification of the unemployment benefit as part of the SSF measures. Apart from including the measures described in the previous report for the SSFs, AIReF includes the cost of Royal Decree-Law 2/2024 of May 21st to

[17] This included both support for passenger transport channelled through the ARs and LGs, with an impact of €784m, and the extension of the reduction in the price of multi-journey tickets, both offered by concessionaires of regular public road passenger transport services under the responsibility of the CSA, and the reduction in the price of tickets offered by Renfe Viajeros in rail transport, with an impact of €680m.

simplify and improve the level of welfare protection, which, as it comes into force in November, is low in 2024. For the CG, AIReF's estimate maintains the measures described in the previous report. These measures include structural and temporary measures to increase the revenue of the CG.

4.5.1. Measures to combat the energy crisis

The total cost of the temporary measures established to mitigate the price rises resulting from the energy crisis will be 0.3 points of GDP in 2024, according to AIReF's estimates. Royal Decree-Law 8/2023 of December 27th extended some of the measures to respond to the effects of inflation and to protect the most vulnerable groups, which would otherwise have expired on December 31st 2023. In this report, AIReF has added the impact of the measures included in Royal Decree-Law 3/2024 and Royal Decree-Law 4/2024 to its estimates. The impact of all the measures in 2024 is estimated at more than €5 bn.

The total cost of expenditure measures for the CG caused by the economic crisis and the war in Ukraine amounts to 0.1% of GDP by 2024, just over €2 bn. However, no significant impact is expected for the latest measures approved by the Central Government since AIReF's Report on the Initial Budgets. Royal Decree-Laws 3/2024 and 4/2024 have increased CG expenditure by some €150m. Among the items included in these Royal Decree-Laws are the extension of those aimed at encouraging young people to use public land transport for journeys made in the summer of 2024, which amount to €70m, and a transfer to the ARs aimed at transforming the passenger and goods road transport fleet, amounting to €50m. Certain energy measures are also extended, which will be financed with the surplus from the electricity system in 2023. In addition, the update of the instalment payments of the Regional and Local Financing System and the increase in public employees' wages are included, without this entailing an increase in expenditure, given that both increases were already evaluated in AIReF's expenditure estimates for 2024 in the previous report.

The revenue measures adopted to mitigate the rise in energy and food prices will entail a reduction in revenue in 2024 of around 0.3 points of GDP, almost 0.1 points higher than estimated in the previous report. The evaluation of their impact is revised, mainly due to the extension of some of the VAT reductions on certain foodstuffs, initially established in Royal Decree-Law 8/2023 until June 30th 2024 and now extended through Royal Decree-Law 3/2024 and Royal Decree-Law 4/2024 until the year-end. Specifically, this includes the extension of the elimination of VAT on basic foodstuffs in the third quarter and its reduction from 4% to 2% in the fourth quarter; the elimination of VAT on olive oil in the third quarter and its reduction to 2% in the fourth quarter; and the reduction in the rate on seed oils and pasta from 10% to 5% in the third quarter and from 10% to 7.5% in the fourth quarter.

TABLE 17.IMPACT OF MEASURES IN RESPONSE TO THE ENERGY CRISIS IN NATIONAL ACCOUNTING TERMS: AIREF ESTIMATE

Impact in National Accounting terms	Annual impact 2024		
	Report Initial Budgets	Current (Includes RDL 3 and 4/2024)	Difference Current - Initial Budgets
Revenue Measures	**-2,428**	**-3,229**	**-801**
Revenue Measures (%GDP)	**-0.2**	**-0.2**	**-0.1**
VAT:			
VAT Electricity	-963	-963	0
VAT on gas, briquettes and pellets	-40	-40	0
VAT on basic foodstuffs From **4% to 0%** until 30/09/2024 From **4% to 2%** from 01/10/2024 to 31/12/2024	-882	-1,544	-662
VAT on olive oil From **10% to 5%** until 30/06/2024 From **10% to 0%** from 01/04/2024 to 30/09/2024 From **10% to 2%** from 01/10/2024 to 31/12/2024	-79	-141	-63
VAT on seed oils and pasta From **10% to 5%** until 30/09/2024 From **10% to 7.5%** from 01/10/2024 to 31/12/2024	-112	-206	-95
STs:			
ST Electricity	-352	-334	18
Expenditure Measures	**1,958**	**2,093**	**135**
Expenditure Measures (%GDP)	**0.1**	**0.1**	**0.0**
Fuel allowance	112	112	0
Sectoral support	330	380	50
Other support to individuals	1,516	1,601	85
Support to refugees			0
TOTAL	**-4,386**	**-5,322**	**-936**
TOTAL (% GDP)	**-0.3**	**-0.3**	**-0.1**
Other			
Tax on the Value of Electricity Production: Suspension	-746	-741	5

Source: Government and AIReF estimates

4.5.2. Measures taken at a regional level

The revenue measures adopted by the Autonomous Regions will result in lower tax collection of €200m in 2024, and a much greater impact on the revenue of the ARs this year. No new revenue measures have been adopted in the ARs with respect to those communicated in April, although some have been announced that could have an effect on tax collection in subsequent years. As noted in previous reports, the main tax measures adopted by the ARs since the end of 2022 have focused on Personal Income Tax, in many cases affecting tax periods starting on January 1st 2022. These measures, whose revenue impact is estimated at around €1.6 bn in 2023 and €540m in 2024, have a greater effect - approximately €3 bn - on the 2024 revenue of the ARs under the common regime. Due to the functioning of the financing system, the lower tax collection resulting from the measures that was not recorded in the 2022 instalment payments affects the 2024 settlement and, additionally, entails a reduction in the 2024 instalment payments. Significant tax reductions have also been adopted for Inheritance and Gift Tax and, to a lesser extent, the Tax on Asset Transfers and Documented Legal Acts. In contrast, an increase in tax collection of €450m is expected for Wealth Tax due to the cancellation of the initially regulated discounts for taxpayers subject to the Solidarity Tax on Large Fortunes, and of some €130m due to the creation of the new State Tax on Waste, which will take full effect this year. In Navarre, an increase in revenue is expected from the withdrawal of part of the tax relief measures in force in 2023, in parallel to that applied by the State.

TABLE 18. REVENUE IMPACT IN 2024 OF THE REVENUE MEASURES ADOPTED BY THE ARS (€MILLION)

ARs	PIT (*)	Inherit. & Gift Tax	Wealth Tax	Tax on Asset Tran. & DLA	Other taxes	TOTAL
ANDALUSIA	0	0	15	-1	31	44
ARAGON	-33	-4	-18	0	15	-40
ASTURIAS	0	-2	0	-7	4	-5
BALEARIC ISLANDS	14	-68	0	0	0	-54
CANARY ISLANDS	37	-11	0	0	13	40
CANTABRIA	17	-2	0	-16	1	0
CASTILE AND LEON	-3	0	0	0	6	3
CASTILE-LA MANCHA	50	0	0	0	6	56
CATALONIA	0	1	0	0	10	10
EXTREMADURA	-43	-4	-6	0	1	-52
GALICIA	-8	-2	25	-12	3	5
MADRID	-317	-24	555	-1	21	233
MURCIA	5	0	-23	-11	5	-25
NAVARRE	27	0	1	0	66	94
BASQUE COUNTRY	0					
RIOJA	-11	-5	0	0	1	-15
VALENCIA	-270	-212	0	-19	6	-495
TOTAL ARs	-535	-333	549	-68	188	-199

Source: AIReF, based on information from the ARs.

(*) Effect on the 2024 tax collection of all GG sub-sectors. The effect on regional revenue varies in amount and year due to the functioning of the financing system.

The permanent expenditure measures adopted or planned by the ARs will increase the sub-sector's spending by €1.3 bn in 2024, €500 m more than expected in the previous report. Since the Report on the Main Budgetary Lines, the ARs have adopted new expenditure measures on staff which they value at €400m, to be added to the €800m increase estimated in April for the staff measures planned at that time. Since 2023, significant wage and staffing increases have been implemented, in addition to the wage increase derived from the basic regulations, the effects of which have been concentrated in 2023 and 2024 and in some cases extend to 2028.

TABLE 19.INCREASE IN EXPENDITURE IN 2024 DUE TO PERMANENT SPENDING MEASURES ADOPTED OR PLANNED BY THE ARS (€MILLION AND % GDP)

ARs	Comp. Empl.	Social transfers in kind	Subsidies & other transfers to private sector	Capital expenditure	Other	TOTAL	
						€m	%GDP
ANDALUSIA	136	0	0	0	0	136	**0.1**
ARAGON	0	-1	0	0	0	-1	**0.0**
ASTURIAS	59	0	0	0	0	59	**0.2**
BALEARIC ISLANDS	2	0	-5	5	0	2	**0.0**
CANARY ISLANDS	23	0	47	8	0	78	**0.1**
CANTABRIA	0	0	0	0	0	0	**0.0**
CASTILE AND LEON	60	0	4	0	0	64	**0.1**
CASTILE-LA MANCHA	0	0	0	0	0	0	**0.0**
CATALONIA	617	0	0	0	0	617	**0.2**
EXTREMADURA	22	0	0	0	0	22	**0.1**
GALICIA	113	0	0	0	0	113	**0.1**
MADRID	15	0	0	0	0	15	**0.0**
MURCIA	121	11	0	0	-3	130	**0.3**
NAVARRE	24	0	10	0	0	34	**0.1**
BASQUE COUNTRY	0	0	0	0	0	0	**0.0**
RIOJA	0	0	0	0	0	0	**0.0**
VALENCIA	39	0	0	0	0	39	**0.0**
TOTAL ARs	**1,233**	**10**	**56**	**13**	**-2**	**1,309**	**0.1**

Source: AIReF, based on information from the ARs.

4.6. Contingent liabilities and fiscal risks

The recent materialisation of some fiscal risks related to the enforcement of court rulings could have a greater impact on the General Government deficit than initially expected. Last May, the question referred by the Supreme Court to the Court of Justice of the European Union on the regional tax rate of the Special Tax on Hydrocarbons was resolved against the interests of the State. Following the ruling of the European Court, the only remaining uncertainty is the quantification of the final impact of the Supreme Court ruling and the year in which it will be recorded in national accounting terms. In the last General State Accounts published, corresponding to 2022, the Government had estimated an effect of up to €6.5 bn for this tax risk. Moreover, in January this year, the Constitutional Court declared several aspects of Royal Decree-Law 3/2016 reforming Corporate Income Tax to be unconstitutional. Some refunds are already being paid out, which are expected to continue throughout 2024.

In addition, several rulings handed down in previous fiscal years will have an extended impact on the 2024 headline deficit. The Supreme Court, in February 2023, recognised the right to a Personal Income Tax refund for pensioners who contributed to the former mutual labour insurance companies and, in July 2022, declared the Business Activity Tax (Spanish acronym: IAE) on mobile telephone operators to be contrary to European law. In both cases, although some refunds were paid out in 2023, the impact will continue in the 2024 deficit. In particular, the Court of Auditors' report on the 2022 General State Account, published on June 28th 2024, refers to the provision recorded by the State for the IAE refund amounting to €1.291 bn, to which a further €100m would have to be added for interest. Given that in 2023, €137m were allocated in national accounting terms for this ruling, a further €1.25 bn would remain to be recorded, and it is foreseeable that part of this amount will fall in 2024.

Apart from these risks that have already materialised, other risks arising from legal cases remain outstanding. Some of these risks are identified in the 2022 General State Account:

- **International arbitration**: in the field of energy, the dispute over renewable energies is still open and, although the arbitration proceedings are being appealed, the amount of the court rulings against Spain is hovering around €1.164 bn.
- **Motorway concessionaires:** several proceedings remain open (i) the contentious-administrative appeals against the agreements of the Council of Ministers that approved the resolutions for the settlement of the toll motorway concession contracts, the amount of which is not quantified; (ii) the equity loans awarded to motorway concessionaires in a delicate financial situation, for an amount of €148m and (iii) the claims by motorway concessionaires on requests for economic equilibrium due to COVID-19, the amount of which totals €427m.
- **Electricity social voucher:** there are several contentious-administrative appeals against the regulation of the electricity social voucher, the amount of which is not quantified. However, €366m have already been allocated in 2022.
- **Other:** various disputes in relation to the entities included in the General Account (ACUAMED and the Gijón Port Authority Group).

In addition, there are other risks arising from legal proceedings not contained in the above list. First, in September 2023, the General Court of the European Union (EGC) revoked the European Commission's decision declaring illegal the tax relief for companies carrying out indirect acquisitions of foreign firms. This ruling has been appealed by the European Commission and is thus pending resolution. Second, the Treasury challenged before the National High Court the favourable resolution of the Central Economic-Administrative Court (Spanish acronym: TEAC) in favour of Banco Santander to seek to reimburse the deferred tax assets (DTAs) that Banco Santander took for the losses assumed in the takeover of Banco Popular. In the latter case, a resolution in favour of the State would have the effect of reducing the deficit.

Furthermore, there is a risk regarding the impact on the deficit of investments in defence modernisation programmes, the amount of which is not known and for which no information is provided. These special modernisation programmes are in the process of being implemented and the volume of these investments should have an increasingly significant impact on the deficit due to the Government's commitment to NATO to increase defence spending to 2% of GDP by 2029. Despite the significance of this expenditure, there is only budgetary information available, but no information on the impact it could have on the 2024 deficit. This is because, regardless of its budgetary accounting, in national accounting terms it is only recorded in the deficit when military weapons are made available to the Ministry of Defence. However, no information on payments settled is available until the publication of the year-end data the following year. Nor is information provided on planned military deliveries for the current year.

Another risk stems from the adoption of additional revenue and/or expenditure measures by different tiers of government. As stated in the previous report, in addition to the extension to 2024 of some support derived from the energy and price crisis under Royal Decree-Law 8/2023, there was a risk that the Central Government would adopt new measures outside the extended budget, which would have an impact on the deficit at year-end. This risk materialised with the approval by Royal Decree-Law 3/2024 on public transport discounts for young people during the summer and the extension by Royal Decree-Law 4/2024 of certain anti-crisis measures. In addition, some ARs approved staff measures. All these measures have an impact on the headline deficit for the year and have already been included in AIReF's forecasts.

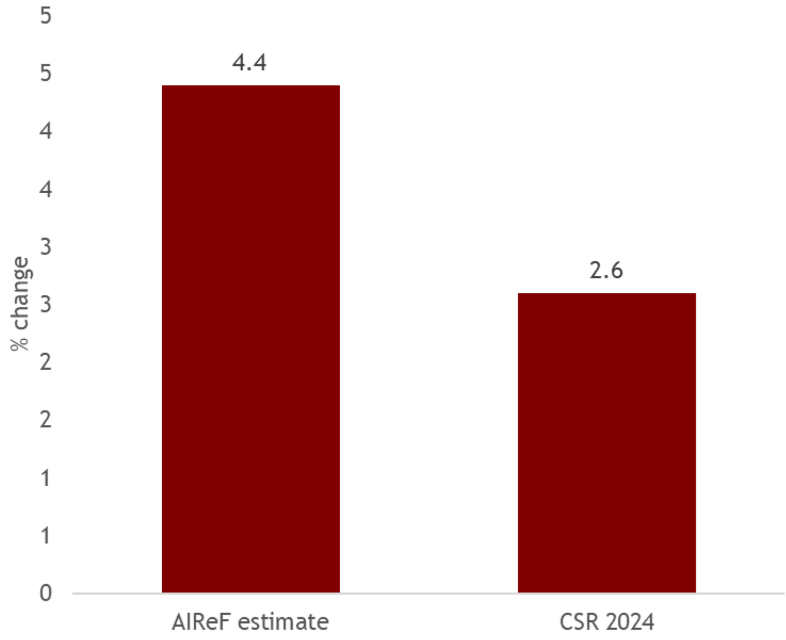
Lastly, uncertainty regarding the macroeconomic scenario implies risks to the materialisation of the projected fiscal scenario. Geopolitical conflicts, inflationary and trade tensions, financing conditions and the slower pace of execution of the RTRP are some of the main risks that could have a negative impact on economic growth. All these elements remain key in the evolution of certain variables such as employment, wages, private consumption and gross operating surplus, which will affect the final path of tax revenue and contributions, as well as interest expenditure, with an impact on the deficit in 2024.

5. FISCAL POLICY STANCE

For 2024, the Country Specific Recommendation (CSR) for Spain establishes that overall nationally-financed primary expenditure (current and capital), net of revenue measures, should not increase by more than 2.6% per year. In addition, and in terms of the composition of public finances, Spain is recommended to preserve nationally-financed public investment.

Current estimates suggest that primary expenditure net of revenue measures will grow in 2024 at a much higher rate than permitted under the CSR. According to AIReF's forecasts, the net primary expenditure variable will grow this year at a rate of 4.3% - i.e. 1.7 percentage points higher than permitted. Accordingly, net primary expenditure recorded in 2024 would exceed the maximum allowed by €10.7 bn, which in GDP terms represents 0.7 points. This would be the magnitude of the measures that, either in terms of contained spending or an increase in revenue, would need to be adopted in the remainder of the year in order to comply with the CSR applicable to Spain.

FIGURE 44. NATIONALLY-FINANCED PRIMARY EXPENDITURE NET OF REVENUE MEASURES IN 2024. COMPARISON WITH THE 2024 FISCAL CSR, TOTAL GG



Source: AIReF

The estimates in the previous report published by AIReF[18] pointed to a smaller deviation in expenditure with respect to the benchmark established in the CSR; hence, since April this gap has widened. The forecasts three months ago reflected a lower increase in net primary expenditure, at a rate of 4%. The CSR reference was thus exceeded by 1.4 percentage points.

As regards the evolution of nationally-financed public investment, the projections for 2024 would be consistent with what is established in the CSR for this year. This year, GG investment would be maintained, both its rate of change and its weight in GDP terms.

[18] See the Report on the Initial Budgets of the GG for 2024.

FIGURE 45. EVOLUTION OF NATIONALLY-FINANCED PUBLIC INVESTMENT

FIGURE 45. A NATIONALLY-FINANCED GG INVESTMENT (% Y-O-Y CHANGE)

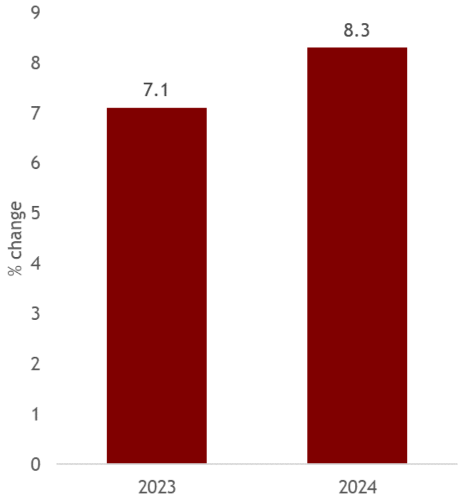
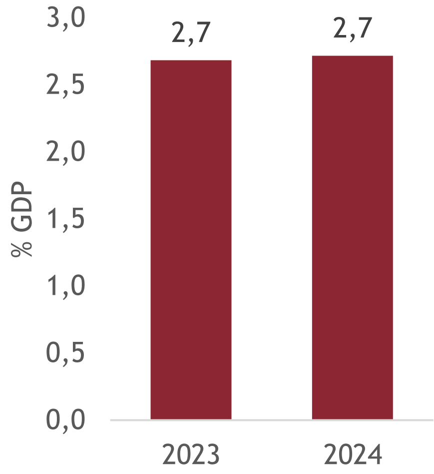


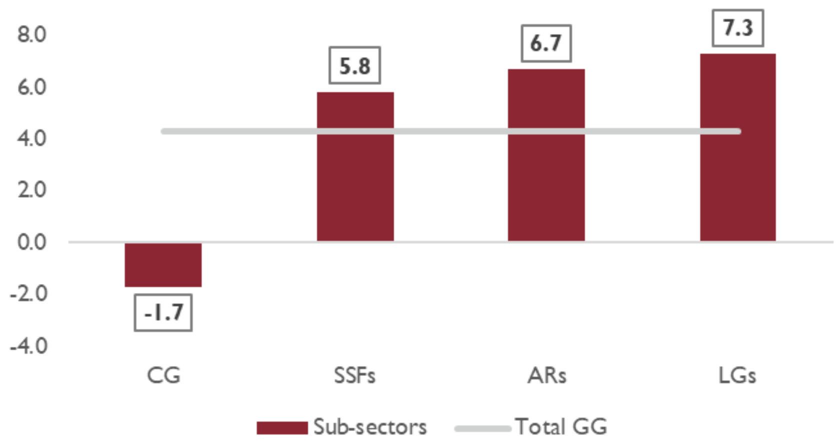
FIGURE 45. B. NATIONALLY-FINANCED GG INVESTMENT (% GDP)



Source: AIReF

By sub-sector, with the exception of the CG, all other tiers of government show growth in expenditure net of revenue measures above the 2.6% limit. For the CG, AIReF forecasts a fall of 1.7% compared with the increase forecast in the previous report due to the reduction in the expenditure forecast. For their part, expenditure by the Social Security Funds will grow by 5.8%, driven by the pension increase. This implies the SSFs exceeding the limit by 0.4 points of GDP, while the CG offsets the deviation with 0.5 points of GDP. As for the ARs and LGs, primary expenditure net of revenue measures will grow by 6.7% for the ARs and 7.3% for the LGs, 0.5 points of GDP above the limit in the case of the ARs and 0.2 points of GDP for the LGs. Under AIReF's revenue forecast, compliance with the recommendation would lead the ARs to post a surplus of 0.3% of GDP.

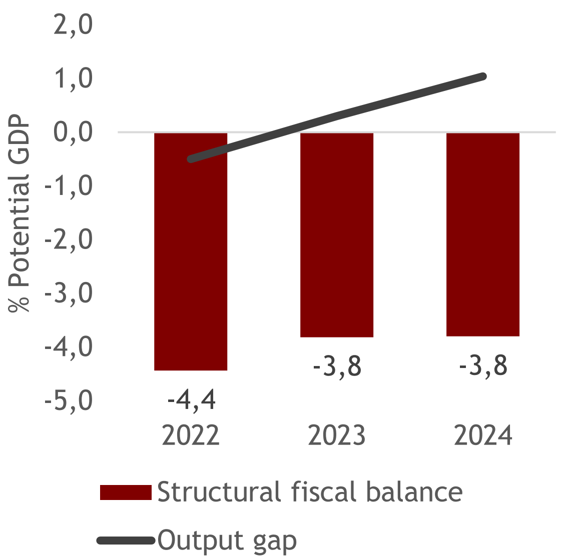
FIGURE 46. NATIONALLY-FINANCED PRIMARY EXPENDITURE NET OF REVENUE MEASURES IN 2024. BY GG SUB-SECTOR (% YEAR-ON-YEAR CHANGE)



Source: AIReF

Looking at the structural situation of public finances, the misalignment between revenue and expenditure remains high, far from the structural balance that anchors fiscal policy in the national fiscal framework. This imbalance can be seen despite the improvement in the structural-fiscal balance in recent years, related to the disappearance of most of the measures adopted to mitigate the effects of the energy crisis.

FIGURE 47. STRUCTURAL-FISCAL BALANCE

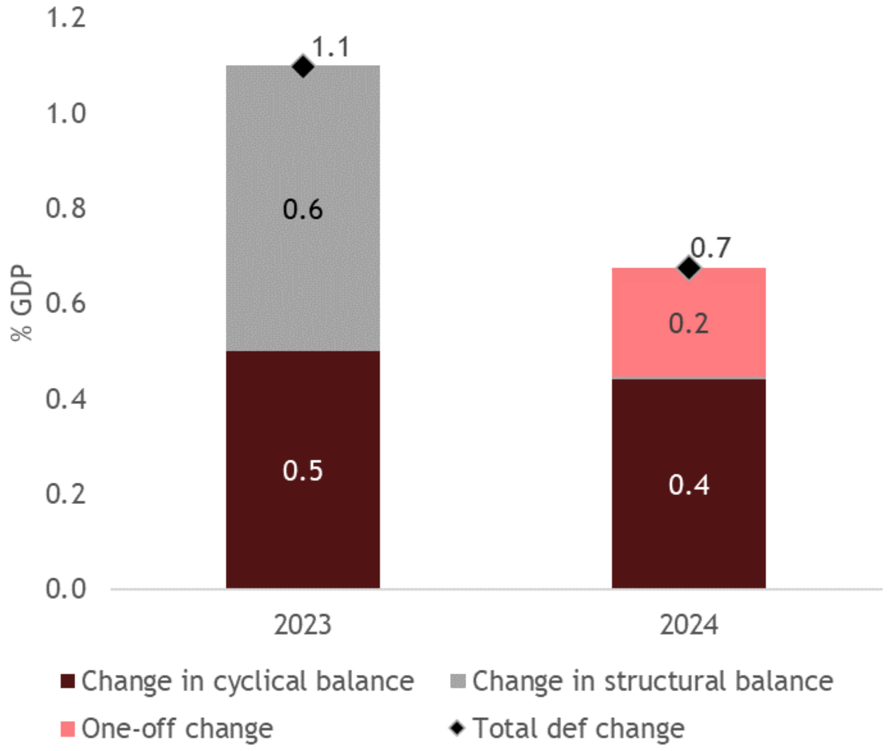


Source: AIReF

Breaking down the change in the public deficit - observed in 2023 and projected for 2024 - into its cyclical and structural components, the

contribution of the latter virtually disappears. This, together with a somewhat smaller cyclical contribution, would explain the smaller reduction in the deficit projected for 2024 compared with the previous year.

FIGURE 48. CONTRIBUTIONS TO THE CHANGE IN THE HEADLINE DEFICIT OF THE GG IN 2023 AND 2024



Source: AIReF

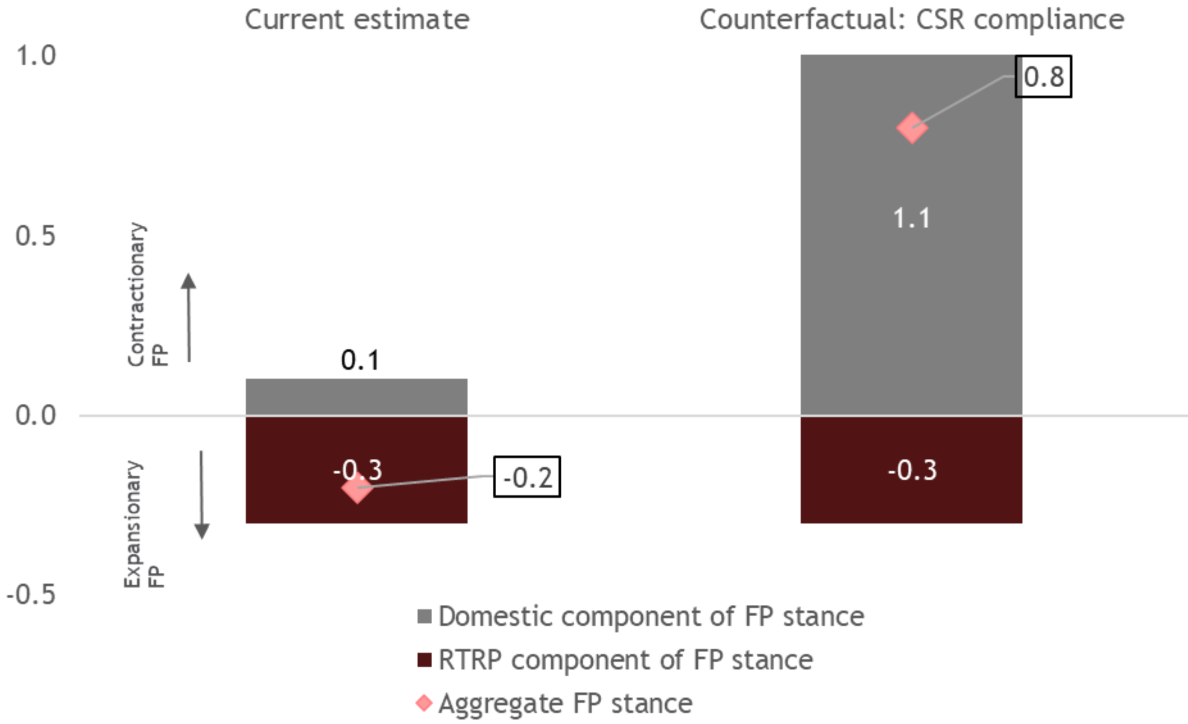
Lastly, the aggregate fiscal policy stance should be analysed including Next Generation EU funds. Although the current volatility intensifies the uncertainty surrounding the estimation of the output gap, the structural-fiscal balance remains a relevant tool to approximate the underlying situation of the national component of public finances. Similarly, its change allows us to approximate the stance of the nationally-financed part of fiscal policy. However, from a macroeconomic point of view, it is important to analyse the aggregate fiscal policy stance including the considerable boost provided by Next Generation funds (NGEU). Since these funds have, in principle, a deficit-neutral impact, the evolution of the structural-fiscal balance does not capture the magnitude of the boost associated with these funds. Measuring the evolution of net primary expenditure, including NGEU funds, relative to the economy's potential medium-term performance allows the aggregate fiscal policy stance to be estimated. This complementary measure of discretionary fiscal effort (DFE)[19] is relevant in the current circumstances.

The discretionary fiscal effort (DFE) indicator suggests that the aggregate fiscal policy stance - including spending from NGEU funds in addition to nationally-financed expenditure - would be slightly expansionary this year. Current estimates suggest that the national component of fiscal policy in 2024 would have a broadly neutral stance (with a net primary expenditure growth rate of 4.3%, very close to the potential performance of our economy in the medium term)[20]. When taking into account the boost from the NGEU funds - which would amount to 0.3 points of GDP in 2024 - the aggregate result would indicate a slightly expansionary stance for fiscal policy as a whole.

An alternative scenario in 2024, compatible with compliance with the CSR, would imply a strongly contractionary stance for fiscal policy as a whole. If primary expenditure net of revenue measures were to grow at 2.6% as established in the CSR addressed to Spain - instead of 4.3% as AIReF's estimates suggest - the national component would contribute a contraction of 1.1 points of GDP to the fiscal stance. This contraction would only be partially offset by the expansion from the NGEU funds, resulting in an aggregate contraction of 0.8 points of GDP.

[19] For more breakdowns on the methodology for calculating discretionary fiscal effort, see Carnot, N. & F. de Castro (2015). 'The Discretionary Fiscal Effort: an Assessment of Fiscal Policy and its Output Effect'. European Commission. *Economic Papers 543* (February 2015).
[20] Taking into account the GDP deflator forecast for 2024 and the ten-year average rate of potential growth, this medium-term benchmark is estimated at 4.6%.

FIGURE 49. DISCRETIONARY FISCAL EFFORT INDICATOR (DFE), GDP PP, 2024*.

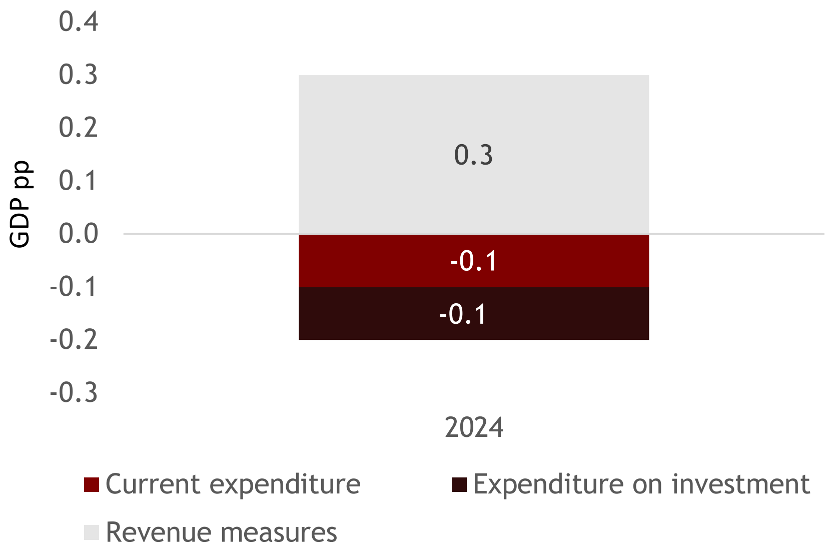


*Note: a negative sign represents an expansionary fiscal policy and *vice versa*.

Source: AIReF

In terms of composition, the disappearance of certain revenue measures prevents a more expansionary stance of the domestic component of fiscal policy. Both current and investment spending would contribute a slightly expansionary tone to the aggregate, as opposed to revenue measures that represent a contraction.

FIGURE 50. CONTRIBUTIONS TO THE NATIONAL COMPONENT OF THE DISCRETIONARY FISCAL EFFORT (DFE), GDP PP , 2024*.



*Note: a negative sign represents an expansionary contribution to the aggregate fiscal tone and *vice versa*.

Source: AIReF

6. PUBLIC DEBT

6.1. General Government total

The Spanish debt-to-GDP ratio stood at 108.9% in the first quarter of 2024, an increase of 1.2 percentage points from year-end 2023, and 10.7 percentage points from the pre-pandemic level. In annual terms, the rate of decline in the ratio has slowed, by 2.2 points in the last four quarters, and in quarterly terms it has broken a streak of 11 consecutive quarters of continuous decline. It is worth noting that historically the first quarter of the year has a positive seasonal effect as public issuers tend to take advantage of the buoyant demand at the start of the year. The cumulative reduction since the ceiling reached in the first quarter of 2021 (125.3%) is 16.4 points. In monetary terms, public debt continued to grow in 2024 to reach €1.604 trillion in April.

Spain is currently one of the EMU countries with the highest debt levels, behind Greece, Italy and France, and with a similar level to Belgium. In 2019, Spain was already one of the euro area countries with the highest debt ratios, and the pandemic has contributed to consolidating this situation. Despite the 16-point reduction from the ceiling, Spain, together with France and Belgium, are the countries with high ratios that have increased their debt the most due to the COVID crisis. With the exception of Greece, it can also be seen that the most indebted EU countries are those with some of the largest imbalances in their public accounts. Portugal, after an initial very considerable upturn, has managed to reduce its deficit in the last three years to reach a budgetary surplus that has allowed it to reduce its debt considerably.

Figure 51. DEBT (% GDP), QUARTERLY EVOLUTION TO 2024 Q-I

Source: Bank of Spain, INE and AIReF

FIGURE 52. CONTRIBUTION TO CHANGE IN DEBT (% GDP) 2020-2023

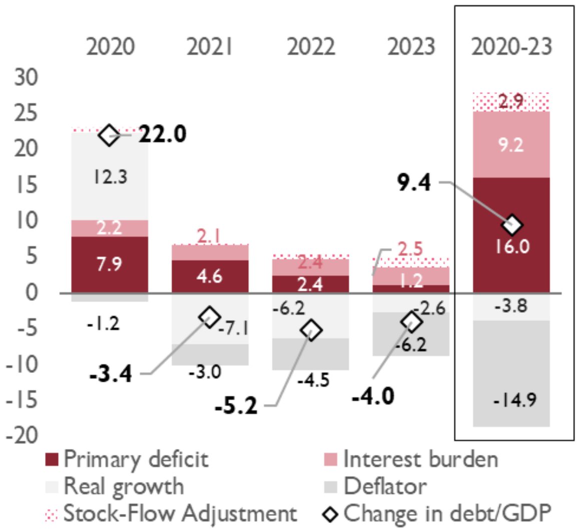


Figure 53. EUROPEAN UNION COUNTRIES WITH A DEBT RATIO ABOVE 60% OF GDP

FIGURE 53. A. DEBT (% GDP) IN 2023, AND CHANGE FROM PRE-COVID LEVEL

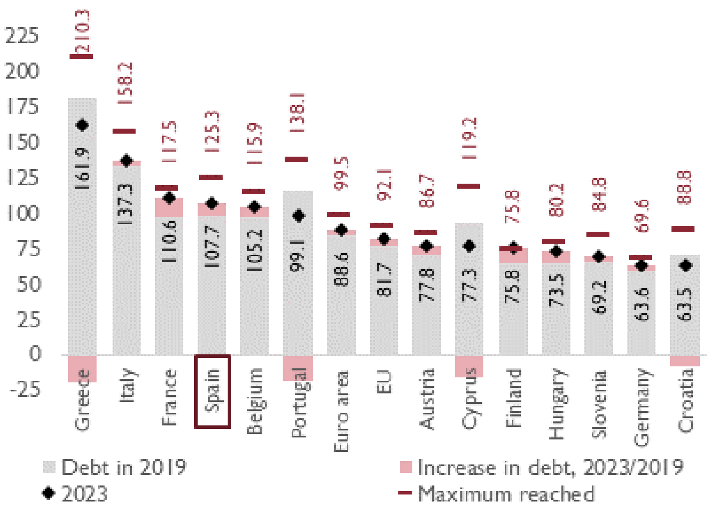
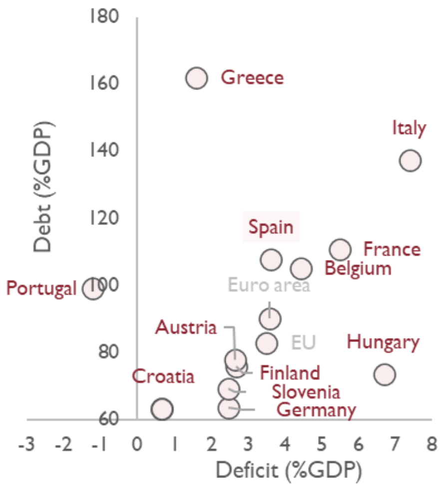


FIGURE 53. B. HEADLINE DEFICIT AND DEBT (% GDP) IN 2023



Source: Eurostat and Ameco

AIReF's macro-fiscal forecasts project a decrease in the debt-to-GDP ratio of 2.3 points in 2024 on the level recorded in 2023, which would place the ratio at 105.3% at the end of 2024. This forecast is slightly lower than that presented by the Government and the Commission in their latest update (105.5%), and somewhat more optimistic than the latest IMF projection (106.3). The reduction in the ratio continues to be underpinned by nominal GDP growth, where the deflator continues to make a significant contribution.

FIGURE 54. DEBT PROJECTIONS (% GDP)

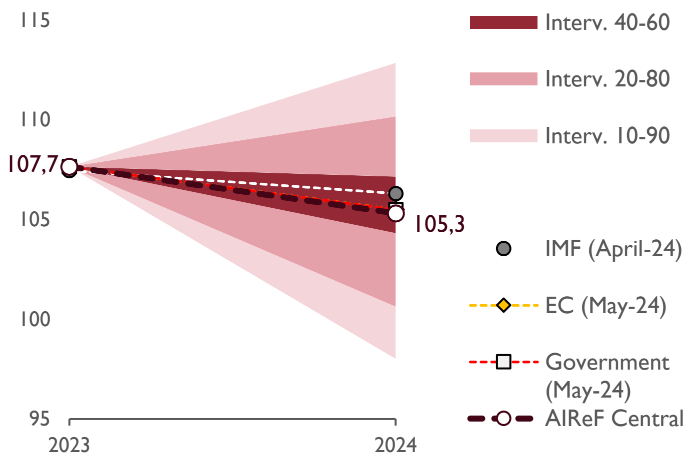
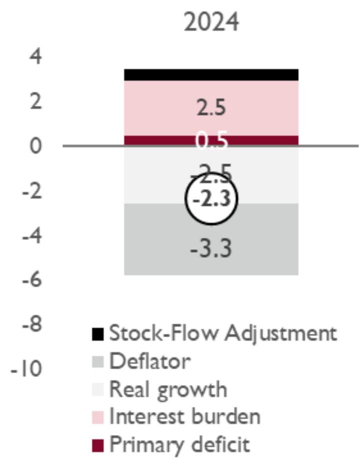


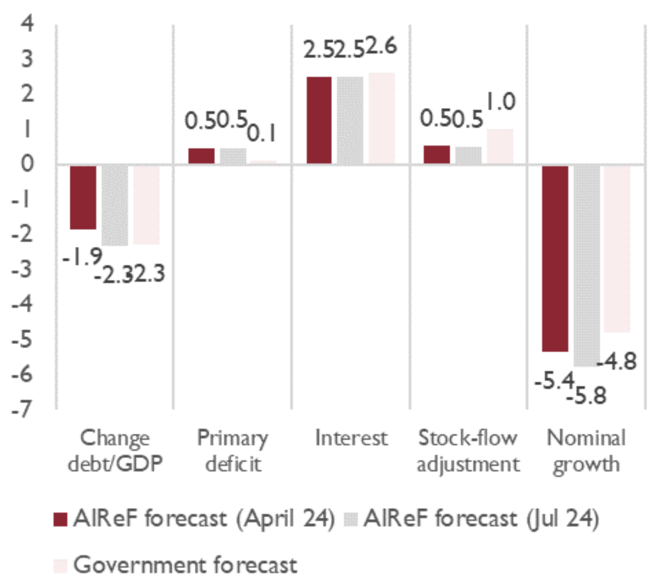
FIGURE 55. CONTRIBUTIONS TO THE CHANGE (GDP POINTS)



Source: AIReF

The update of the debt ratio projection represents an improvement of 0.4 points on AIReF's projection in the "Report on the Initial Budgets of the GG for 2024". The improvement is underpinned by a greater contribution from nominal growth due to the revision of the expected rate of change in real GDP to 2.4% from the previous 2%.

FIGURE 56. CONTRIBUTIONS TO CHANGE IN DEBT IN 2024 (GDP POINTS)



Source: AIReF

6.1.1. Inflation, central banks and financing conditions

After a significant decline in 2023, inflation has moderated its fall in 2024, showing some signs of stabilising at levels somewhat above those desired by central banks. After an all-time high in 2022, inflation declined significantly in 2023. In 2024, inflation is showing some signs of stabilising at levels not far from, but above, the central banks' benchmark levels and a final correction to the 2% target is expected to be much more gradual. Headline inflation in the euro area stood at 2.5% in June, down 0.1 points from the previous month, bringing it to between 2.5-3% for eight consecutive months. Core inflation also fell by 0.1 points in June to 2.8%.

FIGURE 57. EURO AREA HARMONISED INFLATION AND ECB DEPOSIT FACILITY RATE

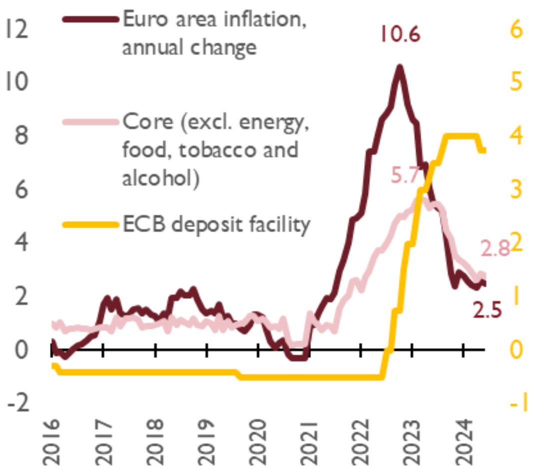
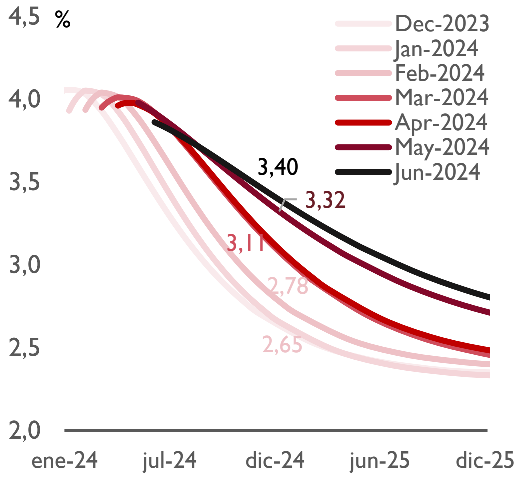


FIGURE 58. EXPECTED ECB DEPOSIT FACILITY RATE (*)

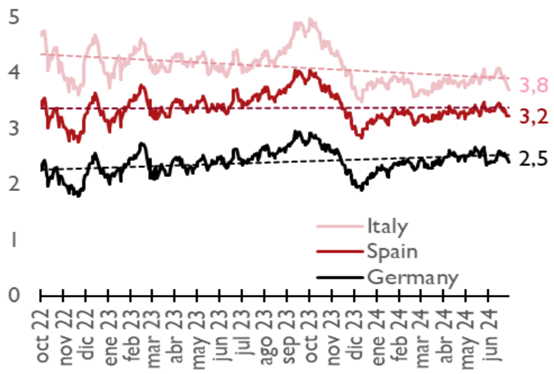


(*) Discounted through the instantaneous forward curve of the OIS.
Source: Refinitiv and AIReF

The central banks of the main developed economies are facing a possible change of cycle in monetary policy decisions. After a few months of pause following almost two years of continuous interest rate hikes, central banks are taking the first steps to ease the policy stance. The Bank of Switzerland initiated the cycle of interest rate drops in developed economies last March. It was subsequently joined by the Swedish central bank, with an announcement of a 25-basis point cut in May, and the ECB with the same cut in June, bringing the deposit rate to 3.75% and the refinancing rate to 4.25%, as had already been widely discounted by the markets.

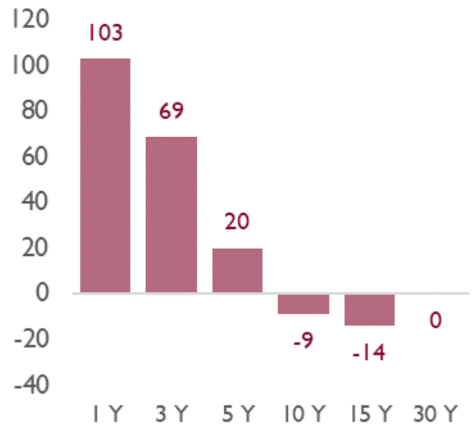
Despite these initial movements, there is still great uncertainty about the pace of decline in the coming months. Market expectations have been cooling over the last few months, from cumulative cuts of 100-150 basis points over the whole of 2024 to the 40-50 basis points being discounted in June. The latest data have not helped gain the necessary confidence for a first rate cut in the United States, when at the start of the year it was taken for granted that by this point in the calendar the FED would have already reduced its policy rate once or twice. For its part, the ECB is giving no clear signals about future moves. What does seem to be a certainty is that monetary policy will move in restrictive territory for a prolonged period of time, closely related to the evolution of the different price and economic activity indicators.

FIGURE 59. 10-YEAR BOND YIELD (BP)



Source: Refinitiv

FIGURE 60. YIELD DIFFERENCE OF SPANISH CURVE, JULY 24 - OCTOBER 22 (BP)



Source: AIReF

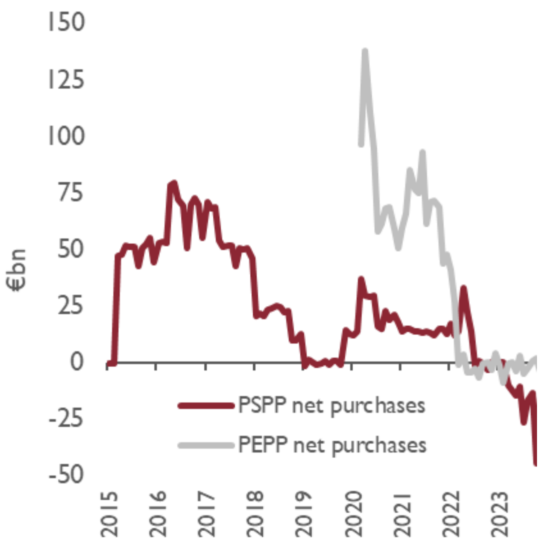
Over the last year and a half, sovereign debt yields have shown a fairly stabilised evolution in their longer-term tranches. After the strong and rapid increase in sovereign debt yield curves as a result of the inflationary episode and the reaction of central banks, a certain stability can be observed over the last 18 months in the yields of the longer tranches of the curve in the different countries. This evolution has not been exempt from certain fluctuations whereby price and activity indicators have been passing on the expectations of the monetary authorities' future decisions.

The ECB has cut its balance sheet by more than €2 trillion since the June 2022 peak. Since mid-2022, the Eurosystem's balance sheet has shrunk by €2.27 trillion, or more than 22%. Most of this decline is due to the fact that banks have repaid a substantial part of the Eurosystem's borrowing through targeted long-term refinancing operations (TLTROs). This has returned many assets previously used as collateral, including government bonds, to the market. The reduction in the Eurosystem's balance sheet and the fact that governments across the euro area have issued record amounts of debt have substantially increased the availability of bonds in the market.

In addition, the ECB is reducing the amount of bonds in its portfolio that it started buying in 2014 with the launch of the first debt purchase programme, by not reinvesting maturing bonds under its Public Sector Purchase Programme (PSPP). In June 2022, the ECB's Governing Council decided to discontinue net asset purchases under the PSPP, but to continue reinvesting all repayments between July 2022 and February 2023. In December 2022, the decision was taken that as of March 2023 the portfolio would decrease at a moderate and predictable pace with no net purchases and partial reinvestments. In June 2023, it was confirmed that reinvestments under the PSPP would be discontinued as of July 2023. Since the June 2022 peaks, public debt holdings under the programme were reduced by €321 bn by the end of May 2024. Maturities over the next 12 months are estimated at €255 bn.

FIGURE 61. CENTRAL BANK BALANCE SHEETS

FIGURE 62. NET PURCHASES UNDER THE ECB'S PSPP AND PEPP PROGRAMMES

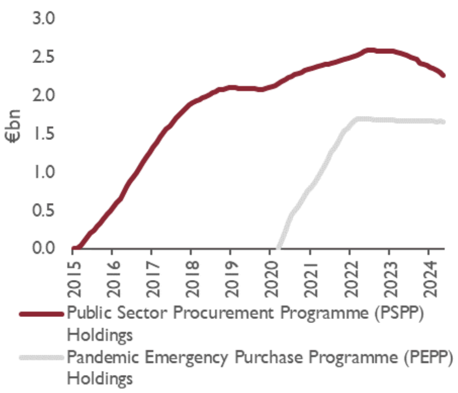


Source: European Central Bank, Federal Reserve and Bank of Japan.

The reduction of the ECB's balance sheet holdings of public debt is set to accelerate at the end of 2024 with the discontinuation of reinvestments under the Pandemic Emergency Purchase Programme (PEPP). In December 2023, the ECB's Governing Council announced its intention to continue reinvesting, in full, the principal payments on maturing securities purchased under the PEPP during the first half of 2024 and to reduce the PEPP portfolio by €7.5 bn per month, on average, during the second half of the year. At the same time, the Governing Council announced its intention to discontinue reinvestments under the PEPP at the end of 2024. Since the June 2022 peaks, public debt holdings under the programme were reduced by €38 bn by the end of May 2024.

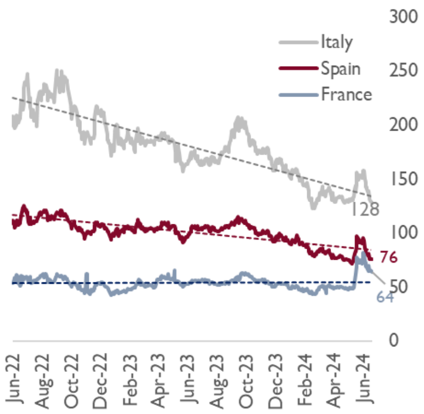
Public debt holdings held by the ECB under the PSPP and PEPP programmes are still very high, amounting to almost €4 trillion. The process of "quantitative tightening" is taking its first steps in terms of government bond flows, with a long way to go (the ECB has not yet become a net seller of bonds). Holdings have been reduced overall (PSPP+PEPP) by €355 bn since the end of June 2022, or 8%. At the end of May 2024, the portfolio stood at €3.93 trillion. It is still too early to assess the impact of the divestment on both public debt yields and spreads in the different euro area countries, although the ECB has equipped itself with tools such as the "The Transmission Protection Instrument" to moderate and control possible adverse effects.

FIGURE 63. ECB ASSET PURCHASE PROGRAMME HOLDINGS



Source: European Central Bank

FIGURE 64. 10-YEAR SPREAD VIS-À-VIS GERMANY (BP)



Source: Refinitiv

In the two years since the ECB started to raise interest rates and reduce its balance sheet, the bond market has been relatively calm. The ECB has been the main buyer of European bonds in recent years, thus helping to contain risk premiums and maintain low financing costs. Bond yields have risen as monetary policy has tightened, but not alarmingly so for the ECB, and risk premiums have softened in recent months despite debt issuance being at an all-time high at the start of the year, and the ECB's asset balance having shrunk by 22%. Following the European elections and the snap elections in France, there has been some uncertainty in the markets with increases in the spreads of southern European countries and France.

The reduction in the Eurosystem's balance sheet has taken place against a background of high public debt issuance, which has led private investors to intensify their demand in bond markets. Historically, foreign investors have been the main holders of public debt in Spain and the euro area, accounting for around 40% of holdings before the start of the Eurosystem's asset purchase programme. However, when the Eurosystem expanded its balance sheet, foreign investors halved their holdings of euro area public debt. When the Eurosystem ended reinvestments under the PSPP, they returned and absorbed a considerable share of net public debt issuance. However, their share is still much lower than it was a decade ago.

FIGURE 65. YIELDS AND HOLDINGS OF BILLS HELD BY HOUSEHOLDS (SPAIN)

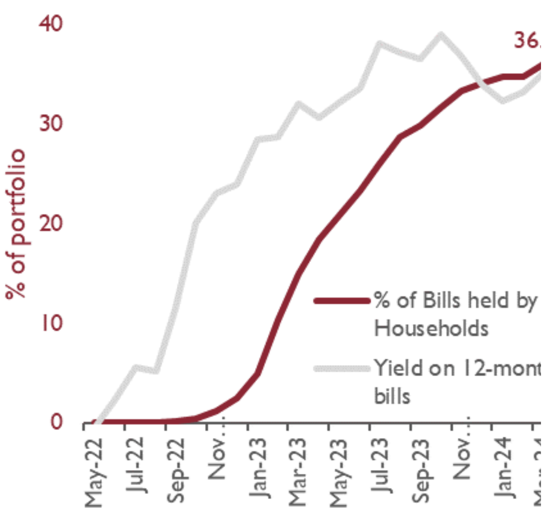
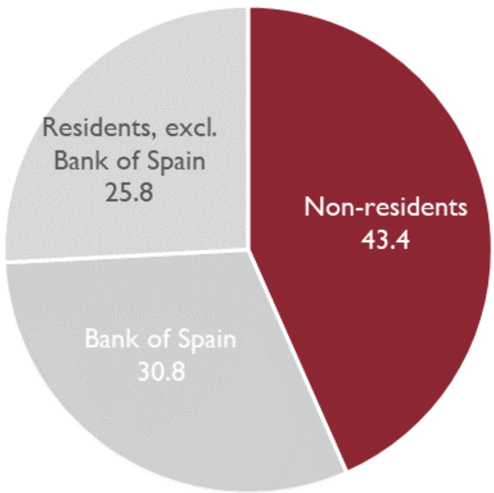


FIGURE 66. GOVERNMENT BOND HOLDINGS BY TYPE OF INVESTOR (%), MARCH 2024



Source: Refinitiv and Bank of Spain

Of note is the speed and intensity of purchases by the household sector. The share of public debt held by households has returned to around 3.5%, close to the level before the Eurosystem launched its public sector purchase programme (PSPP) in 2015. Several factors have made the purchase of public debt attractive for households. Rising yields, together with governments offering specific products for individuals, attracted household investment, especially as many commercial banks were slow to pass on the increase in policy rates to deposit rates. In addition, the increase in savings during the pandemic meant that households had more money available to invest in bonds and Treasury bills.

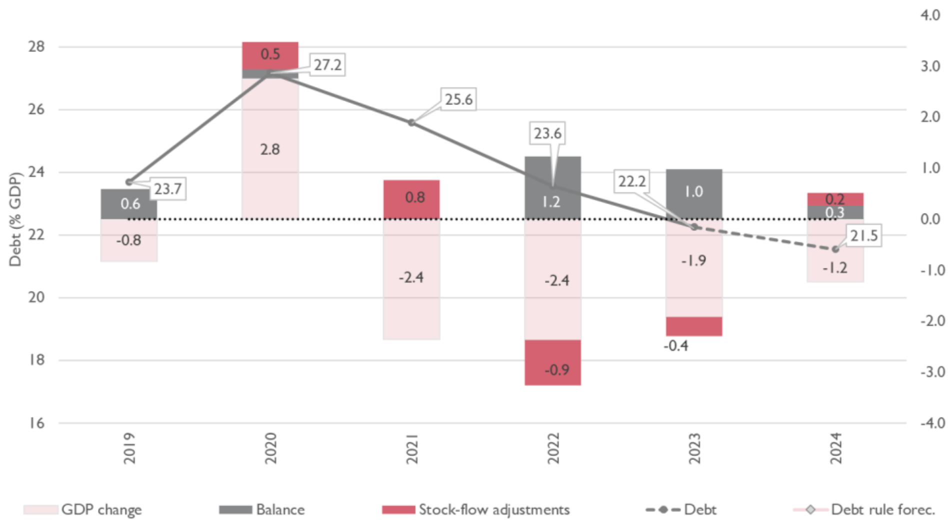
Since mid-2022, foreign investors have increased their holdings of government bonds and debentures by 3.3 points to 43.4% of the total. For their part, resident investors have increased their holdings by 1.9 points to complete the reduction in debt held by the Bank of Spain of 5.2 points. Retail investors' high interest in Treasury bills was very significant during this period, becoming the main holder, with a historical increase of €25.806 bn up to March 2024. As a result, households accounted for more than one third (36.1%) of total Treasury bill holdings at that date, making them the main type of investor in this segment.

Financial companies have increased their share to 8%. These increases in Treasury bill holdings came at the expense of a reduction in the share of non-residents (-40.1 points) and financial institutions (-9.1 points).

6.2. Autonomous Regions

AIReF estimates that the Autonomous Regions will reduce their level of indebtedness in 2024 by more than half a point of GDP, to stand at year-end at 21.5%. Starting from 22.2% in 2023, the ratio would improve by more than half a point due to the effect of the expected growth in GDP, partially offset by the forecast balance and by certain adjustments, such as the financing of the previous year's deficit overruns, the application of the financing overruns pending at year-end 2023 and the postponement of the negative 2008-2009 settlement of the regional financing system.

FIGURE 67. EVOLUTION OF THE LEVEL OF DEBT AS A PERCENTAGE OF GDP OF THE ARS AND EXPLANATORY FACTORS (% GDP)

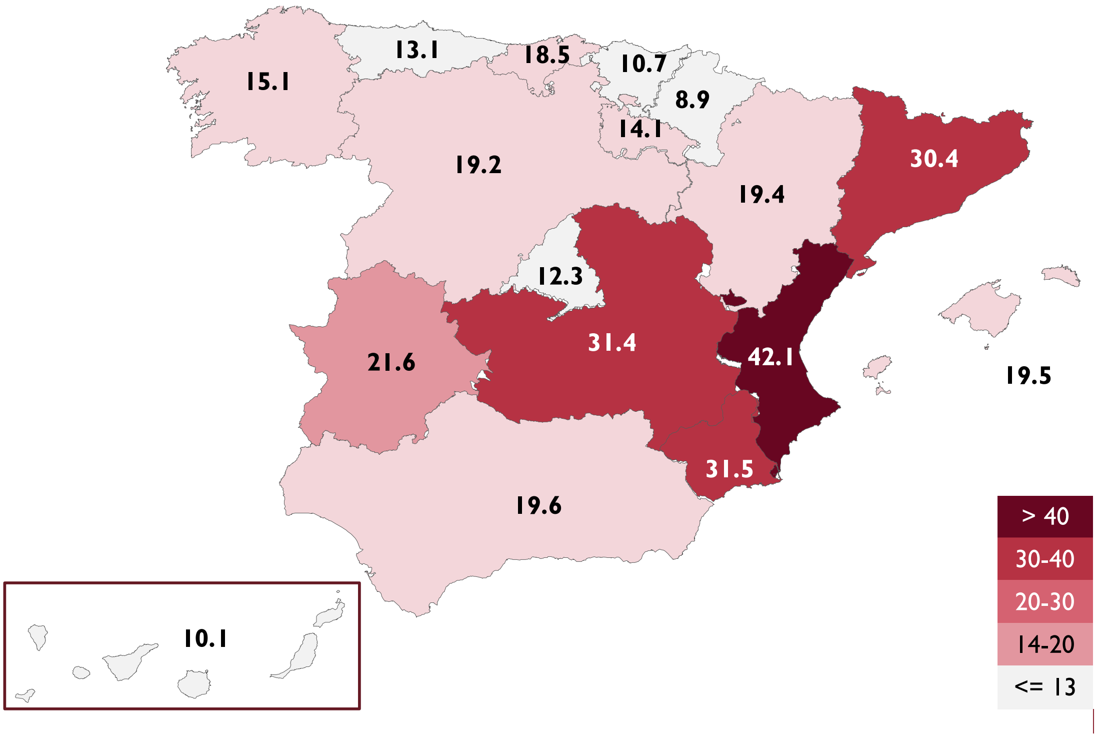


Source: BdE and AIReF

The ARs as a whole expect to reach a level of debt in 2024 that is slightly higher than AIReF's forecast. The ARs as a whole, expect to reach a level of debt in 2024 that would be 0.2 points higher than AIReF's forecast. Despite the closeness of the forecasts, there are significant differences in the components, as some of the AR scenarios handle more optimistic fiscal balance forecasts than AIReF's, while others do not foresee the application in 2024 of the excess financing outstanding at the end of 2023. The two factors offset each other to arrive at an aggregate forecast of the debt-to-GDP ratio that is only slightly higher than AIReF's forecast.

At an individual level, the debt-to-GDP ratio falls in almost all the ARs. Although there are seven ARs (Asturias, Balearic Islands, Canary Islands, Cantabria, Galicia, Navarre, Basque Country and Rioja) which, under the assumptions of a regulatory scenario, should see their debt reduced in absolute terms in 2024; expressed as a percentage of regional GDP, debt would fall with respect to 2023 in all the ARs except Murcia. Under these assumptions, Asturias would join the group of those below the 13% reference level (Navarre, the Canary Islands, Madrid and the Basque Country), while the ratio of Rioja would be very close to the 13% reference level. Four ARs (Catalonia, Castile-La Mancha, Murcia and Valencia), on the other hand, have debt ratios above 30%.

FIGURE 68. DEBT OVER GDP OF THE ARS. 2024 YEARE-END FORECAST (% GDP)

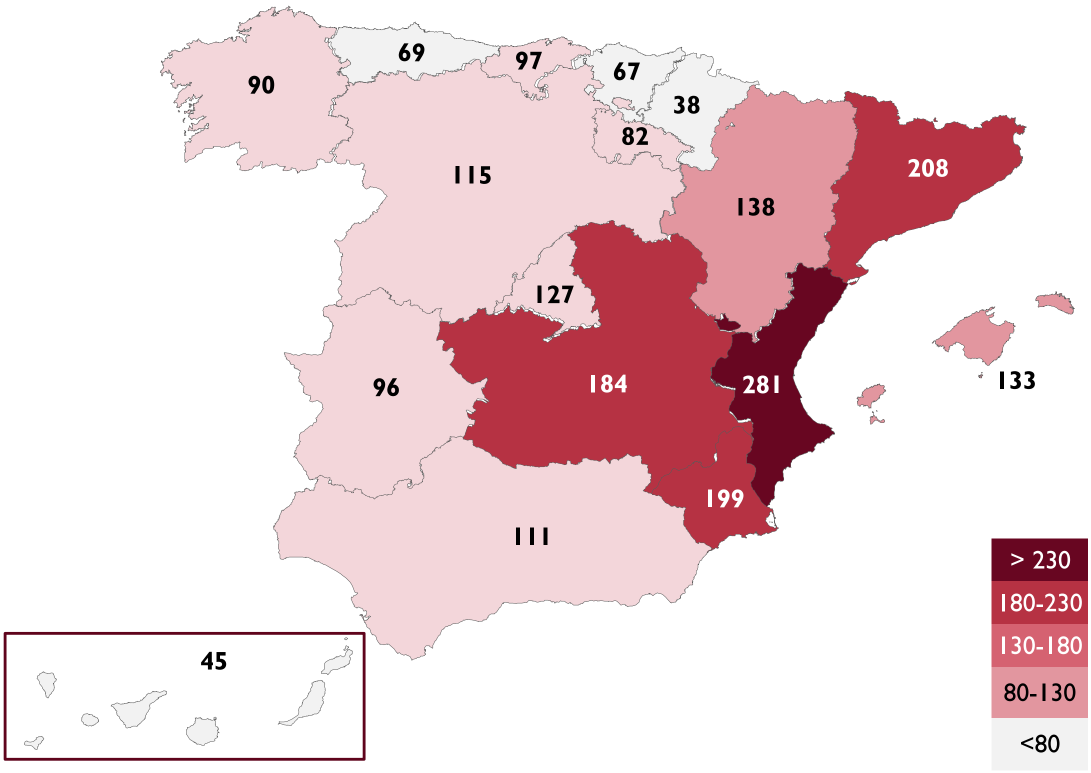


Source: AIReF

The ratio of debt to current revenue[21] decreases in 2024 in all the ARs. Given the positive evolution of the revenue of the ARs, derived in the case of those under the common regime from the revenue from the regional financing system, in 2024 all of them manage to reduce the ratio of debt to current revenue with respect to 2023. In the sub-sector as a whole, it is reduced by more than 10 percentage points, from 154% in 2023 to 142% in 2024.

[21] The revenue/debt ratio is calculated by AIReF on the basis of net current revenue in national accounting terms. The evolution of this ratio is conditioned by the particularities of the financing system of the ARs and the extraordinary transfers received by the ARs in 2020 and 2021.

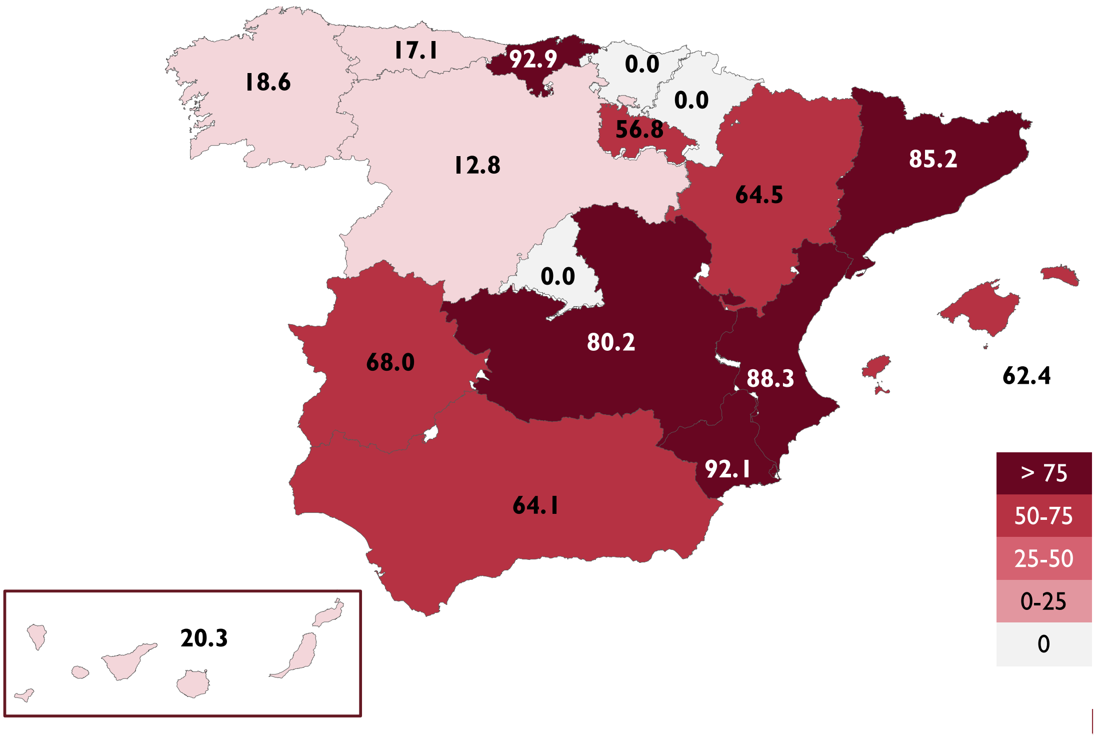
FIGURE 69. DEBT AS A PERCENTAGE OF CURRENT REVENUE OF THE ARS. 2024 YEARE-END FORECAST



Source: AIReF

Extraordinary financing mechanisms together account for more than 60% of the debt of the ARs, although there are very different situations. In the first quarter of 2024, extraordinary mechanisms accounted for 60.5% of the debt of the ARs, having been reduced by 0.4 points with respect to the end of 2023. In five regions (Cantabria, Murcia, Valencia, Catalonia and Castile-La Mancha), recourse to the mechanisms account for more than 80% of the debt, while three (Madrid, Navarre and the Basque Country) have no debt from this resource.

FIGURE 70. RECOURSE TO EXTRAORDINARY FINANCING MECHANISMS OF THE AUTONOMOUS REGIONS 2024 Q1 (% TOTAL DEBT OF THE REGION)



Source: BdE

Additional data on the debt situation of the sub-sector and of each AR can be consulted in the Debt Monitor of the Autonomous Regions[22].

6.3. Local Governments

AIReF forecasts that the LG sub-sector will reach a debt-to-GDP ratio of around 1.5% by the end of 2024. The latest debt and deposit data for this sub-sector published by the Bank of Spain for the end of the first quarter of 2024 show that the debt-to-GDP ratio for the LG sub-sector has stabilised at 1.6%, the same as at the end of 2023. AIReF forecasts a slightly better level of debt for the LGs at the end of this year than last year, which would bring the debt-to-GDP ratio to around 1.5%. This estimate is affected by the uncertainty regarding the level of spending by the LGs at year-end in the current situation of returning to a framework of compliance with fiscal rules.

With regard to the LGs' bank deposits, AIReF estimates that their weight as a percentage of GDP will remain the same as at the end of 2023, at around 2.6% of GDP. In 2023, the LGs increased their deposits by €1.5 bn, thereby improving

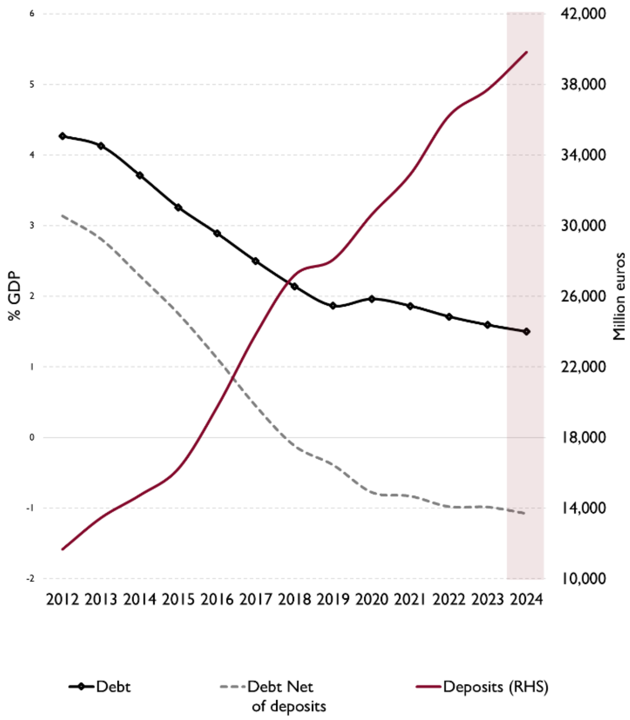
[22] Debt Monitor of the Autonomous Regions.

their net asset position. In 2024, AIReF expects this trend to continue and even intensify, although their weight of GDP will stabilise due to the expected growth in GDP.

The information available on the net asset position for the first quarter of 2024 makes it possible to anticipate the results at the end of the year. Net deposit liabilities, which have been negative since 2018 as the level of local deposits has since exceeded the level of their outstanding debt, stood at around -1% of GDP at the end of 2022 and 2023. AIReF expects this net asset position to improve slightly in 2024, to stand at -1.1% of GDP.

The figure below shows the evolution of the observed data for LG debt, deposits and net liability position (as a percentage of GDP) from 2012 to 2023. It also shows AIReF's year-end forecast for 2024.

FIGURE 71. EVOLUTION OF LOCAL GOVERNMENTS' DEBT AND DEPOSITS



Source: Bank of Spain and AIReF

7. APPLICATION OF THE CORRECTION MECHANISMS PROVIDED FOR IN ORGANIC LAW 2/2012 OF APRIL 27TH ON BUDGETARY STABILITY AND FINANCIAL SUSTAINABILITY

The Independent Authority for Fiscal Responsibility (AIReF) may report on the advisability of activating the preventive, corrective and coercive measures provided for in the Organic Law on Budgetary Stability and Financial Sustainability (LOEPSF), as established in the Law on its creation. Thus, Article 20.1.b) of AIReF's Organic Statute specifies that AIReF will issue a report on the application of the correction mechanisms established in the LOEPSF when, in issuing of any of the reports provided for in its regulations, it detects a risk of deviation in compliance with the budgetary stability or financial sustainability targets, or non-compliance with the expenditure rule by a GG authority. This circumstance shall be highlighted as a separate section in the report, for the purposes established in Article 21 of Organic Law 6/2013, of November 14th.

In April, AIReF detected a risk of non-compliance with the expenditure rule in all the ARs and some LGs and made a recommendation to them. The reports published on the initial budgets of each of the ARs and LGs analysed individually had detected significant deviation risks with respect to compliance with the expenditure rule in 2024. Consequently, the authorities concerned were recommended to *monitor their budgetary execution, adopting the measures they deemed appropriate to correct the growth of eligible expenditure for the purposes of the expenditure rule and avoid the structural deterioration of their accounts in the medium and long term*.

AIReF notes that the risk of non-compliance persists. Although most of the GG authorities expressed their intention to comply with the recommendation made in April, AIReF continues to see risks of non-compliance with the rule in the analysis in the individual reports on the budgetary execution, public debt and expenditure rule for 2024 of all the ARs and some LGs.

AIReF considers it advisable for the Ministry of Finance to apply the preventive measures provided for in Article 19 of the LOEPSF. As already indicated in April, the risks observed not only imply non-compliance with the expenditure rule in force but may also jeopardise compliance with the country-specific recommendation issued by the European Council for 2024. In addition, they imply a deterioration of public finances in the medium term, and in view of the new European fiscal framework, which will require a controlled forecast of eligible expenditure in future years, a high level in 2024 may require more demanding adjustments. Without prejudice to the individual recommendations already made to the ARs where the risk of deviation continues to be observed, AIReF considers it advisable for The Mistry of Finance to activate the preventive measures contained in the LOEPSF in relation to these ARs.

7.1. Autonomous Regions

Under AIReF's current forecasts for 2024, eligible expenditure for the purposes of the expenditure rule will grow in all the Autonomous Regions significantly above the reference rate of 2.6% set for this year. The eligible expenditure in 2023 grew by almost 9% in the regional sub-sector, with rates above 4% in all ARs except Castile-La Mancha. From the previous year's level, the changes estimated by AIReF for 2024 vary by AR, ranging from 4% to 11%. These rates are mainly conditioned by the expected growth in expenditure and, among other elements, the recording and variation of expenditure financed with European funds and the effect of the tax cut measures adopted in each of the ARs.

TABLE 20. CHANGE IN ELIGIBLE EXPENDITURE BY AR. YEAR-END 2023 AND AIREF FORECASTS 2024 (% YEAR-ON-YEAR CHANGE)

ARs	Year-end 2023 (A)	AIReF Forecasts 2024
ANDALUSIA	13.4%	4.7%
ARAGON	8.5%	5.2%
ASTURIAS	5.0%	8.9%
BALEARIC ISLANDS	5.3%	11.2%
CANARY ISLANDS	6.2%	8.5%
CANTABRIA	4.2%	10.7%
CASTILE AND LEON	7.7%	6.0%
CASTILE-LA MANCHA	3.2%	6.5%
CATALONIA	8.2%	6.4%
EXTREMADURA	7.8%	7.8%
GALICIA	9.3%	9.0%
MADRID	12.0%	5.2%
MURCIA	8.8%	7.8%
NAVARRE	5.9%	10.4%
BASQUE COUNTRY	4.6%	4.2%
RIOJA	5.6%	6.3%
VALENCIA	8.0%	7.5%
TOTAL AUTONOMOUS REGIONS	**8.7%**	**6.7%**

Source: AIReF

The risk of non-compliance with the expenditure rule increases in most of the Autonomous Regions if the budget balance considered as a benchmark for the sub-sector is reached in 2024. With the exception of six ARs, the change in eligible expenditure would be higher than that indicated in the previous section if, under AIReF's current revenue estimates, the budget balance considered by the Government for the AR sub-sector were to be achieved.

TABLE 21.CHANGE IN ELIGIBLE EXPENDITURE BY AR. AIREF 2024 FORECASTS IF THE BUDGET BALANCE IS ACHIEVED (% YEAR-ON-YEAR CHANGE)

ARs	AIReF 2024 forecasts if balance =0.0%
ANDALUSIA	3.3%
ARAGON	8.0%
ASTURIAS	16.1%
BALEARIC ISLANDS	19.4%
CANARY ISLANDS	11.5%
CANTABRIA	13.1%
CASTILE AND LEON	7.2%
CASTILE-LA MANCHA	3.9%
CATALONIA	2.9%
EXTREMADURA	8.8%
GALICIA	10.8%
MADRID	2.9%
MURCIA	-3.0%
NAVARRE	15.4%
BASQUE COUNTRY	4.7%
RIOJA	14.4%
VALENCIA	-5.7%
TOTAL AUTONOMOUS REGIONS	**4.7%**

Source: AIReF

7.2. Local Governments

The City Councils of Valencia, Palma, Las Palmas de Gran Canaria, Gijón/Xixón, Vitoria-Gasteiz, Alcorcón, Jaén and San Andrés del Rabanedo, the Provincial Councils of Barcelona and Seville, the Island Councils of Tenerife and Majorca and the Chartered Council of Gipuzkoa will close 2024 with growth in eligible expenditure of more than 4%. In its Report on the Initial Budgets for 2024, AIReF recommended to the ten large LGs where the forecast increase in eligible expenditure for this year was well above double the allowed rate of 2.6%, that they should monitor their budgetary execution by adopting the measures they deemed appropriate to correct the growth in eligible expenditure for the expenditure rule and thus avoid the structural deterioration of their accounts in the medium and long term. This applied to the City Councils of Madrid, Valencia, Palma, Las Palmas de Gran Canaria, Alicante/Alacant, Gijón/Xixón; the Provincial Councils of Barcelona and Seville, the Island Council of Tenerife and the Chartered Council of Araba/Álava. With the current data, AIReF's forecasts suggest that, given the data reported by the LGs on budgetary execution and exclusions/regulatory revenue measures, the City Councils of Valencia, Palma, Las Palmas de Gran Canaria and Gijón/Xixón, the Provincial Councils of Barcelona and Seville and the Island Council of Tenerife, which were recommended in April to monitor their execution to avoid breaching the expenditure rule, will achieve growth in eligible expenditure of more than 4% by the end of 2024. In addition, the Supplementary Report of the LGs also found a risk of non-compliance in the City Councils of Vitoria-Gasteiz, Alcorcón, Jaén and San Andrés del Rabanedo, the Island Council of Majorca and the Chartered Council of Gipuzkoa, with forecasts of growth in eligible expenditure also exceeding 4%.

For these LGs, compliance with the expenditure rule would require them to increase the fiscal balance forecast by AIReF by an average of close to 6 percentage points of revenue. In the 13 ARs analysed where there is a high risk of non-compliance with the expenditure rule, in order to ensure compliance, the fiscal balance estimated by AIReF, assuming the other elements remain constant, would have to be increased by significant amounts in the cases of the Provincial Council of Barcelona, the City Council of Alcorcón (by more than 14 points), the City Council of Jaén (by more than 11 points) and the Provincial Council of Seville (by more than 8 points).

TABLE 22. INCREASE IN NET LENDING OF LGS IF THEY COMPLY WITH EXPENDITURE RULE

Government	NL 2024	Eligible expenditure 2024	NL compatible with 2024 expenditure rule compliance	Increase in NL compatible with expenditure rule compliance
	% / REV	Change 2024 (%)	% / REV	% / REV
City Council Valencia	6,7	4,4	8,1	1,4
City Council Palma	10,0	5,8	12,6	2,6
City Council Las Palmas GC	17,4	5,3	19,4	2,0
City Council Gijón/Xixón	8,8	4,9	10,7	1,9
City Council Vitoria-Gasteiz	0,0	7,4	4,1	4,2
Prov. Council Barcelona	-2,9	18,5	11,5	14,4
Prov. Council Seville	16,9	18,7	25,2	8,4
Island Council Tenerife	0,3	7,4	3,8	3,5
Island Council Majorca	-12,0	7,7	-7,8	4,2
Chartered Council of Gipuzkoa	2,0	5,3	3,6	1,6
Alcorcón	12,9	20,8	26,3	13,4
Jaén	-11,1	15,8	0,3	11,4
San Andrés del Rabanedo	20,5	8,5	24,2	3,7

Source: AIReF

8. RECOMMENDATIONS

8.1. New recommendations

Activation of preventive measures of the LOEPSF for ARs and LGs due to risk of non-compliance with the expenditure rule.

As noted in Section Seven of this report, the risk of non-compliance with the expenditure rule persists in several ARs and LGs. This situation and its implications for compliance with the country-specific recommendation and the medium-term deterioration of public accounts make it advisable to implement the measures provided in the LOEPSF.

AIReF recommends that the Ministry of Finance, due to the persistent risk seen at the regional level, should***:***

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1. ***Activate the preventive measures contained in Article 19 of the Organic Law on Budgetary Stability and Financial Sustainability, in relation to the following Autonomous Regions:***
   - ***Autonomous Region of Andalusia***
   - ***Autonomous Region of Aragon***
   - ***Autonomous Region of Asturias***
   - ***Autonomous Region of the Balearic Islands***
   - ***Autonomous Region of the Canary Islands***
   - ***Autonomous Region of Cantabria***
   - ***Autonomous Region of Castile and Leon***

- ***Autonomous Region of Castile-La Mancha***
- ***Autonomous Region of Catalonia***
- ***Autonomous Region of Extremadura***
- ***Autonomous Region of Galicia***
- ***Autonomous Region of Madrid***
- ***Autonomous Region of Murcia***
- ***Autonomous Region of Navarre***
- ***Autonomous Region of the Basque Country***
- ***Autonomous Region of Rioja***
- ***Autonomous Region of Valencia***

AIReF recommends that the Ministry of Finance, due to the persistent risk seen at a local level, should:

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2. ***Activate the preventive measures contained in Article 19 of the Organic Law on Budgetary Stability and Financial Sustainability, for the following large Local Governments:***
   - ***City Council of Valencia***
   - ***City Council of Palma***
   - ***City Council of Las Palmas de Gran Canaria***
   - ***City Council of Gijón/Xixón***
   - ***Provincial Council of Barcelona***
   - ***Provincial Council of Seville***
   - ***Island Council of Tenerife***
   - ***City Council of Vitoria-Gasteiz***
   - ***City Council of Alcorcón***
   - ***City Council of Jaén***
   - ***City Council of San Andrés del Rabanedo***
   - ***Island Council of Majorca***
   - ***Chartered Council of Gipuzkoa***

Explanation of the deviations and adoption of measures to comply with the national expenditure rule of the CG and the CSR for the GG sector.

The expenditure rule provided in the LOEPSF is fully in force for 2024 as it does not require parliamentary approval. For this reason, the maximum growth in eligible expenditure net of discretionary revenue measures is 2.6% for each GG authority, except for the SSF sub-sector, which is excluded from the national expenditure rule. In addition, at a European level, Spain has to comply with the country-specific recommendation (CSR) that limits the growth in expenditure net of discretionary revenue measures and one-off and other temporary measures for all GG authorities to 2.6% this year.

AIReF estimates expenditure growth in the CG for the purposes of the national expenditure rule of around 4.8%, which exceeds the 2.6% limit set for this year (see Section 4.4.1 Central Government). It also provides for an increase in expenditure net of discretionary revenue measures and one-off measures (one-off measures related to court rulings) for the GG sector of 4.3%, which is higher than the 2.6% limit set for this year (see Section 4.4.1 Central Government). This would imply non-compliance with the CSR 2024 (see Section 5. Fiscal policy stance). For its part, the European Commission's forecasts also point to Spain's non-compliance with the CSR 2024[23]. According to its calculations, net national primary expenditure will increase by 3.8% in 2024, which exceeds the maximum recommended growth rate.

Given the risk of non-compliance with fiscal rules, the LOEPSF does not provide specific prevention measures for the CG, beyond the automatic measures imposing the monitoring of budgetary execution data and the adjustment of public spending to ensure that at fiscal year-end the budgetary stability target is met. However, in the case of the ARs and LGs, it establishes other preventive mechanisms such as the issue of a warning of the risk of non-compliance that will be notified to the Fiscal and Financial Policy Council, if it is an Autonomous Region, or to the National Commission of Local Administrations, if it is a Local Government. The authority warned shall have a period of one month to adopt the necessary measures to avoid the risk. In addition, this warning will be made public for general knowledge.

Accordingly, in parallel to what is required of the ARs and LGs, AIReF considers that, in view of the risk of non-compliance with the national expenditure rule by the CG and the CSR for 2024, the Ministry of Finance should appear before Congress to explain the estimated growth in expenditure net of discretionary revenue measures and the possible deviations from the 2.6% limit, as it would be Congress that would have to approve the Economic and Financial Plan that the CG would be obliged to submit if that deviation were to be confirmed (Article 23.2 of the LOEPSF). Furthermore, it should set out the measures it intends to adopt to redirect the increase in expenditure towards lower rates of growth that would allow compliance at year-end with both the national expenditure rule and the CSR.

Consequently, AIReF **recommends that the Ministry of Finance should:**

[23] Recommendation of the European Commission. European Semester 2024. CSR

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3. Appear before Congress to explain the growth of expenditure net of discretionary revenue measures and possible deviations, on the one hand, for the purposes of the national expenditure rule for the Central Government and, on the other hand, in relation to the country-specific recommendation (CSR) for 2024, given the risk of non-compliance in both cases with the 2.6% rate of change at year-end. It should also indicate the measures it intends to take to ensure compliance.

Monitoring of budgetary execution in 2024 to avoid breaches of the expenditure rule with an impact on the structural deterioration of public accounts.

For those large LGs for which, with the current information, AIReF estimates breaches of the expenditure rule by a wide margin in 2024 (more than 4% with the approved rate being 2.6%) and which were not the subject of a recommendation in this regard in the report issued last April, they are recommended at this point in the budgetary cycle and in a similar manner to what was stated in the last report, to monitor budgetary execution in order to avoid risks of non-compliance with the expenditure rule in 2024, which would imply not only the deterioration of their finances, but also an increase in the level of eligible expenditure for the following years in which the application of the new fiscal framework would require the implementation of more demanding adjustments. These LGs are the City Council of Vitoria-Gasteiz (without information in April and with estimated growth in eligible expenditure of over 7%), the Island Council of Majorca (with expected growth in eligible expenditure of almost 8%) and the Chartered Council of Gipuzkoa (with forecast growth in eligible expenditure of over 5%).

In the case of the LGs with sustainability risks analysed by AIReF in this report, there is also a high risk of non-compliance with the expenditure rule due to growth in eligible expenditure of more than 4% and, therefore, similar to what has been done for the large LGs and ARs, AIReF recommends them to monitor their budgetary execution in order to avoid the risk of non-compliance with the expenditure rule in 2024 with the same implications as for the rest of the ARs and LGs with recommendations. These LGs are the City Councils of Alcorcón (with estimated growth in eligible expenditure of more than 20%), Jaén (with expected growth in eligible expenditure of more than 15%) and San Andrés del Rabanedo (around 9%).

Consequently, AIReF **recommends that to the City Councils of Vitoria-Gasteiz, Alcorcón, Jaén and San Andrés del Rabanedo, the Island Council of Majorca and the Chartered Council of Gipuzkoa should:**

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4. ***Monitor the execution of their budget by adopting 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 in the medium and long term.***

Guide to calculating expenditure net of discretionary revenue measures for the General Government sector and by sub-sector

With the entry into force of the reform of the European fiscal framework, the expenditure rule has taken on greater importance and has become the key indicator for fiscal monitoring. In this new framework, non-compliance may lead to the opening of an Excessive Deficit Procedure (EDP). In particular, deviations from the expenditure rule recorded in the control account that exceed the annual and cumulative limits established, which are 0.3% of GDP per year and 0.6% cumulatively, will be considered.

The recently approved European rule is not calculated in the same way as the national expenditure rule. Unlike the latter, the European expenditure rule excludes national expenditure on projects co-financed by European funds and one-off and other temporary measures from the operational spending variable. Moreover, it applies to the whole of the General Government sector while the national expenditure rule is applied individually to each authority, with the exception of the Social Security Funds. Furthermore, the calculation of the reference rate of expenditure is not based on nominal GDP over the medium term, as is the case with the national expenditure rule, but depends on each country's debt sustainability analysis and is set in the medium-term fiscal structural plan for a period of four years.

These differences highlight that it will be necessary to adapt our national fiscal framework to update it and align it with the reform of the European fiscal framework. The transposition of the reform of the Directive on National Fiscal Frameworks should help to minimise the discrepancies between the national and European frameworks and should be completed by December 31st, 2025. It is therefore crucial to establish national rules consistent with the European framework and distribute the targets and their implementation among the different tiers of government, taking into account the singularities of the sub-sectors that make up the Spanish General Government.

In this context, AIReF considers it necessary for the Ministry to draw up an explanatory guide to calculate the operational variable of the expenditure rule, known as primary expenditure net of discretionary revenue measures, in accordance with the definition of the new European framework. This guide should contain instructions on the calculation of the consolidated rule for the whole General Government sector, and provide specific information for the calculation in each of the sub-sectors (including the SSFs) according to their specific characteristics.

Consequently, AIReF **recommends that the Ministry of Finance should:**

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5. Publish a guide for the calculation of expenditure net of discretionary revenue measures under the new European framework, both for the 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.

Resumption of publication of the evolution of the national expenditure rule in the same terms as before the pandemic

Before the pandemic, the IGAE published the evolution of the eligible expenditure for the purposes of the national expenditure rule for the CG sub-sector and the AR sub-sector in the monthly national accounting data reports. In addition, the quarterly reports included the evolution of this spending in the case of the LGs sub-sector. Subsequently, with the suspension of the fiscal rules as a result of the pandemic, this information ceased to be published.

Currently, with the activation of the national expenditure rule for 2024, AIReF considers it advisable to resume publishing this information in order to facilitate the monitoring of this fiscal rule for compliance purposes.

AIReF therefore **recommends that the Ministry of Finance should:**

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6. Resume publication of the evolution of eligible expenditure for the purposes of calculating the national expenditure rule for the Central Government and Autonomous Region sub-sectors, including an individual breakdown by Region, and the Local Government sub-sector, in the same terms as before the pandemic.

The President of AIReF

Cristina Herrero Sánchez