

Debt Observatory

**AIReF ANALYZES THE EVOLUTION OF DEBT AND CONDUCTS
A SPECIFIC ANALYSIS OF THE SITUATION OF THE
AUTONOMOUS REGIONS AND A SIMULATION OF DIFFERENT
ADJUSTMENT SCENARIOS**

- The Independent Authority of Fiscal Responsibility (AIReF) includes in this edition of the Observatory individual files for each Autonomous Region with the evolution of their debt, the use of financing mechanisms, AIReF's medium-term baseline forecasts, and a simulation of different fiscal adjustment scenarios.
- In the Observatory, AIReF notes that the debt ratio of the total public administrations stood in the first quarter of 2024 at 108,9%, 1.2 points higher than the end of 2023, thus breaking a streak of eleven consecutive quarters of declines.
- AIReF points out that Spain is one of the countries of the EMU with higher levels of debt, behind Greece, Italy and France, and with a level similar to Belgium's
- AIReF also reviews the evolution of inflation and the policies implemented by the Central Banks of the major economies, which are facing a potential change of cycle in monetary policy decisions, even though there remains a lot of uncertainty
- Regarding Autonomous Regions, AIReF points out that their debt ratio has been moderating since the peak in 2020, reaching 22,2% of GDP in 2023, 9.2 percentage points above the reference value established in the Stability Law (13%).
- The debt situation varies greatly from one Autonomous Region to another, with a difference up to 30 percentage points between the Comunitat Valenciana, the most indebted region, and the Canary Islands, the least indebted one. In per capita terms, debt varies from 2,828 euros in the Canary Islands to 10,878 euros in Catalonia.
- The share of extraordinary financing mechanisms has remained stable over the last 6 years at around 60% of the total debt of the Autonomous Regions. Catalonia, Comunitat Valenciana, and Andalusia accumulate 75% of the total value of the funds.

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- **AIReF's baseline scenario projects a reduction of 2.6 percentage points in the debt of the Autonomous Regions, placing it at 19.7% of the GDP in 2028, with a path showing sustained but very gradual reduction, converging towards the 17% level.**
- **AIReF calibrates three different consolidation scenarios in the Autonomous Regions with an annual adjustment which could range from one to three tenths of GDP over four years to reduce the debt ratio to 13% between 2031 and 2040**

The Independent Authority of Fiscal Responsibility (AIReF) published today on its webpage the latest update of the public debt Observatory, in which it analyzes the evolution of the public debt in the first quarter of the year, which stood at 108.9%, 1.2 percentage points higher than by the end of 2023, thus breaking a streak of eleven consecutive quarters of declines. Furthermore, it conducts a specific analysis of the situation of the Autonomous Regions and includes an individual file each region with the evolution of their debt, the use of financing mechanisms, AIReF's medium-term baseline forecasts, and a simulation of different fiscal adjustment scenarios.

At the regional level, the Institution notes that, from the minimum reached in 2007 (5.8%), the debt to GDP ratio of the Autonomous Communities increased more than 21 percentage points to reach its peak in 2020 (27.2%) coinciding with the upsurge of the pandemic. Since then, it has decreased by 4.9 points to reach 22.2% of the GDP by the end of 2023, but the subsector is still above the legal reference of 13% established by law. The debt situation varies greatly from one Autonomous Region to another. In fact, the difference between the most indebted region (Comunitat Valenciana, with 42.2 points of GDP) and the least indebted one (the Canary Islands, with 12.2 points) is 30 points. Out of the 17 regions, 14 exceed the threshold of 13% of regional GDP established by the Stability Law.

According to AIReF, the accumulation of historically high levels of debt has been driven by the financial crisis of 2008 and, to a lesser extent, the one caused by the pandemic in 2020. The response to both crises has been very different at the subsector level. While during the financial crisis three quarters of the increase in the debt ratio was absorbed by the Central Administration and Social Security Funds (51 out of the 69.3 points of GDP), and a quarter by the regional administrations (18.3 points), during the COVID-19 crisis the Central Administration and the Social Security Funds bore the entire cost (11.2 points), neutralizing the impact on regional administrations, which even saw their debt reduced.

Currently, the Autonomous Regions with the highest levels of debt relative to their GDP are Comunitat Valenciana, Castilla-La Mancha, Murcia and Catalonia, with debts which represent more than a 30% of their economies. Catalonia is the Autonomous Region with the highest debt in absolute and in per capita terms, closely followed by Comunitat Valenciana. In the first quarter of 2024, Catalonia had a debt of 8,300 million euros, 10,878 euros per capita, while Comunitat Valenciana had a debt of 57,700 million euros, 10,842 per capita. On the other hand, Madrid, Vasque Country, Navarra and the Canary Islands have debt levels that are at or even below the reference of 13% of their GDP.

Since reaching their peak in 2020, the Autonomous Regions which have reduced their debt the most have been Balearic Islands and Navarra. In contrast, Murcia and Comunitat

Valenciana, while reducing their debt from the peak, have increased it by 1.6 and 0.3 points since 2019. Compared to 2008, the level of debt in all Autonomous Regions remains considerably higher, with notable increases in the debt of Comunitat Valenciana, Murcia and Castilla-La Mancha.

Financing mechanisms

AIReF notes that the implementation of financing mechanisms has provided high liquidity to regional administrations at very low costs. It points out that the share of these mechanisms has remained stable in the recent years, around 60% of the total debt of the Autonomous Regions and its use has been very heterogeneous among the Autonomous Regions, and even within each region over time. For instance, Navarra and Vasque Country have never resorted to this type of financing and Madrid has not participated since 2020. Moreover, there are Autonomous Regions which have considerably reduced their participation, such as the Canary Islands (from 80% to 20%), Galicia (from 57% to 18%) and Asturias (from 48% to 17%). In contrast, others have increased their use, such as Extremadura (from 23% to 68%), La Rioja (from 24% to 57%). Currently, Catalonia, Comunitat Valenciana and Andalusia accumulate 75% of the total value of the funds.

Baseline forecasts and adjustments

The debt projection for the first year of the fiscal plan required by the new fiscal rules places a group of five Autonomous Regions below the reference level, with two others very close to it. Another group of six regions are placed at an average distance of around 5-7 points. Three regions have levels of debt around 30%. Lastly, Comunitat Valenciana stands out for having the highest level of debt, 30 points above the reference level. Throughout the plan horizon, the negative debt dynamics in Comunitat Valenciana and Murcia are notable.

AIReF's baseline scenario projects a reduction of 2.6 points in the debt ratio for the group of Autonomous Regions in the medium term, which would place it at 19.7% of GDP by 2028, with a path which shows a sustained and very gradual path, converging towards the level of 17%. In a more pessimistic scenario, the ratio would show an unfavorable trend from 2028, growing to exceed the historical peak in the medium term (2042).

In this context, AIReF calibrates three possible fiscal consolidation scenarios for a four-year adjustment plan (from 2025 to 2028): one in which the 13% reference level is reached in 5, 10 or 15 years depending on the starting situation of each Autonomous Region, another one in which primary expenditure increases at the same rate of 2.7% across all Autonomous Regions (rate calculated based on the adjustment required to comply with the new framework of rules for all public administrations) and a third one achieving budget balance by 2028, contingent upon feasibility (minimum growth in primary expenditure of 2%, with a maximum cap of 3.3% depending on the variation of potential nominal GDP). In the first scenario, an annual adjustment of 0.33 points would be required in the subsector, and the debt would be below 13% by 2031. In the second one, the annual adjustment would be 0.11 points and the 13% would be achieved by 2037. In the third one, the adjustment would be 0.08 points per year and the debt would fall below 13% until 2041.

Public debt in the first quarter

Beyond the regional analysis, AIReF notes in the Observatory that the Spanish debt ratio stood at 108.9% in the first quarter of 2024, which represents an increase of 1.2 points with respect to the end of 2023, and 10.7 points compared to the pre-pandemic level. In annual terms, there is a deceleration in the pace of reduction of the ratio, and in quarterly terms, a streak of eleven consecutive quarters of continuous decline has broken. Spain is, in addition, one of the countries of the EMU with the higher levels of debt, behind Greece, Italy and France, and with a level similar to Belgium's.

AIReF also reviews in the Observatory the evolution of inflation and points that, after a significant decrease in 2023, it has moderated its decline in 2024 showing certain symptoms of stabilization in slightly higher levels than desired by Central Banks. Currently, AIReF states that the final correction towards the 2% target is expected to be much more gradual than anticipated a few months ago. In this context, Central Banks of the major developed economies are facing a potential change of cycle in monetary policy decisions after a few months on hold and following nearly two years of continuous interest rates hikes. In fact, following the Central Banks of Switzerland and Sweden, the European Central Bank (ECB) announced 25 basis points cut last June, as anticipated by the markets. Nevertheless, there continues to be significant uncertainty regarding the pace of decline in interest rates in the coming months.

However, AIReF does perceive that monetary policy will move into a restrictive territory for a very long period of time, closely tied to the evolution of various price and economic activity indicators. During the last year the profitability of sovereign debt has shown a very stable trend. After the strong and rapid increase registered in yield curves of sovereign debt as a consequence of the episode of inflation and the Central Banks reaction, over the last 18 months, there has been a fairly sideways movement in yields across different maturities and countries.

Debt trends

On the other hand, AIReF reviews the trends of the Spanish and Eurosystem public debt. It points out that, since mid-2022, the Eurosystem balance has reduced in 2.27 trillion euros, in other words, more than 22%. On its part, the BCE is reducing the amount of bonds it holds in its portfolio, which began purchasing in 2014 with the launch of the first debt-buying program. Since the peak in June 2022, holds have been reduced by 321.000 million euros as of the end of May 2024. Furthermore, in the next twelve months, a reduction of 255.000 million euros is estimated due to maturities.

Regarding yield, AIReF maintains that bond yields have increased due to the tightening of monetary policy, but not alarmingly so. The risk premiums have eased in recent months despite debt issuances being the highest in history at the beginning of the year, and despite the ECB's asset balance being reduced by 22%. However, after the European elections and the early elections in France, there has been some uncertainty in the markets with increases in the different counties of Southern Europe and France.

Finally, AIReF notes that reduction of the Eurosystem balance has occurred in a context of high public debt issuance, which has compelled private investors to intensify their demand in fixed income markets. Households have widely increased their purchases of debt due to higher

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yields and the lack of transmission of interest rate increases by commercial banks to their deposits.

Since mid-2022, foreign investors have increased their holdings in bonds and securities by 3.3 points, up to the 43.4% of the total, while resident investors have increased their holdings by 1.9 points, completing the reduction of debt held by the Bank of Spain by 5.2 points. Currently, households hold more than a third (36.1%) of total Treasury bill holdings, making them the primary investor in this segment, and financial corporations have increased their participation to 8%. Conversely, the participation of non-residents and financial institutions have decreased (-40.1 and -9.1 points respectively).