Despite the uncertain environment, the good macro and fiscal tone in the Spanish economy continues

Macro perspectives for Spain and the finances of its Regional Governments

1Q2025 EXECUTIVE SUMMARY

BFF INSIGHTS

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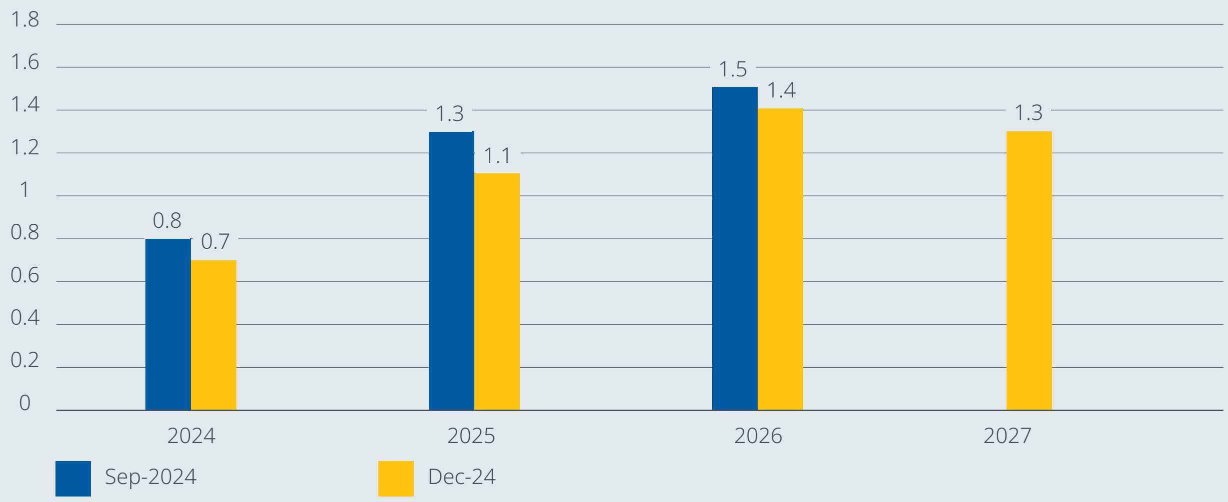
Executive Summary

The international context

In recent months, no significant changes have been observed in the pattern of behavior of global economic activity. Despite the hawkish tone of monetary policy in most major advanced economies and the persistence of high levels of uncertainty, (i) the pace of growth in global economic activity remains moderate, (ii) services remain the main driver of growth, and (iii) the Economic and Monetary Union (EMU) continues to show some signs of weakness, especially in comparison with the United States, where activity remains remarkably strong, and China, where the recent dynamism of activity has been favoured, in part, by the deployment of various stimulus measures.

Looking ahead to the coming quarters, our forecasts do not anticipate substantial changes in the pace of expansion of global economic activity. In this regard, the Eurosystem's December projections exercise incorporates a slight downward revision in the pace of EMU GDP expansion compared to the September projections (as can be seen in Figure 1), of 0.1 percentage points (pp) in 2024 (to 0.7%), 0.2 pp in 2025 (to 1.1%) and 0.1 pp in 2026 (to 1.4%).

FIGURE 1 Expected GDP growth in the Eurozone 2024-2027 (% y.o.y.)



Source: Bank of Spain

The euro area is showing resilience, although divergences between countries, sectors and components of demand remain. GDP accelerated in the third quarter, with growth of 0.4% quarter-on-quarter, thanks to the improvement observed in the Spanish and, to a lesser extent, in the French economy, and despite the weakness shown by the Italian and German economies.

However, **in the fourth quarter of 2024 economic activity in the euro area slowed down significantly,** showing flat growth of 0% quarter-on-quarter, **with again outstanding economic growth in Spain of 0.8%,** in line with the last two quarters, while both Germany (-0.2%) and France (-0.1%) showed negative growth and Italy zero growth.

By sector, the divergence between the situation suffered by industry, where the indicators do not show a clear improvement, and services, where the recovery environment persists, remains. Growth continues to be based on a positive contribution from external demand, although signs of improvement in domestic consumption are beginning to emerge. The latter has been thanks to a European labour market that continues to show strength, with the unemployment rate remaining around the lows reached during the cycle due, in part, to the fact that the adjustment has focused on reducing unfilled vacancies rather than on employment.

With core inflation in check, along with some signs of economic slowdown and cooling of the labour market, monetary policy is transitioning into a phase of easing, moving from restrictive to neutral. Both the ECB and the Federal Reserve (FED), along with other major central banks, have started this process with interest rate cuts, a trend that is likely to extend throughout

2025, starting a path towards neutral interest rates, **albeit with a marked divergence in the pace of interest rate reductions between the Fed and the ECB,** according to the actions and messages of the last meetings of both central banks held in January.

Both the ECB and the Fed have opted for a strategy of gradual adjustments. Although the ECB has lowered the deposit rate from the maximum of 4.00% to 2.75%, and the Fed has placed the federal funds range between 4.25% and 4.50% (compared to the maximum of 5.25%-5.50%), both levels remain restrictive. In a soft-landing scenario, rate cuts are expected to continue gradually throughout 2025, reaching values of 2% and 3.5% respectively.

However, this central scenario is surrounded by exceptionally high uncertainty, associated, fundamentally, with the ongoing geopolitical tensions and, more recently, with the possible policies that the new administration in the United States could deploy in the coming months.

According to the announcements made during the election campaign, the Trump Administration could propose, among other initiatives, the introduction of significant tariffs on its imports, a tightening of its immigration policy, tax cuts and deregulation policies in certain areas – for example, in energy and banking matters.

The magnitude of these adverse impacts would depend, among other factors, on the potential trade retaliation adopted by the affected countries, the possible effects of trade diversion and the possible deterioration in the confidence of the agents. Such an effect would also be visible in EMU and Spain, although Spain's direct trade exposure to the United States is lower than that observed in the euro area average and, for example, in Germany and Italy.

A 10% tariff increase on US imports from the European Union could subtract more than 1% from the eurozone's GDP over the next two years compared to the scenario in the absence of the shock. This is just an example and the result will depend both on the time at which the measure is taken, as well as on the increase in tariffs that is finally observed, or on the sectors in which it is focused.

The different exposure to the American economy will mean that the consequences will be heterogeneous by country. For example, given the assumption of a 10% increase in tariffs, **the effect on Spanish GDP could be around 0.2 pp, on average during 2025 and 0.7pp in 2026,** lower than in the rest of the euro area given the relatively smaller importance of trade in goods with the US. This is not to say that there are no companies, sectors or regions that may be particularly affected by the changes.

Spain: Tailwinds continue in the economy in 2025.

In Spain, after the high dynamism of activity recorded in the third quarter, the available indicators suggest that the rate of GDP expansion would have remained robust in the last quarter of the year, as reflected in the provisional growth figures for the last quarter of 2024, despite the negative impact – foreseeably transitory – that the DANA that affected several Spanish provinces at the end of October would have had on economic activity.

GDP growth in the third and fourth quarters of 2024 stood at 0.8% quarter-on-quarter, again higher than expected. This growth was mainly due to the high dynamism shown by both private and public consumption, while investment once again surprised to the downside.

Within domestic demand, it was private consumption that accounted for much of the higher growth. This better performance was concentrated in household spending on services and durable goods, while weakness persists in the consumption of perishables and semi-durables. The stagnation in these last two components precedes the pandemic and coincides with trends that are also seen in the rest of European countries.

This good performance of most of the demand components contrasts with the persistence of the weakness of gross fixed capital formation. In the last two quarters, the negative trend in the acquisition of transport equipment and the lack of traction in non-residential construction stand out. Both should be sectors benefiting from the funds related to the Recovery, Transformation and Resilience Plan (PRTR) and the change of production model towards a more sustainable one in environmental terms.

Regarding the impact of the DANA catastrophe, according to the most recent indicators and the evidence related to other similar historical episodes, **it could have deducted between 0.1 pp and 0.2 pp from GDP growth in the last quarter of 2024 and between 0.1 and 0.4 pp in 2025.** In any case, in line with the information available, it is projected that this negative impact will be eminently transitory and will be offset in the first months of 2025 by the fiscal boost from the various support measures approved for affected families and companies – as long as an agile and effective deployment of this support is carried out.

Compared to our November projections (Figure 2), **GDP growth is revised upwards in both 2024 and 2025 – to 3.1% and 2.5%, respectively – while it remains unchanged in 2026 – at 1.9% – before experiencing a slight slowdown in 2027 – to 1.7% – an advance in activity towards values more in line with the potential growth capacity of the Spanish economy.** The upward revision of the output growth rate in 2024, of three tenths, is due to the positive carry-over effect resulting from the new data from the Quarterly National Accounts published by the National Institute of Statistics at the end of September and to a more intense than expected dynamism in activity in the second half of the year.

FIGURE 2 Updated macro picture of the Spanish economy in 2024-2027

		Forecast February 2024				Forecast November 2024		
	2023	2024	2025	2026	2027	2024	2025	2026
GDP	2.7	3.1	2.5	1.9	1.7	2.8	2.2	1.9
Private consumption	1.8	2.8	2.9	2.0	1.8	2.2	2.1	1.8
Public consumption	5.2	4.2	1.9	1.8	1.7	1.8	2.0	1.7
Gross capital formation	-1.6	0.8	3.1	2.2	1.9	1.8	2.1	2.4
Export of goods and services	2.8	3.3	3.0	3.2	2.9	3.5	2.7	3.2
Import of goods and services	0.3	2.1	3.8	3.5	3.2	1.4	2.5	3.5
National Demand (contribution to growth)	1.7	2.6	2.6	1.9	1.7	2.0	2.0	1.8
Net foreign demand (contribution to growth)	1.0	0.5	-0.1	0.0	0.0	0.8	0.2	0.1
Nominal GDP	9.1	6.3	4.8	3.8	4.0	5.9	4.4	3.7
GDP deflator	6.2	3.1	2.2	1.8	2.2	3.0	2.2	1.8
HCPI	3.4	2.9	2.1	1.7	2.4	2.9	2.1	1.8
HCPI without energy and food	4.1	2.9	2.3	1.9	1.8	2.8	2.2	1.9
Employment (people)	3.0	2.1	1.6	1.1	1.0	2.2	1.6	1.1
Employment (hours)	2.0	1.2	1.3	1.1	1.0	1.8	1.7	1.1
Unemployment rate (% active population). Annual average	12.2	11.5	10.8	10.4	9.9	11.5	11.0	10.7
Capacity (+) / need (-) for financing of the nation (% GDP)	3.7	4.1	4.2	4.2	3.6	4.5	5.0	5.0
Capacity (+) / need (-) for financing of the Public Administrations (% GDP)	-3.5	-3.4	-2.9	-2.7	-2.7	-3.3	-3.1	-3.2
Debt of Public Administrations (% GDP)	105.1	103.1	102.6	102.5	101.8	105.4	105.4	106.3

Source: INE

For its part, **the GDP growth rate forecast for 2025 is also revised upwards by three tenths as a result of two factors:** a) firstly, the positive carry-over effect associated with a stronger than anticipated activity in the last quarters of 2024, and b) secondly, the higher growth now forecast for GDP during the first half of 2025, largely due to the aforementioned fiscal impulse that would result from the various support measures deployed in response to the DANA.

Several factors could help consolidate a GDP increase of 2.5% in 2025 and 1.9% in 2026. Among them, an economic policy response that is fast, focused and efficient to reverse the negative economic impact of the DANA. In addition, improvements in competitiveness are expected given the fall in the price of oil and the increase in the supply of renewable energy. The rains will intensify the recovery in the agri-food sector. Domestic demand will be supported by falling inflation, rising wages, advancing employment and lowering interest rates. The economy has shown a greater capacity for growth than expected thanks to immigration, the increase in the employment rate and in productivity per hour worked.

According to our projections, **GDP growth in the period 2024-2027 will be based on the dynamism of domestic demand.** In particular, private consumption will be the item with the greatest contribution to the growth of activity in this period, as a result of the favourable evolution projected for disposable income, employment and household confidence, as well as the expected population increase. All in all, in 2027 private consumption would be 10.4% above its pre-pandemic level, a smaller positive gap than that observed for GDP – 13.5%.

The unemployment rate, which stood at 12.2% in 2023, **is expected to decline gradually over the projection horizon, reaching a value slightly below 10% in 2027.**

The labour force has increased uninterruptedly since the second quarter of 2021 to accumulate 1.2 million more people. The increase is explained by employment, which has grown by 2 million people in the same period. Job creation has been concentrated among the foreign population. For example, in the third quarter of 2024, immigration accounted for three-quarters of the increase in employment. Since the fourth quarter of 2019, the number of employed people of foreign nationality has increased by 39%, while that of Spanish nationality has barely increased by 9%.

The estimate of potential growth of the Spanish economy has increased. At the end of the pandemic, we estimated that GDP growth in 2024 consistent with the non-generation of internal and external imbalances would be around 1.2%. The continuous upward revisions of the historical series carried out by the INE since then, together with the behaviour of the external accounts, inflation, interest rates, the labour market and the housing market, now point to **growth of around 1.8%.** This is in line with what different institutions have been publishing.

The new inflation forecasts do not incorporate significant changes compared to those published in November and continue to contemplate a path of gradual moderation of inflationary pressures. Specifically, headline inflation rates are projected at 2.9% in 2024, 2.1% in 2025 and 1.7% in 2026. This slowdown would reflect a gradual moderation in core inflation – from an average rate of 4.1% in 2023 to 2.9% in 2024, 2.3% in 2025 and 1.9% in 2022.

Main risks facing the Spanish economy

The risks around the central scenario of these projections for the Spanish economy are downwards in terms of activity and slightly upwards in relation to inflation.

In the international arena, **the main source of risk emanates from a possible shift in economic policies by the new US administration in the coming months.** A turnaround on which there are not enough details to make a precise assessment, but which, as already mentioned, would foreseeably have a downward impact on global, European and Spanish economic activity.

In a context in which, as we have already mentioned, there is extraordinary uncertainty about the policies that could be deployed and the magnitude of their impacts, it seems feasible that **the possible adverse effects of these policies will be somewhat less intense in the Spanish economy than in other of the main economies of the EMU.** This would be a consequence, in principle, of the lower relative intensity of Spain's trade flows with the United States.

Thus, for example, exports of goods from Spain to the United States accounted for 5% of total Spanish exports in 2023. This percentage rises to 8.4% in the case of EMU, 9.7% in Germany and 10.7% in Italy. In the same vein, Spain's trade balance with the United States stood at –0.02% of GDP in 2023, while it was +0.2% of GDP in the euro area as a whole, +1.9% in Germany and +2.1% in Italy.

The uncertainty arising from the armed conflicts in Ukraine and the Middle East also continues to be relevant and, in addition, the risks associated with political instability and economic weakness in some European countries, such as France and Germany, are gaining relevance.

We must also include within the potential **external risks the possibility of a sharp correction in the price of financial assets in international capital markets.** In a context in which the financial markets have been showing very favourable dynamics in recent months – with some international stock indices close to all-time highs and with relatively low-risk premiums – episodes of financial turbulence that could lead to a sharp correction in the prices of financial assets and a deterioration in the macroeconomic outlook in the short and medium term cannot be ruled out.

At the national level, it is worth noting the **uncertainty about the speed with which the disinflationary process** will run over the projection horizon and about the path of recovery of business investment, a fundamental heading to sustain economic growth and which has been persistently surprising to the downside in recent quarters.

On the other hand, **the future evolution of business investment, since it has continued to show a weaker behavior than expected in recent quarters.**

Doubts about the ability of tourism services to continue contributing to the recovery could increase to the extent that the limits to their growth do not lead to greater investment. The shortage of affordable housing restricts the improvement in the quality of life and can hinder the migratory flow, which is worrying in a context of falling labour force of Spanish nationality. On the other hand, investment, in general, continues to show a weak response to activity.

There is also uncertainty regarding the future course of fiscal policy in our country. In particular, strict compliance with the commitments made by the Spanish authorities in the Medium-Term Fiscal and Structural Plan would entail a budgetary adjustment in addition to that incorporated in these projections, which would imply a downside risk to activity over the projection horizon. The magnitude of this risk will depend on the design of such a path of additional fiscal adjustment.

Uncertainty about economic policy remains high, pending the announcement of more measures to comply with fiscal consolidation for the following year and without a consensus on how to address the medium-term challenges.

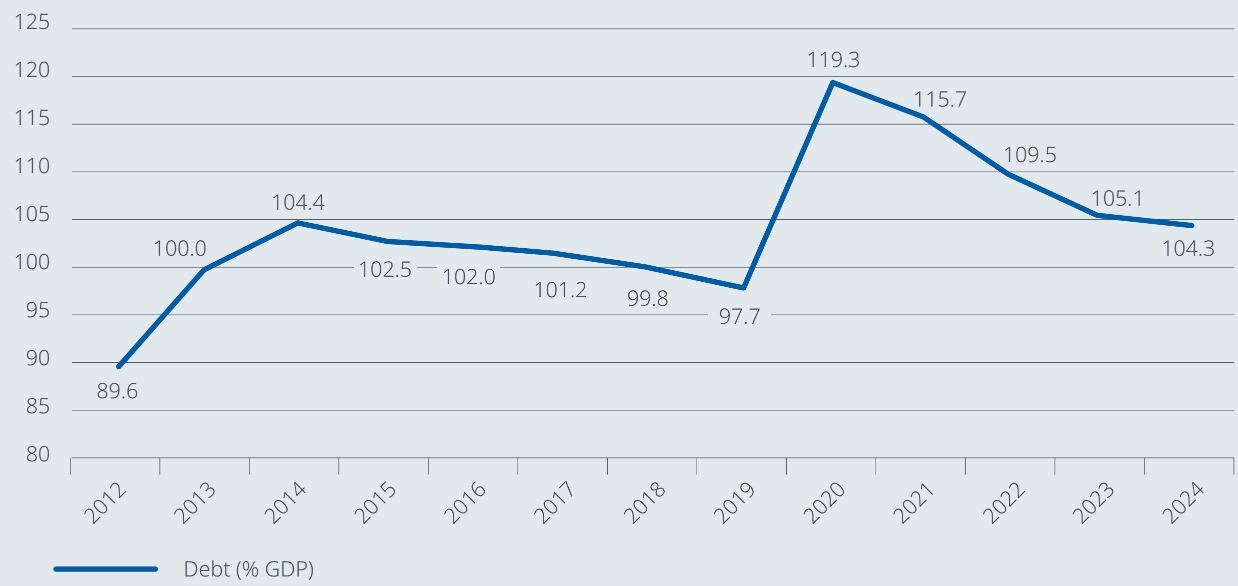
Fiscal and debt scenario

Until November 2024, the latest data reported by the Ministry of Finance, **the accumulated general government deficit stood at 1.85% of GDP** (including an impact of 0.26% derived from the DANA) vs 1.93% in the same period of 2023, which would result in an improvement of three tenths if we exclude the impact of the DANA. It should be noted that this last expenditure is excluded for the purposes of calculating the deficit for the fulfilment of the target, which stands at 3% GDP for 2024.

AIReF estimates that the deficit closed 2024 at 3.3% of GDP, including 3 tenths of the impact of the DANA. Excluding this impact, the forecast for the 2024 deficit would remain at around 3% of GDP. By administration, the central government deficit forecast for 2024 would be 2.5% of GDP; while the deficit of the Social Security Funds would close at 0.5%, one tenth less than in 2023; for their part, the Autonomous Communities would reach a deficit of 0.4% of GDP in 2024 once the impact of the DANA has been taken into account and finally the local Corporations would register a surplus of 0.1% of GDP, with an effect of less than one tenth in that year.

The Spanish debt-to-GDP ratio stood at 104.4% in the third quarter of 2024, a reduction of seven tenths compared to the end of 2023, a reduction of 3 pp of GDP in the last 12 months and an increase of 6.8 pp compared to the pre-pandemic level. The recent revision of GDP has reduced the debt ratio by almost 3 percentage points, although Spain remains one of the countries with the highest levels of debt in the EMU. In monetary terms, in 2024 public debt has continued to grow, at a slightly lower rate than nominal GDP, reaching 1.628 trillion euros in October, representing a year-on-year growth rate of 3.5%.

FIGURE 3 Evolution of the public debt/GDP ratio (%) in 2012-3Q2024



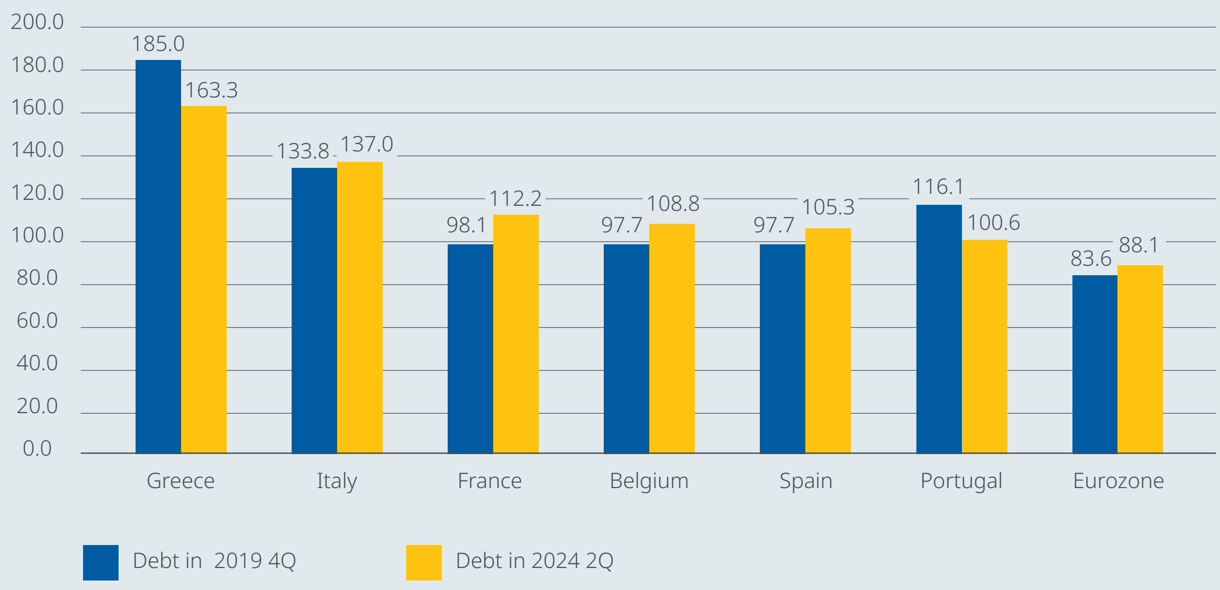
Source: Bank of Spain

The accumulation of debt levels over the last twenty years has been driven by the 2008 financial crisis, when it soared from a debt-to-GDP ratio of 35.8% in 2007 to 105.1% in 2014 (an increase of 69.3 pp) and the pandemic in 2020, when it went from a starting point of a debt-to-GDP ratio of 98.2% to a peak of 124.2% in 1Q21. which has been reduced by 19.8 points to 3Q24.

Economic growth continues to be the main driver of the decline in the ratio. In the 2020-2023 period, its contribution to debt reduction has been 20 points, while a public deficit with a downward trend has helped to consolidate the reduction despite a slight upturn in the financial burden. For its part, the latest revision of GDP, which reflects an increase of 41,386 million euros in the level of GDP in the second quarter of 2024 according to data from the latest revision of the National Accounts, has led to a reduction of 2.9 points as an effect of a higher denominator of the quotient.

Despite the decline, **Spain is currently one of the countries in the Economic and Monetary Union (EMU) with the highest levels of debt, behind Greece, Italy, France and Belgium** (Figure 4). In the European Union, six countries have a debt ratio above 100%. The most prominent cases are those of Greece and Italy. Although Greece continues to be the country with the largest ratio, its evolution is favourable, having reduced its debt by more than 20 points in recent years. France, Spain and Belgium are the next group of countries to exceed 100%, maintaining a ratio above the pre-pandemic level. Portugal has reduced its ratio by more than 15 points and is on the verge of falling below the 100% threshold.

FIGURE 4 Debt (% GDP) evolution compared to the pre-Covid level of EU countries with a ratio above 100%



Source: Eurostat

AIReF's medium-term inertial projection estimates a reduction in the debt ratio of 7.2 points of GDP compared to the 2023 level and places it at 98% in 2029. The reduction will be supported by nominal GDP growth (25.4 points), where the deflator will make a very notable contribution (13.6 points). The public deficit contributes to the increase in debt by 16.8 points, of which 15.9 are interest.

Moderation in the contribution of nominal growth would mean a slowdown in debt reduction, which would be exhausted by the end of the decade. The moderation in the contribution of nominal growth, which will slide gradually downwards in the period 2024-2029 (from 5.9% to 3.5%), with an upward trend in interest rates (from 2.4% to 2.9%) and a primary balance stabilised at around 0%, will result in a slowdown in the pace of debt reduction.

In the long term, **AIReF estimates that debt could return to an upward path in a scenario of constant policies, standing at 108.9% in 2041.** This increase would be determined by an accumulation of deficit of 66 points (60 points due to debt interest payments), which will not be sufficiently compensated by the contribution of GDP growth to the reduction of the deficit (62.7 points).

The government's inertial forecast places the debt ratio at 119.2% of GDP, a level higher than that projected by AIReF. A worse performance of the public balance, with a cumulative contribution of 80.4 points, will not be sufficiently compensated by a greater contribution of nominal GDP growth to the reduction of the same (68.6 points).

Deficit and debt dynamics of the Autonomous Communities

Until November, **the non-financial balance of the regional treasuries was in surplus** (5,651 million euros, a figure equivalent to 0.35% of GDP), compared to the deficit recorded in the same period of the previous year (0.4% of GDP). Regional revenues increased by 12.3% year-on-year compared to November 2023, while expenditure in the same period increased by 6.7%.

To a large extent, as a result of the additional €20 billion of funds to be transferred to the system, **ten of the seventeen Spanish autonomous communities are expected to end 2024 with a budget surplus or a balanced budget,** compared to five in 2023. On average, Spanish autonomous communities are expected to register a budget deficit (ex-DANA) of 0.3% on average, which is an improvement of 0.6% compared to 2023. In 2024, all autonomous communities will fail to comply with the spending rule, although only six will end up with a deficit.

Resources from the financing system will reach a new record in 2025, as can be seen in Figure 5.

FIGURE 5 Evolution of resources of the financing system (SFA) 2018-2025 (million euros)

	2018	2019	2020	2021	2022	2023	2024	2025
State account transfers	95,919	102,735	105,803	105,523	112,137	124,215	134,623	147,412
YoY%	3.9%	7.1%	3.0%	-0.3%	6.3%	10.8%	8.4%	9.5%
Settlement (n-2)	8,835	6,103	10,710	8,942	-3,075	11,106	19,686	11,692
Total resources SFA	**104,754**	**108,838**	**116,413**	**114,465**	**109,062**	**135,321**	**154,309**	**159,104**
YoY%	3.8%	3.9%	7.1%	-1.8%	-2.0%	20.7%	14.0%	2.5%

Source: Ministry of Finance

AIReF estimates that by 2025 the autonomous communities will reach a deficit of 0.5% of GDP, with a computable expenditure higher than the rate of 3.2% set for the national expenditure rule. The expenditure eligible for the purposes of the expenditure rule will grow by 4.5% in 2025 compared to the 3.2% increase foreseen by the Autonomous Communities in their budgets.

AIReF forecasts that by 2025 six Autonomous Communities will maintain surpluses or balances close to balance. In almost all the Autonomous Communities under the common regime, AIReF estimates a deterioration compared to the end of 2024, as expenditure is expected to grow more intensely than revenue, driven by the evolution of resources from a) the financing system and b) those from European funds outside the RTRP.

In the medium term and under a scenario of constant policies, from 2025, when the flows derived from the financing system begin to normalise, **the balance of the Autonomous Communities will remain at a deficit of close to half a point, which would improve from 2027 to 0.3% of GDP in 2028 and 2029.**

FIGURE 6 AIReF forecast of the balance by Autonomous Communities 2024-2029. Constant policy scenario (% GDP)

Autonomous Communities	**2024**	**2025**	**2026**	**2027**	**2028**	**2029**
Andalusia	0.0	-0.4	-0.4	-0.4	-0.3	-0.3
Aragon	0.1	-0.5	-0.5	-0.3	-0.2	-0.3
Asturias	1.0	0.6	0.4	0.6	0.7	0.7
Balearic Islands	0.3	-0.1	-0.1	0.1	0.2	0.1
Canary Islands	0.4	0.5	0.9	1.4	1.4	1.5
Cantabria	0.4	0.3	-0.2	0.4	0.1	0.0
Castile Leon	0.1	-0.1	-0.2	-0.1	-0.1	-0.2
Castile La Mancha	-0.3	-0.4	-0.4	-0.2	-0.3	-0.4
Catalonia	-0.4	-0.6	-0.7	-0.6	-0.5	-0.6
Extremadura	0.0	-1.0	-1.2	-0.7	-0.7	-0.7
Galicia	0.0	0.0	-0.1	0.1	0.1	0.1
Community of Madrid	-0.2	-0.3	-0.3	-0.2	0.0	0.0
Murcia Region	-1.7	-2.0	-2.0	-1.9	-1.8	-1.8
Navarre	-0.2	0.1	0.2	0.4	0.5	0.7
Basque Country	-0.2	-0.1	0.0	0.3	0.5	0.5
La Rioja	0.3	-0.2	-0.7	-0.3	-0.3	-0.2
Community of Valencia	-2.0	-2.1	-2.0	-1.9	-1.8	-1.9
Total Autonomous Communities	**-0.3**	**-0.5**	**-0.5**	**-0.4**	**-0.3**	**-0.3**

Source: AIReF

A benign outlook for 2025-26 plus a positive outlook could facilitate regional access to capital markets. The Minister of Finance has already announced the disbursement of **7,510 million euros in the first quarter of 2025 to the autonomous communities that have requested the support of the extraordinary liquidity mechanisms this year:** Aragon (370 million), the Balearic Islands (310 million), Catalonia (2,850 million), Cantabria (112 million), Murcia (193 million), Extremadura (149 million), Rioja (37 million), Valencia (3,100 million), Castilla-La Mancha (941 million) and Andalusia (FF compartment, 62 million).

FIGURE 7 Disbursement of extraordinary liquidity mechanisms in 2024 (millions of Euros)

	FFCCAA 2024						
Autonomous Community	**1Q**	**2Q**	**3Q**	**4Q**	**EF 1**	**EF 2**	**TOTAL**
Andalusia	64.02	62.83	473.73	66.61	1,217.25	368.75	2,253.19
Aragon	645.58	9.67	240.89	158.79	175.50	17.50	1,247.93
Balearic Islands	322.98	29.96	483.89	10.95			847.78
Cantabria	116.55	65.36					281.91
Castilla-La Mancha	589.30	59.62	913.99	134.63	309.00	128.00	2,134.54
Catalonia	3,059.34	309.02	4,502.44	462.25	2,088.75	983.25	11,405.05
Extremadura	457.77	141.12	149.31	139.22	135.75	67.25	1,090.42
Murcia	289.57	153.49	672.18	18.97	583.50	205.50	1,923.21
La Rioja	64.67	8.51	76.64	8.86	2,209.50	717.50	158.68
C. Valenciana	2,795.97	3,889.23	109.15				10,008.48
Total Regions	**8,405.75**	**1,061.35**	**11,567.66**	**1,109.43**	**6,719.25**	**2,487.75**	**31,351.19**

Source: Ministry of Finance

FIGURE 8 Disbursement of extraordinary liquidity mechanisms in the first quarter of 2025 (millions of Euros)

Autonomous Community	**SECTION I Maturities [1]**	**SECTION II Negative settlements [2]**	**SECTION III 2025 Deficit [3]**	**Amount**	**Total 4=[3]+[2]+[1] %**
Andalusia	6.50	55.82		62.32	0.01
Financial Facility Total	**6.50**	**55.82**		**62.32**	**0.01**
Aragon	361.19	8.85		370.04	0.05
Balearic Islands	310.22			310.22	0.04
Cantabria	111.77			111.77	0.01
Castilla-La Mancha	927.78	12.83		940.61	0.12
Catalonia	2,815.93	31.20		2,847.13	0.38
Extremadura	138.71	9.95		148.66	0.02
Murcia	186.09	7.32		193.41	0.03
La Rioja	34.19	2.48		36.67	0.00
C. Valenciana	2,534.02	28.81		2,556.83	0.34
FLA	**7,419.90**	**95.44**	**0.00**	**7,515.34**	**0.99**
Total FF + FLA 2025	**7,426.40**	**151.26**	**0.00**	**7,577.66**	**1.00**

Source: Ministry of Finance

With regard to the debt ratios of the Autonomous Communities, **the trend in the regional debt balance, measured as a fraction of GDP, quintupled in less than a decade as a result of the Great Recession.** Subsequently, its value stabilised at around 25% of GDP during the recovery phase, showing only a slight decline between 2016 and 2019, and rebounded strongly in 2020 with the COVID crisis, largely due to a denominator effect as a result of the sharp fall in GDP, which then recovered at a healthy pace between 2021 and 2023, considerably reducing the debt burden.

Spain has the second most indebted regional governments in the world after the Canadian provinces. In the Eurozone, Spanish regions were the subnational governments with the highest percentage of public debt to GDP in 2023: 22.2% compared to 17.7% in Belgian regions, 15.1% in the German Länder and 5.4% in Austrian states.

At the individual level, **although the debt between the Autonomous Communities increased substantially during the previous crisis, there are very important differences between them that have been growing over time in absolute terms,** but not relatively. Currently, the regions with the lowest debt in relation to their GDP are Madrid, the Canary Islands, the Basque Country and Navarre, while those with the highest debt burden are Murcia, Castilla la Mancha, Catalonia and, above all, Valencia, where debt exceeds 40% of GDP. From the beginning to the end of the 2003-2023 period, the debt burden has multiplied almost 11 times in Castilla la Mancha and around 2 times in Madrid and Galicia.

The main areas of concern are: (a) **the high stock of debt that most of the autonomous communities have accumulated;** and (b) **the fact that the improvement in the regional budget balance in the final years of this period is partly based on anomalous and hard-to-sustain factors,** including unusually low investment and strong interest subsidies through the FLA and other state liquidity mechanisms.

In general, **most of the Autonomous Communities have levels of indebtedness that exceed the reference value established by law** (13% of regional GDP). At the end of 2023, the ratio of the subsector of the Autonomous Communities as a whole was 9.2 points above the reference level. Of the 17 regions, 14 exceed the reference of 13% of regional GDP.

AIReF estimates that the Autonomous Communities will reduce their level of indebtedness by more than one point from 2023 (21.7%) **to reach 20.4% of GDP in 2025.** From the 2023 level, the ratio is expected to improve in 2024 and 2025 due to expected GDP growth, partly offset by the deficits forecast for the subsector as a whole.

By instruments, the largest creditor is the Financing Fund of the Autonomous Communities, with 60% of the total debt, followed by loans with national financial institutions (18%) and bonds (14%).

The expected evolution of GDP, partly offset by the deficit estimates of the regional administration, means that **the debt ratio tends to fall in the medium term.** However, **the pace of reduction is expected to be very moderate, not falling below 19% by 2029.** This trend, together with the expectations of the financial markets, means that the interest burden will see its weight in GDP increase steadily.

According to AIReF's estimates, **four regions could have a debt ratio above 30%, while five could be below the 13% established in the LOEPSF.** The Valencian Community, the Region of Murcia, Castilla-La Mancha and Catalonia are expected to register a debt/GDP of more than 30% in 2024.

On the other hand, in 2025, the Principality of Asturias is expected to join the group of communities with a debt ratio within the reference of 13% of GDP, which already included the Autonomous Community of Navarre, the Canary Islands, the Basque Country and the Community of Madrid.

The aggregate extraordinary financing mechanisms represent more than 60% of the debt of the Autonomous Communities in the first quarter of 2024, having decreased by four tenths compared to the end of 2023 but still in line with the relative historical maximum of the series of 61.1% reached in the period 2018-19, although there are very heterogeneous situations.

In five regions (Cantabria, the Region of Murcia, the Valencian Community, Catalonia and Castilla-La Mancha), **the use of the extraordinary mechanisms represents more than 80% of their outstanding debt, while three regions** (the Community of Madrid, the Autonomous Community of Navarre and the Basque Country) have no outstanding debt linked to the extraordinary mechanisms.

FIGURE 9 Weight of extraordinary liquidity mechanisms in the debt of the Autonomous Communities in 3Q24

		Bonds			Loans								
						Domestic financial institutions							
						Total							
	Total	Total	Short-term	Long-term	Total		Non-recourse factoring	Short-term	Long-term	RoW	Financing Fund Spanish Regions	Public-private partnerships (APPs) & other imputed debt	Relative share of extraordinary mechanisms over total debt
TOTAL	**333,177**	**48,008**	**381**	**47,626**	**285,169**	**53,905**	**1,152**	**2,725**	**51,180**	**15,877**	**208,638**	**6,749**	**62.6%**
1. Andalusia	39,842	6,900	270	6,630	32,941	5,639	24	23	5,616	2,592	24,290	421	61.0%
2. Aragon	9,365	753	-	753	8,612	1,668	13	20	1,647	305	6,636	3	70.9%
3. Asturias	4,096	150	-	150	3,946	2,878	12	9	2,869	392	586	90	14.3%
4. Baleares	8,661	570	-	570	8,091	2,059	15	114	1,945	31	5,827	174	67.3%
5. Canarias	6,467	806	-	806	5,661	4,352	20	17	4,334	23	1,286	-	19.9%
6. Cantabria	3,248	40	-	40	3,208	37	31	1	36	81	3,019	71	92.9%
7. Castilla-La Mancha	16,473	383	-	383	16,090	1,776	27	27	1,748	327	13,987	-	84.9%
8. Castilla -Leon	14,006	2,950	-	2,950	11,056	7,613	203	212	7,401	1,423	1,774	246	12.7%
9. Catalonia	88,917	2,283	-	2,283	86,634	2,850	136	1,306	1,544	3,190	77,053	3,541	86.7%
10. Extremadura	5,453	132	-	132	5,322	1,220	4	4	1,216	95	4,007	-	73.5%
11. Galicia	12,154	3,025	-	3,025	9,129	5,560	12	11	5,548	1,162	2,089	318	17.2%
12. La Rioja	1,632	-	-	-	1,632	434	2	2	432	127	1,071	-	65.6%
13. Madrid	36,915	20,849	111	20,737	16,066	11,599	41	48	11,552	3,031	-	1,436	-
14. Murcia	12,802	45	-	45	12,757	224	39	72	152	258	12,269	6	95.8%
15. Navarre	2,817	1,009	-	1,009	1,808	1,278	7	6	1,272	260	-	269	-
16. Basque Country	10,833	7,761	-	7,761	3,072	2,240	6	26	2,214	832	-	-	-
17. Valencia	59,498	353	-	353	59,145	2,479	561	826	1,652	1,748	54,745	173	92.0%
Pro memoria: Public companies not included in the public admin sector	4,100	627	3	625	3,473	1,748	19	28	1,721	1,725	-	-	-

Source: Bank of Spain

Unfortunately, and except for very specific exceptions such as Andalusia, the prolongation of the extraordinary liquidity mechanisms initiated in 2012 to the present has not led to an improvement in the tax execution data of the Autonomous Communities that have been financed mainly or exclusively since 2012.

Spain is the only country with a federal structure that has a double channel of financing for its regions. Either regional entities are financed entirely in the market (Germany, Canada, Australia) or they are financed 100% by public agencies (Nordic countries). This is a consequence of the extension of the extraordinary financing mechanisms, beyond the initially planned horizon of 2-3 years, and which has de facto, at a subsidized cost, offered financing to the Autonomous Communities with the greatest debt sustainability problems.

The regional financing system continues to produce striking inequalities between the different regions

The Spanish regional financing system (SFA) generates significant net flows of resources between the State and the Autonomous Communities and between the Autonomous Communities that tend to equalize the adjusted per capita financing of the different territories.

The financing system provides the autonomous communities with lower incomes with extra resources, above their tax revenues, for an amount of almost 20,000 million euros. These resources come partly from the State (which contributes almost 11,000 million euros) and partly from the autonomous communities with the highest per capita income (Madrid, Catalonia and the Balearic Islands), which contribute almost 9,000 million euros.

Equalization contributions account for around 8% of regional tax revenues in the Balearic Islands, 9% in Catalonia and 24% in Madrid. On the side of the receiving regions, revenues thus exceed 20% of homogeneous tax revenues in ten cases and are especially important in the Canary Islands, where they represent more than half of total revenues, and in Extremadura, where they exceed 40%, as can be seen in Figure 10.

FIGURE 10 Components of the index of effective financing to homogeneous competences, per-capita adjusted, 2022

Region	Homogeneous Tax Revenues	Guarantee Transfer	Sufficiency Fund for Homogeneous Competencies Adjusted	Cooperation Fund	Competitiveness Fund and DA3	Total Effective Financing Index per-capita adjusted
Catalonia	109.0	-5.1	-9.3	0.0	6.2	100.9
Galicia	71.8	20.4	4.9	5.3	0.0	102.5
Andalusia	72.8	21.3	-2.1	2.6	0.0	94.6
Asturias	80.1	14.1	3.9	5.4	0.0	103.5
Cantabria	86.7	6.2	24.3	0.0	0.0	117.2
La Rioja	83.4	12.0	16.9	5.2	0.0	117.5
Murcia	70.8	20.9	-6.2	2.3	2.9	90.8
Valencia	85.8	9.6	-14.3	2.2	8.4	91.8
Aragon	86.6	8.0	5.4	4.9	0.0	104.9
Castilla-La Mancha	68.1	23.2	1.3	2.3	0.0	94.9
Canary Islands	54.6	47.4	-4.4	2.4	9.8	109.8
Extremadura	61.0	29.8	16.5	5.9	0.0	113.2
Balearic Islands	124.0	-6.5	-27.5	0.0	25.2	115.2
Madrid	133.6	-23.5	-12.3	0.0	2.2	100.0
Castile and Leon	78.8	15.4	6.8	5.2	0.0	106.2
Average	**90.4**	**8.5**	**-4.6**	**2.2**	**3.6**	**100.0**

Source: Fedea

Progress in inter-territorial equity has been minimal throughout the history of the financial system, with a slight deterioration again in 2022 compared to that already observed in 2021. The concentration of the improvement in adjusted per capita financing in the above-average regions impacts their relative position. Fluctuations (or lack thereof) in the input/exit mechanisms of the co-operation sub-funds have a significant impact on the final result, given that these are regions with low demographic weight.

Despite the fact that the financing model fulfils its redistributive function, **there is a significant inequality in the distribution of resources between autonomous communities and with a high degree of arbitrariness.** Working with averages of more than 20 years, there is a range of 27 percentage points between the regions best and worst treated in the common system, which can generate considerable differences in the quality of public services of regional competence.

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