

Spain: 2024-2025 GDP estimates revised upwards, but the new fiscal governance framework adds uncertainty

Macro perspectives for Spain and the finances of its Regional Governments

3Q2024 EXECUTIVE SUMMARY



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Executive Summary

Global macro scenario

In recent months, on a global scale, economic activity has accelerated somewhat, while the disinflation process has been prolonged, albeit with less intensity than expected. The pace of expansion in activity accelerated slightly in the first months of the year – especially in the case of the services branches – and was more dynamic than expected in some geographical areas, such as the euro area.

Overall, this favourable trend in global economic activity was mainly based on the buoyancy of consumption, both private and public, in a context in which labour markets continued to perform well. On the supply side, the strength of activity continued to be based primarily on services. As a result of all this, and the most recent indicators, in recent months **the consensus of analysts has revised the outlook for global growth for 2024 slightly upwards, to around 3%, a still modest advance in historical terms.**

In the euro area, economic activity shows incipient signs of a recovery that could consolidate in the coming quarters. According to Eurostat's estimate, the GDP of the Economic and Monetary Union (EMU) grew by 0.3% in the first quarter of 2024, compared to a slight fall of 0.1% in the previous quarter. The rate recorded exceeded by two tenths of a percentage point the growth expected by the ECB's March projections exercise and implied appreciable positive surprises in the four large economies of the region.

For its part, **inflation has continued its deceleration in the first months of 2024, although less strongly than in the course of 2023.** In part, this has been due to the fact that, in regions such as the Economic and Monetary Union and the United States, services inflation – which, according to historical standards, is characterized by a higher degree of inertia than the rest of the components of the consumption basket – has recently been showing a greater downward resistance than anticipated. In addition, in recent months, oil and gas prices on international markets have been higher than expected, in a context in which considerable geopolitical tensions still persist.

Looking ahead to the coming quarters, no significant changes are expected in these relatively favorable macro-financial dynamics. In particular, the analysts' consensus expects that, against a backdrop where global services and labour markets continue to show considerable strength, global economic activity will gain some traction over the 2024-2026 period. In any case, the rate of expansion of global GDP in this period would be relatively modest from a historical perspective as a result, among other factors, of the high uncertainty that still characterises the current geopolitical scenario and the eminently restrictive tone that is anticipated for global monetary policy for much of this time horizon.

The macro scenario in Spain: the dynamism of economic activity continues to surprise on the upside

In Spain, **economic activity was highly dynamic in the first quarter of the year – higher than expected** – and the indicators available for the second quarter suggest that GDP would continue to show an appreciable rate of expansion. The Spanish economy recorded a quarter-on-quarter growth rate of 0.7% in the first three months of the year – compared to the 0.4% forecast by the Bank of Spain in March.

The high dynamism of activity in the first three months of the year was supported by net foreign demand – with a contribution of 0.5 pp to GDP growth – in a context in which exports of tourism services increased by 19% quarter-on-quarter. On the other hand, the contribution of domestic demand to GDP growth – of 0.2 pp – moderated compared to that observed in the final part of 2023.

Compared to our May projections, **GDP growth in 2024 is revised upwards by 0.4 percentage points (pp) to 2.3%** and remains unchanged in 2025 (1.9%) and 2026 (1.7%). The main factor explaining the revision of the average rate of growth of output this year is the positive carry-over effect resulting from the new data collected in the updated national accounts, both from the upward revision of the growth rates of the last quarters of 2023 and from the above-expected growth in the first quarter of the year.

FIGURE 1 Projection of the main macromagnitudes of the Spanish economy.
Annual rates of change in volume (%) and as a percentage of GDP

Annual rate of change in volume (%) and GDP %	2023	Forecasts June 2024			Forecasts March 2024		
		2024	2025	2026	2024	2025	2026
GDP	2.5	2.3	1.9	1.7	1.9	1.9	1.7
Private consumption	1.8	2.4	2.0	1.7	2.3	1.9	1.7
Public consumption	3.8	1.6	1.7	1.5	1.2	1.7	1.5
Gross capital formation	-0.4	2.2	2.4	2.1	1.9	2.4	2.0
Exports goods and services	2.3	2.4	2.4	2.7	1.7	3.0	2.9
Imports goods and services	0.3	2.0	2.7	3.0	2.1	3.4	3.0
National Demand (contribution to growth)	1.7	2.1	1.9	1.7	2.0	1.9	1.6
Net External Demand (contribution to growth)	0.8	0.2	0.0	0.0	-0.1	0.0	0.1
Nominal GDP	8.6	5.4	4.0	3.5	4.8	4.1	3.6
GDP deflator	5.9	3.0	2.1	1.8	2.9	2.2	1.9
HICP	3.4	3.0	2.0	1.8	2.7	1.9	1.7
HICP without energy and food	4.1	2.6	2.0	1.9	2.2	1.9	1.8
Employment (hours)	1.9	1.1	1.7	1.2	1.8	1.1	0.9
Unemployment rate (% active population) Annual average.	12.2	11.6	11.3	11.2	11.6	11.5	11.3
Capacity (+)/ need (-) of financing of the nation (GDP%)	3.7	3.6	3.7	3.7	3.4	3.5	3.6
Capacity (+)/ need (-) of financing of the Public Administrations (GDP %)	-3.6	-3.3	-3.1	-3.2	-3.5	-3.5	-3.5
Debt of Public Administrations (GDP%)	107.7	105.8	106.2	107.2	106.5	107.2	108.4

Source: INE, Bank of Spain

Note: latest published data from the quarterly national accounting: first quarter 2024

Looking ahead to the coming quarters, **GDP growth rates are expected to gradually converge towards those in line with the potential growth capacity of the Spanish economy**, which, according to Bank of Spain estimates, would be around 1.6% year-on-year at the end of the projection horizon.

This expected evolution of GDP reflects the net impact on economic activity of various factors that affect it in opposite directions. On the one hand, some of the tailwinds that have recently driven the growth of the Spanish economy are expected to weaken in the coming quarters, such as the existence of significant pent-up demand for certain goods and services and the correction of some of the negative supply shocks that weighed on activity in 2021 and 2022.

Domestic demand will be the main support for activity throughout the 2024-2026 period. Household consumption, which will be the component with the greatest positive contribution to GDP growth, will show increasing dynamism in the coming quarters, favoured by the increase in real incomes – in line with the expected evolution of job creation, wages and inflation – the increase in population and the improvement in household confidence.

The potential for job creation has increased with immigration and the increase in the participation rate. In 2019, the labour force increased, on average, by around 1% per year. In 2023, growth was 2.1%. Immigration is a fundamental part of the Spanish economy's ability to generate jobs: in 2023, 71% of new employment corresponded to foreign-born people.

By the end of 2026, the GDP of the Spanish economy will be 8.9% higher than that recorded before the start of the COVID-19 pandemic, an increase that, however, will be significantly lower (4.8%) in per capita terms.

Main risks to our projections

The risks around the central scenario of these projections are oriented to the downside with regard to the economic activity, while, in the case of inflation forecasts, these are considered to be skewed upwards in the coming quarters and balanced in 2025 and 2026.

Externally, the main sources of uncertainty continue to focus on the future evolution of the current sources of global geopolitical tension, for example, those associated with the war in Ukraine and the Gaza Strip or the trade tensions between the United States and China, which represent, in the event of an escalation, a considerable downside risk to activity and an upside risk to prices. On the other hand, at the domestic level, there is still a high degree of uncertainty in terms of i) the pace of implementation of the projects associated with the NGEU programme and their impact on private investment and economic activity.

The stagnation of investment is a bottleneck for improving productivity and competitiveness. The economic recovery is taking place without capital accumulation commensurate with the increase in activity as seen in other growth environments: investment is still 1% below pre-pandemic levels, while GDP is already almost 4% above.

After a significant reduction in the last three years, we project a stabilization of the debt ratio in the medium term

The Spanish debt-to-GDP ratio stood at 107.7% at the end of 2023, a reduction of 4 points in the year, mainly as a result of a high contribution from the GDP deflator. Compared to the 2019 level, the increase is 9.4 points (Figure 2). AIREF's macro-fiscal forecasts project a decrease in the debt ratio of 1.8 points of GDP this year, although in the first quarter of 2024 it stood at 108.9%.

FIGURE 2 Evolution of General Government Debt in 2007-2023 (% of GDP)

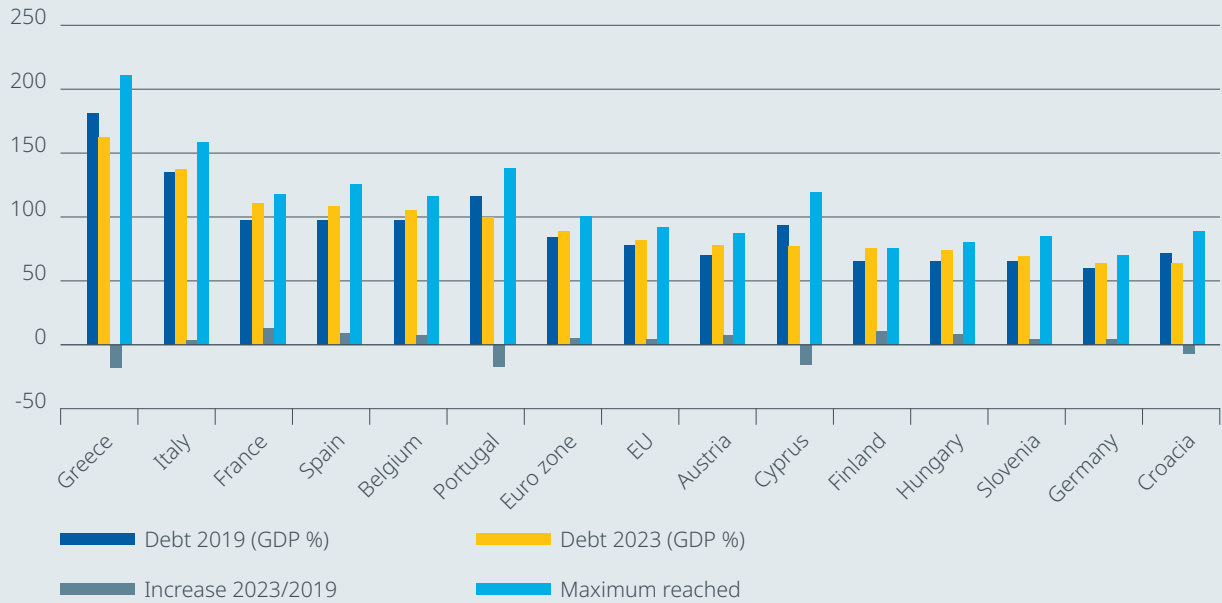


Source: Bank of Spain

The accumulation of historic debt levels has been marked by the financial crisis of 2008, from which it went from a starting situation of a debt-to-GDP ratio of 35.8% in 2007 to 105.1% in 2014 (an increase of 69.3 pp) and that caused by the pandemic in 2020, where it went from a starting point of 98.2% debt-to-GDP ratio to a peak of over 120% in 2020 it has fallen to 107.7% at the end of 2023, but it is still represented, as we mentioned at the beginning of this section, an increase of 9.4 pp from the starting point of 2019.

Spain is currently one of the EMU countries with the highest levels of debt, behind Greece, Italy and France, and with a level similar to that of Belgium (Figure 3). In 2019, Spain was already one of the countries in the eurozone with the highest debt ratio, and the pandemic has helped to consolidate this situation. Portugal, after a very considerable initial upturn, has managed to reduce its deficit in the last three years to reach a budget surplus that has allowed it to considerably reduce its debt.

FIGURE 3 Debt (% GDP) in 2023 and variation compared to the pre-Covid level



Source: Bank of Spain

We think that there is a clear asymmetry in the control of the key variables of the new fiscal framework that will come into force from 2025. On the one hand, **the Central Administration concentrates 74% of public debt in Spain**, while on the side of primary spending, the Autonomous Communities manage 32% of public spending, with health and dependency under great pressure due to the population ageing. Local entities account for 12% of expenditure with competences in the areas of water, waste, urban transport, social assistance for the elderly, etc. In total, **territorial administrations manage 44% of public spending**, which will be crucial in the new European fiscal framework.

The Autonomous Communities: the role of extraordinary financing mechanisms and future debt path

From the minimum reached in 2007 (5.8%), the debt-to-GDP ratio of the autonomous communities increased by more than 21 points to its maximum value in 2020 (27.2%), coinciding with the rebound of the pandemic. Since then, the ratio has fallen by 4.9 points to 22.2% of GDP at the end of 2023, slightly below the levels of around 24% where the ratio had stabilised in the years prior to COVID. **The subsector as a whole exceeds the legal reference of 13% established by the Organic Law on Budgetary Stability (LOEPSF) by 9.2 points**, with 2010 being the last year in which it was below this reference.

After a very rapid growth between 2012 and 2016 in the use of the mechanisms responsible for providing liquidity to the autonomous communities (Regional Liquidity Fund, Financial Facility and Supplier Payment Fund), the weight of these funds in regional financing has remained very stable in the last period (2017-2023), at around 60%. Three autonomous communities, Catalonia, the Valencian Community and Andalusia, account for 75% of the total value of the extraordinary liquidity mechanisms (Figure 4).

FIGURE 4 Individual breakdown of financial debt and weight in extraordinary financing mechanisms

	Public Debt		Debt FFCCAA	
	(GDP%)	(over total subsector%)	(over debt Autonomous Communities %)	(over total FFCCAA %)
Comunidad Valenciana	41.5	17.5	88.3	25.6
Castile La Mancha	31.5	4.9	80.2	6.5
Murcia	31.4	3.8	92.1	5.7
Catalonia	31.1	26.5	85.2	37.3
Balearic Islands	22.1	2.6	62.4	2.7
Extremadura	21.6	1.6	68.0	1.8
Aragon	19.7	2.7	64.5	2.9
Castile Leon	19.6	4.2	12.8	0.9
Cantabria	19.6	1.0	92.9	1.5
Andalusia	19.3	11.6	64.1	12.3
Rioja	16.6	0.5	56.8	0.5
Galicia	16.2	3.8	18.6	1.2
Asturias	14.8	1.3	17.1	0.4
Madrid	13.3	11.7	0.0	0.0
Basque Country	12.7	3.4	0.0	0.0
Cantabria	11.7	1.9	20.3	0.6
Navarra	11.7	0.9	0.0	0.0
Total	22.2	100.0	60.5	100.0

Source: Bank of Spain

The Government Delegate Commission for Economic Affairs (CDGAE), agreed to allocate to the Autonomous Communities for the third quarter of 2024 a total of 11,624.39 million euros from the Financing Fund for Autonomous Communities. Specifically, 11,150.66 million euros were allocated to the Regional Liquidity Fund (FLA) and the remaining 473.73 million to the Financial Facility (FF) compartment.

This agreement, as was the case with previous quarters, **does not include an allocation for the Autonomous Communities of Asturias, the Canary Islands, Castilla y León, Galicia, Madrid, Navarra and the Basque Country**, given that they have not requested financing from the Financial Facility and Regional Liquidity Fund compartments corresponding to the 2024 Financing Fund for the Autonomous Communities.

FIGURE 5 Quarterly distribution of the extraordinary financing mechanisms by Autonomous Community in 2024

Autonomous Communities	FFCCAA2024				
	Q1*	Q2	Q3	EF 1	Total
Andalusia	64.0	62.8	473.7	1,217.3	1,817.8
Aragon	645.6	9.7	240.9	175.5	1,071.6
Balearic Islands	323.0	30.0	483.9	-	836.8
Cantabria	116.6		222.1	-	338.6
Castile La Mancha	589.3	59.6	914.0	309.0	1,871.9
Catalonia	3,059.3	309.0	4,502.4	2,088.8	9,959.6
Extremadura	457.8	141.1	149.3	135.8	884.0
Murcia	289.6	153.5	672.2	583.5	1,698.7
Rioja	64.7	8.5	76.6	-	149.8
Valencia	2,796.0	287.1	3,889.2	2,209.5	9,181.8
Total Autonomous Communities	8,405.8	1,061.4	11,624.4	6,719.3	27,810.7

Source: Ministry of Finance
In euro millions

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