

Spain's Momentum: Growth Up, Regional Financing Model Reform Ahead

Macro perspectives for Spain and the finances
of its Regional Governments

4Q2025 EXECUTIVE SUMMARY



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Executive Summary

The international context: resilience and challenges in the global economy

The global economy remains remarkably resilient due to several factors, including fiscal stimulus, AI, looser monetary conditions, a weaker dollar, pre-emptive exports, and lower-than-nominal effective tariffs, despite the uncertainty surrounding Trump's tariff policy. For the third quarter as a whole, data from major international economies indicated some growth, prompting the OECD to revise its global growth forecast for 2025 upwards by 0.3 percentage points to 3.2%. Despite fiscal support, looser monetary conditions, and the rise of AI, activity is likely to be impacted by increased protectionism, immigration limits, uncertainty, and geopolitical tensions. Nevertheless, recent data suggest that the effects will be more gradual than initially expected.

Furthermore, **risks to the global economy remain**, with trade relations being one of the primary challenges. The summer agreements established the somewhat defined «rules of the game» and considerably reduce the risk of the most severe scenarios, but uncertainty has not disappeared, and further shifts in the US position cannot be ruled out, which is why trade uncertainty indices remain very high.

The recent Asia-Pacific (APEC) summit, which included a meeting in South Korea between the presidents of China and the US, **concluded with an agreement that includes a one-year delay of new export controls on rare earths and other critical minerals, established in October by China**. It was also agreed to resume purchases of U.S. soybeans and other agricultural products in exchange for an across-the-board reduction of 10 pp in the tariff on Chinese imports.

Even though, considerable uncertainty persists regarding how the new trade relations framework will influence the development of global value chains and, consequently, the economic activity of various regions.

It should be noted that, in this complex international environment, **high valuations of risky financial assets continue to be observed in global markets** - particularly in US equities and, notably, in the technology sector - so a sudden correction in these valuations could tighten financial conditions and dampen activity worldwide.

While fiscal policy, looser monetary conditions, and the push for technological advancement are supportive, **activity will be limited by protectionism, migration restrictions, uncertainty, and geopolitical tensions.** Recent data indicate that the negative effects of these headwinds will be more gradual than expected three months ago. In the United States, the forecast of 1.7% growth in 2025 (compared to 2.4% in 2024) remains unchanged, with a slight downward revision to 1.8% in 2026. Euro area GDP is projected to grow by 1.3% this year, exceeding July's expectations due to stronger growth in the first half, and by 1.0% next year if the boost from defence spending offsets the impact of the tariff increase.

The eurozone closes a third quarter with growth, again, very modest and with great disparity by country. Eurozone GDP grew by 0.2% quarter-on-quarter in Q3, one tenth more than in the previous quarter, which would be in line with an estimate of 1.3% growth for 2025. However, **the aggregate figure masks a large divergence by country.** On the one hand, Germany and Italy stagnated, after falling by 0.2% and 0.1% in Q2, respectively. On the other hand, France surprised positively by growing by 0.5% quarter-on-quarter, after 0.3% in Q2. This apparent strength of France rests on transitory factors: orders for aeronautical equipment boosted exports by 2.2% (0.3% previously), causing external demand to contribute 0.9 pp to the growth of the economy. The Q3 result highlights the underlying weakness that continues to afflict the eurozone.

The US continues to surprise with its dynamism, even though the labour market is cooling. The U.S. economy shows little evidence of the impact from the tariff increase. Firstly, the final GDP revision indicates a 0.9% quarter-on-quarter growth for Q2, up from the initially reported 0.8%, driven by resilient private consumption (+0.6%) and strong fixed capital investment (1.1%), supported by increased investments in new technologies and AI (computer equipment +2.8% and software 6.1%). Additionally, the latest data also points to a vigorous Q3. In fact, in August, private consumption remained strong (retail sales increased again by 0.6% month-on-month), and industrial production maintained its momentum. Overall, GDP trackers from the New York Fed and the Atlanta Fed suggest that GDP likely grew between 0.6% and 0.9% quarter-on-quarter in Q3.

In this period of economic dynamism, **inflation continues to resist decline:** in September, headline inflation increased by 0.3 percentage points to 3.0%, while core inflation rose by 0.2 percentage points to 3.0% year-on-year, matching the headline figure. Although these figures still exceed the 2% target, the data indicate a modest impact from tariffs so far, possibly because companies are absorbing much of the cost increases they cause.

However, **the latest labour market data are beginning to show signs of exhaustion.** The annual review of the statistics showed almost 911,000 fewer jobs in the period April 2024-March 2025 than initially shown, and in August barely 22,000 jobs were created, compared to an average of more than 100,000 jobs in the first four months of the year, and with an unemployment rate that rises to 4.3% compared to 3.5% at the beginning of the year. The tariffs will keep U.S. inflation relatively high, close to 3% in 2025-2026. However, the slowdown in growth, coupled with the gradual cooling of the labor market and with inflation reflecting the temporary rebound in prices due to tariffs, but without broad inflationary pressures, **will allow the Fed to lower interest rates to 3% in 2026.**

China sustains weak domestic demand. Retail sales increased by 3.4% year-on-year, compared to an average of 5.4% in the second quarter (Q2). This loss of momentum is expected to persist in the coming months: household spending will be constrained by the fading effects of fiscal incentives, which had stimulated the purchase of durable goods at the start of the year. **Therefore, the outlook for a slowing Chinese economy remains, with estimated GDP growth of 4.8% in 2025 and 4.5% in 2026.**

Finally, **the risks of more negative scenarios increase in an environment of high uncertainty, recurrent shocks, less global cooperation and possible disruptions.** Along with trade and immigration policies, threats to the Fed's autonomy are among the biggest concerns.

The Spanish economy: dynamism in a fragile environment

The Spanish economy has performed unexpectedly well in the first half of 2025. GDP increased by 0.6% in Q1 and sped up to 0.8% in Q2, surpassing the initial forecasts of 0.5%, which are mainly based on domestic demand, especially private consumption and investment. All these events occurred in a context where the eurozone economy was once again showing signs of slowing.

In our opinion, **a post-COVID and post-war European environment in Ukraine has been shaped by a range of factors that favour the Spanish economy.** These elements also serve as levers for greater growth, supporting policies Spain has long committed to. There has been a shift in Europeans' preferences towards leisure. An economy that produces more leisure and tourism services benefits at the expense of economies focused on other products. Furthermore, immigration plays a role in transforming what in other countries is a major bottleneck in the labour market due to a lack of workers into a growth limiter; **in Spain, it is not.**

We would highlight that **growth has been balanced and healthy,** driven by both investment and private consumption, thanks, among other factors, to a solid financial situation of households and companies, favourable financing conditions, the normalisation of inflation and the strength of the labour market. This good performance is even more relevant if we consider the international context, marked by the increase in trade tensions with the US and the associated uncertainty.

After a few years of external demand driving the leadership, the timing of the handover is particularly favourable. The normalisation of interest rates by the ECB, the overall healthy financial position of the private sector, and population growth serve as, or are expected to continue as, supporting factors.

Provisional Q3 growth data confirm that economic activity is maintaining a good pace, with growth of 0.6% quarter-on-quarter (2.8% year-on-year). As for the breakdown of growth in Q3 by component, domestic demand contributed 3.7 pp to year-on-year GDP growth (0.2 pp more than in the previous quarter), while external demand subtracted 0.8 pp (negative contribution of 0.5 pp in Q2). Although employment growth is somewhat more moderate than in the previous quarter (two tenths lower), it is still significant. The absence of a more intense slowdown is explained by the better

relative performance of exports, particularly those of goods, and the solid growth of domestic demand. Although sales of goods to the United States (US) have suffered due to the increase in tariffs and a higher-than-expected appreciation of the euro against the dollar, those to the rest of the world continue to increase. In addition, the signing of the agreement between the European Union (EU) and the American economy reduces uncertainty for the affected companies and families.

All signs point to the Spanish economy continuing to grow rapidly in the coming months, supported by the ECB's interest rate cuts, stable energy prices, and steady high levels of immigration. In this environment, private consumption and investment are expected to become the main drivers of growth.

The resilience of the Spanish economy continues to surprise

In recent quarters, the resilience of the Spanish economy in the face of the adverse international context has been a positive surprise. In addition, the INE has revised upwards the growth profile of recent years¹ and, especially, that of recent quarters. **All this leads us to revise upwards this year's growth forecast, from 2.3% forecast in our previous report in September, to 2.9%. For 2026, we continue to expect some slowdown in the pace of growth, but we revised our forecast upwards by 0.6 pp to 2.3%. The estimated impact of the NGEU funds on the Spanish economy will be in a cumulative range of between 5.5 pp and 6.4 pp of GDP until 2028.**

The upward review in our estimates reflects resilience to rising tariffs, reduced tariff policy uncertainty, and a greater impact of NGEU funds. The revision of the historical series made by the INE also influences this. This is despite the recent rise in electricity costs, the depreciation of the exchange rate, and the impact of fires. If this forecast is realised, the Spanish economy will have grown at an average rate of 3% since it recovered pre-pandemic levels in 2022.

From 2026 onwards, growth is projected to gradually slow to 1.5 per cent in 2030, as the momentum associated with the RTRP disappears and migration flows moderate. The lower dynamism of world trade projected by most international institutions also helps to explain this profile.

Specifically, **between 2022 and 2024, the growth of the Spanish economy was mainly supported by the foreign sector, especially tourism, and to a lesser extent by non-tourism services, public consumption and the increase in the population due to immigration.** The population has grown at 1.0% per year for three consecutive years. As a reference, between 2015 and 2019, growth was 0.3% on average. The growth in population is mainly due to the increase in the foreign and dual nationality population

(1) The INE has raised the growth of the Spanish economy in 2024 by three tenths, from 3.2% to 3.5%..

With the new INE data for 2024, **domestic demand is 9.0% above the level of Q4 2019**, compared to the 8.3% previously estimated, driven mainly by investment, which is now 11.4% above the pre-pandemic level, rather than 6.8%. This results from a strong revision of investment in non-residential construction, which has shifted from being 0.5% below to 9.4% above. This may indicate that funds linked to the Recovery and Resilience Mechanism (RRF) are having a greater impact than previously estimated. If this leads to increases in productive capacity or improvements in productivity, the recovery could continue to exhibit high growth rates.

In 2025, **sources of growth have started to shift towards domestic demand, a trend expected to continue into 2026**. Falling inflation and interest rates will help restore purchasing power and make financing more accessible on better terms. The increased allocation of NGEU funds and higher defence expenditure will also support growth.

Despite the positive outlook, **growth in 2025 and 2026 is expected to follow a slowing trajectory as some of the favourable factors of recent years weaken**. Notably, tourism growth is normalising, public consumption receives less boost, and population flows are moderating. Additionally, the persistent weakness of the European economy and the rise in tariffs between the US and the EU contribute to this trend. Conversely, the construction sector might partially compensate for the slowdown in tourism.

Compliance with fiscal rules will require a significant effort to control the growth of public spending and an average annual structural adjustment of 0.4 pp of GDP over the next five years. All this in an environment of growing spending needs linked, among others, to ageing – an increase of more than 5 pp of GDP is expected until 2070; to the defense; or investment, which is at historic lows. In addition, the reform of the regional financing system and the commitment to cancel part of the debt pose a challenge for public finances.

Therefore, **the expansion of activity will continue to be supported by the positive, though diminishing, contribution of services exports and the strong recovery of domestic demand**.

Inflationary pressures are under control. According to the main CPI indicator, headline inflation increased by 0.7 percentage points in October to 3.1%, the highest level since June'24. However, this was mainly due to a base effect on fuels and electricity, as their prices rose more than in October 2024. In 2026, **inflation is expected to continue moderating and reach 2.0% annual average, after a closing forecast of 2.5% for 2025**.

Conversely, **the data published so far indicate a significant rise in employment**, up 2.7% year-on-year, according to the LFS for the second quarter. In 2025, job creation is projected to remain strong, around 2.5% this year. For 2026, some slowdown is anticipated, though growth will stay high: employment is expected to increase by 2%, compared to the 1.6% previously forecast. Consequently, the forecast for the unemployment rate has also been revised favourably, moving from 11.3% in 2024 to 10.4% in 2025, and is predicted to fall below double digits in 2026, at 9.7%, for the first time since 2007.

On the real estate side, **the residential market is experiencing an expansive phase**, driven by lower interest rates, favourable economic conditions, improved purchasing power, demographic growth, and strong demand from foreign buyers.

One of the few negatives for the Spanish economy in 2025 is **the sharp increase in the trade deficit during the first half of the year**. Unlike the real estate sector, the current environment does not favour the foreign sector. Domestic demand continues to drive import growth. Additionally, trade uncertainty and weakness in the euro area are adversely impacting exports. In the first half of the year, goods exports rose by 1.0% year-on-year, but import growth at 5.4% has resulted in a deficit of 25,113 million euros for the first half of 2025, significantly higher than the same period last year (-15,822 million).

The risks associated with the scenario are numerous. Upside risks include the possibility that consumption and investment will grow more than expected, especially if uncertainty decreases more quickly than anticipated and households and businesses also normalise savings levels faster. NGEU funds could also have a greater impact, or residential investment could rebound more strongly than forecast.

However, **the main risks still lean towards the downside and are of a geopolitical nature**. Although uncertainty regarding the US-EU trade war has diminished, further episodes of tension cannot be discounted. Additionally, the fall of the government in France and doubts about the sustainability of its debt have heightened risks to financial stability. Furthermore, an escalation of the conflict in the Middle East could cause a sharp rise in oil prices.

U.S. economic policies remain a source of instability, along with uncertainty around the sustainability of growth in some key sectors and obstacles to investment, labor force, and productivity growth. The impact of the increase in tariffs on trade with the US has been negative, in line with expectations, and it cannot be ruled out that it will continue to be so in the future, despite the agreement signed. This is due to the volatility that economic policy has shown in the U.S. and the fact that some of the factors that allowed the effects to be attenuated during the first quarters may be exhausted.

Additionally, **the appreciation of the euro against the dollar affects exporters by reducing their competitiveness**. Furthermore, despite the upward revision, the expected GDP growth in the euro area remains modest, limiting the growth in overseas sales. Related to this, the rise in foreign tourism is beginning to show signs of exhaustion, partly due to the slowdown in European demand. Gains in competitiveness from investments in renewables may decrease amid high regulatory uncertainty and rising costs. Meanwhile, the automotive sector faces pressure from shifting household preferences, a lack of infrastructure to support electric vehicle adoption, and increased external competition.

Conversely, **the shortage of affordable housing hampers the well-being of the younger population and the attraction of human capital**. Labour shortages in certain sectors and regions, coupled with sluggish labour productivity, constrain future growth potential. Ultimately, reducing the public deficit over the coming years will depend on implementing structural measures as the cycle's

impact on this imbalance diminishes. Political fragmentation and a lack of consensus continue to adversely affect activity.

Challenges of the Spanish economy

To strengthen the current expansionary cycle, **it is crucial that activity growth remains sustainable, avoids creating new imbalances, and corrects existing ones.** Consequently, one of the main challenges facing the Spanish economy lies in the real estate sector.

The demand for housing has increased significantly in recent years, as shown by the rise in households and home sales. Meanwhile, the supply of housing is responding slowly and inadequately to meet this demand. The pressure on house prices mainly reflects this imbalance. The housing shortfall built up in recent years exceeds half a million. Correcting an imbalance of this scale will be difficult, so price pressures are likely to stay high in the short term. It is crucial to act decisively and effectively to stop this imbalance and begin addressing it as soon as possible.

A second area that requires special attention is public accounts. Spain's public debt has been gradually but consistently reduced in recent years. Everything indicates that, finally, **this year the deficit will be below 3.0%.** A milestone that will reinforce this process and help to differentiate the situation of the Spanish economy from that of other economies, currently in the spotlight of investors, such as the US and France. Both have a public deficit of more than 6%, and there are serious doubts about their ability to turn this situation around. The threat of a spike in sovereign risk premiums is once again looming over financial markets, and when this happens, many investors find it difficult to differentiate between economies. You don't have to go far back in time to have good examples of this. In this context, **it is important to take advantage of the current economic moment to reinforce the commitment to the adjustment of the Spanish public accounts and to offer the maximum possible visibility and credibility regarding the evolution of revenues and expenditures** in the short and medium term.

Another structural issue of the Spanish economy is **the low profitability of Spanish companies compared to other European economies.** This lower profitability is linked to the well-known productivity gap, caused by multiple factors, which restricts the process of convergence of the Spanish economy with the wealthier countries in the euro area.

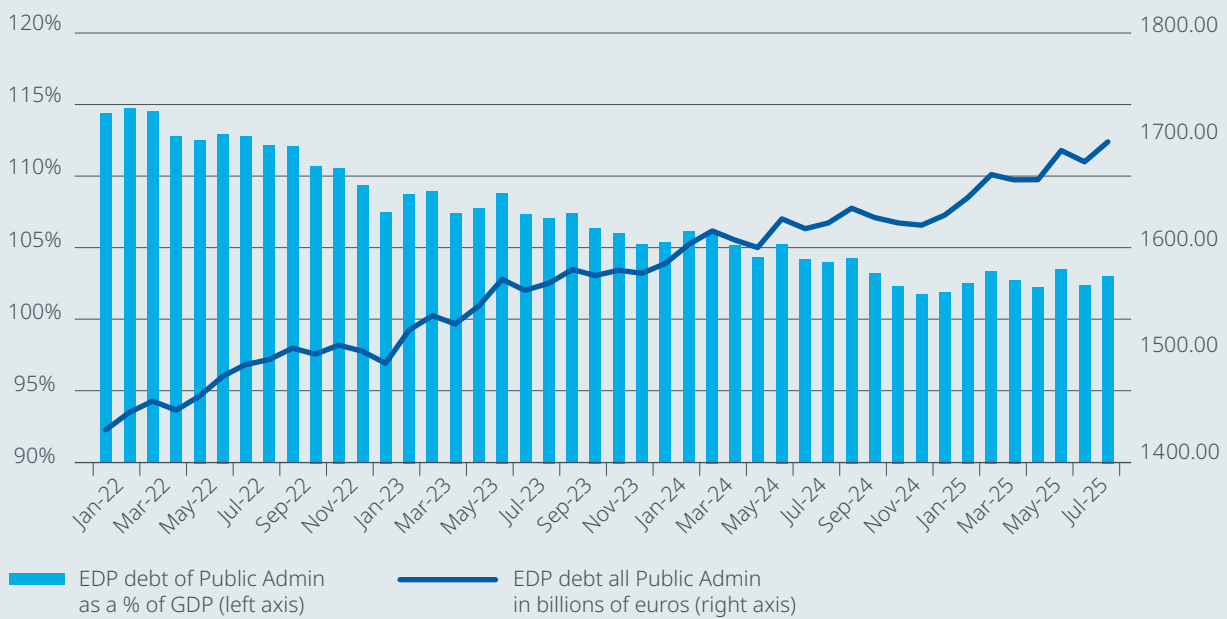
Finally, **special attention must also be given to the export sector.** Much of the recent success of the Spanish economy relies on the opening up of its productive base. In response to the collapse of domestic demand caused by the financial crisis nearly two decades ago, many companies faced challenges in entering the international market. Many jobs were preserved, and over the years, many more were also created. International openness has also acted as a catalyst for productivity enhancements across many sectors and, at the macroeconomic level, has enabled the maintenance of a substantial trade surplus which has helped to reduce high external debt.

Public debt to GDP ratio decline continues, albeit at a more moderate pace

General Government EDP Debt

With the available data, the ratio of general government debt according to the Excessive Deficit Protocol (EDP) in relation to nominal Gross Domestic Product (GDP) stood at 103% in August 2025, a decrease of 0.9 percentage points compared to a year earlier. In absolute terms, the debt balance amounted to €1,699 billion, with a year-on-year growth rate of 4.7%.

FIGURE 1 General Government EDP Debt



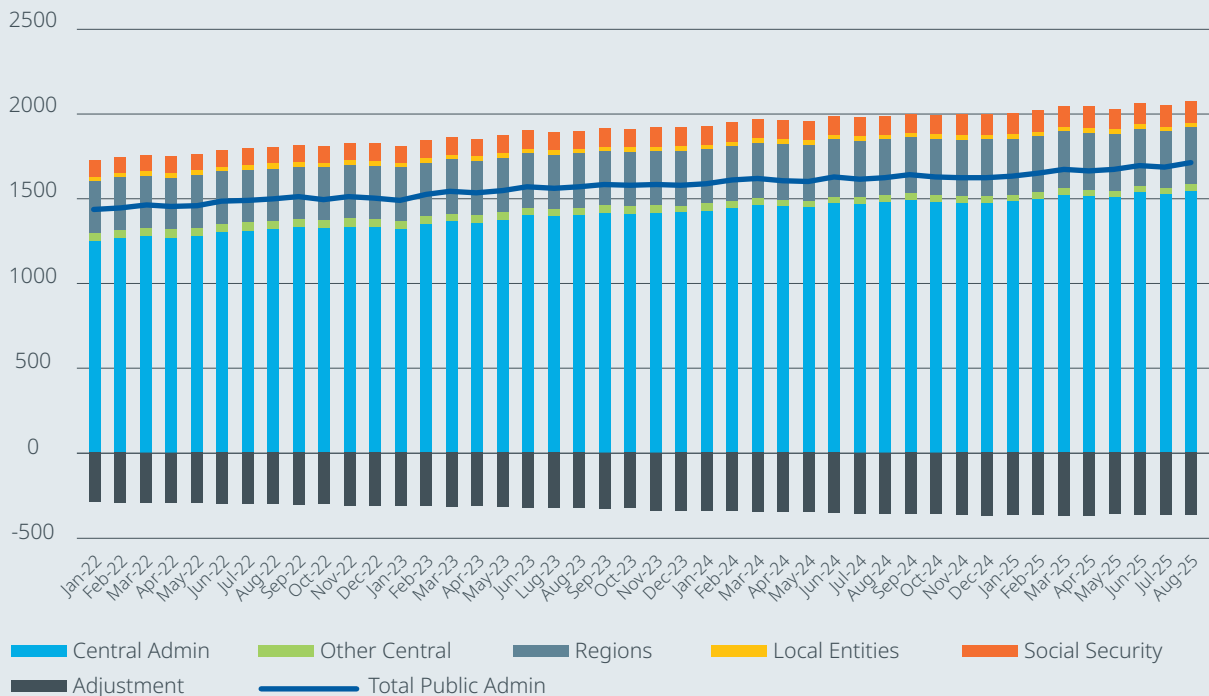
Source: Bank of Spain

EDP debt by subsector

The total government debt was €1,546 billion, representing a 4.9% increase compared to the previous year, or 93.7% of GDP. For the Other Units of the Central Government, the debt was €35 billion (2.1% of GDP), which is an 8.1% decrease from the same period last year. Meanwhile, the debt of the Social Security Administrations stood at €126 billion, an 8.6% increase from the previous year, accounting for 7.6% of GDP.

On the regional government side, the debt of the Autonomous Communities was EUR 340 billion in August 2025, representing 20.6% of GDP, with a year-on-year change of 1.9%. Meanwhile, the debt of local corporations stood at EUR 23 billion in August 2025 (1.4% of GDP), which is 1.5% lower than the previous year. Conversely, the consolidation of the general government sector - that is, the debt held by the various subsectors comprising the general government - was EUR 371 billion, up by 2.2% from the previous year, accounting for 22.5% of GDP.

FIGURE 2 General Government EDP Debt by Subsector (billion euros)



Source: Bank of Spain

The reduction of the public deficit will continue in 2025-2026

We estimate that the reduction in the public deficit will continue in 2025 and 2026, with an estimated deficit of 2.6% (below the government's full-2025 target of 2.8%) **and 2.2% of GDP respectively**, compared to a figure of 3.2% in 2024.

The Spanish debt-to-GDP ratio stood at 103.4% in the second quarter of 2025, a reduction of 1.8 points compared to the same quarter of the previous year and an increase of 5.8 points compared to the pre-pandemic level. The ratio remains constant compared to the first quarter of 2025 and shows a rebound of 1.8 points compared to the last quarter of 2024, partly explained by the positive seasonality of the first part of the year, where public issuers take advantage of the strong demand for debt. The cumulative reduction from the ceiling reached in the first quarter of 2021 (124.2%) is 20.8 points.

As a result of this improvement in the fiscal deficit and the estimated economic growth, the debt-to-GDP ratio will fall below the 100% threshold (99.5%) in 2026, compared with **105.2% in 2023 and 101.7% in 2024**.

The sustainability analysis indicates that debt would continue to fall to 95% of GDP in 2030, although at a significantly lower rate than in recent years due to the slowdown in the economy's nominal growth. The above figure would result in a reduction in the public debt-to-GDP ratio of 6.4 points between 2024 and 2030. It is supported by stable nominal growth of around 3.5%, an average primary surplus of 0.5% of GDP and interest payments of close to 2.7%, thus maintaining a favourable difference between growth and interest rates that underpins the progressive reduction of debt.

Until June, the overall deficit of the general government (AA), excluding local corporations (CC. LL.) and expenditure related to the DANA, stood at 1.6% of GDP (1.9% in June 2024). The budget execution data up to June indicate that public revenues grew strongly, supported by tax collection. Specifically, consolidated government revenues increased by 6.9% year-on-year through June (up from 6.6% year-on-year in the first six months of 2024 and an average of 3.7% for the first half of 2014-2019), significantly above the 5.4% growth in nominal GDP.

Our central scenario envisages that the Autonomous Communities will reduce their level of indebtedness by one and a half points from 2024, reaching 19.6% of GDP in 2026. Starting from 21.1% in 2024, the ratio would improve in 2025 and 2026 due to the effect of expected GDP growth, partly offset by the deficits forecast for the subsector as a whole. Under these estimates, **four Autonomous Communities could have a debt ratio of more than 20% in 2026, while six could be below the 13% set in the LOEPSF.**

Exceptional financing mechanisms lower their share in the total debt of the Autonomous Communities to 60%

The refinancing of higher-cost operations with the State (FLA-23 and, to a lesser extent, FLA 24) has generated significant savings and improved the financial burden. This scenario was mainly capitalised on by Catalonia, Castilla-La Mancha, Extremadura, and Cantabria, which in the second quarter carried out refinancing operations for a volume of close to 7 billion euros.

As a result, **the debt associated with the Financing Funds for the Autonomous Communities decreased by €4,187 million during the quarter, reducing its proportion to 60% of the total regional debt** (down from 62% previously). Conversely, long-term loans with residents increased by €7,041 million, accounting for 18% of the total (up from 16%), indicating a process of diversification driven by investment.

Finally, regarding the bond market, the remarkable dynamism seen in the first quarter continues, with gross issuance in the second quarter exceeding €2,200 million. In total, sub-sovereign placements amount to around €5,000 million, 10% higher than the total issued in 2024. Notably, regional issuances from Galicia, Castilla y León, Andalusia, and Madrid each worth €500 million, have an average spread over the Treasury of 14 basis points.

Upward revisions to the ratings of the Autonomous Communities facilitate the gradual return to the markets.

In recent weeks, **the major ratings agencies (Standard & Poor's, Fitch, and Moody's) have upgraded the credit ratings of almost all regions.** The last review took place at the beginning of October by Moody's, which raised the rating of eleven Autonomous Communities by one notch, except for Andalusia, which was increased by two notches. According to the agency's report, these improvements are due to the sovereign's rating rise. This improvement is based on a more favourable economic environment, which has led to higher tax revenues and increased state transfers, strengthening the financial outlook of sub-sovereign entities. Additionally, significant fiscal progress has been observed in recent years, with forecasts indicating positive non-financial balances, a reduction in the debt burden, and better access to financing. A positive impact from NextGenerationEU funds is also anticipated from 2026, further enhancing the financial resilience of these entities.

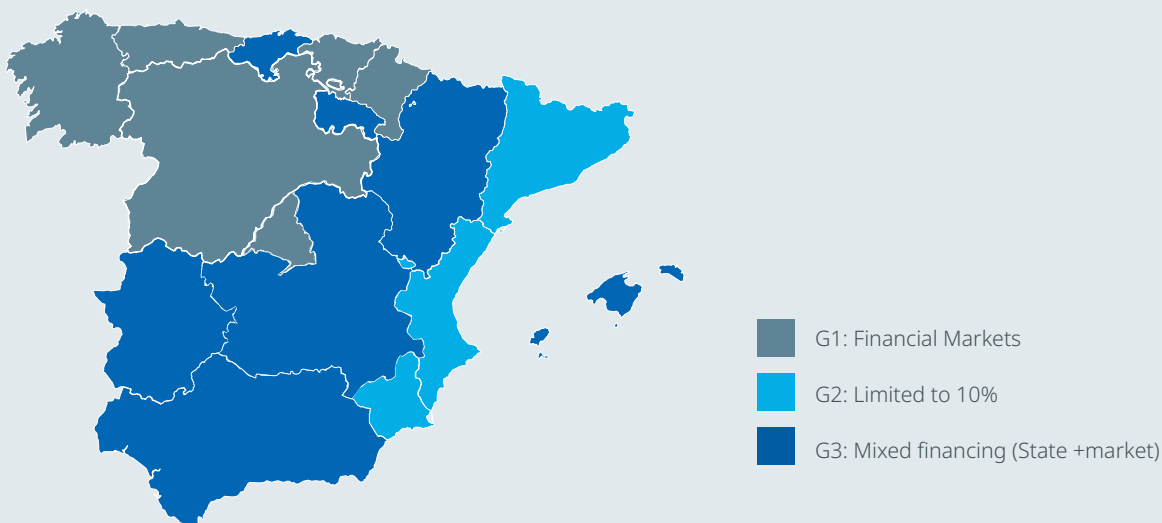
These improvements are incorporated as a favourable element within the transition period envisaged for returning to the markets, as outlined in the CDGAE Agreement approved on 28 July. This Agreement relaxes the conditions to allow the combination of state resources (FFCA) and those from capital markets during 2026-2028. Based on the strategy that the regions have adopted in recent years, we could categorise three groups of communities according to their approach to meeting their needs: G1) those that will cover all their needs in the markets, as they have done until now; G2) those that may combine resources, but with limits of up to 10%; and G3) those that can combine resources without limits and in accordance with their Multi-Year Debt Plan. In any case, there would be no legal restriction preventing any of the G1 communities from moving to G2 or vice versa.

FIGURE 3 Ratings of the Autonomous Communities

| Region | Fitch | | Moody's | | S&P | | DBRS | |
|--------------|----------|-----------|-----------|-------------|-----------|----------|-----------------|-----------------|
| | 2025 | 2024 | 2025 | 2024 | 2025 | 2024 | 2025 | 2024 |
| AND | | WD | A3 | Baa2 | A- | A- | | |
| ARA | | | | | A- | BBB+ | | |
| BAL | | | | | A- | A- | | |
| PVA | A | A | A2 | A3 | AA- | AA- | | |
| CAN | | | | | A+ | A | | |
| CLM | BBB- | BBB- | Baa3 | Ba1 | | | | |
| CYL | | | A3 | Baa1 | | | | |
| EXT | | | Baa1 | Baa2 | BBB+ | BBB | | |
| GAL | | | A3 | Baa1 | A | A | | |
| MAD | A- | A- | A3 | Baa1 | A | A | A (high) | A (high) |
| MUR | BBB- | BBB- | Baa3 | Ba1 | | | | |
| NAV | | | | | AA | AA- | | |
| AST | | | A3 | Baa1 | | | | |
| CNT | | | | | A+ | | | |
| CAT | BBB | BBB | Baa3 | Ba1 | | | BBB (high) | BBB |
| RIO | BBB+ | BBB+ | | | | | | |
| VAL | BBB- | BBB- | Baa3 | Ba1 | BB | BB | | |
| SPAIN | A | A- | A3 | Baa1 | A+ | A | A (high) | A (high) |

Source: Rating agencies

FIGURE 4 Expected Autonomous Community funding strategy for 2026



Source: Ministry of Finance

The Finance Minister is nearing a proposal for a new regional financing framework

The Finance Minister suggests that all autonomous communities should have the ability to collect major taxes such as personal income tax or VAT. In this way, it aims to guarantee that any potential reform of regional financing (LOFCA) gains the approval of the autonomous communities, which would have the option to be involved in a real-time revenue model rather than relying on payments on account. Catalonia, Madrid and the Balearic Islands would have to contribute a quota of solidarity in the new system.

The current regional financing model has been awaiting reform since 2014. Now, additionally, the Government has taken steps with Catalonia towards **a unique financing model in the region**, which has caused tension among political groups and autonomous communities.

Overall, and between the increase in the tax basket and the vertical levelling, they would inject the Autonomous Communities as a whole with about 23,000 million additional spending capacity, according to sources familiar with the project that is still under negotiation. The proposal has already been presented to the Catalan government (Generalitat), and the Catalan administration would receive between 4,000 and 5,000 million in additional resources, representing roughly 17% to 21% of the new resources in the financing system. This figure aligns with, or is slightly higher than, its proportion in the national GDP.

This proposal would involve increasing the resources of the financing system by nearly 14%. If there is no agreement, it is because the technical details are still being negotiated, such as the new basket of taxes that will comprise the model, or the principle of ordinality, which is fundamental for the Catalan government.

The principle of ordinality suggests that once the contributions of various autonomies are made, those that contribute the most should also receive the most. However, in the case of Catalonia, it is always among the top contributors per capita income, yet it remains in tenth position for the resources it receives due to the current corrective mechanisms of the system.

The Finance Minister aims to update the financing system, which has been under review for eleven years, **to address not only the underfunding issues in Catalonia but also those affecting the entire Mediterranean arc - including Andalusia, Valencia, and the Balearic Islands.** It would also benefit Madrid, as it is one of the Autonomous Communities that contributes more than it receives and is among the wealthiest. In principle, the Ministry of Finance plans to transfer the new system to a Fiscal and Financial Policy Council, which will be convened before the year's end.

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