



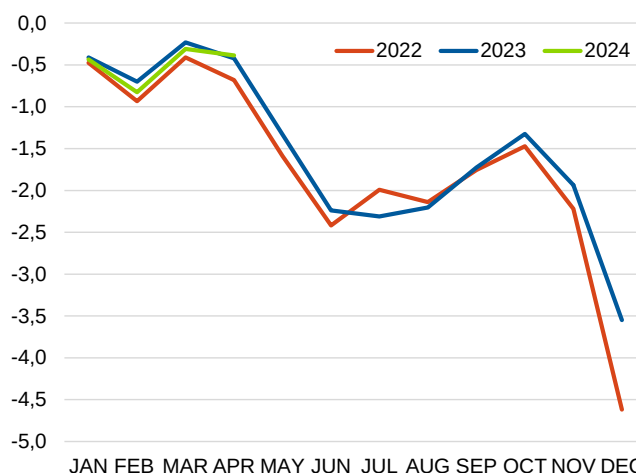
The improved economic outlook has prompted us to lower our forecast for the deficit to 3.1%

To April, the overall deficit stood at 0.39% of GDP.

The state budget outturn dynamics (based on data released to May) and the figures for the regional governments for the first four months of the year yield the following key takeaways:

1. At the **overall government level**, excluding the local administrations, the deficit is down slightly year-on-year in absolute terms. Relative to GDP, it is running at **0.39% (around €6 billion)**.

Exhibit 1. Trend in deficit (all levels of govt. except local), % of GDP



Source: Ministry of Finance and Government

2. **The state deficit to May stands at 0.7% of GDP, almost 0.2pp below the 5M23 deficit.** The improvement is attributable to **solid growth in tax revenue coupled with contained growth in non-financial spending**, albeit expected to spike in July with the payments associated with the regional financing scheme.
3. **To April, the deficit across the regional governments is running at nearly twice the level observed in 4M2023, at €7.98 billion (0.5% GDP).** The delay in updating the regional governments' funding is causing this deterioration in their finances. Scant growth in their non-financial revenue (+1.6% YoY) contrasts with sharp growth in spending (+6.3% YoY), mainly growth in **employee compensation** (and without yet reflecting the pay increases announced this week for 2024), **investment** (+16.9% YoY), **expenditure on intermediate goods** (+3.8% YoY) and **interest** (+27.9% YoY). Despite the expected improvement in the regional governments' finances once they receive their payments on account and prior-year settlements, the growth on display in spending could compromise the consolidation hoped for in this sub-sector, impeding the budget balance assumed by the government.
4. The **Social Security Funds recorded a balanced budget to April**, compared to a deficit of 0.07% in 4M23. The improvement was driven by growth in receipts of 9% year-on-year (1.6pp above the growth in expenditure), thanks to momentum in contributions (+7.2% YoY) but also growth in transfers from the state.
5. **The local government deficit increased to €1.34 billion in 1Q24** (up from €179 million in 1Q23), which is equivalent to almost **0.1pp of GDP**. This deterioration should prove transitory as it is mainly the result of an 11% reduction in current transfers from the state year-on-year due to the delay in updating the regional and local government financing system's funding on account of the carryover of the state budget. Growth in non-financial spending was low in 1Q24 (below GDP growth), so that we do not envisage risks of budget imbalance at the local

Deficit by region (% of GDP)

	Apr 2023	Apr 2024	YoY (pp.)
AND	-0.1	-0.8	-0.67
ARA	-0.2	-0.4	-0.26
AST	0.3	-0.1	-0.36
BAL	-1.0	-1.2	-0.11
CAN	-0.2	-0.9	-0.68
CNT	0.0	-0.7	-0.73
CLM	-0.6	-0.8	-0.18
CYL	-0.2	-0.4	-0.26
CAT	-0.4	-0.6	-0.13
EXT	-0.6	-0.9	-0.23
GAL	-0.2	-0.5	-0.31
MAD	-0.4	-0.5	-0.14
MUR	-0.7	-1.1	-0.34
NAV	0.4	0.4	0.01
RIO	-0.2	-0.7	-0.58
VAL	-0.6	-0.4	0.14
PVO	0.2	0.6	0.34
TOTAL	-0.3	-0.5	-0.21

Source: Ministry of Finance and Government



government level once these administrations collect their payments on account and prior-year settlements (€28.56 billion).

State budget outturn to May 2024

Growth in tax revenue to May remained a solid 7.5% YoY.

The revenue figures to May extend the growth observed in previous months: year-on-year growth of 7.5%.

Table 1. Trend in revenue by tax on a like-for-like basis (incl. regional governments' share)

	MAY. 2023	MAY. 2024	YoY 24/23	DEC. 2023	YoY 23/22
Direct taxes	58,196	64,336	10.6%	161,406	15.3%
Personal income tax	47,673	52,568	10.3%	120,691	16.0%
Corporate income tax	9,037	9,962	10.2%	36,304	13.9%
Other taxes	1,486	1,806	21.5%	4,411	4.9%
Indirect taxes	50,885	52,897	4.0%	111,732	14.5%
VAT	40,037	41,704	4.2%	84,816	17.1%
Special taxes	8,425	8,803	4.5%	21,258	2.5%
Other taxes	2,423	2,390	-1.4%	5,658	27.0%
TOTAL TAX REVENUE	109,081	117,233	7.5%	273,137	14.9%

Source: IGAE

Personal income tax receipts increased by 10.3% YoY, driven by withholdings by the authorities and large enterprises, as well as the start of the 2023 tax return season

Payment of a one-off reimbursement in 2023 is one of the reasons for the spike in corporate income tax revenue.

Growth in VAT has slowed but remains above 2023 levels.

- **Growth in the main direct taxes (personal and corporate income tax) has picked up by nearly one point, with growth in the other taxes up by over four points.**
 - **Personal income tax: accelerating momentum on like-for-like terms to 10.3% YoY**, thanks to the healthy trend in government withholdings against salaries and pensions, as well as private sector withholdings, particularly by large enterprises. The start of the 2023 income tax season in April has implied an increase in annual return reimbursements and an execution rate that is five points ahead of that observed at the same juncture of last year with respect to the 2022 returns.
 - **Corporate income tax: the growth rate, boosted by the first payment on account in April, increased by 0.8pp to 10.2% YoY.** This improvement is mainly attributable to the base effect created by the reimbursement in May 2023 of over €1 billion following a court ruling related with deferred tax assets; however, it is also shaped by growth in taxable earnings at large enterprises and groups (+9.5%) and regulatory changes.
- **VAT: like-for-like growth slowed to 4.2% YoY, which is nevertheless 2.7pp above the growth observed at the same juncture of 2023.** The growth in VAT receipts is being unlocked by the gradual reversal of the rate cuts applied to energy products (electricity, gas, pellets, timber, etc.), which have gone back up from 5% to 10%. However, following approval of [Royal Decree-Law 4/2024 \(of 26 June 2024\)](#), the government has since cut VAT on oil and pasta from 10% to 5% and extended the rate cut on bread, flour and fruit from 4% to 0% until September.
- Among the other indirect taxes, it is worth **highlighting**:
 - **Excise duty: growth in revenue increased to 4.5% YoY on a like-for-like basis.** That growth is primarily attributable to receipts from electricity, where the rate was put back up from 0.5% to 2.5%.



Non-financial expenditure continues to grow at a moderate pace of 1.5% YoY.

Transfers to the regional governments have yet to reflect the exceptional increase in funding that will begin to have an impact in July (settlements) and September (payments on account).

The Social Security Funds have benefitted from the biggest increase in transfers.

We are improving our forecast for the deficit to 3.1% of GDP in 2024.

- **Growth of 21.7% in receipts from the tax on certain digital services** (€174 million) and a **drop of 14.1% in receipts from the tax on financial transactions** (€116 million).

- Within 'Levies, public rates and other income', the **temporary windfall taxes** (on credit institutions, specialised lending institutions and energy companies) **are running at €1.46 billion this year**, similar to the 2023 amount.

Spending meanwhile, continues to register modest growth of 1.5% year-on-year, ticking higher in May, however. That is partly because transfers between levels of government continue to rise at a moderate 0.6% year-on-year pending recognition and payment of the funds associated with the 2022 regional system funding settlement¹, which will trigger growth in this item. **The headings rising the fastest are interest expense (+14%) and expenditure on intermediate goods (+8.2%).**

As for transfers among the different levels of government, the patterns remain highly uneven.

- The **regional governments have so far been transferred 2.9% more than in 2023** of the funds corresponding to the regional financial scheme, **still far from the projected 8.3% increase.** These funds include €1.63 billion more than last year in payments on account, which may be attributable to the delay in updating those amounts. The updated deliveries contemplated in the legislation passed last Tuesday will not be made until September, which is when the releases in respect of the additional funding are scheduled to be made.
- **The Social Security Funds have so far been transferred 18.1% more than in 2023**, with the Social Security System receiving the bulk. As we explained in our Technical Note last May, the difference between the two periods has to do with faster budget execution in 2024 with respect to the contributions by the state related with compliance with the first recommendation of the 2020 Toledo Pact (state contribution to finance the grants implicit in the so-called special sea and farming regimes and training contracts).

Note, lastly, that the 10% contraction in investment (FBK and investment aid) is also helping contain spending.

Updated deficit forecast for 2024. Approval of the legislation extending certain anti-crisis and other fiscal measures

Royal Decree-Law 4/2024 was just published in Spain's official state journal, extending certain measures for tackling the economic and social consequences derived from the conflicts in Ukraine and the Middle East and enacting urgent fiscal, energy and social measures. The new legislation contains information that impacts the public finance dynamics:

1. **Rollover of certain anti-crisis measures.** The main measures affecting the budget are: a) the **reduction of the VAT rate on food**, which has been extended for three more months until the end of September 2024; and b) **extension of the electricity social voucher**, along with a roadmap for its normalisation through July 2025. The impact of these measures as a whole is negligible (a scant 0.05pp of GDP).
2. **Approval of wage increases for public employees**, specifically a fixed increase of 2% with retroactive effect to the start of the year. The door has been left open to an additional, irreversible increase of 0.5%, depending on the trend in inflation. These developments not have an impact on our forecasts as they were already factored in.

¹ Over €20 billion contemplated for the regional governments with a negative impact on state revenue and a positive impact on spending.



3. **Update of payments on account**, confirming the exceptional increase the regional governments are set to receive throughout the year. A good amount of the additional funds will be received together with the settlement in respect of 2022 in July, while the updated payments on account with respect to those they have been receiving so far this year will begin to materialise from September. However, the estimates for the main taxes that give rise to these settlements, particularly personal income tax, suggest a little room for meeting expectations as they are based on very prudent growth in personal income tax receipts of around 5.5%, whereas revenue growth has been running at around 9% in recent months, which is even higher than the growth in payments on account awarded to the regional governments (8.3% YoY).

The brighter outlook for GDP, with positive effects for tax revenue and social security contributions, improves the deficit prospects of the central government and Social Security.

In contrast, in view of dynamic spending by the regional governments, we are now forecasting a deficit in that sub-sector of 0.1pp.

Another factor to consider is the **upward revision to our forecast for nominal GDP growth in 2024 to 5.5%**, thanks to the positive surprise in external demand, mainly via tourist services, which led the Spanish economy to grow by more than expected in the first quarter. This revision improves the deficit forecast for the central government by 0.2pp (from 2.9% to 2.7% of GDP) and the deficit forecast for the Social Security by 0.05pp, thanks to the positive impact of the additional economic growth on the job market.

However, in light of the current spending dynamics at the regional government level during the first four months of the year, we are revising our forecast for this sub-sector, now assigning it a deficit **0.1pp of GDP**. As a result (leaving our forecasts for local government unchanged in light of their controlled spending and the positive impact of upcoming system transfers) we are setting our new **deficit forecast at 3.1% of GDP**.

Table 2. Public deficit forecasts. % of GDP

	2022	2023	2024		
			Afi	AIReF	Govern.
Central	-3.1	-2.1	-2.7	-2.6	-3.0
Regional	-1.1	-0.9	-0.1	-0.2	0.0
Local	-0.1	-0.1	0.1	0.1	0.2
SS	-0.4	-0.6	-0.4	-0.3	-0.2
TOTAL	-4.7	-3.7	-3.1	-3.0	-3.0

Source: IGAE