The 2023-2026 Stability Programme: reduction of Spain's budget deficit through economic growth

Economic growth, key to the deficit reduction

The 2023-2026 Stability Programme presented by the government proposes a gradual reduction of the budget deficit, driven by the recovery of the Spanish economy, bringing it down from 4.8% of GDP in 2022 to 3.9% in 2023 and to 2.5% by 2026.[1] In contrast, AIReF estimates that by 2026 the public deficit will be 3.0% of GDP, mainly due to a less optimistic revenue forecast.[2]

The macro table on which the Stability Plan is based is similar to that of the consensus of analysts and has been reviewed by AIReF. The forecasts reflect cumulative GDP growth of 8.2% between 2023 and 2026, with investment playing a key role in 2024 due to the NGEU programme.[3] This assumes that inflation will fall to 2% in 2025 and that the labour market will remain buoyant, with an unemployment rate below 10.0% in 2026 and an average year-on-year growth of the population in employment of 2.1% in 2023-2026 (creation of 1.1 million full-time equivalent jobs by 2026).

If we analyse the expected evolution of the public accounts in some detail, on the revenues side the Programme takes into account the measures approved in the 2023 budget (the increase in the income tax rate for capital incomes, the tax on banks and the energy sector, the solidarity tax on large fortunes in 2023-2024, etc.), as well as the increase in social security contributions foreseen in the pension reform. Thus, revenues as a percentage of GDP are expected to increase to 43.4% of GDP in 2023 (43.0% in 2022) and this will continue to increase over the coming years, driven by growth in direct taxes and social security contributions above nominal GDP. In the case of direct taxes, this reflects the buoyancy of collections due to the anticipated strength of the labour market as well as the assumption that there will be a consolidation of post-pandemic structural factors, such as the materialisation of the submerged economy following the labour reform, a reduced level of tax fraud and the rise in e-commerce. As for social security contributions, the forecasts capture the buoyancy of the labour market and the increase in contributions under the pension reform. Thus, fiscal pressure is expected to increase in the coming years, despite the fact that the Programme does not contemplate any rise in tax rates.

1. This is based on a scenario that contemplates the impact of the measures approved to date.
2. In 2026, AIReF's forecast for revenues as a percentage of GDP is 0.6 pps lower than in the Stability Programme. In contrast, its forecast for public expenditure as a percentage of GDP is very similar.
3. Investment is expected to grow by 5.0% year-on-year in 2024 (0.9% in 2023).

Spain: macro scenario per the Stability Programme

	2022	2023	2024	2025	2026
Real GDP (% growth)	5.5	2.1	2.4	1.8	1.7
Nominal GDP (% growth)	10	6.1	5.9	3.9	3.6
Unemployment rate (% annual average)	12.9	12.2	10.9	10.3	9.8
Remuneration per employee (% growth)	2	4.7	3.3	2.4	1.7
Private consumption deflator (%)	6.8	3.9	3.2	2	1.9
3-month Euribor	0.3	3.3	3	2.5	–
Natural gas price (€/MWh)	100	59	50	50	50
Yield on 10-year Spanish bond	2.2	3.5	3.6	3.8	–

Source: *2023-2026 Stability Programme, Spanish government.*

Spain: government 2023-2026 Stability Programme

Key elements	% of GDP 2022	% of GDP 2023	% of GDP 2024	% of GDP 2026
Government revenues	**43.0**	**43.4**	**43.3**	**43.8**
Indirect taxes (VAT, etc.)	12.1	11.9	12.0	11.8
Direct taxes	12.4	13.2	13.5	14.3
Capital taxes	0.4	0.4	0.3	0.3
Social security contributions	13.6	13.9	14.0	14.0
Other revenues *	4.6	4.0	3.5	3.4
Government expenditure	**47.8**	**47.3**	**46.3**	**46.3**
Wage earners' remuneration	11.6	11.3	11.2	11.2
Social benefits (not in kind)	17.2	17.7	17.6	17.7
Gross capital formation	2.8	2.7	2.6	2.4
Interest expense	2.4	2.4	2.6	2.9
Subsidies	2.0	1.8	1.3	1.4
Government balance	**–4.8**	**–3.9**	**–3.0**	**–2.5**
Primary balance	**–2.4**	**–1.5**	**–0.4**	**0.4**
Cyclical balance	**–1.0**	**–0.5**	**–0.1**	**0.1**
Structural balance	**–3.6**	**–3.4**	**–2.9**	**–2.5**

Note: ** Includes revenues from property income and transfers of European funds excluding NGEU.*
Source: *2023-2026 Stability Programme, Spanish government.*

Public expenditure would gradually decline as a percentage of GDP due to the large increase in nominal GDP and a certain containment of non-pension and interest expenditure. Thus, primary public expenditure (i.e. excluding interest payments) would go from 45.4% of GDP in 2022 to 43.4% in 2026. Of particular note is the reduction (as a percentage of GDP) of wage earners' remuneration, which would fall from 11.6% in 2022 to 11.2% in 2026, as well as that of subsidies, from 2.0% in

2022 (very high due to the 20-cent-per-litre fuel discount, now withdrawn in 2023) to 1.4% in 2026. In contrast, pension expenditure, which is linked to inflation by law, is expected to grow faster than nominal GDP in 2023 and at a similar rate to GDP in 2024-2026.

As for interest charges – a key variable for debt sustainability – the Stability Programme projects that it will increase moderately, bringing it to 2.9% of GDP in 2026 (2.4% in 2022), since nominal GDP growth and the long average maturity of Spanish debt will limit the increase. That said, this figure is very similar to the 2012 level of 3.0%. These figures are based on the assumption that the yield on the Spanish 10-year bond will stand at 3.5% to 4.0% between 2023 and 2025, reflecting the rise in interest rates currently taking place. However, according to a sensitivity exercise performed within the Programme itself, with an additional 120-bp rate rise relative to the baseline scenario, the interest bill would reach 3.6% of GDP in 2026 and the budget deficit would stand at 3.6% of GDP[4] (as opposed to 2.5% in the baseline scenario).

On the other hand, public debt would gradually reduce as a percentage of GDP, but would remain high. This would go from 113.2% of GDP in 2022 to 106.8% in 2026. The bulk of this reduction is driven by nominal GDP growth.[5]

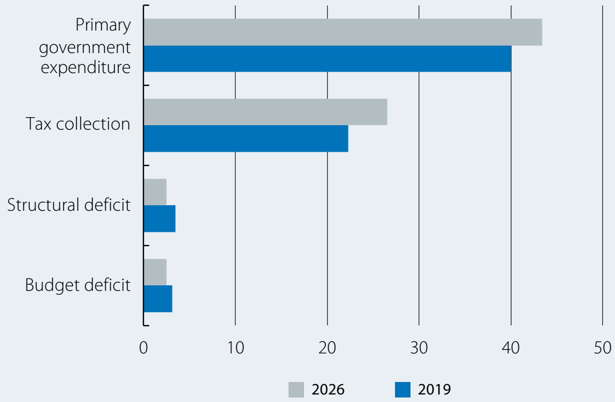
Finally, the structural deficit would follow a gradual decline. Specifically, it would go from 3.6% of GDP in 2022 to 2.5% in 2026, which is still a high figure. This decrease would be the result of the more prominent role in the economy of tax revenues and social security contributions, as well as the withdrawal beginning in 2024 of the spending measures introduced following the outbreak of the war in Ukraine.

The public accounts of the future: a comparison of 2026 with the pre-pandemic world

One particularly revealing exercise is to compare the state of the public accounts in 2026, as projected by the government in its Stability Programme, with that of the pre-COVID world. Two key results stand out from this comparison.

(i) In 2026, the relative weight of the public sector in the economy will be considerably higher than in 2019; in particular, primary public expenditure (excluding interest payments) will be 3.4 pp higher as a percentage

Spain: comparison of the public accounts in 2026 and 2019
(% of GDP)



Source: *CaixaBank Research, based on data from the 2023-2026 and 2021-2024 Stability Programmes.*

of GDP, which represents a 40.6% increase in expenditure between 2019 and 2026 (exceeding the 28.9% growth of nominal GDP). This suggests that public expenditure will experience a structural leap due to factors such as the indexation of pensions to inflation and the sustained increase in health expenditure.[6]

(ii) The government projects that the increase in tax revenues, following the significant growth of collections in 2021-2022, will be consolidated and will even continue without the need for new tax measures. Specifically, according to the Stability Programme, tax revenues will be 5.2 pps higher in 2026 as a percentage of GDP than they were in 2019, representing a 47.9% increase in tax revenues (exceeding the 28.9% growth of nominal GDP). In short, the Stability Programme anticipates that the strength of the economy over the coming years will facilitate the reduction of the budget deficit. However, a deficit of 2.5% of GDP clearly cannot be the end point and further deficit reduction will be necessary in order to recover fiscal policy's margin to react. There is no doubt that, one day, we will need to use it again.

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4. The budget deficit would increase mechanically as a result of higher interest payments and also because this increase in rates would have a negative impact on GDP growth, which in turn would lead to lower tax revenues and an increase in benefits to cushion the shock.
5. In cumulative terms, the Programme considers nominal GDP growth of 20.9% between 2023 and 2026.

6. It appears that social benefits, which predominantly comprise pension expenditure, have increased permanently and will be 1.9 pps higher as a percentage of GDP in 2026 than prior to the pandemic.