

Lower budget deficit in 2025 in Spain, but the structural challenges persist

Reduction of the budget deficit in 2025

On 1 May, the government published and submitted to the regional authorities the *2025 Annual Progress Report*, as part of its commitments under the new fiscal rules regarding the tracking of the 2025-2028 fiscal and structural plan (which was extended up until 2031) published last autumn. The report, which replaces the old Stability Plan, sets out the macro-economic tables through to 2028 as well as budgetary projections for 2025.

One of the report's key messages is the improvement in the general government balance this year. It is estimated that the deficit will fall from 3.2% of GDP in 2024 to 2.8% in 2025, which aligns with CaixaBank Research's forecast of last February. This figure includes the impact of the expenditure associated with the floods in the province of Valencia, which is estimated at 0.3 pps of GDP in 2025, slightly less than in 2024. Excluding these exceptional expenses, the deficit would stand at 2.5% this year. The deficit reduction is largely explained by three key factors: higher revenues as a result of the complete reversal of the VAT cuts on electricity, gas and food, as well as due to the introduction of new regulatory measures; the stabilisation of government expenditure as a percentage of GDP, and macroeconomic developments that remain favourable.

In the macroeconomic sphere, the government forecasts buoyant growth for the Spanish economy, reaching 2.6% in 2025 and 2.2% in 2026 (see first table). These are the same forecasts as those envisaged by the government in February, albeit with some nuances: in 2025, it incorporates a small negative impact of 0.1 pp of GDP derived from the tariffs, which impacts exports in particular¹ and is offset by more buoyant private consumption (the growth forecast for this item has improved from 2.8% to 3.2%). In its analysis,² AIReF judges the 2.6% forecast to be somewhat optimistic, considering that stronger domestic demand is unlikely to be enough to offset the intensity of the external shocks linked to the high uncertainty and new tariffs.

Government revenues (excluding transfers from the EU, which are deficit-neutral as they are also reflected under expenditure) are expected to grow by 6.3% year-on-year, exceeding nominal GDP growth (predicted to be 5.3%). Consequently, as a percentage of GDP they are expected to increase from 40.9% in 2024 to 41.3% in 2025. This buoyancy in revenues is explained by strong economic growth that will boost tax collections and social security contributions, as well as several fiscal measures that will provide additional revenues relative to 2024 amounting to 0.6% of GDP. Of these 0.6 pps, half will come from the complete reversal in January 2025 of the VAT cuts on electricity and food that were introduced in 2022 following the energy shock and which began to be reversed in 2024, as well as from the

1. They have lowered export growth from 2.3% to 1.2%. Investment has also been reduced, but only very slightly, from 4.5% to 4.3%.

2. See AIReF. «Report on Monitoring of 2025-2028 Medium-Term Structural Fiscal Plan», Report 23/25, 14 May 2025.

Spain: macro forecast scenario per the Annual Progress Report

	2024	2025 (f)	2026 (f)
Real GDP (% growth)	3.2	2.6	2.2
Nominal GDP (% growth)	6.2	5.3	4.6
Unemployment rate (annual average %)	11.3	10.3	9.6
Remuneration per wage earner (% growth)	5.0	3.7	2.9
Private consumption deflator (%)	4.0	2.7	2.4
Real GDP per hour (% growth)	1.2	0.5	0.6
Short-term interest rate (annual average %)	3.6	2.2	2.0
Oil price (dollars/barrel)	79.9	65.0	64.6

Note: (f) Forecasts.

Source: CaixaBank Research, based on the Spanish government's Annual Progress Report.

excise duty on electricity which returned to its usual rate in July 2024. The other 0.3 pps will be obtained through recent fiscal measures.³ On the other hand, non-fiscal income (interest, dividends, etc.) will be reduced by 0.2 pps of GDP.

In parallel, government expenditure (excluding that funded by the EU) will remain virtually stable in terms of GDP, going from 44.1% in 2024 to 44.0% in 2025. This containment is partly due to a reduction of 0.3 pps of GDP in one-off expenditure linked to commitments arising from court rulings. In 2024, one-off expenditure resulting from such rulings⁴ had an impact on the deficit of more than 8 billion euros,⁵ or 0.5% of GDP, and in 2025 the impact estimated in the report is slightly lower, at 0.2% of GDP.⁶ This reduction in one-offs, coupled with a slight decrease as a percentage of GDP in other items of expenditure (wage earners' remuneration, intermediate consumption and social benefits in kind), will more than offset the anticipated increase between 2024 and 2025 in interest expenditure and public investment financed at the national level. In particular, according to the report, interest expenditure will increase from 2.4% of GDP in 2024 to 2.7% in 2025, despite the decline in interest rates. Finally, spending on social cash transfers will grow at the same rate as nominal GDP. This item will thus remain at around 17% of GDP (the bulk is spending on public pensions, which will be around 14.0% of GDP).

3. Specifically, the introduction of a minimum rate of 15% in corporation tax applicable to multinationals in compliance with EU rules, new limitations on the offsetting of prior tax losses and deductions for large corporations in corporation tax, the rise in the maximum rate of personal income tax on capital income, increases in taxes on tobacco and the increase in social security contributions through the Intergenerational Equity Mechanism and the «solidarity contribution».

4. Includes personal income tax refunds for members of mutual insurance schemes and the cancellation of the 2016 corporation tax reform, among others.

5. In fact, the 2024 deficit includes a negative impact from court rulings of 11.27 billion euros (0.7% of GDP). However, of this amount, only a little over 8 billion (0.5% of GDP) was non-recurring expenses which, therefore, will have no impact on the deficit in subsequent years.

6. They include the ruling on the pension supplement for fathers, among others. The AIReF report states that there is significant uncertainty over what the final impact will be this year.

Moreover, although the report envisages an increase in defence and security spending from 1.4% to 2.0% of GDP, it is assured that this will have virtually no impact on the deficit in 2025, as this increase will be achieved by redirecting other budgetary items of expenditure or lending not related to defence (including 1.36 billion euros of NGEU loans), as well as through spending savings.⁷

As for public debt, its decline this year will be very limited despite the reduction in the deficit, going from 101.8% of GDP in 2024 to 101.7% in 2025. This downward resistance is due to the incorporation of the first disbursements of the loans from the Next Generation EU (NGEU) programme.⁸ It should be recalled that the NGEU loans received by Member States must be recorded as debt with the EU's institutions,⁹ but they do not count towards the deficit unless the money is spent by a public administration/corporation or there is some kind of default that the state has to assume *a posteriori*.

European fiscal rules: compliance in 2025 by a narrow margin

The report also analyses compliance with the new European fiscal rules, focusing on controlling net expenditure or computable expenditure, this being the key variable for the expenditure rule that came into effect this year.¹⁰

For 2025, the growth of this expenditure is estimated at 4.1% year-on-year, exceeding the 3.7% agreed with Brussels in the autumn. Net expenditure represents approximately 40% of GDP, so a growth that is 0.4 pps more than what was agreed would be equivalent to approximately 0.15% of GDP. This deviation is attributed to the increase in defence spending, which, for the moment, has not been excluded by activating the escape clause.¹¹

The rules allow for annual deviations in net expenditure of up to 0.3% of GDP, and up to 0.6% in the cumulative balance in the fiscal and structural plan's adjustment period, which ends in 2031. The report explains that the deviation is contained and remains within the tolerated limit given that, at 0.15% of GDP, it falls within the margin allowed by the European legislation.¹² In addition, when assessing the cumulative deviation, the Progress Report highlights that

7. The increase in defence spending is expected to amount to 10.47 billion. Of this amount, current expenditure would be around 2.26 billion (wage earners' remuneration, intermediate consumption and subsidies), with 3.68 billion corresponding to capital expenditure and 4.53 billion to loans.

8. The report estimates that the disbursements in the form of loans from the European Commission will amount to 1.4 pps of GDP in 2025. Therefore, if we exclude the NGEU loans, then the public debt would meet the European requirement of a minimum reduction of 1 pp of GDP per year on average over the fiscal plan's time horizon.

9. Bank of Spain (2022). «Los fondos Next Generation EU (NGEU): cómo se contabilizan en la Balanza de Pagos/Posición de Inversión Internacional».

10. It should be recalled that, by definition, this metric is net government expenditure on interest, discretionary measures related to revenue, expenditure on EU programmes fully offset by revenue from EU funds (such as NGEU), national expenditure on co-financing programmes funded by the Union, cyclical components of expenditure on unemployment benefits and one-off items of expenditure.

11. Countries have the option to request the escape clause so that the cumulative increase in defence spending of up to 1.5 points of GDP relative to 2021 levels does not count towards the deficit or the debt for the purposes of the fiscal rules.

12. AIReF estimates that the deviation will be somewhat greater (increase in expenditure of 4.5% year-on-year instead of 4.1%), which would mean an annual deviation of precisely 0.3% of GDP.

Spain: budget table from the Annual Progress Report

Key elements	2023 (% of GDP)	2024 (% of GDP)	2025 (f) (% of GDP)
Government revenues¹	40.6	40.9	41.3
Indirect taxes (VAT, etc.)	11.0	11.1	11.3
Direct taxes	12.2	12.5	12.8
Capital taxes	0.4	0.4	0.3
Social security contributions	13.2	13.2	13.4
Other income ²	3.8	3.7	3.5
Government expenditure¹	44.1	44.1	44.0
Wage earners' remuneration	10.9	10.8	10.7
Intermediate consumption	5.7	5.6	5.5
Social monetary benefits	16.8	16.9	16.9
Social benefits in kind	2.7	2.7	2.6
Gross capital formation financed nationally	2.3	2.2	2.4
Interest expense	2.4	2.4	2.7
Subsidies	1.4	1.2	1.1
Other expenses ³	1.9	2.3	2.1
Government balance	-3.5	-3.2	-2.8
Government balance excl. floods	-3.5	-2.8	-2.5
Structural balance	-3.4	-2.9	-2.8
Public debt	105.1	101.8	101.7

Notes: (f) Forecasts. 1. Excludes transfers from the EU. 2. Includes interest, income from corporations and others. 3. Includes capital transfers and other support for investment, which is where the expenditure arising from court rulings is reflected.

Source: CaixaBank Research, based on the Spanish government's Annual Progress Report.

in 2024 net expenditure was lower than the government's fiscal commitment of 0.4% of GDP in 2025, and this generates a sufficient buffer to absorb the projected deviation in 2025, as well as helping to correct deviations in the cumulative balance over the coming years.¹³

In terms of the structural balance, this is expected to record only a very slight decline as a percentage of GDP in 2025, unlike what is expected for the total deficit, as it excludes the improvement resulting from the business cycle¹⁴ and the reduction of one-offs. Specifically, the structural balance is expected to go from -2.9% of GDP in 2024 to -2.8% in 2025, a stabilisation that suggests a neutral fiscal policy tone.¹⁵ This is still a high structural deficit, albeit smaller than that of France (structural deficit of 5.2% of GDP in 2025 according to the European Commission's forecasts) and Italy (3.7% of GDP).

In short, the 2025 Annual Progress Report envisages the reduction of the budget deficit and compliance with the fiscal rules in 2025, albeit by a narrow margin. The credibility of the plan will depend on the ability to stay on the path agreed with the Commission over the coming years, especially in an uncertain economic environment and with structural pressures on spending stemming from the ageing of the population.

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13. Thus, the cumulative growth of net expenditure in 2024-2025 would be 8.4%, placing it below the agreed increase of 9.2%. This equates to it remaining below an amount equivalent to 0.3% of GDP in 2025. Thus, in the cumulative balance for 2024-2025 there would be, in fact, no deviation.

14. The report predicts a positive output gap of 1.3% in 2025 (1.0% in 2024).

15. The primary structural balance – which is the one examined for the fiscal rules – is expected to improve by just 0.2 pps, from -0.4% to -0.2% of GDP.