Public finances (also) in the spotlight

The complex global economic scenario could see a new source of concern soon added to the mix: the health of public finances. This time the trigger would not be an emerging or southern European country. The new US administration has approved a fiscal plan which, according to initial estimates, would keep the US budget deficit at very high levels in the coming years, at around 7% of GDP, and could put public debt on a concerning upward trajectory; in the next five years, it could increase by 15 pps, to 130% GDP. Added to this is the deterioration of the growth outlook for the world's leading economy, as a result of the economic policy being pursued. Since November 2024, the growth forecast for this year has declined by more than 0.5 pps and the medium-term growth outlook is also deteriorating.

The experience of recent years tells us that confidence in the sustainability of public finances can quickly evaporate. This was the case recently in the United Kingdom, when Liz Truss announced a fiscal plan with sweeping tax cuts that cast doubt over the British public finances. More than 10 years ago, during the global financial crisis, the rise in risk premiums of the so-called PIIGS countries was also sudden and pronounced. Moreover, it is important to consider that during such episodes investors' risk aversion increases, so the tightening of financial conditions tends to be widespread, without properly differentiating between the particular situation of each economy. This requires us to redouble our efforts when the winds are blowing in our favour.

In this context, Spain's public debt stands at slightly over 100% of GDP, which is higher than the level of most developed economies (75% have a lower level), although below that of large economies such as France, Italy, the United States and Japan. Spain's public debt recorded one of the biggest increases during the pandemic (22 pps between 2019 and 2020), but following the reduction of recent years it is now close to 2019 levels, standing just 4 pps higher.

The two key levers in order for public debt to continue to fall are the general government deficit and economic growth. The government deficit closed 2024 at 3.2% of GDP, which is well below that of the US, France and the United Kingdom (7.3%, 5.8% and 5.7%, respectively) and opens the door for the country's debt to decline, albeit gradually and provided that growth remains dynamic. In this regard, it should be noted that the growth rate of Spain's GDP to date has stood out among developed economies, with around 90% of them recording lower growth in 2024, and moreover it has been widespread across the various sectors of the economy. According to the CaixaBank Research Sectoral Indicator, more than 50% of sectors currently have a higher growth rate than their historical average, and no sector is growing at less than 1%. The strength of the Spanish economy is especially relevant in the current context. All this has helped to maintain the risk premium on Spanish public debt on a downward trajectory and to allow it to fall below that of France and Italy.

In order to further bolster this position, the government deficit will need to continue to shrink in the coming years and economic growth should remain relatively dynamic. In this regard, it is key that improvements are achieved in the economy's productivity growth relative to the figures of the last decade. Between 2014 and 2024, GDP growth per hour worked grew by just 0.5% per year on average. However, the latest figures are encouraging. Between 2022 and 2024, productivity growth has doubled, reaching an average of 1.0% per year.

As for the government deficit, in the short term it is expected to continue to decline, thanks to the continued strong growth rate anticipated in economic activity. In the medium term, however, pressure on public spending will increase, due to higher spending on defence, health and social benefits, making this reduction difficult. In this regard, public revenues in Spain are close to the median for developed countries. On the other hand, it is also observed that practically all developed countries with a higher GDP per capita than Spain have more efficient public sectors, according to the World Bank indicator that measures the quality of public services and the effectiveness of public policies. In this sphere, which is crucial for boosting economic progress and reducing inequality, there is significant scope for improvement.

Oriol Aspachs
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