



# The Kingdom of Spain's Funding Programme and Economic Policy Strategy

April 2014

# The Treasury's Funding Programme for 2014

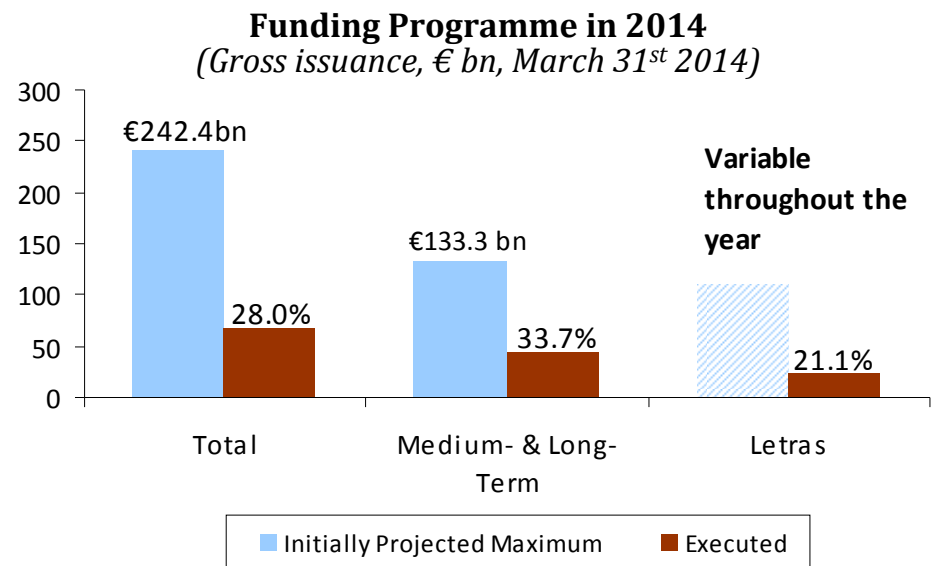
- ▶ Lower net issuance in line with fiscal consolidation path, but larger gross issuance than in 2013 due to bond redemptions. Net funding to be obtained fully through medium- and long-term issuance. Projected zero net issuance of Letras
- ▶ Up to March 31<sup>st</sup> the Spanish Treasury has funded €44.9 bn of the maximum expected amount of medium- and long-term gross issuance. This represents 33.7% of the total (€133.3 bn)
- ▶ Including Letras, the Spanish Treasury has issued €68.0 bn so far in 2014

| <i>(billion euros, in effective terms)</i> |              |
|--|--------------|
| <b>Total Net Issuance</b>                  | <b>65.0</b>  |
| <b>Total Gross Issuance</b>                | <b>242.4</b> |
| <b>Medium- and Long-Term</b>               |              |
| Gross Issuance <sup>1</sup>                | 133.3        |
| Net Issuance <sup>1</sup>                  | 65.0         |
| <b>Letras del Tesoro</b>                   |              |
| Forecast Gross Issuance <sup>2</sup>       | 109.1        |
| Net Issuance                               | 0.0          |

1 Includes debt in other currencies, Bonos & Obligaciones, and assumed debts

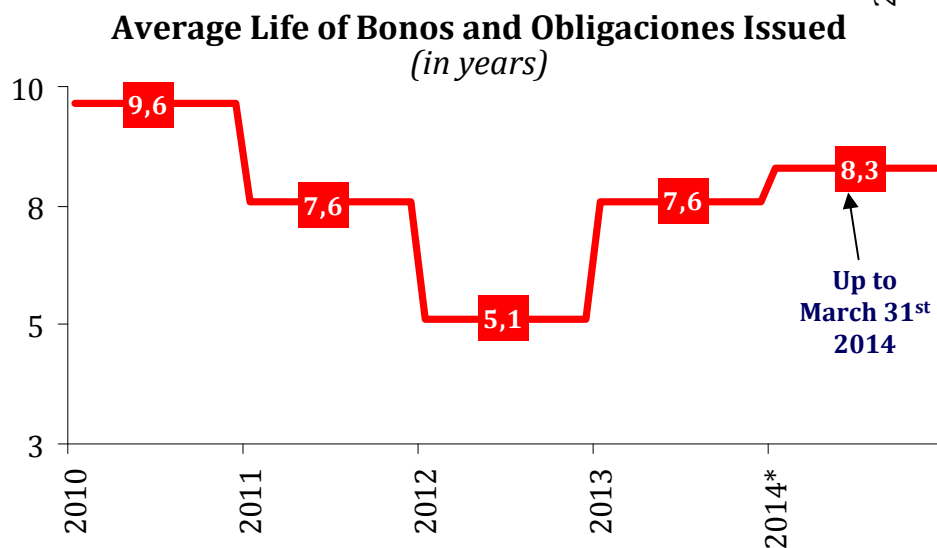
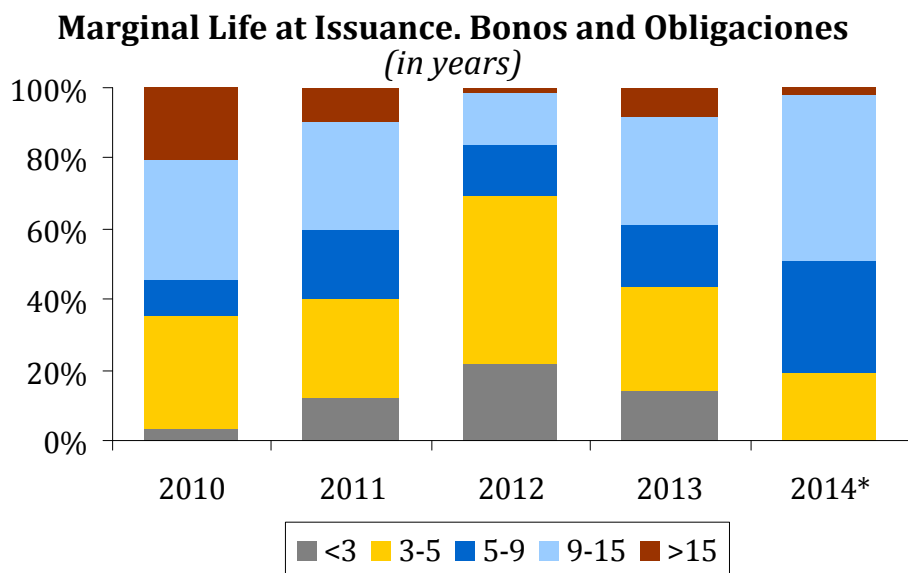
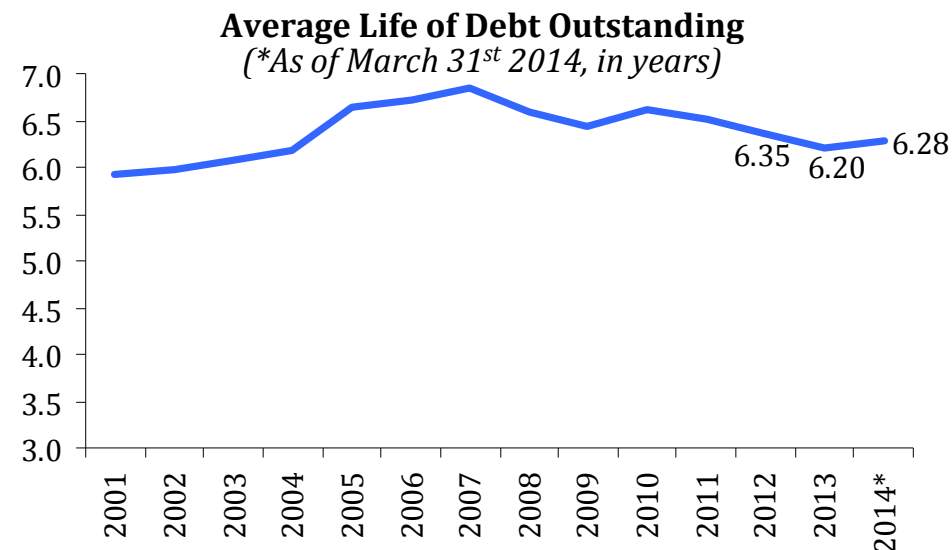
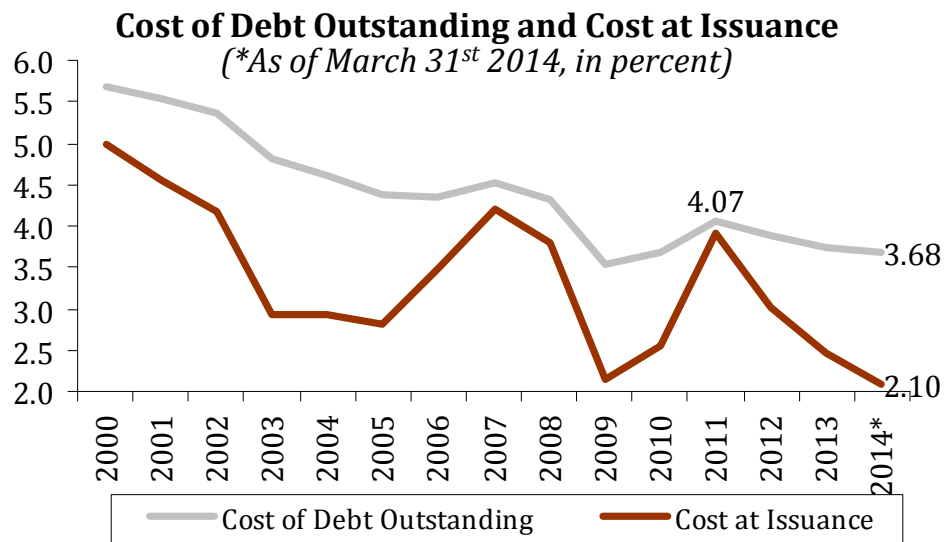
2 Redemptions of Letras, and therefore also gross issuance, will depend on the Letras issuance strategy in 2014

Source: [Secretaría General del Tesoro y Política Financiera](#).



Source: [Secretaría General del Tesoro y Política Financiera](#).

# Average cost and life of debt outstanding



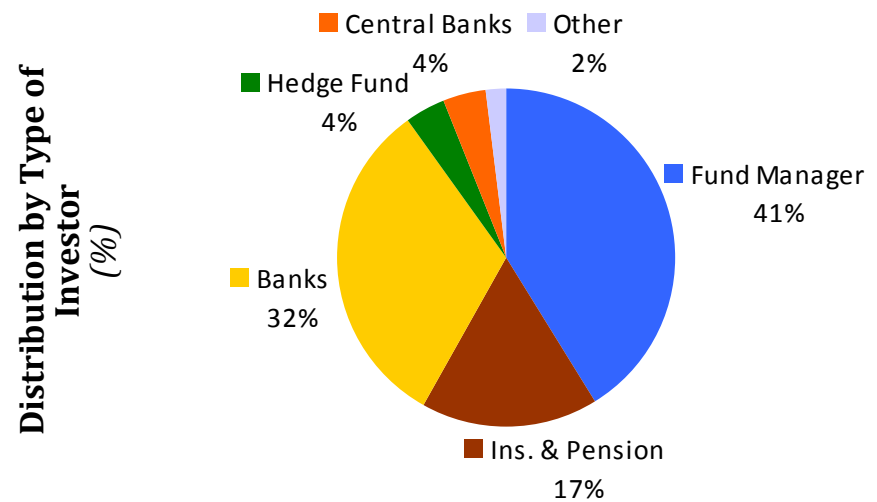
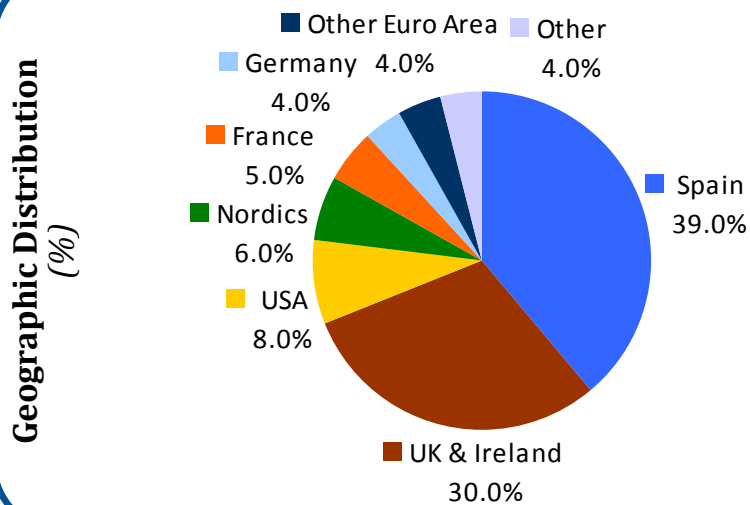
\*As of March 31<sup>st</sup> 2014, in years

\*As of March 31<sup>st</sup> 2014, in years

## Syndicated issuance: January 2014, new 10-year reference

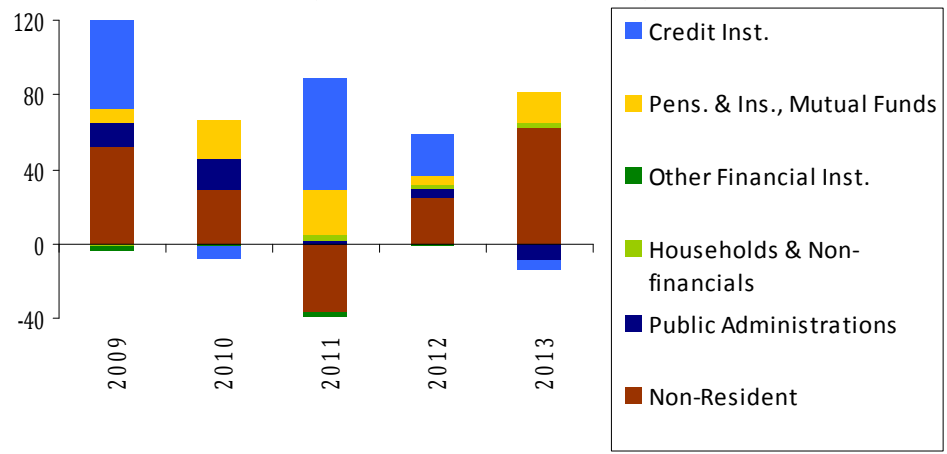
- ▶ On January 22<sup>nd</sup> 2014, the Spanish Treasury launched a 10-year bond (3.80%, April 2024)
- ▶ The orderbook saw demand in excess of €39.6 bn from over 450 accounts. In response to its focus on quality of distribution the final amount issued was €10 bn
- ▶ Pricing was set at 4:05pm CET at mid-swaps+178bps, equivalent to a reoffer yield of 3.845%
- ▶ The issue saw strong international participation (61%), with good interest from UK and Ireland who accounted for 30% of the orderbook. The US represented 8% of the transaction, whilst there was also granular distribution across Europe

JANUARY - NEW 10 YEAR REFERENCE. APRIL 2024



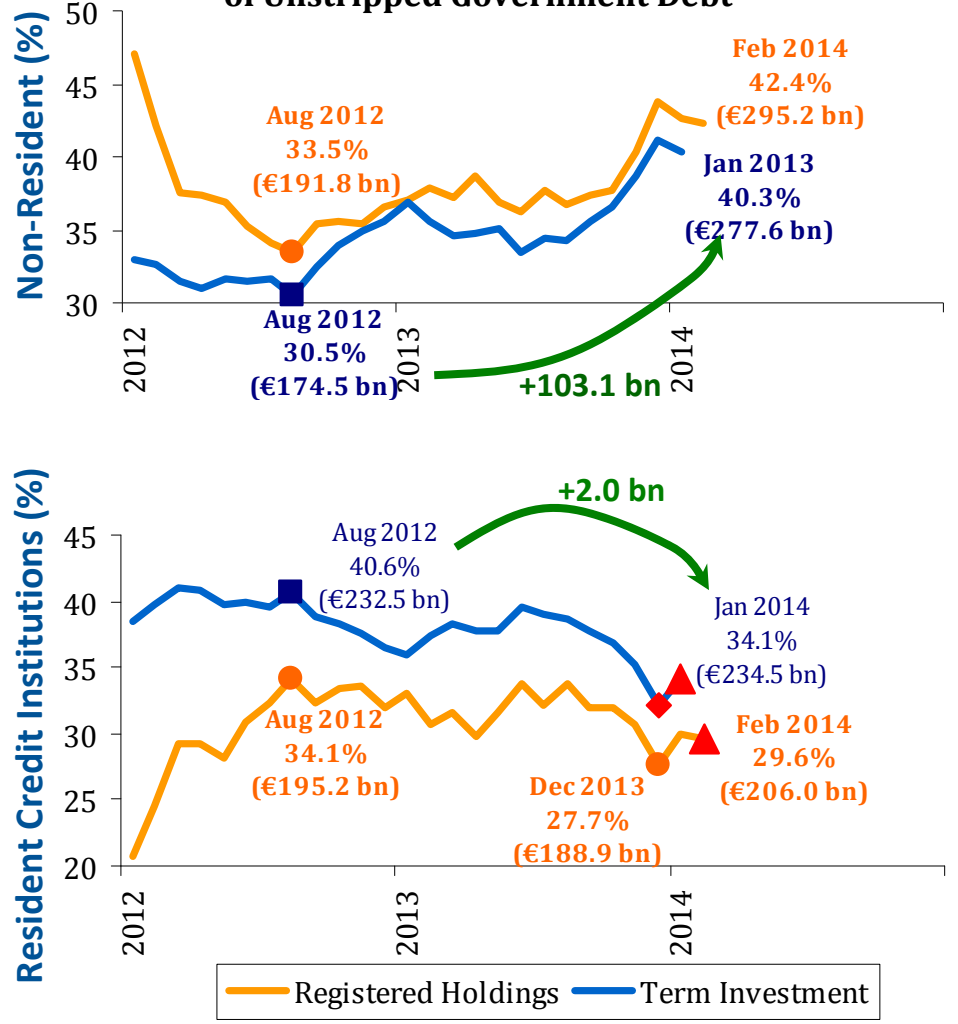
# Recent trends in investor base

**Change in Term Investment by Investor Type**  
(Term Investment. € bn)



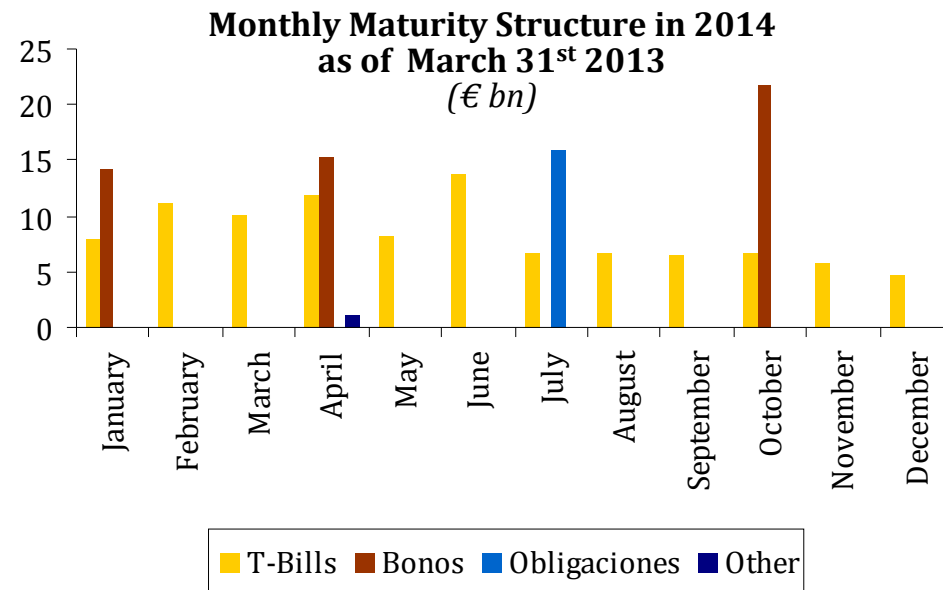
Source: *Secretaría General del Tesoro y Política Financiera.*  
\* Term Investment: as of December 2013

**Holdings of Unstripped Government Debt**

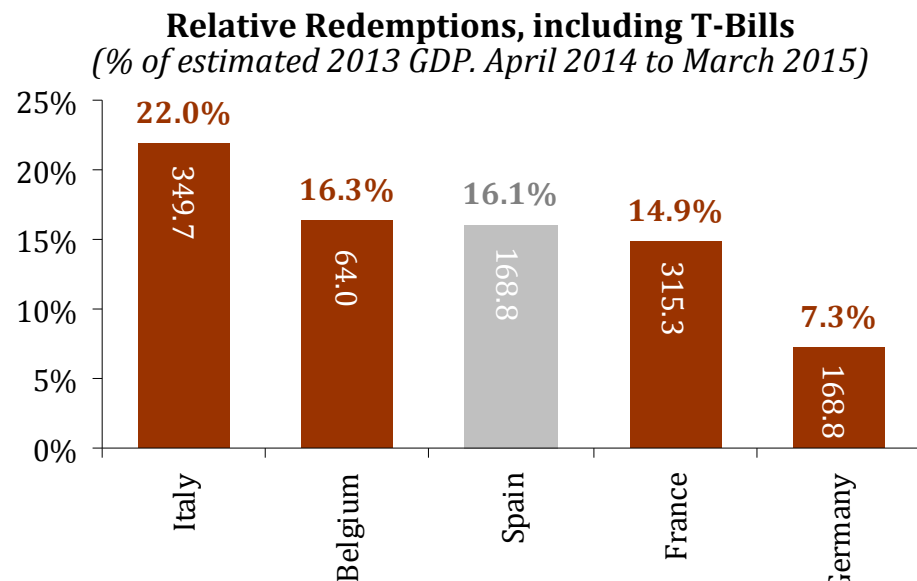


# Prudent debt management

- ▶ Redemption dates of medium- and long-term bonds (mainly January, April, July and October) are accommodated to match the dates of biggest inflows of tax revenues
- ▶ Excess liquidity is lent in the money market each month through weekly, bi-monthly and monthly repo auctions

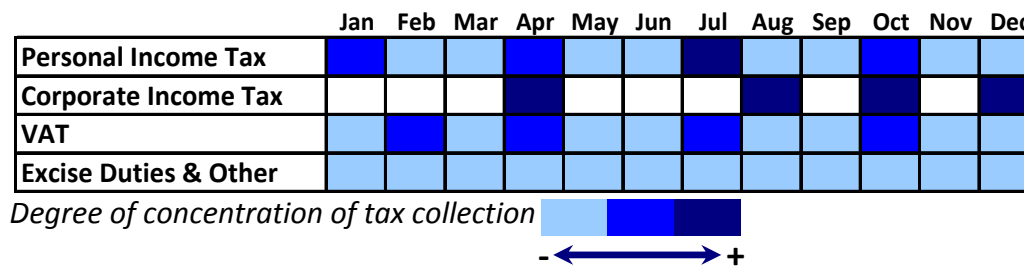


Source: *Secretaría General del Tesoro y Política Financiera*.



Source: *Secretaría General del Tesoro y Política Financiera* for Spain, February 28th data for Italy, and Bloomberg for other countries.

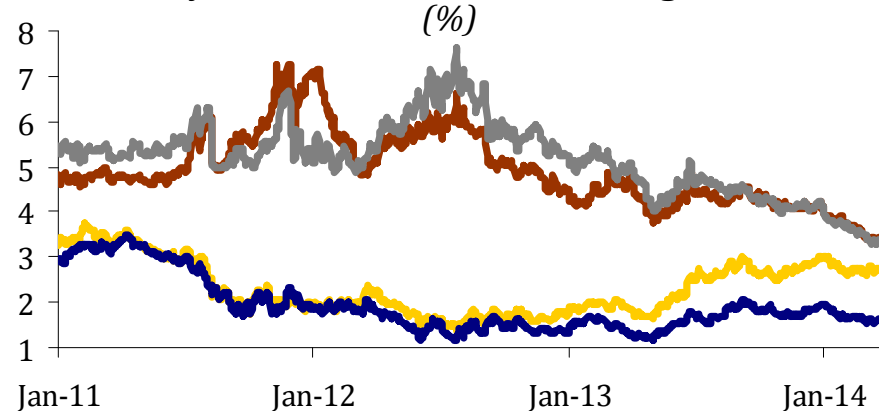
### Administrative Distribution of Tax Collection



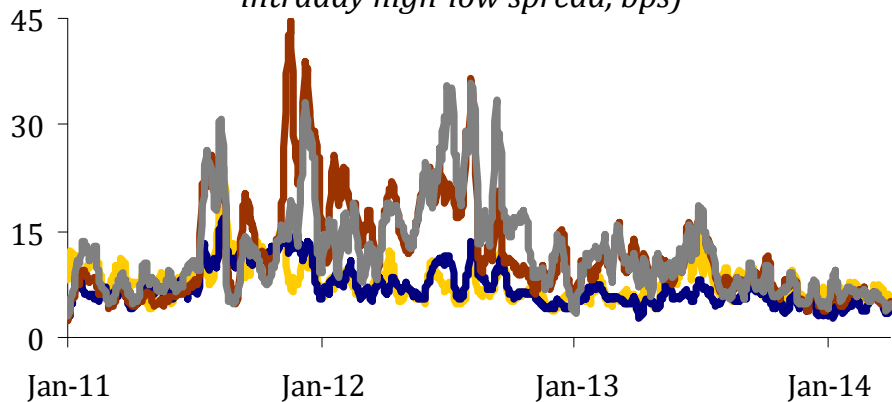
# Interest rate volatility has diminished

- ▶ Significant tightening in sovereign spreads
- ▶ Rates have stabilised for longer periods, enabling more efficient investment decisions by market agents

Generic 10-year Government Bond Average Yield Levels (%)



Intraday Yield Range, 10-Day Rolling Average (Generic 10-year Government Bond yields intraday high-low spread, bps)

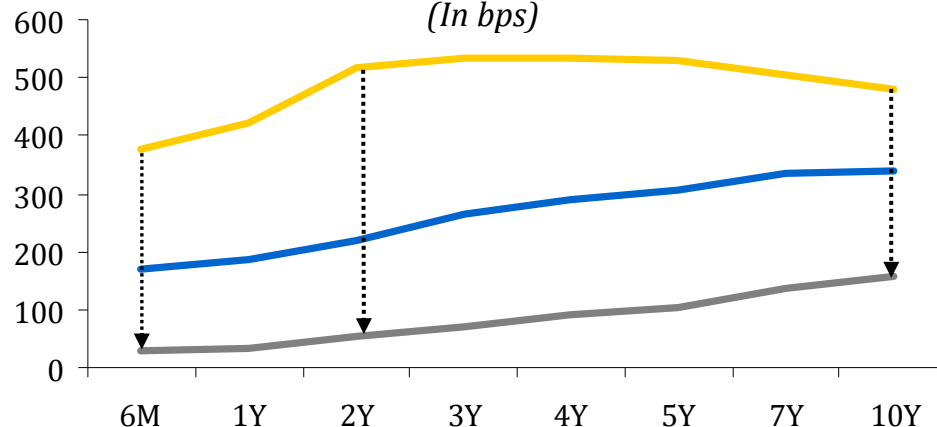


US Germany Italy Spain

Source: Bloomberg.

Source: Bloomberg.

Spain CDS Curves (In bps)

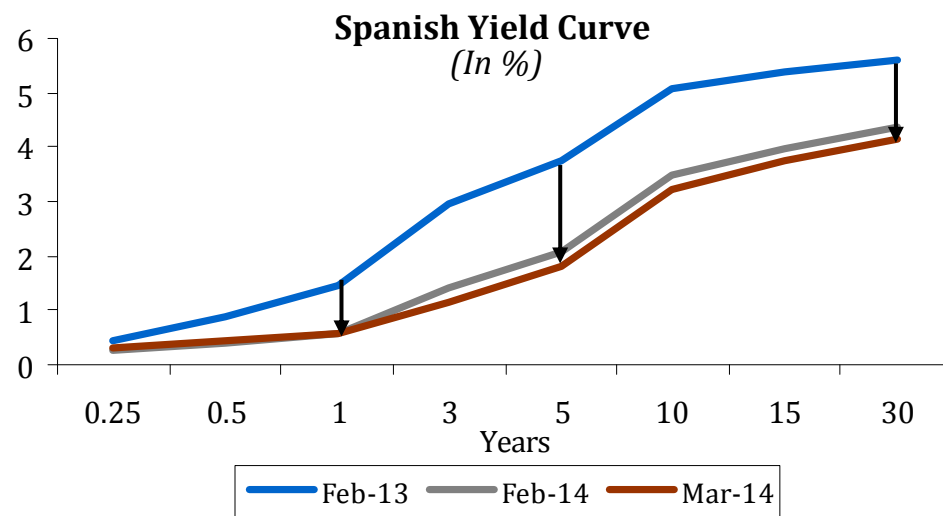


Jul-12 Mar-13 Mar-14

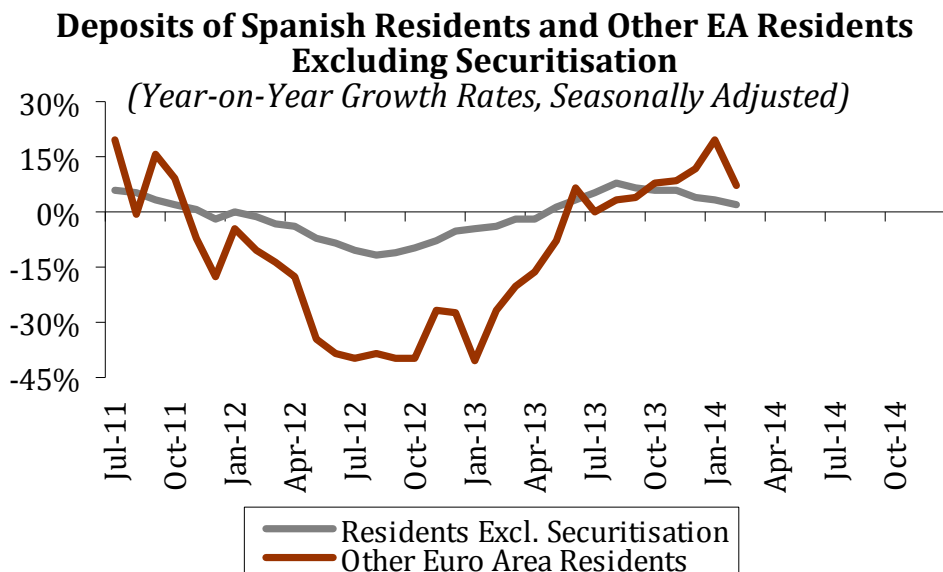
Source: Bloomberg.

## Market sentiment is improving...

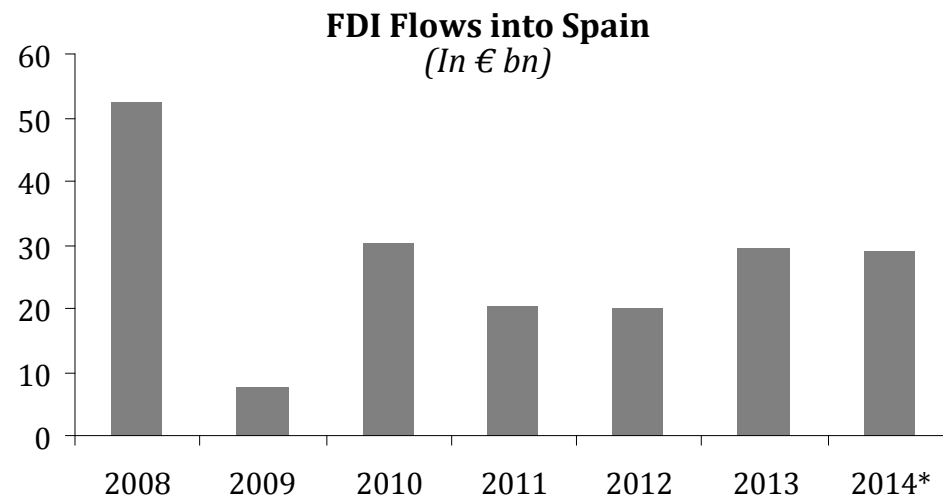
- ▶ Improved market confidence visible in the debt market since summer 2012
- ▶ Reform effort is beginning to show results, key variables moving in the right direction
- ▶ Still much to be done. No room for complacency in Spain or in Europe



Source: Bloomberg.



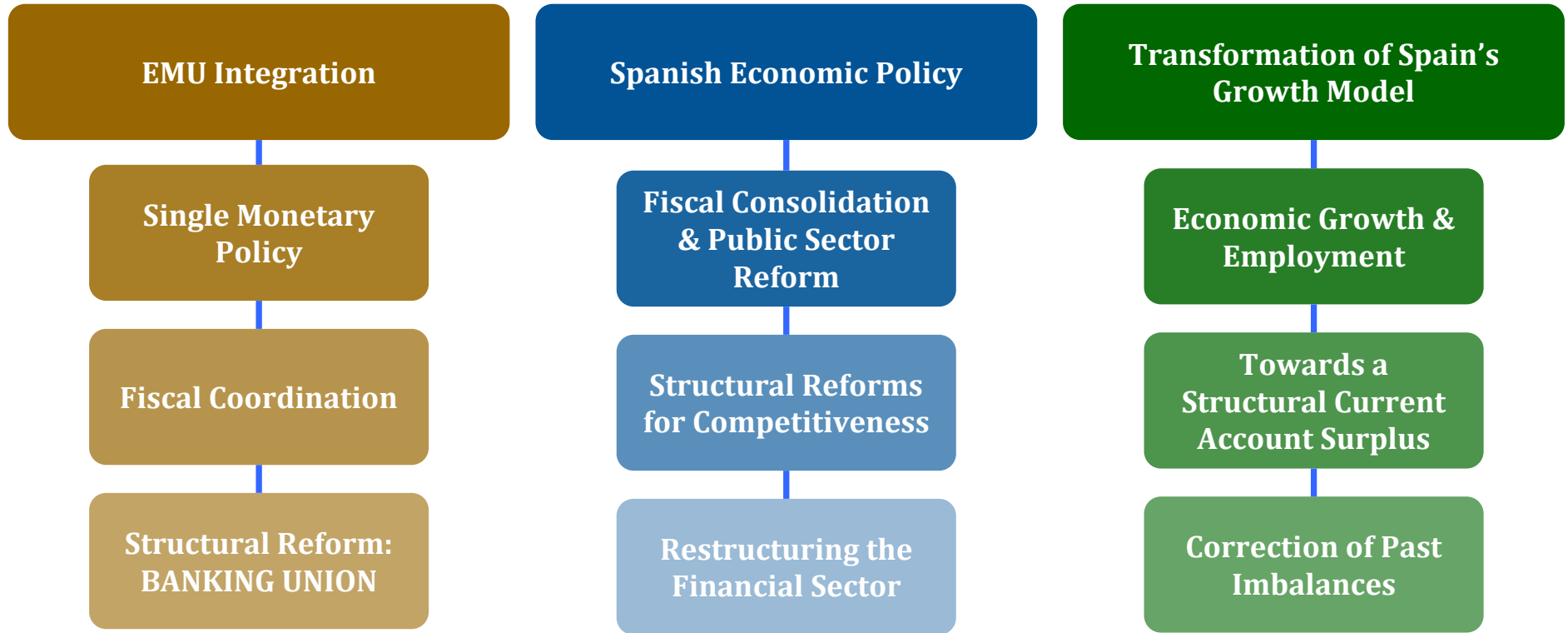
Source: Bank of Spain.



Source: Bank of Spain.

\* 2014: last 12 months, February 2013 to January 2014

... but there is no room for complacency: progress depends on several factors



Progress in each of these areas is necessary for improvement to continue

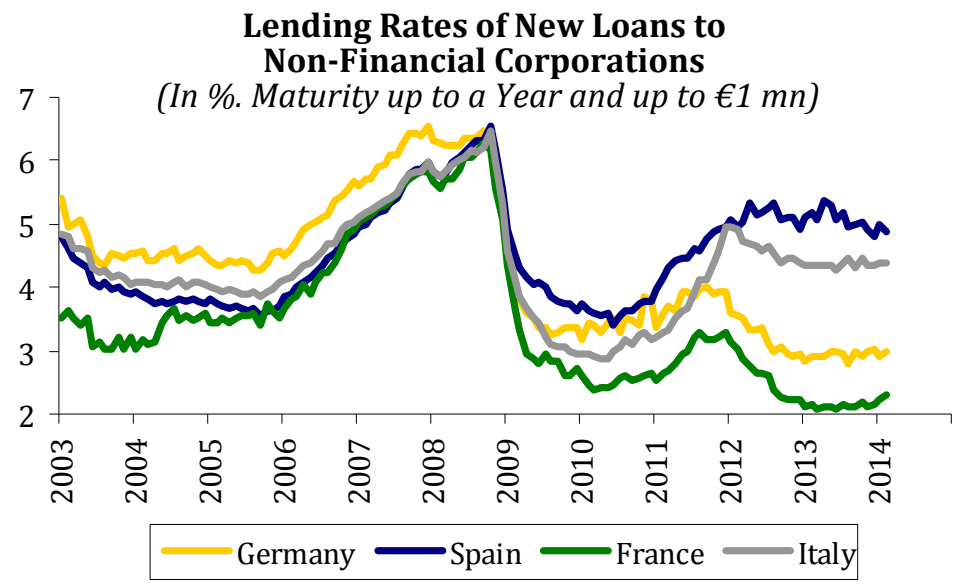
1. Closer EMU Integration

2. Spanish Economic Policy

3. Transformation of Spain's Growth Model

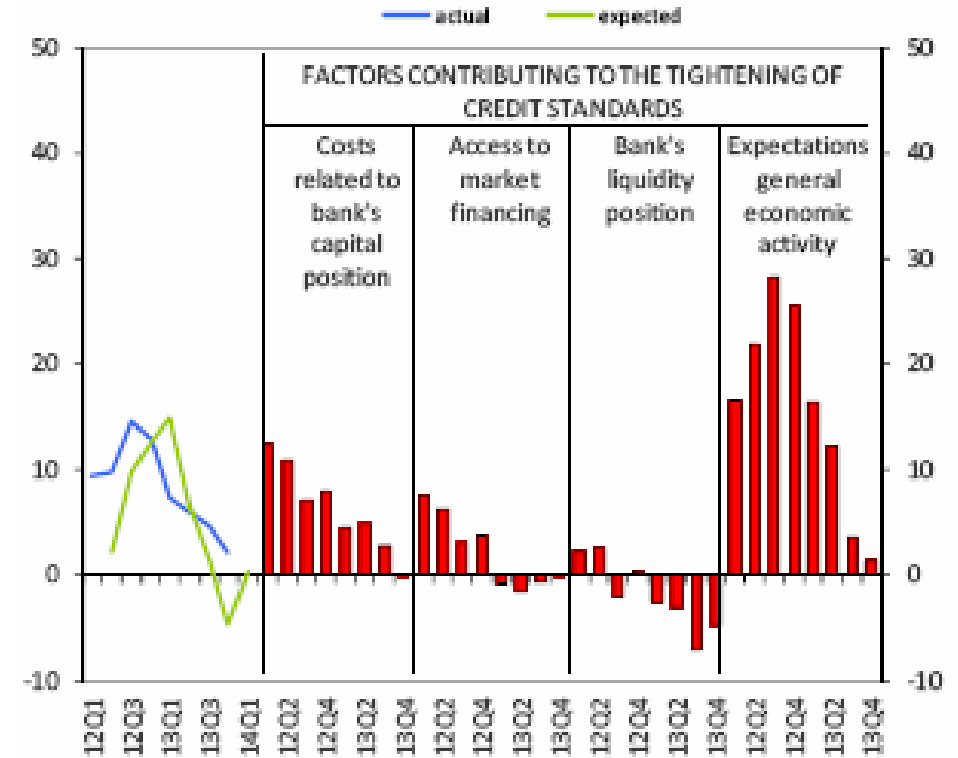
# A credible commitment towards a robust and complete Monetary Union

► Despite the advances in Euro Area institutional set-up, fragmentation and unbalanced access to credit persist, generating asymmetries in the Monetary Policy Transmission Mechanism



Source: [European Central Bank](#).

**Changes in Credit Standards Applied to the Approval of Loans or Credit Lines to Enterprises**  
(Net Percentages of Banks Contributing to Tightening Credit Standards)



Source: [European Central Bank](#).

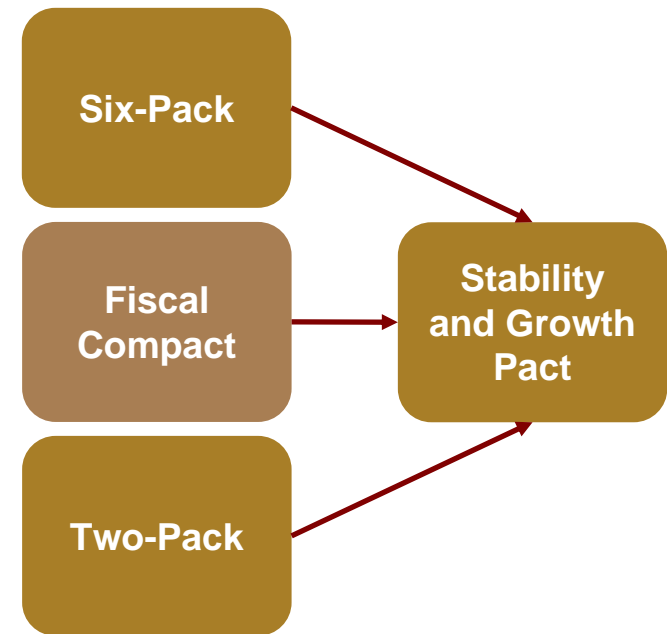
# Economic and budgetary coordination in the EU and the Euro Area

- ▶ Increasing economic, financial and budgetary coordination among EA Member States will produce a sounder growth model
- ▶ The Two-Pack has introduced a system of monitoring that reinforces the requirements set out under the Stability and Growth Pact and in the Six-Pack for EA Member States
  - ❑ Stronger preventive and corrective action through a reinforced Stability and Growth Pact and deeper fiscal coordination
  - ❑ Stronger budgetary coordination and surveillance, starting with the 2014 budgetary cycle
  - ❑ Preventing and correcting financial instability

|                    | Euro Area |      |      | US    |       |       | UK   |      |      |
|--------------------|-----------|------|------|-------|-------|-------|------|------|------|
|                    | 2013      | 2014 | 2015 | 2013  | 2014  | 2015  | 2013 | 2014 | 2015 |
| GDP (% yoy change) | -0.4      | 1.0  | 1.4  | 1.9   | 2.8   | 3.0   | 1.7  | 2.4  | 2.2  |
| Deficit (% of GDP) | -3.1      | -2.5 | -2.1 | -5.8  | -4.7  | -3.9  | -6.1 | -5.8 | -4.9 |
| Debt/GDP (%)       | 95.7      | 96.1 | 95.3 | 106.0 | 107.3 | 107.0 | 92.1 | 95.3 | 97.9 |
| CA balance (% GDP) | 2.3       | 2.5  | 2.6  | -2.7  | -2.8  | -2.9  | -2.8 | -2.3 | -1.9 |

Source: *IME*.

GDP data refer to *WEO Update, January 2014*. Rest of data refer to the *WEO October 2013*



## A credible commitment towards a robust and complete Monetary Union

- ▶ Banking Union will imply a level playing-field for financial institutions
- ▶ Clearly defined calendar towards Banking Union around:
  - Single Supervisory Mechanism
  - Approval of a uniform solvency regulation (CRD-IV)
  - Definition of a Single Supervisor
  - Single Resolution Mechanism
    - ✓ Approval of the Single Resolution Directive
    - ✓ Single Resolution Fund
- ▶ Result: breaking the link between the financial sector and the sovereign

**1. Closer EMU Integration**

**2. Spanish Economic Policy**

**3. Transformation of Spain's Growth Model**

# Reforms for competitiveness: the reform process continues in 2014

## 2012: First Generation Reforms

Labour Market

Budgetary Framework

Financial Sector

## 2013: Second Generation Reforms

Evaluation Labour Reform

Budgetary Plan 2013-2014

Services/Product Markets

Pension System

Single Market Law

Local Administrations

Financial Sector Programme

## 2014: Third Generation Reforms

Job Activation Strategy and Plan for Youth Employment

Sector-based Reforms in Competitiveness: Energy and Transport Sectors

Independent Fiscal Authority and Economic & Financial Information Hub for the Government

Reform of the Tax System

Review of the System for Regional Financing

Further Reform of the Public Administrations Local Reform and CORA Measures

De-indexing the Spanish Economy

New Legal Framework for Bank Finance and Alternative Funding Sources

ICO Mediation Credit Facilities and Strategic Plan for Exporters

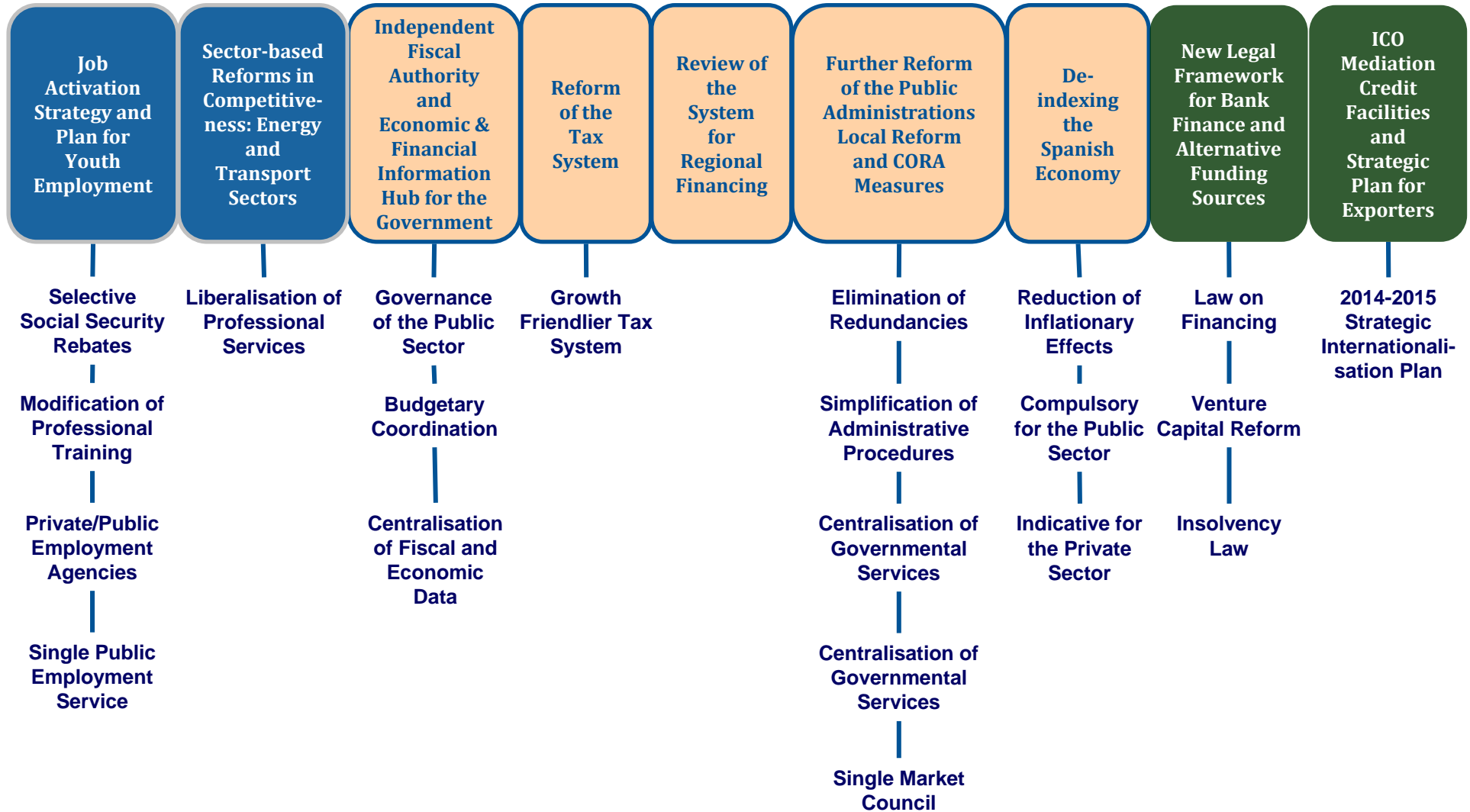
- Economic Structural Reforms
- Public Sector Reforms
- Financial Sector Reforms

Links to detailed presentations describing the Reform Agenda

[Reform of the Administrations 2013](#)  
[December 2013 Reform Update](#)  
[State of the Nation Debate](#)  
[OECD: CORA Reforms](#)

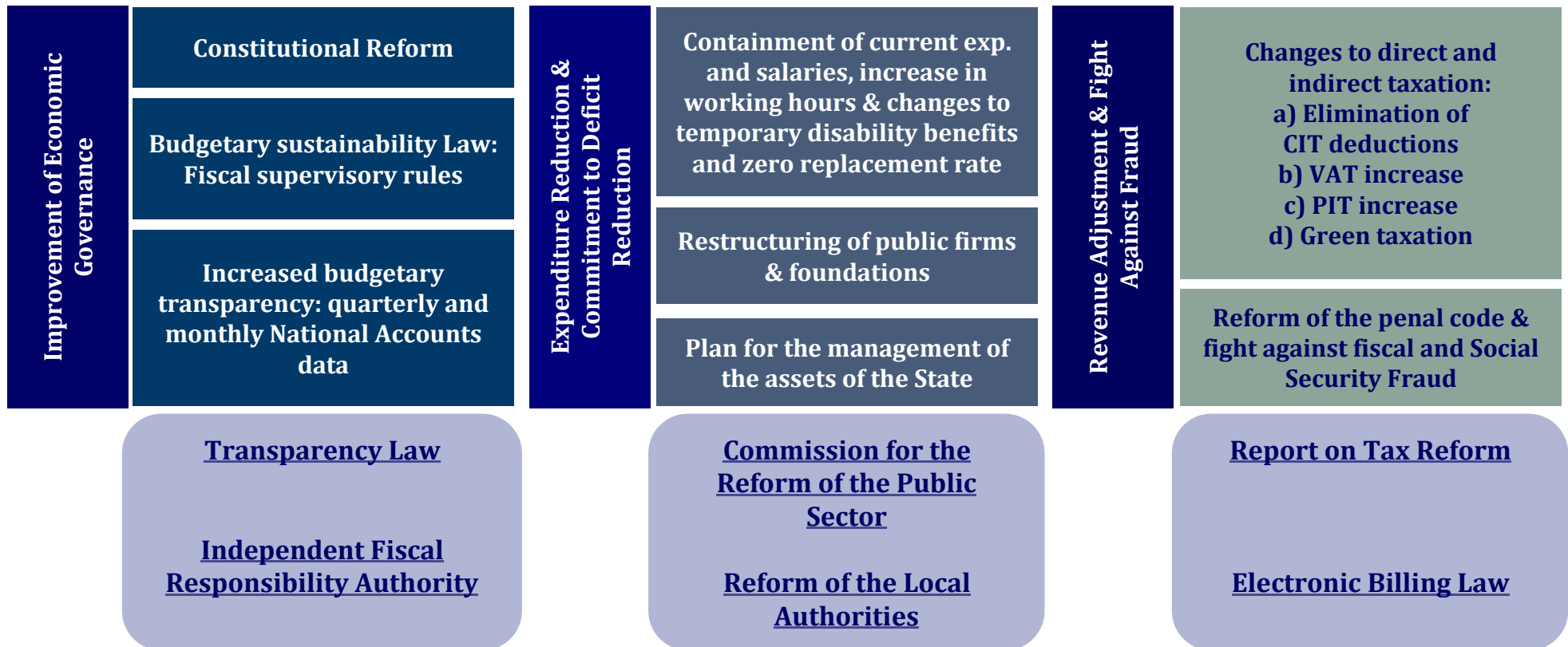
# The reform process continues into 2014

## MAIN 2014 REFORMS



# The reform of the public administrations (I)

- ▶ The reform of the public sector builds on the structural reform process initiated in 2012:
  - ❑ A thorough reform of the local authorities to review expenditure priorities
  - ❑ A full review of the Central Government expenditure through the CORA Committee
  - ❑ Review of the tax code: expert committee's proposal was presented in March



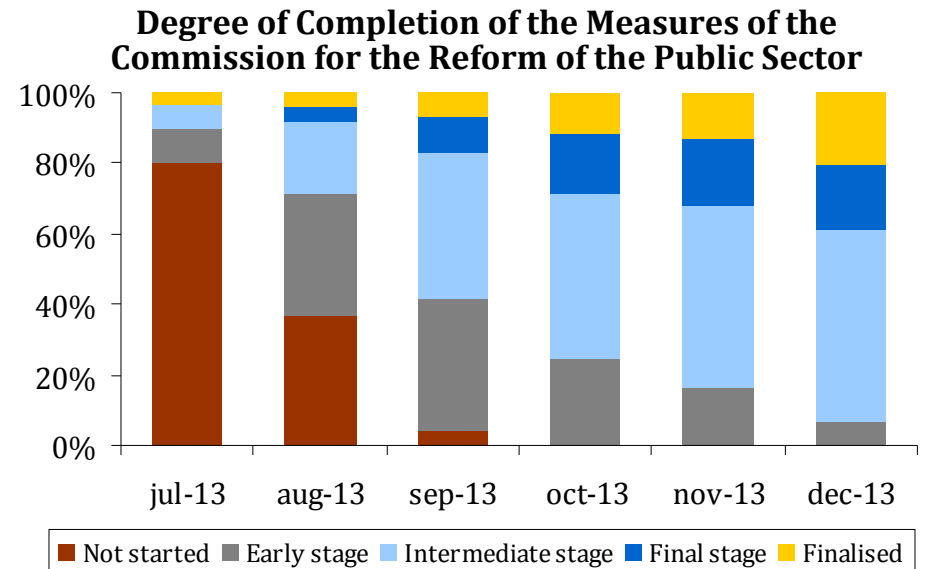
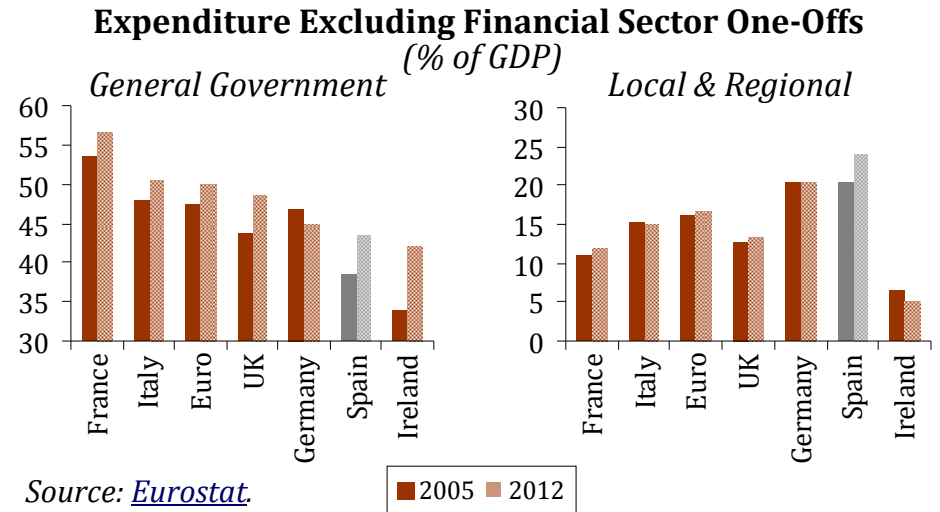
## The reform of the Public Administrations (II)

▶ The Law for the Reform of the Public Administrations targets gains in efficiency and the professionalisation of political and administrative functions at all levels of government

▶ The reform has four main objectives:

- To clarify local governments' responsibilities in order to avoid overlaps
- To rationalise the organisational structure
- To ensure financial and fiscal discipline
- To promote business-friendly regulation

▶ Apart from the legislative measures the Central Government is implementing a series of structural measures to streamline expenditure and to reform the State Administrations



Source: *Ministerio de Hacienda y Administraciones Públicas.*

# The fiscal path of the Public Administrations 2013-2016

► 2013 Budgetary Execution. Deficit excluding financial sector one-offs 6.62%:

- ❑ Nominal Adjustment of 0.2 pp of GDP, equivalent to a structural adjustment of 1.56 pp of GDP
- ❑ Broadly in line with nominal deficit target set in June 2013

► The consolidation path for 2014-2016 to take place under positive economic growth

► Proposal for Fiscal Reform expected in early 2014 to produce effects as from 2015

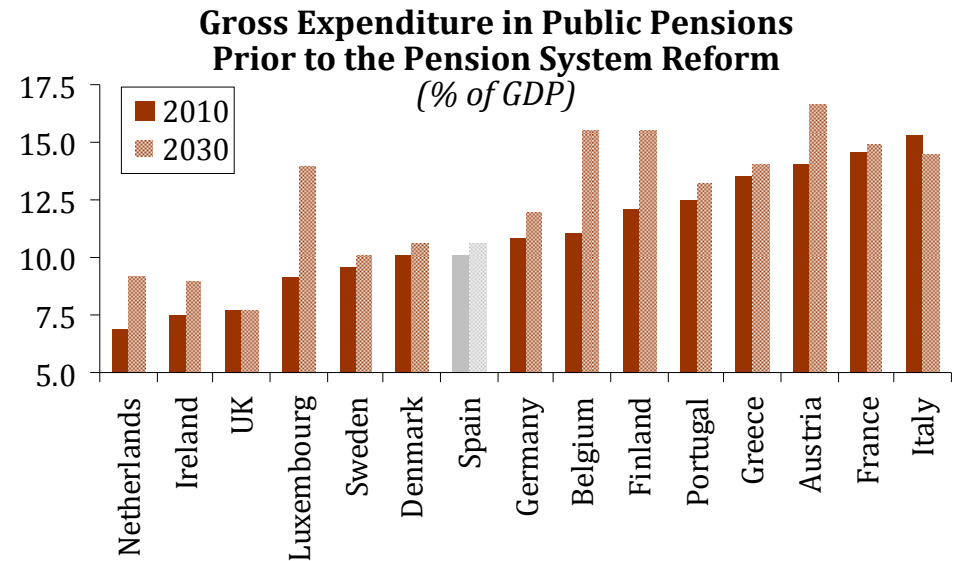
► Target to reach primary surplus by 2016

| Net Lending(+)/Borrowing(-) of the General Government. Excl. Financial Sector One-Offs |              |              |             |             |             |
|--|--------------|--------------|-------------|-------------|-------------|
| (% of GDP)   | 2012         | 2013         | Forecast    |             |             |
|  |              |              | 2014        | 2015        | 2016        |
| Central Government   | -4.2         | -4.3         | -3.7        | -2.9        | -2.1        |
| Autonomous Regions   | -1.9         | -1.5         | -1.0        | -0.7        | -0.2        |
| Local Governments  | 0.2          | 0.4          | 0.0         | 0.0         | 0.0         |
| Social Security Administrations  | -1.0         | -1.2         | -1.1        | -0.6        | -0.5        |
| <b>General Government</b>  | <b>-6.84</b> | <b>-6.62</b> | <b>-5.8</b> | <b>-4.2</b> | <b>-2.8</b> |
| <b>Nominal Adjustment</b>  | <b>2.2</b>   | <b>0.2</b>   | <b>0.8</b>  | <b>1.6</b>  | <b>1.4</b>  |
| <b>Financial Sector one-offs</b>   | <b>3.8</b>   | <b>0.5</b>   | <b>0.0</b>  | <b>0.0</b>  | <b>0.0</b>  |

| Impact of Measures Approved 2012-2013 (% of GDP) |            |            |            |            |
|--|------------|------------|------------|------------|
|  | 2012       | 2013       | 2014       | 2015       |
| <b>Expenditure-side</b>                          | <b>2.5</b> | <b>1.5</b> | <b>0.8</b> | <b>1.0</b> |
| Public employment measures                       | 0.0        | 0.3        | 0.2        | 0.1        |
| Dec. 2012 Extraordinary Payment                  | 0.5        | -0.5       |            |            |
| Labour Market & Social Security                  | 0.1        | 0.3        | 0.1        | 0.1        |
| Long-term Care & other Social Spending           | 0.0        | 0.1        |            |            |
| Specific Central Gov. Measures                   | 0.9        | 0.4        | 0.1        | 0.1        |
| Specific Regional Gov. Measures                  | 0.9        | 0.7        | 0.2        | 0.2        |
| Specific Local Gov. Measures                     | 0.2        | 0.1        | 0.2        | 0.5        |
| <b>Revenue-side</b>                              | <b>1.8</b> | <b>2.2</b> | <b>0.8</b> | <b>0.3</b> |
| Taxes  | 1.2        | 1.7        | 0.5        | 0.1        |
| Social Security                                  |            | 0.2        | 0.1        | 0.0        |
| Fight Against Social Security Fraud              | 0.2        |            |            |            |
| Specific Regional Gov. Measures                  | 0.4        | 0.4        | 0.2        | 0.2        |
| Specific Local Gov. Measures                     |            | 0.0        | 0.1        | 0.0        |
| <b>Total effective Adjustment</b>                | <b>4.3</b> | <b>3.7</b> | <b>1.6</b> | <b>1.3</b> |

# The Pension System reform reduces the impact of population ageing

- ▶ Building on the 2011 reform which already introduced measures to adapt the pension system, during March 2013 a Royal Decree was presented in order to foster active ageing and to increase the effective retirement age
- ▶ In December 2013 the Pension System Reform was approved. It introduces two factors to which pensions will be linked to:
  - A yearly Update factor
  - Life expectancy; will entry into force in 2019 and will be evaluated every 5 years
- ▶ “De-Indexation” Law will further eliminate second-round inflationary pressures stemming from the Pension System



Source: *European Commission*.

# The labour market reform is addressing Spain's most important imbalance

► The labour market reform tackles the main shortcomings of the Spanish labour market: high structural unemployment, a high youth unemployment, an excessive worker turnover and volatility and wage indexation which limit gains in competitiveness

| Collective Bargaining  | Internal Flexibility of Firms   | External Flexibility of Firms  | Contracts   |
|--|---|--|---|
| <ul style="list-style-type: none"> <li>→ Dynamic bargaining more responsive to the needs of businesses and workers</li> </ul>  | <ul style="list-style-type: none"> <li>→ Avoiding lay-offs: rigidity fostered job cuts as a means of adjusting to economic changes</li> </ul>   | <ul style="list-style-type: none"> <li>→ Reduction of severance pay for unfair dismissals</li> </ul>   | <ul style="list-style-type: none"> <li>① Crisis contract: new contract for entrepreneurs aimed at small businesses. It has a one-year trial period. Tied to employment tax breaks and fiscal tax credit, specially for hiring young workers. Breaks and credits are designed to limit the dead-weight effect</li> <li>② Training and skill building: deep regulatory modifications to provide a structural change and develop a dual training system that allows a balance of training and work</li> <li>③ Flexible regulation of telework</li> <li>④ Part-time contract: increased flexibility, allowing overtime</li> </ul> |
| <ul style="list-style-type: none"> <li>→ Move beyond the model of indexing salaries and wages</li> </ul>   |   | <ul style="list-style-type: none"> <li>→ Clear and objective regulatory framework of fair dismissals</li> </ul>  |   |
| <ul style="list-style-type: none"> <li>→ Balanced regulatory framework in line with economic circumstances</li> </ul>  | <ul style="list-style-type: none"> <li>① Classification of workers based on skills not on professional occupations</li> <li>② Simplification of rules for the reallocation of workers</li> <li>③ Streamlining the adoption of significant changes in working conditions</li> <li>④ Furloughs/Time-reductions if legitimate financial, productive or organisational reasons exist</li> <li>⑤ Distribution of working-time</li> </ul> | <ul style="list-style-type: none"> <li>① Severance pay for unfair dismissal down to 33days/Max 24months of salary vs. 45days/Max 42 months</li> <li>② Clarification of fair dismissal causes (20days/Max 12 Mo)</li> <li>③ Removal of administrative authorisation for collective layoffs</li> <li>④ Elimination of procedural salaries</li> <li>⑤ Fair dismissals for economic causes of civil servants</li> <li>⑥ Streamlining of dismissals based on absenteeism</li> </ul> |   |
| <ul style="list-style-type: none"> <li>① Opting out from higher-level agreements</li> <li>② Priority of company-level agreements</li> <li>③ Limiting the statutory extension rule of expired agreements up to one year (unlimited before)</li> </ul> |   |  |   |

# Evaluation report of the OECD on the labour market reform

- ▶ The labour market reform has reduced sensitivity of the labour market to the economic cycle and introduced a more efficient wage-setting behaviour
- ▶ It has increased flexibility and reduced segmentation

## CONCLUSIONS

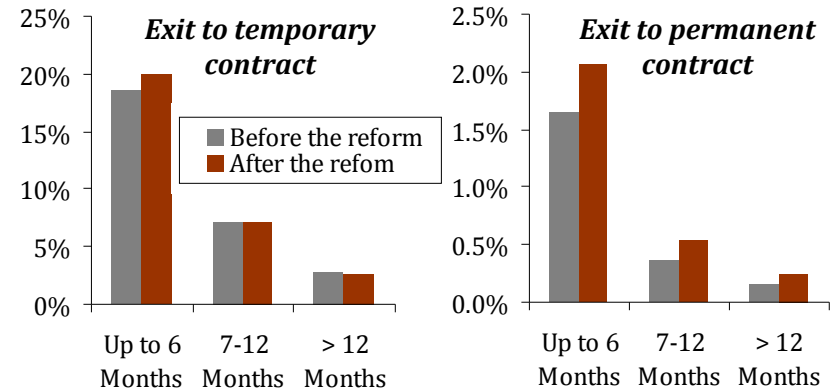
The reform has significantly contributed to:

- Increasing competitiveness: enhanced yearly productivity growth, resulting in at least 0.15 faster GDP growth each year
- Job creation
- Increasing the exit probabilities, away from unemployment
- Reducing separation rates
- Reducing labour market segmentation

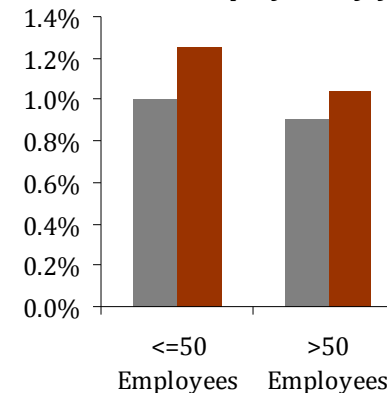
## RECOMMENDATIONS

- ❑ Regulation for collective dismissals should be enhanced, reducing further the discretionary role of courts to invalidate dismissals
- ❑ Lengthening the maximum duration of trial periods up to at least the OECD average
- ❑ Greater convergence of employers' costs of termination for permanent and temporary contracts
- ❑ Greater integration of active and passive policies is required

**Individual Monthly Transition Probabilities from Unemployment to Employment**  
(by type of new contract and unemployment duration)



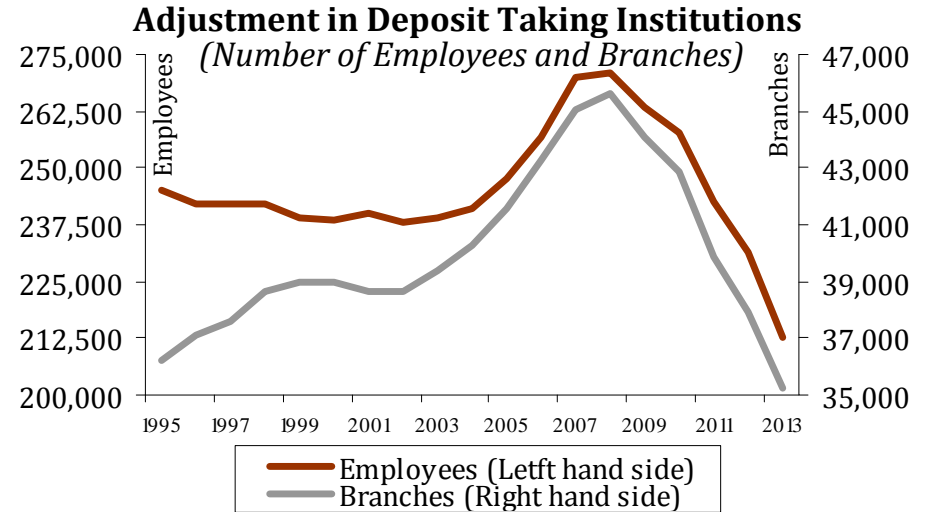
**Individual Monthly Transition Probabilities from Unemployment to Permanent Employment**  
(Up to 6 months unemployed, by firm size)



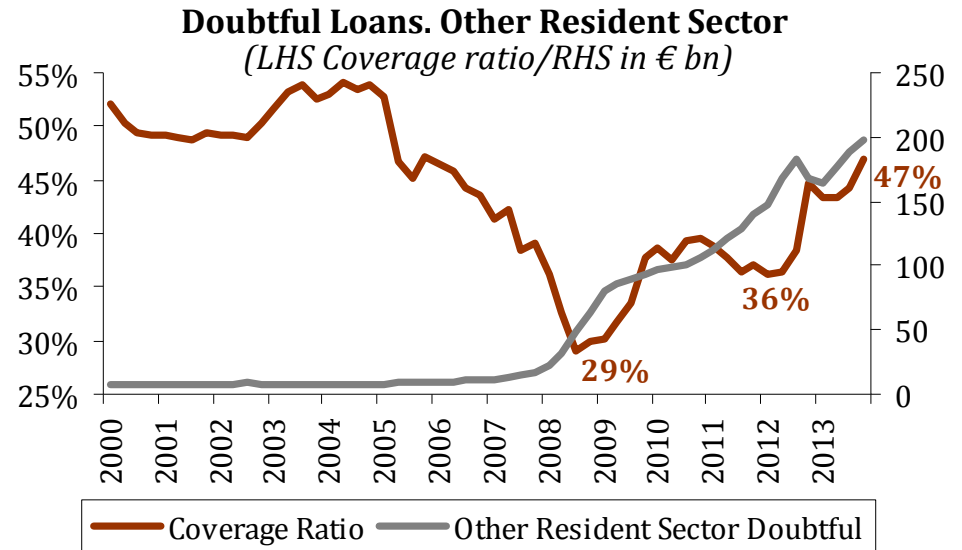
Source: [OECD](#).

# Adjustment and recapitalisation of the financial system

- ▶ The winding-down of the financial sector has removed the excess capacity built up during the housing boom
- ▶ Capital increases and voluntary liability management exercises in the last 4 years above €100 bn:
  - ❑ FROB and Deposit Guarantee Fund: €59 bn
  - ❑ Burden-sharing exercises: €13.6 bn
  - ❑ Private capital increases in excess of €25 bn
- ▶ Clean-up effort in the period 2008-2013 above €250 bn, especially intense in 2012, when it reached €100 bn
  - ❑ Coverage ratios of doubtful loans to “other resident sector” has increased from 36% in 2012Q1 to 47% by 2013Q4



Source: [Bank of Spain](#).

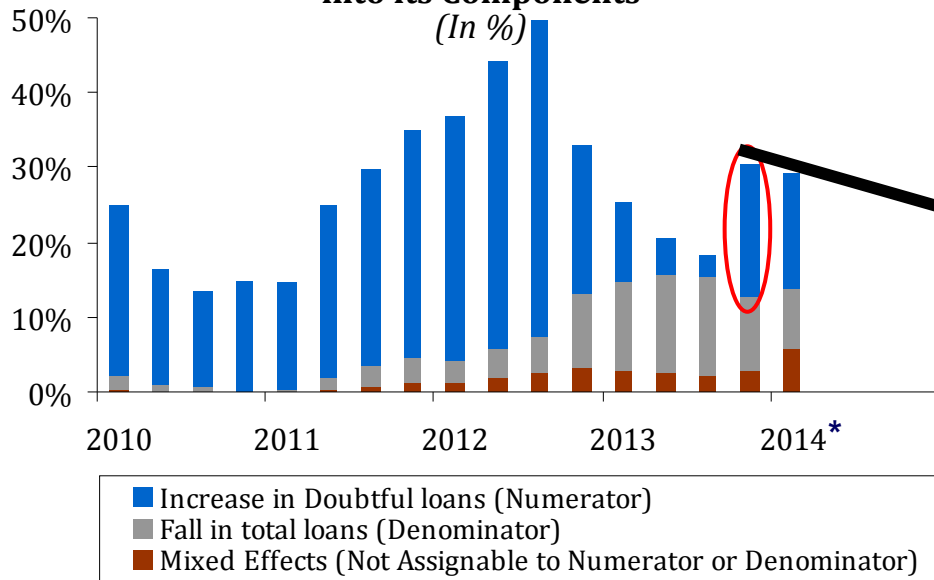


Source: [Bank of Spain](#).

# Enhanced transparency and refinanced loan provisioning requirements

- ▶ Increase in the quality and quantity of information provided by banks, including on refinanced loans
- ▶ Disclosure requirements have been enhanced and harmonised for all entities in key areas of their portfolios such as restructured and refinanced loans, NPL's, asset quality across asset classes, concentration by sector, etc.

**Breakdown of Year-on-Year Growth Rate of NPL Ratio into its Components**  
(In %)



| Restructured and Refinanced Loans (€ bn) |         |                                     |
|--|---------|-------------------------------------|
|  | Initial | After Corrections<br>As of Sep 2013 |
| Normal                                   | 73.6    | 48.2                                |
| Sub-standard                             | 37.2    | 40.9                                |
| Doubtful                                 | 71.7    | 92.2                                |

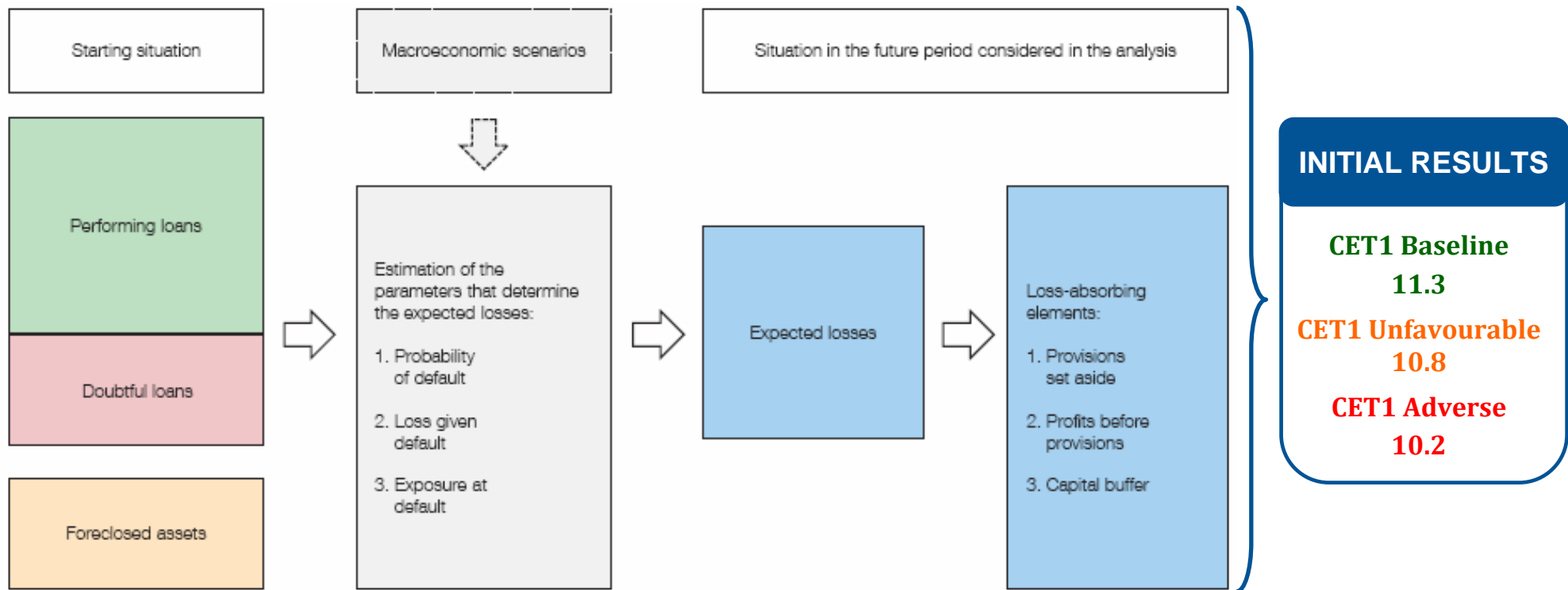
Source: *Bank of Spain.*

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\* January 2014 over January 2013

# Spanish banks subject to regular forward-looking analysis

- ▶ Each bank to be assessed using a forward-looking analysis in order to take preventive measures to correct their solvency situation using three alternative macroeconomic scenarios
  - ❑ Sensitivity analysis in respect of a pre-determined set of shocks
  - ❑ Assessment and advice has been sought from independent experts
  - ❑ Using the supervisor's own models (top-down approach), without the need to draw on each bank's own models, enriched via a bottom-up approach at the level of individual loans, including guarantees



# The Asset Management Company: SAREB

▶ Equity €4.8 bn: 28 shareholders, of which 27 are private investors, including domestic and foreign banks and insurance companies

- ❑ The only public shareholder is FROB, with a 45% stake
- ❑ 25% share capital / 75% subordinated debt

▶ Business Plan with a 15-year horizon; expected RoE of approx. 13–14% under conservative assumptions

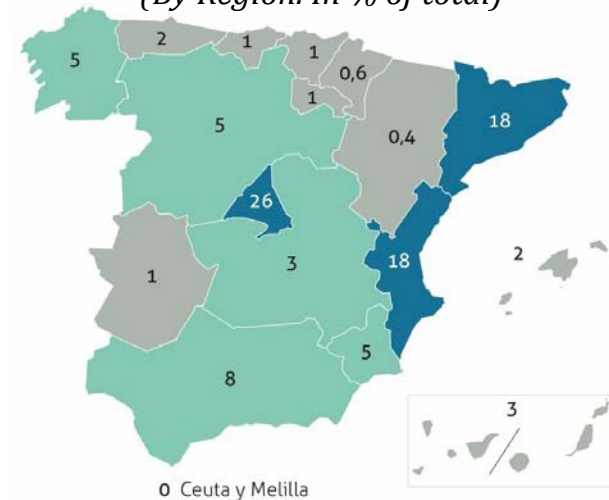
▶ Max. volume of assets → €90.0bn

▶ Transferred assets: €50.5bn, for a gross book value of €106.6bn → Overall average impairment close to 52%

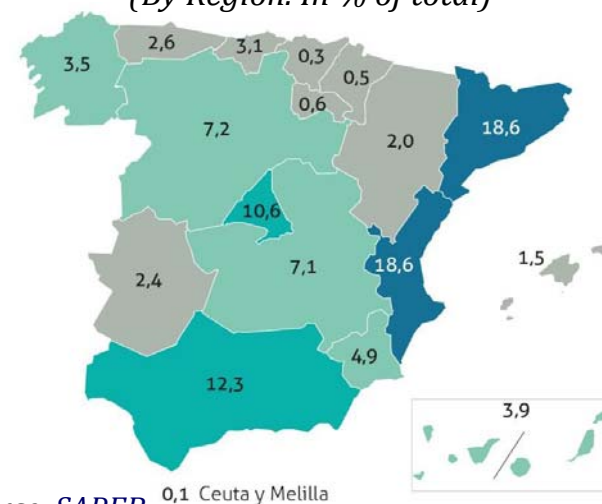
▶ A total of around 200.000 assets have been transferred

- ❑ Foreclosed RE assets → 107.000 assets for a value €11.3bn
- ❑ Loans to RE developers → 90.500 assets for a value of €39.4bn

**Financial Assets in SAREB's Initial Portfolio**  
(By Region. In % of total)



**Real Estate Assets in SAREB's Initial Portfolio**  
(By Region. In % of total)



Source: [SAREB](#).

## The Financial Sector Assistance Programme has been completed

- ▶ The recapitalisation of the FROB owned banks and the transfer of assets to SAREB has boosted capital ratios
- ▶ Spanish banks have increased their loss-absorption capacity and solvency as a result of stricter provisioning requirements and the transfer of assets to the SAREB
- ▶ The impact of the banking sector programme on the Spanish economy reinforces two positive trends:
  - ❑ The clean-up of balance sheets accelerates deleveraging in the non-viable part of the economy
  - ❑ In return it offers banks capital and liquid securities that can be lent to the viable economy
- ▶ The measures adopted are helping to improve confidence in the system, which should lower banks' funding costs

*... **Compliance with the horizontal policy requirements in the Memorandum of Understanding is complete.** This contributed to a thorough **overhaul of the governance, regulatory and supervisory framework** of the Spanish banking sector. Continuing on this path of close monitoring, pro-active supervision, advancing reform in the broader governance of the banking sector and fostering non-bank financial intermediation will help securing these achievements and contribute to a more resilient financial sector in Spain...*

*Statement by the EC and the ECB following the conclusion of the fifth review of the Financial Assistance Programme for Spain*

# Measures to improve the financing of the economy

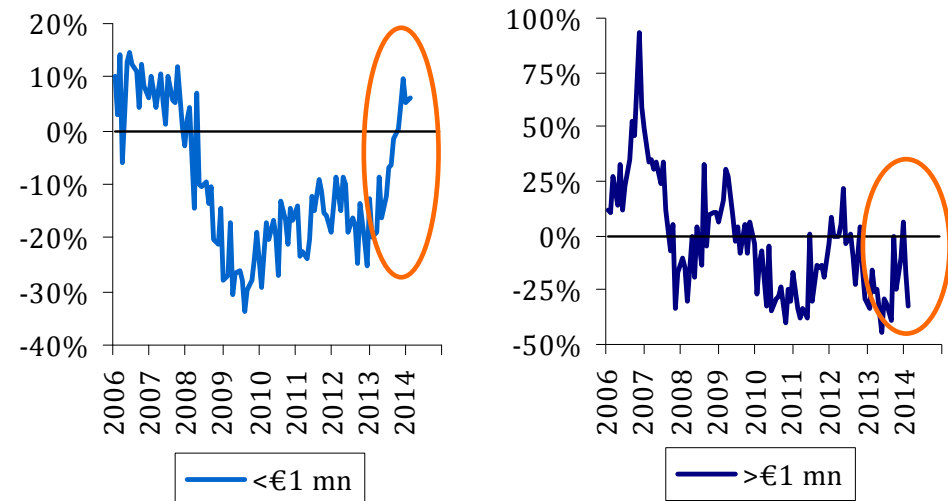
▶ Alongside slightly improving loan data in late 2013, a series of measures were introduced in order to improve the financing of the Spanish economy

- ❑ Securities markets: the alternative fixed income market (MARF)
- ❑ Venture capital: FOND-ICO Global held its first six tenders for the allocation of investment commitments in December 2013, second call in February 2014. National Network of Business Incubators, reinforcement of Business Angels
- ❑ Banking Channel: ICO lines (€16bn; can be increased up to €24 bn),
- ❑ Loan Guarantees: reinforcement of the mutual guarantee system, CESCE line, ICO-CAF facility

▶ Further steps envisage:

- ❑ Improvements in the regime governing the issue of debentures, securitisations and institutional investors
- ❑ Amendments to the legislation governing risk capital
- ❑ Reform of the regulation on bankruptcy

**New Credit to Non-Financial Firms by Size of Loan**  
(Year-on-Year Growth Rates)



Source: Bank of Spain.

**1. Closer EMU Integration**

**2. Spanish Economic Policy**

**3. Transformation of Spain's Growth Model**

## Growth outlook in 2014

- ▶ Growth forecast for 2014 in line with the European Commission's forecast: pick-up in domestic demand, specially in gross fixed capital formation and private consumption
  - ❑ Unemployment rate to fall mildly from current levels; net job-creation to resume in 2014
  - ❑ For the first time since 1998, net lending capacity to the Rest of the World

| Macroeconomic scenario<br><i>(Year-on-year growth rates in percent)</i> | 2012        | 2013        | 2014 (f)                                  |                         |                       |
|---|-------------|-------------|---|-------------------------|-----------------------|
|   |             |             | European Commission<br>(Spring Forecasts) | OECD<br>(November 2013) | IMF<br>(January 2014) |
| Private consumption   | -2.8        | -2.1        | 0.6                                       | -0.4                    | 1.2                   |
| Government consumption  | -4.8        | -2.3        | -0.9                                      | -2.9                    | -1.7                  |
| Gross Fixed Capital Formation   | -7.0        | -5.1        | 0.1                                       | -1.6                    | 0.6                   |
| <b>National Demand*</b>   | <b>-4.1</b> | <b>-2.7</b> | <b>0.2</b>                                | <b>-1.1</b>             | <b>0.5</b>            |
| Exports of goods and services   | 2.1         | 4.9         | 5.4                                       | 5.4                     | --                    |
| Imports of goods and services   | -5.7        | 0.4         | 3.3                                       | 0.7                     | --                    |
| <b>External demand*</b>   | <b>2.5</b>  | <b>1.5</b>  | <b>0.8</b>                                | <b>1.6</b>              | <b>0.4</b>            |
| <b>Gross Domestic Product</b>   | <b>-1.6</b> | <b>-1.2</b> | <b>1.0</b>                                | <b>0.5</b>              | <b>0.9</b>            |
| <b>Other macroeconomic variables</b>                                    |             |             |   |                         |                       |
| Unemployment rate (in %)  | 25.0        | 26.0        |   |                         |                       |
| Full-time Equivalent Employment (Q4 on Q4 in %)                         | -5.0        | -1.6        |   |                         |                       |
| Unit Labour costs (Year-on-year)  | -3.0        | -1.5        |   |                         |                       |
| GDP deflator (Year-on-year)   | 0.0         | 0.6         |   |                         |                       |
| Net lending(+)/borrowing(-) with RoW (% of GDP)                         | -0.6        | 1.5         |   |                         |                       |
| Deficit Excl. Financial Sector One-Offs (f)                             | -6.8        | -6.6        |   |                         |                       |
| Primary Deficit Excl. Financial Sector One-Offs                         | -3.8        | -3.2        |   |                         |                       |
| Debt/GDP ratio (in % of GDP)  | 86.0        | 93.9        |   |                         |                       |

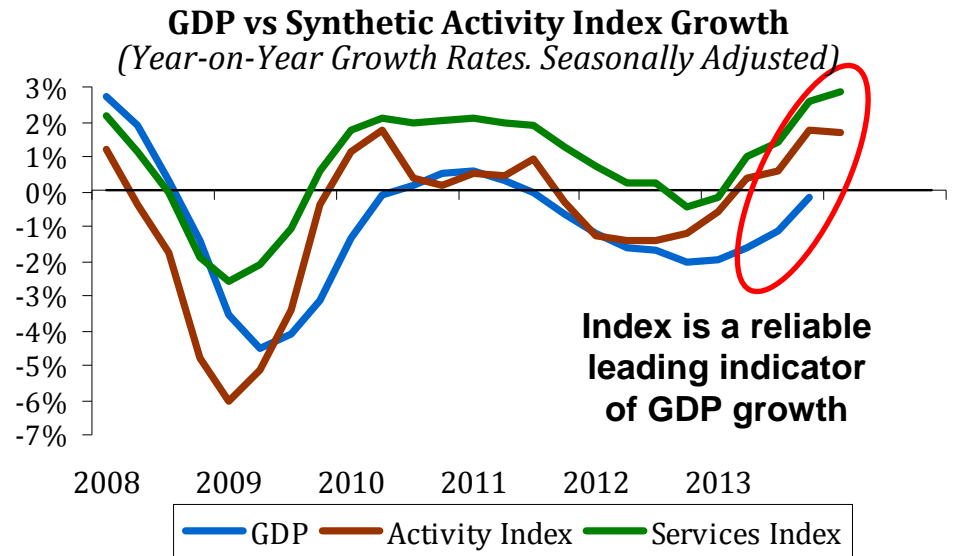
Sources: *National Statistics Institute, OECD, IMF and European Commission.*

\* Contributions to GDP in p.p.

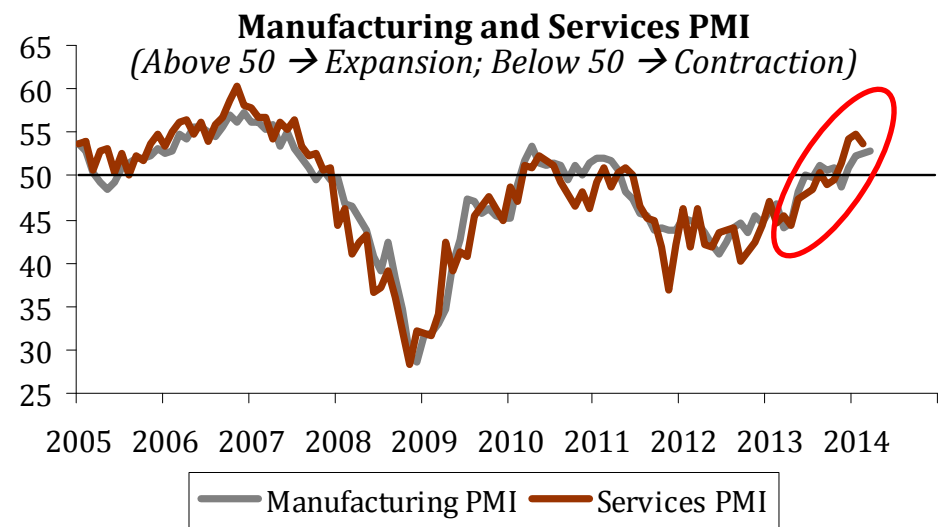
# Recent coincident and leading indicators point to an economic recovery

► Positive trends in external demand and productivity have a positive effect on internal demand and employment

- ❑ Coincident and leading indicators point towards a change of cycle, especially in the services sector
- ❑ Synthetic Activity Indices (composite indices designed to gauge overall economic activity): forward-looking signs of improving activity
- ❑ The rebalancing towards tradable goods and services is gaining steam while, non-tradable sectors, like the construction sector, still pose a drag on overall employment creation and growth



Source: [Ministerio de Economía y Competitividad](#).



Source: [Ministerio de Economía y Competitividad](#).

## Transforming Spain's economic model

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▶ The Spanish economy is transitioning from an internal investment- and consumption-based economy with huge current account deficits into one with an increasing surplus

- ❑ The weight of exports in GDP has increased from 23.9% in 2009 to 34.1% by 2013-Q4
- ❑ Current Account has reverted from a deficit of 10% of GDP in 2007 to a surplus in 2013
- ❑ The cyclical current account adjustment is giving way to a structural one

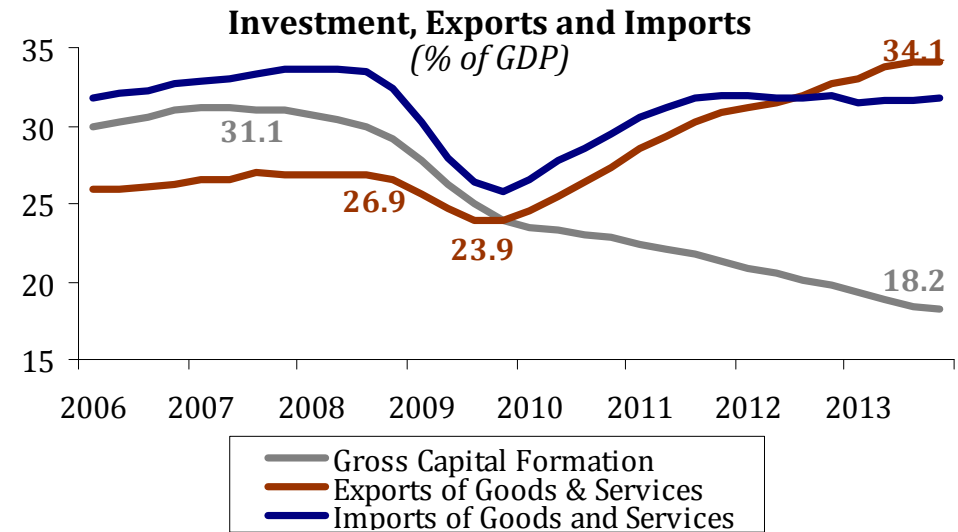
▶ This process has been supported by the structural reform process and deleveraging in the private sector

- ❑ The productivity- and cost-gap built up during the initial years of the EMU is eroding quickly
- ❑ Lower growth needed for employment creation in the private sector
- ❑ Non-financial firms' debt has declined from 143.8% of GDP in 2010 to 130.8% by 2013-Q3
- ❑ Households debt has declined from 87.4% of GDP in 2010 to 78.2% by 2013-Q3

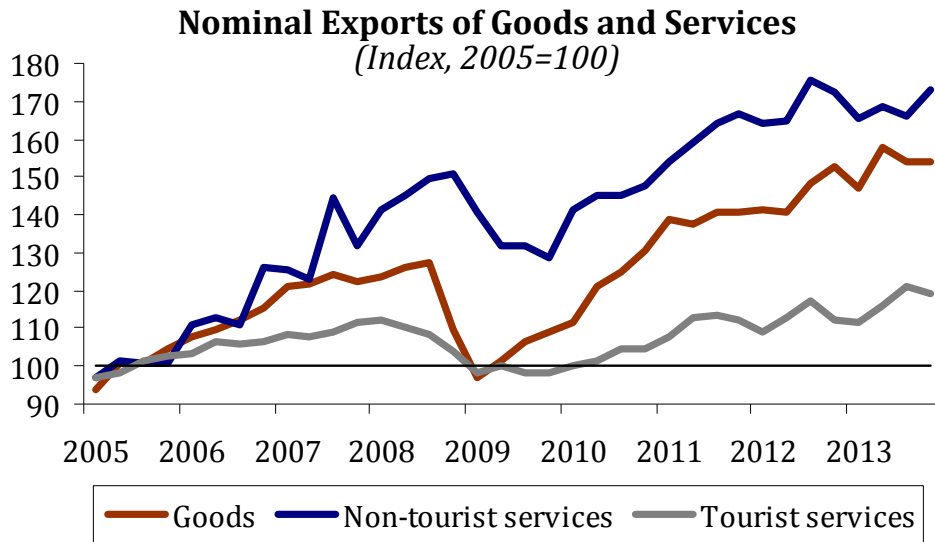
# Rapid expansion of the external sector...

► As a reflection of the structural change in the Spanish economy the weight of exports in GDP has increased from 23.9% in 2009 to 34.1% by 2013-Q4, while the weight of investment has declined substantially

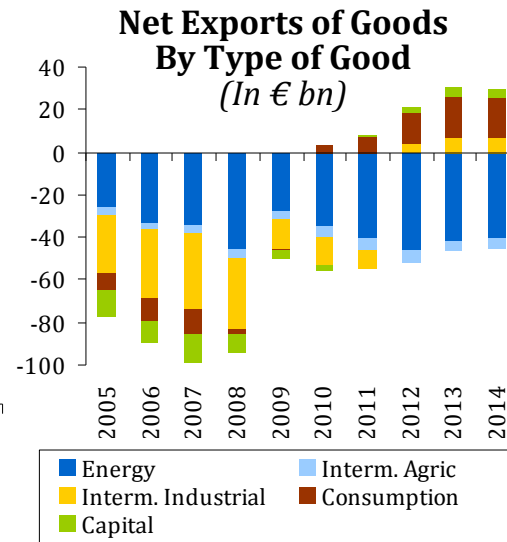
- ❑ Rapid expansion of exports of goods and especially of non-tourist services
- ❑ Increasing product and geographical diversification of exports of goods and services



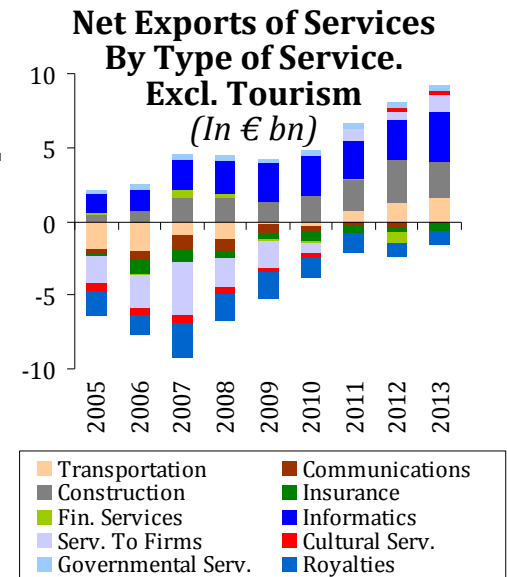
Source: *National Statistics Institute.*



Source: *National Statistics Institute.*

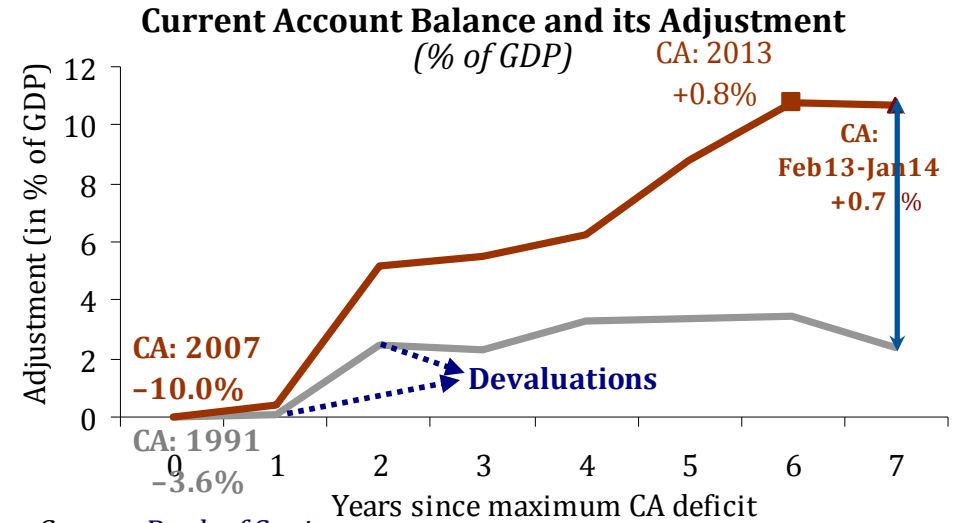


Source: *Bank of Spain.*



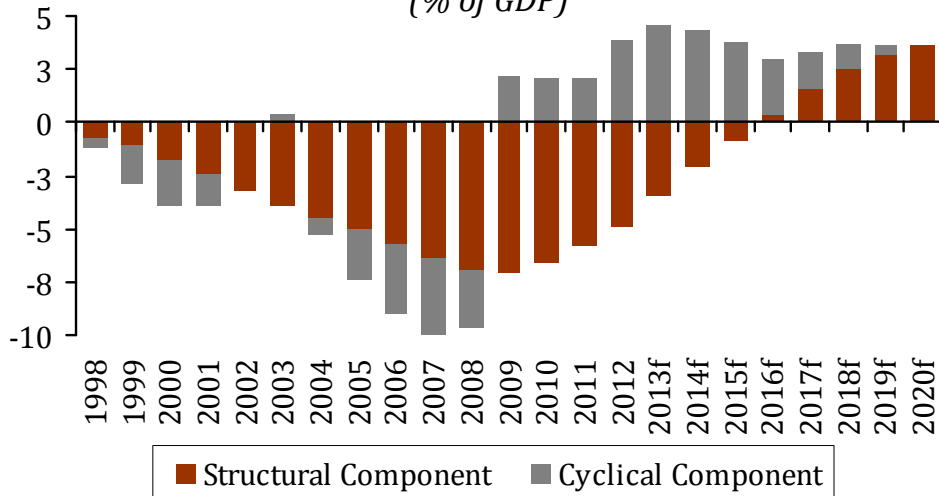
# The cyclical current account adjustment is giving way to a structural one

- ▶ Cumulative CA surplus February 2013 to January 2014: 0.7% of GDP
- ▶ Internal devaluation process more effective in CA correction than nominal devaluations
- ▶ Estimates of the composition reveal a strong cyclical component up to 2014 and a structural surplus from 2016 onwards



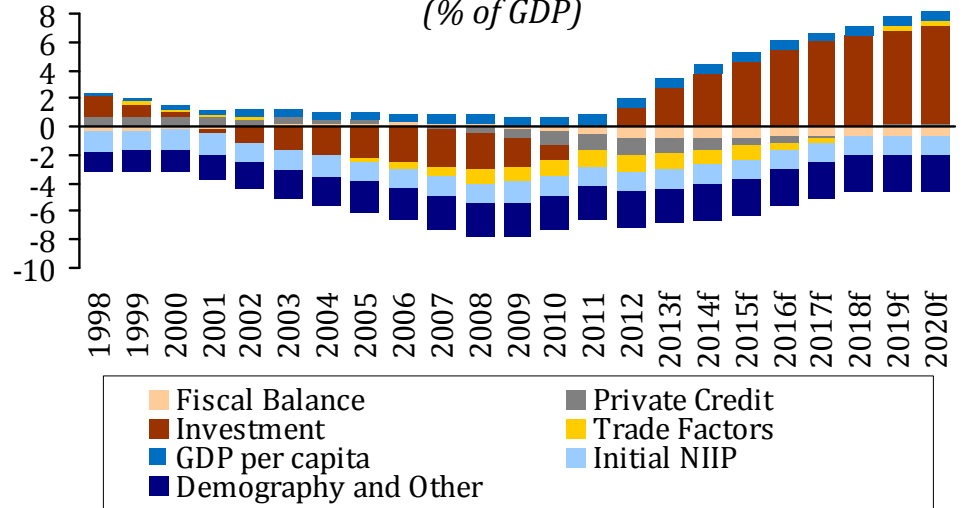
Source: [Bank of Spain](#).

Structural and Cyclical Components of the Current Account (% of GDP)



Source: [BBVA Research](#).

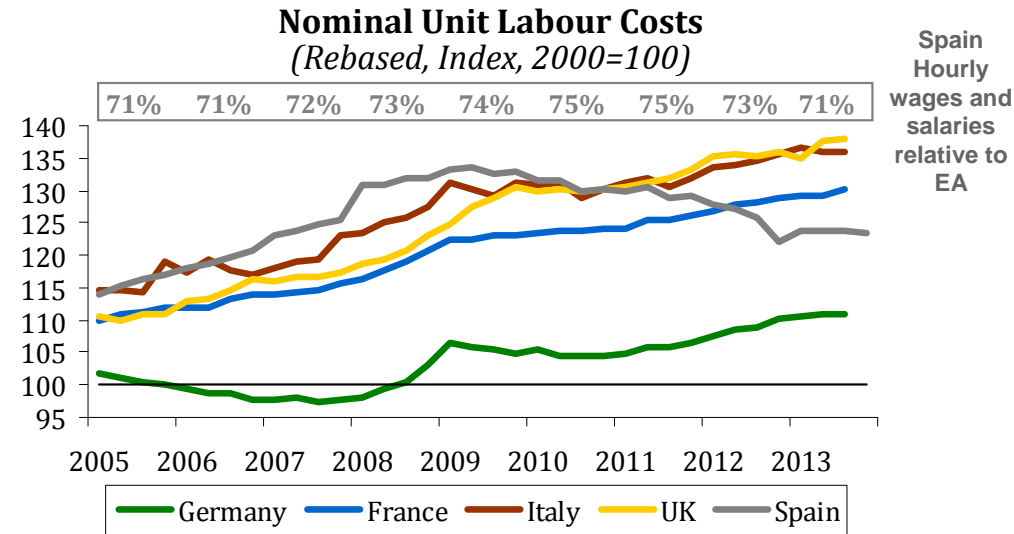
Structural Current Account Breakdown on its Determinants (% of GDP)



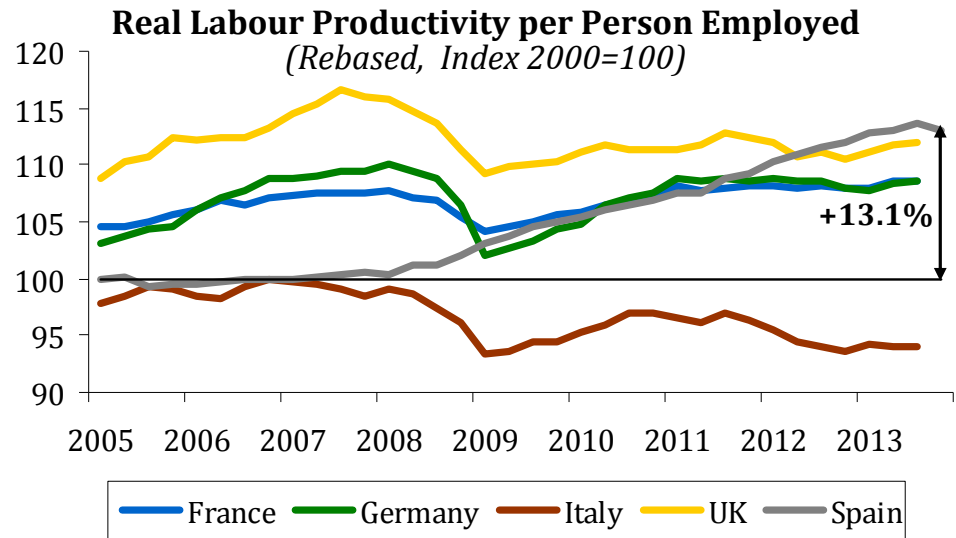
Source: [BBVA Research](#).

# This process has been supported by the structural reform process...

- ▶ The initial productivity shock was caused by the soaring unemployment
- ▶ The structural reforms since 2011 have had a positive impact on unit labour costs and productivity:
  - ❑ Nominal unit labour costs have declined by 7.6% since the peak in 2009 and are at similar levels than in 2007
  - ❑ Productivity has steadily increased since 2008 due to the shift towards tradable goods and services



Source: [Eurostat](#).



Source: [Eurostat](#).

# Labour market reform: wage moderation and enhanced flexibility mechanisms

► First results of the labour market reform: intense use of opt-out clauses in wage negotiation, more part-time jobs and fewer employees under temporary contracts

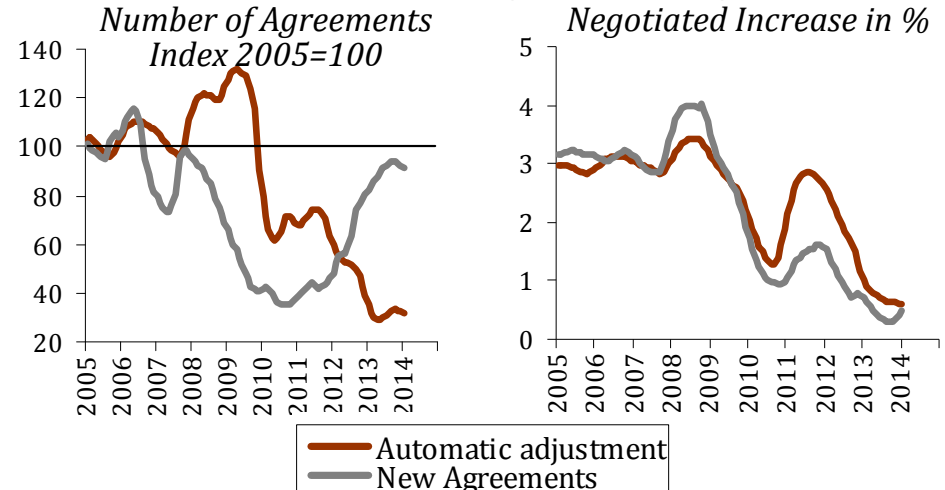
❑ Phasing out of automatic renewal of expired collective agreements, and increasing number of new agreements, have accelerated wage moderation

► Mild acceleration of self-employment and private employees, contraction of public employees

❑ Since 2011 the number of employees in the public sector has diminished substantially, reaching 2007 levels: a reduction by 424.8 thousand employees since 2011-Q3

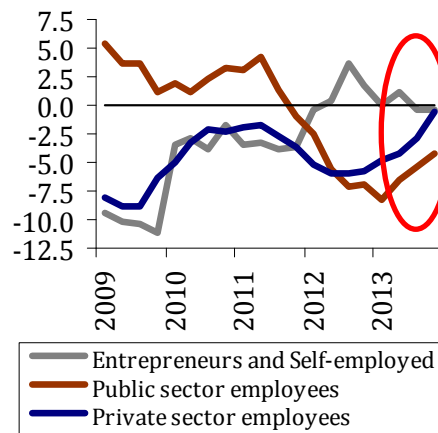
❑ Private sector employees, entrepreneurs and self-employed are recovering since 2013

**Collective Wage Bargaining & Negotiated Wage Increase. Automatic Revision of Wages vs. New Agreements**



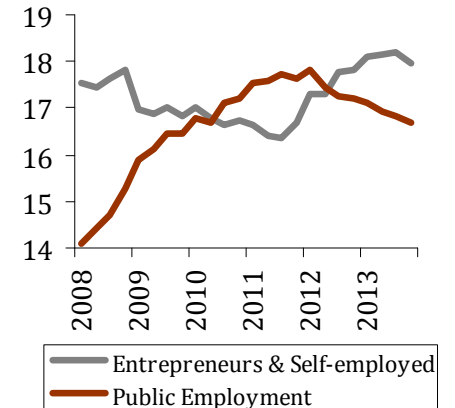
Source: *Bank of Spain.*

**Evolution of Employment (Year-on-year growth rates)**



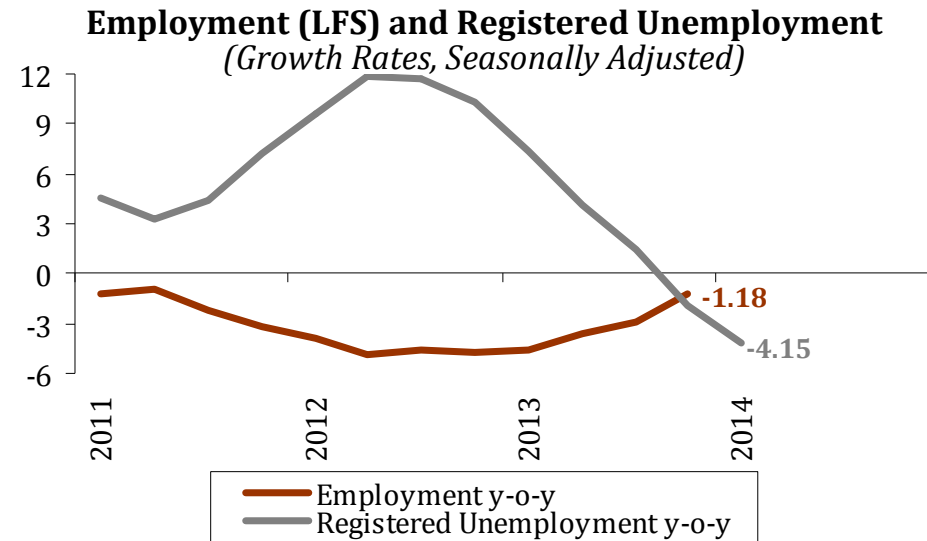
Source: *National Statistics Institute.*

**Share in Total Employment (% of Total)**

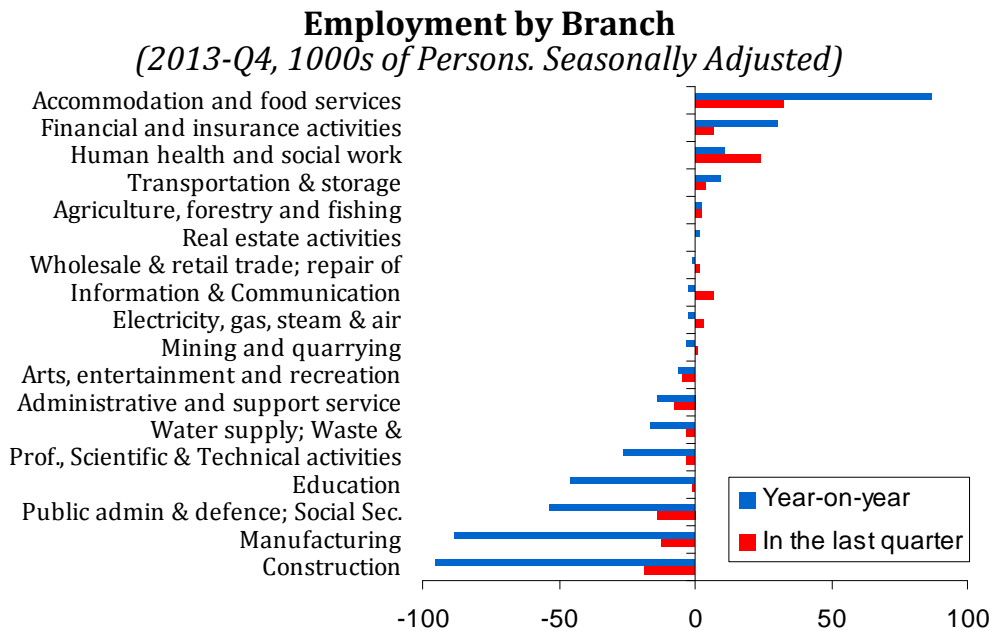


# Lower growth needed for employment creation in the private sector

- ▶ First signs of stabilisation in the labour market linked to increased activity in services (food services; insurance; health and IT), together with car manufacturing
- ▶ New regulatory framework has decreased the minimum GDP growth required for net private sector job creation

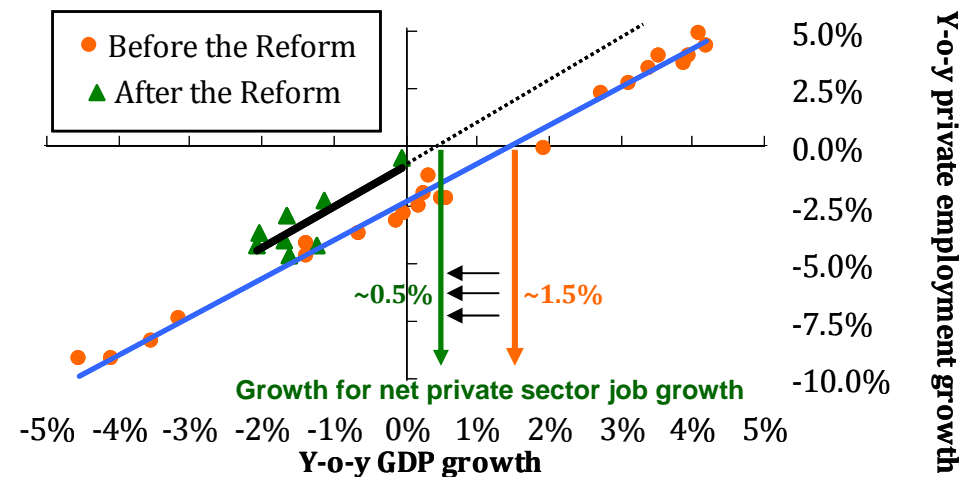


Source: [National Statistics Institute](#).



Source: [National Statistics Institute](#).

### Growth Required for Private Employment Creation (Quarterly Data, Seasonally and Calendar Adjusted)

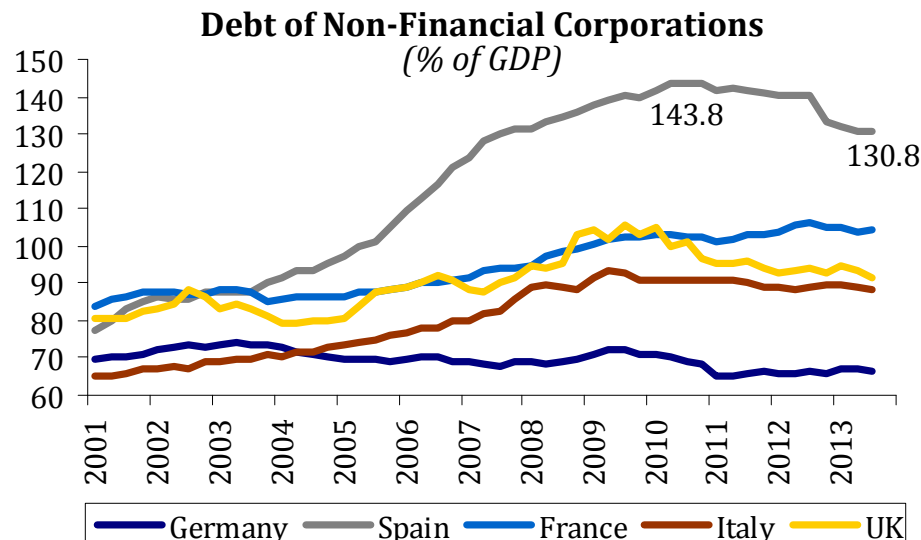


Source: [National Statistics Institute](#).

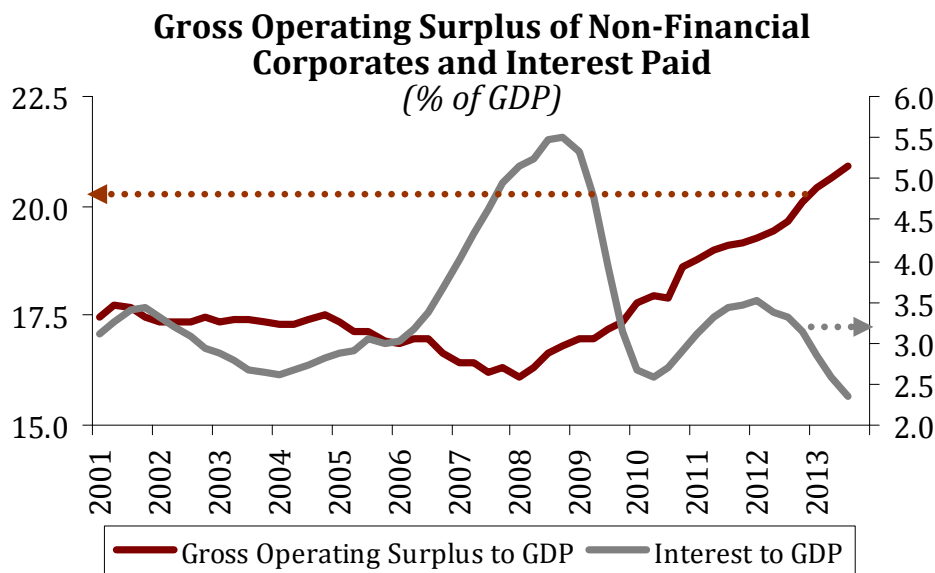
# Deleveraging of the private sector: non-financial corporations

► Non-financial firms reduced their debt stock by c.13.0% of GDP since 2010

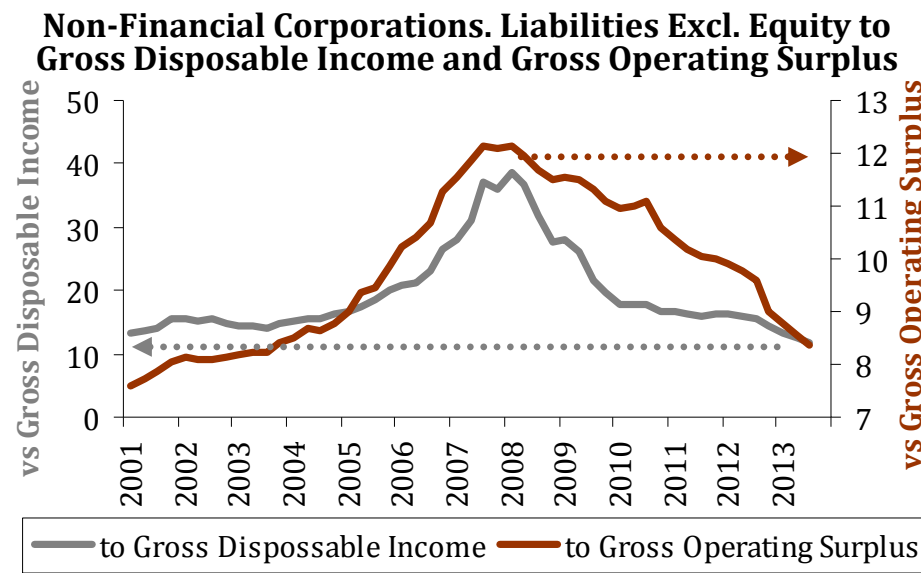
- ❑ Gross operating surplus of non-financial corporations has jumped from below 16% of GDP to above 21% in 5 years
- ❑ Strong flow correction: indebtedness excl. equity to Gross Operating Surplus and to Gross Disposable income around 2004 levels



Source: [ECB](#).



Source: [National Statistics Institute](#).



Source: [National Statistics Institute](#) and [Bank of Spain](#).

# Deleveraging of the private sector: households

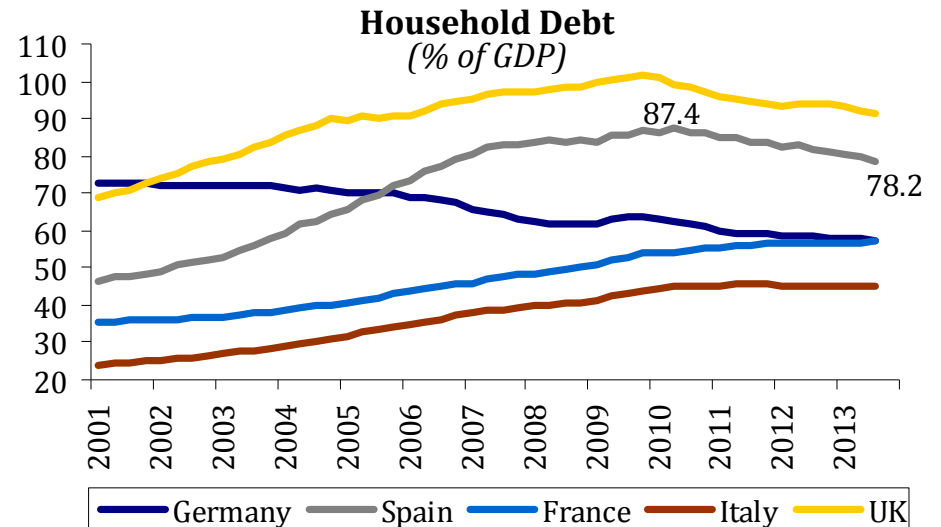
▶ Households have progressively reduced their leverage ratios and their debt has returned to 2007 levels

❑ Debt/GDP of Spanish households has declined from 87.4% in 2010Q2 to 78.2% by 2013Q3

▶ Projections of existing mortgage debt amortisation schedules point in the direction of a fast deleveraging process

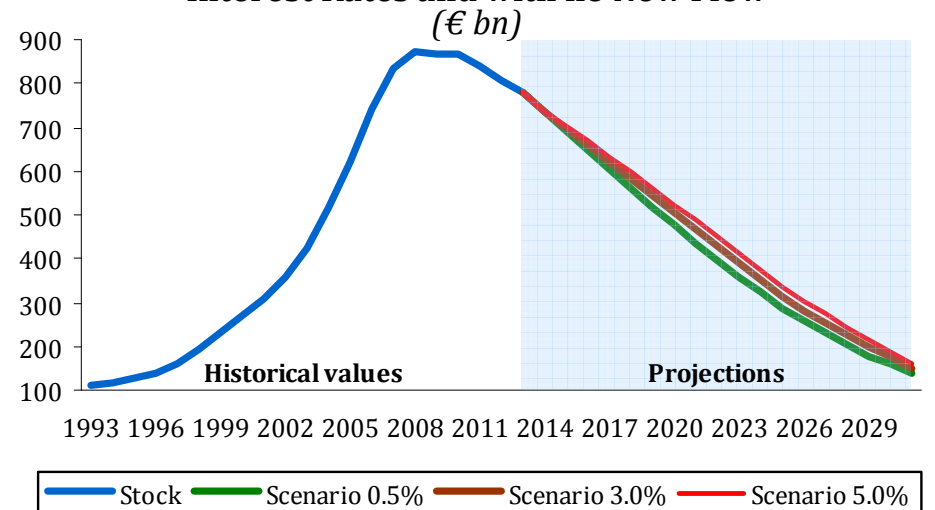
❑ By 2018 the Household Debt/GDP ratio would be in line with the current ratios of Germany or France

❑ By 2020-2023 the existing mortgage stock would be halved vs. today's levels



Source: ECB.

## Deleveraging Scenarios of Mortgage Debt at Different Interest Rates and with no New Flow

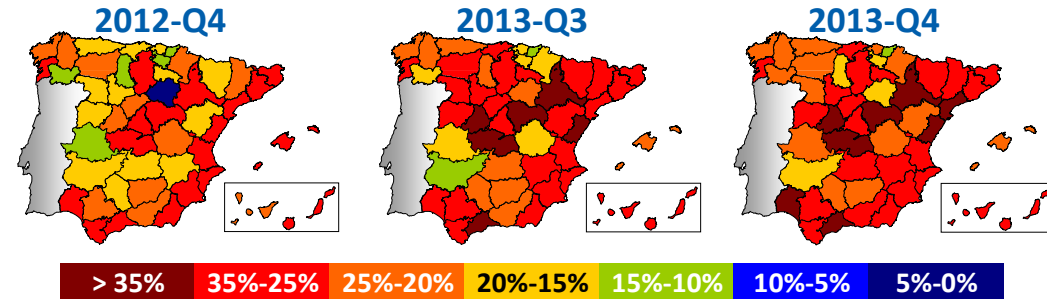


Source: Santander GBM Research.

# The construction sector has accelerated its adjustment

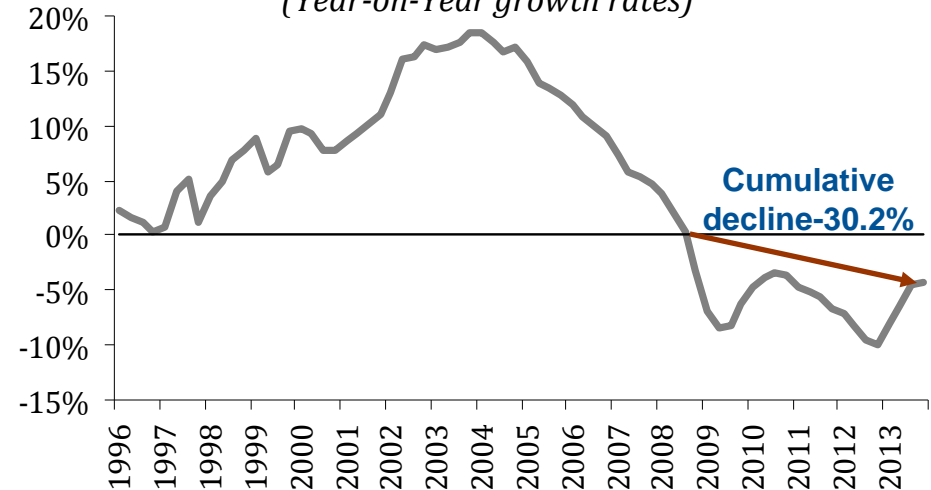
- ▶ Real estate prices have fallen on average by approx. 30% since the peak in 2008
- ▶ The adjustment has been very heterogeneous and more intense around most populated and coastal provinces
  - The average nominal price decline since the peak for new dwellings reaches 30%
- ▶ Performing and non-performing RRE assets have been largely transferred to SAREB, as per the financial sector MoU

Nominal Housing Price Adjustment Since the Peak in Each Province (In percent)



Source: *Ministerio de Fomento.*

Nominal Housing Price Adjustment (Year-on-Year growth rates)



Source: *Ministerio de Fomento.*

## More and updated information on the Spanish economy



[For data sources click each figure or table](#)

## Thank you for your attention

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