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GOBIERNO DE ESPAÑA

MINISTERIO DE ECONOMÍA Y COMPETITIVIDAD

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

July 2014

Imbalances are being addressed through reforms…

- In 2012 Spain faced a severe financial crisis
- The main sources of uncertainty were rooted around three main disequilibria:
  - Macroeconomic and fiscal imbalances
  - Accumulated imbalances in the banking sector
  - Leverage of the private sector
- The Spanish Government has addressed these imbalances through an intense reform agenda

1. Closer EMU Integration

2. Spanish Economic Policy

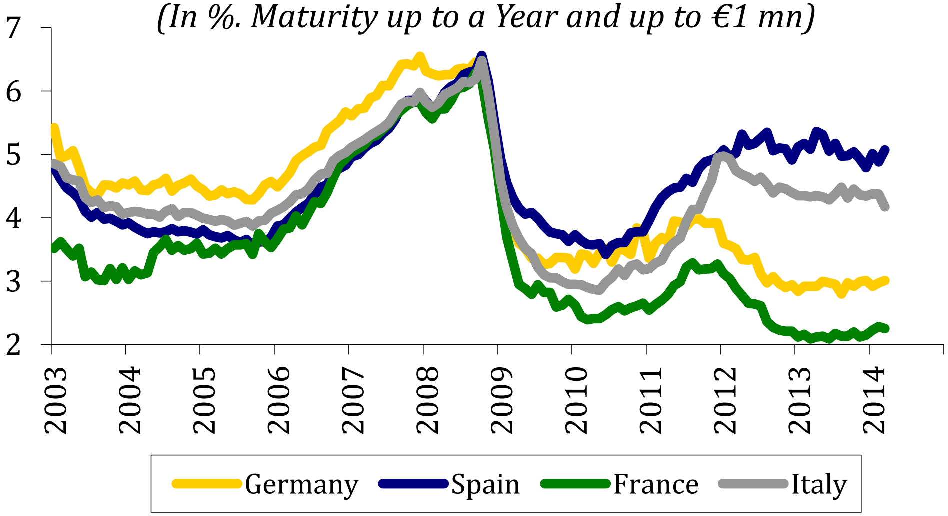
3. Transformation of Spain’s Growth Model

4. The Funding Programme of the Spanish Treasury

A credible commitment towards a robust and complete Monetary Union

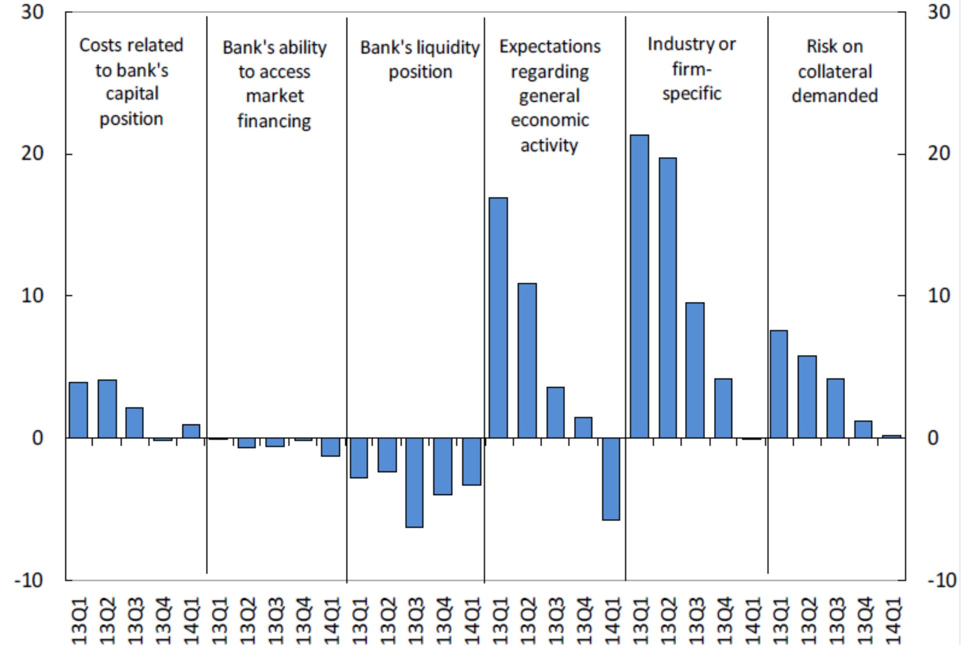
- Despite the progress in Euro Area institutional set-up, fragmentation and unbalanced access to credit persist, generating asymmetries in the monetary policy transmission mechanism

Lending Rates of New Loans to Non-Financial Corporations
(In %. Maturity up to a Year and up to €1 mn)



Source: European Central Bank. [Data]

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

- **Improving economic, financial and budgetary coordination among EA Member States will produce a sounder growth model**

- **The Two-Pack and in the Six-Pack have introduced a system of monitoring that reinforces the requirements set out under the Stability and Growth Pact 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)	-0.5	1.2	1.5	1.9	2.8	3.0	1.8	2.9	2.5
Deficit (% of GDP)	-3.0	-2.6	-2.0	-7.3	-6.4	-5.6	-5.8	-5.3	-4.1
Debt/GDP (%)	95.2	95.6	94.5	104.5	105.7	105.7	90.1	91.5	92.7
CA balance (% GDP)	2.9	2.9	3.1	-2.3	-2.2	-2.6	-3.3	-2.7	-2.2

Source: IMF. Data

A credible commitment towards a robust and complete Monetary Union

- Main pillars of the Banking Union:
  - Single Supervisory Mechanism
  - Approval of a uniform solvency regulation (CRD-IV)
  - Common resolution framework (BRRD)
  - Single Resolution Mechanism
    - ✓ Strong central decision-making Board
    - ✓ Creation of a Single Resolution Fund
- Result:
  - Level playing field for financial institutions
  - Bulk of potential recapitalisations to be borne by financial institutions
  - Limiting tax-payer burden
  - Breaking the link between the financial sector and the sovereign

Reforms for competitiveness: the reform process continues in 2014

2012: First Generation Reforms

- Labour Market
- Budgetary Framework
- Financial Sector

2013: Second Generation Reforms

- Labour Market Reform
- Services/Product Markets
- Serv. Market Liberalisation
- Single Market Law
- Budgetary Plan 2013-2014
- Pension System Reform
- Local Administrations
- De-indexation
- Financial Sector Reform
- Strategic Plan for Exporters
- ICO Mediation Credit Lines

Main Reforms in 2014

- IMPLEMENTATION OF REFORMS ADOPTED IN 2012-2013
- Job Activation Strategy and Plan for Youth Employment
- Reform of the Tax System
- New Legal Framework for Bank Finance and Alternative Funding Sources
- Financial Sector Reform; Royal Decree on Debt Restructuring

Economic Structural Reforms

Public Sector Reforms

Financial Sector Reforms

Links to detailed presentations describing the Reform Agenda

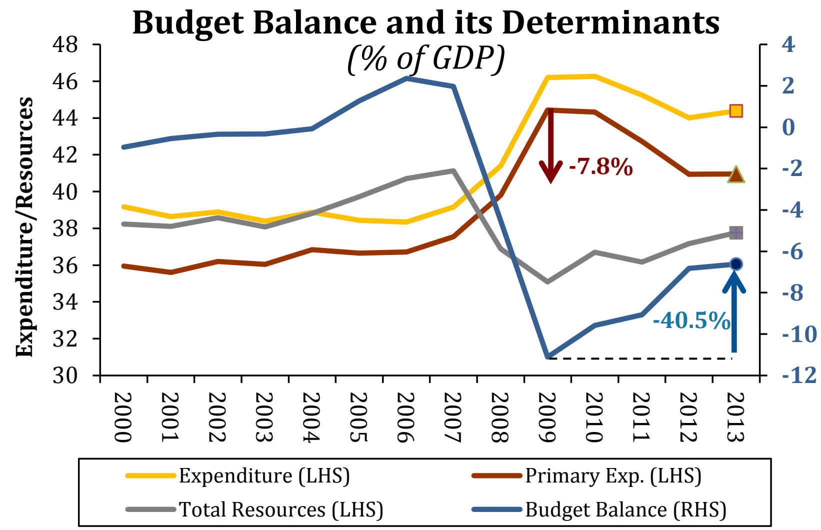
Reform of the Administrations 2013

OECD: CORA Reforms

Growth, Efficiency and Competitiveness Plan

The fiscal path of the Public Administrations 2014-2017

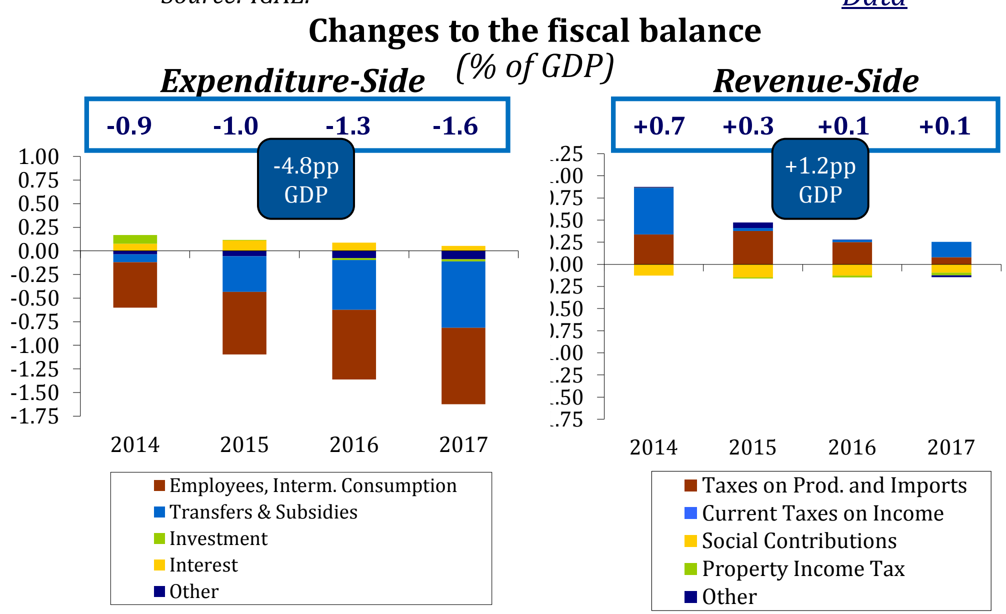
- 2014 deficit target revised down to 5.5% of GDP
- Emphasis on expenditure reduction (4.8 pp of GDP between 2014 and 2017). Incorporates impact on tax collection of the tax reform on collection



Source: IGAE. Data

Net Lending(+)/Borrowing(-) of the General Government. Excl. Financial Sector One-Offs (% of GDP)	2013	Forecast 2014	2015	2016	2017
Central Government	-4.3	-3.5	-2.9	-2.2	-1.1
Autonomous Regions	-1.5	-1.0	-0.7	-0.3	0.0
Local Governments	0.4	0.0	0.0	0.0	0.0
Social Security Administrations	-1.2	-1.0	-0.6	-0.3	0.0
General Government	**-6.62**	**-5.5**	**-4.2**	**-2.8**	**-1.1**
Primary Balance	**-3.20**	**-2.0**	**-0.6**	**0.9**	**2.7**
Structural Balance	**-2.0**	**-1.3**	**-1.0**	**-0.5**	**0.1**
Structural Primary Balance	**1.4**	**2.2**	**2.6**	**3.2**	**3.8**
Nominal Adjustment	**0.2**	**1.1**	**1.3**	**1.4**	**1.7**
Financial Sector one-offs	**0.5**	**-**	**-**	**-**	**-**

Source: Ministerio de Economía y Competitividad. Data

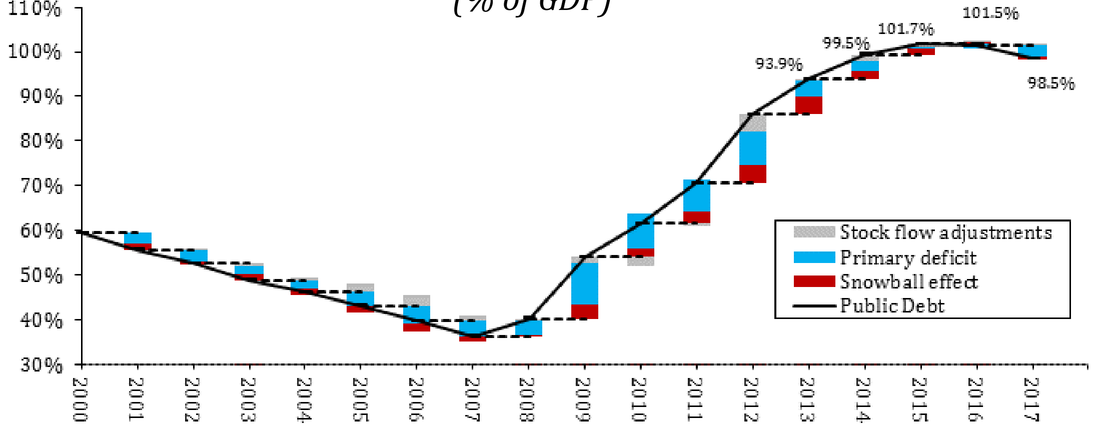


Source: Ministerio de Economía y Competitividad. Data

Debt/GDP dynamics 2014-2017

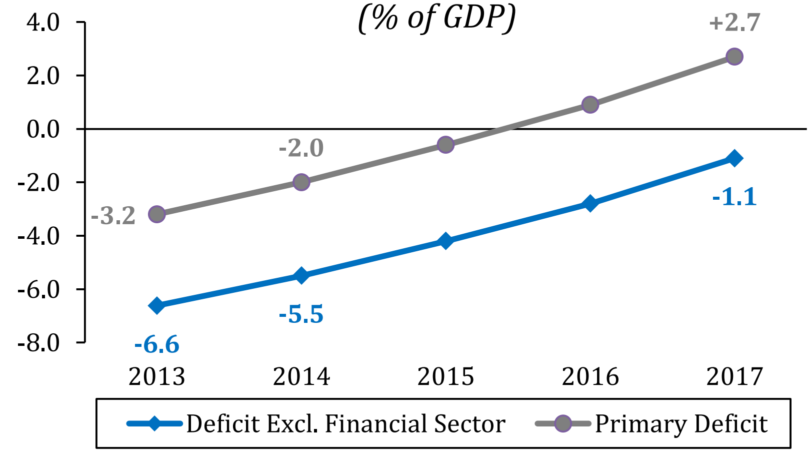
- Debt to GDP ratio to peak above 100% of GDP in 2015-2016
- Lower impact stemming from one-off components (Fund for Payment to Suppliers, financial sector recapitalisation, FADE, etc.)
- Primary surplus to be reached in 2016, reversing the Debt to GDP trajectory
- Achievement of structural surplus in 2017, ensuring the decline in the ratio

Forecast of General Government Debt
(% of GDP)



Source: Ministerio de Economía y Competitividad. Data

Deficit and Primary Deficit
(% of GDP)

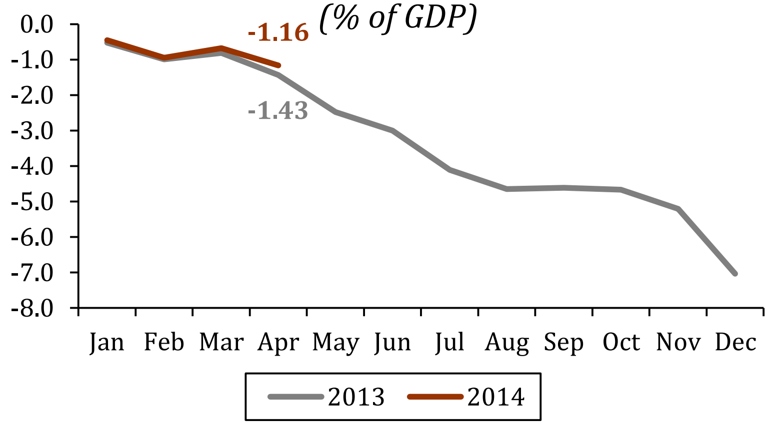


Source: Ministerio de Economía y Competitividad. Data

Budgetary execution in 2014

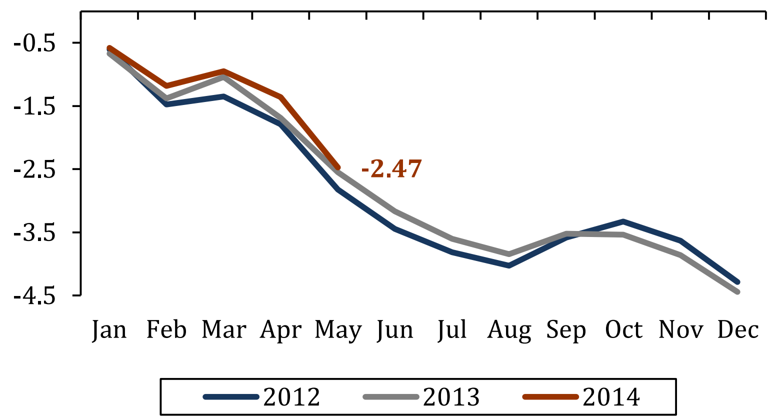
- **2014 deficit target revised to 5.5% of GDP**
- **Monthly budgetary execution data for the most relevant administrations released in National Accounting terms since April 2013**
  - Central Government (*April 2014 data*): the combined deficit of the Central Government Administration and the autonomous entities of the Central Govt. reached €12.3 bn
    - Central Gov. Administration (*May 2014 data*): deficit €25.7 bn vs €26.1 bn in May 2013
      - ✓ Income increased by 5.7% y-o-y
      - ✓ Expenditure increased by 3.0% y-o-y
  - Regional Governments (*April 2014 data*): deficit reached €4.5 bn
  - Social Security Administrations (*April 2014 data*): the Social Security posted a surplus of €4.7 bn

Combined Deficit of Central & Regional Governments and Social Security Administrations. Excl. Financial Sector Recapitalisation *(% of GDP)*



Source: IGAE. Data

Breakdown of the Budget Balance of the Central Government Excl. Financial Sector Recapitalisation *(% of GDP)*



Source: IGAE.
Up to May 2014

Data

The reform of the public administrations

- **The reform of the public sector builds on the structural reform process initiated in 2012:**
  - **Reform of the Local authorities**, including a review expenditure priorities
  - **Review of the Central Government expenditure** through the CORA Committee
  - **Law on commercial debt**: control of average payment period to providers of public administrations
  - **Review of the Tax Code**: expert committee's proposal was presented in March, Government's draft law was produced in June

Transparency Law

Independent Fiscal Responsibility Authority

Commission for the Reform of the Public Sector

Reform of the Local Authorities

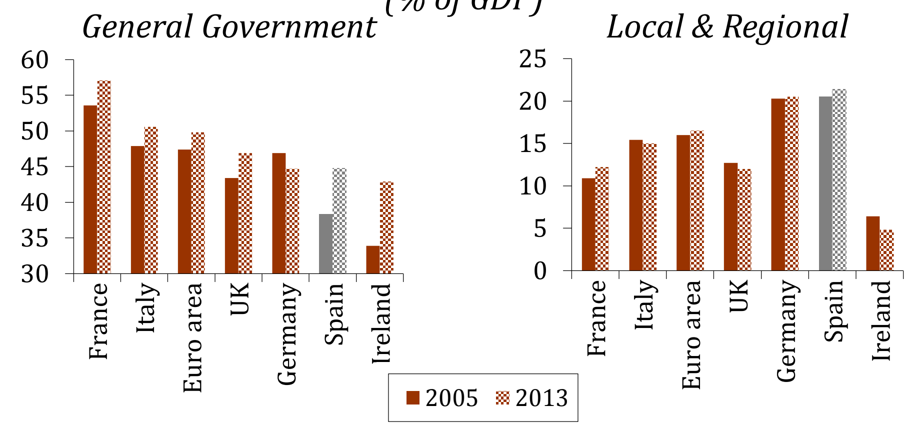
Draft Law: Tax Reform

Electronic Billing Law

The reform of the public administrations: streamlining expenditure

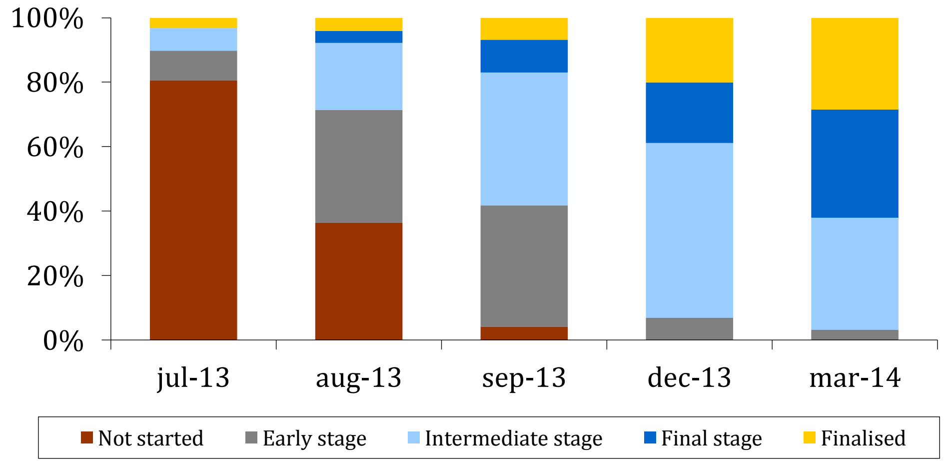
- **The Law for the Reform of the Public Administrations targets gains in efficiency and the professionalisation of political and administrative functions at all levels of government**
- **The reform has four main objectives:**
  - ❑ To clarify local governments' responsibilities in order to avoid overlaps
  - ❑ 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**

Expenditure Excluding Financial Sector One-Offs
(% of GDP)



Source: Eurostat. Data

Degree of Completion of the Measures of the Commission for the Reform of the Public Sector



Source: Ministerio de Hacienda y Administraciones Públicas. Data

Tax reform: draft law

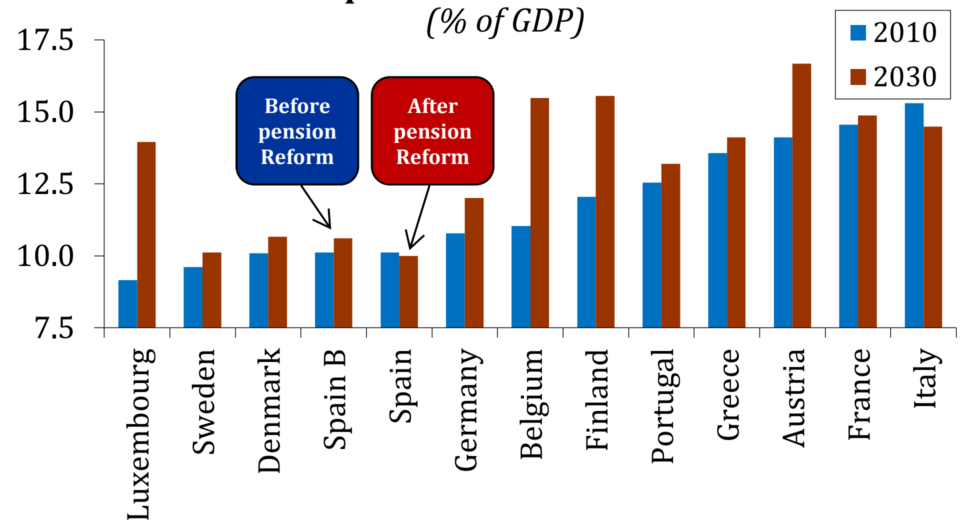
- The Governments draft law was presented on June 20th and its referral to Parliament is expected in July
- It aims at reducing taxation on labour income, to strengthen competitiveness and to promote saving and investment and modernises Personal Income tax and the Corporate Income tax
- Reinforcement of the fight against tax fraud

<table>
<tr><th>Changes to Personal Income Tax</th><th>Changes to Tax on Capital</th><th>Changes to Corporate Income Tax</th><th>VAT</th><th>Fight Against Tax Fraud</th><th>R&D and cultural investment</th></tr>
<tr><td>► Reduction in number of tranches and rates in two years</td><td>► Lower rates in two years and more progressive</td><td>► Reduced general rate: from 30% to 25% in two years (reduced rate for new firms 15%)</td><td rowspan="3">► Health care products VAT rate adapted to ECC regulations:
-Intermediate products for drug development, medical instruments and equipment, medical devices and pharmaceutical products</td><td>► Lists of defaulters to be published</td><td rowspan="3">► Extension of partial exemption (85%) of the tax on electricity. Exemptions extended to all productive processes in which the costs of electricity exceeds 50% of production costs</td></tr>
<tr><td rowspan="3">► Modification of personal income allowance:
- Higher personal income minima
- Family tax deductions: enabling negative tax rates for large families and with dependent persons with serious disabilities</td><td>► Elimination of tax deduction for dividends</td><td>► In the case of the financial sector kept at 30%</td><td>► Annual publication of tax havens</td></tr>
<tr><td>► Capital gains generated in less than 12 months no longer penalised</td><td rowspan="3">► Substitution of deductions in CIT
● Deductions eliminated:
- Environmental investments
- Expenses for vocational training
- Reinvestment of extraordinary benefits
● New deductions (favouring the deleveraging process):
- Capitalisation reserves. 10% of corporate income deducible if incorporated into reserves.
- Equalisation reserve for SMEs
● Limits to the financial expenditure deductions (favouring the deleveraging process, reduced to 30% of gross operating profit)</td><td>Tax audit process: New deadlines and suspension of Statutes of Limitation in specific situations</td></tr>
<tr><td rowspan="3">► New savings instrument: savings or insurance schemes maintained longer than five years ('Cuenta Ahorro 5'): exempt form capital gains tax</td><td rowspan="6">► New rules on the localisation of assets; taxing at destination of electronic, telecommunications and radio-television services when the addressee is a private individual</td><td>► Administrative assessment in evidence of tax fraud</td><td rowspan="3">► Companies investing more than 10% of their accounting net income in R&D will extend their percentage of deduction to 50%.</td></tr>
<tr><td>► Limits to exemptions to severance payments in case of unjustified dismissal</td><td>► Tax assessment cases are extended to smuggling offenses</td></tr>
<tr><td>► Tax deductions for house rental:
- Elimination for new rentals (Expenditure side)
- Lower tax deductions for house rentals (Income side)</td><td>► Update and simplification of depreciation tables</td><td>► Better precision in the indirect assessment regime</td></tr>
<tr><td>► Lower tax withholding for professional and self-employed workers with incomes below €15,000</td><td>► Limit for deductible contributions linked to pension plans lowered to €8,000/year</td><td>► No deductibility of equity securities impairments extended to fixed income portfolios and fixed assets</td><td>► Imprescriptibility of the Administration's right to check tax credits derived from statute-barred tax years</td><td rowspan="3">► Incentives for cultural activities</td></tr>
<tr><td>► Limits to simplified method ('Modulos') to certain professional activities</td><td rowspan="2">► Better fiscal treatment in case of assets received in lieu of payment if affected by preference shares</td><td>► General limit 60% for Tax loss carryforwards as from 2016</td><td rowspan="2">► Interruption of the limitation period of related tax obligations</td></tr>
<tr><td>► Elimination of abatement coefficients and monetary correction gains</td><td>► To maintain income from the CIT, in 2015 previous measures maintained</td></tr>
</table>

The Pension System reform reduces the impact of population ageing

- **Building on the 2011 reform which already introduced measures to adapt the pension system, in March 2013 a Royal Decree was presented in order to foster active ageing, increasing 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 which links pensions to the financial situation of the pension system, to the number of pensioners and to average pension
  - ❑ Life expectancy; will enter into force in 2019 and will be evaluated every 5 years
- **"*De-Indexation*" Law eliminates second-round inflationary pressures stemming from the Pension System**

Gross Expenditure in Public Pensions
(% of GDP)



Source: European Commission and Ministerio de Economía y Competitividad

Data

The labour market reform addresses Spain's most important imbalance

The labour market reform tackles the main shortcomings of the Spanish labour market: high structural unemployment, high youth unemployment, duality, high employment volatility and wage indexation which limit gains in competitiveness

Collective Bargaining

➡ Dynamic bargaining more responsive to the needs of businesses and workers

➡ Move beyond the model of indexing salaries and wages

➡ Balanced regulatory framework in line with economic circumstances

❶ Opting out from higher-level agreements
❷ Priority of company-level agreements
❸ Limiting the statutory extension rule of expired agreements up to one year (unlimited before)

Internal Flexibility of Firms

➡ Avoiding lay-offs: rigidity fostered job cuts as a means of adjusting to economic changes
➡ Lack of flexibility avoided innovation and gains in competitiveness

❶ Classification of workers based on skills not on professional occupations
❷ Simplification of rules for the reallocation of workers
❸ Streamlining the adoption of significant changes in working conditions
❹ Furloughs/Time-reductions if legitimate financial, productive or organisational reasons exist
❺ Distribution of working-time

External Flexibility of Firms

➡ Reduction of severance pay for unfair dismissals

➡ Clear and objective regulatory framework of fair dismissals

❶ Severance pay for unfair dismissal down to 33days/Max 24months of salary vs. 45days/Max 42 months
❷ Clarification of fair dismissal causes (20days/Max 12 Mo)
❸ Removal of administrative authorisation for collective layoffs
❹ Elimination of procedural salaries
❺ Fair dismissals for economic causes of civil servants
❻ Streamlining of dismissals based on absenteeism

Contracts

❶ 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
❷ 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
❸ Flexible regulation of telework
❹ Part-time contract: increased flexibility, allowing overtime

Activation policies & fight against unemployment

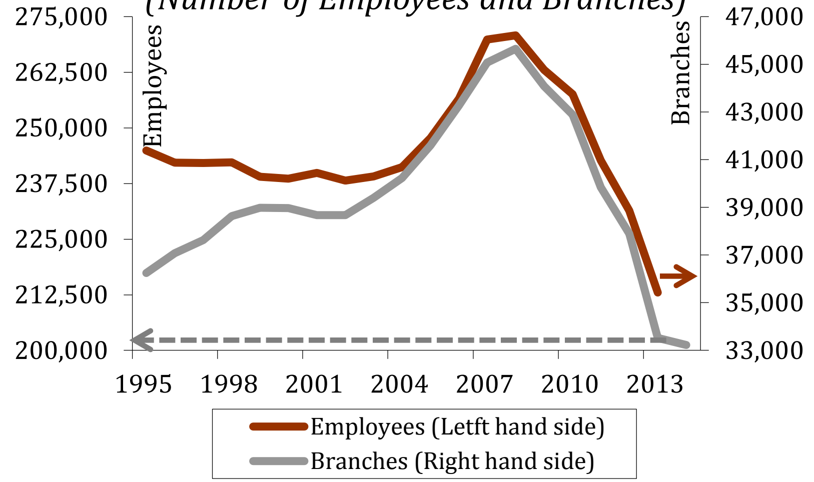
Activation policies complement the labor reform. Spain is reforming its public employment services and launching new tools to fight against unemployment and accelerate resource reallocation:

- New coordination and programming framework through annual employment plans: funding to regions subject to efficiency measures through a new set of indicators, best practice sharing
- Training for the employment and vocational training reform: competition, transparency and close monitoring of actions
- Private sector collaboration in matching services and new national employment website to spur mobility and improve matching process
- Hiring subsidies to lower labour costs, specially for SMEs and younger workers
- Rationalisation, better targeting and more conditionality of unemployment benefits
- Special plans for the youth: European youth guarantee and Spanish Strategy for youth unemployment and entrepreneurship

Adjustment and recapitalisation of the financial system (I)

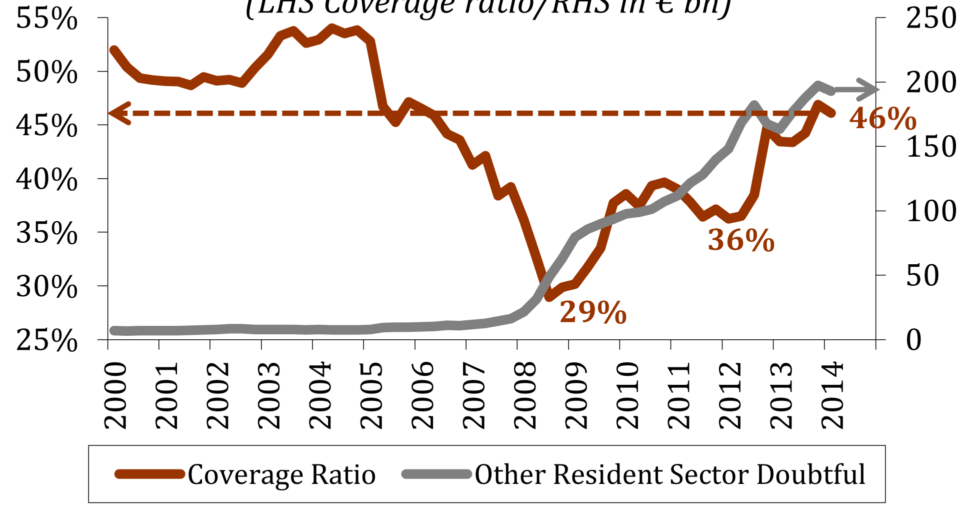
- **The winding-down of the financial sector has removed the excess capacity built up during the housing boom**
- **Capital increases and voluntary liability management exercises in the last 4 years above €100 bn:**
  - FROB and Deposit Guarantee Fund: €59 bn
  - Burden-sharing exercises: €13.6 bn
  - Private capital increases in excess of €25 bn
- **Clean-up effort in the period 2008-2013 amounted to €270 bn, especially intense in 2012, when it reached €122 bn**
  - Coverage ratios of doubtful loans to "other resident sector" has increased from 36% in 2012Q1 to 46% by 2014Q1

Adjustment in Deposit Taking Institutions
(Number of Employees and Branches)



Source: Bank of Spain. Data

Doubtful Loans. Other Resident Sector
(LHS Coverage ratio/RHS in € bn)



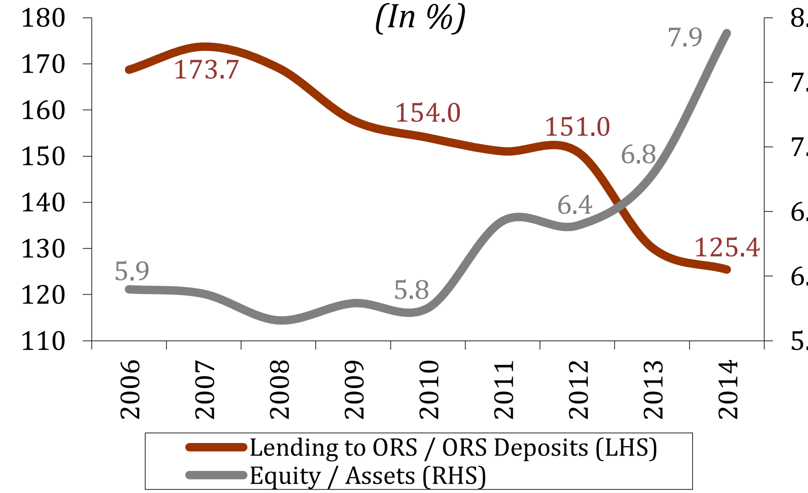
Source: Bank of Spain. Data

RECAPITALISATION OF THE FINANCIAL SECTOR

Adjustment and recapitalisation of the financial system (II)

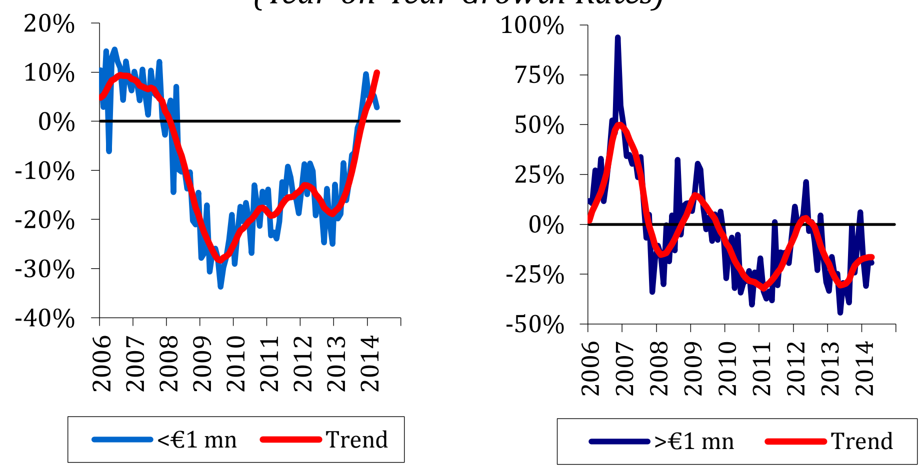
- **Capitalisation of the financial sector: equity-to-asset ratio of the overall sector has increased from 5.8 in 2010 to 7.9 in the first quarter of 2014**
- **Conversely the lending-to-deposits ratio has declined from 154% to 125.4%, substantially closing the funding gap**
- **This improves private-sector credit: new lending operations to non-financial firms have started to pick up after a prolonged period of posting negative growth rates**

Equity-to-Assets and Lending-to-Deposits Ratios
(In %)



Source: Bank of Spain. Data

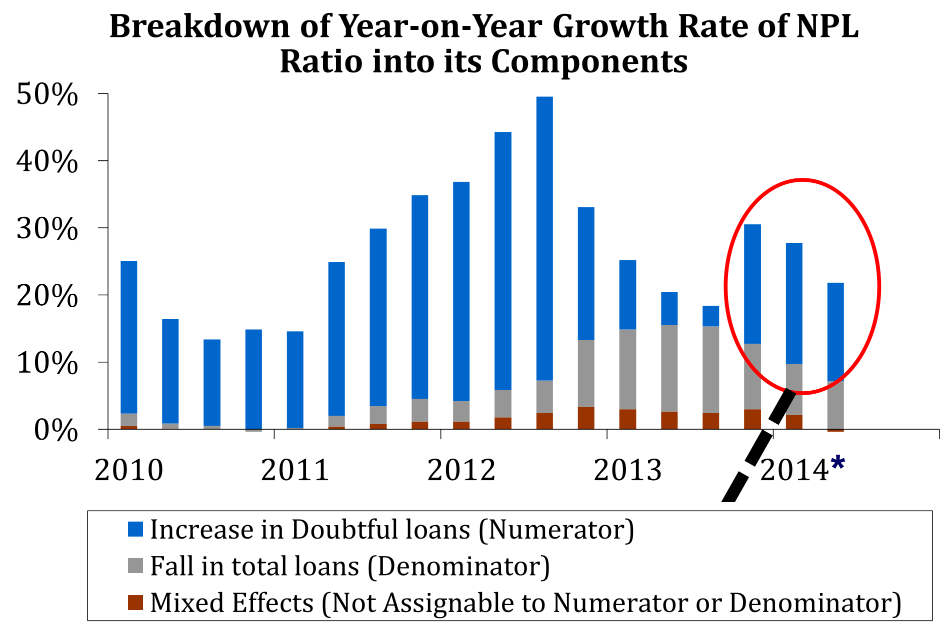
New Credit to Non-Financial Firms by Size of Loan
(Year-on-Year Growth Rates)



Source: Bank of Spain. Data

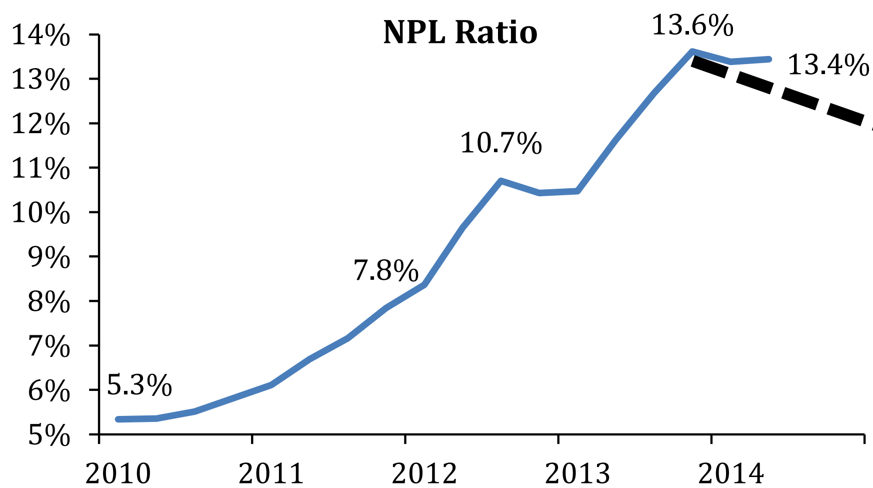
Enhanced transparency and refinanced loan provisioning requirements

- 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



Source: Bank of Spain.
** Last: April 2014 over April 2013*

Data



Source: Bank of Spain.
** March 2014 over March 2013*

Data

Restructured and Refinanced Loans (€ bn)	Initial	After Corrections As of Dec 2013
Normal	73.6	61.7
Sub-standard	37.2	41.0
Doubtful	71.7	108.6

Source: Bank of Spain.

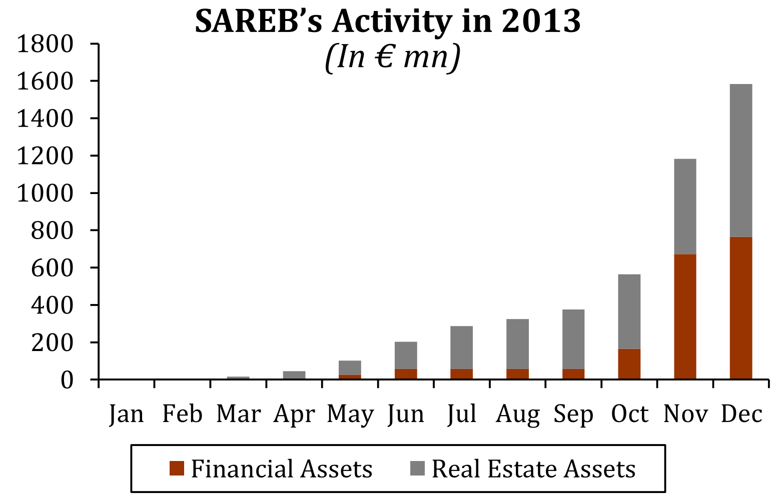
Data

The Asset Management Company: SAREB

- **Overall Sareb received total assets ammounting to €50,781 mn, valued at transfer prices**
  - ❑ €34.438 mn financial assets (loans to real estate promotion)
  - ❑ €11.343 mn real estate assets
- **These assets were transfered to SAREB after applying discounts to the gross amounts held by Group 1 and Group 2 banks**
- **In 2013 SAREB's activity concentrated in the second half of the year**
- **For more information www.sareb.es**

Average discount applied (%)

Financial Assets	With guarantee	*Finished houses*	*32.4*
		Unfinished houses	*40.3*
		Urban land	*53.6*
		Other land	*56.6*
		Other guarantees	*33.8*
	Without guarantee		67.6
Real Estate Assets	New housing		54.2
	Unfinished houses		63.2
	Land		79.5



Source: SAREB. Data

Measures to improve the financing of the economy

A series of measures were introduced in order to improve the financing of the Spanish economy

- Alternative Fixed Income Market
- Venture Capital Funds
- ICO-Lines
- Mutual Guarantee System

2014 FINANCIAL SECTOR REFORM

Measures to improve Spanish firms' access to finance	Royal Decree on Debt Restructuring: removal of obstacles to agreements between debtors and creditors	Improvement of venture capital funds' regime
SMEs banking credit	Individual Refinancing Agreements	More flexible investment regime for venture capital funds
Mutual guarantee funds reform	Simplification of Collective Refinancing Agreements	New type of SMEs venture capital funds with an even more flexible investment regime to fuel equity and debt financing to SMEs
Financial credit establishments at sales point	COMMON MEASURES - Extension of agreements to dissenting creditors - Interruption of enforcement measures up to conclusion of arrangements - Fresh money as claim against the estate	Reduction of administrative burdens for venture capital funds
Revision of the securitisation regime		Compliance with AIFM Directive
Access to capital markets		
Crowdfunding Regulation		

- Provides legal certainty
- Financial creditors not in a worse position
- Avoids closing down viable firms
- Frees up capital and funding for viable firms
- Better provisioning framework

Forthcoming AQR and Stress Test

- **AQRs are a prerequisite for stress tests. They ensure the reliability of the starting point of the stress test:**
  - Uniform definition of concepts (RWA, NPLs, etc.)
  - A transparent level playing field with independent supervision
- **EBA expects to publish the final results of the 2014 EU-wide stress test in October 2014**

Adverse Scenario EBA Stress Test 2014

	EBA 2014				*OW Spain 2012*			
	2014	2015	2016	Cumulative 2014-2016 *(In p.p.)*	2012	2013	2014	*Cumulative 2012-2014 (In p.p.)*
Real GDP (% growth)	-0.3	-1.0	0.1	**-1.2**	-4.1	-2.1	-0.3	***-6.4***
GDP Deflator (% growth)	0.3	0.4	0.8	**1.5**	0.0	-0.7	0.1	***-0.6***
Unemployment Rate (Level)	26.3	26.8	27.1	**3.8**	25.0	26.8	27.2	***25.9***
Housing Prices	-7.4	-3.0	0.9	**-9.4**	-19.9	-4.5	-2.0	***-25.0***
Commercial Property Prices	-2.8	-2.2	-0.6	**-5.5**	--	--	--	***--***
Land Prices	--	--	--	**--**	-50.0	-16.0	-6.0	***-60.5***
Euribor, 3 months (In %)	-2.8	-2.2	-0.6	**-5.5**	1.9	1.8	1.8	***5.6***
SPGB 10YR (Yield in %)	5.7	5.5	5.6	**17.8**	7.4	7.7	7.7	***24.6***
Credit to Households	--	--	--	**--**	-6.8	-6.8	-4.0	***-16.6***
Credit Non-Financial Firms	--	--	--	**--**	-6.4	-5.3	-4.0	***-14.9***
IBEX	-23.4	-21.1	-24.9	**-54.6**	-51.3	-5.0	0.0	***-53.7***

Source: Ministerio de Economía y Competitividad and EBA.

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3. Transformation of Spain's Growth Model

4. The Funding Programme of the Spanish Treasury

Transforming Spain's economic model

- **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 34.6% by 2014-Q1
  - Current Account has reverted from a deficit of 10% of GDP in 2007 to a surplus since 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
  - Re-composition of the asset/liability structure of firms' balance sheets
  - Non-financial firms' debt has declined from 143.8% of GDP in 2010 to 129.0% by 2013-Q4; Firms' Consolidated debt has adjusted by 20.5%
  - Households' debt has declined from 87.4% of GDP in 2010 to 77.1% by 2013-Q4

Macroeconomic scenario

- **Growth forecast for 2014-2017 envisages increasing growth, stemming from private national and external demand**
  - Net job-creation to resume in 2014
  - Current account surplus to widen in the next four years

Click dots to view detail

Macroeconomic scenario *(Year-on-year growth rates in percent)*	2013	2014 Full year forecast	2014 *2014-Q1*	2015(f)	2014(f) European Commission (Spring Forecast)	2014(f) OECD (May 2014)	2014(f) IMF (April 2014)
Private consumption	-2.1	1.4	*1.6*	1.8	1.3	1.0	1.2
Government consumption	-2.3	-1.3	*-0.2*	-1.9	-0.8	-3.6	-1.7
Gross Fixed Capital Formation	-5.1	0.5	*-1.1*	3.0	-1.4	0.3	0.6
National Demand*	**-2.7**	**0.7**	***0.7***	**1.2**	**0.4**	**-0.1**	**0.5**
Exports of goods and services	4.9	5.0	*8.1*	6.1	5.5	5.6	--
Imports of goods and services	0.4	3.6	*9.3*	5.0	3.4	2.6	--
External demand*	**1.5**	**0.6**	***-0.2***	**0.5**	**0.8**	**1.1**	**0.4**
Gross Domestic Product	**-1.2**	**1.2**	***0.5***	**1.8**	**1.1**	**1.0**	**0.9**
Other macroeconomic variables							
Unemployment rate (in %)	26.1	24.9	*25.9*	23.3			
Full-time Equivalent Employment (Year-on-year)	-3.4	0.6	*-0.3*	1.2			
Unit Labour costs (Year-on-year)	-1.6	-0.4	*-0.9*	0.0			
GDP deflator (Year-on-year)	0.6	0.5	*1.2*	0.8			
Net lending(+)/borrowing(-) with RoW (% of GDP)	1.5	2.0	*1.1*	2.4			
Deficit Excl. Financial Sector One-Offs	-6.6	-5.5	*-0.67***	-4.2			
Primary Deficit(-)/Surplus(+) Excl. Financial Sector	-3.2	-2.0	*+0.14***	-0.6			
Debt/GDP ratio (in % of GDP)	93.9	99.5	*95.2*	101.7			

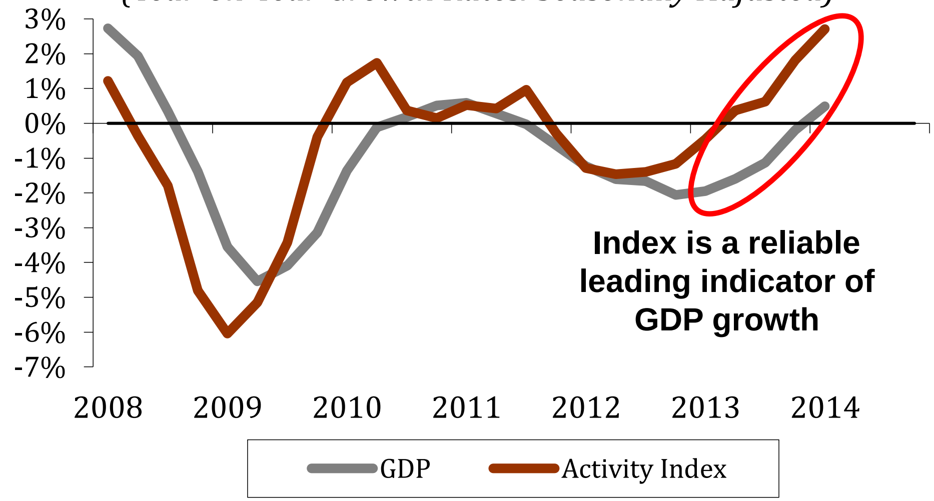
Sources: Ministerio de Economía y Competitividad, OECD, IMF and European Commission.

** Contributions to GDP in p.p. ** Data for Central Government, Regions and Social Security*

Recent coincident and leading indicators point to an economic recovery

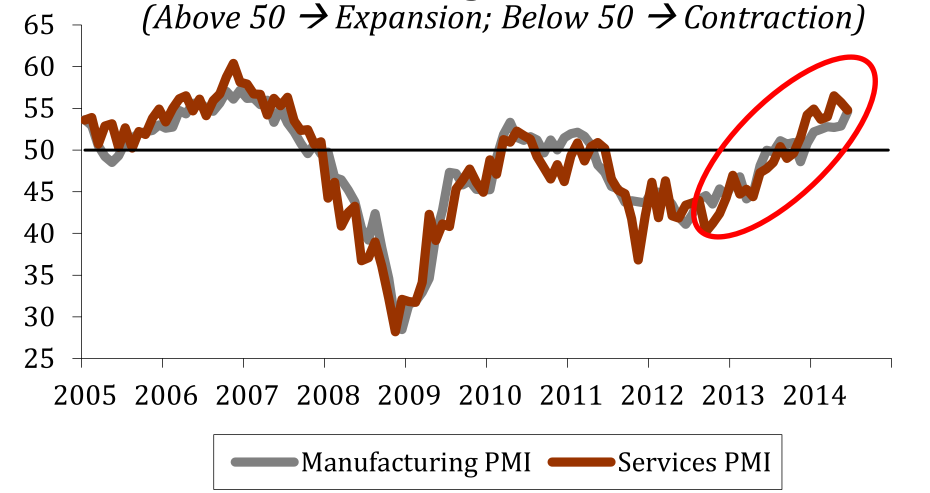
- **Positive trends in external demand and productivity have a positive effect on internal demand and employment**
  - Coincident and leading indicators point towards a change of cycle, especially in the services sector
  - Synthetic Activity Indices (composite indices designed to gauge overall economic 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

GDP vs Synthetic Activity Index Growth
(Year-on-Year Growth Rates. Seasonally Adjusted)



Source: Ministerio de Economía y Competitividad, Data

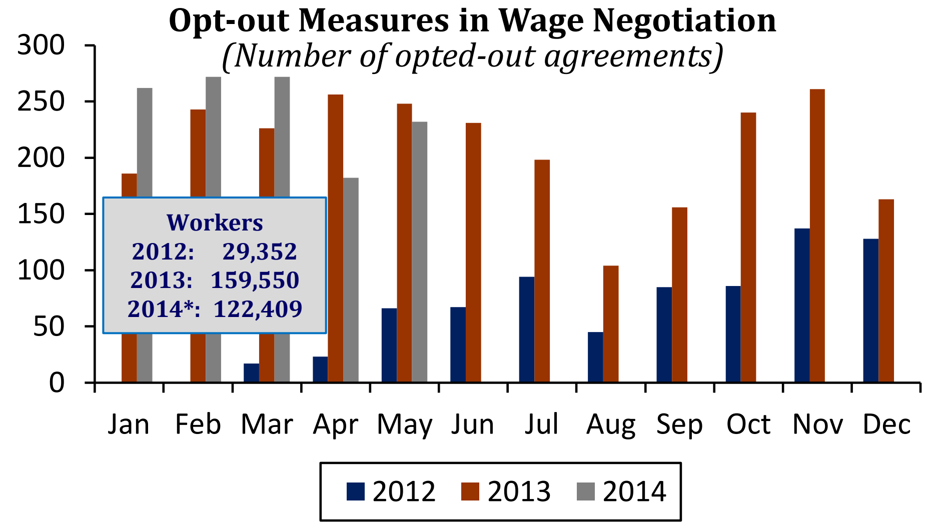
Manufacturing and Services PMI
(Above 50 → Expansion; Below 50 → Contraction)



Source: Ministerio de Economía y Competitividad, Data

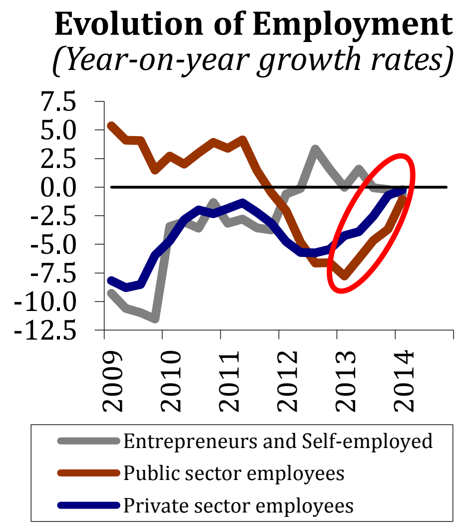
Labour market reform: wage moderation and enhanced flexibility mechanisms

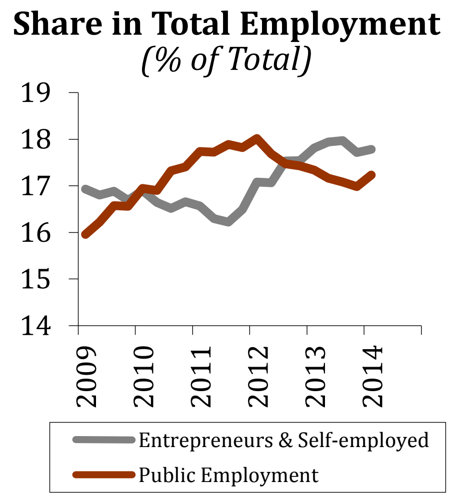
- **The reform has eased opting out from collective agreements; most linked to wage negotiation (approx. 90% of all opting-outs clauses in 2013)**
  - Phasing out of automatic renewal of expired collective agreements, and increasing number of new agreements, have accelerated wage moderation
- **Mild 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 386,100 employees since 2011-Q3
  - Private sector employees, entrepreneurs and self-employed are recovering or have stabilised since 2013



Source: Ministerio de Empleo y Seguridad Social.
** 2014: from June 2013 to May 2014*

Data



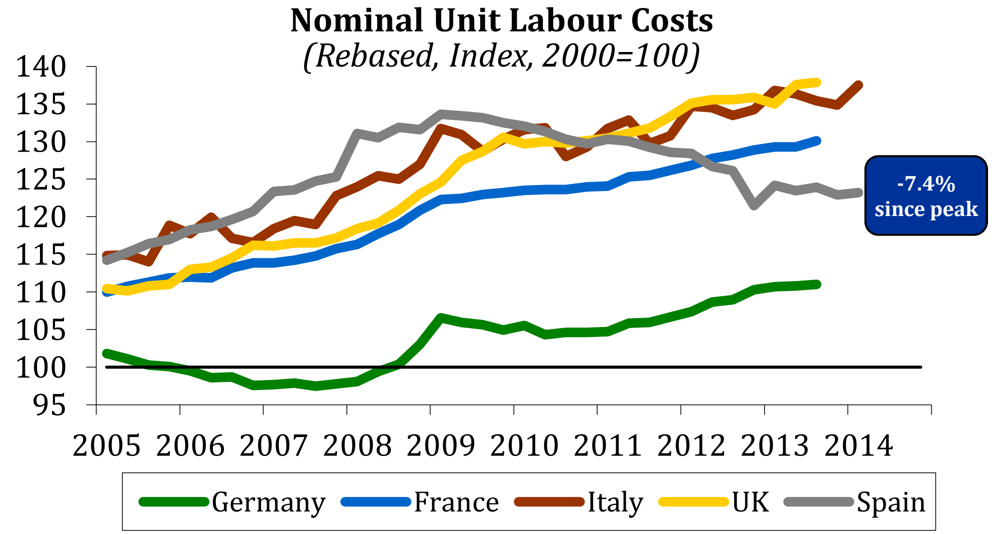


Source: National Statistics Institute.

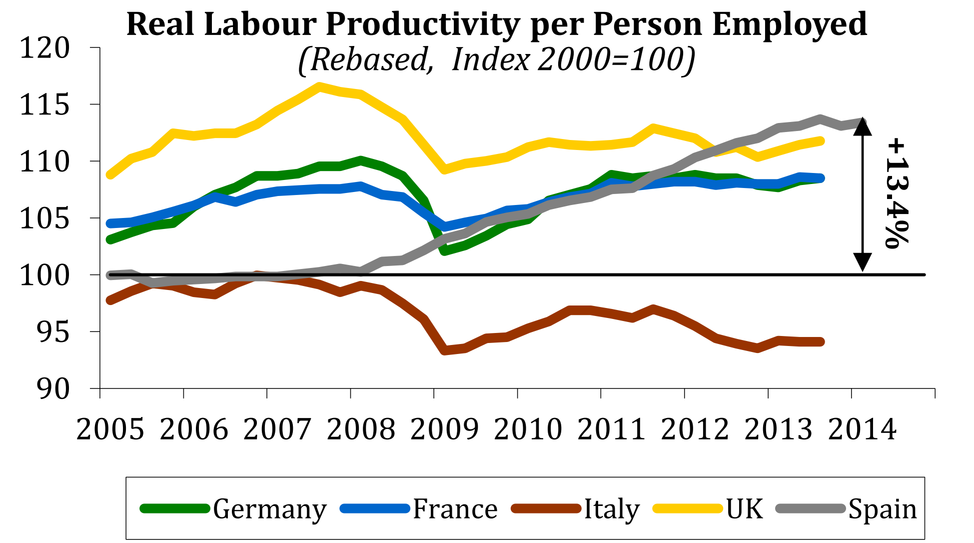
Data

Wage moderation, rebalancing and competitiveness

- **The initial productivity shock in 2008-2009 caused by 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 7.4% since the peak in 2009 and are at similar levels than in 2007-Q1
  - Real productivity has steadily increased since 2008 due to the shift from non tradable goods towards tradable goods and services, erasing relative productivity losses registered up to 2008



Source: Eurostat. Data

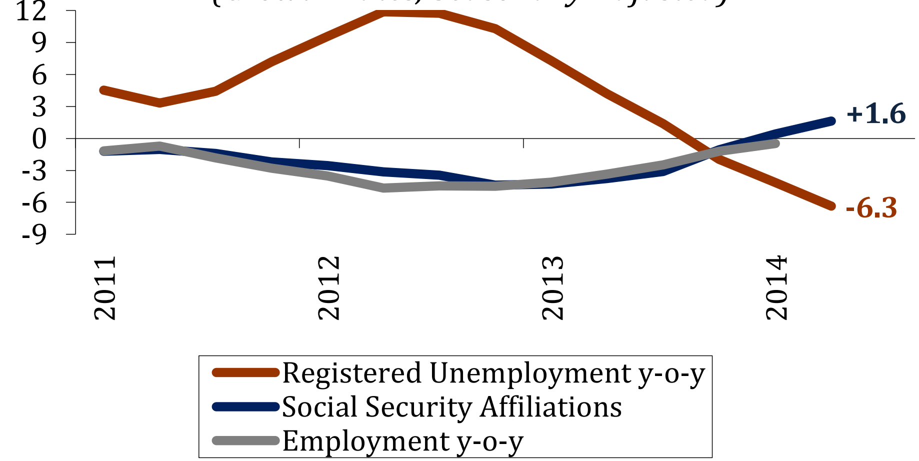


Source: Eurostat. Data

Lower growth needed for employment creation in the private sector

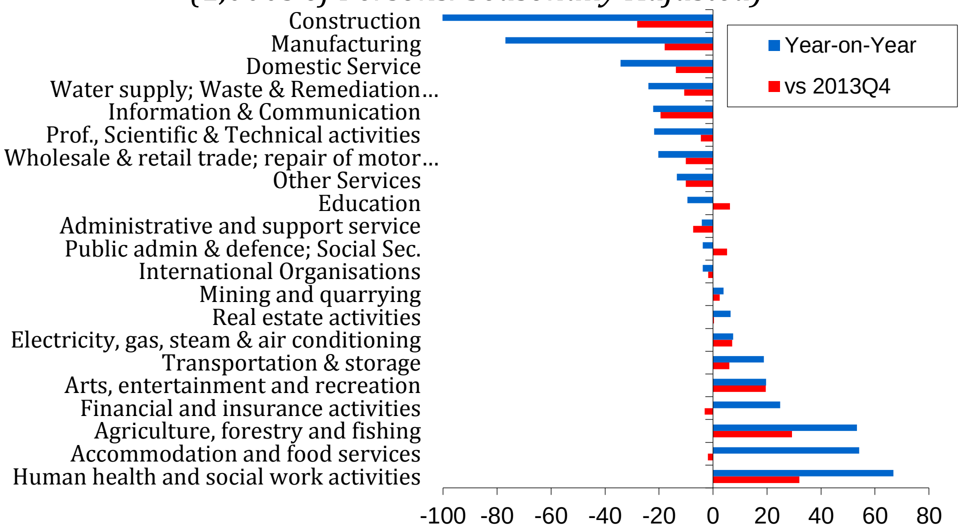
- First signs of stabilisation in the labour market linked to increased activity in services (food services; insurance; health and IT), together with car manufacturing
- New regulatory framework has decreased the minimum GDP growth required for net private sector job creation

Employment, Social Security Affiliations* & Registered Unemployment
(Growth Rates, Seasonally Adjusted)



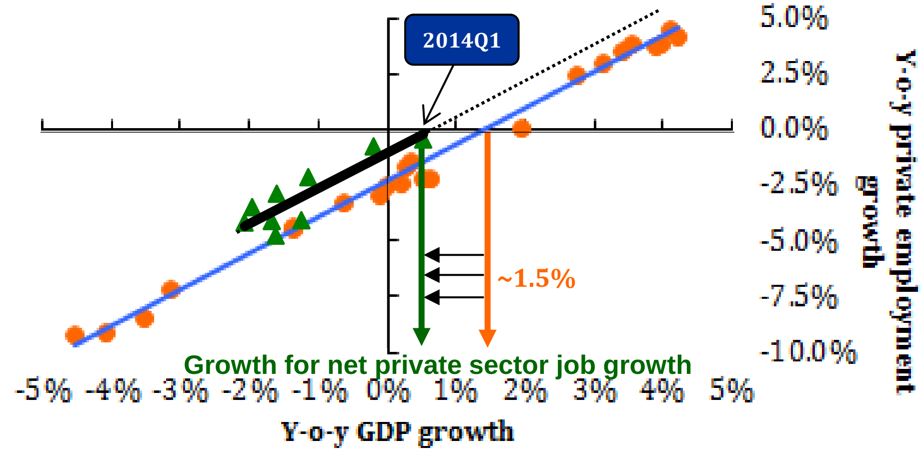
Source: National Statistics Institute, Data

Employment by Branch
(1,000s of Persons. Seasonally Adjusted)



Source: National Statistics Institute, Data

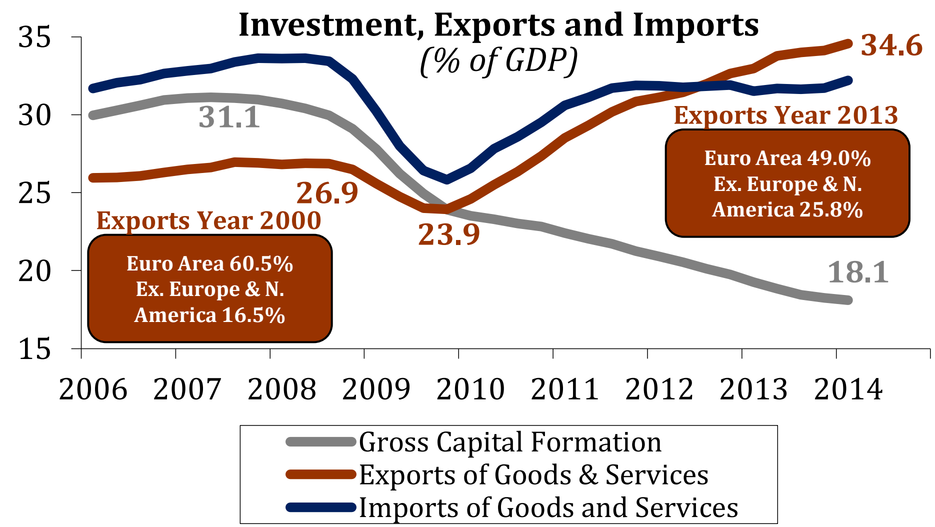
Growth Required for Private Employment Creation
(Quarterly Data, Seasonally and Calendar Adjusted)



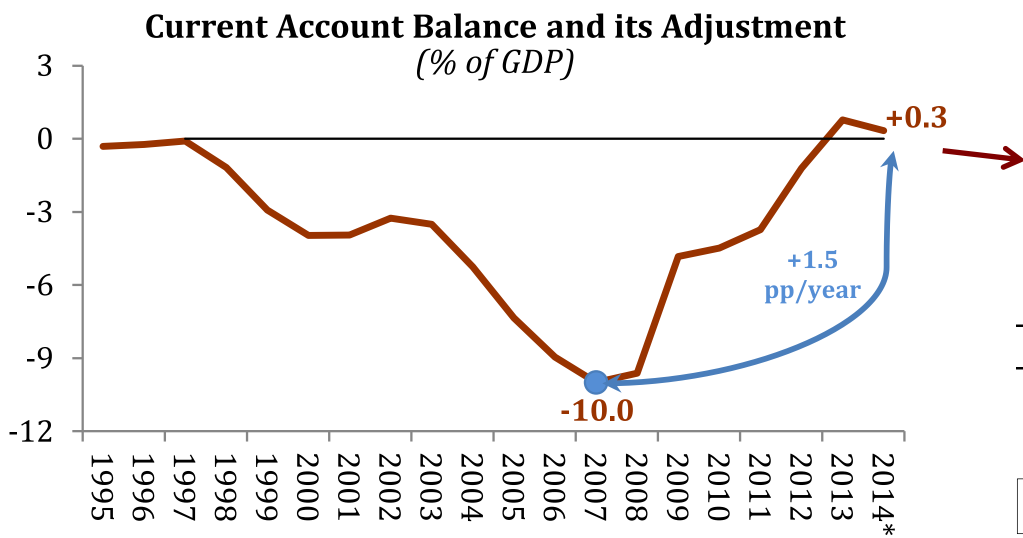
Source: National Statistics Institute. Data

Rapid expansion of the external sector

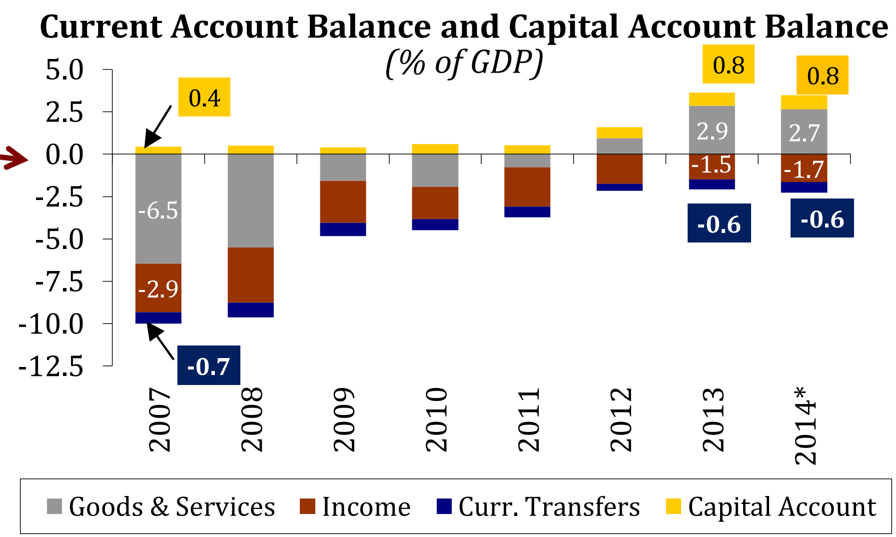
- As a reflection of the structural change in the Spanish economy the weight of exports in GDP has increased from 23.9% in 2009 to 34.6% by 2014-Q1, while the weight of investment has declined substantially
- Cumulative CA surplus May 2013 to April 2014: 0.3% of GDP
- Internal devaluation process more effective in CA correction than nominal devaluations



Source: National Statistics Institute. Data



Source: Bank of Spain.
** Up to April 2014* Data



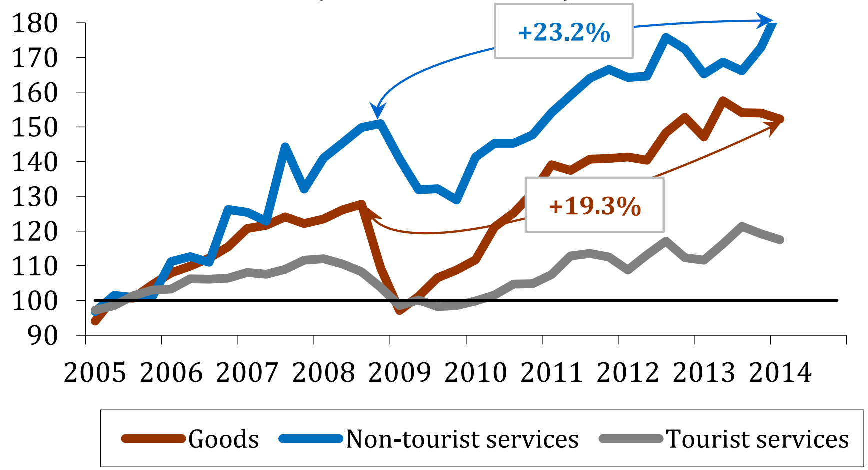
Source: Bank of Spain.
** Up to March 2014* Data

Recent evolution of the external sector

- Recent balance of payments statistics reflect a stabilising trend in exports of consumer goods and intermediate industrial products, while imports are increasing in line with investment in machinery but also consumer goods

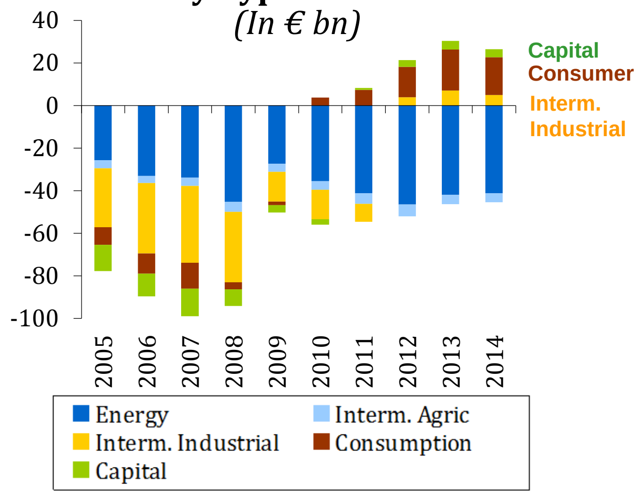
- Exports of services maintain notable growth rates; exports of construction services are recovering positive growth rates

Nominal Exports of Goods and Services
(Index, 2005=100)



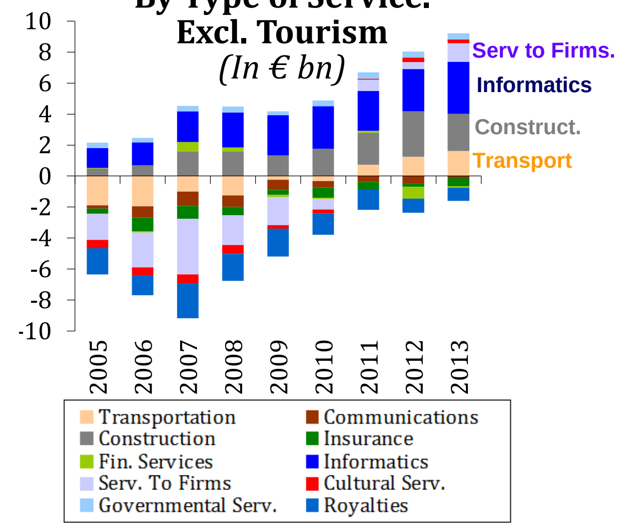
Source: National Statistics Institute. Data

Net Exports of Goods By Type of Good
(In € bn)



Source: Bank of Spain. Data

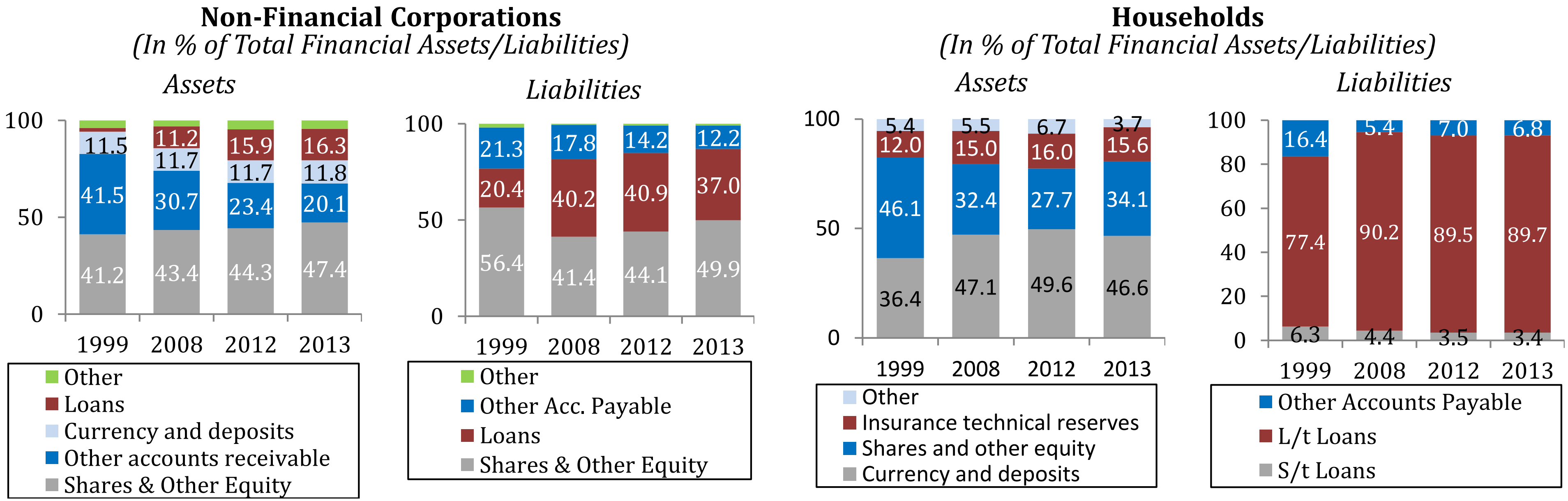
Net Exports of Services By Type of Service. Excl. Tourism
(In € bn)



Source: Bank of Spain. Data

Deleveraging of the private sector: re-composition of assets and liabilities

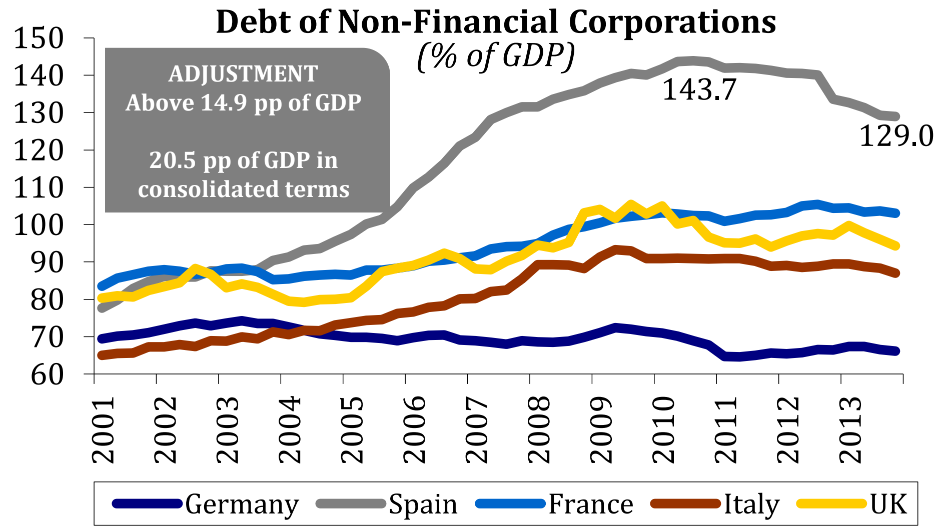
- **The private sector is gradually switching from traditional debt to equity, in both, assets and liabilities**
  - Non financial corporations: liabilities less intensive in loans and commercial credit, more holdings of equity
  - Households holdings of equity have improved household wealth through stock market growth



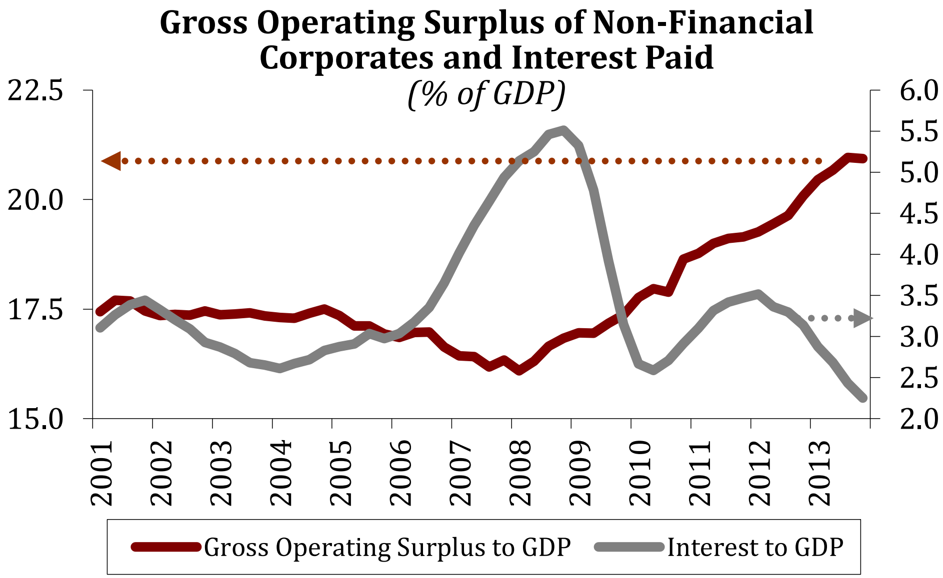
Source: Bank of Spain.

Deleveraging of the private sector: non-financial corporations

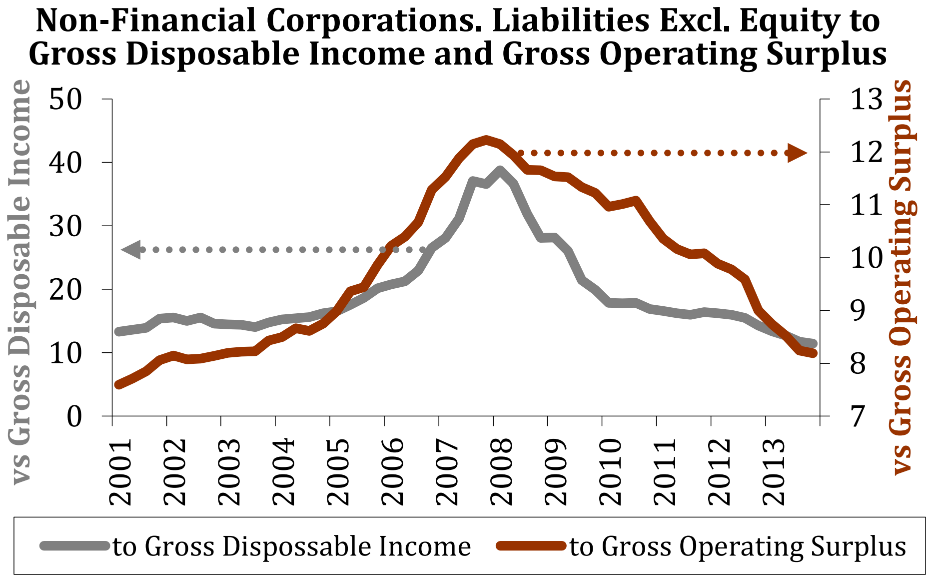
- **Non-financial firms reduced their debt stock by c.15% of GDP. Despite generating savings firms are concentrated on reducing debt**
  - Gross operating surplus of non-financial corporations has jumped form below 16% of GDP to above 21% in 5 years
  - Strong flow correction: indebtedness excl. equity to Gross Operating Surplus and to Gross Disposable income around 2004 levels



Source: ECB. Data



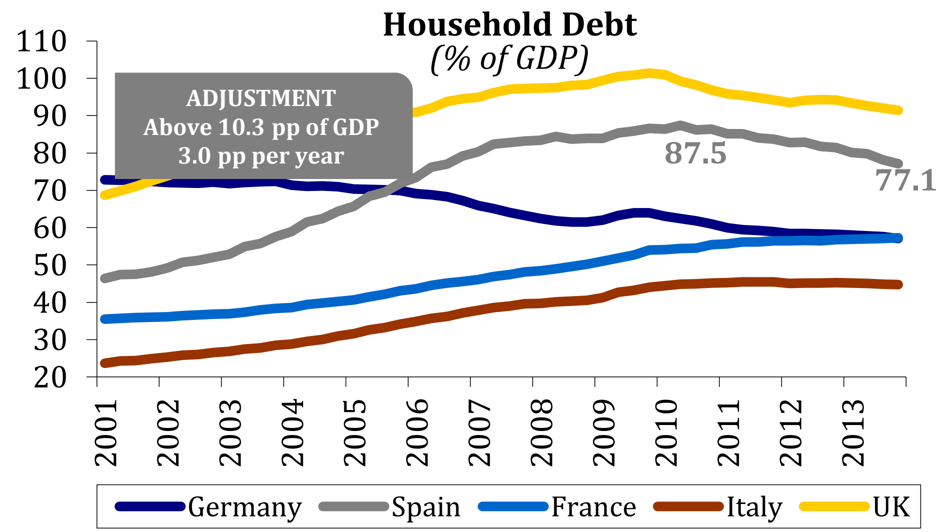
Source: National Statistics Institute. Data



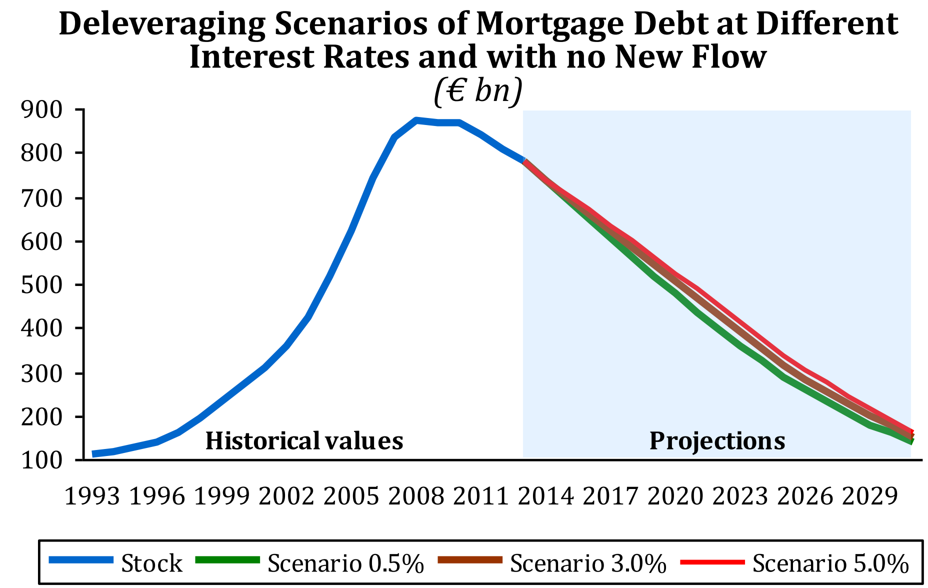
Source: National Statistics Institute and Bank of Spain. Data

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 77.1% by 2013Q4
- **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. Data

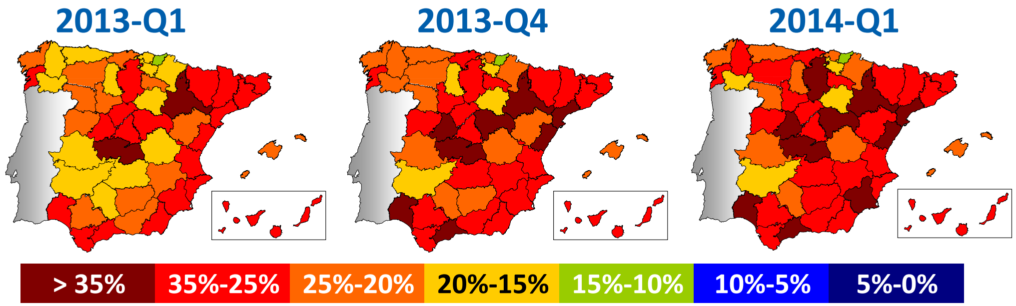


Source: Santander GBM Research.

The construction sector has accelerated its adjustment

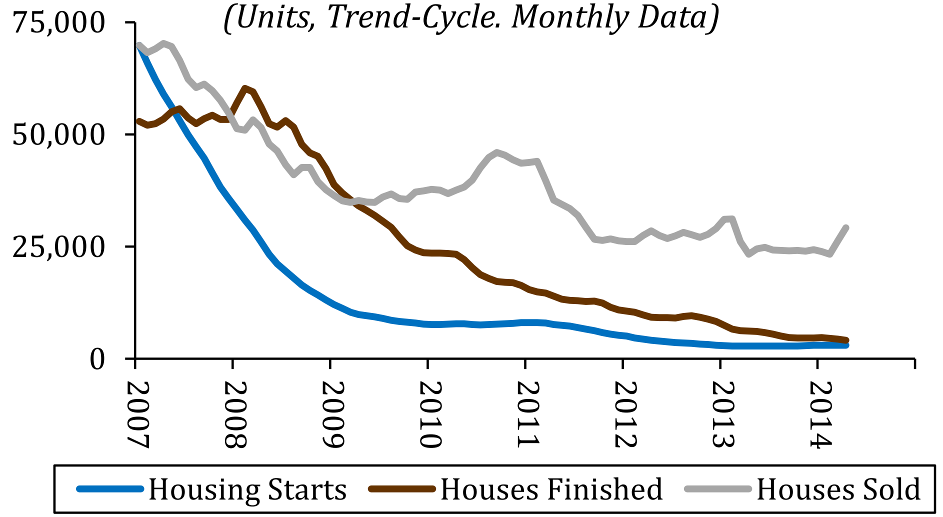
- **Real estate prices have fallen on average by approx. 30% since the peak in 2008**
- **The adjustment has been very heterogeneous and more intense around most populated and coastal provinces**
  - The average nominal price decline since the peak for new dwellings reaches 30%
- **Significantly more houses sold than started or finished: gradual reduction of unsold stock**

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



Source: Ministerio de Fomento.

Monthly Houses Started, Finished and Sold
(Units, Trend-Cycle. Monthly Data)



Source: Ministerio de Economía y Competitividad. *Data*

1. Closer EMU Integration

2. Spanish Economic Policy

3. Transformation of Spain's Growth Model

4. The Funding Programme of the Spanish Treasury

The Treasury's Revised Funding Programme for 2014

- The net funding in the Treasury's Funding Programme for 2014 has been revised downwards by €10 bn, in line with fiscal consolidation strategy for 2014
- Up to June 30th the Spanish Treasury has funded €86.3bn of the expected amount of medium- and long-term gross issuance
- Including Letras, the Spanish Treasury has issued €135.6 bn so far in 2014

(billion euros, in effective terms)	*January 2014*	*June 2014 Update*
Total Net Issuance	**65.0**	**55.0**
Total Gross Issuance[1,2]	**242.4**	**231.3**
Medium- and Long-Term		
Gross Issuance [2,3]	133.3	129.3
Net Issuance[3]	65.0	61.0
Letras del Tesoro		
Forecast Gross Issuance[1]	109.1	102.0
Net Issuance	0.0	-6.0

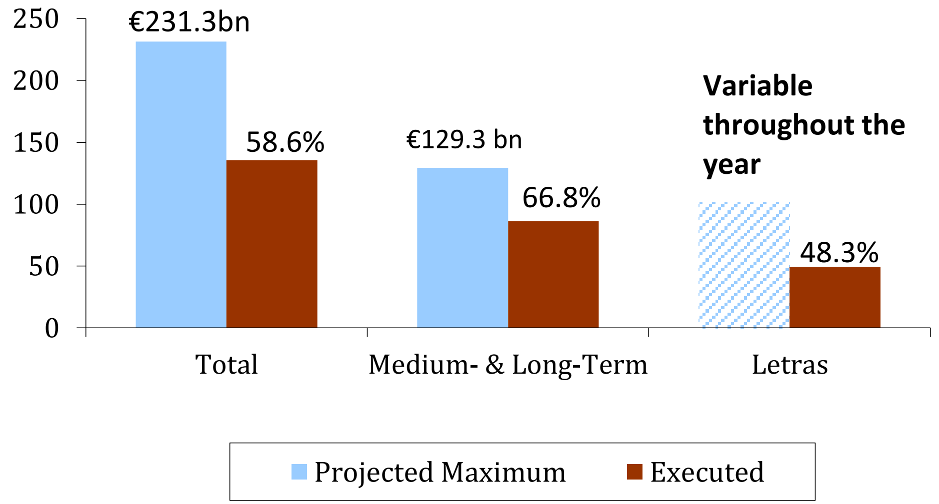
1 Redemptions of Letras, and therefore also gross issuance, will depend on the Letras issuance stra tegy in 2014

2 Excluding additional issuance for early redemptions.

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

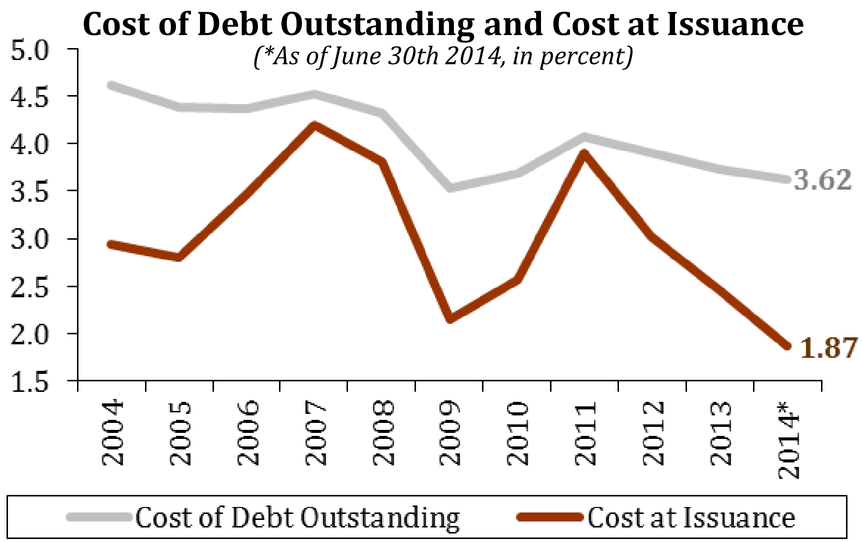
Funding Programme in 2014

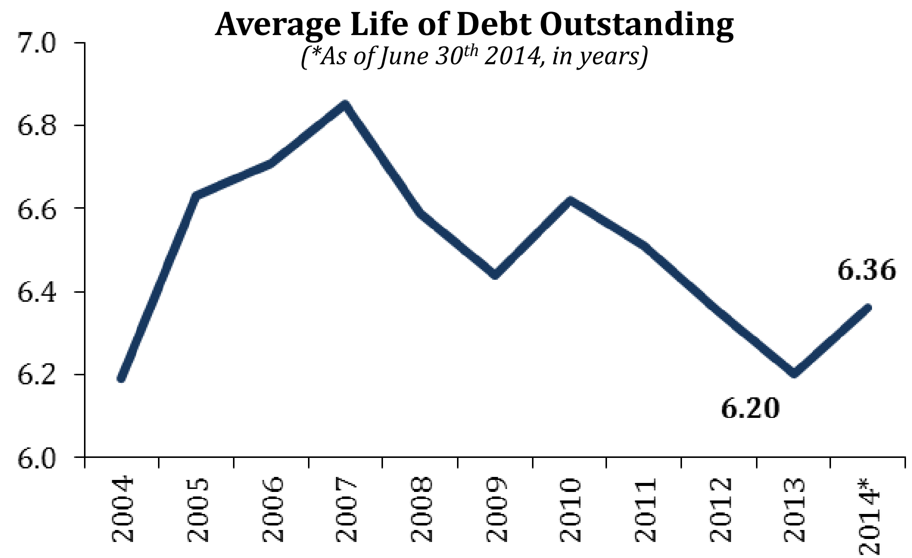
(Gross issuance, € bn, June 30th 2014)

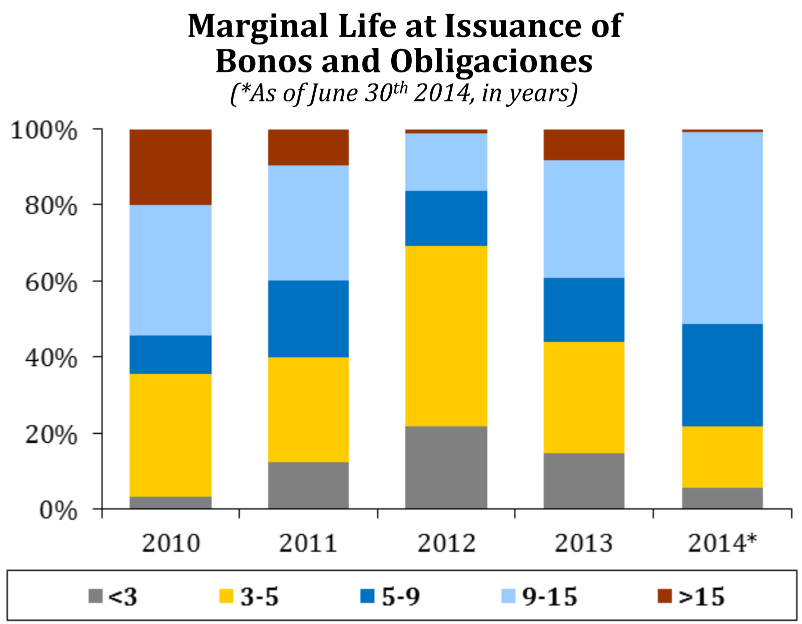


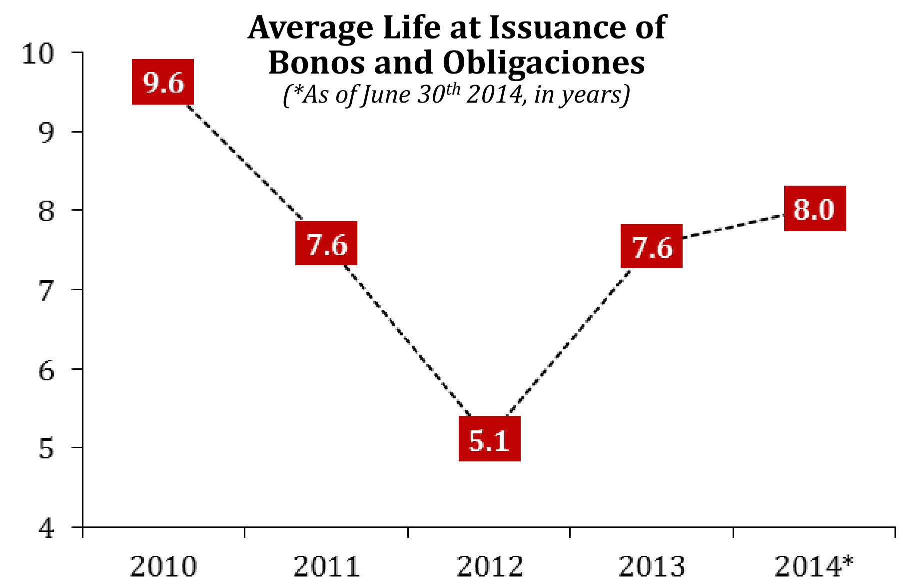
Source: Secretaría General del Tesoro y Política Financiera. Data

Cost and life of debt







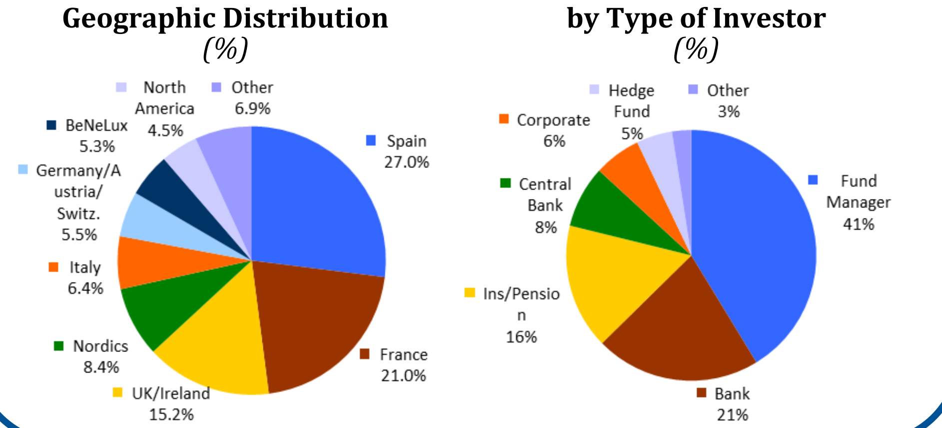


Source: Secretaría General del Tesoro y Política Financiera. Data

Syndicated issuance in 2014

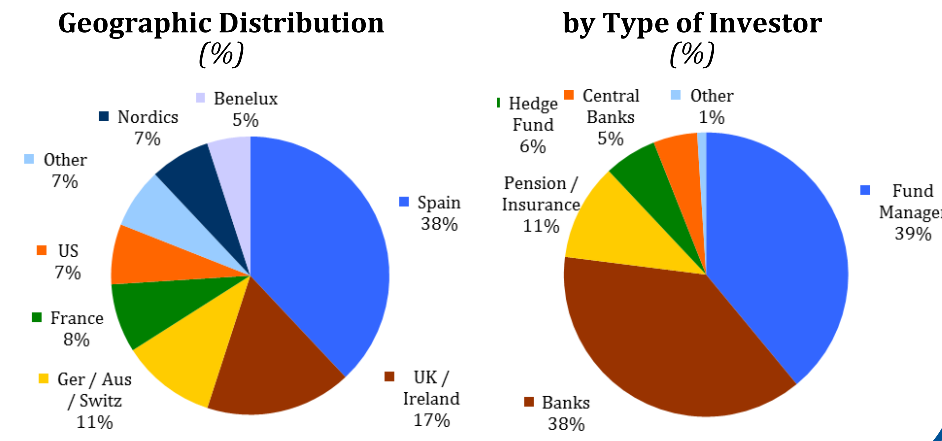
- In May 2014 the Spanish Treasury launched its inaugural bond linked to Euro Area harmonised inflation excluding tobacco.
- This transaction initiates the Kingdom of Spain's Euro Area inflation-linked programme, as announced in its 2014 issuance Strategy for 2014

MAY- INAUGURAL 10 YEAR BOND LINKED TO EA HICP EX. TOBACCO. NOVEMBER 2024

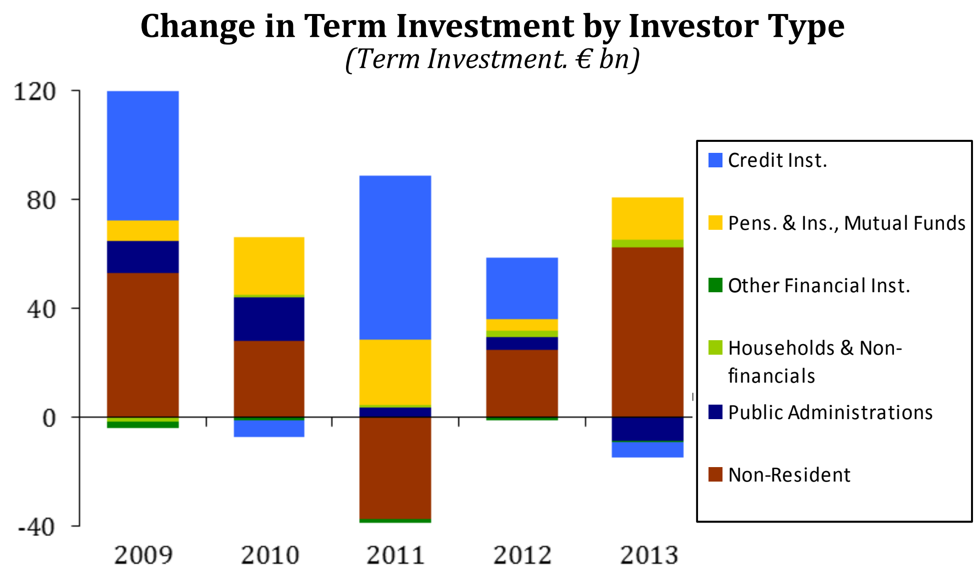


- In June 2014, the Spanish Treasury launched its third syndicated transaction of the year in concurrence with a switch offer (reducing the gross refinancing needs of the Kingdom of Spain in 2015)
- The new €9bn (€3.7bn switch / €5.3bn cash) 10 year benchmark issue (due 31 October 2024) has a 2.750% coupon and was priced at a spread of 118 bps over mid swaps

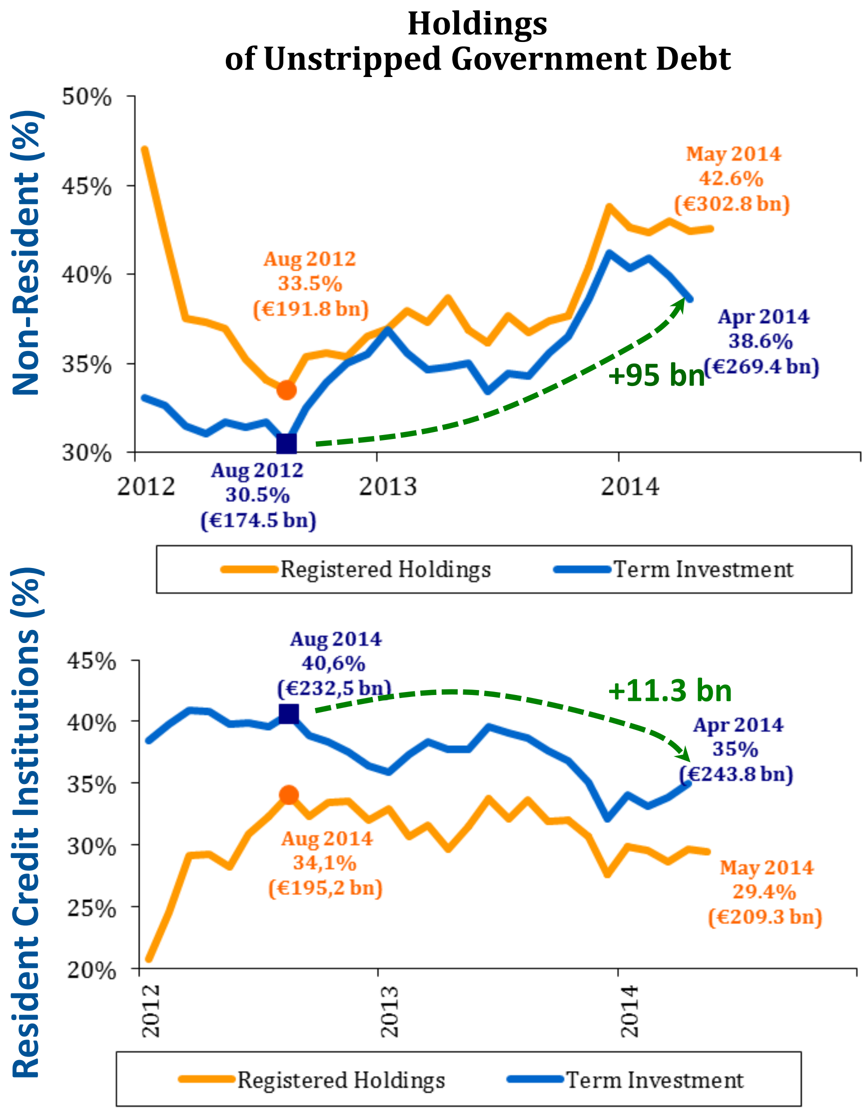
JUNE - NEW 10 YEAR REFERENCE. OCTOBER 2024 CASH BOOK



Recent trends in investor base

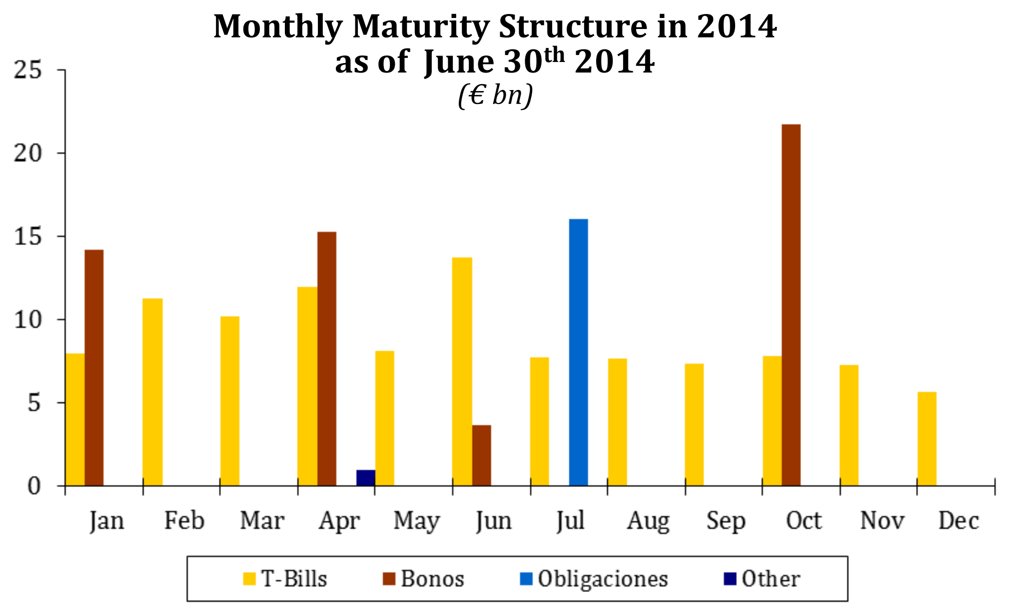


Source: Secretaría General del Tesoro y Política Financiera. Data

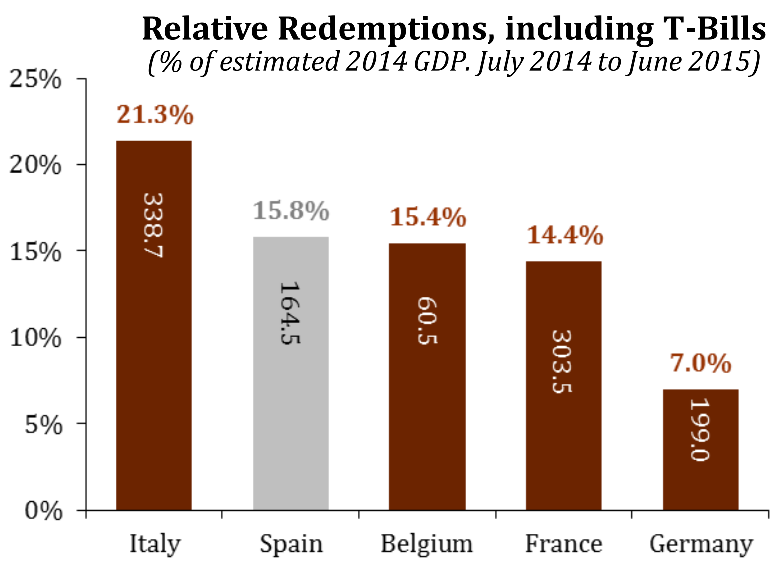


Prudent debt management

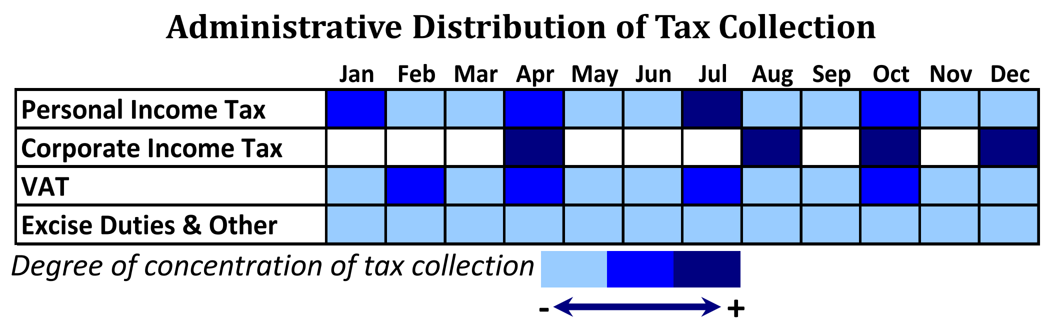
- Redemption dates of medium- and long-term bonds (mainly January, April, July and October) are accommodated to match the dates of biggest inflows of tax revenues
- Excess liquidity is lent in the money market each month through weekly, bi-monthly and monthly repo auctions



Source: Secretaría General del Tesoro y Política Financiera. Data

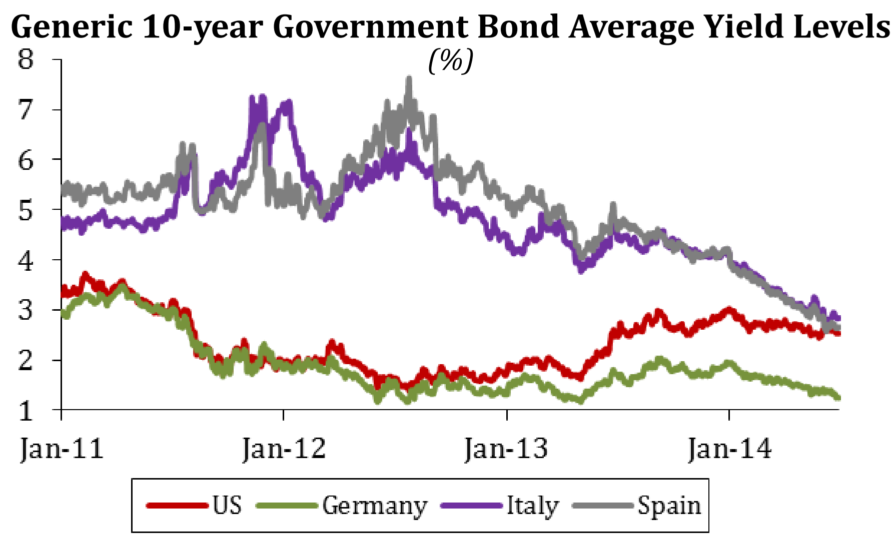


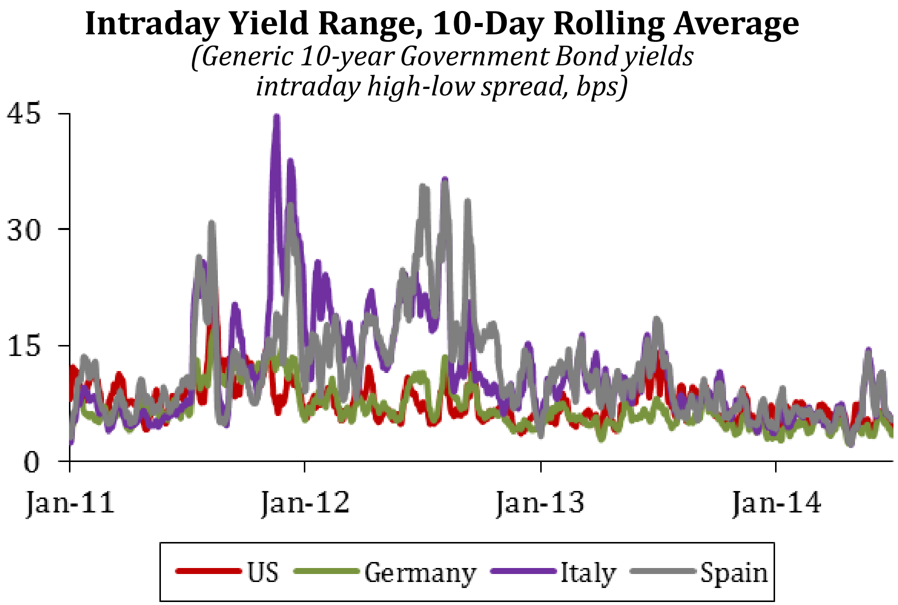
Source: Secretaría General del Tesoro y Política Financiera for Spain, May 31st data for Italy, and Bloomberg for other countries. Data

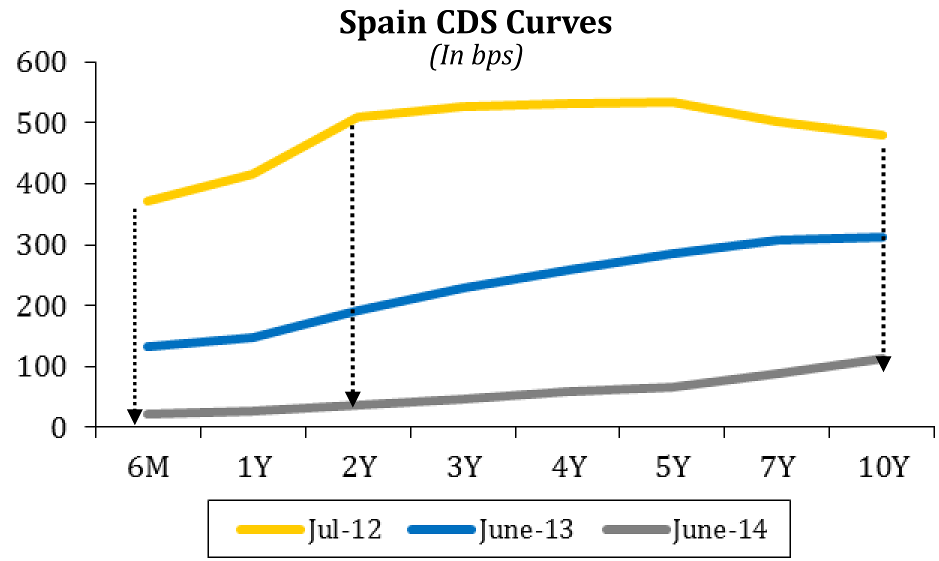


Interest rate volatility has diminished

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







Source: Bloomberg.

[Data]

More and updated information on the Spanish economy

For data sources click each figure or table

For spreadsheets click on 'Data'

Thank you for your attention

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